A look at new vehicles for renewable energy project financing: MLPs, REITs and Crowdfunding

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The recent debate in Ohio over Substitute Senate Bill 58 is another reminder of the nearly constant uncertainty facing the renewable energy industry. In part, Substitute Senate Bill 58 seeks to modify Ohio's mandate that 12.5 percent of energy provided by electric distribution utilities come from renewable energy resources by eliminating the requirement that a portion of that renewable energy be generated in Ohio. This effort is not particularly unique. In Ohio, there have been previous, unsuccessful, attempts to repeal or alter the state's renewable requirements. Outside of Ohio, state-level renewable energy mandates were challenged in at least 29 states.

Renewable energy developers also face uncertainty at the federal level. The Production Tax Credit (PTC), often relied on for wind energy development, expired at the end of 2013. After repeated one-year extensions of the PTC, it seems unlikely that Congress will again renew the incentive in the near future. Additionally, the Business Energy Investment Tax Credit, heavily utilized by the solar industry, is set to expire at the end of 2016.

With regulatory uncertainty surrounding traditional government-supported incentives, renewable energy developers are increasingly examining alternative means of financing. Below, three such options are highlighted: Master Limited Partnerships, Real Estate Investment Trusts, and Crowdfunding.

Master Limited Partnerships

A Master Limited Partnership (MLP) is a business structure that is taxed as a partnership but whose ownership interests are traded like corporate stock on a market, meaning that income from an MLP is taxed only at the shareholder level. An MLP consists of limited partners and general partners. Generally, the limited partners, which may number in the thousands, invest capital and receive quarterly required distributions similar to shareholder dividends in a C-corporation. Thus, MLPs offer investors liquidity, limited liability, and dividends like classic corporations. MLPs are significant owners of America's energy infrastructure, controlling substantial assets involved in the transportation, processing, refining, marketing, and storage of the nation's energy resources. These assets include major pipeline systems that deliver products such: as natural gas, crude oil, and refined fuels to end markets.

Currently, the MLP structure is not available to renewable energy projects. The Internal Revenue Code requires that at least 90 percent of MLP revenue come from "qualifying income." 26 USC § 7704(c)(2). "Qualifying income" is defined to include "income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource . . . ." 26 USC § 7704(d)(1). Specifically, the natural resource must be "depletable." 26 USC § 7704(d)(1) referencing 26 USC § 613(b)(7).

However, proposed legislation seeks to expand MLPs to renewable energy projects. The "Master Limited Partnerships Parity Act" amends the Internal Revenue Code to expand the definition of "qualifying income" for such MLPs to include income and gains from renewable and alternative fuels (in addition to fossil fuels), including energy derived from thermal resources, waste, renewable fuels and chemicals, energy efficient buildings, gasification, and carbon capture in secure geological storage. The legislation is sponsored by Senator Chris Coons (D-DE) and is co-sponsored by Senators Jerry Moran (R-KS), Debbie Stabenow (D-MI), Lisa Murkowski (R-AK), Susan Collins (R-ME), and Mary Landrieu (D-LA). Although still in the U.S. Senate Committee on Finance, many industry insiders speculate that the bill has a strong chance of passage due to its bipartisan and industry-supported coalition.

Real Estate Investment Trusts

Real Estate Investment Trusts (REITs) sell like stock on the major exchanges and invest in real estate. REITs are entities that are treated as corporations for tax purposes, but are generally exempt from corporate-level income tax. To qualify for this favorable tax treatment, each REIT must pay out at least 90 percent of its taxable income each taxable year in dividends to its shareholders.

In order to qualify as a REIT, a significant portion of the company's assets and income must be related to real estate. Such "good income" includes rents from real property, real property gains, dividends and gains from investments in other REITs, interest on real estate, income from foreclosure property, and income from temporary improvements. See 26 USC § 856(c). However, it is unclear whether assets and income generated from clean energy projects should qualify as "good income," and without guidance from Congress, the Treasury Department, or the Internal Revenue Service (IRS), taking such a position would be risky.

To an extent, REITs are already investing in clean energy projects through the utilization of a Taxable REIT Subsidiary (TRS). A TRS is an entity that provides services to the REITs' tenants without jeopardizing its status as a REIT because unlike its parent REIT, a TRS pays corporate income tax. A TRS might be used to develop and own a distributed solar project and sell the power generated to the buildings tenants. Or, as an alternative, TRS might develop a distributed solar project and then sell it to an investor or utility.

Additionally, there is increasing movement to have solar projects themselves qualify as "good income," thereby enabling distributed and utility scale solar projects to benefit from the REIT structure. In January, 2013, a solar start-up, Renewable Energy Trust Capital, Inc., requested a private letter ruling from the IRS to classify solar farms as "real property" that may be included in REITs. Despite initial hopes for a quick and favorable ruling, no ruling has yet been announced.

Crowdfunding

Over the last few years, crowdfunding has gone from a novel way to fund a creative project to a serious fundraising mechanism. Crowdfunding, which stands for Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure, is simply a mechanism for raising funds from a large number of investors who usually participate in small amounts. Crowdfunding usually takes one of two forms. The first is donation-based funding, which is the collective effort of individuals who network and pool their money, usually via the Internet, to support efforts initiated by other people or organizations.

The second form of crowdfunding is the funding of a company by selling small amounts of equity to many investors. In this form of crowdfunding, individuals who fund become owners or shareholders and have a potential for financial return, unlike in the donation-based model. This latter form of crowdfunding was enabled by the Jumpstart Our Business Startups Act, signed into law by President Obama in April, 2012. Prior to its passage, the small pool of then-existing crowdfunding sites were only permitted to operate on a reward or donation basis, essentially offering a product, discount, or enticement in exchange for monetary funding. It is estimated by the firm Massolution that the crowdfunding industry raised about $6 billion in 2013.

Crowdfunding is increasingly being used as a vehicle for investment in renewable energy projects. For example, in January 2013, Mosaic introduced a crowdfunding platform that makes it possible for small, non-accredited investors to earn interest financing clean energy projects. Since then, Mosaic reports that it has had over $5.6 million invested into solar projects through its platform, with over 2,300 investors in 44 states. Mosaic further reports that it has made 100 percent on-time payments with yields around 5.5 percent to investors and zero defaults to-date.

In addition to well-known crowdfunding platforms like Kickstarter and Indiegogo, a number of platforms, such as GreenFunder and SunFunder, are focused specifically on providing crowdfunding opportunities for renewable energy and other cleantech projects. However, until the Securities Exchange Commission (SEC) issues final crowdfunding rules, likely not until late 2014, the viability of this mechanism for fundraising remains uncertain. Among other things, the SEC's crowdfunding rules may set the standards for exempt crowdfunding offerings to non-accredited investors and establish dollar limits on an investor's financial position.

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