The ABCs of solar PPAs for public sector entities

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In the past ten years, the cost of a solar panel installation has fallen by over 60 percent. As a result, onsite solar power has become an increasingly attractive way for consumers to manage electric costs and achieve sustainability goals.

Many of our firm's public sector clients have been approached by solar developers over the years about signing a power purchase agreement (PPA). Developers promise to provide electricity at a fixed or reduced cost with no up-front payment, financing, construction or maintenance burdens. Is it too good to be true, they ask? Maybe not.

PPAs are a strong and viable tool when structured effectively. A PPA can enable municipalities, schools, townships and other political subdivisions to benefit from renewable energy while minimizing up-front expenditures and outsourcing operation and maintenance costs. Additionally, a PPA provides a predictable electricity cost over the term of the contract, often a period of 15-25 years. But political subdivisions need to carefully weigh all of the options and risks before moving forward.

Overview of PPA financing

Under a PPA financing model, a private energy company (provider) procures, installs, operates and owns the system on local government premises. The political subdivision enters into a long-term contract, the PPA, to purchase the electricity generated by the system from the provider. The expected cash flow from the PPA helps the provider secure financing to build the project. In addition to the revenue generated from electricity sales, the provider can benefit from federal tax incentives, depreciation, or other incentives or programs that may be available to fund such projects. For example, the Federal Investment Tax Credit offers tax-paying entities a 30 percent tax credit of the total cost of their system.

Renewable energy certificates (RECs) are also an important component of an energy project, and while they can be lucrative, they are also risky. Weighing that risk and deciding who should bear it is critical. Ohio requires that at least 12.5 percent of the electricity provided by electric utilities to their customers come from renewable sources by 2027. Utilities typically comply with this requirement by using RECs, which represent one megawatt-hour of electricity produced from a renewable source. Under most PPAs, the RECs remain with the provider, which then sells the RECs to utilities on the compliance market. The projected value of RECs, as well as other tax or grant incentives, should offset the overall project cost and result in lower cost of power to the public entity.

Interconnection and net metering

Interconnection and net metering are also important for local governments to understand when exploring a PPA. Our clients often have questions about these processes and their roles in each. While providers generally prepare the necessary applications and take care of associated costs, it is the public entity—not the provider—that is the utility's customer. As a result, the public entity should understand its role in interconnection and net metering.

Interconnection is the process by which renewable energy systems are connected to the electrical grid. Before a public entity can start generating power through a system, which is connected to the grid, the public entity and utility must enter into an interconnection agreement that spells out the conditions, equipment and processes for generating power and connecting to the grid. Ohio law establishes uniform requirements for interconnection, including application requirements, expedited procedures,

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uniform requirements for interconnection agreements and backup electricity supply with Ohio's investor-owned utilities. Projects within the territory of a municipal utility will be subject to the interconnection processes of that particular municipal utility. In addition to the law, public utilities should review any contracts they have with utilities or other electricity providers to be certain that purchasing power from alternative sources is allowed. For instance, many of Ohio's rural electric cooperatives have taken the position that third-party PPAs are impermissible within their territories.

Net metering allows utility customers to receive credit on their electricity bill if surplus electricity is sent back to the utility. The law establishes the state's net metering provisions, including the amount of excess electricity that may be credited and the value of the credit. It is important to know that the law does not apply to all utilities. Municipal utilities and rural electric cooperatives are not legally required to allow net metering, and public entities served by these utility systems should make sure that the provider has checked to ascertain if a project is possible. Finally, the rate of the net metering credit offered by the utility should be carefully considered when sizing a system and considering the economic benefits.

Top 5 critical early decisions

There are many things that public entities should consider when moving forward with a PPA. However, there are a few decisions that can make or break a project. Getting these items resolved as soon as possible will result in a better project and fewer headaches along the way.

1. Work with a reputable provider with a proven track record. Ask for references and follow up on them. It is not unusual for each project to be set up through a separate LLC, which will not independently have any track record. But the LLC's parent company, the provider, should be able to establish that they are capable, experienced and have the financial capacity to get the project completed. An RFP or formal bidding process may not be legally required but might be a good idea in some cases.
2. Identify future energy needs. A system that is either too small or too large will not be cost effective. There is an art to sizing your project to achieve optimal return on investment and meet your long-term energy needs. A good provider should be able to calculate, and explain to you, what system size is best and how it may be impacted by future technology developments, planned energy efficiency projects or possible infrastructure changes.
3. Identify potential locations. This is a very long-term proposition and having a good assessment of the current condition of the project location and future property needs is important. Moving a system is possible, but expensive. An environmental assessment of the property may be needed, and the parties will need to determine what warranties concerning the condition of the property may be necessary.
4. Nail down the financing structure. Understanding how the provider intends to finance the project is very important. If the provider is depending on the public entity to provide security for the deal or, in the case of a political subdivision, use its authority to obtain a tax-exempt loan or bond, that needs to be discussed and decided as soon as possible. Providers also need to understand the unique legal limitations related to annual appropriation requirements and long-term property leases by political subdivisions. More importantly, the provider's lender needs to understand and agree with these legal requirements. Some PPAs contain system purchase options, and the public entity will want to be sure that the parameters for a future purchase of the system are clearly defined.
5. Determine the major expenses and responsibilities. Political subdivisions should have a clear understanding of which party is responsible for filing permits, zoning applications, interconnection and net metering applications, as well as applying for rebates or state incentives. Responsibility for the cost and maintenance of the project property, including security features such as fencing, should also be decided. Check with your insurance carrier to determine if there is any added cost involved with insuring the system. It is important that the public entity understands exactly what the provider will pay for, and what the provider expects you to cover.

Conclusion

Financing a system through a PPA carries a number of advantages:

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1. no/low up-front cost
2. ability for tax-exempt entity to enjoy lower electricity prices thanks to savings passed on from federal tax incentives
3. a predictable cost of electricity over 15-25 years
4. no need to deal with complex system design and permitting process
5. no operating and maintenance responsibilities

However, implementing a PPA inevitably requires the engagement of multiple skill sets and roles: decision maker, energy manager, facilities manager, contracting officer, attorney, budget official, real estate manager, and environmental and safety experts. Although a single individual may hold several of these roles, it is important that all roles and skillsets are engaged early in the process.

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Authors

Dylan F. Borchers

Partner

Columbus
614.227.4914
dborchers@bricker.com

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