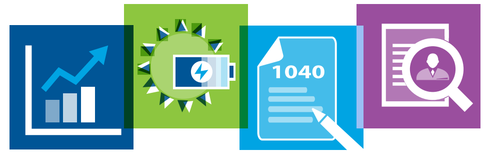

Energy Insights

An Update from the Third Quarter of 2016

By Robert S. Winner

In this edition of Seyfarth Shaw's Energy Insights Newsletter, our Energy and Clean Technologies team covers important developments in Q3 2016 for the energy industry, including 1) investments by internet companies in renewable energy to support their core businesses, 2) the eligibility of PACE financed properties for FHA-insured mortgages, and 3) the impact the extension of PTCs and ITCs, as well as the IRS's clarification on rules surrounding commencement of construction, has had on wind projects.

What do Cloud Computing and Wind Farms Have in Common? According to Internet Tech Giants Like Google - a lot

Google recently announced the purchase of the entire 12-year power production from a yet-to-be-built Norwegian wind power farm to supply its European data centers with renewable energy. In the past couple of years, they have invested in a North Dakota wind farm with 113 turbines developed by NextEra Energy Resources producing about 169.5 megawatts of power, as well as in the Lake Turkana Wind Power Project in Kenya, which is expected to generate 1,400 gigawatt-hours of power per year, or 15 percent of the country's electricity consumption, according to Vestas, one of the project's co-developers. Investments have also been made in a solar plant in South Africa, along with other wind investments in Iowa, Texas and Oklahoma. Google is not the only internet giant contracting for more renewable energy. Other internet tech giants and cloud based service providers are contracting with wind and solar farm developers to generate power in states such as Texas, Indiana, North Carolina, Ohio and Virginia to support their expanding web services and cloud data centers.

So, why all this investment in what seems to be non-core businesses? According to Greentech Media's Andrew Mulherkar, it's about cost management and predictability, sustainability and resiliency. One could also argue it is also a necessity. For these companies to continue to expand their platforms and customer reach, and support their growing services, more computing and cloud power in untapped regions is required. Many renewable energy companies in the business of constructing, owning and operating energy generating facilities can't use their balance sheets or just a power purchase agreement to support and obtain the financing needed to construct such facilities. Sizeable equity contributions must be made, and what better source than the purchaser of the power itself to invest. While these investments sound non-core, the internet and tech giants view it as very connected and necessary.

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HUD and FHA Go Live with PACE Financing

Effective as of September 17, 2016, the U.S. Department of Housing and Urban Development (HUD) and Federal Housing Administration (FHA) will now permit properties encumbered with a Property Assessed Clean Energy (PACE) obligation to be eligible for FHA-insured mortgage financing, whether for new purchases or refinancing.

Pursuant to Mortgagee Letter 2016-11 issued back in July, HUD and FHA announced their support for clean energy and energy efficiency improvements by allowing Property Assessed Clean Energy (PACE) financing and improvements on its residential properties. The terms and conditions of the PACE obligation may vary by state, local government, and PACE program. PACE programs also determine the scope of allowable improvements made under their respective PACE programs.

In order for a PACE-encumbered property to be considered for FHA-insured mortgage financing, (1) the PACE obligation must be treated like a special tax assessment under the PACE-enabling legislation or ordinance; (2) only delinquent special assessment payments may take priority over a mortgage; (3) the PACE obligation must freely and automatically transfer upon sale; (4) the PACE obligation must be recorded on the land records; and (5) an outstanding PACE obligation must run with the land.

For properties with existing PACE obligations, the property sales contract must indicate whether the obligation will remain with the property or be satisfied by the seller at, or prior to, closing. Where the obligation will remain, all terms and conditions of the PACE obligation must be fully disclosed to the borrower and made part of the sales contract between the seller and the borrower. Further, any appraiser must analyze and report the impact on the value of the property, whether positive or negative, of the PACE-related improvements, and of any additional obligation (i.e., the PACE special assessment).

Notwithstanding the restrictions, this is an important step towards improving government-backed housing and reaching national energy efficiency goals.

IRS Extension of Production Tax Credit Qualifications and Safe Harbors for Wind Developments a Success in Spurring Growth

Back in December of 2015, the Protecting Americans from Tax Hikes Act of 2016 (PATH Act) extended the expiration date of the production tax credits (PTC) for wind facilities to those commencing construction prior to January 1, 2020. Thereafter, on May 5, 2016, the Internal Revenue Service (IRS) issued Notice 2016-31 which extends the window of time for eligible wind facilities to meet the "beginning construction" requirements necessary to qualify for renewable energy PTC, and also clarified the application of the "Five Percent Test" and "Physical Work Test" safe harbors under the continuous work requirement to be eligible for the PTC. The Notice also provided examples of activities that qualify for the physical work test, which includes (1) beginning work of a significant nature, such as excavation, (2) setting anchoring bolts, and (3) pouring concrete, but specifically excludes pre-construction activities such as project design, securing financing, exploring, or conducting environmental studies.

A project will also be deemed to have "begun construction" if, pursuant to the Five Percent Test, it has paid or incurred five percent or more of the total project cost. Work on existing facilities only qualifies if the used property is no more than twenty percent of the project's face value. For retrofitted technology, the Five Percent Test applies to new property only. Additionally, a project may not alternate the Physical Work Test and the Five Percent Test year-to-year to satisfy the continuous progress requirement. The Notice further

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provides clarification on excusable project disruptions, which allow projects to continue to satisfy the continuous progress requirement. Excusable disruptions include severe weather conditions, natural disasters, labor stoppages, interconnection-related delays, and permitting or government requested delays. And based on data reviewed, it appears that the lengthy extension by the PATH Act and the predictability of the IRS Notice has been very helpful to the wind industry.

In 2015, according to the American Wind Energy Association, wind energy was the No. 1 source of new electric generation capacity in the U.S., delivering 41% of new capacity installations. In the wind rich regions of the Midwest, Pacific Northwest, and Plains states, wind was the primary choice for new power, providing over 59% or more of all new electric generation capacity between 2011 and 2015. The U.S. led the world in wind energy generation, producing a record 191 million MWh of wind energy during 2015 – enough to power 17.5 million American homes. However, "under construction" announcements in the fourth quarter of 2015 were down dramatically to 9,400 MW pending re-authorization of the PTC. Nevertheless, by the third quarter of 2016, "under construction" levels were back up to mid-2015 levels, indicating that the PTC is still a driver for wind project development and completion, and ultimately an economic driver for the clean energy economy.

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