

Hannon Armstrong Sustainable Infrastructure Capital, Inc.  
Form 10-Q  
May 09, 2016  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2016**

**OR**

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 001-35877**

**HANNON ARMSTRONG SUSTAINABLE INFRASTRUCTURE CAPITAL, INC.**

**(Exact name of registrant as specified in its charter)**

**Maryland**  
**(State or other jurisdiction of  
incorporation or organization)**

**46-1347456**  
**(I.R.S. Employer  
Identification No.)**

**1906 Towne Centre Blvd, Suite 370 Annapolis,  
Maryland**  
**(Address of principal executive offices)**

**21401**  
**(Zip code)**

**(410) 571-9860**

**(Registrant's telephone number, including area code)**

**N/A**

**(Former name, former address and former fiscal year, if changed since last report)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: 38,950,289 shares of common stock, par value \$0.01 per share, outstanding as of May 6, 2016 (which includes 1,384,663 shares of unvested restricted common stock).

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

We make forward-looking statements in this Quarterly Report on Form 10-Q ( Form 10-Q ) within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ) that are subject to risks and uncertainties. For these statements, we claim the protections of the safe harbor for forward-looking statements contained in such Sections. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. When we use the words believe, expect, anticipate, estimate, plan, continue, intend, should, may or similar expressions, we intend to identify forward-looking statements.

Forward-looking statements are subject to significant risks and uncertainties. Investors are cautioned against placing undue reliance on such statements. Actual results may differ materially from those set forth in the forward-looking statements. Factors that could cause actual results to differ materially from those described in the forward-looking statements are contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 (our 2015 Form 10-K ) that was filed with the U.S. Securities and Exchange Commission (the SEC ), and include risks discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operation of this Form 10-Q and in other periodic reports that we file with the SEC. Statements regarding the following subjects, among others, may be forward-looking:

our expected returns and performance of our investments;

the state of government legislation, regulation and policies that support energy efficiency, renewable energy and sustainable infrastructure projects and that enhance the economic feasibility of energy efficiency, renewable energy and sustainable infrastructure projects and the general market demands for such projects;

market trends in our industry, energy markets, commodity prices, interest rates, the debt and lending markets or the general economy;

our business and investment strategy;

availability of opportunities to finance energy efficiency, renewable energy and sustainable infrastructure projects and our ability to complete potential new opportunities in our pipeline;

our relationships with originators, investors, market intermediaries and professional advisers;

competition from other providers of financing;

our or any other companies' projected operating results;

actions and initiatives of the U.S. federal, state and local governments and changes to U.S. federal, state and local government policies, regulations, tax laws and rates and the execution and impact of these actions, initiatives and policies;

the state of the U.S. economy generally or in specific geographic regions, states or municipalities; economic trends and economic recoveries;

our ability to obtain and maintain financing arrangements on favorable terms, including securitizations;

general volatility of the securities markets in which we participate;

changes in the value of our assets, our portfolio of assets and our investment and underwriting process;

interest rate and maturity mismatches between our assets and any borrowings used to fund such assets;

changes in interest rates and the market value of our assets and target assets;

changes in commodity prices;

**Table of Contents**

effects of hedging instruments on our assets;

rates of default or decreased recovery rates on our assets;

the degree to which our hedging strategies may or may not protect us from interest rate volatility;

impact of and changes in accounting guidance and similar matters;

our ability to maintain our qualification, as a real estate investment trust for U.S. federal income tax purposes (a REIT );

our ability to maintain our exception from registration under the Investment Company Act of 1940, as amended (the 1940 Act );

availability of qualified personnel;

estimates relating to our ability to make distributions to our stockholders in the future; and

our understanding of our competition.

Forward-looking statements are based on beliefs, assumptions and expectations as of the date of this Form 10-Q. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise over time, and it is not possible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements after the date of this Form 10-Q, whether as a result of new information, future events or otherwise.

The risks included here are not exhaustive. Other sections of this Form 10-Q or our 2015 Form 10-K may include additional factors that could adversely affect our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors, nor can it assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

The following discussion is a supplement to and should be read in conjunction with our 2015 Form 10-K.

**Table of Contents**

**TABLE OF CONTENTS**

|  | <b>Page</b> |
|--|-------------|
| <b><u>PART 1 FINANCIAL INFORMATION</u></b>   | 1           |
| Item 1. <u>Financial Statements</u>  | 1           |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 25          |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>                            | 36          |
| Item 4. <u>Controls and Procedures</u>   | 39          |
| <b><u>PART II. OTHER INFORMATION</u></b>   | 40          |
| Item 1. <u>Legal Proceedings</u>   | 40          |
| Item 1A. <u>Risk Factors</u>   | 40          |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | 40          |
| Item 3. <u>Defaults Upon Senior Securities</u>   | 40          |
| Item 4. <u>Mine Safety Disclosures</u>   | 40          |
| Item 5. <u>Other Information</u>   | 40          |
| Item 6. <u>Exhibits</u>  | 41          |
| <b><u>SIGNATURES</u></b>   | 42          |

Table of Contents**PART 1 FINANCIAL INFORMATION****Item 1. Financial Statements****HANNON ARMSTRONG SUSTAINABLE INFRASTRUCTURE CAPITAL, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****AS OF MARCH 31, 2016 and DECEMBER 31, 2015****(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)****(UNAUDITED)**

|  | <b>March 31,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|---------------------------|------------------------------|
| <b>Assets</b>  |                           |                              |
| Financing receivables  | \$ 818,789                | \$ 783,967                   |
| Financing receivables held-for-sale  | 42,041                    | 60,376                       |
| Investments available-for-sale   | 36,733                    | 29,017                       |
| Real estate  | 131,695                   | 128,769                      |
| Real estate related intangible assets  | 31,032                    | 26,930                       |
| Equity method investments in affiliates  | 304,180                   | 318,769                      |
| Cash and cash equivalents  | 26,585                    | 42,645                       |
| Other assets   | 85,922                    | 79,148                       |
| <b>Total Assets</b>  | <b>\$ 1,476,977</b>       | <b>\$ 1,469,621</b>          |
| <b>Liabilities and Stockholders Equity</b>   |                           |                              |
| <b>Liabilities:</b>  |                           |                              |
| Accounts payable, accrued expenses and other   | \$ 22,899                 | \$ 17,875                    |
| Deferred funding obligations   | 62,541                    | 108,499                      |
| Credit facility  | 321,944                   | 247,350                      |
| Asset-backed nonrecourse debt (secured by assets of \$701 million and \$718 million, respectively)   | 551,691                   | 563,189                      |
| Other nonrecourse debt (secured by financing receivables of \$91 million and \$97 million, respectively)                                       | 94,231                    | 100,602                      |
| <b>Total Liabilities</b>   | <b>1,053,306</b>          | <b>1,037,515</b>             |
| <b>Stockholders Equity:</b>  |                           |                              |
| Preferred stock, par value \$0.01 per share, 50,000,000 shares authorized, no shares issued and outstanding                                    |                           |                              |
| Common stock, par value \$0.01 per share, 450,000,000 shares authorized, 37,030,467 and 37,010,603 shares issued and outstanding, respectively | 370                       | 370                          |
| Additional paid in capital   | 485,756                   | 482,431                      |

Edgar Filing: Hannon Armstrong Sustainable Infrastructure Capital, Inc. - Form 10-Q

|   |                     |                     |
|---|---------------------|---------------------|
| Retained deficit                                  | (61,202)            | (52,701)            |
| Accumulated other comprehensive loss              | (5,091)             | (1,905)             |
| Non-controlling interest                          | 3,838               | 3,911               |
| Total Stockholders' Equity                        | 423,671             | 432,106             |
| <b>Total Liabilities and Stockholders' Equity</b> | <b>\$ 1,476,977</b> | <b>\$ 1,469,621</b> |

*See accompanying notes.*

- 1 -



Table of Contents**HANNON ARMSTRONG SUSTAINABLE INFRASTRUCTURE CAPITAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)****(UNAUDITED)**

|  | <b>For the Three Months Ended<br/>March 31,</b> |                 |
|--|---|-----------------|
|  | <b>2016</b>                                     | <b>2015</b>     |
| Revenue:   |   |                 |
| Interest income, financing receivables                                 | \$ 11,489                                       | \$ 8,328        |
| Interest income, investments   | 375   | 396             |
| Rental income  | 2,815   | 2,088           |
| Gain on sale of receivables and investments                            | 5,502   | 2,870           |
| Fee income   | 302   | 226             |
| <b>Total Revenue</b>   | <b>20,483</b>                                   | <b>13,908</b>   |
| Investment interest expense  | (11,275)  | (6,148)         |
| Provision for credit losses  |   |                 |
| <b>Total Revenue, net of investment interest expense and provision</b> | <b>9,208</b>                                    | <b>7,760</b>    |
| Compensation and benefits  | (4,418)   | (3,851)         |
| General and administrative   | (1,934)   | (1,505)         |
| Other, net   | 118   | (227)           |
| Income (loss) from equity method investments in affiliates             | 270   | (53)            |
| Other Expenses, net  | (5,964)   | (5,636)         |
| Net income before income taxes   | 3,244   | 2,124           |
| Income tax (expense) benefit   | (47)  | 23              |
| <b>Net Income</b>  | <b>\$ 3,197</b>                                 | <b>\$ 2,147</b> |
| Net income attributable to non-controlling interest holders            | 28  | 25              |
| <b>Net Income Attributable to Controlling Shareholders</b>             | <b>\$ 3,169</b>                                 | <b>\$ 2,122</b> |
| Basic earnings per common share  | \$ 0.07   | \$ 0.07         |
| Diluted earnings per common share                                      | \$ 0.07   | \$ 0.07         |
| Weighted average common shares outstanding basic                       | 37,016,210                                      | 26,386,080      |
| Weighted average common shares outstanding diluted                     | 37,016,210                                      | 26,386,080      |

*See accompanying notes.*



Table of Contents

**HANNON ARMSTRONG SUSTAINABLE INFRASTRUCTURE CAPITAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**(DOLLARS IN THOUSANDS)**  
**(UNAUDITED)**

|   | <b>Three Months Ended March<br/>31,</b> |                 |
|---|---|-----------------|
|   | <b>2016</b>                             | <b>2015</b>     |
| Net Income  | \$ 3,197                                | \$ 2,147        |
| Unrealized (loss)/gain on interest rate swaps, net of taxes benefit/(provision) of \$0.0 million in 2016                                | (3,482)                                 |                 |
| Unrealized gain on available-for-sale securities, net of taxes benefit/(provision) of \$0.0 million in 2016 and (\$0.1) million in 2015 | 272                                     | 81              |
| Comprehensive (loss) income   | \$ (13)                                 | \$ 2,228        |
| Less: Comprehensive income attributable to non-controlling interests holders  |   | 26              |
| <b>Comprehensive (Loss) Income Attributable to Controlling Shareholders</b>   | <b>\$ (13)</b>                          | <b>\$ 2,202</b> |

*See accompanying notes.*

**Table of Contents****HANNON ARMSTRONG SUSTAINABLE INFRASTRUCTURE CAPITAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(DOLLARS IN THOUSANDS)****(UNAUDITED)**

|   | <b>Three Months Ended March 31,</b> |               |
|---|-------------------------------------|---------------|
|   | <b>2016</b>                         | <b>2015</b>   |
| <b>Cash flows from operating activities</b>                                       |                                     |               |
| Net income  | \$ 3,197                            | \$ 2,147      |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                     |               |
| Depreciation and amortization   | 1,786                               | 764           |
| Equity-based compensation   | 2,008                               | 2,201         |
| From equity method investments in affiliates                                      | 220                                 | 53            |
| Gain on sale of financing receivables and investments                             | (4,314)                             | (3,255)       |
| Changes in financing receivables held-for-sale                                    | 5,382                               | 14,907        |
| Changes in accounts payable and accrued expenses                                  | 2,776                               | (1,269)       |
| Other   | (1,189)                             | (575)         |
| <b>Net cash provided by operating activities</b>                                  | <b>9,866</b>                        | <b>14,973</b> |
| <b>Cash flows from investing activities</b>                                       |                                     |               |
| Purchases of financing receivables  | (76,142)                            | (19,565)      |
| Principal collections from financing receivables                                  | 8,662                               | 39,185        |
| Proceeds from sales of financing receivables                                      | 29,127                              | 12,851        |
| Purchases of investments  | (12,864)                            | (5,000)       |
| Principal collections from investments  | 677                                 | 7,607         |
| Proceeds from sales of investments  |                                     | 2,280         |
| Purchases of real estate  | (7,327)                             | (16,540)      |
| Investments in equity method affiliates, net                                      | (1,622)                             |               |
| Distributions received from equity method affiliates                              | 15,991                              | 6,343         |
| Other   | (314)                               | (2,871)       |
| <b>Net cash (used in) provided by investing activities</b>                        | <b>(43,812)</b>                     | <b>24,290</b> |
| <b>Cash flows from financing activities</b>                                       |                                     |               |
| Proceeds from credit facility   | 90,800                              | 35,000        |
| Principal payments on credit facility   | (16,328)                            | (29,613)      |
| Proceeds from nonrecourse debt  |                                     | 11,626        |
| Principal payments on nonrecourse debt  | (18,509)                            | (13,764)      |
| Payments on deferred funding obligations  | (25,594)                            | (27,823)      |
| Payments of dividends and distributions   | (11,566)                            | (7,196)       |
| Other   | (917)                               | (236)         |

Edgar Filing: Hannon Armstrong Sustainable Infrastructure Capital, Inc. - Form 10-Q

|   |                  |                  |
|---|------------------|------------------|
| Net cash provided by (used in) financing activities | 17,886           | (32,006)         |
| (Decrease) increase in cash and cash equivalents    | (16,060)         | 7,257            |
| Cash and cash equivalents at beginning of period    | 42,645           | 58,199           |
| <b>Cash and cash equivalents at end of period</b>   | <b>\$ 26,585</b> | <b>\$ 65,456</b> |
| Interest paid                                       | \$ 9,319         | \$ 4,653         |

*See accompanying notes.*

- 4 -

**Table of Contents**

**HANNON ARMSTRONG SUSTAINABLE INFRASTRUCTURE CAPITAL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**March 31, 2016**

**1. The Company**

Hannon Armstrong Sustainable Infrastructure Capital, Inc. ( the Company ) provides debt and equity to the energy efficiency and renewable energy markets. The Company and its subsidiaries are hereafter referred to as we, us, or our. We refer to the financings that we hold on our balance sheet as our Portfolio. Our Portfolio may include:

Financing Receivables, such as project loans, receivables and direct financing leases,

Investments, such as debt and equity securities,

Real Estate, such as land or other physical assets and related intangible assets used in renewable energy projects, and

Equity Investments in unconsolidated affiliates, such as projects where we hold a non-consolidated equity interest in a project.

We finance our business through cash on hand, borrowings under our credit facility and debt transactions, and various asset-backed securitization transactions and equity issuances. We also generate fee income through asset-backed securitizations, by providing broker/dealer services and by servicing assets owned by third parties. Some of our subsidiaries are special purpose entities that are formed for specific operations associated with financing sustainable infrastructure receivables for specific long term contracts.

Our common stock is listed on the New York Stock Exchange ( NYSE ) under the symbol HASI. We have qualified as a REIT and also intend to operate our business in a manner that will continue to permit us to maintain our exception from registration as an investment company under the Investment Company Act of 1940, as amended. We operate our business through, and serve as the sole general partner of, our operating partnership subsidiary, Hannon Armstrong Sustainable Infrastructure, L.P, (the Operating Partnership ), which was formed to acquire and directly or indirectly own our assets.

***Investments in Equity Method Affiliates***

We have made several minority interest investments in wind projects operated by various wind energy companies through limited liability entities with an affiliate of JPMorgan Chase & Co ( JPMorgan ), an affiliate of Invenergy LLC ( Invenergy ) and Bluestem Creston Ridge, LLC ( Bluestem ). The following table sets forth certain information related to our equity method investments.

| <b>Date</b>   | <b>Transaction</b>                       | <b>Investment</b>     | <b>Partner</b> |
|---------------|--|-----------------------|----------------|
|               |  | (dollars in millions) |                |
| October 2014  | Strong Upwind Holdings I, LLC            | \$ 141                | JPMorgan       |
| April 2015    | Strong Upwind Holdings II, LLC           | \$ 36                 | JPMorgan       |
| August 2015   | Creston Ridge Management, LLC            | \$ 14                 | Bluestem       |
| December 2015 | Strong Upwind Holdings III, LLC          | \$ 84                 | JPMorgan       |
| December 2015 | Buckeye Wind Energy Class B Holdings LLC | \$ 71                 | Invenergy      |

Through these five equity method investments, we indirectly own minority interests in six limited liability holding companies that own twelve operating wind projects. See Note 2 for our accounting treatment of these investments and Note 13 for the aggregate financial position and results of operations of the significant holding companies.

## **Table of Contents**

### **2. Summary of Significant Accounting Policies**

#### ***Basis of Presentation***

The condensed consolidated financial statements reflect all normal and recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the financial position, results of operations, comprehensive income and cash flows for the periods presented. The preparation of financial statements in accordance with U.S. generally accepted accounting principles ( U.S. GAAP ) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and such differences could be material. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the entire year. Certain information and footnote disclosures normally included in our annual consolidated financial statements have been condensed or omitted. Certain amounts in the prior year have been reclassified to conform to the current year presentation, including the format of the revenue section of the income statement to include a calculation of Total Revenue. We also implemented ASU No. 2015-03, Interest Imputation of Interest, which simplifies the presentation of debt issuance costs. See Recently Issued Accounting Pronouncements below and Note 8 for further information.

The condensed consolidated financial statements include the accounts of the Company and its controlled subsidiaries, including the Operating Partnership. All significant intercompany transactions and balances have been eliminated in consolidation.

Following the guidance for non-controlling interests in Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 810, *Consolidation*, references in this report to our earnings per share and our net income and shareholders' equity attributable to common shareholders do not include amounts attributable to non-controlling interests.

#### ***Financing Receivables***

Financing receivables include financing energy efficiency and renewable energy project loans, receivables and direct financing leases.

Unless otherwise noted, we generally have the ability and intent to hold our financing receivables for the foreseeable future and thus they are classified as held for investment. Our ability and intent to hold certain financing receivables may change from time to time depending on a number of factors, including economic, liquidity and capital conditions. The carrying value of financing receivables held for investment represents the present value of the note, lease or other payments, net of any unearned fee income, which is recognized as income over the term of the note or lease using the effective interest method. Financing receivables that are held for investment are carried, unless deemed impaired, at cost, net of any unamortized acquisition premiums or discounts and include origination and acquisition costs, as applicable. Financing receivables that we intend to sell in the short-term are classified as held-for-sale and are carried at the lower of amortized cost or fair value on our balance sheet. The net purchases and proceeds from these sales of our held-for-sale financing receivables are recorded as an operating activity in our statement of cash flows based on our intent at the time of purchase. We may secure nonrecourse debt with the proceeds from our financing receivables.

We evaluate our financing receivables for potential delinquency or impairment on at least a quarterly basis and more frequently when economic or other conditions warrant such an evaluation. When a financing receivable becomes 90 days or more past due, and if we otherwise do not expect the debtor to be able to service all of its debt or other obligations, we will generally consider the financing receivable delinquent or impaired and place the financing receivable on non-accrual status and cease recognizing income from that financing receivable until the borrower has



demonstrated the ability and intent to pay contractual amounts due. If a financing receivable's status significantly improves regarding the debtor's ability to service the debt or other obligations, we will remove it from non-accrual status.

A financing receivable is also considered impaired as of the date when, based on current information and events, it is determined that it is probable that we will be unable to collect all amounts due in accordance with the original contracted terms. Many of our financing receivables are secured by energy efficiency and renewable energy

## **Table of Contents**

infrastructure projects. Accordingly, we regularly evaluate the extent and impact of any credit deterioration associated with the performance and value of the underlying project, as well as the financial and operating capability of the borrower, its sponsors or the obligor as well as any guarantors. We consider a number of qualitative and quantitative factors in our assessment, including, as appropriate, a project's operating results, loan-to-value ratios and any cash reserves, the ability of expected cash from operations to cover the cash flow requirements currently and into the future, key terms of the transaction, the ability of the borrower to refinance the transaction, other credit support from the sponsor or guarantor and the project's collateral value. In addition, we consider the overall economic environment, the sustainable infrastructure sector, the effect of local, industry, and broader economic factors, the impact of any variation in weather and the historical and anticipated trends in interest rates, defaults and loss severities for similar transactions.

If a financing receivable is considered to be impaired, we record an allowance to reduce the carrying value of the financing receivable to the present value of expected future cash flows discounted at the financing receivable's contractual effective rate or the amount realizable from other contractual terms such as the currently estimated fair market value of the collateral less estimated selling costs, if repayment is expected solely from the collateral. We charge off financing receivables against the allowance when we determine the unpaid principal balance is uncollectible, net of recovered amounts.

## ***Investments***

Investments include debt securities that meet the criteria of ASC 320, *Investments Debt and Equity Securities*. We have designated our debt securities as available-for-sale and carry these securities at fair value on our balance sheet. Unrealized gains and losses, to the extent not considered other than temporary impairment ( OTTI ), on available-for-sale debt securities are recorded as a component of accumulated other comprehensive income ( OCI ) in equity on our balance sheet.

We evaluate our investments for OTTI on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Our OTTI assessment is a subjective process requiring the use of judgments and assumptions. Accordingly, we regularly evaluate the extent and impact of any credit deterioration associated with the financial and operating performance and value of the underlying project. We consider a number of qualitative and quantitative factors in our assessment. We first consider the current fair value of the security and the duration of any unrealized loss. Other factors considered include changes in the credit rating, performance of the underlying project, key terms of the transaction, the value of any collateral and any support provided by the sponsor or guarantor.

To the extent that we have identified an OTTI for a security and intend to hold the investment to maturity and we do not expect that we will be required to sell the security prior to recovery of the amortized cost basis, we recognize only the credit component of OTTI in earnings. We determine the credit component using the difference between the securities' amortized cost basis and the present value of its expected future cash flows, discounted using the effective interest method or its estimated collateral value. Any remaining unrealized loss due to factors other than credit, or the non-credit component, is recorded in accumulated OCI.

To the extent we hold investments with an OTTI and if we have made the decision to sell the security or it is more likely than not that we will be required to sell the security prior to recovery of its amortized cost basis, we recognize the entire portion of the impairment in earnings.

Premiums or discounts on investment securities are amortized or accreted into investment interest income using the effective interest method.

***Real Estate***

Real estate reflects land or other real estate held on our balance sheet. Real estate intangibles reflect the value of associated lease intangibles, net of any amortization. In accordance with ASC 805, *Business Combinations*, the fair value of the real estate acquired in a business combination with in-place leases is allocated to (i) the acquired tangible assets, consisting of land or other real property such as buildings, and (ii) the identified intangible assets and liabilities, consisting of the value of above-market and below-market leases and the value of other acquired intangible assets, based in each case on their fair values.

## **Table of Contents**

The fair value of the tangible assets of an acquired leased property is determined by valuing the property as if it were vacant, and the as-if-vacant value is then allocated to land, building and tenant improvements, if any, based on the determination of the fair values of these assets. The as-if-vacant fair value of a property is determined by management based on an appraisal of the property by a qualified appraiser.

In allocating the fair value of the identified intangible assets and liabilities of an acquired property, above-market and below-market in-place lease values are recorded as intangible assets based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases, and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining term of the lease, including renewal periods likely of being exercised by the lessee. The capitalized above-market lease values are amortized as a reduction of rental income and the capitalized below-market lease values are amortized as an increase to rental income. We also record, as appropriate, an intangible asset for in-place leases. The value of the leases in place at the time of the transaction is equal to the potential revenue (rent and expenses) lost if the leases were not in place (during downtime) and that would be incurred to obtain the lease. The amortization is calculated over the initial term unless management believes that it is likely that the tenant would exercise the renewal option, whereby we would amortize the value attributable to the renewal over the renewal period. If a lease were to be terminated, all unamortized amounts relating to that lease would be written off.

We record the purchases of real estate, other than in a business combination (i.e. real estate with no in-place leases), as asset acquisitions that are recorded at cost, including acquisition and closing costs.

Our real estate is generally leased to tenants on a net lease basis, whereby the tenant is responsible for all operating expenses relating to the property, generally including property taxes, insurance, maintenance, repairs and capital expenditures. Scheduled rental revenue typically varies during the lease term and thus rental income is recognized on a straight-line basis, unless there is considerable risk as to collectability, so as to produce a constant periodic rent over the term of the lease. Accrued rental income is the aggregate difference between the scheduled rents which vary during the lease term and the income recognized on a straight-line basis and is recorded in other assets. Rental expenses (if any) are charged to operations as incurred.

### ***Securitization of Receivables***

We have established various special purpose entities or securitization trusts for the purpose of securitizing certain financing receivables or other debt investments. We determined that the trusts used in securitizations are variable interest entities, or VIEs, as defined in ASC 810, Consolidation. We typically serve as primary or master servicer of these trusts; however, as the servicer, we do not have the power to make significant decisions impacting the performance of the trusts. Based on an analysis of the structure of the trusts, under U.S. GAAP, we have concluded that we are not the primary beneficiary of the trusts as we do not have power over the trusts' significant activities. Therefore, we do not consolidate these trusts in our condensed consolidated financial statements.

We account for transfers of financing receivables to these securitization trusts as sales pursuant to ASC 860, Transfers and Servicing, as we have concluded the transferred receivables have been isolated from the transferor (i.e., put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership) and we have surrendered control over the transferred receivables. We have received true-sale-at-law opinions for all of our securitization trust structures and non-consolidation legal opinions for all but one old securitization trust structure that support our conclusion regarding the transferred receivables. When we sell receivables in securitizations, we generally retain minor interests in the form of servicing rights and residual assets, which we refer to as securitization assets.

Gain or loss on the sale of receivables is calculated based on the excess of the proceeds received from the securitization (less any transaction costs) plus any retained interests obtained over the cost basis of the receivables sold. For retained interests, we generally estimate fair value based on the present value of future expected cash flows using our best estimates of the key assumptions of anticipated losses, prepayment rates, and current market discount rates commensurate with the risks involved.

- 8 -

## **Table of Contents**

We initially account for all separately recognized servicing assets and servicing liabilities at fair value and subsequently measure such servicing assets and liabilities using the amortization method. Servicing assets and liabilities are amortized in proportion to, and over the period of, estimated net servicing income with servicing income recognized as earned. We assess servicing assets for impairment at each reporting date. If the amortized cost of servicing assets is greater than the estimated fair value, we will recognize an impairment in net income.

Our other retained interest in securitized assets, the residual assets, are classified as available-for-sale securities and carried at fair value on the condensed consolidated balance sheets in Other Assets. We generally do not sell our residual assets. Our residual assets are evaluated for impairment on a quarterly basis. Interest income related to the residual assets is recognized using the effective interest rate method. If there is a change in expected cash flows related to the residual assets, we calculate a new yield based on the current amortized cost of the residual assets and the revised expected cash flows. This yield is used prospectively to recognize interest income.

### ***Cash and Cash Equivalents***

Cash and cash equivalents include short-term government securities, certificates of deposit and money market funds, all of which had an original maturity of three months or less at the date of purchase. These securities are carried at their purchase price, which approximates fair value.

### ***Restricted Cash***

Restricted cash includes cash and cash equivalents set aside with certain lenders primarily to support deferred funding and other obligations outstanding as of the balance sheet dates. Restricted Cash is reported as part of Other Assets in the consolidated balance sheets.

### ***Variable Interest Entities and Equity Method Investments in Affiliates***

We account for our investment in entities that are considered voting or variable interest entities under ASC 810. We perform an ongoing assessment to determine the primary beneficiary of each entity as required by ASC 810. We have established various special purpose entities or securitization trusts for the purpose of securitizing certain financing receivables or other debt investments which are not consolidated in our financial statements as described in Securitization of Receivables above.

Substantially all of the activities of the special purpose entities that are formed for the purpose of holding our financing receivables and investments on our balance sheet are closely associated with our activities. Based on our assessment, we determined that we have power over and receive the benefits of these special purpose entities; hence, we are the primary beneficiary and should consolidate these entities under the provisions of ASC 810.

As described in Note 1, we made equity investments in various wind projects. We share in the cash flows and tax attributes according to a negotiated schedule. Wind projects are typically owned in partnerships structures (using limited liability corporations, or LLCs taxed as partnerships) where we, along with other large institutional investors, if any, receive a stated preferred return consisting of a priority distribution of the project's cash flows, and in some cases, tax attributes. Once this preferred return is achieved, the partnership flips and the wind energy company which operates the project, receives a larger portion of the cash flows through its interest in the holding company and we, along with the other institutional investors, will have an on-going residual interest.

There were no new equity investments in wind projects in 2016, and each of the existing investments continue to be accounted for under the equity method of accounting as of March 31, 2016. Certain of our equity method investments

were determined to be VIEs. Our maximum exposure to loss associated with all of our equity method investments is limited to our recorded value of our investments.

Under the equity method of accounting, the carrying value of our equity method investments is determined based on amounts we invested, adjusted for the equity in earnings or losses of investee allocated based on the limited liability entity agreement, less distributions received. Because the limited liability entity and holding company agreements contain preferences with regard to cash flows from operations, capital events and liquidation, we reflect our share of profits and losses by determining the difference between our claim on the investee's book value at the end and the beginning of the period. This claim is calculated as the amount we would receive (or be obligated to pay) if the investee were to liquidate all of its assets at recorded amounts determined in accordance with U.S. GAAP and distribute the resulting cash to creditors and investors in accordance with their respective priorities.

## **Table of Contents**

This method is commonly referred to as the hypothetical liquidation at book value method or ( HLBV ). Intra company gains and losses are eliminated for an amount equal to our interest and are reflected in the share in loss from equity method investments in affiliates in the consolidated statements of operations. Cash distributions received from our equity method investments are classified as operating cash flows to the extent of cumulative HLBV earnings. Any additional cash flows are deemed to be returns of the investment and are classified as investing cash flows. We have elected to recognize earnings from these investments one quarter in arrears to allow for the receipt of financial information.

We evaluate the realization of our investment accounted for using the equity method if circumstances indicate that our investment is OTTI. OTTI occurs when the estimated fair value of an investment is below the carrying value and the difference is determined to not be recoverable. This evaluation requires significant judgment regarding, but not limited to, the severity and duration of the impairment; the ability and intent to hold the securities until recovery; financial condition, liquidity, and near-term prospects of the issuer; specific events; and other factors. Based on an evaluation of our equity method investments, we determined that no impairment had occurred during the three months ended March 31, 2016 or 2015.

## ***Derivative Financial Instruments***

We may utilize derivative financial instruments, primarily interest rate swaps, to manage, or hedge, our interest rate risk exposures associated with new debt issuances, to manage our exposure to fluctuations in interest rates on variable rate debt, and to optimize the mix of our fixed and floating-rate debt. In addition, we may use forward-starting interest rate swap contracts to manage a portion of our interest rate exposure for anticipated refinancing of our long-term debts. Our objective is to manage the impact of interest rates on the results of operations and cash flows and the market value of our debt.

We use interest rate swaps designated as cash flow hedges to manage our interest rate exposures associated with new debt issuances and to manage our exposure to fluctuations in interest rates on variable rate debt. We attempt to use derivative instruments that are considered highly effective in reducing our exposure to the interest rate risk that they are designated to hedge. This effectiveness is essential in order to qualify for hedge accounting. Instruments that meet these hedging criteria are formally designated as hedges at the inception of the derivative contract. Derivatives are recorded on the consolidated balance sheet at fair value. If a derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in Accumulated Other Comprehensive Income, net of associated deferred income tax effects, in our Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) and are recognized in the Consolidated Statements of Operations when the hedged item affects earnings. Changes in fair value of the ineffective portions of these hedges are recognized in Other, net in our Consolidated Statements of Operations. For derivative instruments not designated as hedging instruments, changes in fair value are recognized in our Consolidated Statements of Operations in the period that the change occurs. We assess, both at the inception of the hedge and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. We do not hold derivatives for trading purposes.

Interest rate swap contracts contain a credit risk that counterparties may be unable to fulfill the terms of the agreement. We attempt to minimize that risk by evaluating the creditworthiness of its counterparties, who are limited to major banks and financial institutions, and do not anticipate nonperformance by the counterparties.

## ***Income Taxes***



We elected and qualified to be taxed as a REIT for U.S. federal income tax purposes, commencing with our taxable year ended December 31, 2013. To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement that we currently distribute at least 90% of our net taxable income, excluding capital gains, to our shareholders. We intend to continue to meet the requirements for qualification as a REIT. As a REIT, we are not subject to U.S. federal corporate income tax on that portion of net income that is currently distributed to our owners. However, our taxable REIT subsidiaries ( TRS ) will generally be subject to U.S. federal, state, and local income taxes as well as taxes of foreign jurisdictions, if any.

## **Table of Contents**

We account for income taxes of our TRS using the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to the differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in earnings in the period when the new rate is enacted.

We apply accounting guidance with respect to how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. This guidance requires the accounting and disclosure of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are more likely than not to be sustained by the applicable tax authority. We are required to analyze all open tax years, as defined by the statute of limitations, for all major jurisdictions, which includes U.S. federal and certain states. We have no examinations in progress, none are expected at this time, and years 2012 through 2014 are open. As of March 31, 2016 and December 31, 2015, we had no uncertain tax positions. Our policy is to recognize interest expense and penalties related to income tax matters as a component of other expense. There were no accrued interest and penalties as of March 31, 2016 and December 31, 2015, and no interest and penalties were recognized during the three months ended March 31, 2016 and 2015.

### ***Equity-Based Compensation***

At the time of completion of our IPO, we adopted our 2013 Equity Incentive Plan (the 2013 Plan ), which provides for grants of stock options, stock appreciation rights, restricted stock units, shares of restricted common stock, phantom shares, dividend equivalent rights, long-term incentive-plan units ( LTIP units ) and other restricted limited partnership units issued by our Operating Partnership and other equity-based awards. From time to time, we may award unvested restricted stock as compensation to members of our senior management team, our independent directors, employees, advisors, consultants and other personnel under our 2013 Plan.

We record compensation expense for stock awards in accordance with ASC 718, *Compensation Stock Compensation*. We record compensation expense for unvested shares that vest solely based on service conditions on a straight-line basis over the vesting period based upon the fair market value of the shares on the date of grant, adjusted for forfeitures. For awards where the vesting is contingent upon achievement of certain performance targets, compensation expense is recorded over the requisite service period (which includes the performance period) based on our estimate of the achievement of the various performance targets, adjusted for forfeitures. Our share price at the date of grant and actual performance results at the end of the performance period determine the fair value and the number of shares that will ultimately be awarded. The award earned is generally between 0% and 150% of the initial target, depending on the extent to which the performance target are met.

### ***Earnings Per Share***

We compute earnings per share of common stock in accordance with ASC 260, *Earnings Per Share*. Basic earnings per share is calculated by dividing net income attributable to controlling stockholders (after consideration of the earnings allocated to unvested shares of restricted common stock or restricted stock units) by the weighted-average number of shares of common stock outstanding during the period excluding the weighted average number of unvested shares of restricted common stock or restricted stock units ( participating securities as defined in Note 12). Diluted earnings per share is calculated by dividing net income attributable to controlling stockholders by the weighted-average number of shares of common stock outstanding during the period plus other potentially dilutive securities. No adjustment is made for shares that are anti-dilutive during a period.

***Segment Reporting***

We provide and arrange debt and equity financing for sustainable infrastructure projects and report all of our activities as one business segment.

- 11 -

## **Table of Contents**

### ***Recently Issued Accounting Pronouncements***

#### *Revenue from Contracts with Customers*

In May 2014, the FASB issued Accounting Standards Update ( ASU ) No. 2014-09, *Revenue from Contracts with Customers*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. The FASB proposed delaying the effective date of the standard by one year and issued a proposal that is intended to clarify and simplify the guidance. The updated standard becomes effective for us on January 1, 2018 and we expect will be first presented in our March 31, 2018, Form 10-Q. We have not yet selected a transition method, and we are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

#### *Debt Issuance Costs*

In April 2015, the FASB issued ASU No. 2015-03, *Interest Imputation of Interest*, which simplifies the presentation of debt issuance costs. ASU 2015-03 requires debt issuance costs related to long-term debt to be presented in the balance sheet as a reduction to the carrying amount of the related debt liability, consistent with the presentation of discounts. ASU 2015-03 is effective for fiscal years beginning after December 15, 2015, and for interim periods within those fiscal years, and is eligible for early adoption. We have adopted this standard in our consolidated financial statements for our nonrecourse debt as of December 31, 2015. As allowed under the ASU, we continue to record unamortized issuance costs related to our credit facility in Other Assets. We do not have a material amount of unamortized debt issuance costs and thus the adoption of the new standard did not have a material effect on our consolidated financial statements and related disclosures. See Note 8 for further information.

#### *Income Taxes*

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes Balance Sheet Classification of Deferred Taxes*. The purpose of the standard is to simplify the presentation of deferred taxes on a classified balance sheet. Under current GAAP, deferred income tax assets and liabilities are separated into current and noncurrent amounts in the balance sheet. The amendments in ASU 2015-17 require that all deferred tax assets and liabilities be classified as noncurrent in the balance sheet. The ASU will be effective for us beginning January 1, 2017, including interim periods in the calendar year 2017, but with early adoption permitted. Since we do not report a classified balance sheet, we do not expect the adoption of ASU 2015-17 to have a material impact on our consolidated financial statements and related disclosures.

#### *Leases*

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (a) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (b) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Changes were made to align lessor accounting with the lessee accounting model and ASU No. 2014-09, *Revenue from Contracts with Customers*. The new lease guidance simplifies the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. The ASU will be effective for us beginning January 1, 2019. Early application is permitted for all public business entities upon issuance. Lessees must apply a modified retrospective transition approach for leases existing at,

or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees may not apply a full retrospective transition approach. We are currently evaluating the impact of the application of this accounting standard update on our consolidated financial statements and related disclosures.

#### *Share-Based Payments*

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting. Under the new guidance, entities will be required to recognize all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. In addition, the new guidance will allow an employer to repurchase up to the maximum statutory income tax rates in the applicable jurisdictions without triggering liability accounting and allow an entity to make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures as they occur. The guidance is effective for us beginning after December 15, 2016, and interim periods

---

**Table of Contents**

within those years. Early adoption is permitted in any annual or interim period for which financial statements haven't been issued or made available for issuance, but all of the guidance must be adopted in the same period. If we early adopt the guidance in an interim period, any adjustments must be reflected as of the beginning of the calendar year that includes that interim period. We anticipate implementing this standard in the second quarter of 2016 and do not expect the implementation to have a material impact on our consolidated financial statements and related disclosures.

*Consolidation*

In February 2015, the FASB issued ASU No. 2015-02 Consolidation (Topic 810) Amendments to the Consolidation Analysis, which affects the following areas of the consolidation analysis: limited partnerships and similar entities, evaluation of fees paid to a decision maker or service provider as a variable interest and in determination of the primary beneficiary, effect of related parties on the primary beneficiary determination and for certain investment funds. ASU No. 2015-02 is effective for us for our fiscal year ending December 31, 2016 and interim periods therein. The adoption of this standard did not have a material impact on our consolidated financial position, results of operations and cash flows.

*Equity Method Investments*

In March 2016, the FASB issued ASU No. 2016-07 Simplifying the Transition to the Equity Method of Accounting. The new standard eliminates the requirement for an investor to retroactively apply the equity method when an increase in ownership interest in an investee triggers equity method accounting. It also simplifies in certain areas the accounting for equity method investments. The new standard becomes effective for us in fiscal year ending December 31, 2017 and interim periods therein. The adoption of this standard is not expected to have a material impact on our consolidated financial position, results of operations and cash flows.

**3. Fair Value Measurements**

Fair value is defined as the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. The fair value accounting guidance provides a three-level hierarchy for classifying financial instruments. The levels of inputs used to determine the fair value of our financial assets and liabilities carried on the balance sheet at fair value and for those for which only disclosure of fair value is required are characterized in accordance with the fair value hierarchy established by ASC 820, *Fair Value Measurements*. Where inputs for a financial asset or liability fall in more than one level in the fair value hierarchy, the financial asset or liability is classified in its entirety based on the lowest level input that is significant to the fair value measurement of that financial asset or liability. We use our judgment and consider factors specific to the financial assets and liabilities in determining the significance of an input to the fair value measurements. As of March 31, 2016 and December 31, 2015, only our residual assets (described in Note 5), financing receivables held-for-sale, interest rate swaps and investments available-for-sale, if any, were carried at fair value on the condensed consolidated balance sheets on a recurring basis. The three levels of the fair value hierarchy are described below:

Level 1 Quoted prices (unadjusted) in active markets that are accessible at the measurement date.

Level 2 Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3 Unobservable inputs are used when little or no market data is available.

Unless otherwise discussed below, fair value is measured using a discounted cash flow model, contractual terms and Level 3 unobservable inputs which consist of base interest rates and spreads over base rates which are based upon market observation and recent comparable transactions. An increase in these unobservable inputs would result in a lower fair value and a decline would result in a higher fair value. The financing receivables held for sale are carried at the lower of cost or market.

**Table of Contents**

|   | <b>As of March 31, 2016</b>  |                       |              |
|---|------------------------------|-----------------------|--------------|
|   | <b>Fair Value</b>            | <b>Carrying Value</b> | <b>Level</b> |
|   | <i>(dollars in millions)</i> |                       |              |
| <b>Assets</b>                                 |                              |                       |              |
| Financing receivables                         | \$ 874                       | \$ 819                | Level 3      |
| Financing receivables held-for-sale           | 42                           | 42                    | Level 3      |
| Investments available-for-sale <sup>(1)</sup> | 37                           | 37                    | Level 3      |
| <b>Liabilities</b>                            |                              |                       |              |
| Credit facility                               | \$ 322                       | \$ 322                | Level 3      |
| Asset-backed nonrecourse notes <sup>(2)</sup> | 578                          | 567                   | Level 3      |
| Other nonrecourse debt                        | 107                          | 94                    | Level 3      |
| Derivative liabilities                        | 4                            | 4                     | Level 2      |

(1) The amortized cost of our investments available-for-sale as of March 31, 2016, was \$38 million.

(2) Fair value and Carrying value of asset-backed nonrecourse notes excludes unamortized debt issuance costs.

|   | <b>As of December 31, 2015</b> |                       |              |
|---|--------------------------------|-----------------------|--------------|
|   | <b>Fair Value</b>              | <b>Carrying Value</b> | <b>Level</b> |
|   | <i>(dollars in millions)</i>   |                       |              |
| <b>Assets</b>                                 |                                |                       |              |
| Financing receivables                         | \$ 806                         | \$ 784                | Level 3      |
| Financing receivables held-for-sale           | 61                             | 60                    | Level 3      |
| Investments available-for-sale <sup>(1)</sup> | 29                             | 29                    | Level 3      |
| <b>Liabilities</b>                            |                                |                       |              |
| Credit facility                               | \$ 247                         | \$ 247                | Level 3      |
| Asset-backed nonrecourse notes <sup>(2)</sup> | 579                            | 579                   | Level 3      |
| Other nonrecourse debt                        | 111                            | 101                   | Level 3      |
| Derivative liabilities                        | 1                              | 1                     | Level 2      |

(1) The amortized cost of our investments available-for-sale as of December 31, 2015, was \$31 million.

(2) Fair value and Carrying value of asset-backed nonrecourse notes excludes unamortized debt issuance costs.

**Investments**

We carry our investments in debt securities at fair value on our balance sheet as investments available-for-sale. The following table reconciles the beginning and ending balances for our Level 3 investments that are carried at fair value on a recurring basis:

**For the three months  
ended March 31,**



|  | <b>2016</b>                  | <b>2015</b>  |
|--|------------------------------|--------------|
|  | <i>(dollars in millions)</i> |              |
| <b>Balance, beginning of period</b>                          | <b>\$ 29</b>                 | <b>\$ 27</b> |
| Purchases of investments available-for-sale                  | 21                           | 5            |
| Payments on investments available-for-sale                   |                              | (8)          |
| Sale of investments available-for-sale                       | (14)                         | (2)          |
| Gains on investments available-for-sale recorded in earnings | 1                            | 1            |
| Losses on investments available-for-sale recorded in OCI     |                              |              |
| <b>Balance, end of period</b>                                | <b>\$ 37</b>                 | <b>\$ 23</b> |

For investments held at fair value, we used a range of interest rate spreads of 2% to 5% based upon comparable transactions.

As of December 31, 2015, we held a \$13 million senior secured debt investment, along with a large financial institution who held the remaining approximately \$45 million in outstanding debt securities, in an operating wind project that was being foreclosed upon and expected to be sold. The foreclosure and sale was completed in 2016 and we recovered the full value of our debt investment and recognized a gain of \$0.8 million.

**Table of Contents*****Interest Rate Swap Agreements***

The fair values of the derivative financial instruments are determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. We have determined that the significant inputs, such as interest yield curves and discount rates, used to value our derivatives fall within Level 2 of the fair value hierarchy and that the credit valuation adjustments associated with our counterparties and our own credit risk utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of our or our counterparties default. As of March 31, 2016 and December 31, 2015, we assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our derivative positions and determined that the credit valuation adjustments were not significant to the overall valuation of our derivatives. As a result, we determined that our derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy. The fair values of the derivative financial instruments are included in the accounts payable, accrued expenses and other line item in the consolidated balance sheets.

***Non-recurring Fair Value Measurements***

Our financial statements may include non-recurring fair value measurements related to acquisitions and non-monetary transactions, if any. Assets acquired in a business combination are recorded at their fair value. We may use third party valuation firms to assist us with developing our estimates of fair value.

***Concentration of Credit Risk***

Financing receivables, investments and leases consist of primarily U.S. federal government-backed receivables, investment grade state and local government receivables and receivables from various sustainable infrastructure projects and do not, in our view, represent a significant concentration of credit risk. See Note 6 for an analysis by type of obligor. As described above, we do not believe we have a significant credit exposure to our interest rate swap providers. We had cash deposits that are subject to credit risk as shown below:

|  | <b>March 31,<br/>2016</b>    | <b>December 31,<br/>2015</b> |
|--|------------------------------|------------------------------|
|  | <i>(dollars in millions)</i> |                              |
| Cash deposits  | \$ 27                        | \$ 43                        |
| Restricted cash deposits (included in Other assets)            | 36                           | 36                           |
| <b>Total cash deposits</b>                                     | <b>\$ 63</b>                 | <b>\$ 79</b>                 |
| Amount of cash deposits in excess of amounts federally insured | \$ 58                        | \$ 75                        |

**4. Non-Controlling Interest*****Non-Controlling Interest in Consolidated Entities***

Units of limited partnership interests in the Operating Partnership ( OP units ) that are owned by limited partners other than the Company are included in non-controlling interest on our consolidated balance sheets. The outstanding OP units held by outside limited partners represents approximately 1% of our outstanding OP units and are redeemable for cash, or at our option, for a like number of shares of our common stock. No OP units were exchanged for shares of

common stock during the three months ended March 31, 2016. We exchanged 46,290 OP units held by our non-controlling interest holders for the same number of shares of our common stock during the three months ended March 31, 2015. The non-controlling interest holders are generally allocated their pro rata share of income, other comprehensive income and equity transactions.

**Table of Contents****5. Securitization of Receivables**

The following summarizes certain transactions with our securitization trusts:

|  | <b>For the Three Months<br/>Ended March 31,</b> |             |
|--|---|-------------|
|  | <b>2016</b>                                     | <b>2015</b> |
|  | <i>(dollars in millions)</i>                    |             |
| Gains on securitizations                               | \$ 5  | \$ 3        |
| Purchase of receivables securitized                    | \$ 141  | \$ 60       |
| Proceeds from securitizations                          | \$ 146  | \$ 63       |
| Residual and servicing assets included in Other Assets | \$ 11   | \$ 9        |
| Cash received from residual and servicing assets       | \$ 1  | \$ 1        |

In connection with securitization transactions, we typically retain servicing responsibilities and residual assets. In certain instances, we receive annual servicing fees ranging from 0.05% to 0.20% of the outstanding balance. Included in other assets in our condensed consolidated balance sheets are our servicing assets at amortized cost and our residual assets at fair value. Our residual assets are subordinate to investors' interests, and their values are subject to credit, prepayment and interest rate risks on the transferred financial assets. The investors and the securitization trusts have no recourse to our other assets for failure of debtors to pay when due. In computing gains and losses on securitizations, we use the same discount rates we use for the fair value calculation of residual assets, which are determined based on a review of comparable market transactions. Depending on the nature of the transaction risks, the discount rate ranged from 4% to 8%.

As of March 31, 2016 and December 31, 2015, our managed assets were approximately \$3.2 billion, of which \$1.8 billion were securitized assets held in unconsolidated securitization trusts. There were no securitization credit losses during the three months ended March 31, 2016 or 2015, and no material securitization delinquencies as of March 31, 2016 and December 31, 2015. The securitized assets consist of financing receivables from contracts for the installation of energy efficiency and other technologies in facilities owned by, or operated for or by, the federal government where the ultimate obligor is the U.S. federal government. The contracts may have guarantees of energy savings from third party service providers, the majority of which are entities rated investment grade by an independent rating agency. Based on the nature of the receivables and experience to date, we do not currently expect to incur any credit losses on the receivables sold.

**6. Our Portfolio**

As of March 31, 2016, our Portfolio included approximately \$1.4 billion of financing receivables, investments, real estate and equity method investments on our balance sheet. The financing receivables and investments are typically collateralized by contractually committed debt obligations of government entities or private high credit quality obligors and are often supported by additional forms of credit enhancement, including security interests and supplier guaranties. The real estate is typically land and related lease intangibles for long-term leases to wind and solar projects with high credit quality obligors. The equity method investments represent our minority equity investments in wind projects.

The following is an analysis of our Portfolio by type of obligor and credit quality as of March 31, 2016:

|  | <b>Investment Grade</b>      |  |  | <b>Subtotal,<br/>Debt and<br/>Real Estate</b> | <b>Equity Method<br/>Investments<sup>(4)</sup></b> | <b>Total</b>    |
|--|------------------------------|--|--|---|--|-----------------|
|  | <b>Government<br/>(1)</b>    | <b>Commercial<br/>Investment<br/>Grade<sup>(2)</sup></b> | <b>Commercial<br/>Non-Investment<br/>Grade<sup>(3)</sup></b> |   |  |                 |
|  | <i>(dollars in millions)</i> |  |  |   |  |                 |
| Financing receivables                      | \$ 374                       | \$ 428   | \$ 17  | \$ 819  | \$   | \$ 819          |
| Financing receivables held-for-sale        | 42                           |  |  | 42  |  | 42              |
| Investments                                | 21                           | 16   |  | 37  |  | 37              |
| Real estate <sup>(5)</sup>                 |                              | 163  |  | 163   |  | 163             |
| Equity method investments                  |                              |  |  |   | 304  | 304             |
| <b>Total</b>                               | <b>\$ 437</b>                | <b>\$ 607</b>  | <b>\$ 17</b>   | <b>\$ 1,061</b>                               | <b>\$ 304</b>                                      | <b>\$ 1,365</b> |
| <b>% of Debt and Real Estate Portfolio</b> |                              |  |  |   |  |                 |
| Average Remaining Balance <sup>(6)</sup>   | 41%                          | 57%  | 2%   | 100%  | N/A  | N/A             |
|  | \$ 12                        | \$ 10  | \$ 17  | \$ 11   | \$ 25  | \$ 12           |

(1) Transactions where the ultimate obligor is the U.S. federal government or state or local governments where the obligors are rated investment grade (either by an independent rating agency or based upon our internal credit analysis). This amount includes \$260 million of U.S. federal government transactions and \$ 177 million of transactions where the ultimate obligors are state or local governments. Transactions may have guaranties of energy savings from third party service providers, the majority of which are entities rated investment grade by an independent rating agency.

**Table of Contents**

- (2) Transactions where the projects or the ultimate obligors are commercial entities, including institutions such as hospitals or universities, that have been rated investment grade (either by an independent rating agency or based on our internal credit analysis). Of this total, \$11 million of the transactions have been rated investment grade by an independent rating agency. Commercial investment grade financing receivables include \$174 million of internally rated residential solar loans where the cash flows which support our financing receivables are subordinated to the tax equity investors (whose return is largely derived from the renewable energy tax incentives) and for which we rely on certain tax related indemnities of the publicly traded residential solar provider.
- (3) Transactions where the projects or the ultimate obligors are commercial entities, including institutions such as hospitals or universities, that have ratings below investment grade (either by an independent rating agency or using our internal credit analysis).
- (4) Consists of ownership interests in operating wind projects.
- (5) Includes the real estate and the lease intangible assets through which we receive scheduled lease payments, typically under long-term triple net lease agreements.
- (6) Excludes 79 transactions each with outstanding balances that are less than \$1 million and that in the aggregate total \$28 million.

The components of financing receivables as of March 31, 2016 and December 31, 2015, were as follows:

|  | <b>March 31,<br/>2016</b>    | <b>December 31,<br/>2015</b> |
|--|------------------------------|------------------------------|
|  | <i>(dollars in millions)</i> |                              |
| Financing receivables                              |                              |                              |
| Financing or minimum lease payments <sup>(1)</sup> | \$ 1,116                     | \$ 1,025                     |
| Unearned interest income                           | (295)                        | (238)                        |
| Allowance for credit losses                        |                              |                              |
| Unearned fee income, net of initial direct costs   | (2)                          | (3)                          |
| Financing receivables <sup>(1)</sup>               | \$ 819                       | \$ 784                       |

- (1) Excludes \$42 million and \$60 million in financing receivables held-for-sale as of March 31, 2016 and December 31, 2015, respectively.

In accordance with the terms of certain financing receivables purchase agreements, payments of the purchase price is scheduled to be made over time, generally within twelve months of entering into the transaction, and as a result, we have recorded deferred funding obligations of \$63 million and \$108 million as of March 31, 2016 and December 31, 2015, respectively.

The following table provides a summary of our anticipated maturity dates of our financing receivables and investments and the weighted average yield for each range of maturities as of March 31, 2016:

| <b>Total</b>                 | <b>Less than 1<br/>year</b> | <b>1-5 years</b> | <b>5-10 years</b> | <b>More than 10<br/>years</b> |
|------------------------------|-----------------------------|------------------|-------------------|-------------------------------|
| <i>(dollars in millions)</i> |                             |                  |                   |                               |

**Financing Receivables** <sup>(1)</sup>

|                                  |        |    |        |       |        |
|----------------------------------|--------|----|--------|-------|--------|
| Maturities by period             | \$ 819 | \$ | \$ 130 | \$ 39 | \$ 650 |
| Weighted average yield by period | 5%     | 4% | 6%     | 4%    | 5%     |
| <b>Investments</b>               |        |    |        |       |        |
| Maturities by period             | \$ 37  | \$ | \$     | \$ 1  | \$ 36  |
| Weighted average yield by period | 4%     | %  | %      | 5%    | 4%     |

(1) Excludes financing receivables held-for-sale of \$42 million.

Our real estate is leased to renewable energy projects, typically under long-term triple net leases with expiration dates that range between the years 2033 and 2051 under the initial terms and 2047 and 2080 if all extensions are exercised. The components of our real estate portfolio as of March 31, 2016 and December 31, 2015, were as follows:

|   | <b>March 31, 2016</b>        | <b>December 31, 2015</b> |
|---|------------------------------|--------------------------|
|   | <i>(dollars in millions)</i> |                          |
| <b>Real Estate</b>                                  |                              |                          |
| Land  | \$ 132                       | \$ 129                   |
| Real estate related intangibles                     | 33                           | 28                       |
| Accumulated amortization of real estate intangibles | (2)                          | (1)                      |
| <b>Real Estate</b>                                  | <b>\$ 163</b>                | <b>\$ 156</b>            |

**Table of Contents**

There are conservation easement agreements covering several of our properties that limit the use of the property upon expiration of the respective leases. The real estate related intangible assets are amortized on a straight-line basis over the contracted lease term. As of March 31, 2016, the future amortization expense of these intangible assets is as follows:

| <b>Year Ending December 31,</b>         | <i>(dollars in millions)</i> |
|---|------------------------------|
| From April 1, 2016 to December 31, 2016 | \$ 1                         |
| 2017                                    | 1                            |
| 2018                                    | 1                            |
| 2019                                    | 1                            |
| 2020                                    | 1                            |
| 2021                                    | 1                            |
| Thereafter                              | 25                           |
| <b>Total</b>                            | <b>\$ 31</b>                 |

As of March 31, 2016, the future minimum rental income payments under our land lease agreements are as follows:

| <b>Year Ending December 31,</b>         | <i>(dollars in millions)</i> |
|---|------------------------------|
| From April 1, 2016 to December 31, 2016 | \$ 6                         |
| 2017                                    | 10                           |
| 2018                                    | 11                           |
| 2019                                    | 11                           |
| 2020                                    | 10                           |
| 2021                                    | 11                           |
| Thereafter                              | 290                          |
| <b>Total</b>                            | <b>\$ 349</b>                |

We had no financing receivables, investments or leases that were impaired or on nonaccrual status as of March 31, 2016 or December 31, 2015. There was no provision for credit losses for the three months ended March 31, 2016 or 2015. We did not have any loan modifications that qualify as trouble debt restructurings for the three months ended March 31, 2016 or 2015.

**7. Credit Facility**

We have a senior secured revolving credit facility which provides for total maximum advances of \$1.5 billion with the aggregate amount outstanding at any point in time of \$500 million and which consists of two components, the G&I Facility and the PF Facility. The G&I Facility can be used to leverage certain qualifying government and institutional financings entered into by us and the PF Facility can be used to leverage certain qualifying project financings entered into by us.



The facility was originally entered into in 2013 and has been amended a number of times, including in January 2016. The effect of the various amendments has been to increase the size, flexibility and allocation of the facility and extend the termination date to July 19, 2019. The limit of borrowing at any point in time and the total maximum advances is summarized below:

-18-

**Table of Contents**

| As of             | Limit of Borrowing at any point in time |             |              |             | Maximum Total Advances |
|-------------------|---|-------------|--------------|-------------|------------------------|
|                   | G&I Facility                            | PF Facility | G&I Facility | PF Facility |                        |
|                   | <i>(dollars in millions)</i>            |             |              |             |                        |
| December 31, 2014 | \$ 125                                  | \$ 325      | \$ 375       | \$ 975      |                        |
| December 31, 2015 | \$ 150                                  | \$ 350      | \$ 450       | \$ 1,050    |                        |
| January 2016      | \$ 250                                  | \$ 250      | \$ 600       | \$ 900      |                        |

Loans under the G&I Facility bear interest at a rate equal to the London Interbank Offered Rate ( LIBOR ) plus 1.5% or, under certain circumstances, 1.5% plus the highest of (i) the Federal Funds Rate plus 0.5%, (ii) the rate of interest publicly announced by Bank of America from time to time as its prime rate, and (iii) LIBOR plus 1.0%. Loans under the PF Facility bear interest at a rate equal to LIBOR plus 2.5% or, under certain circumstances, 2.5% plus the highest of (i) the Federal Funds Rate plus 0.5%, (ii) the rate of interest publicly announced by Bank of America from time to time as its prime rate, and (iii) LIBOR plus 1.0%. Under the PF Facility, we also have the option to borrow at a fixed rate of interest until the expiration of the credit facility in July 2019. The fixed rate is determined by agreement with the Administrative Agent and is based on the prevailing US SWAP rate of an equivalent term to the average-life of the fixed rate portion of the borrowing plus an agreed upon margin. The loans are made through wholly-owned special purpose subsidiaries (the Borrowers ) and we have guaranteed the obligations of the Borrowers under the credit facility pursuant to (x) a Continuing Guaranty, dated July 19, 2013, and (y) a Limited Guaranty, dated July 19, 2013, both as amended and restated.

Any financing we propose to be included in the borrowing base as collateral under the facility is subject to the approval of the administrative agent in its sole discretion and the payment of a placement fee. We may, with the consent of the administrative agent, borrow against new projects before such projects become Approved Financings (as defined in the PF Facility loan agreement) but after they have been pledged as collateral. The amount eligible to be drawn under the facility for purposes of financing such investments will be based on a discount to the value of each investment or an applicable valuation percentage. Under the G&I Facility, the applicable valuation percentage for non-delinquent investments is 85% in the case of a U.S. federal government obligor, 80% in the case of an institutional obligor or a state and local obligor, and with respect to other obligors or in certain circumstances, such other percentage as the administrative agent may prescribe. Under the PF Facility, the applicable valuation percentage is 67% or such other percentage as the administrative agent may prescribe. The sum of approved financings after taking into account the valuation percentages and any changes in the valuation of the financings in accordance with the loan agreements determines the borrowing capacity, subject to the overall facility limits described above.

The following table provides additional detail on our credit facility as of March 31, 2016 and December 31, 2015:

|  | March 31, 2016               | December 31, 2015 |
|--|------------------------------|-------------------|
|  | <i>(dollars in millions)</i> |                   |
| Outstanding balance                            | \$ 322                       | \$ 247            |
| Value of collateral pledged to credit facility | \$ 471                       | \$ 356            |
| Weighted average short-term borrowing rate     | 2.4%                         | 2.3%              |

We incurred approximately \$13 million of costs associated with the credit facility that have been capitalized (included in other assets on the consolidated balance sheets) and are being amortized on a straight-line basis over the term of the Loan Agreements. On each monthly payment date, the Borrowers shall also pay to the administrative agent, for the benefit of the lenders, certain availability fees for each Loan Agreement equal to 0.50%, divided by 360, multiplied by the excess of the available borrowing capacity under each component of the credit facility over the actual amount

borrowed under such component.

The credit facility contains terms, conditions, covenants, and representations and warranties that are customary and typical for a transaction of this nature, including various affirmative and negative covenants, and limitations on the incurrence of liens and indebtedness, investments, fundamental organizational changes, dispositions, changes in the nature of business, transactions with affiliates, use of proceeds and stock repurchases.

**Table of Contents**

The credit facility also includes customary events of default, including the existence of a default in more than 50% of underlying financings. The occurrence of an event of default may result in termination of the credit facility, acceleration of amounts due under the credit facility, and accrual of default interest at a rate of LIBOR plus 2.50% in the case of the G&I Facility and at a rate of LIBOR plus 5.00% in the case of the PF Facility.

We were in compliance with the required financial covenants described below at each quarterly reporting date that such covenants were applicable:

| Covenant   | Covenant Threshold |
|--|--------------------|
| Minimum Liquidity (defined as available borrowings under the Loan Agreements plus unrestricted cash divided by actual borrowings) of greater than: | 5%                 |
| 12 month rolling Net Interest Margin of greater than:  | zero               |
| Maximum Debt to Equity Ratio of less than: <sup>(1)</sup>  | 4 to 1             |

<sup>(1)</sup> Debt is defined as Total Indebtedness excluding accounts payable and accrued expenses and nonrecourse debt.

**8. Nonrecourse Debt*****Asset-Backed Nonrecourse Debt***

We have outstanding the following nonrecourse asset-backed debt and bank loans (dollars in millions):

|                                    | Issue Date     | Original Principal | Interest Rate        | Maturity Date  | Anticipated Balance at Maturity |
|------------------------------------|----------------|--------------------|----------------------|----------------|---------------------------------|
| HASI Sustainable Yield Bond 2013-1 | December 2013  | \$ 100             | 2.79%                | December 2019  | \$ 57                           |
| ABS Loan Agreement                 | October 2014   | \$ 115             | 5.74%                | September 2021 | \$ 17                           |
| HASI Sustainable Yield Bond 2015-1 | September 2015 | \$ 101             | 4.28%                | October 2034   | \$                              |
| HASI SYB Loan Agreement 2015-1     | December 2015  | \$ 90              | 4.13% <sup>(1)</sup> | December 2021  | \$                              |
| HASI SYB Loan Agreement 2015-2     | December 2015  | \$ 42              | 4.63% <sup>(1)</sup> | December 2023  | \$                              |
| HASI SYB Loan Agreement 2015-3     | December 2015  | \$ 162             | 4.92%                | December 2020  | \$ 132                          |

<sup>(1)</sup> Interest rate represents the current period's LIBOR based rate plus the spread. Also see the interest rate swap contracts shown in the table below.

Outstanding amounts under the nonrecourse asset-backed debt agreements and bank loans and the value of assets pledged as security are as follows (dollars in millions):

|                                      | <b>Outstanding</b>    |               | <b>Value of Assets Pledged as of,</b> |                     | <b>Description of Assets Pledged</b>  |
|--------------------------------------|-----------------------|---------------|---------------------------------------|---------------------|---|
|                                      | <b>Balance as of</b>  | <b>2015</b>   | <b>2016</b>                           | <b>2015</b>         |   |
|                                      | <b>March 31, 2016</b> |               | <b>March 31,</b>                      | <b>December 31,</b> |   |
| HASI Sustainable Yield Bond 2013-1   | \$ 82                 | \$ 83         | \$ 98                                 | \$ 99               | Financing receivables   |
| ABS Loan Agreement                   | \$ 99                 | \$ 102        | \$ 110                                | \$ 117              | Equity interest in Strong Upwind Holdings I, LLC  |
| HASI Sustainable Yield Bond 2015-1   | \$ 99                 | \$ 100        | \$ 139                                | \$ 139              | Financing receivables, real estate and real estate intangibles                          |
| HASI SYB Loan Agreement 2015-1       | \$ 84                 | \$ 90         | \$ 110                                | \$ 117              | Equity interest in Strong Upwind Holdings II and III, LLC, related interest rate swap   |
| HASI SYB Loan Agreement 2015-2       | \$ 42                 | \$ 42         | \$ 70                                 | \$ 71               | Equity interest in Buckeye Wind Energy Class B Holdings LLC, related interest rate swap |
| HASI SYB Loan Agreement 2015-3       | \$ 161                | \$ 162        | \$ 174                                | \$ 175              | Residential Solar Financing receivables   |
| Debt issuance costs                  | \$ (15)               | \$ (16)       |                                       |                     |   |
| <b>Asset-backed nonrecourse debt</b> | <b>\$ 552</b>         | <b>\$ 563</b> |                                       |                     |   |

**Table of Contents**

We have pledged the ownership interest in the relevant assets or the relevant assets themselves to bankruptcy remote entities as security for the nonrecourse debt. The assets and credit of these entities are not available to satisfy any of our other debts and obligations, except as set forth in the debt agreements. The debtors can only look to the cash flows of the pledged assets to satisfy the debt and we are not liable for nonpayment of such cash flows. The debt agreements contain terms, conditions, covenants, and representations and warranties that are customary and typical for a transaction of this nature, including limitations on the incurrence of liens and indebtedness, investments, fundamental organizational changes, dispositions, changes in the nature of business, transactions with affiliates, use of proceeds and stock repurchases. The agreements also include customary events of default, the occurrence of which may result in termination of the agreements, acceleration of amounts due, and accrual of default interest. We typically act as servicer for the debt transactions.

We have guaranteed the performance of the representations and warranties and other obligations of certain of our subsidiaries under certain of the debt agreements and provided an indemnity against certain losses from bad acts of such subsidiaries including fraud, failure to disclose a material fact, theft, misappropriation, voluntary bankruptcy or unauthorized transfers. In the case of the debt secured by our wind equity interests, we have also guaranteed our compliance with certain tax matters and certain obligations if JPMorgan exercises its right to withdraw from our partnerships.

The HASI Sustainable Yield Bond ( HASI SYB ) 2015-1 consists of two notes, (i) \$101 million in aggregate principal amount of 4.28% HASI SYB 2015-1A, Class A Bonds (the Class A Bonds ) and (ii) \$18 million in aggregate principal amount of 5.0% HASI SYB 2015-1B, Class B Bonds (the Class B Bonds ), both with an anticipated repayment date in October 2034. The Class A Bonds rank senior to the Class B Bonds in priority of payment. We retained the Class B Bonds. The other loan and debt transactions were negotiated with, and held by, commercial banks, including one loan agreement that has a corporate financial subsidiary as a co-lender.

In connection with several of our nonrecourse debt borrowings, we have entered into the following interest rate swaps that are designated as cash flow hedges (dollars in millions):

|                                | Base<br>Rate  | Hedged<br>Rate | Notional Value as<br>of |                   | Fair Value as of |                   | Term                            |
|--------------------------------|---------------|----------------|-------------------------|-------------------|------------------|-------------------|---------------------------------|
|                                |               |                | March 31, 2016          | December 31, 2015 | March 31, 2016   | December 31, 2015 |                                 |
| HASI SYB Loan Agreement 2015-1 | 3 month Libor | 1.55%          | \$ 77                   | \$ 81             | \$ (1.1)         | \$ (0.3)          | December 2015 to September 2021 |
| HASI SYB Loan Agreement 2015-2 | 3 month Libor | 1.52%          | \$ 37                   | \$ 38             | \$ (0.6)         | \$ (0.1)          | December 2015 to December 2018  |
| HASI SYB Loan Agreement 2015-2 | 3 month Libor | 2.55%          | \$ 29                   | \$ 29             | \$ (0.8)         | \$ (0.2)          | December 2018 to December 2024  |
| HASI SYB Loan Agreement 2015-3 | 1 month Libor | 2.34%          | \$ 119                  | \$                | \$ (1.6)         | \$                | November 2020 to August 2028    |
| <b>Total</b>                   |               |                | <b>\$ 262</b>           | <b>\$ 148</b>     | <b>\$ (4.1)</b>  | <b>\$ (0.6)</b>   |                                 |

The total fair value of our hedges relating to interest rate hedges that are effective in offsetting variable cash flows is reflected as unrealized losses in accumulated other comprehensive income and in Accounts payable, accrued expenses

and other in the accompanying consolidated balance sheet. As of March 31, 2016 and December 31, 2015, all of our derivatives were designated as hedging instruments and there was no ineffectiveness recorded on our designated hedges and no portion of the Accumulated other comprehensive income, net of associated deferred income tax effects, related to our interest rate hedges was reclassified into interest expense.

**Table of Contents****Other Nonrecourse Debt**

We have other nonrecourse debt that was used to finance certain of our financing receivables for the term of the financing receivables. Amounts due under nonrecourse notes are secured by financing receivables with a carrying value of approximately \$91 million and \$97 million as of March 31, 2016 and December 31, 2015, respectively, and there is no recourse to our general assets. Debt service payment requirements, in a majority of cases, are equal to or less than the cash flows received from the underlying financing receivables.

Additional information related to other nonrecourse debt by interest rate is as follows:

| <b>As of March 31, 2016</b>   | <b>Balance</b>               | <b>Maturity</b> |
|---|------------------------------|-----------------|
|   | <i>(dollars in millions)</i> |                 |
| Fixed-rate promissory notes, interest rates from 2.26% to 5.00% per annum | \$ 31                        | 2017 to 2032    |
| Fixed-rate promissory notes, interest rates from 5.01% to 6.50% per annum | 42                           | 2017 to 2031    |
| Fixed-rate promissory notes, interest rates from 6.51% to 8.00% per annum | 21                           | 2019 to 2031    |
| <b>Other nonrecourse debt</b>   | <b>\$ 94</b>                 |                 |

| <b>As of December 31, 2015</b>  | <b>Balance</b>               | <b>Maturity</b> |
|---|------------------------------|-----------------|
|   | <i>(dollars in millions)</i> |                 |
| Fixed-rate promissory notes, interest rates from 2.26% to 5.00% per annum | \$ 33                        | 2017 to 2032    |
| Fixed-rate promissory notes, interest rates from 5.01% to 6.50% per annum | 46                           | 2017 to 2031    |
| Fixed-rate promissory notes, interest rates from 6.51% to 8.00% per annum | 22                           | 2019 to 2031    |
| <b>Other nonrecourse debt</b>   | <b>\$ 101</b>                |                 |

The stated minimum maturities of nonrecourse debt as of March 31, 2016, were as follows:

| <b>As of March 31,</b> | <b>Nonrecourse Debt</b>                   |                                   | <b>Total</b> |
|------------------------|---|-----------------------------------|--------------|
|                        | <b>Asset Backed<br/>Nonrecourse Notes</b> | <b>Other Nonrecourse<br/>Debt</b> |              |
|                        | <i>(dollars in millions)</i>              |                                   |              |
| 2016                   | \$ 31                                     | \$ 16                             | \$ 47        |
| 2017                   | 31  | 13                                | 44           |
| 2018                   | 31  | 6                                 | 37           |
| 2019                   | 92  | 4                                 | 96           |



|                               |               |              |               |
|-------------------------------|---------------|--------------|---------------|
| 2020                          | 164           | 5            | 169           |
| Thereafter                    | 218           | 50           | 268           |
|                               | <b>\$ 567</b> | <b>\$ 94</b> | <b>\$ 661</b> |
| Deferred financing costs, net | (15)          |              | (15)          |
|                               | <b>\$ 552</b> | <b>\$ 94</b> | <b>\$ 646</b> |

The stated minimum maturities of nonrecourse debt above include only the mandatory minimum principal payments. To the extent there are additional cash flows received from Strong Upwind Holdings II, LLC, Strong Upwind Holdings III, LLC or Buckeye Wind Energy Class B Holdings LLC, these additional cash flows are required to be used to make additional principal payments against the respective HASI SYB Loan Agreement 2015-1 and HASI SYB Loan Agreement 2015-2 notes.

## 9. Commitments and Contingencies

### *Litigation*

The nature of our operations exposes us to the risk of claims and litigation in the normal course of our business. Other than non-material litigation arising out of the ordinary course of business, we are not currently subject to any legal proceedings that are probable of having a material adverse effect on our financial position, results of operations or cash flows.

## 10. Income Tax

We recorded a tax expense of less than \$0.1 million for the three months ended March 31, 2016 and a tax benefit of less than \$0.1 million for the three months ended March 31, 2015. Our income tax expense and benefit was determined using a federal rate of 35% and a combined state rate, net of federal benefit, of 5%.

**Table of Contents****11. Equity*****Dividends and Distributions***

Our board of directors declared the following dividends in 2015 and 2016:

| <b>Announced Date</b> | <b>Record Date</b> | <b>Pay Date</b> | <b>Amount per share</b> |
|-----------------------|--------------------|-----------------|-------------------------|
| 3/17/15               | 3/30/15            | 4/9/15          | \$ 0.26                 |
| 6/16/15               | 6/30/15            | 7/9/15          | \$ 0.26                 |
| 9/16/15               | 9/30/15            | 10/8/15         | \$ 0.26                 |
| 12/15/15              | 12/30/15           | 1/7/16          | \$ 0.30                 |
| 3/15/16               | 3/30/16            | 4/7/16          | \$ 0.30                 |

We completed the following public offerings of common stock in 2015:

| <b>Closing Date</b> | <b>Shares Issued<sup>1</sup></b>                       | <b>Price Per Share</b> | <b>Net Proceeds<sup>2</sup></b> |
|---------------------|--|------------------------|---------------------------------|
|                     | <i>(amounts in millions, except per share amounts)</i> |                        |                                 |
| 5/4/15              | 4.60   | \$ 18.50               | \$ 82                           |
| 10/19/15            | 5.75   | \$ 18.00               | \$ 99                           |

<sup>1</sup> Includes shares issued in connection with the exercise of the underwriters' option to purchase additional shares.

<sup>2</sup> Net proceeds from the offerings is shown after deducting underwriting discounts, commissions and other offering costs.

***Awards of Shares of Restricted Common Stock under our 2013 Plan***

We recognize equity-based compensation expense as described in Note 2 and have issued both awards with service conditions and awards with both service and performance conditions. During the three months ended March 31, 2016, our board of directors awarded employees and directors 357,640 shares of restricted common stock that vest in 2016 to 2019 and 290,330 shares of restricted common stock to certain employees that vest upon the achievement of certain performance targets. As of March 31, 2016, we have concluded that it is probable that the performance conditions will be met.

For both the three months ended March 31, 2016 and 2015, we recorded \$2 million of equity-based compensation expense. The total unrecognized compensation expense related to awards of shares of restricted common stock was approximately \$19 million as of March 31, 2016, that is expected to be recognized over a weighted-average term of approximately two years. The calculation of the equity-based compensation expense assumes a forfeiture rate up to 5%.

A summary of the unvested shares of restricted common stock that have been issued is as follows:

|                       |                          | <b>Restricted<br/>Shares of<br/>Common Stock</b> | <b>Weighted Average<br/>Share Price</b> | <b>Value<br/>(in millions)</b> |
|-----------------------|--------------------------|--|---|--------------------------------|
| <b>Balance</b>        | <b>December 31, 2014</b> | <b>964,820</b>                                   | <b>\$ 13.41</b>                         | <b>\$ 12.9</b>                 |
| Granted               |                          | 586,648  | 17.29                                   | 10.2                           |
| Vested                |                          | (285,289)  | 13.61                                   | (3.9)                          |
| Forfeited             |                          | (18,110)   | 15.54                                   | (0.3)                          |
| <b>Balance</b>        | <b>December 31, 2015</b> | <b>1,248,069</b>                                 | <b>\$ 15.16</b>                         | <b>\$ 18.9</b>                 |
| Granted               |                          | 647,970  | 18.58                                   | 12.0                           |
| Vested                |                          | (29,268)   | 14.23                                   | (0.4)                          |
| Forfeited             |                          |  |   |                                |
| <b>Ending Balance</b> | <b>March 31, 2016</b>    | <b>1,866,771</b>                                 | <b>\$ 16.36</b>                         | <b>\$ 30.5</b>                 |

## 12. Earnings per Share of Common Stock

Both the net income or loss attributable to the non-controlling OP units and the non-controlling limited partners outstanding OP units have been excluded from the net of income or loss and the diluted earnings per share calculation attributable to common stockholders.

**Table of Contents**

Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. Any shares of common stock which, if included in the diluted earnings per share calculation, would have an anti-dilutive effect have been excluded from the diluted earnings per share calculation.

The computation of basic and diluted earnings per common share is as follows:

| <b>Numerator:</b>   | <b>Three Months Ended<br/>March 31,</b>                   |             |
|---|---|-------------|
|   | <b>2016</b>   | <b>2015</b> |
|   | <i>(in millions, except share and<br/>per share data)</i> |             |
| Net income attributable to controlling<br>shareholders and participating securities | \$ 3.2  | \$ 2.1      |
| Less: Dividends paid on participating securities                                    | (0.6)   | (0.4)       |
| Undistributed earnings attributable to<br>participating securities                  |   |             |
| Net income attributable to controlling<br>shareholders                              | \$ 2.6  | \$ 1.7      |
| <b>Denominator:</b>   |   |             |
| Weighted-average number of common shares<br>basic                                   | 37,016,210  | 26,386,080  |
| Weighted-average number of common shares<br>diluted                                 | 37,016,210  | 26,386,080  |
| Basic earnings per common share   | \$ 0.07   | \$ 0.07     |
| Diluted earnings per common share   | \$ 0.07   | \$ 0.07     |
| <b>Other Information:</b>   |   |             |
| Weighted-average number of OP units   | 284,992   | 325,110     |
| Unvested restricted common stock outstanding  | 1,866,771   | 1,520,286   |

**13. Equity Method Investments in Affiliate*****Strong Upwind***

As described in Notes 1 and 2, we have noncontrolling equity investments in entities that own minority interests in wind projects. We recognized income of \$0.3 million and a loss of \$0.1 million during the three months ended March 31, 2016 and 2015, respectively, from our equity method investments.

The following is a summary of the consolidated financial position and results of operations of the significant holding companies, accounted for using the equity method:

|                                   | <b>As of and for the year</b>           |             |
|-----------------------------------|---|-------------|
|                                   | <b>ended December 31,</b>               |             |
|                                   | <b>2015</b>                             | <b>2014</b> |
|                                   | <i>(dollars in millions, unaudited)</i> |             |
| Current Assets                    | \$ 52                                   | \$ 62       |
| Total Assets                      | \$ 1,413                                | \$ 1,501    |
| Current Liabilities               | \$ 14                                   | \$ 18       |
| Total Liabilities                 | \$ 63                                   | \$ 66       |
| Members' Equity                   | \$ 1,350                                | \$ 1,435    |
| Revenue                           | \$ 142                                  | \$ 154      |
| Income from Continuing Operations | \$ 27                                   | \$ 44       |
| Net Income                        | \$ 27                                   | \$ 44       |

- 24 -

## **Table of Contents**

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*In this Form 10-Q, unless specifically stated otherwise or the context otherwise indicates, references to we, our, us, and HASI refer to Hannon Armstrong Sustainable Infrastructure Capital, Inc., a Maryland corporation, Hannon Armstrong Sustainable Infrastructure, L.P., and any of our other subsidiaries. Hannon Armstrong Sustainable Infrastructure, L.P. is a Delaware limited partnership of which we are the sole general partner and to which we refer in this Form 10-Q as our Operating Partnership.*

*The following discussion is a supplement to and should be read in conjunction with the accompanying condensed consolidated financial statements and related notes and with our 2015 Form 10-K, that was filed with the SEC.*

#### **Our Business**

We provide debt and equity financing to the energy efficiency and renewable energy markets. We focus on providing preferred or senior level capital to established sponsors and high credit quality obligors for assets that generate long-term, recurring and predictable cash flows.

We are internally managed and our management team has extensive industry knowledge and experience having completed its first renewable energy financing over 25 years ago and its first energy efficiency financing over 15 years ago. We have deep and long-standing relationships in the markets we target with leading energy service providers, manufacturers, project developers and owners. We originate many of our transactions through programmatic finance relationships with global energy service companies ( ESCOs ), such as Honeywell International, Ingersoll Rand, Johnson Controls, Schneider Electric, Siemens and United Technologies. We also originate transactions with renewable energy manufacturers, developers and operators such as EDF Renewable Energy, EDP Renewables, E.ON, First Solar, Invenergy, SunPower and other companies who own and operate renewable energy projects, including a number of U.S. utility companies. Additionally, we rely on relationships with a variety of key financial participants, including institutional investors, private equity funds, senior lenders, and investment and commercial banks, as well as leading intermediaries, to complement our origination and financing activities. We believe we are the leading provider of financing for energy efficiency projects for the U.S. federal government, the largest property owner and energy user in the United States.

We focus our investment activities primarily on:

Energy Efficiency Projects: projects, typically undertaken by ESCOs, which reduce a building's or facility's energy usage or cost by improving or installing various building components, including heating, ventilation and air conditioning systems ( HVAC systems ), lighting, energy controls, roofs, windows, building shells, and/or combined heat and power systems; and

Renewable Energy Projects: projects that deploy cleaner energy sources, such as solar and wind to generate power production.

We may also provide financing solutions for other projects, such as water or communications infrastructure, that improve water or energy efficiency, increase energy system resiliency, positively impact the environment or more efficiently use natural resources.

Our goal is to deliver attractive risk-adjusted returns to our stockholders by investing in projects that generate long-term, recurring and predictable cash flows or cost savings. The cash flows or cost savings are generally generated from proven technologies that minimize performance uncertainty, enabling us to more accurately predict project cash flow over the term of the financing or investment. We provide capital through debt financings and a variety of preferred and common equity structures with a preference for structures in which we hold a senior or preferred position in the capital structure.

- 25 -

## Table of Contents

We completed approximately \$213 million of transactions during the three months ended March 31, 2016, compared to approximately \$104 million in the same period in 2015. Our strategy includes holding a large portion of these transactions on our balance sheet. As of March 31, 2016 we held approximately \$1.4 billion of transactions on our balance sheet, including approximately 56% of our 2016 transactions. The transactions that we hold on our balance sheet as of a given date, which we refer to as our Portfolio included the following as of March 31, 2016:

Financing Receivables, such as project loans, receivables and direct financing leases,

Debt securities,

Real Estate, such as land or other physical assets and related intangible assets used in sustainable infrastructure projects, and

Equity Investments in unconsolidated affiliates, such as projects where we hold a non-controlling equity interest in a project.

For more information on the assets included in our Portfolio, see the Our Portfolio section of Financial Condition and Results of Operation discussed below.

We also originate transactions for securitization trusts or similar vehicles that we manage or service in which institutional investors purchase all or a portion of the economics of the transaction and where we receive upfront revenues and in some cases, ongoing fees for managing the assets. As of March 31, 2016, we managed approximately \$1.8 billion in these trusts or vehicles that are not consolidated on our balance sheet. When combined with our Portfolio, as of March 31, 2016, we manage approximately \$3.2 billion of assets which we refer to as our managed assets.

Since April 2013, we have raised net proceeds of approximately \$470 million in public offerings of our common stock and completed approximately \$610 million of nonrecourse borrowings and secured a credit facility with maximum capacity of \$500 million.

Our financings typically benefit from contractually committed obligations of government entities or private, high credit quality obligors. The cash flows or cost savings are generally produced from proven technologies that minimize performance uncertainty, enabling us to more accurately predict project cash flows over the term of the financing or investment. We provide debt and equity financing for energy efficiency projects, which reduce the amount or cost of energy usage. We often work with ESCOs who achieve these savings by improving or installing various building components, including HVAC systems, lighting, energy controls, roofs, windows, building shells, and/or combined heat and power systems. We are assigned the payment stream and other contractual rights, often using our pre-existing master purchase agreements with the ESCOs. Our financings are generally also secured by the installed improvements.

We also provide debt and equity financing, or own the land used, for projects that deploy renewable energy sources such as solar or wind. We focus on financing renewable energy projects that use proven technology and that often have contractually committed agreements, such as power purchase agreements ( PPAs ), with high credit quality utilities or large electricity users under which the utility or user purchases the power produced by the project at a



minimum price with potential price escalators for a portion of the project's estimated life. These projects are building or facility specific and may be combined with other energy efficiency projects or are standalone projects designed to sell power to electric utilities or large users.

We have a large and active pipeline of potential new opportunities that are in various stages of our underwriting process. We refer to potential opportunities as being part of our pipeline if we have determined that the project fits within our investment strategy and exhibits the appropriate risk/reward characteristics through an initial credit analysis, including a quantitative and qualitative assessment of the opportunity, as well as research on the market and sponsor. Our pipeline of transactions that could potentially close in the next 12 months consists of opportunities in which we will be the lead originator, as well as projects in which we may participate with other institutional investors. As of March 31, 2016, our pipeline consisted of more than \$2.5 billion in new debt and equity opportunities. There can, however, be no assurance that any or all of the transactions in our pipeline will be completed.

## **Table of Contents**

We elected to be, and intend to continue to operate our business so as to qualify to be taxed as a REIT for U.S. federal income tax purposes, commencing with our taxable year ended December 31, 2013. We also intend to continue to operate our business in a manner that will permit us to maintain our exception from registration as an investment company under the 1940 Act.

## **Factors Impacting our Operating Results**

We expect that our results of operations will be affected by a number of factors and will primarily depend on the size of our Portfolio, including the mix of transactions which we hold in our Portfolio, the income we receive from securitizations, syndications and other services, our Portfolio's credit risk profile, changes in market interest rates and liquidity, commodity prices, U.S. federal, state and/or municipal governmental policies, general market conditions in local, regional and national economies and our ability to qualify as a REIT and maintain our exception from registration as an investment company under the 1940 Act. We provide a summary of the factors impacting our operating results in our 2015 Form 10-K under "MD&A Factors Impacting our Operating Results."

## **Critical Accounting Policies and Use of Estimates**

Our financial statements are prepared in accordance with U.S. GAAP, which requires the use of estimates and assumptions that involve the exercise of judgment and use of assumptions as to future uncertainties. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. We provide a summary of our significant accounting policies under Note 2 in our 2015 Form 10-K and under Note 2 of this Form 10-Q.

We have identified the following accounting policies as critical because they require significant judgments and assumptions about highly complex and inherently uncertain matters and the use of reasonably different estimates and assumptions could have a material impact on our reported results of operations or financial condition. These critical accounting policies govern:

Financing receivables and the related accounting for allowance for credit losses and impairments

Investments and the related accounting for impairments

Real estate

Securitization of receivables and other fee income

Valuation of financial instruments

Variable interest entities and equity method investments in affiliates

Derivative financial instruments

Income taxes

Equity-based compensation

We evaluate our critical accounting estimates and judgments on an ongoing basis and update them, as necessary, based on changing conditions.

We provide additional information on our critical accounting policies and use of estimates under MD&A Critical Accounting Policies and Use of Estimates in our 2015 Form 10-K.

### ***Financial Condition and Results of Operation***

#### **Our Portfolio**

As of March 31, 2016, our Portfolio was approximately \$1.4 billion and included \$387 million of energy efficiency investments, \$955 million of renewable energy (wind and solar) transactions and \$23 million of other sustainable infrastructure investments. Approximately 61% of our Portfolio consisted of fixed rate loans, financing receivables, direct financing leases or debt securities, approximately 5% consisted of floating rate debt, approximately 12% was real estate investments with long-term leases and approximately 22% represented minority ownership of wind projects in eleven wind projects. Our real estate investments consist of over 14,000 acres of land leased under long-term lease agreements with over 25 solar projects.

**Table of Contents**

Excluding our equity investments, approximately 41% of our Portfolio consisted of U.S. federal government or state or local government obligors, approximately 57% consisted of investment grade commercial obligations and 2% consisted of non-investment grade rated commercial obligations, in all cases rated either by an independent third party rating service or our internal credit rating system. Our Portfolio, as of March 31, 2016, consists of approximately 110 transactions of greater than \$1 million with a weighted average remaining life (excluding match-funded transactions) of approximately eleven years. For further information on our Portfolio, see Notes 1 and 6 to our financial statements of this Form 10-Q.

The table below provides details on the interest rate and maturity of our financing receivables and investments as of March 31, 2016:

|   | Balance in<br>Millions | Maturity     |
|---|------------------------|--------------|
| Floating-rate financing receivables, interest rates of 5.78% per annum                | \$ 73                  | 2020         |
| Fixed-rate financing receivables, interest rates from 1.52% to 5.00% per annum        | 323                    | 2017 to 2039 |
| Fixed-rate financing receivables, interest rates from 5.01% to 6.50% per annum        | 209                    | 2017 to 2046 |
| Fixed-rate financing receivables, interest rates from 6.60% to 9.62% per annum        | 214                    | 2018 to 2069 |
| Financing receivables   | 819                    |              |
| Allowance for credit losses   | -                      |              |
| Financing receivables, net of allowance   | 819                    |              |
| Financing receivables held for sale, interest rates of less than 5.00% per annum      | 42                     | 2031         |
| Fixed-rate investment in debt securities, interest rates of less than 5.00% per annum | 37                     | 2017 to 2036 |
| <b>Total Financing Receivables and Investments</b>                                    | <b>\$ 898</b>          |              |

The table below presents, for each major category of our Portfolio and the related interest-bearing liabilities, the average outstanding balances, investment income earned, the interest expense incurred, and average yield or cost. Our earnings from our equity method investments are not included in Total Revenue and thus we have excluded our equity method investments and the related earnings and interest expenses from these calculations. Our net investment margin represents the difference between the interest, investment and rental income generated by our Portfolio and the interest expense, divided by our Portfolio balance.

|  | <b>Three Months Ended March 31,</b> |             |
|--|-------------------------------------|-------------|
|  | <b>2016</b>                         | <b>2015</b> |
|  | <i>(dollars in millions)</i>        |             |
| Interest Income, Financing receivables | \$ 11                               | \$ 8        |

Edgar Filing: Hannon Armstrong Sustainable Infrastructure Capital, Inc. - Form 10-Q

|  |          |        |
|--|----------|--------|
| Average monthly balance of financing receivables | \$ 869   | \$ 627 |
| Average interest rate from financing receivables | 5.3%     | 5.3%   |
| Interest Income, Investments                     | \$ 1     | \$ 1   |
| Average monthly balance of investments           | \$ 30    | \$ 25  |
| Average interest rate of investments             | 5.0%     | 6.2%   |
| Rental Income                                    | \$ 3     | \$ 2   |
| Average monthly balance of real estate           | \$ 160   | \$ 116 |
| Average yield on real estate                     | 7.1%     | 7.2%   |
| Average monthly balance of Portfolio             | \$ 1,059 | \$ 768 |
| Average yield from Portfolio                     | 5.5%     | 5.6%   |
| Investment interest expense <sup>(1)</sup>       | \$ (8)   | \$ (4) |
| Average monthly balance of debt <sup>(1)</sup>   | \$ 728   | \$ 527 |
| Average interest rate from debt <sup>(1)</sup>   | 4.2%     | 3.4%   |
| Average interest spread <sup>(1)</sup>           | 1.4%     | 2.3%   |
| Net investment margin <sup>(1)</sup>             | 2.7%     | 3.3%   |

- 28 -



*Comparison of the Three Months Ended March 31, 2016 vs. Three Months Ended March 31, 2015*

|  | <b>Three Months Ended March 31,</b> |             |                  |                 |
|--|-------------------------------------|-------------|------------------|-----------------|
|  | <b>2016</b>                         | <b>2015</b> | <b>\$ Change</b> | <b>% Change</b> |
|  | <i>(dollars in millions)</i>        |             |                  |                 |
| <b>Net Investment Revenue:</b>   |                                     |             |                  |                 |
| Interest Income, Financing receivables                                 | \$ 11                               | \$ 8        | \$ 3             | 38%             |
| Interest Income, Investments   | 1                                   | 1           |                  | NM              |
| Rental Income  | 3                                   | 2           | 1                | 50%             |
| Gain on sale of receivables and investments                            | 5                                   | 3           | 2                | 67%             |
| Fee income   |                                     |             |                  | NM              |
| <b>Total Revenue</b>   | <b>20</b>                           | <b>14</b>   | <b>6</b>         | <b>43%</b>      |
| Investment interest expense  | (11)                                | (6)         | (5)              | 83%             |
| Provision for credit losses  |                                     |             |                  | NM              |
| <b>Total Revenue, net of investment interest expense and provision</b> | <b>9</b>                            | <b>8</b>    | <b>1</b>         | <b>13%</b>      |
| Compensation and benefits  | (5)                                 | (4)         | (1)              | (25)%           |
| General and administrative   | (2)                                 | (2)         |                  | NM              |
| Other, net   |                                     |             |                  | NM              |
| Income (loss) in equity method investments                             | 1                                   |             | 1                | 100%            |
| <b>Other Expenses, net</b>   | <b>(6)</b>                          | <b>(6)</b>  |                  | <b>NM</b>       |
| Net income before income tax   | 3                                   | 2           | 1                | 50%             |
| Income tax (expense) benefit   |                                     |             |                  | NM              |
| <b>Net Income</b>  | <b>\$ 3</b>                         | <b>\$ 2</b> | <b>\$ 1</b>      | <b>50%</b>      |

\*NM Percentage change is not meaningful.

## **Table of Contents**

Net income increased by approximately \$1 million as a result of a \$1 million increase in total revenue, net of investment interest expense and provision. These results do not include the Non-GAAP Core Earnings adjustment related to recognizing income based on the effective interest methodology in order to treat our wind equity investments in a manner similar to our other investments, which is discussed in the Non-GAAP Financial Measures section below.

Interest Income, Financing Receivables increased by \$3 million due to an increase in average size of the financing receivables in the Portfolio from \$0.6 billion in the three months ended March 31, 2015 to \$0.9 billion in the same period in 2016.

Rental income grew by \$1 million due to an increase in average investment in real estate from \$0.1 billion in the three months ended March 31, 2015 to \$0.2 billion in the same period in 2016

Gain on sale of receivables and investments grew by \$2 million due to an increase in securitization activity and the gain on the realization of a debt security.

The increase in revenue was offset by \$5 million of higher interest expense due to higher fixed rate debt. Interest expense for 2016 includes approximately \$4 million of interest expense related to \$225 million of nonrecourse loans for our wind equity investments as compared to interest expense of approximately \$2 million in the same period in 2015 on borrowings of approximately \$115 million. See the Non-GAAP Financial Measures section below for more information.

Other expenses, net were nearly unchanged as an increase in compensation and benefits due to higher staffing costs was offset by the income in equity method investments.

## **Non-GAAP Financial Measures**

We consider the following non-GAAP financial measures useful to investors as key supplemental measures of our performance: (1) core earnings, (2) managed assets and (3) investment income from managed assets. These non-GAAP financial measures should be considered along with, but not as alternatives to, net income or loss as measures of our operating performance. These non-GAAP financial measures, as calculated by us, may not be comparable to similarly named financial measures as reported by other companies that do not define such terms exactly as we define such terms.

### ***Core Earnings***

We calculate Core Earnings as U.S. GAAP net income excluding non-cash equity compensation expense, non-cash provision for credit losses, amortization of intangibles, one-time acquisition related costs, if any and any non-cash tax charges. We also make an adjustment to account for our equity method investments in the wind projects on an effective interest method as described below. In the future, Core Earnings may also exclude one-time events pursuant to changes in U.S. GAAP and certain other non-cash charges as approved by a majority of our independent directors.





---

**Table of Contents**

Our equity method investments in the wind projects are structured using typical wind partnership flip structures where we, along with other institutional investors, if any, receive a pre-negotiated preferred return consisting of priority distributions from the project cash flows along with tax attributes. Once this preferred return is achieved, the partnership flips and the wind energy company, which operates the project, receives the majority of the cash flows through its equity interests with the institutional investors retaining an ongoing residual interest. Given this structure, we negotiated our purchase price of our wind investments based on our assessment of the expected cash flows from each investment discounted back to net present value based on a discount rate that represented an expected yield on the investment. This is similar to how we value the expected cash flows in financing receivables. Under U.S. GAAP, we are required to account for these investments utilizing the hypothetical liquidation at book value method ( HLBV ), in which we recognize income or loss based on the change in the amount each partner would receive if the assets were liquidated at book value, in this case, at the end of the immediately preceding quarter after adjusting for any distributions or contributions made during such quarter. As HLBV incorporates non-cash items, such as depreciation, and because we are entitled to receive a preferred return of cash flows on our investments independent of how profits and losses are allocated, the HLBV allocation does not, in our opinion, reflect the economics of our investments. As a result, and in an attempt to treat these investments in a manner similar to our other investments and our initial valuation, in calculating Core Earnings for the above periods, we adjusted the income we receive from these investments as if we were recognizing income or loss based on an effective interest methodology. Generally, under this methodology income is recognized over the life of the asset using a constant effective yield. The initial constant effective yield we selected is equal to the discount rates we determined when making our investment decisions. On at least a quarterly basis, we will review and, if appropriate, adjust the discount rates and the income or loss we receive from these investments for purposes of calculating Core Earnings in future periods, as necessary, to reflect changes in both actual cash flows received and our estimates of the future cash flows from the projects. Our allocation of profits and losses in our JPMorgan transactions is projected to change in 2019, which is expected to result in an increase of the amount of HLBV profits or losses allocated to us.

We have borrowed approximately \$225 million on a nonrecourse basis as of March 31, 2016, using our equity method investments as collateral. Included in our U.S. GAAP investment interest expense for the three months ended March 31, 2016, was approximately \$4 million of interest expense related to these nonrecourse loans. For the three months ended March 31, 2016, we collected cash distributions from our wind investments of approximately \$16 million, of which \$7 million represents our Core Earnings adjustment for these investments based upon the effective yield methodology discussed above.

We believe that Core Earnings provides an additional measure of our core operating performance by eliminating the impact of certain non-cash expenses and facilitating a comparison of our financial results to those of other comparable REITs with fewer or no non-cash charges and comparison of our own operating results from period to period. Our management uses Core Earnings in this way. We believe that our investors also use Core Earnings, or a comparable supplemental performance measure, to evaluate and compare our performance to that of our peers, and as such, we believe that the disclosure of Core Earnings is useful to (and expected by) our investors.

However, Core Earnings does not represent cash generated from operating activities in accordance with U.S. GAAP and should not be considered as an alternative to net income (determined in accordance with U.S. GAAP), or an indication of our cash flow from operating activities (determined in accordance with U.S. GAAP), a measure of our liquidity, or an indication of funds available to fund our cash needs, including our ability to make cash distributions. In addition, our methodology for calculating Core Earnings may differ from the methodologies employed by other REITs to calculate the same or similar supplemental performance measures, and accordingly, our reported Core Earnings may not be comparable to the core earnings reported by other REITs.

We have calculated our Core Earnings for the three months ended March 31, 2016 and March 31, 2015. The table below provides a reconciliation of our U.S. GAAP net income to Core Earnings:

|   | Three Months Ended March 31,<br>2016 |                | 2015            |                |
|---|--------------------------------------|----------------|-----------------|----------------|
|   | \$                                   | Per Share      | \$              | Per Share      |
| Net income attributable to controlling shareholders     | \$ 3,169                             | \$ 0.07        | \$ 2,122        | \$ 0.07        |
| Core Earnings Adjustments                               |                                      |                |                 |                |
| Equity method investments in Wind Projects              | 6,641                                |                | 2,883           |                |
| Non-cash equity-based compensation charge               | 2,008                                |                | 2,201           |                |
| Amortization of real estate intangibles                 | 299                                  |                | 149             |                |
| Amortization of other intangibles                       | 51                                   |                | 50              |                |
| Non-cash provision/ (benefit) for taxes                 |                                      |                | (27)            |                |
| Current year earnings attributable to minority interest | 28                                   |                | 25              |                |
| <b>Core Earnings<sup>(1)</sup></b>                      | <b>\$ 12,196</b>                     | <b>\$ 0.32</b> | <b>\$ 7,403</b> | <b>\$ 0.27</b> |

- (1) Core Earnings per share is based on 38,591,182 shares for the three months ended March 31, 2016 and 27,774,980 shares for the three months ended March 31, 2015, which represents the weighted average number of fully-diluted shares outstanding including participating securities and the minority interest in our Operating Partnership.

**Table of Contents*****Managed Assets and Investment Income from Managed Assets***

As we both consolidate assets on our balance sheet and securitize investments, certain of our financing receivables and other assets are not reflected on our balance sheet where we may have a residual interest in the performance of the investment. Thus, we also calculate both our investments and our investment revenue on a non-GAAP managed basis, which assumes that securitized financing receivables are not sold, with the effect that the income from securitized financing receivables are included in our revenue in the same manner as the income from financing receivables that we consolidated on our balance sheet. We believe that our managed asset and revenue information is useful to investors because it portrays the results of both on- and off-balance sheet financing receivables that we manage, which enables investors to understand and evaluate the credit performance associated with the portfolio of financing receivables and investments reported on our consolidated balance sheet and our retained interests in securitized financing receivables. Our non-GAAP managed assets and revenue measures may not be comparable to similarly titled measures used by other companies.

The following is a reconciliation of our U.S. GAAP Portfolio to our managed assets as of March 31, 2016 and December 31, 2015 and our U.S. GAAP income from our Portfolio (excluding our equity investments) to our investment revenue from managed assets for the three months ended March 31, 2016 and 2015:

|  | <b>March 31,<br/>2016</b>           | <b>As of<br/>December 31,<br/>2015</b> |
|--|-------------------------------------|--|
|  | <i>(dollars in millions)</i>        |  |
| Financing receivables  | \$ 819                              | \$ 784                                 |
| Financing receivables held-for-sale                          | 42                                  | 60                                     |
| Investments  | 37                                  | 29                                     |
| Real estate  | 163                                 | 156                                    |
| Equity method investments in affiliates                      | 304                                 | 319                                    |
| Assets held in securitization trusts                         | 1,856                               | 1,840                                  |
| <b>Managed Assets</b>  | <b>\$ 3,221</b>                     | <b>\$ 3,188</b>                        |
| <br>Credit losses as a percentage of assets under management | <br>0.0%                            | <br>0.0%                               |
|  | <b>Three Months ended March 31,</b> |  |
|  | <b>2016</b>                         | <b>2015</b>                            |
|  | <i>(dollars in millions)</i>        |  |
| Interest income, financing receivables                       | \$ 11                               | \$ 8                                   |
| Interest income, investments                                 | 1                                   | 1                                      |
| Rental income  | 3                                   | 2                                      |
| Income from assets held in securitization trusts             | 24                                  | 24                                     |
| <b>Investment Revenue from Managed Assets</b>                | <b>\$ 39</b>                        | <b>\$ 35</b>                           |

**Liquidity and Capital Resources**

Liquidity is a measure of our ability to meet potential short term (within one year) and long term cash requirements, including ongoing commitments to repay borrowings, fund and maintain our current and future assets, make distributions to our stockholders and other general business needs. We will use significant cash to make debt and equity investments, repay principal and interest on our borrowings, make distributions to our stockholders and fund our operations.

- 32 -

## **Table of Contents**

We use borrowings as part of our financing strategy to increase potential returns to our stockholders and have available to us a broad range of financing sources. In July 2013, we entered into a \$350 million senior secured revolving credit facility with maximum total advances of \$700 million. Since that time, we have entered into a number of amendments intended to increase the flexibility and borrowing capability under the credit facility and to extend the maturity date. The facility has been increased to \$500 million with maximum total advances of \$1.5 billion and the facility was extended an additional year and matures in July 2019.

In addition, we have completed approximately \$610 million of nonrecourse borrowings since April 2013, including approximately \$395 million in 2015. We have worked to expand our liquidity and access to the debt and bank loan markets and in 2015, entered into borrowing relationships with three new lenders and with several institutional investors through our \$101 million issuance of HASI Sustainable Yield Bonds in 2015. We believe that our 2013 financing was one of the first asset-backed securitizations that provided details on GHG saved by the technologies that secured the financing. We believe that investors will increasingly be interested in debt investments that have a measurable GHG savings.

We have also finance our business through fixed rate nonrecourse debt where the debt was match-funded with corresponding fixed rate yielding assets and through the use of non-consolidated securitizations. In our securitization transactions, we transfer the loans or other assets we originate to securitization trusts or other bankruptcy remote special purpose funding vehicles. Large institutional investors, primarily insurance companies and commercial banks, have provided the financing needed for these assets by purchasing the notes issued by the funding vehicle.

We continue to use both of these funding sources and, as of March 31, 2016, had outstanding approximately \$94 million of this match funded debt, all of which was consolidated on to our balance sheet and is referred to as Other nonrecourse debt in our balance sheet. As of March 31, 2016, the outstanding principal balance of our assets financed through the use of securitizations which are not consolidated on our balance sheet was approximately \$1.8 billion. For further information on the credit facility, asset backed nonrecourse notes, securitizations and our nonrecourse match funded debt, see Note 5, 7 and 8 to our financial statements of this Form 10-Q.

We plan to use other fixed and floating rate borrowings in the form of additional bank credit facilities (including term loans and revolving facilities), warehouse facilities, repurchase agreements and public and private equity and debt issuances, including match funded arrangements, as a means of financing our business. We also expect to use both on-balance sheet and non-consolidated securitizations and also believe we will be able to customize securitized tranches to meet investment preferences of different investors. We may also consider the use of separately funded special purpose entities or funds to allow us to expand the investments that we make.

The decision on how we finance specific assets or groups of assets is largely driven by capital allocations and risk and portfolio management considerations, as well as the overall interest rate environment, prevailing credit spreads and the terms of available financing and market conditions. Over time, as market conditions change, we may use other forms of leverage in addition to these financings arrangements.

We may continue to raise funds through capital market transactions by issuing capital stock. We have raised net proceeds of approximately \$470 million including \$181 million in two follow on public offerings completed in 2015. See our 2015 Form 10-K for a summary of our public offerings of common stock.

In August 2014, we filed a registration statement with the SEC registering the possible offering and sale of up to \$500 million of any combination of our common stock, preferred stock, depositary shares and warrants and rights (collectively referred to as the securities. ) that has been declared effective by the SEC. We may offer the securities directly, through agents, or to or through underwriters. Sales of the securities may be made by means of ordinary

brokers transactions on the NYSE or otherwise at market prices prevailing at the time of sale or at negotiated prices. The specific terms of the securities offering and the names of any underwriters involved in the sale of the securities will be set forth in the applicable prospectus supplement.

Although we are not restricted by any regulatory requirements to maintain our leverage ratio at or below any particular level, the amount of leverage we may deploy for particular assets will depend upon the availability of particular types of financing and our assessment of the credit, liquidity, price volatility and other risks of those

**Table of Contents**

assets, the interest rate environment and the credit quality of our financing counterparties. In March 2015, we increased our leverage target to 2.5 to 1 from less than 2.0 to 1. Our debt to equity ratio was approximately 2.3 to 1 as of March 31, 2016. We also have increased the percentage of fixed rate debt from zero at the IPO to approximately 66% as of March 31, 2016, or near the upper end of our targeted fixed rate debt percentage range of approximately 50% to 70%. The calculation of our debt at fixed rates and leverage is shown in the chart below:

|                          | March 31, 2016<br>(\$ in millions) | % of Total  |
|--------------------------|------------------------------------|-------------|
| Floating-Rate Borrowings | \$ 333                             | 34%         |
| Fixed-Rate debt          | \$ 635                             | 66%         |
| <b>Total Debt(1)</b>     | <b>\$ 968</b>                      | <b>100%</b> |
| Equity                   | \$ 424                             |             |
| Leverage                 | 2.3 to 1                           |             |

- (1) Floating-Rate Borrowings include borrowings under our floating-rate Credit Facility and approximately \$11 million of nonrecourse debt that has not been hedged. Fixed-Rate debt includes the present notional value of nonrecourse debt that is hedged using interest rate swaps. Debt excludes securitizations that are not consolidated on our balance sheet (where the collateral is typically borrowings with U.S. government obligors)

We intend to use leverage for the primary purpose of financing our portfolio and business activities and not for the purpose of speculating on changes in interest rates. While we may temporarily exceed the leverage target, if our board of directors approves a material change to our leverage target, we anticipate advising our stockholders of this change through disclosure in our periodic reports and other filings under the Exchange Act.

While we generally intend to hold our target assets that we do not securitize upon acquisition as long term investments, certain of our investments may be sold in order to manage our interest rate risk and liquidity needs, to meet other operating objectives and to adapt to market conditions. The timing and impact of future sales of financings, if any, cannot be predicted with any certainty. Since we expect that our assets will generally be financed, we expect that a significant portion of the proceeds from sales of our assets (if any), prepayments and scheduled amortization will be used to repay balances under our financing sources.

We believe these identified sources of liquidity will be adequate for purposes of meeting our short term and long term liquidity needs, which include funding future investments, operating costs and distributions to our stockholders. To qualify as a REIT, we must distribute annually at least 90% of our REIT's taxable income without regard to the deduction for dividends paid and excluding net capital gains. These dividend requirements limit our ability to retain earnings and thereby replenish or increase capital for growth and our operations.

**Sources and Uses of Cash**

We had approximately \$27 million and \$43 million of unrestricted cash and cash equivalents as of March 31, 2016 and December 31, 2015, respectively.





## **Table of Contents**

### ***Cash Flows Relating to Operating Activities***

Net cash provided by operating activities was approximately \$10 million for three months ended March 31, 2016, driven primarily by net income of \$3 million, adjustments for noncash items of \$4 million, consisting primarily of equity-based compensation and depreciation and amortization and cash inflows, from the net changes of approximately \$1 million related to the sale of financing receivables and investments (including the change in financing receivables held-for-sale) and approximately \$2 million from changes in accounts payable and accrued expenses and other.

Net cash provided by operating activities was \$15 million for the three months ended March 31, 2015, driven primarily by the sale of financing receivables held-for-sale of \$15 million and net income of \$2 million, offset by cash used to pay accounts payable and accrued expenses and other of \$2 million. Depreciation and equity based compensation were offset by other adjustments.

### ***Cash Flows Relating to Investing Activities***

Net cash used in investing activities was approximately \$44 million for three months ended March 31, 2016. We used \$89 million to purchase financing receivables and investments, \$7 million to purchase real estate, and made an additional \$2 million investment in our wind equity investments. We received \$29 million from the sale of financing receivables and investments and cash distributions from our investment in our wind projects of \$16 million. In addition, we collected cash from principal payments on our financing receivables and investments of \$9 million.

Net cash provided by investing activities was \$24 million for the three months ended March 31, 2015. We collected cash from principal payments on and sales of our financing receivables and investments of \$47 million. In addition, we received cash distributions from our investment in our wind projects of \$6 million and \$15 million from the sale of financing receivable and investments. These cash inflows were partially offset by investments added to our Portfolio of \$41 million, which includes purchases of financing receivables and investments of approximately \$25 million and real estate assets of approximately \$16 million. In addition, there was a \$3 million change in other investing activities, which consist primarily of restricted cash.

### ***Cash Flows Relating to Financing Activities***

Net cash provided by financing activities was approximately \$18 million for the three months ended March 31, 2016. This includes credit facility proceeds of \$90 million that were partially offset by payments to reduce our borrowings under the credit facility, deferred funding obligations, and nonrecourse debts totaling \$60 million and the payment of dividends and a change in other financing activity cash outflows of \$12 million.

Net cash used in financing activities was \$32 million for the three months ended March 31, 2015. This includes payments to reduce our nonrecourse debt, credit facility and deferred funding obligations totaling \$71 million and the payment of dividends and distributions to our stockholders of \$7 million. These cash outflows were partially offset by nonrecourse debt and credit facility borrowings of \$46 million to finance investments in our Portfolio.

### ***Off-Balance Sheet Arrangements***

We have relationships with non-consolidated entities or financial partnerships, such as entities often referred to as structured investment vehicles, or special purpose or variable interest entities, established to facilitate the sale of securitized assets. Other than our securitization assets of approximately \$11 million as of March 31, 2016, that may be at risk in the event of defaults in our securitization trusts, we have not guaranteed any obligations of nonconsolidated

entities or entered into any commitment or intent to provide additional funding to any such entities. A more detailed description of our relations with non-consolidated entities can be found in Note 2 included in the notes to the condensed consolidated financial statements included in this Form 10-Q and as described under MD&A Critical Accounting Policies and Use of Estimates, in our 2015 Form 10-K, filed with the SEC.

- 35 -

## **Table of Contents**

### **Dividends**

U.S. federal income tax law generally requires that a REIT distribute annually at least 90% of its REIT taxable income, without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its REIT taxable income. Our current policy is to pay quarterly distributions, which on an annual basis will equal or exceed substantially all of our REIT taxable income. Any distributions we make will be at the discretion of our board of directors and will depend upon, among other things, our actual results of operations. These results and our ability to pay distributions will be affected by various factors, including the net interest and other income from our portfolio, our operating expenses and any other expenditures. In the event that our board of directors determines to make distributions in excess of the income or cash flow generated from our assets, we may make such distributions from the proceeds of future offerings of equity or debt securities or other forms of debt financing or the sale of assets. To the extent that in respect of any calendar year, cash available for distribution is less than our taxable income, we could be required to sell assets or borrow funds to make cash distributions or make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities. We will generally not be required to make distributions with respect to activities conducted through our domestic TRS.

We anticipate that our distributions generally will be taxable as ordinary income to our stockholders, although a portion of the distributions may be designated by us as qualified dividend income or capital gain or may constitute a return of capital. In addition, a portion of such distributions may be taxable stock dividends payable in our shares. We will furnish annually to each of our stockholders a statement setting forth distributions paid during the preceding year and their characterization as ordinary income, return of capital, qualified dividend income or capital gain.

The dividends declared in 2015 and 2016 are described under Note 11 to our financial statements in this Form 10-Q.

### **Book Value Considerations**

As of March 31, 2016, we carried only our investments available-for-sale, interest rate swaps and retained assets in securitized receivables at fair value on our balance sheet. As a result, in reviewing our book value, there are a number of important factors and limitations to consider. Other than the approximately \$37 million in investments available-for-sale, approximately \$4 million liability for interest rate swaps and the \$10 million in residual assets relating to our retained interests in securitized receivables that are on our balance sheet at fair value as of March 31, 2016, the carrying value of our remaining assets and liabilities are calculated as of a particular point in time, which is largely determined at the time such assets and liabilities were added to our balance sheet using a cost basis in accordance with U.S. GAAP. As such, our remaining assets and liabilities do not incorporate other factors that may have a significant impact on their value, most notably any impact of business activities, changes in estimates, or changes in general economic conditions or interest rates since the dates the assets or liabilities were initially recorded. Accordingly, our book value does not necessarily represent an estimate of our net realizable value, liquidation value or our market value as a whole.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

#### **Quantitative and Qualitative Disclosures About Market Risk**

We anticipate that our primary market risks will be related to commodity prices, the credit quality of our counterparties and project companies, market interest rates and the liquidity of our assets. We will seek to manage these risks while, at the same time, seeking to provide an opportunity to stockholders to realize attractive returns through ownership of our common stock.

***Credit Risks***

We source and identify quality opportunities within our broad areas of expertise and apply our rigorous underwriting processes to our transactions, which, we believe, will generally enable us to minimize our credit losses and keep financing costs low. While we do not anticipate facing significant credit risk in our financings related to U.S. federal government energy efficiency projects, we are subject to varying degrees of credit risk in these projects in relation to guarantees provided by ESCOs where payments under energy savings performance contracts are contingent upon achieving pre-determined levels of energy savings. We are also exposed to credit risk in projects including those projects we have under long-term lease arrangements that do not benefit from the U.S. federal government as obligor. We increasingly target such projects as part of our strategy. In the case of various renewable energy and sustainable infrastructure projects, we will also be exposed to the credit risk of the obligor of the project's power purchase agreement or other long-term contractual revenue commitments. We may encounter enhanced credit risk as we expect that over time our strategy will increasingly include mezzanine debt, real estate and equity investments. We seek to manage credit risk thorough due diligence and underwriting processes, strong structural protections in our transaction agreements with customers and continual, active asset management and portfolio monitoring. Nevertheless, unanticipated credit losses could occur and during periods of economic downturn in the global economy, our exposure to credit risks from obligors increases, and our efforts to monitor and mitigate the associated risks may not be completely effective in reducing our credit risks.

**Table of Contents**

***Interest Rate and Borrowing Risks***

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control.

We are subject to interest rate risk in connection with new asset originations and our credit facility, and in the future, will be subject to interest rate risk for any new floating or inverse floating rate assets and credit facilities. Because short-term borrowings are generally short-term commitments of capital, lenders may respond to market conditions, making it more difficult for us to secure continued financing. If we are not able to renew our then existing facilities or arrange for new financing on terms acceptable to us, or if we default on our covenants or are otherwise unable to access funds under any of these facilities, we may have to curtail entering into new transactions and/or dispose of assets. We face particular risk in this regard given that we expect many of our borrowings will have a shorter duration than the assets they finance. Increasing interest rates may reduce the demand for our investments while declining interest rates may increase the demand. Both our current and future credit facilities may be of limited duration and are periodically refinanced at then current market rates. We expect to attempt to reduce interest rate risks and to minimize exposure to interest rate fluctuations through the use of match funded or fixed rate financing structures, when appropriate, whereby we may seek (1) to match the maturities of our debt obligations with the maturities of our assets, (2) to borrow at fixed rates for a period of time, like in our asset backed securitizations, or (3) to match the interest rates on our assets with like-kind debt (i.e., we may finance floating rate assets with floating rate debt and fixed-rate assets with fixed-rate debt), directly or through the use of interest rate swap agreements, interest rate cap agreements or other financial instruments, or through a combination of these strategies. We expect these instruments will allow us to minimize, but not eliminate, the risk that we have to refinance our liabilities before the maturities of our assets and to reduce the impact of changing interest rates on our earnings. In addition to the use of traditional derivative instruments, we also seek to mitigate interest rate risk by using securitizations, syndications and other techniques to construct a portfolio with a staggered maturity profile. We monitor the impact of interest rate changes on the market for new originations and often have the flexibility to increase the term of the project to offset interest rate increases.

Our nonrecourse debt is at fixed rates or we have used interest rate hedges which convert the floating rate to fixed rate as described in Note 8 to our financial statements in this Form 10-Q. Changes in market rates impact the fair value of the fixed rate debt but have no impact on our consolidated financial statements, other than the fair value change of our interest rate hedges which should be offset by a corresponding change in the value of the debt. If interest rates rise, and our fixed debt balance remains constant, we expect the fair value of our debt to decrease and the value of our hedge to increase. See Note 3 to our financial statements in this Form 10-Q for the estimated fair value of our fixed rate nonrecourse debt, which is based on having the same debt service requirements that could have been borrowed at the date presented, at prevailing current market interest rates.

Our credit facility is a variable rate loan with approximately \$322 million outstanding as of March 31, 2016 and we have approximately \$11 million of variable rate exposure under our nonrecourse debt. Significant increases in interest rates would result in higher interest expense while decreases in interest rates would result in lower interest expense. As described above, we may use various financing techniques including interest rate swap agreements, interest rate cap agreements or other financial instruments, or a combination of these strategies to mitigate the variable interest nature of this facility. A 50 basis point increase in LIBOR would increase the quarterly interest expense related to the \$333 million in variable rate borrowings by \$0.4 million. Such hypothetical impact of interest rates on our variable rate borrowings does not consider the effect of any change in overall economic activity that could occur in a rising interest rate environment. Further, in the event of such a change in interest rates, we may take actions to further mitigate our exposure to such a change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the analysis assumes no changes in our financial structure.



## **Table of Contents**

We record our retained assets at fair value in our financial statements and any changes in the discount rate would impact the value of these assets. See Note 3 to our financial statements in this Form 10-Q.

### ***Liquidity and Concentration Risk***

The assets that comprise our asset portfolio are not and will not be publicly traded. A portion of these assets may be subject to legal and other restrictions on resale or will otherwise be less liquid than publicly-traded securities. The illiquidity of our assets may make it difficult for us to sell such assets if the need or desire arises, including in response to changes in economic and other conditions. Our projects typically have one obligor and thus we are subject to concentration risk and could incur significant losses if any of these projects perform poorly or if we are required to write down the value of any these projects. See also [Credit Risks](#) above.

### ***Commodity Price Risk***

When we provide debt or equity for a project that acts as a substitute for an underlying commodity we are exposed to volatility in prices for that commodity. For example, the performance of renewable energy projects that produce electricity can be impacted by volatility in the market prices of various forms of energy, including electricity, coal and natural gas. This is especially true for utility scale projects that sell power on a wholesale basis like many of our wind projects as opposed to distributed renewable projects or energy efficiency projects which compete against the retail or delivered costs of electricity which includes the cost of transmitting and distributing the electricity to the end user.

Although we generally focus on renewable energy projects that have the majority of their operating cash flow supported by long term PPAs, ranging from 10 to 30 years, to the extent that the projects have shorter term contracts (which may have the potential of producing higher current returns) or sell their power in the open market on a merchant basis, the cash flows of such projects, and thus the repayment of, or the returns available for, our assets, may be subject to risk if energy prices change. We also mitigate our exposure through structural protections. These structural protections, which are typically in the form of a preferred return, are design to allow recovery of our capital and an acceptable return over time. When structuring and underwriting these transactions, we evaluate these transactions using a variety of scenarios, including natural gas prices remaining low for an extended period of time. In the case of utility scale solar projects, we focus on owning the land under the project where our rent is paid out of project operational costs before the debt or equity in the project receives any payments.

We believe the current low prices in natural gas will increase demand for some types of our projects, such as combined heat and power, but may reduce the demand for other projects such as renewable energy that may be a substitute for natural gas. We seek to structure our energy efficiency financings so that we typically avoid exposure to commodity price risk. However, volatility in energy prices may cause building owners and other parties to be reluctant to commit to projects for which repayment is based upon a fixed monetary value for energy savings that would not decline if the price of energy declines.

### ***Risk Management***

Our ongoing active asset management and portfolio monitoring processes provide investment oversight and valuable insight into our origination, underwriting and structuring processes. These processes create value through active monitoring of the state of our markets, enforcement of existing contracts and real-time receivables management. Subject to maintaining our qualification as a REIT, and as described above, we engage in a variety of interest rate management techniques that seek to mitigate the economic effect of interest rate changes on the values of, and returns on, some of our assets. While there have been only two incidents of credit loss, amounting to approximately \$18 million (net of recoveries) on the more than \$5 billion of transactions we originated since 2000, which represents an



aggregate loss of less than approximately 0.4% on cumulative transactions originated over this time period, there can be no assurance that we will continue to be as successful, particularly as we invest in more credit sensitive assets or more equity positions and engage in increasing numbers of transactions with obligors other than U.S. federal government agencies.

**Table of Contents**

We seek to manage credit risk using thorough due diligence and underwriting processes, strong structural protections in our loan agreements with customers and continual, active asset management and portfolio monitoring.

**Item 4. Controls and Procedures**

The Company's Chief Executive Officer and Chief Financial Officer, based on their evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, have concluded that as of March 31, 2016, the Company's disclosure controls and procedures were effective to give reasonable assurances to the timely collection, evaluation and disclosure of information relating to the Company that would potentially be subject to disclosure under the Exchange Act and the rules and regulations promulgated thereunder.

Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in our periodic reports.

***Changes in Internal Controls over Financial Reporting***

There have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the three month period ended March 31, 2016, that have materially affected, or was reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

The nature of our operations exposes us to the risk of claims and litigation in the normal course of our business. Other than non-material litigation arising out of the ordinary course of business, we are not currently subject to any legal proceedings that are probable of having a material adverse effect on our financial position, results of operations or cash flows.

**Item 1A. Risk Factors**

For a discussion of our potential risks and uncertainties, see the information in Item 1A. Risk Factors of our 2015 Form 10-K, filed with the SEC, which is accessible on the SEC's website at [www.sec.gov](http://www.sec.gov).

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds*****Purchases of Equity Securities***

During the three months ended March 31, 2016, certain of our employees surrendered common stock owned by them to satisfy their statutory minimum federal and state tax obligations associated with the vesting of their restricted stock awards. No OP units were exchanged for shares of common stock during the three months ended March 31, 2016.

The table below summarizes all of our repurchases of common stock during 2016. The number of shares purchased represents shares of common stock surrendered by certain of our employees to satisfy their minimum tax and other compensation related withholdings associated with the vesting of restricted stock. The price paid per share is based on the closing price of our common stock as of the date of the withholding.

| Period        | Total number of shares purchased | Average price per share | Total number of shares                                    |  |
|---------------|----------------------------------|-------------------------|---|--|
|               |                                  |                         | purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
| January 2016  | N/A                              | N/A                     | N/A   | N/A  |
| February 2016 | 413                              | \$ 17.49                | N/A   | N/A  |
| March 2016    | 8,991                            | \$ 18.06                | N/A   | N/A  |

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

- 40 -

**Table of Contents****Item 6. Exhibits**

| <b>Exhibit number</b> | <b>Exhibit description</b>  |
|-----------------------|---|
| 3.1                   | Articles of Amendment and Restatement of Hannon Armstrong Sustainable Infrastructure Capital, Inc. (incorporated by reference to Exhibit 3.1 to the Registrant's Form 10-Q for the quarter ended June 30, 2013 (No. 001-35877), filed on August 9, 2013)                  |
| 3.2                   | Bylaws of Hannon Armstrong Sustainable Infrastructure Capital, Inc. (incorporated by reference to Exhibit 3.2 to the Registrant's Form 10-Q for the quarter ended June 30, 2013 (No. 001-35877), filed on August 9, 2013)   |
| 3.3                   | Amended and Restated Agreement of Limited Partnership of Hannon Armstrong Sustainable Infrastructure, L.P. (incorporated by reference to Exhibit 3.3 to the Registrant's Form 10-Q for the quarter ended June 30, 2013 (No. 001-35877), filed on August 9, 2013)          |
| 4.1                   | Specimen Common Stock Certificate of Hannon Armstrong Sustainable Infrastructure Capital, Inc. (incorporated by reference to Exhibit 4.1 to the Registrant's Form S-11 (No. 333-186711), filed on April 12, 2013)   |
| 10.1                  | Amendment No. 5 to Amended and Restated Loan Agreement (G&I) and Amendment No. 4 to Amended & Restated Intercreditor Agreement, dated January 25, 2016 (incorporated by reference to Exhibit 1.1 to the Registrant's Form 8-K (No. 001-35877), filed on January 29, 2016) |
| 10.2                  | Amendment No. 5 to Amended and Restated Loan Agreement (PF), dated January 25, 2016 (incorporated by reference to Exhibit 1.2 to the Registrant's Form 8-K (No. 001-35877), filed on January 29, 2016)  |
| 10.3                  | Reaffirmation of Guaranty (G&I), dated January 25, 2016 (incorporated by reference to Exhibit 1.3 to the Registrant's Form 8-K (No. 001-35877), filed on January 29, 2016)  |
| 10.4                  | Reaffirmation of Guaranty (PF), dated January 25, 2016 (incorporated by reference to Exhibit 1.4 to the Registrant's Form 8-K (No. 001-35877), filed on January 29, 2016)   |
| 31.1*                 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 31.2*                 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 32.1**                | Certification of Chief Executive Officer pursuant to section 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002  |
| 32.2**                | Certification of Chief Financial Officer pursuant to section 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002  |
| 101.INS               | XBRL Instance Document  |
| 101.SCH               | XBRL Taxonomy Extension Schema  |
| 101.CAL               | XBRL Taxonomy Extension Calculation Linkbase  |
| 101.DEF               | XBRL Taxonomy Extension Definition Linkbase   |
| 101.LAB               | XBRL Taxonomy Extension Label Linkbase  |

101 PRE XBRL Taxonomy Extension Presentation Linkbase

\* Filed herewith.

\*\* Furnished herewith.

- 41 -

Table of Contents

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**HANNON ARMSTRONG SUSTAINABLE  
INFRASTRUCTURE CAPITAL, INC.**

(Registrant)

Date: May 9, 2016

/s/ Jeffrey W. Eckel

Jeffrey W. Eckel  
Chairman, Chief Executive Officer and President

Date: May 9, 2016

/s/ J. Brendan Herron

J. Brendan Herron  
Chief Financial Officer and Executive Vice  
President  
(Duly Authorized Officer and Chief  
Accounting Officer)