EXCERPT

NOVOGRADAC
Journal of Tax Credits™

March 2024 • Volume XV • Issue III
Published by Novogradac

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Clean Energy Credits, QOF Contribute to Funding for Ambitious Processing Facility for EV Battery Component

BRAD STANHOPE, SENIOR EDITOR, NOVOGRADAC

Owners of an ambitious project to process a key element for electric vehicle (EV) batteries are also pursuing a novel financing approach–using clean energy tax credits created under the Inflation Reduction Act (IRA) of 2022 together with opportunity zones (OZ) financing [through a qualified opportunity zone fund (QOF)]–to finance the $250 million development.

EVelution Energy is developing the first solar-powered, carbon-neutral, EV battery-grade cobalt processing facility in the nation in Yuma County, Arizona. The facility will help meet a major need for the rapidly growing U.S. EV industry while combining multiple relatively new tax incentives.

"The demand is a no-brainer," said Gil Michel-Garcia, executive vice president and general counsel for EVelution Energy. "You have so much demand for this stuff, almost all of which is currently made in China and there's no reason it can't come from the U.S. It's profitable and it's in our national security interest."

Image: Courtesy of EVelution Energy LLC
An artist's rendering of EVelution Energy's planned EV battery-grade cobalt processing facility in Yuma County, Arizona. The development will benefit from qualified opportunity investment and clean energy tax credits.

Financing will include the use of renewable energy investment tax credits (ITCs) for the cost of building the solar component of the project and production tax credits (PTCs) for the cost of producing the critical minerals (cobalt), coupled with OZ financing, which allows for the deferment of invested capital gains, a subsequent capital tax gain exemption on the profits, passthrough accelerated depreciation and no depreciation recapture from investments in OZs.

The challenge is navigating the complexity of these disparate tax incentives, as well as the novelty of the cobalt world.

"The hard part is–and I think this is true for the entire opportunity zones financial ecosystem–explaining the whole idea of refineries and volatile commodities, which is a completely different business for most OZ investors," said Michel-Garcia. "We have to do a lot of education to get people up to speed on how this particular business works."

Michel-Garcia and EVelution Energy CEO Navaid Alam, are used to challenges.

Road to EVelution Energy

Michel-Garcia and Alam met while working as corporate attorneys for a large Wall Street law firm 25 years ago, then went their separate ways. Alam formed a private equity firm and focused on infrastructure development in emerging markets–including building ports, grain terminals and flour mills in Africa. Alam also worked domestically, building a major grain terminal in Louisiana.

He and Michel-Garcia met again in Mexico, where Alam had an office and Michel-Garcia was working as an outside and special counsel for Grupo Mexico, one of the largest copper producers in the world.

Eventually, Michel-Garcia and Alam made the jump into copper trading on their own, working in Mexico and subsequently in the Democratic Republic of the Congo (DRC). One byproduct of copper is cobalt, which is separated from copper through a chemical process. A second process converts that cobalt into cobalt sulfate, which is a crucial element for electric vehicle batteries, because it's dense and heat-resistant.

The problem? Most of that cobalt from the DRC was being shipped to China, where it was processed into cobalt sulfate.

"We realized that if we built our own cobalt processing plant in the U.S., we wouldn't need to send the cobalt to China," Alam said.

He had an idea for a location for such a plant, as his infrastructure company owned 150 acres near Yuma, Arizona, that had been targeted for an ethanol factory that was never built. The site was set and the need jumped with the passage of the IRA, which contained numerous incentives for clean energy and critical minerals processing.

Clean Energy Credits to Meet a Need

Federal officials expect more than $130 billion in investment for electric vehicles by 2028, encouraged by the IRC Section 30D credit for electric vehicles.

Electric vehicles need batteries and most EV batteries need cobalt. To be eligible for the $7,500 credit, no part of the vehicle can be made by a so-called Foreign Entity of Concern (FEOC), a company that's controlled by a government that's an adversary of the U.S.–a list that includes China, which currently produces 70% of the world's EV battery-grade cobalt sulfate.

"If you get any of the critical minerals for the battery–any cobalt, lithium, nickel, phosphate, manganese–from an FEOC, the tax credit on the entire battery is gone," Michel-Garcia said. "That means that U.S. car manufacturers need to get all of their EV-battery critical minerals from non-foreign-entities of concern."

That's where EVelution Energy comes in. The company expects its Yuma facility to produce approximately 33,000 metric tons of EV battery grade cobalt sulfate per year, representing between 20% and 40% of the expected 2026 cobalt demand for U.S. domestic EV production.

Construction on the facility will start this year and operations are slated to begin in 2026.

Processing cobalt isn't the only green feature planned at the Arizona facility. It will be energy self-sufficient via solar power, will process and reuse most of its water and will dispose of its waste materials off-site in a licensed landfill capable of receiving all nonhazardous waste material.

And the property is in an OZ.

A Good Sense of Yuma

"Only after we decided to build it [in the Yuma area] did we realize it's in a qualified opportunity zone," Alam said. "We were already familiar with the county, the people, the governor, the state and thought it was logistically a good place. It's on the border of California right on the interstate and not far from the ports of Ensenada and Long Beach. It's a great place to build a cobalt refinery."

Alam and Michel-Garcia said that local, state and federal officials, including Gov. Katie Hobbs and U.S. Sens. Kyrsten Sinema and Mark Kelly have been very helpful.

Response to the QOF has been tepid: It has a target of $10 million for its OZ financing and has raised about $2.6 million.

"We started raising money and have raised a little, but it hasn't been incredible," said Alam. "We're still in the process of raising funds, but it's been hard to get or find [OZ] investors who could and would take advantage of this."

Clean energy and mining aren't common in the OZ world. Michel-Garcia and Alam had to come up with a business model to attract general investment and then created a novel approach to attract investment in the QOF.

Special Business Model

Prices for cobalt fluctuate each month, providing a challenge for most OZ investors.

"People ask, 'how do I know you're not going to lose money?'" said Michel-Garcia. "Then their eyes glaze over because it's too complicated to walk through the financial model that we use to ensure a positive margin between the variable monthly price that we pay for the cobalt hydroxide that we process and the variable monthly price at which we sell the cobalt sulfate that we produce."

EVelution Energy created a plan to address that concern: The end customer agrees to pay a percentage above the purchase price, guaranteeing a profit regardless of the monthly variations in the market price of cobalt.

"How we buy is transparent: we buy it at the market price and then mark it up," said Michel-Garcia. "We take on all the risks with labor costs and everything else. The markup makes it easier to understand [for investors] and makes it predictable."

Michel-Garcia said that outside of a few specialized banks, many equity providers are unfamiliar with trading commodities. However, the combination of the clean energy tax credits and OZ tax benefits should be attractive.

"Our numbers look really good, based on the models and the IRA and OZ benefits," said Alam. "They work together. We have very healthy margins without issues related to rates and commodity prices."

A Novel Approach to OZ Benefits

For QOF investors, EVelution Energy starts with the 30% ITC for the solar portion of the property, which is expected to meet the standards for two bonuses: The 10% domestic content bonus and the 10% economically disadvantaged area bonus.

That money–estimated at about $25 million-$30 million–can be used to cover the return of the original QOF investments (plus a 10% preferred return) in 2026.

"The opportunity zones deferral ends at the end of 2026 and you have to pay taxes in 2027," Michel-Garcia said. "We're conscious of that, so we told people that if you invest [now], during the predevelopment phase, we offer a guaranteed 10% preferred return. If they buy in 2024, under the structure [of OZs], they can defer the payment of capital gains taxes on the amounts that they invest in the QOF until the end of 2026. Our project is expected to be fully operational by 2026, so the way that the investment tax credits work, we'll get up to 50% investment tax credit on the cost of building the renewable portion of our project, which is the solar panels and battery storage, which we will then use to repay OZ investors before they have to pay capital gains taxes on their OZ investment. They will get all of the money they invested back, plus the 10% preferred return, in 2026, before they pay taxes on it, and will retain the 10-year QOF benefit from their investment going forward without having any capital at risk."

Beyond EVs

While EVs are the target, Michel-Garcia said there are other potential business flows for EVelution Energy; further processing the cobalt sulfate into cobalt metal.

In 2022, the U.S. imported approximately 10,000 metric tons of cobalt metal, which is used primarily in the aerospace and defense industries, such as in jet engines, the inside of machine gun barrels and the coverings of stealth bombers, supersonic missiles and reentry vehicles. Michel-Garcia said the U.S. Department of Defense previously stockpiled cobalt metal during the Cold War and now is expected to rebuild a national stockpile of it–something EVelution could do.

Michel-Garcia and Alam are optimistic about the future of their processing plant for electric vehicles and beyond and the novel use of clean energy and OZ tax incentives is key to the success. ❖

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ISSN 2152-646X