GLOBAL TRANSACTIONAL RISK PRACTICE

Driving Solar Project Success Through Qualified Basis and Other ITC Insurance Programs

The successful financing of any renewable energy project in the United States is typically contingent on a its eligibility for tax credits. For projects that rely on the investment tax credit, renewable energy companies can use insurance to protect against a successful tax authority challenge to reduce the fair market value (FMV) used to compute the ITC or the ITC percentage applicable to the "begun construction" date.

Marsh specialists understand the challenges that renewable energy companies face during the development lifecycle. We can help to guide you through those challenges and craft a holistic tax insurance program that is tailored to meet your unique needs.

WHY BUILD A QUALIFIED BASIS INSURANCE PROGRAM?

There are several reasons why a company may wish to secure a qualified basis insurance solution. Such programs can offer:

- Tailored and bespoke commercial coverage.
- Certainty for developers and capital providers to proceed without concerns as to tax attributes.
- Holistic protection for lost tax credits in both filed tax returns and anticipated future tax credits.
- Low retentions and competitive pricing through a deep pool of 16 insurance markets providing in excess of $1 billion capacity per transaction.
- An efficient process, usually with less than three weeks from initial discussion to binding of policy.

A Flexible Solution for Solar Project Participants

Tax insurance policies are bespoke and can be crafted to provide protection in the context of a specific situation. Marsh can help you design coverage for:

- A specific individual project.
- A portfolio of projects, with coverage locked in upfront and flexible terms to accommodate each project as it reaches COD.
- Distributed generation, where the policy maps to a funding commitment that will cover multiple systems as they are installed and transferred into the “fund” — for example, as residential rooftop solar installations are completed.

What Does a Qualified Basis Framework Look Like?

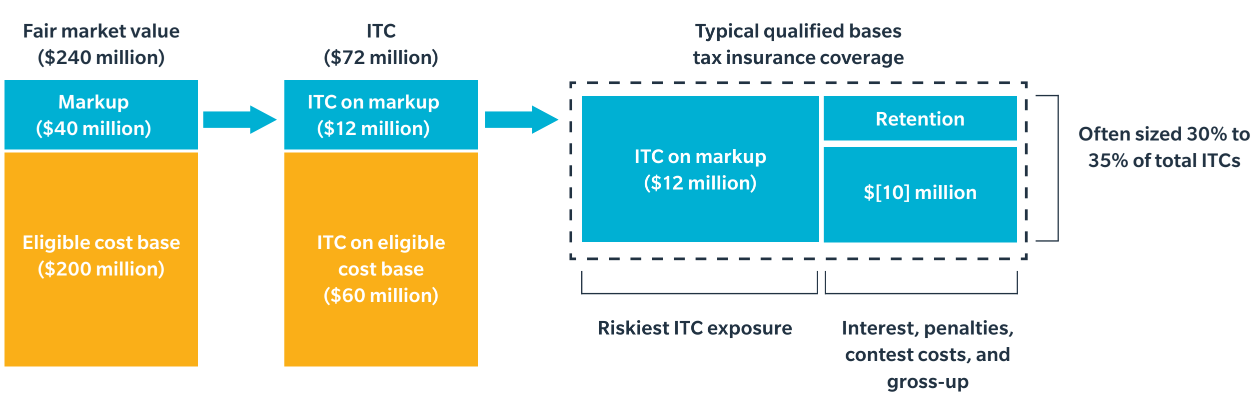
Investors, developers, and sponsors that purchase tax insurance often do not procure 100% ITC coverage. Instead, they typically insure the ITC on the markup, as this is regarded as the risky exposure. The markup is the amount by which the eligible FMV exceeds the eligible cost basis. Insurers are generally comfortable with 15% to 20%; above this amount, additional scrutiny in underwriting and due diligence is likely.

Once interest, penalties, contest costs, and a gross-up are included, this methodology translates to a policy limit equal to 30% to 35% of the total ITCs.

Insurers typically require the following information for underwriting:

- FMV appraisal, cost segregation report and 1060 analysis.
- Transaction documents.
- Information on the project, such as a CIM, management report, or other report.
- A financial model and tax exposure calculation detailing the rationale for the limit being procured.

FIGURE 1 Qualified Basis Framework



What's Covered in a Qualified Basis Policy

Qualified basis policies focus on the FMV of a project or discrete systems within a project and can be procured by either the project entity or developer/sponsor.

Policy Beneficiary	All Capital Providers	Developer/Sponsor
Purpose	To facilitate financing by backstopping eligibility to ITCs and/or providing credit enhancement to the developer/sponsor tax indemnity by supplementing a pool of highly rated insurers. This benefits all capital providers; the interests of developers/sponsors, tax equity investors, and back-leverage lenders are aligned.	To protect the balance sheet of a developer or sponsor from concentrated risk under the tax indemnity or multiple tax indemnities.
Scope of Coverage	Ensures that the eligible FMV will be respected. For example, the covered tax position may be stated as: *"For US federal income tax purposes, the basis in the "energy property" (as defined in section 48(a)(3) of the code) of each system for the purposes of determining the amount of ITCs available with respect to such system is at least equal to the project purchase price with respect to such system (the "basis risk").* Additional insureds and loss payees may also be added to the policy.	Tailored to match the tax indemnity provided in favor of the financing party related to the FMV being respected.
Sizing of Limit	Typically sized to cover the ITCs on the markup plus interest, penalties, contest costs, and a gross-up (to cover taxes on the policy payout).	Sized to the commercial needs of the developer/sponsor.
Relationship to Transaction Documentation	The transaction documents governing the named insured must prevent the party undertaking the contest (the partnership representative, if a partnership flip structure is used) from taking action that invalidates the policy.	The developer/sponsor must — in the transaction documents — preserve at least a veto right to prevent the party undertaking the contest from taking action that invalidates the policy.

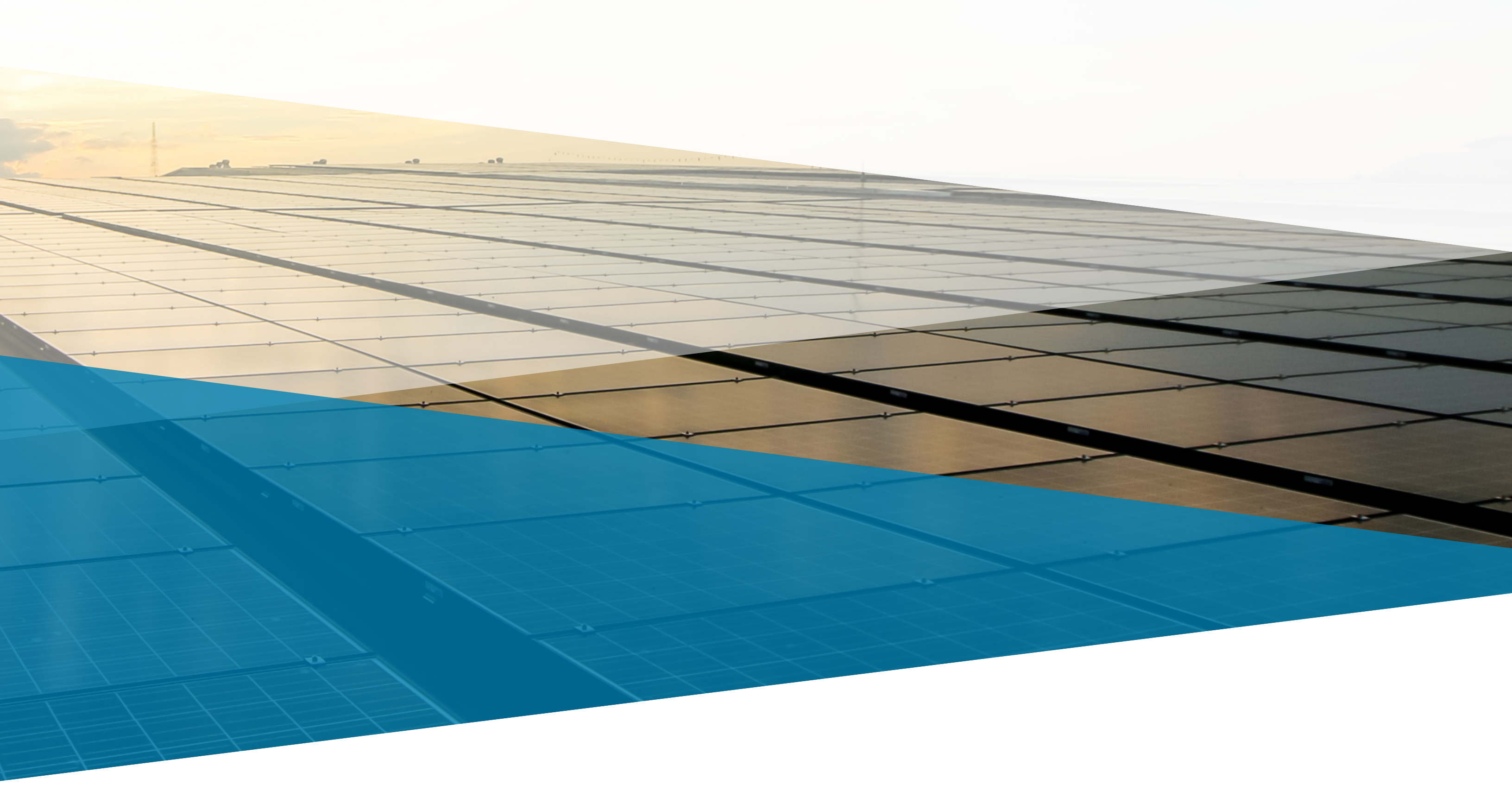
Other ITC Insurance Programs

In addition to qualified basis, tax insurance policies can be crafted to address one or more identified tax positions for a renewable energy insurance buyer, including:

- Begun construction: Confirms that onsite or offsite physical works are of a significant nature.
- Continuity and delay: Provides assurance that the facts and circumstances satisfy the "continuous efforts" or "continuous construction" requirement for tax credit eligibility notwithstanding COD is beyond the continuity safe harbor period.
- Repowering: Underwrites both the (re)qualification for tax credits and backstops the 80/20 appraisal.
- Structural: Backstops the allocation of tax and cash attributes between tax equity and cash equity. For commonly used tax equity structures, the tax equity market is comfortable without coverage. Insurance may be relevant for unique or unusual facts related to an acquisition structure and/or tax equity structure.
- Battery storage: Coverage for storage that is integrated within a solar facility can be included in a policy. Dialogue on standalone storage is still ongoing.

As with qualified basis, these policies can be incepted within the financing structure or with the developer/sponsor. In addition to interest, penalties, contest costs, and a gross-up, the policy can be sized to meet what is required commercially. Determining the appropriate policy limit starts with quantifying your potential liability for additional taxes:

- Begun construction and continuity: Depending on the situation, either the delta between the base case credits and the alternate begun construction date (for example, 30% ITC for 2019 versus 22% PTC for 2021) or 100% of the tax credits.
- Qualified basis: The ITCs attributable to the markup above cost basis.
- Repowering and structural: 100% of the tax credits due to the binary nature of the covered risk.



Hybrid Investment Tax Credit Insurance

Hybrid policies cover the identified tax issues as discussed above, along with certain fundamental representations and warranties provided by the developer/sponsor in documentation, such as an ECCA or LLC agreement (with coverage designed in the style of R&W insurance). Hybrid policies are not common, but may be appropriate where the credit quality behind the representations and warranties is not strong.

Why Marsh?

With experience helping renewable energy companies and backgrounds in taxation, corporate law, investment banking, and accounting policy, specialists from Marsh's Global Transactional Risk Practice are well-positioned to help you secure cost-effective protection that is tailored to your commercial objectives. Our specialists understand the critical risks that you may be facing during the development lifecycle. We have relationships with nearly all leading transactional risk insurance markets to help you build an insurance program that is best suited to your needs.

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