



American Public Power Association

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Understanding the Clean Renewable Energy Bond Program

Background:

Until recently, only for-profit investor-owned utilities were eligible to receive a tax incentive for producing electricity from renewable energy sources. The Clean Renewable Energy Bond (CREB) program is a new financial incentive for consumer-owned utilities and other eligible entities to invest in new renewable electricity generation facilities. President Bush signed the CREB program into law on August 8, 2005, as part of H.R. 6, the Energy Policy Act of 2005 (the "Act").

Summary:

CREB is a tax credit bond, a relatively new type of debt instrument. Prior to the enactment of the CREB program, there was only one type of tax credit bond program in place for the reconstruction of schools. In a CREB financing, the holder of the debt instrument receives a federal tax credit in lieu of interest paid by the issuer. Thus, CREBs provide an issuer with the ability to borrow at a 0% interest rate. The tax credit may be applied against the bond holder's regular and alternative minimum tax liability. The tax credit amount is also treated as taxable interest to the holder of the bonds. For example, assume that a bondholder is in a 30% tax bracket. If the bondholder receives a \$100 tax credit, \$30 (or 30% of \$100) is treated as taxable interest income leaving a net tax credit or return of \$70.

Under the Act, CREBs can be issued no earlier than December 31, 2005, and no later than January 1, 2008, with a national aggregate issuance cap of \$800 million (with no more than \$500 million for government bodies).

How the CREB Program Works:

Qualified Projects: Qualified facilities under the CREB program are renewable energy facilities described in Section 45(d) of the Internal Revenue Code of 1986, without regard to the placed-in-service date requirements under that section. These facilities are: wind energy facilities, open-loop and closed-loop biomass facilities, geothermal energy facilities, solar energy facilities, small irrigation power facilities, landfill gas facilities, trash combustion facilities, refined coal production facilities and certain hydropower facilities (incremental hydro or hydropower added to existing dams).

Eligible Issuers: Eligible issuers include State and local governments, U.S. territories and possessions, the District of Columbia, Indian tribal governments, CoBank, Cooperative electric companies and the National Rural Utilities Cooperative Finance Corporation.

Allocation of Volume Cap: Under the CREB program, the Secretary of the Treasury is responsible for allocating the national volume cap. Since the Act provides no specific guidance to the Secretary regarding the allocation process, it is currently unclear how the volume cap will be allocated until a proposed rule is published by Treasury. The Act contains a national limitation of \$800 million that the Secretary may allocate, in the aggregate, to qualified projects. In addition, the Secretary is prohibited from allocating more than \$500 million to “government bodies.” Governmental entities are defined as State and local governments, Indian tribal governments, the District of Columbia, U.S. territories and possessions.

Tax Credit Rate: The tax credit rate is set daily by the Treasury Department. Such rate shall apply as of the date that there is a written binding contract for the sale or the exchange of the bond (i.e., the date of the bond purchase agreement). The Act directs the Treasury to set a credit rate that will permit CREBs to be issued without discount or interest rate cost to the issuer.

Maturity Limitation of Bond: The Secretary of the Treasury is responsible for determining the maximum term or duration of the bonds. The maximum maturity is the term that the Secretary estimates will result in the present value of the obligation to repay the principal on the bond being equal to 50% of the face amount of the bonds. The interest rate used for this purpose is determined at least monthly by the Treasury using the average annual interest rate on tax-exempt bonds having a term of 10 years. For example, if an issuer issued \$10 million of CREBs and the applicable Treasury discount rate is 6%, the term of the bonds is established by determining how long it will take \$5 million invested at 6% to equal \$10 million. Under the Act, however, the issuer is required to repay the principal amount of bonds in level annual installments. At the current average interest rate for tax-exempt 10-year bonds, APPA has estimated that the maximum term for CREBs will be an average of 11-14 years.

Arbitrage Restrictions: Similar to rules applicable to tax-exempt bonds, CREBs are subject to arbitrage regulations and rebate requirements.

Expenditure Requirements for Bond Proceeds: Under the Act, an issuer must spend 95 percent or more of the proceeds of the bond on a qualified project within five years from the date of issue. The Secretary has the authority to extend the five-year spending period upon petition by the issuer to account for unforeseen delays or other unforeseen circumstances surrounding the project.

Use of Bond Proceeds for Reimbursement and Refinancing Purposes: The Act generally provides that issuers may use CREBs to reimburse expenditures for qualified projects incurred after the provisions effective date (December 31, 2005), provided that reimbursement resolutions are adopted in a timely manner. In addition, conventional taxable financing incurred after December 31, 2005, for qualified projects may also be refinanced with CREBs.

For more information about the CREB program, please contact Michael Brairton, Government Relations Representative, at mbrairton@appanet.org or 202/467-2928.