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FOR COMMUNITY BANKS, THE SUN ALSO RISES
Solar Tax Credit Investments Now More Accessible

By Josh Miller, CEO, The KeyState Companies

For more than a decade, large financial institutions like U.S. Bank and Wells Fargo, joined by Fortune 500 giants like Apple and Google, have been the dominant players in solar investment tax credits (ITCs). Driven by federal incentives, these companies have provided funding for the largest solar projects in the country, collecting healthy returns while raising their corporate profiles as environmental/social/governance (ESG) leaders.

The benefits of solar ITCs are hard to ignore. Tax credit investors funding renewable energy projects can significantly offset their federal tax liability and recognize a meaningful annual GAAP earnings benefit. From 2005-20, renewable energy tax credits have fueled the explosive growth of solar and wind power production nearly 18-fold.

Large corporate investors continue to focus on major, utility-scale renewable energy projects in an effort to deploy their capital at scale. However, the landscape is beginning to shift, catalyzed by higher natural gas prices and stark geopolitical realities that make the call for sustainable energy more urgent. State legislatures across the U.S. have passed renewable energy generation targets and mandates, creating a growing pipeline of mid-size solar projects that must be built and financed.

Community banks are a logical source of financing for these mid-size renewable projects. Solar ITCs have a notably better return profile than other types of tax credit investments commonly made by banks. Solar ITCs and the accelerated depreciation associated with a solar power project are fully recognized once it is built and begins producing power. This is quite different from other tax credit investments, such as new markets tax credits (NMTCs), low-income housing tax credits (LIHTCs) and historic rehabilitation tax credits (HTCs), where credits are recognized over the holding period of the investment (5, 7, 10, or 15 years).

Like other tax equity investments, solar tax equity investments require complex deal structures, specialized project diligence and underwriting, and active ongoing monitoring. Specialty investment management firms like KeyState provide support to community banks hoping to make solar tax credit (i.e., "solar tax equity") investments by syndicating the investments across small groups of community banks. Without support, community banks may struggle to consistently identify suitable solar project investment opportunities built by qualified solar development partners.

Not all solar projects are created equally, and it is critical for a community bank to properly evaluate all aspects of a solar tax equity investment. Investment in particular types of solar projects including utility, C&I, municipal, and community solar projects, can provide stable and predictable returns. However, a community bank investor should perform considerable due diligence or partner with a firm to assist with the diligence. There are typically three stages of diligence:

- The bank should review the return profile and GAAP model with their tax and audit firms to validate the benefits illustrated by the solar developer and the anticipated impact of the investment on the bank's earnings profile and capital.
- The bank should work with regulatory counsel to identify the path to approval for the investment. Solar tax equity investments are permissible for national (little "n") banks under an April 1, 2021 OCC Rule (12 CFR 7.1025). Banks have been making solar tax equity investments based on OCC published guidance for more than a decade. In 2021, this new OCC rule codified that guidance. It provides a straightforward roadmap and goes so far as to encourage community banks to consider solar tax equity investments. Alternatively, under Section 4(c)(6) of the Bank Holding Company Act, holding companies under $10 billion in assets may also invest in a properly structured solar tax equity fund managed by a professional asset manager.
- The bank must underwrite the solar developer and each individual solar project. Community banks should partner with a firm that has experience evaluating and underwriting solar projects, and the bank's diligence should ensure that there are structural mitigants in place to fully address the unique risks associated with solar tax equity financings.

Beyond the compelling return profile and stable and predictable cash flows offered by conservative, investment-grade solar projects, achieving energy independence and reducing carbon emissions are critical goals in and of themselves. Solar tax credit investments can be a key component to a bank's broader ESG strategy. The bank can monitor and report the amount of clean energy generation being produced by the projects it has financed and include this information in an annual renewable energy finance impact report or a broader annual sustainability report.

Josh Miller is CEO of The KeyState Companies, which manages tax advantaged investment and insurance structures for over 130 community banks across the country. KeyState Renewables launched its solar tax equity fund platform, SOLCAP, in 2019. To date, SOLCAP has financed over $120 million across 35 mid-size U.S. solar projects in seven states.