



The Inflation Reduction Act

A Q&A with investors

BlackRock

FOR QUALIFIED PURCHASERS, PROFESSIONAL CLIENTS, QUALIFIED INVESTORS/QUALIFIED CLIENTS AND PROFESSIONAL,
INSTITUTIONAL & WHOLESALE INVESTORS

Ready to roll out: A close look at the new law

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Key takeaways

- The Inflation Reduction Act is the biggest commitment ever made by the United States to reduce carbon emissions and advance sustainable technology.
- The law creates policy certainty for the wind and solar industries, which have struggled with supply chain snarls and inflation in recent years and have seen investments stall as a result.
- Carbon capture technologies and green hydrogen will likely be two big winners from the bill, thanks to increased subsidies that should attract investors to these new and developing technologies.
- Requirements in the law for materials to be made in the U.S. will boost segments of domestic industry across the energy sector.
- The law has the potential to create a virtuous cycle across many industries, bringing down costs and increasing demand -- effectively increasing the market for renewable investments.
- The permitting reform bill which was also agreed to in principle as the IRA was negotiated could open up new infrastructure opportunities across the U.S. as projects are approved more quickly.

Introduction

We asked three of the leading portfolio managers on some key questions about the Inflation Reduction Act -- what the new law means for the industry, the economy and investors.

President Biden signed the IRA into law on August 16, officially enacting one of the biggest financial commitments ever made by the United States to reduce carbon emissions and advance sustainable technology. The law also changes how subsidies are paid out, and provides incentives across the energy industry.

What's the biggest takeaway?

David Giordano: This law creates a long runway for U.S. energy transition investments. It creates more certainty around the fundamental policy incentives, which can be significant value drivers for these assets.

Pieter Houllberghs: For investors like us in sustainable assets, the law injected optimism and momentum -- it's a strong kickstart that will allow other technologies to replicate what we've seen in solar and wind over the last 10-15 years in terms of wider adoption and lower costs.

Does the law create more opportunities in equity or credit?

David Giordano: It's probably both, but I think the bigger opportunity is on the equity side, given the funding stability of the tax credits in the early years. And there's a need for so much new development. We've been in a bit of a stalled pattern around the development of new assets in the U.S. because we've been in this limbo state -- we had increasing capital costs with supply chain constraints and the broader inflation issues. So overall, in the short- and medium-term, I think it's probably a bigger play on the equity side.

What's the most important change to current rules?

Mark Florian: There's going to be five years where you can get cash payments rather than tax credits. Those credits have been a limiting factor for wind and solar -- the way they were structured was very complex and it required bringing in a separate entity. The switch to a structure where you're paid directly is huge.

David Giordano: I agree. Just the fact that it allows investors to take a cash benefit instead of the tax benefit will open up more potential sites for development. It will also open these investments to more partners, such as nonprofits, government entities, co-ops and tribes. Basically, the economics are much more easily shared across different ownership types.

The option to take these incentives as cash also opens them to foreign investors who don't have a U.S. tax base. And the tax credits will be more easily transferable, which will also encourage more capital to flow in from various sources. I think we'll probably see a pretty big influx of capital coming into the U.S., which is the largest, lowest penetration market for sustainable energy in the world right now.

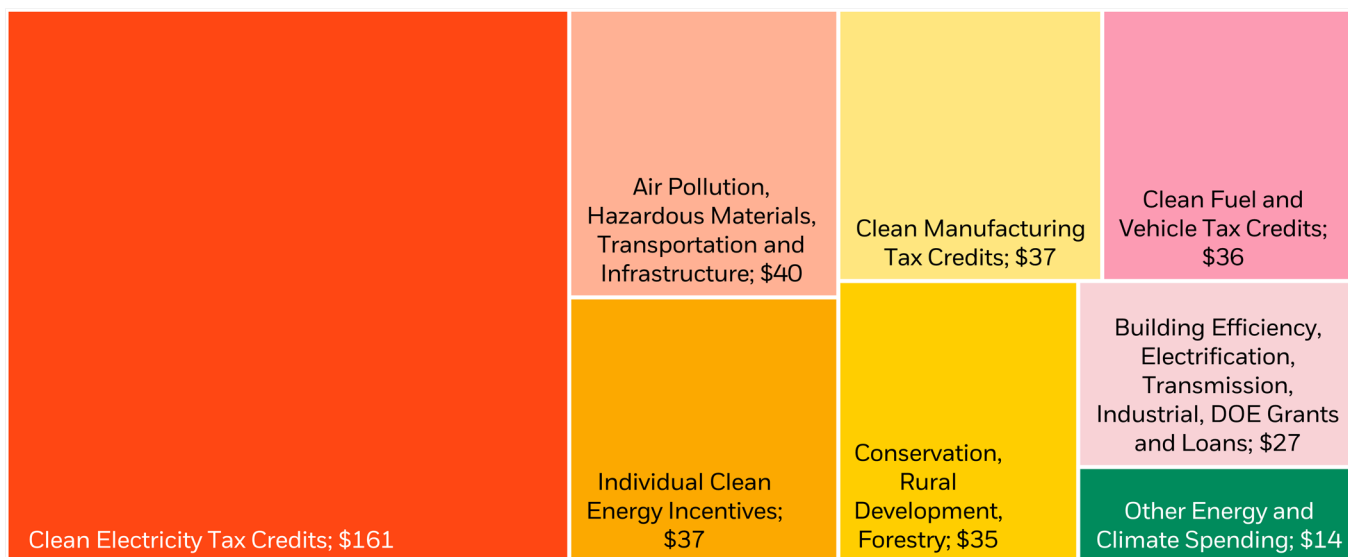
What will the law do for the U.S. sustainable tech industry?

Pieter Houllberghs: Half or more of the opportunities we see globally are in the U.S. and Canada -- it's been a hotbed for innovation, with leadership from startup entrepreneurs and investors. The new legislation is a strong show of government support, which together with what we're seeing from investors and business leaders suggests the U.S. will maintain a leadership role in the industry.

David Giordano: The bill incentivizes companies to buy from U.S. suppliers. And we've seen in other markets there's been a very swift implementation by large equipment suppliers to meet domestic-content requirements.

By the numbers

A breakdown of the IRA's climate-related spending, in US\$ billions



Source: Committee for a Responsible Federal Budget, August 2022. Notes: The chart shows projections for capital investment based on the Committee for a Responsible Federal Budget's analysis of the bill's potential impacts. The analysis should be considered approximate and may be updated or refined by subsequent analysis.

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On more projects, even if it's not fully domestic manufacturing, there will be U.S. assembly plants involved to allow for a more diversified supply chain. We've already seen some of the big players looking to build out capacity to manufacture turbine blades and assemble solar cells and things like that. So some of it was already happening, and the law will accelerate that trend.

How will the law help develop new types of transition and net zero technologies?

Pieter Houleberghs: The incentives in the law could drive a virtuous cycle across newer technologies and markets: It will encourage more adoption, which drives down costs, which drives up adoption, which then further drives down costs -- which is what we as investors look for. The multiplier effect of the incentives in the bill means that the market for attractive green investments effectively just got bigger.

Which sectors will benefit most from the law?

David Giordano: Wind and solar will benefit because of the certainty the bill provides. And it's also now brought battery storage into the mix in a way that it wasn't before. This should accelerate the construction of more utility-scale storage projects. Things like carbon capture now have a lot more certainty around them as well. And we'll begin to see more clean hydrogen as part of the U.S.'s medium-term development cycle.

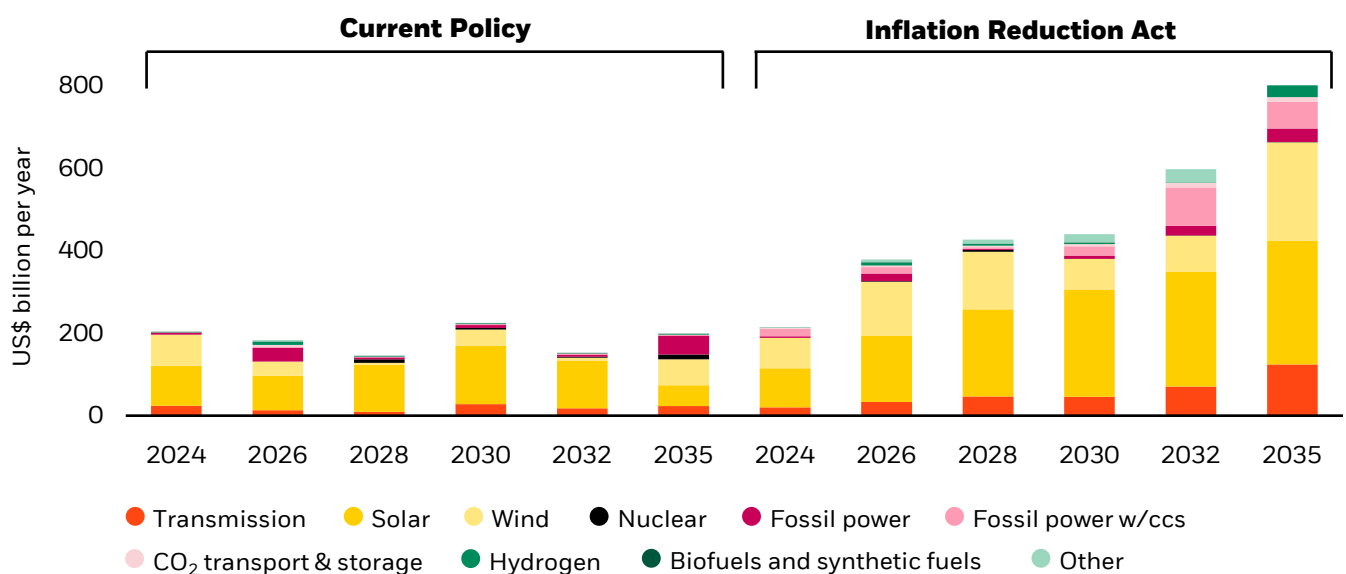
Pieter Houleberghs: Yes, carbon capture and clean hydrogen stand out as two technologies that are more subsidy dependent and could benefit the most. Point-source carbon capture, where capture equipment is installed at power plants and factories to prevent emissions from going into the atmosphere, is possible at a lower cost than capturing carbon dioxide directly from ambient air. From current levels in the existing tax code of US\$50 per ton, the legislation increases the tax incentive per ton for point source capture to US\$85 and for direct air capture to US\$180. At these improved levels, it will make more sense for developers to build projects, as the improved incentives start to put these new technologies and projects significantly into the money.

Mark Florian: Direct air capture can be placed anywhere in the world, ideally right on top of a place where you can sequester the carbon dioxide. This means you don't have to build huge midstream systems and pipelines to move it hundreds of miles. If you can build sequestration machines right on top of the sequestration sites, it takes out a lot of the costs. The heightened incentives around this technology make it much more viable looking into the future.

Pieter Houleberghs: Also, the green hydrogen space is growing slowly under the status quo, but the improved incentives in the form of a new hydrogen production tax credit will accelerate its development in a meaningful way.

More capital

Estimated investment in U.S. energy supply infrastructure



Source: REPEAT Project at repeatproject.org, August 2022. Notes: The chart shows projections for capital investment based on repeatproject.org's analysis of the bill's potential impacts. It does not include impacts on clean energy components, batteries, electric vehicles or critical minerals. The analysis should be considered approximate and may be updated or refined by subsequent analysis.

What are some of the most pressing infrastructure and energy concerns going forward?

Mark Florian: Our power systems need three things: to be cleaner over time, to also be relatively cheap and to be available every minute of every day. As we make the transition and there's a higher concentration of wind and solar in the system, we need to ensure the availability of power. We think natural gas has a role going forward as renewables get bigger and bigger -- you need some sort of flexible fuel that can be turned on and turned off very quickly to help the intermittency of renewables.

The deal that created the law included an agreement to reform permitting rules. How important is that aspect?

Mark Florian: There have been years-long discussions about how we accelerate infrastructure investments in the U.S., and one of the barriers has been the permitting process.

As I understand the plans for the new legislation, it would put time limits on how long an environmental review can take for a project. This would be huge for the energy grid and for conventional types of energy in midstream, and also for renewables. The change could be a great catalyst in terms of moving a lot of infrastructure investment.

What will be the broader impact of the law?

David Giordano: I think the bill will make the sustainable energy industry more tangible. People will see more manufacturing and assembly plants in their communities; up and down the east coast from Massachusetts to Virginia there's going to be more offshore wind; you'll see more solar arrays, electric vehicles, and charging stations in the Midwest; and more sustainable projects in places like Arizona and New Mexico.

Mark Florian: I come back to those three elements, where you want energy to be cleaner, and also relatively cheap and available 24/7. And that should ultimately be a benefit to all U.S. consumers.

At a Glance: The IRA's Big Investments

US\$27 billion

for the Greenhouse Gas Reduction Fund to support state and local investment in green technology

US\$9 billion

in rebates for high-efficiency electric appliances and whole-home energy efficiency renovations

US\$12.8 billion

in loans and grants to help rural communities deploy clean energy

US\$3 billion

to purchase electric mail trucks for the U.S. Postal Service

US\$3 billion

plus to build and upgrade the electric grid and related infrastructure

US\$2 billion

in grants for domestic production of clean vehicles

US\$5.8 billion

to support decarbonization at high-emitting industries

Sources: Evergreen Action; Blackrock Investment Institute, August 2022. Notes: The chart shows projections for capital investment based on Evergreen Action's analysis of the bill's potential impacts. The analysis should be considered approximate and may be updated or refined by subsequent

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