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Tribal Energy Project Development

Deals in Indian Country

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Overview of Presentation

- Changing the historical paradigm
- Project finance basics and update on market trends in renewables
- Overview of the basic development process
- Goals and key elements of the joint venture for tribal energy projects

Historical Paradigm

- Energy facilities in Indian Country owned by non-tribal entities
- Typical business model
  - Lease/royalty arrangement
  - Some exceptions, but very few
- Tribal employment common, but management less common
- Federal control over development of tribal energy resources

Shifting the Paradigm

- Tribal owned, operated, regulated energy facilities to serve local and wholesale demand
- Significant tribal investment positions
- Tribal management and labor
- Greater tribal control over development of energy resources

= EQUITY, SUSTAINABILITY AND SHARING OF RISK

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Fundamental Truths About Project Finance

- Tax incentives alone don’t drive the deal
- Ready market is vital
- Lenders loan to cash flow, and against assets
- The investment is secured against the assets
- Biggest risks occur BEFORE cash flows

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Types of Risks Managed in the Deal

- Construction risk
- Operation risk
- Sales risk
- Contract extension risk
- Environmental/regulatory risk

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What are Investors Looking For?

- Specific range for Return on Investment (ROI)
- Three essentials/questions:
  – 1. Project Size: scale and flexibility?
  – 2. Management Team: can it deliver?
  – 3. The Plan: will it work?

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Renewable Energy Project Finance

- **Majority of utility scale renewable projects have been financed with a tax equity model**
- **Tax equity model is a combination of:**
  - **Small amount of sponsor equity,**
  - **Bank debt, and**
  - **Tax equity (monetization of tax credits)**

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The Goal of Debt in the Deal

- Non-recourse debt, meaning the lenders do not have any other collateral except for the assets of the project
- Loan repayment is from the project cash flows net of operating and capital expenses
- Project cash flows will provide scheduled debt repayment

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What is tax-exempt debt?

- Tax-exempt debt is a less expensive way for a Tribe to borrow money for a development project.
- Less expensive because the interest payments that the Tribe makes in repaying the debt is not treated as taxable income to the person who provides the money
- Lender will therefore offer a lower interest rate = savings for Tribe.

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Trends in Funding Energy Projects

- **The landscape has changed;**
  - **Loss of tax equity investors and reduced supply of credit and debt**
  - **Shortage of bank finance in Q1 2009 compared to last year:**
    - **44% drop from Q4 2008**
    - **50% drop from Q1 2008**
  - **Less bank syndication; likely more “club” deals with a smaller number of lenders**
  - **Conservative approach re: financeable projects and transactions**

Some Things Change, Some Things Don't

- Dramatic reduction in large tax equity investors
- Banks prioritizing financing requests
- Terms have returned to conservative
  - Long term PPA/PSA's
  - Creditworthy counterparties
  - Strong EPC contract/parties
  - Low technology risk
- Strong credit profile is essential

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It Ain't All Bad News

- Globally over $97 billion of clean energy projects were financed in 2008 as compared to $84.5 B in 2007
- US became the leader in new capacity investment with $24 billion invested (20% of global investment)
- US added more renewable capacity than conventional capacity for the first time

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Balance Sheet vs. Project Finance

- On-balance sheet financing remained a dominant deal type at $48.6 billion, a 2.4% increase over 2007
- Project finance almost matched on-balance sheet finance at $48.5 billion, a 35.2% increase over 2007

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Wind and Solar

- **Wind project financing increased by 16% during 2008 from $41.3 billion to $47.9 billion**
- **Solar project financing increased by 84% during 2008 from $12.1 billion to $22.1 billion**

Data provided by NERA Economic Consulting

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New Energy Economy

- Climate change=pressure for fossil fuel alternatives
- Economic recovery efforts creating focus on green energy, energy efficiency and job creation
- Increased emphasis on collaboration between states, tribes, local communities and NGO's
- Developing vision for the future: energy generated from renewable resources, transmission systems with "smart-grid" technology

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The Point of the Stimulus:

- Double renewable generation by 2011 and reach a 10% renewable penetration goal by 2012
  - RES legislation may adopt different market penetration goals
- $134 Billion of new capital investment and renewable energy infrastructure required by 2011; $217 Billion by 2012
- Pace of investment in renewables and efficiency expected to increase dramatically over the prior years

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Phases of Project Development

- Phase 1: Initial Assessment
- Phase 2: Feasibility and Scoping
- Phase 3: Studies and Initial Preconstruction Development
- Phase 4: Capital, Contracts and Permits
- Phase 5: Project Construction and Commissioning
- Phase 6: Project Operation and Maintenance

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Phase One

- Tribal sponsor conducts preliminary assessment including:
  - demand for power
  - potential generating resources
  - availability of cost-effective interconnection with the power grid
  - control of potential project sites

Phase Two

- Tribal sponsor evaluates or “scopes” all aspects, including:
  - Proposals from outside project developers
  - Consideration of tribal resources
    - Financial resources
    - Capacity
    - Business and institutional resources
- This phase usually results in a formal decision or authorization to move forward

Phase Three

- **Developer (which may be some combination of the tribe and a non-tribal party, or it may be either) invests in load and transmission studies and preliminary engineering designs, and begins to discuss electric load needs and terms with potential customers**

Phase Four

- Completion of Pre-Construction Development
  - Permits
  - Transmission and power sales agreements
  - Financing

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The Business Deal

- Depending on the tribe, this can start as early as Phase 1, but usually no later than the end of Phase 2.
- Details of the business deal this afternoon
- Importance of the tribe focusing on its goals and objectives before entering into the development process

A Team Approach

- Every energy project requires a team coordinated by the Tribe
- The team must have financial, legal, political and public relations experience
- Within each discipline, certain subject matter expertise is essential
  - Legal: e.g., tax, real estate/land, finance, contracts (PPA's, joint venture, equity), Indian law, environmental law, government relations
  - Energy development experience key

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Should the Tribe be a Passive or Active Player?

- Pros and cons of each approach
- Assess tribes resources and willingness to commit to the project regardless of choice
- Long-term partnership with non-Indian parties on Indian lands in both cases:
  - Tribal-owned/operated: PPA's, investors
  - Not tribal owned/operated: long-term presence and partnership
- DOE Tribal Energy Program can help tribes evaluate this issue

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Key Drivers for Energy Investment

- Tax benefits: Accelerated depreciation and Production Tax Credits
- Serve local energy demands and/or economic development with utility scale projects with revenues to tribe
- Cash flow to equity investors
- Affiliate contracts
- Economic Development and Other Policy
  - State/federal incentives
  - Environmental/social benefits

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Understanding the Investors

- Strategic investors
  - Capacity to develop investment in the sector
  - Capacity to accept project risks because of knowledge and active management
- These are the people/entities that will likely approach the tribe first to explore the possibility of project development

Institutional Equity Investors

- Mainly passive investors, motivated by tax benefits and overall return
- Experienced in other energy tax credit regimes
- Will not accept significant development risk
- Requirements similar to lender requirements

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Early Stage Development Equity

- Substantial development costs required to reach a financeable project
- Sponsor and developer may lack adequate capital, development expertise and ability to arrange additional financing
- Alternatively, sponsor finds developer with capital, expertise and financing ability

Late Stage/Construction Stage Equity

- Made through purchase or joint venture/limited liability company
- Required to support power purchase agreements (PPA) or interconnection agreement security, turbine purchase order and construction loans

The Formation of the Deal – One Model

- Sponsor (including the tribe and/or a tribal entity such as an enterprise, tribal corporation or Section 17 corporation)
- Developer (could be tribe or non-tribal entity)
- Project company formed to carry out:
  - Development
  - Construction
  - Operation

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Joint Venture Process

- Usually begins with a non-binding Letter of Intent coupled with a Confidentiality and Nondisclosure Agreement
  - Sets the basic tone for discussions between the tribal sponsor and developer
  - Allows both parties to share information without fear of disclosure to competitors
- Most non-tribal third parties will accept dispute resolution at this stage pursuant to tribal law

Joint Venture/Joint Development Agreement

- Guides the parties through the pre-construction development process
- Sets the tone and the “template” for future agreements between the tribal sponsor and the developer
- Establishes the business relationship, and the allocation of project development risk between the tribe and non-tribal project entities

Major Issues in Joint Venture Structure

- Preconstruction development budget
- Project schedule and milestones
- Delineation of development activities and responsibilities between tribal sponsor and developer
- Rights of compensation before and after financial closing
- Allocation of development costs
- Property rights

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Critical Issues for Tribal Parties in Joint Ventures

- Shareholder rights, especially minimum proposed minority shareholder protections (e.g., anti-dilution, rights to acquire interests in the project and project company, management issues)
- Tribal employment and contracting preference
- Compensation for use of tribal lands, taxation

Key Sticking Points

- Dispute resolution, governing law, choice of forum are not the roadblocks they used to be, but must be discussed early
  - Waiver of defense and right of sovereign immunity
  - Exhaustion of remedies in tribal courts
  - Arbitration vs. litigation
- Indemnification, limitation of liability, remedies on default and termination

Negotiating the Sticking Points

- **Limited waiver of immunity to suit essential - limit to specific assets, protect tribal officials and individuals, tie to dispute resolution**
- **Binding arbitration to avoid state court jurisdiction**
- **Authority to compel arbitration, enforce awards, protect parties during arbitration in any court of competent jurisdiction**
- **Insist on clear terms preserving tribal jurisdiction (covenant not to contest tribal jurisdiction on tribal status as Indian nation)**

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Basic Trend #1: Motive

- Tribal energy projects serve social, economic, environmental and political objectives
- A lot of good ideas searching for limited resources – separate your project from the pack
- Motives must be clear, up front, and packaged in a concise, well developed business plan
- Don't let the investor define the tribe's motives
- When the parties understand each other's motives, they can see solutions, not just obstacles

Basic Trend #2: Scalable and Flexible

- **Scalability: projects that can be designed in different sizes, capacities and configurations have a greater chance of capturing a wide range of tax credits and other incentives**
- **Flexibility: projects that offer different and flexible approaches to investor revenues and risks are more bankable**

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Building Wealth in Indian Country

- **Energy development a long-term strategy**
- **Successful energy projects, _no matter how large or small_, require 3 elements:**
  - **Efficient business structures**
  - **Standardized and fair regulatory processes administered by reliable, stable and transparent government authorities**
  - **Enforceable, fair and balanced contracts**
- **Once a level playing field is established, these three elements will generate a wide variety of economic opportunities for the tribe**

For More Information

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