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While financing renewable energy has long been seen as mainly the domain of larger banks, smaller institutions have started making their mark in this business. Banks interested in this option could consider investing in a solar tax equity fund, which offers community-based financial institutions easier entry into financing renewable energy projects.

KEY METRICS

35%

The proportion of worldwide electricity expected to be generated by renewables by 2025
Source: The World Economic Forum

5 MEGAWATTS

The average amount of energy generated by a SOLCAP-financed project
Source: The KeyState Companies

KEY TAKEAWAYS

- Solar tax equity investments can offer community banks an attractive inroad into renewable energy.
- As investors, banks typically receive a 30% tax credit, plus revenue from the energy generated and sold from the resulting development.
- The U.S. Department of Agriculture's Renewable Energy for America Program (REAP) has also made renewable energy financing more palatable to community banks by providing a government guarantee for eligible projects.
- Because it provides a government guarantee on bank financing for eligible projects, bankers say REAP financing can be compared to Small Business Administration lending and can complement that activity.

Community banks are making greater inroads into financing renewable energy, motivated by a bullish long-term growth outlook and an array of incentives.

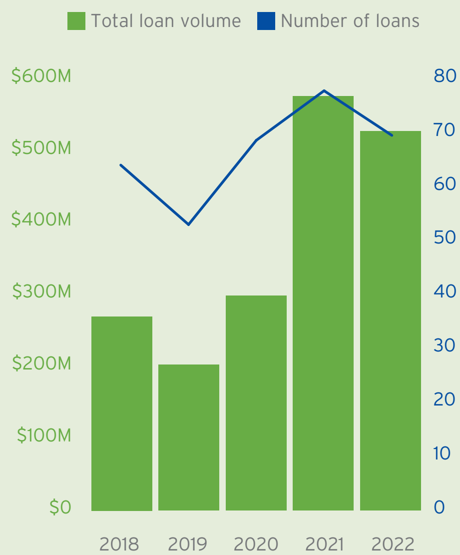
For North Riverside, Illinois-based West Town Bank & Trust, a $422 million subsidiary of Integrated Financial Holdings, financing solar development projects is attractive due to their consistent rates of return and predictable cash flows, says A. Riddick Skinner, executive vice president of government lending. He compares it to project financing for a hotel, a familiar space for many banks.

"I'd probably get a good operator with a good piece of real estate, but it's only worth the amount of heads in beds it gets. I can't guarantee that it's gonna have heads in beds every night," Skinner says. "But I can guarantee that Duke [Energy Corp.] is gonna buy all the power this thing's gonna produce. And I think I know how much it's going to produce."

The Impact of Tax Equity

For a growing number of small- and medium-sized solar energy developers, projects are financed in part through tax equity investments, a transaction that exchanges tax credits for financing. These investments typically make up between 40% and 60% of a project's financing, according to Josh Miller, CEO of The KeyState Companies, which advises community banks on tax credit investments. Investors typically receive an investment tax credit of 30% or more, based on the project's appraised value, plus depreciation deductions and cash proceeds from the sale of the energy. The 2022 Inflation Reduction Act extended the Renewable Energy Investment Tax Credit for at least 10 more years.

USDA REAP Financing
Source: U.S. Department of Agriculture, Palmetto Energy Capital



$225 million

Tax equity investments deployed on behalf of banks by The KeyState Companies since 2019

$10 million

Average bank's investment in a SOLCAP solar tax equity investment fund
The KeyState Companies

A bank investing in a solar tax equity fund would earn back its entire investment in the first year, in the form of reduced tax liability, says Miller. Over the next five years, a bank would then receive additional income from the sale of energy produced by the projects it has helped finance. KeyState has been working with solar tax equity investments since 2019, when it launched its SOLCAP tax equity fund platform.

"For any bank that is not active in tax credit investments, whether it be solar, [Low Income Housing Tax Credits] or New Markets [Tax Credits], they are an untapped resource," he says. "With tax credit investments, a bank can convert its federal tax liability into earnings, which can be quite meaningful year after year."

As of March 2023, KeyState has closed seven solar tax equity funds, working with 15 banks that range from $1 billion to $40 billion in assets. Most of those banks invest annually, the firm says, creating a recurring earnings benefit. A single fund ranges from $20 million to $100 million and could have three to eight banks invested, Miller says. In total, the funds have deployed $225 million across 53 projects.

"It's our job on the front end to not only explain the investment but to assist [investors] with all of the underwriting," Miller says. KeyState also handles the modeling and assists with regulatory approvals. The bank investors are ultimately responsible for evaluating the developers and solar projects. After that point, KeyState's role transitions into an asset manager, Miller says. The company provides participating banks with quarterly updates on their investments.

Solar tax equity investments can also help banks boost their environmental, social and governance (ESG) bona fides. Banks may soon be able to earn credit under the Community Reinvestment Act in states that passed legislation intended to make renewable energy more accessible to low- and moderate-income households, Miller says, including Illinois, New York, New Jersey, Maine and Virginia.

A Complement to SBA Lending

The U.S. Department of Agriculture's Rural Energy for America Program (REAP), launched in 2015, has also made solar energy lending more attractive to the banking industry by providing a government guarantee to project financing that meets certain criteria. That can be appealing to banks that already have some familiarity with Small Business Administration lending, which has similar guarantees. That program saw a spike in activity between 2019 and 2020 due to a greater number of solar and biogas projects, coupled with lower interest rates and more incentives.

West Town Bank has done a fair amount of REAP financing. So has $10.4 billion Live Oak Bancshares, based in Wilmington, North Carolina. The bank, an active SBA lender, has originated just north of $1.5 billion in solar energy project lending since 2016, much of it through the USDA's program. In its own role, Live Oak would find itself on the other side of the table from a company like KeyState, meaning that Live Oak provides the loan while a fund provides the tax equity investment.

Jennifer Williams, senior vice president of renewable energy at Live Oak, says the bank likes the renewable energy space due to its expected future growth, as well as its contributions to rural economic development and job creation.

"This is an exciting time and there's a growing need, particularly in tax equity investment," Williams says. "There are some real needs that a regional bank can meet by being a good partner to someone local."

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Founded in 1991, KeyState provides over 140 community banks with innovative investment structures that enhance a community bank's annual earnings. KeyState Renewables has raised and deployed $225 million in solar tax equity through its SOLCAP solar tax credit fund platform since 2020, financing 53 solar projects in 7 states. Learn more at **www.key-state.com**.