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Master Tenant Lease Pass-Through

The **Solar Lease Pass-Through** (also called an "inverted lease") described in a separate write-up involves two parties, a Developer who is the lessor and an Investor who is the lessee. A more complex version of this structure is a two-tier partnership arrangement that involves four parties: an Owner partnership as the lessor, a Master Tenant partnership as the lessee, an Investor who participates in the Master Tenant partnership, and a Developer who participants in both partnerships.

The centerpiece of the transaction remains a lease pass-through where the Owner partnership passes the Investment Tax Credit (ITC) through to the Master Tenant partnership. The amount the Master Tenant partnership pays the Owner partnership is usually in the range of 1.2 to 1.3 times the ITC and is referred to as the credit price. At the beginning of the lease, the Master Tenant partnership makes a prepayment of rent equal to the credit price and for the remainder of the lease receives the project EBITDA, using a portion of it to pay the rent and retaining the balance.

The Master Tenant partnership receives the ITC, but does not apply basis reduction because it has no depreciable asset. Instead, the Master Tenant partnership reports income equal to half the ITC, spread straight-line over the life of the associated asset, which is five years for solar equipment. The Owner partnership, which does own the asset, depreciates the full basis.

The Master Tenant partnership is a **Partnership Flip** structure consisting of the Investor and the Developer. The Investor typically has a 99% interest and the Developer a 1% interest. Prior to the flip date the Investor may require a preferred return on his contributed capital, receive 99% of the ITC and taxable income, and 5% of the distributable cash. After that date, the sharing percentages "flip" with perhaps 95% of the taxable income allocated to the Developer and the cash allocations calculated to give the Investor a required return on investment. This return is usually expressed as an XIRR on the full-term pre-tax cash flows including the ITC. Typical returns are in the 2.00% to 3.00% range.

The participants of the Owner partnership are the Master Tenant partnership with a 49% interest and the Developer with a 51% interest. The capital contributions and cash distributions are allocated in the same 49%/51% ratio and the taxable income is typically allocated 99% to the Master Tenant partnership and 1% to the Developer. These allocations remain constant for the term of the partnership.

The Investor receives a return as a participant in the Master Tenant partnership. After making an equity contribution, the Investor receives ITC, a preferred return, an allocation of rent from the Owner partnership, EBITDA in excess of rent from the Master Tenant partnership, and taxable income.

The Developer's return on investment comes from both the Master Tenant and Owner partnerships. The Developer makes equity contributions to both partnerships and receives allocations of rent and taxable income from the Owner partnership and allocations of EBITDA in excess of rent and taxable income from the Master Tenant partnership.

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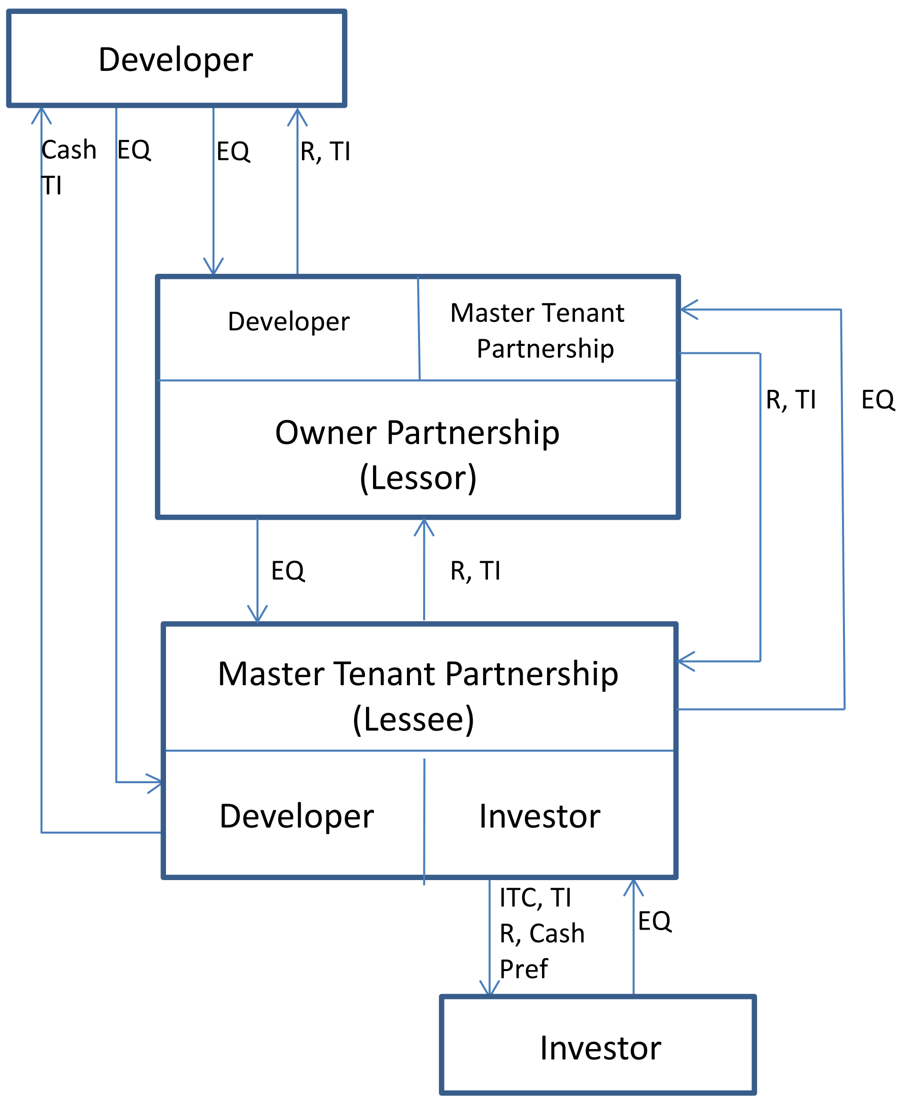

EQ = Equity Contribution
R = Rent
TI = Taxable Income
Cash = EBITDA - Rent
Pref = Preferred Return

Labels only show allocations greater than 5%

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