CREBs and QECBs

CDIAC Presentation

Solar Energy: Public Financing Options for California's Local Governments

CREBS and QECBs - Overview

- **General Rules;**
- **New Clean Renewable Energy Bonds ("New CREBs");**
- **Qualified Energy Conservation Bonds ("QECBs");**

I. Introduction to Tax Credit Bonds

- **Credit in Lieu of Interest.** TCBs pay the holder a federal tax credit in lieu of interest. Because holders of TCBs receive a tax credit, interest rates (in the form of supplemental interest) can be lower while providing the same after tax return to the investor that taxable investments provide.

- **Amount of Credit.**

  – Determined by multiplying the TCBs "credit rate" by the face amount of the holder's TCB.

  – Credit rate is determined daily by the Treasury Department.

  – Supplemental Coupon in certain circumstances.

  – Tax credit accrues quarterly and is includible in gross income.

- **Maturity Limitation.** TCBs are generally structured as "bullet" maturity bonds, with the Treasury Department establishing the maximum maturity, which is typically between 14 and 15 years, on a monthly basis.

I. Introduction to Tax Credit Bonds, cont'd

- **Use of Proceeds.**
  - Issuers must spend 100% of the TCB proceeds on project costs (with an allowance of up to 2% for costs of issuance) within 3 years from issue date.
  - Any proceeds remaining after 3 years must be used to redeem TCBs, unless an extension is obtained from the IRS.
  - Reimbursement for amounts paid <u>after</u> the date that an allocation of TCB limitation is made by the Secretary with respect to the issue (query when allocation by Secretary occurs), but only if –
    - Declaration of intent prior to the payment of the original expenditure,
    - Adoption of an official intent not later than 60 days after payment of the original expenditure, and
    - reimbursement made not later than 18 months after date of original expenditure.

I. Introduction to Tax Credit Bonds, cont'd

- **Arbitrage.**
  - Sale Proceeds. Invest proceeds of TCBs for 3 years after issuance at an unrestricted yield. Not subject to rebate either.
- **Credit Stripping.** Tax credits may be "stripped" from the TCBs.
  - holder of the tax credit with respect to the TCB may be a different party from the holder of the TCB itself.
  - It is expected that this feature will make TCBs more attractive to the market place and allow issuers to better tailor these offerings to satisfy buy-side interest.
- **Prevailing Wage.** Federal Davis-Bacon prevailing wage rules apply to projects financed with proceeds of each of the types of TCBs described in this outline.

I. Introduction to Tax Credit Bonds, cont'd

- **70% Credit.** Generally, supplemental coupon for the balance of the interest.

- **To be distinguished from "Old CREBs" which were designed to provide a theoretical 100% Credit.**

II. New Clean Renewable Energy Bonds

- **Permitted Issuers.** New CREBs can be issued by:
  - a public power provider,
  - a state or local government (including an Indian tribal government),
  - a cooperative electric company,
  - a not-for-profit electric utility that has received a loan or guarantee under the Rural Electrification Act, or
  - a lender that is a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and was in existence on February 1, 2002, and shall include any affiliated entity that is controlled by such lender.

II. New Clean Renewable Energy Bonds, cont'd

- **Ownership Limitations.** A facility financed with New CREBs must be owned by:
  - — a public power provider,
  - — a cooperative electric company, or
  - — a State or local government (including an Indian tribal government).
- **No Private Use Limitations.**
  - — A facility financed with New CREBs can be leased to or managed by a private business, or the output of the facility can be purchased by a private business (provided such arrangements do not transfer tax ownership of the facility)

II. New Clean Renewable Energy Bonds, cont'd

- **New CREBs Volume Cap and Allocation.** Currently $2.4 billion, will be allocated:
  - one-third to public power providers, to be allocated to on a pro rata basis;
  - one-third to governmental bodies, to be allocated first to projects requesting the smallest dollar amount of allocation; and
  - one-third to electric co-ops, to be allocated first to projects requesting the smallest dollar amount of allocation.
  - See IRS Notice 2009-33 for more detail regarding the allocation application process; <u>**application deadline was August 4, 2009**</u>
  - An allocation of authority to issue New CREBs is valid for three years after the IRS issues the letter granting the allocation.

II. New Clean Renewable Energy Bonds, cont'd

- **Eligible Projects.** New CREBs may only be issued to finance "qualified renewable energy facilities."
  - Wind Facilities.
  - Closed-Loop Biomass Facilities.
  - Open-Loop Biomass Facilities.
  - Geothermal or Solar Energy Facilities.
  - Small Irrigation Power Facilities.
  - Landfill Gas Facilities.
  - Trash Facilities.
  - Qualifying Hydropower Facilities.
  - Marine and Hydrokinetic Renewable Energy Facilities.

III. Qualified Energy Conservation Bonds

- **70% Credit.**
- **Permitted Issuers.** QECBs can be issued by State or local government issuers (including an Indian tribal government).
- **Private Use Limitations.**
  - Generally QECBs are subject to the private business tests and private loan test of section 141 of the Code.
  - However, up to 30% of a State's QECB volume cap authority can be used for private activity bonds. Unlike governmental purpose QECBs, the proceeds of private activity QECBs must be applied to finance capital expenditures.

III. Qualified Energy Conservation Bonds, cont'd

- **QECB Volume Cap and Allocation Process.** The amount of volume cap for QECBs is currently $3.2 billion. States are allocated volume cap according to population. IRS Notice 2009-29 provides each State's volume cap allocation. States are required to reallocate a substantial portion of such cap to large local governments (i.e., cities and counties with populations or 100,000 or more). California received $381,329,000 in total allocation.
- **Eligible Projects.** Pursuant to section 54D(f) of the Code, "qualified conservation purpose" means any of the following:
  - **<u>Capital Projects</u>.** Capital expenditures incurred for purposes of –
    - Reducing energy consumption in publicly owned buildings by at least 20%,
    - Implementing green community programs,
    - Rural development involving the production of electricity from renewable energy resources, or
    - Any facility eligible for the production tax credit under Section 45 of the Internal Revenue Code except for Indian coal facilities and refined coal production facilities (*i.e.*, New CREBs projects).

III. Qualified Energy Conservation Bonds, cont'd

— **Research.** Expenditures with respect to research facilities and research grants to support research in –

- Development of cellulosic ethanol or non-fossil fuels,
- Technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels,
- Increasing the efficiency of existing technologies for producing non-fossil fuels,
- Automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation, or
- Technologies to reduce energy use in buildings.

— **Mass Commuting.** Mass commuting facilities and related facilities that reduce the consumption of energy, including expenditures to reduce pollution from vehicles used for mass commuting.

III. Qualified Energy Conservation Bonds, cont'd

– **<u>Demonstration Projects</u>.** Demonstration projects designed to promote commercialization of –

- Green building technology,
- Conversion of agricultural waste for use in the production of fuel or otherwise,
- Advanced battery manufacturing technologies,
- Technologies to reduce peak use of electricity, or
- Technologies for the capture and sequestration of carbon dioxide emitted from combusting fossil fuels in order to produce electricity.

– **<u>Public Education</u>.** Public education campaigns to promote energy efficiency (other than movies, concerts and other events held primarily for entertainment purposes).