

A Shifting Landscape In Equipment Finance For PV Projects

For many small commercial projects, a PPA may not be the most cost-effective financing structure.

■ David ten Kroode

Take a look at the landscape of equipment leasing for commercial projects in the U.S., and you will see the renewable energy and energy efficiency equipment sectors rising in prominence alongside the more traditional market segments of technology, medical, office and heavy machinery.



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Renewable energy projects are generally capital-intensive, and they require a large amount of up-front financing. Unfortunately, the current economic climate means funds for capital investments remain scarce.

In response, equipment finance companies are evolving to support the ever-growing needs of this market. These changes include new equipment financing solutions - such as longer terms combined with payment schedules that allow for grants to be applied against the outstanding principal - simplified loan structures and processes, and contractual documents more conducive to solar characteristics.

In combination with a developing market for used solar photovoltaic equipment, the future of equipment

finance for renewable energy installations and upgrades looks promising.

By understanding these shifts and knowing what to look for when employing an equipment financing option, solar vendors can close more deals faster and add to their top-line growth. For building owners and other users of PV systems, equipment financing can make possible energy-saving PV solar equipment retrofits that more than pay for themselves through energy cost savings.

In 2008, the U.S. added 342 MW of PV solar, including 292 MW of grid-tied capacity, according to data from the Solar Energy Industries Associa-

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tion. For grid-tied PV, this number represents an 81% growth rate over the 161 MW of grid-tied installations in 2007.

Last year, PV manufacturing capacity increased by 65%, creating much-needed jobs in states like California, Michigan, Ohio and Oregon.

But despite these indicators of a vibrant PV market, vendors of PV

equipment continue to struggle with the broader economic downturn, uncertainty associated with PV panel prices, and commercial customers that are nervous about parting with cash for capital investments in PV solar systems.

Capital leases

Traditionally, utility-scale solar financiers have responded to the market's needs with advanced finance structures like power purchase agreements (PPAs), often combined with sale-leasebacks and special-purpose companies.

But much of the burgeoning market for solar is outside these larger utility projects that had set the tone in the past. This market requires a different approach when it comes to financing small- to medium-sized PV solar projects.

Consider a small commercial project, such as a retailer that wants to install solar panels on the roof at a price tag of \$200,000. An advanced financing structure like a PPA may not be a good fit for the project due to the administrative and legal costs incurred

when setting up such a structure.

An equipment finance company might offer this retailer a standard capital lease for its \$200,000 solar project. As a result, disproportionate legal and administrative expenses for setting up a PPA for a project of this size can be avoided.

Another shift in the solar financing landscape is caused by the change in

tax incentives for solar investments from a tax credit to adding a grant under the American Recovery and Reinvestment Act of 2009 (ARRA).

No longer is it always required to set up a financing structure like a PPA with a partner who can benefit from the federal tax credits for PV solar. A straightforward capital lease or loan can suffice for the lessee to take benefits of the federal grant.

Why are capital leases not the most common financial instrument in this industry? The main reason is that PV solar investment terms are generally longer (eight to 12 years) than traditional equipment leases, which are typically for five years or less. But as the PV solar market matures, this gap can be expected to close as a result of several developments, including these three factors:

■ **Market for used equipment.** Historically, demand for used PV equipment has been a challenge for equipment finance companies, primarily because finance companies use equipment residual values when structuring a lease or loan.

As the market for used solar PV equipment matures, so will the ability to use PV assets as financing collateral. Because higher asset resale values reduce a financier's exposure, an established market for used PV systems will enable equipment financing companies to offer longer terms. This evolution will help the PV solar market as a whole.

■ **Dropping panel prices.** Typical PV financing needs to be spread out over eight to 12 years in order to be considered cashflow-neutral (in which the periodic finance payment replaces the previous utility payment). As panel prices come down, the project can be financed over a shorter period of time and remain cashflow-neutral, which is generally more attractive to finance companies.

■ **Rising price per kilowatt-hour.** When the price of electricity rises, so does the revenue generated by the panels. This, again, will reduce

the solar investment payback period and the term required to make the project pay for itself.

Financing terms

In any industry, one of the easiest ways to increase sales is by making it easier for a customer to buy. By offering an equipment finance solution as part of the sales process, solar PV vendors can more easily accomplish this objective.

As equipment financing providers continue to simplify their solar system financing approaches, it will be much easier for PV vendors to offer their customers one-stop shopping for both solar PV equipment and financing.

To help meet this need, many equipment finance companies are working to offer finance structures for non-utility commercial and government solar projects, which typically range in price from \$100,000 to \$5 million.

As mentioned previously, the equipment finance industry is also moving to longer terms, such as eight to 10 years, rather than three to five years. These terms better fit the longer 15- to 25-year technical life span of PV equipment. The industry is also finding new ways to apply the current tax incentives and grants to offset loans.

These changes will enable solar vendors to tap into the large pool of equipment financing options and enable their customers to acquire PV equipment with no money due up front, thereby conserving cash for their core business.

The first step in completing an equipment finance transaction is selecting the right finance partner. Many PV solar vendors offer equipment financing as part of the sales process, which eliminates the legwork for the business owners.

Business owners who prefer to seek out their own financing source - or those working with vendors that do not offer financing - have several op-

tions for selecting a finance partner.

The Equipment Leasing and Finance Association, for instance, provides an online search tool that enables users to find reputable leasing companies by geographic area, types of equipment financed, type of company and more. Many banks also offer equipment finance, and those that do not can typically provide a referral.

Application procedures

To make the most of any deal, solar PV vendors and building owners should ask these questions of a potential equipment finance partner:

■ Does the company have experience in financing solar PV and other kinds of renewable energy equipment?

■ Are lease structures available that provide the longer terms more conducive to PV equipment?

■ What happens if the building changes ownership or the business owner needs to terminate the lease early?

■ Are options available to apply grants and incentives to the loan or lease?

■ Can the equipment financing partner provide complete project financing that bundles installation and other soft costs into one lease?

■ Does the finance company have a track record of stability and providing expert guidance through economic ups and downs?

Once an equipment finance partner has been selected, the next step is to ask for a quote. In order to prepare such a quote, the parties must be clear from the outset who will be completing the paperwork required to take advantage of the incentives available. In many cases, this step is done by the solar vendor. Both companies must also agree on when payment of the incentives can be expected and who is going to receive those payments.

Once the quote is received and agreed upon, the finance company will begin the credit application pro-

cess. During this phase, the funding source will review a company's financial information to confirm that the company can meet the payment obligation.

Typically, the shorter the lease term, the easier it is for small businesses to obtain credit approval. Companies that can provide financial information for the previous two years can generally expect the credit-approval process to take three to five business days.

Once credit approval is received, the up-front requirements are nearly complete. At this point, it is impor-

tant to make sure the credit approval is valid, at least until construction is complete - which prevents a finance company's changing credit requirements to affect a customer mid-way through the construction phase.

The business owner must also understand what its financial obligations are during the construction period. Often, the length of the construction period, size of the solar project and payment terms of the vendor all have an impact on how much is due at different phases of completion, as well as when the customer begins paying down principal on the lease.

Knowing the landscape of PV equipment financing, as well as the right questions to ask, can help solar PV vendors achieve new levels of profitability and assist business owners in harnessing the power and cost savings of solar systems for their facilities. ☛

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