Timely thematic topic:

Inflation Reduction Act of 2022

August 3, 2022

Senators Manchin and Schumer have reached an agreement on a reconciliation bill. From Senator Manchin's statement, "The Inflation Reduction Act of 2022 (the "Act", formerly Build Back Better) [formerly Build Back Better] invests in the technologies needed for all fuel types – from hydrogen, nuclear, renewables, fossil fuels and energy storage – to be produced and used in the cleanest way possible."

Specifically, the legislation is an enabler for renewables and nuclear generation and a tailwind for transmission investment, with $369 billion earmarked for "Energy Security and Climate Change." Senator Manchin also stated that Democrat leadership committed to support a bill to enhance siting and permitting for domestic fossil fuels. Below some of TortoiseEcofin's portfolio managers provide perspective on how this bill could potentially impact their strategies.

Matthew Breidert
Senior Portfolio Manager and
Managing Director

As written, most of the renewables value chain should see some benefit here, which incentivizes all domestic participants in renewable energy development. Specifically, the tax credits related to wind, solar, storage, and clean hydrogen should accelerate adoption of these technologies. Other lower emissions power sources are expected to see some benefit too, which would continue to help the U.S. in moving away from coal.

One area that we have stressed in needing investment is domestic manufacturing and production in the renewable value chain. This is particularly critical from an energy security standpoint. The proposed reconciliation package appears far more rational in terms of promoting more American-based technology and manufacturing participation in renewable and EV value-chain development than prior versions, something that we believe is critically important to underwrite a more successful and comprehensive energy transition for the U.S.

We believe these measures would create a multi-year improvement in growth, returns and visibility by allowing corporates to make key strategic investment decisions that improve their efficiency and emission reduction goals.

The tax funding mechanisms appear both logical and reasonable and we would anticipate that the net effect to consumers would be disinflationary as prices for domestic clean energy—and potentially energy overall–would be likely to fall in response to this policy implementation.

The market may under-recognise the importance of electricity storage investment—which is directly addressed in this Act—in driving both additional renewable resource growth as well as lowering overall electricity prices by insuring renewable electricity can dispatch across many more hours of each day.

Generally, U.S. clean energy companies (as well as foreign companies with sizable exposure to U.S. development) should benefit from the bill. Companies with nuclear assets should benefit from the nuclear PTC. We generally hold investments in these types of companies across each of the energy transition (ET), global renewables infrastructure (GRI), and sustainable listed infrastructure (SLI) strategies. ET also has exposure further up and down the supply chain with one portfolio also holding two components makers. SLI should see some benefit where there is gas/LNG exposure.

One of the main funding mechanisms is a 15% minimum tax for large corporations. This may create some risk for utilities, but early reports are showing that the effects will be minimal for renewables-focused utilities.

David Roeder
Director

Pending passage, the Act contains a variety of Energy & Climate provisions designed to spur capital investment in the Sustainable Energy sector.

What is extended or expanded?

- Blenders Tax Credit 2-year extension (through 2024) for Renewable Diesel (RD), and 3-year extension (through 2025) for Sustainable Aviation Fuel (SAF).
  - Expected to be $1.00 per gallon for RD, and $1.25 per gallon for SAF (plus up to $0.50 supplemental for SAF if certain GHG emissions are met on a LifeCycle Analysis basis).
  - These credits provide material additional early-year revenues for new RD and SAF facilities, enabling them to be more economically viable.
- Federal Loan Guarantee expansion of $41.5B, with $1B for USDA's Rural Energy for America Program (REAP) loans, $0.5B for USDA Section 9003 loans, and $40B for Department of Energy (DOE) biofuel facility loans.
  - REAP and Section 9003 Program (aka the Biorefinery, Renewable Chemical, and Biobased Product Manufacturing Assistance Program), provide loan guarantees to spur investment in biomass projects, primarily anaerobic digesters. The new funding would support more than $2B of new projects, which is about 80 new production facilities at current average costs.
  - The $40B of DOE funding would support new RD and SAF facilities primarily, with the larger allocation reflecting the significantly higher capital costs for these facilities.

What is new?

- Investment Tax Credit (ITC) for Biogas Projects that convert biomass waste into either Renewable Natural Gas (RNG) or electricity, if placed into service by January 1, 2025.
  - This should drive more tax-equity financing solutions, and help level the playing field in terms of production output (RNG vs. electricity).
  - Potentially, the ITC for electricity generation could be combined with future e-RIN electricity credits, to make electricity-generating facilities more economically viable.
  - This is a "Boon for Biogas" and should cause a "Race to In-Place" to qualify for the ITC.
- $27B of funding for a Clean Energy Technology Accelerator (aka federal green bank), some of which may support sustainability projects that generate electricity.
- Methane Emission Fines for large oil & gas emitters, with the potential that the fines could be offset via the purchase of carbon removal credits or renewable fuel credits, which provide economic support to many sustainable finance projects.

Brian Kessens, CFA
Managing Director and
Senior Portfolio Manager

The Act's energy security provisions related specifically to oil and natural gas include:

- Increase energy security through increased production, reliability, and all-of-the-above policies
- Decarbonize through investment in energy technologies, natural carbon reduction practices, and displacing dirtier product around the world
- Ensure that fossil fuel resources are not arbitrarily eliminated over the next decade, giving companies the confidence they need to invest in domestic energy that is produced in the cleanest way possible and solidifying the ability to provide reliable baseload energy for America and our allies.

Our initial takeaways from the bill:

- Supports an all of the above (fossil fuels, renewables, and nuclear) energy policy which we think is both practical and maximizes reducing emissions
- Provides incentives for further energy transition investments from energy infrastructure companies, including: Renewables Natural Gas (RNG), Carbon Capture and Sequestration (CCS), and hydrogen
- Reduces desire for the Biden Administration to consider alternative energy policies, use executive authority, or seek to address climate and security in a more blunt, less effective, manner
- May ease the permitting situation for Equitrans Midstream's Mountain Valley Pipeline (MVP) and allow for more natural gas infrastructure if and when more takeaway capacity is needed