ReedSmith

Record Highs and Lows in New Jersey's Uncertain Solar Market

10 May 2012

Authors: James E. McGuire, Henry R. King, J. Ferd Convery, III, Marshall B. McLean

New Jersey's solar market hit record highs on the development side in the face of record lows in Solar Renewable Energy Credit (SREC) prices during the first quarter of 2012. A record 685 solar projects were installed in March 2012, totaling 41,758 kW of solar capacity, shortly after another record high of 84,997 kW of installed solar capacity in January. The first quarter of 2012 recorded 165,390 kW of installed solar capacity, which is more than four times the first quarter of 2011 at 41,027 kW, and nearly seven times the first quarter of 2010 of 24,616 kW. In fact, the first three months of 2012 represent more than 22 percent of the 730,326 kW of installed solar capacity during the past decade.

This record pace of development is contrary to the SREC price signals that hit record lows during the same period. Bloomberg reports that in April, New Jersey's SREC prices dropped below $100/mWh for the first time ever. Reports from the New Jersey Clean Energy Program through March 31, 2012 show SREC monthly lows for the quarter from $100-$115/mWh, with the weighted average from $343-$374/mWh. The most recent SREC auction in February 2012 yielded a price of $171/mWh.

The SREC market is significantly over-supplied. The renewable portfolio standards ("RPS") for Energy Year ("EY") 2012 (June 1, 2011 – May 31, 2012) require that a total of 368 MWs in solar generation capacity be installed by May 31, 2012. That requirement was satisfied in June 2011, only one month into EY 2012, when more than 40 MWs of new installed capacity came online and pushed the total installed capacity over 368 for EY 2012 in satisfaction of the RPS requirement. The New Jersey Board of Public Utilities (BPU) staff estimates that installed solar capacity will exceed the solar RPS through at least energy year 2014 and, depending on the near-term installation rate, the solar capacity may exceed New Jersey solar RPS through energy year 2016. As noted by BPU staff in its solar transition straw proposal: "The pace of construction, installation and operations in the New Jersey solar market is not sustainable within the current solar RPS."

So, why does development continue at record rates in the face of SREC price signals at record lows? One factor is that there was a rush to “start construction” of projects by December 31, 2011, which is a requirement to qualify for the federal 1603 Cash Grant in Lieu of Investment Tax Credit Program. Under that program, project owners can receive a cash grant of 30 percent of eligible cost instead of tax credits under section 48 of the Internal Revenue Code. This program has been very popular, especially for smaller projects for which the owners do not have sufficient taxable income to be offset by tax credits. A second factor is that many projects being completed in 2011 and 2012 signed SREC contracts when SREC prices were much higher, and are just now completing construction to meet the required deadlines in those contracts.

We expect that most of the projects that qualified for the cash grant will be built in 2012, and that the loss of the 1603 Cash Grant Programs will slow the development of new projects, since the transactional costs for monetizing the section 48 tax credits can be prohibitive, especially for smaller projects. The lower SREC prices should also slow the development of new projects in the New Jersey market.

Until the projects that qualified for the 1603 Cash Grant and/or have above-market SREC contracts are built out, we are in a hangover period in which new development will be difficult with low SREC values.

RX – Take Two Aspirin and Wake Up in 2014

A purely market-based approach would urge solar development to give it a rest until supply and demand balance out. Indeed, many large solar developers have shifted their sights to other states that are now following New Jersey’s lead and beginning to heat up, such as Massachusetts, Pennsylvania, Rhode Island, Connecticut and Maryland. One large solar developer reports that its development efforts in 2012 will be in these states and not in New Jersey. In addition, there is some evidence that the rate of development may be slowing down based on the scrub rate for solar projects. The New Jersey Clean Energy Program conducts a deactivation analysis of projects that have either expired or been withdrawn by the developer. The scrub percentage rate had remained relatively constant between 14 percent and 16 percent from June 2011 through February 2012, when it stood at 13.8 percent. For the period ending March 31, 2012, the scrub rate climbed by more than 4 percent to 18.02 percent, indicating that the pace of solar development may be slowing down.

However, there is significant pressure to regain momentum and avoid downsizing in the New Jersey solar market. In response to the anticipated slowdown, action is anticipated in both the regulatory and legislative arenas this month.

The prescription for relief, whether in the regulatory or legislative arenas, should:

- Increase demand in a measured way, so that the New Jersey solar market can develop in a sustainable manner

- Be sustainable over the long term, and thereby facilitate long-term financing

- Provide for regulatory and legislative certainty within the context of the market-based SREC system

The Legislative Remedy

On May 7, Senators Smith and Sweeney introduced legislation (S-1925) that proposes long-awaited relief to the New Jersey solar market. The bill, which is not yet publicly available, is expected to be scheduled for hearings before the Senate Energy and Environment Committee chaired by Sen. Smith on an expedited basis. S-1925 will likely seek to regain lost momentum in New Jersey's solar market by focusing on the following key issues:

- Increasing demand in the near term by providing a one-year bump in the annual RPS requirements combined with adjustments through EY 2028

- Decreasing the Solar Alternative Compliance Payments to account for market conditions, including dramatically lower SREC prices and significant cost reductions for solar panels and equipment

- Preferences for development of solar projects on brownfields and landfills, and restrictions on solar development on farmland-assessed property consistent with the state's 2011 Energy Master Plan

- Regulatory review of larger grid-based projects, which was the deal-breaker in prior legislative efforts resulting in the governor's conditional veto of A-2529/S2306 in January of this year

ReedSmith

- A new aggregated net metering program for local government entities and school districts. This type of program has been especially popular in Massachusetts because it enables local government and schools to save on energy bills, thereby providing a direct benefit to local taxpayers.

- Clarification of what it means to be “connected to the distribution system”

The Regulatory Remedy

The New Jersey BPU Solar Transition Initiative is expected to be considered at the BPU’s May 23 agenda meeting. The Staff Straw March 6 Proposal for the EDC SREC Program would increase demand by extending the program for a three-year period through a competitive loan and/or solicitation program. New projects selected for funding through the EDC SREC Program would be subject to the following proposed elements:

- Program Size: 120 MWs allocated proportionately among the four EDCs

- Funding Time Frame: for year one of the EDC SREC Program, funding would be for 10 years. For years two and three of the program, funding would be for shorter time frames.

- No Floor Price for SRECs, but rather would seek the lowest costs within each market segment

- Costs: incurred by the EDCs for administering the SREC Programs born by the solar developer or generation customer

- Eligibility: Net Metered projects with size limited by customer on-site usage pursuant to the Net Metering Rules set forth in N.J.A.C. 14:8-4, et seq.

- Set Asides: for residential and small commercial; grid-connected landfill and brownfield projects in areas that can be supported by the distribution system

- Sale of SRECs: via centralized auction in EY 2016 timed to minimize market impact

The Staff Straw Proposal for the RPS, which requires a Rulemaking, proposes:

- RPS Acceleration: the additional capacity of the extended EDC SREC Program to be reflected in the solar RPS Rule Amendment effective EY 2016

- SREC Life for New Projects: SREC qualification life for new projects to be reduced from 15 years to 10 years upon effective date set per rule, and with a decreasing trend thereafter through EY 2027

- SACPs: develop a revised Solar Alternative Compliance Payment (SACP) schedule for EY 2017 to EY 2026 that reflects the lower cost of solar installation

It is anticipated that some of the components of the Staff Proposal, such as the size of the EDC SREC Program, the cost of SACPs, and the amount of set asides for residential, will be subject to modification in the final proposal presented to the Board later this month.

The Reed Smith attorneys from the Princeton, New Jersey, office will continue to monitor developments in New Jersey's solar market and will advise clients on all aspects of solar project development, financing and transactions in New Jersey and across the country. For further information please contact Jim McGuire, Henry King, Ferd Convery or Marshall McLean.

About Reed Smith

Reed Smith is a global relationship law firm with more than 1,600 lawyers in 23 offices throughout the United States, Europe, Asia and the Middle East.