Solar Financing Do’s and Don’ts

A lot of work goes on behind the scenes to ensure that customers receive the most competitive lease or power purchase agreement (PPA) rate. In particular, PPAs are highly complicated contracts that involve significant financial negotiations between a solar partner and investors (sale-leaseback and other financial mechanisms) to create a winning deal for all parties involved. If you already have an experienced solar partner like SunPower, there’s no need to worry about most of that because you have an expert guiding your project. However, for those companies who want to be more involved, this list can help you avoid common mistakes and better understand how investors and financiers look at solar deals. With these tips in mind, your company can find the most successful path to a winning, long-term financial deal.

Do’s

Always remember that in solar financing, multiple parties are involved (investors, lenders, etc.). Everyone needs to feel like they’re getting a good deal to move forward on a solar project. To help ensure your combined interests will align, the following is highly recommended:

• **Check the developer's track record.** New solar developers will generally be considered riskier investments, which can drive up financing costs. Research data such as number of MWs installed, years in business, and so forth to find out the quality of the company with whom you’re looking to partner.

• **Find out what kind of financial backing the solar developer has.** The better the backing, the better the likelihood of getting a financially advantageous deal secured because financiers tend to view the developer as less risky. This also helps you to differentiate the long-term players from the fly-by-night start-ups in the solar industry.

• **Consider sophistication of financing.** Some solar companies are coming up with complicated and exotic financial structures that look good on paper, but they are never completed. Be sure to keep this in mind when comparing against more established financial tools such as PPAs and leases.

• **Analyze the risks involved with the solar technologies being considered.** Just as the solar company should be researched, so should the technology. The technology fundamentally determines how a solar system performs, and especially for investors in a PPA deal, they want to know that the technology is reliable.

• **Expect changes to a PPA following a bank’s review.** Don’t consider a PPA deal to be done until a bank has reviewed it. Because this is a complicated contract which doesn’t have the contractual standardization that lease financing has, something will have to be amended 99% of the time.

• **Think in scale since legal, technical, and financing efficiencies benefit your project.** If a broad solar initiative is part of your company’s vision, it’s better to do multiple projects together as part of a large solar project. Especially with financing, certain levels of scale enable better financing terms and access to lower cost capital. Doing solar projects in a piecemeal fashion can increase financing costs as well as the total costs and time spent in doing technical reviews and legal contracts again and again for each new project.

• **Consider if a facility will be there in 20 years.** Solar systems can last at least 25 to 30 years. Facility and store plans should be reviewed to determine if a location will be suitable for this long-term investment.
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• **Compare financing alternatives.** One financial tool doesn’t fit all projects. PPAs are great and so are leases and loans. As mentioned in our “Solar Financing Overview” guide, there’s a time and place for every financial tool. Do your homework to find out which ones work for each site where you are considering solar.

• **Expect to pay for relocation expenses and lost revenue in a PPA deal if a system is moved or shut off due to your action/inaction.** Customers must continue to pay for electricity that would have been produced when a system is shut off and/or being moved to a new site. This is a standard part of this financial agreement because it directly impacts how the investor makes their return.

**Don’ts**

Following this list will give you an inside look at solar financing so that your company can avoid common mistakes that diminish solar value or derail a deal. Once again, this is why a solar partner who has successfully managed complex financial structures and negotiations can be crucial to maximizing the value of going solar.

• **Think that all systems are created equally.** Technology not only matters to your company in being able to reliably produce for the long-term, but it also matters to investors. Especially in PPA deals where the investor earns based on how much energy the system is producing, technology is critically important for an organization to get a competitive long-term energy rate.

• **Size your system to 100% of load.** Trying to meet all of your energy needs through solar may sound like a good idea, but in a PPA, it means that you’ll end up paying for energy that you don’t use. Keep in mind that solar power produces more energy in the middle of the day while the total electricity demands of your site are usually spread out. Sizing to 100% of load means that your system will produce more energy than your site can use during the peak hours, and your company will still have to pay for it in a PPA. Generally, utilities are not required to pay for extra energy under net metering, so your organization would also be giving the utility free electricity. When you build a system, it should be a little less than the overall load, and it should be designed to achieve the most advantageous utility rate structure.

• **Expect the cost of capital to always correlate to your credit rating.** Companies with AAA credit ratings think that they should always get lower cost capital. It’s true in an efficient market, but solar tax equity is not an efficient market. There’s a limited supply of tax equity, and investors are cautious about how they deploy equity in PPA deals.

• **Assume debt is the cheapest way to finance a solar project.** A common misconception is that leverage is good. Customers believe that 100% debt financing is the cheapest way to finance a solar project in the U.S. However, 100% debt financing requires cash flow to pay the debt service. Mixing in equity reduces the amount of cash flow needed to pay for the debt service. Quite simply, paying debt service on 60% of a solar system is less than paying on 100% debt service.

• **Negotiate formulas for termination value schedules (TVS).** Banks will make you change them anyway. Banks prefer a set amount instead of a formula to ensure that they get their return.

• **Assume that it’s ok to assign the PPA without consent.** This is a non-starter. Assignment is a big problem for financiers. If a bank gets approval for a financial deal for a particular company, they do all their approvals based on that specific credit profile. So that’s the credit they expect for twenty years. While your company may want the flexibility to assign the PPA to someone else, banks won’t go for this even if the other company has the same credit rating because that company may have a very different risk profile. In short, financiers will want to approve any counterparty brought into a deal.
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• **Negotiate unfair indemnity obligations.** Investors won’t go for deals with unfair indemnity protections for the host that are outside the norm such as change of tax law risk, environmental indemnities, and other things for which the host would typically absorb the risk.

• **Expect a 99% performance guarantee in the financing contract.** Unexpected or unusual situations can occur, so it is reasonable for customers to expect lower performance levels. However, using high quality solar technology typically means performance issues aren’t a key concern, and since investors make their return based on the technology performing well, everyone’s interests are already aligned in getting the best technology and keeping it running.

• **Expect fixed price purchase options.** A PPA is structured to be a service contract. This ensures that the deal doesn’t appear to be a lease and violate tax laws. Purchase options are always the higher of the TVS or fair market value as calculated at the time.

A Clear Path to Solar Success

Hopefully, these tips will offer a clear path to a competitive financing deal and help you avoid costly missteps that can slow or derail a project entirely. With the right solar financing, your company can create a successful financial deal to deploy clean energy for your company and maximize the total long-term value.