Masters of Their Own Destiny? Master Financing Structure Opens Funding Spigot to Mid-Sized Projects

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Tax credits and accelerated depreciation are the fuel that fires many renewable energy (RE) projects. To allocate risk and reward associated with the project, the developer (also known as the sponsor) and the tax equity investor will often establish an advanced financial structure such as an all-equity partnership flip, a leveraged partnership flip, a sale-leaseback, or an inverted lease.

Unfortunately, establishing one of these advanced financial structures can be an expensive undertaking. Tax equity investors must conduct considerable due diligence on everything from the long-term productivity of the technology deployed to the creditworthiness of the entity purchasing the power (also known as the power off-taker). Many of the due diligence costs don't scale with project size—the cost incurred is the same for a 100 kW project as it is for a 10 MW project. That means, in order to access outside investments such as tax equity, smaller projects are burdened with large overhead costs that increase the cost of power, often rendering the project uneconomic.

But, to quote a great phrase, if "necessity is the mother of invention, profit is the father of innovation." Or maybe that should be master, as in master financing facility (MFF). MFFs are a breed of financing vehicles that pool projects into a single financeable entity. Generally, they employ one of the advanced financial structures mentioned above but can be applied to any structure that works for the developer and investor.

MFFs offer a distinct advantage: by pooling a portfolio of projects, a developer can attract tax equity otherwise unavailable to the individual projects that comprise the portfolio. Because of the complexity of tax equity deals, the transaction costs of setting up the structure would quickly overwhelm any single small or mid-sized (i.e., less than $20 million) project, rendering the project uneconomic. In contrast, by funding a portfolio of projects, an MFF can spread the transaction costs of setting up the tax equity arrangement—such as due diligence of the developer or developing the necessary contracts—over a much larger investment base.

MFFs can also benefit from the diversification of risk. For example, MFFs can mitigate production risk (due to bad weather) or risk of end-user default by developing projects in different regions or serving different off-takers.

MFFs are not available to everyone; there are several requirements that must be met. A developer needs to have enough experience at project development to get the interest of investors (a mom and pop shop probably can't pull it off). They also need a big pipeline of projects in development. And ideally, enough projects need to be at the same stage of development in order to bundle them together.

MFFs have actually been around for over 20 years. Solar Power Partners (SPP), a developer of mid-sized systems, is currently seeking investors for its fourth portfolio to support approximately 10–12 projects representing 10–14 MW of installed capacity [1]. David Kunhardt, SPP's vice president for structured finance, explains the company utilized a partnership flip structure and two inverted leases (also called a lease pass-through) in its prior master financing structures. For its fourth, the company is looking closely at the sale leaseback structure and is currently discussing terms with roughly a dozen institutions who indicate interest. (See Table 1 for SPP's list of portfolios.) Other organizations that have financed successfully using MFFs include Perpetual Energy Systems, Inc., and SolarCity. Among entities that will currently finance an MFF are Bank of America, U.S. Bancorp, and Union Bank of California.

SPP's portfolios are increasingly incorporating larger projects, from an average project size of 340 kW in its initial portfolios to roughly 1 MW systems on average now. SPP's Kunhardt explains that SPP will develop projects down to a size of about 500 kW for new customers. For repeat customers who utilize the prior financial structure applied, SPP will develop systems down to 200 kW, but the deal has to truly rely on all the paperwork completed in the original deal.

Table 1. SPP's List of Portfolios

Portfolio	Structure	Bank	Number of Projects	Number of MW	Avg. Project Size (MW)
1st	Partnership	Macquarie Bank	15	5.08	0.339
2nd	Lease Pass-through	Bank of America	24	8.14	0.340
3rd	Lease Pass-through	U.S. Bancorp CDC	16	15.30	0.957
4th (in development)*	Sale Leaseback	??	10–12	10.00–14.00	1.100

* SPP projection Source: Personal communication with David Kunhardt, SPP

Prior to setting up the MFF, SPP will have most of the project portfolio under contract. For example, for the MFF under development, SPP has 8–9 projects with all documents—including site lease and power

purchase agreement—in place before financing is complete, allowing the ultimate investor to have a high level of comfort regarding the credit quality of the counter-parties and individual project structure. A minority of the portfolios (2–4 projects for the MFF under development) will not be fully signed and sealed, but the investing entity will be able to review all project documents.

Kunhardt indicated that individual projects would be hard-pressed to attract cost-effective tax equity investment without the benefit of the portfolio. Tax investors want to invest a minimum of $20 million–$25 million in order to make it worth their while, and developers need to shepherd a reasonable number of projects simultaneously, given various binding time constraints. He estimated the current portfolio under development will attract a total investment of over $50 million.

Of course, other developers are utilizing MFFs as well.

But the cost of financing remains a very real concern to SPP and other developers. Kunhardt indicated the cost of just setting up the financing (including legal fees, construction loan costs, engineers' reports, appraisals, and similar due diligence efforts) can represent approximately 5% of the total installed costs. "The master financing facility helps monetize all federal and local benefits and is critical to our business, but we still need to standardize the process and lower the cost of acquiring capital," says Kunhardt.