

Sunrun Inc.
Form 10-Q
August 07, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

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

Commission File Number: 001-37511

Sunrun Inc.
(Exact name of registrant as specified in its charter)

Delaware 26-2841711
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

595 Market Street, 29th Floor
San Francisco, California 94105
(Address of principal executive offices and Zip Code)

(415) 580-6900
(Registrant's telephone number, including area code)

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, a smaller reporting company, or an emerging growth company. See the definition of "large accelerated filer", "accelerated

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filer”, “smaller reporting company”, and “emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of August 3, 2017, the number of shares of the registrant’s common stock outstanding was 106,161,704.

Table of Contents

	Page
Item 1	<u>2</u>
<u>Financial Statements (Unaudited)</u>	
<u>Consolidated Balance Sheets</u>	<u>2</u>
<u>Consolidated Statements of Operations</u>	<u>4</u>
<u>Consolidated Statements of Comprehensive Income</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements</u>	<u>7</u>
Item 2.	<u>25</u>
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
Item 3.	<u>40</u>
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	
Item 4.	<u>40</u>
<u>Controls and Procedures</u>	
 <u>PART II – OTHER INFORMATION</u>	
Item 1.	<u>40</u>
<u>Legal Proceedings</u>	
Item 1A.	<u>40</u>
<u>Risk Factors</u>	
Item 2.	<u>67</u>
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	
Item 5.	<u>68</u>
<u>Other Information</u>	
Item 6.	<u>68</u>
<u>Exhibits</u>	
<u>Signatures</u>	<u>69</u>

Sunrun Inc.
Consolidated Balance Sheets
(In Thousands, Except Share Par Values)

	June 30, 2017 (Unaudited)	December 31, 2016
Assets		
Current assets:		
Cash	\$211,321	\$206,364
Restricted cash	15,672	11,882
Accounts receivable (net of allowances for doubtful accounts of \$1,550 and \$1,166 as of June 30, 2017 and December 31, 2016, respectively)	64,030	60,258
State tax credits receivable	—	13,713
Inventories	52,744	67,326
Prepaid expenses and other current assets	12,575	9,802
Total current assets	356,342	369,345
Restricted cash	5,952	6,117
Solar energy systems, net	2,951,260	2,629,366
Property and equipment, net	41,774	48,471
Intangible assets, net	16,397	18,499
Goodwill	87,543	87,543
Prepaid tax asset	—	378,541
Other assets	29,834	34,936
Total assets ⁽¹⁾	\$3,489,102	\$3,572,818
Liabilities and total equity		
Current liabilities:		
Accounts payable	\$75,336	\$66,018
Distributions payable to noncontrolling interests and redeemable noncontrolling interests	13,212	10,654
Accrued expenses and other liabilities	52,961	59,261
Deferred revenue, current portion	70,601	70,849
Deferred grants, current portion	8,363	8,011
Capital lease obligations, current portion	8,525	10,015
Recourse debt, current portion	247,000	—
Long-term non-recourse debt, current portion	18,883	14,153
Lease pass-through financing obligation, current portion	5,869	5,823
Total current liabilities	500,750	244,784
Deferred revenue, net of current portion	578,484	583,401
Deferred grants, net of current portion	222,184	226,893
Capital lease obligations, net of current portion	8,745	12,965
Recourse debt, net of current portion	—	244,000
Long-term non-recourse debt, net of current portion	761,349	639,870
Lease pass-through financing obligation, net of current portion	139,249	137,958
Other liabilities	10,682	5,457
Deferred tax liabilities	54,376	415,397
Total liabilities ⁽¹⁾	2,275,819	2,510,725
Commitments and contingencies (Note 13)		
Redeemable noncontrolling interests	163,077	137,907
Stockholders' equity:		

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Preferred stock, \$0.0001 par value—authorized, 200,000 shares as of June 30, 2017 and December 31, 2016; no shares issued and outstanding as of June 30, 2017 and December 31, 2016	—	—
Common stock, \$0.0001 par value—authorized, 2,000,000 shares as of June 30, 2017 and December 31, 2016; issued and outstanding, 105,940 and 104,321 shares as of June 30, 2017 and December 31, 2016, respectively	11	10
Additional paid-in capital	679,066	668,076
Accumulated other comprehensive income	(3,132) 437
Retained earnings	45,282	4,438
Total stockholders' equity	721,227	672,961
Noncontrolling interests	328,979	251,225
Total equity	1,050,206	924,186
Total liabilities, redeemable noncontrolling interests and total equity	\$3,489,102	\$3,572,818

The Company's consolidated assets as of June 30, 2017 and December 31, 2016 include \$2,379,224 and \$2,065,232, respectively, in assets of variable interest entities, or "VIEs", that can only be used to settle obligations of the VIEs. Solar energy systems, net, as of June 30, 2017 and December 31, 2016 were \$2,237,670 and \$1,920,330, respectively; cash as of June 30, 2017 and December 31, 2016 were \$108,039 and \$120,728, respectively; restricted cash as of June 30, 2017 and December 31, 2016 were \$3,574 and \$1,680, respectively; accounts receivable, net as of June 30, 2017 and December 31, 2016 were \$27,547 and \$20,771, respectively; prepaid expenses and other current assets as of June 30, 2017 and December 31, 2016 were \$235 and \$242, respectively and other assets as of June 30, 2017 and December 31, 2016 were \$2,159 and \$1,481, respectively. The Company's consolidated liabilities as of June 30, 2017 and December 31, 2016 include \$762,273 and \$617,011, respectively, in liabilities of VIEs whose creditors have no recourse to the Company. These liabilities include accounts payable as of June 30, 2017 and December 31, 2016 of \$22,196 and \$14,873, respectively; distributions payable to noncontrolling interests and redeemable noncontrolling interests as of June 30, 2017 and December 31, 2016 of \$13,213 and \$10,654, respectively; accrued expenses and other liabilities as of June 30, 2017 and December 31, 2016 of \$1,471 and \$782, respectively; deferred revenue as of June 30, 2017 and December 31, 2016 of \$444,103 and \$422,685, respectively; deferred grants as of June 30, 2017 and December 31, 2016 of \$106,933 and \$109,034, respectively; and long-term non-recourse debt as of June 30, 2017 and December 31, 2016 of \$172,020 and \$58,983, respectively.

The accompanying notes are an integral part of these consolidated financial statements.

Sunrun Inc.
Consolidated Statements of Operations
(In Thousands, Except Per Share Amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenue:				
Operating leases and incentives	\$65,337	\$45,394	\$113,435	\$79,934
Solar energy systems and product sales	72,511	77,144	128,530	141,347
Total revenue	137,848	122,538	241,965	221,281
Operating expenses:				
Cost of operating leases and incentives	47,114	38,608	91,450	76,708
Cost of solar energy systems and product sales	60,938	61,600	110,369	119,112
Sales and marketing	32,784	43,716	64,460	86,904
Research and development	3,710	2,373	6,706	4,836
General and administrative	25,230	23,614	49,851	46,862
Amortization of intangible assets	1,051	1,051	2,102	2,103
Total operating expenses	170,827	170,962	324,938	336,525
Loss from operations	(32,979)	(48,424)	(82,973)	(115,244)
Interest expense, net	16,602	13,063	31,879	24,578
Other expenses (income), net	208	30	683	(502)
Loss before income taxes	(49,789)	(61,517)	(115,535)	(139,320)
Income tax expense	15,453	3,210	22,791	3,210
Net loss	(65,242)	(64,727)	(138,326)	(142,530)
Net loss attributable to noncontrolling interests and redeemable noncontrolling interests	(90,364)	(97,370)	(176,175)	(188,307)
Net income available to common stockholders	\$25,122	\$32,643	\$37,849	\$45,777
Net income per share available to common stockholders				
Basic	\$0.24	\$0.32	\$0.36	\$0.45
Diluted	\$0.23	\$0.31	\$0.35	\$0.44
Weighted average shares used to compute net income per share available to common stockholders				
Basic	105,093	101,969	104,568	101,621
Diluted	107,347	104,768	106,911	104,494

The accompanying notes are an integral part of these consolidated financial statements.

Sunrun Inc.
 Consolidated Statements of Comprehensive Income
 (In Thousands)
 (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income attributable to common stockholders	\$25,122	\$32,643	\$37,849	\$45,777
Other comprehensive income:				
Unrealized loss on derivatives, net of income taxes	(3,709)	165	(4,473)	(5,633)
Less interest expense on derivatives recognized into earnings, net of income taxes	(340)	(120)	(904)	(645)
Comprehensive income	\$21,753	\$32,928	\$34,280	\$40,789

Sunrun Inc.

Consolidated Statements of Cash Flows

(In Thousands)

(Unaudited)

	Six Months Ended June 30,	
	2017	2016
Operating activities:		
Net loss	\$(138,326)	\$(142,530)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization, net of amortization of deferred grants	65,282	46,564
Deferred income taxes	22,788	3,210
Stock-based compensation expense	11,389	8,647
Noncash interest expense	9,481	5,335
Interest on lease pass-through financing obligations	5,949	6,019
Reduction in lease pass-through financing obligations	(9,162)	(9,491)
Other noncash losses and expenses	4,590	2,924
Changes in operating assets and liabilities:		
Accounts receivable	(4,215)	3,884
Inventories	14,582	(16,839)
Prepaid and other assets	(2,854)	(2,760)
Accounts payable	2,636	(9,889)
Accrued expenses and other liabilities	(11,283)	3,218
Deferred revenue	(4,314)	3,295
Net cash used in operating activities	(33,457)	(98,413)
Investing activities:		
Payments for the costs of solar energy systems, leased and to be leased	(356,726)	(332,472)
Purchases of property and equipment	(4,464)	(8,208)
Business acquisition, net of cash acquired	—	(5,000)
Net cash used in investing activities	(361,190)	(345,680)
Financing activities:		
Proceeds from state tax credits, net of recapture	13,171	9,123
Proceeds from issuance of recourse debt	91,400	257,400
Repayment of recourse debt	(88,400)	(212,000)
Proceeds from issuance of non-recourse debt	199,525	189,746
Repayment of non-recourse debt	(84,830)	(16,543)
Payment of debt fees	(4,955)	(12,277)
Proceeds from lease pass-through financing obligations	3,062	12,805
Contributions received from noncontrolling interests and redeemable noncontrolling interests	303,545	239,621
Distributions paid to noncontrolling interests and redeemable noncontrolling interests	(24,635)	(18,257)
(Payments) proceeds from exercises of stock options, net of withholding taxes on restricted stock units and issuance of shares in connection with the Employee Stock Purchase Plan	(425)	3,616
Offering costs paid related to initial public offering	—	(437)
Payment of capital lease obligations	(5,262)	(6,416)
Change in restricted cash	(2,592)	1,068
Net cash provided by financing activities	399,604	447,449
Net change in cash	4,957	3,356
Cash, beginning of period	206,364	203,864

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Cash, end of period	\$211,321	\$207,220
Supplemental disclosures of cash flow information		
Cash paid for interest	\$17,434	\$10,676
Cash paid for taxes	\$—	\$—
Supplemental disclosures of noncash investing and financing activities		
Purchases of solar energy systems and property and equipment included in accounts payable and accrued expenses	\$25,284	\$15,586
Purchases of solar energy systems included in non-recourse debt	\$12,873	\$—
Distributions payable to noncontrolling interests and redeemable noncontrolling interests	\$13,212	\$8,515
Vehicles acquired under capital leases	\$94	\$10,914

The accompanying notes are an integral part of these consolidated financial statements.

Sunrun Inc.
Notes to Consolidated Financial Statements
(Unaudited)

Note 1. Organization

Sunrun Inc. (“Sunrun” or the “Company”) was originally formed in 2007 as a California limited liability company and was converted into a Delaware corporation in 2008. The Company is engaged in the design, development, installation, sale, ownership and maintenance of residential solar energy systems (“Projects”) in the United States.

Sunrun acquires customers directly and through relationships with various solar and strategic partners (“Partners”). The Projects are constructed either by Sunrun or by Sunrun’s Partners and are owned by the Company. Sunrun’s customers enter into a power purchase agreement (“PPA”) or a lease (each, a “Customer Agreement”) which typically has a term of 20 years. Sunrun monitors, maintains and insures the Projects. The Company also sells solar energy systems and products, such as panels and racking and solar leads generated to customers.

The Company has formed various subsidiaries (“Funds”) to finance the development of Projects. These Funds, structured as limited liability companies, obtain financing from outside investors and purchase or lease Projects from Sunrun under master purchase or master lease agreements. The Company currently utilizes three legal structures in its investment Funds, which are referred to as: (i) lease pass-throughs, (ii) partnership-flips and (iii) joint venture (“JV”) inverted leases.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. As such, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s annual report on Form 10-K for the year ended December 31, 2016. The unaudited consolidated financial statements are prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments (all of which are considered of normal recurring nature) considered necessary to present fairly the Company’s financial results. The results of the six months ended June 30, 2017 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2017 or other future periods.

The consolidated financial statements reflect the accounts and operations of the Company and those of its subsidiaries, including Funds, in which the Company has a controlling financial interest. The typical condition for a controlling financial interest ownership is holding a majority of the voting interests of an entity. However, a controlling financial interest may also exist in entities, such as variable interest entities (“VIEs”), through arrangements that do not involve controlling voting interests. In accordance with the provisions of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification Topic 810 (“ASC 810”) Consolidation, the Company consolidates any VIE of which it is the primary beneficiary. The primary beneficiary, as defined in ASC 810, is the party that has (1) the power to direct the activities of a VIE that most significantly impact the VIE’s economic performance and (2) the obligation to absorb the losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. The Company evaluates its relationships with its VIEs on an ongoing basis to determine whether it continues to be the primary beneficiary. The consolidated financial statements reflect the assets and liabilities of VIEs that are consolidated. All intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The Company regularly makes significant estimates and assumptions, including, but not limited to, the estimates

that affect the collectability of accounts receivable, the valuation of inventories, the useful lives of solar energy systems, the useful lives of property and equipment, the valuation and useful lives of intangible assets, the fair value of assets acquired and liabilities assumed in business combinations, the effective interest rate used to amortize lease pass-through financing obligations, the fair value used to value solar energy systems, the valuation of stock-based compensation, the determination of valuation allowances associated with deferred tax assets, the fair value of debt instruments disclosed and the redemption value of redeemable noncontrolling interests. The Company bases its estimates on historical experience and on various other assumptions believed to be reasonable. Actual results may differ from such estimates.

Segment Information

The Company has one operating segment with one business activity, providing solar energy services and products to customers. The Company's chief operating decision maker ("CODM") is its Chief Executive Officer, who manages operations on a consolidated basis for purposes of allocating resources. When evaluating performance and allocating resources, the CODM reviews financial information presented on a consolidated basis.

Revenues from external customers (including, but not limited to homeowners) for each group of similar products and services are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Operating leases	\$47,034	\$32,980	\$82,096	\$58,307
Incentives	18,303	12,414	31,339	21,627
Operating leases and incentives	65,337	45,394	113,435	79,934
Solar energy systems	28,078	35,878	48,697	66,070
Products	44,433	41,266	79,833	75,277
Solar energy systems and product sales	72,511	77,144	128,530	141,347
Total revenue	\$137,848	\$122,538	\$241,965	\$221,281

Fair Value of Financial Instruments

The Company defines fair value as the exchange price that would be received for an asset or an exit price that would be paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company uses valuation approaches to measure fair value that maximize the use of observable inputs and minimize the use of unobservable inputs. The FASB establishes a three-tier fair value hierarchy for disclosure of fair value measurements as follows:

Level 1—Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date;

Level 2—Inputs are observable, unadjusted quoted prices in active markets for similar assets or liabilities, unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the related assets or liabilities; and

Level 3—Inputs that are unobservable, significant to the measurement of the fair value of the assets or liabilities and are supported by little or no market data.

The Company's financial instruments include cash, receivables, accounts payable, accrued expenses, distributions payable to noncontrolling interests, derivatives, and recourse and non-recourse debt.

Recently Issued and Adopted Accounting Standards

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09 Revenue from Contracts with Customers (Topic 606). The standard establishes a single revenue recognition model for all contracts with customers, eliminates industry specific requirements, and expands disclosure requirements. This ASU is effective for the Company for annual reporting periods beginning after December 15, 2017 including the interim reporting

periods within that fiscal year. Adoption of this ASU is either retrospective to each prior period presented or retrospective with a cumulative adjustment to retained earnings or accumulated deficit as of the adoption date. The Company currently accounts for Customer Agreements pursuant to ASC 840, Leases. The Company currently believes the adoption of ASC 842, Leases ("ASC 842") will cause Customer Agreements to be accounted for under ASC 606. As such, the Company is considering adopting ASC 842 simultaneously with its adoption of ASC 606. Under ASC 606, total consideration for Customer Agreements, including price escalators, may be recognized ratably over the term of the Customer Agreement. Customer Agreements with a prepaid element may include a significant financing component which will increase total consideration and interest expense using the effective interest rate method. The Company expects to accelerate the timing of revenue recognition for certain incentives recognized under "Operating leases and incentives." The accounting is not expected to materially differ for revenue currently recognized as "Solar energy systems and product sales."

The Company is continuing to assess the impact of such changes, as well as other potential impacts of the revenue and lease standards. The Company has a project plan in place to meet the requirements of these standards using internal resources and consultants. The Company has completed its initial assessment and is currently performing contract reviews and developing a preliminary accounting policy.

In February 2016, the FASB issued ASU No. 2016-02 to replace existing lease guidance with ASC 842, Leases. ASC 842 changes how the definition of a lease is applied and judgment may be required in applying the definition of a lease to certain arrangements. The new standard may result in certain contracts no longer being leases. For lessees, the standard requires all leases with an initial term greater than one year be recorded on the balance sheet as an asset and a lease liability. This ASU is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. Adoption of this ASU is applied using a modified retrospective approach.

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation. The new guidance requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It also requires the Company to make an accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures as they occur. The Company adopted the new ASU effective January 1, 2017. The Company elected to continue to estimate the number of awards that are expected to vest. Upon the adoption, deferred tax liabilities decreased by \$3.3 million, and retained earnings increased by \$3.3 million as of January 1, 2017.

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments, which replaces the current incurred loss impairment methodology with a current expected credit losses model. The amendment applies to entities which hold financial assets and net investment in leases that are not accounted for at fair value through net income as well as loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance receivables and any other financial assets not excluded from the scope that have the contractual right to receive cash. This ASU is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. Early adoption is permitted. Adoption of this ASU is applied using a modified retrospective approach, with certain aspects requiring a prospective approach. The Company is currently evaluating this guidance and the impact it may have on the Company's consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, which requires entities to recognize income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. As a result, a reporting entity will recognize the tax expense from the sale of assets in the seller's tax jurisdiction when the transfer occurs, even though the pre-tax effects of the transaction are eliminated in the consolidated financial statements. Any deferred tax asset that arises in the buyer's jurisdiction will also be recognized at the time of the transfer. The Company adopted the standard effective January 1, 2017. As the Company sells solar energy systems to Funds, the Company will record the current tax effects of the gain on such sales as well as a deferred tax asset related to the Company's increased tax basis in the partnership as a result of such sales. As a result of the adoption, the Company reversed net prepaid tax assets of \$378.5 million, recognized gross deferred tax assets of \$378.2 million and recorded a cumulative adjustment decreasing retained earnings by \$0.3 million as of January 1, 2017.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230), Restricted Cash, which requires a statement of cash flows to present the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash and restricted cash equivalents. This ASU is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. Early adoption is permitted. Adoption of this ASU is applied using a retrospective approach. As a result, the Company will no longer present transfers between cash and restricted cash in the consolidated cash flow statements upon adoption in the first quarter of 2018.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business, to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions of assets or businesses. The amendments in this update provide a screen to determine when a set of operations is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. The Company early adopted the new ASU effective January 1, 2017 on a prospective basis.

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment, which eliminates Step 2 from the goodwill impairment test. Instead, under this amendment, an entity shall perform its annual, or interim, goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The ASU is effective for annual or any interim goodwill impairment tests beginning in fiscal years after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of this standard would only have an effect on the Company's consolidated financial statements if it failed Step 1 of the goodwill impairment test, which has not occurred to date.

In May 2017, the FASB issued ASU 2017-09, Compensation – Stock Compensation, Scope of Modification Accounting, which requires entities to apply modification accounting guidance when there are changes in the terms or conditions of a share-based payment award unless all of the following conditions are met: (i) the fair value of the modified award is the same as the fair value of the original award immediately before modification, (ii) the vesting conditions of the modified award are the same as the original award immediately before modification, and (iii) the classification of the modified award is the same as the original award immediately before modification. The Company early adopted the new ASU effective April 1, 2017, on a prospective basis.

Note 3. Fair Value Measurement

At June 30, 2017 and December 31, 2016, the carrying value of receivables, accounts payable, accrued expenses and distributions payable to noncontrolling interests approximates fair value due to their short-term nature. The carrying values and fair values of debt instruments are as follows (in thousands):

	June 30, 2017		December 31, 2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Lines of credit	\$486,300	\$486,300	\$489,200	\$489,200
Syndicated term loans	309,713	309,713	189,989	189,989
Bank term loans	94,040	93,380	81,307	80,542
Note payable	38,328	38,459	36,232	35,396
Solar asset-backed notes	98,851	104,323	101,295	102,869
Total	\$1,027,232	\$1,032,175	\$898,023	\$897,996

At June 30, 2017 and December 31, 2016, the fair value of the Company's lines of credit, syndicated term loans and certain bank term loans approximate their carrying values because their interest rates are variable rates that approximate rates currently available to the Company. At June 30, 2017 and December 31, 2016, the fair value of the Company's other debt instruments are based on rates currently offered for debt with similar maturities and terms. The Company's fair value of the debt instruments fell under the Level 3 hierarchy. These valuation approaches involve some level of management estimation and judgment, the degree of which is dependent on the price transparency for

the instruments or market.

10

The Company determines the fair value of its interest rate swaps using a discounted cash flow model which incorporates an assessment of the risk of non-performance by the interest rate swap counterparty and an evaluation of the Company's credit risk in valuing derivative instruments. The valuation model uses various inputs including contractual terms, interest rate curves, credit spreads and measures of volatility.

The Company determines the fair value of its warrants issued using the Black-Scholes option-pricing model. The significant unobservable input used in the fair value measurement of the warrant liability was the expected volatility of the Company. Generally, increases (decreases) in the expected volatility of the Company would result in a directionally similar impact to the measurement of the Company's warrants.

At June 30, 2017 and December 31, 2016, financial instruments measured at fair value on a recurring basis, based upon the fair value hierarchy are as follows (in thousands):

June 30, 2017

	Level 2	Level 1	Level 3	Total
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Derivative assets:

Interest rate swaps	\$ -	\$ 5,059	\$ —	\$ 5,059
Total	\$ -	\$ 5,059	\$ —	\$ 5,059

Derivative liabilities:

Warrants	\$ -	\$ —	\$ 7	\$ 7
Total	\$ -	\$ —	\$ 7	\$ 7

December 31, 2016

	Level 2	Level 1	Level 3	Total
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Derivative assets:

Interest rate swaps	\$ -	\$ 1,632	\$ —	\$ 1,632
Total	\$ -	\$ 1,632	\$ —	\$ 1,632

Derivative liabilities:

Warrants	\$ -	\$ —	\$ 20	\$ 20
Total	\$ -	\$ —	\$ 20	\$ 20

Note 4. Inventories

Inventories consist of the following (in thousands):

	June 30, 2017	December 31, 2016
Raw materials	\$ 48,681	\$ 62,037
Work-in-process	4,063	5,289
Total	\$ 52,744	\$ 67,326

Note 5. Solar Energy Systems, net

Solar energy systems, net consists of the following (in thousands):

	June 30, 2017	December 31, 2016
Solar energy system equipment costs	\$2,793,188	\$2,459,856
Inverters	287,833	260,011
Initial direct costs	134,325	117,587
Total solar energy systems	3,215,346	2,837,454
Less: accumulated depreciation and amortization	(359,288)	(303,305)
Add: construction-in-progress	95,202	95,217
Total solar energy systems, net	\$2,951,260	\$2,629,366

All solar energy systems, construction-in-progress and inverters have been leased to or are subject to signed Customer Agreements with customers. The Company recorded depreciation expense related to solar energy systems of \$29.2 million and \$22.5 million for the three months ended June 30, 2017 and 2016, respectively, and \$56.8 million and \$42.9 million for the six months ended June 30, 2017 and 2016, respectively. The depreciation expense was reduced by the amortization of deferred grants of \$1.8 million and \$3.4 million for the three months ended June 30, 2017 and 2016, respectively, and \$3.8 million and \$7.4 million for the six months ended June 30, 2017 and 2016, respectively.

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Note 6. Indebtedness

As of June 30, 2017, debt consisted of the following (in thousands, except percentages):

	Carrying Values, net of debt discount			Unused Borrowing Capacity	Annual Contractual Interest Rate	Interest Rate	Maturity Date
	Current	Long Term	Total				
Recourse debt:							
Bank line of credit	\$247,000	\$—	\$247,000	\$ 406	Varies (1)	4.33% - 4.46%	April 2018
Total recourse debt	\$247,000	\$—	\$247,000	\$ 406			
Non-recourse debt:							
Term loan	—	121,532	121,532	12	Varies (2)	3.74% - 3.97%	April 2024
Line of credit (Aggregation Facility)	—	239,300	239,300	8,500	Varies (3)	3.67% - 3.72%	December 2020
Term Loan and Term Loan B	2,606	39,553	42,159	—	Varies (4)	6.17 %	December 2020 and 2021
Term Loan A	568	145,454	146,022	5,000	Varies (5)	3.92 %	December 2021
Bank term loans	1,530	32,307	33,837	—	LIBOR + 2.25%	3.48 %	September 2022
					LIBOR + 3.00%	4.30 %	September 2022
Bank term loan	8,929	24,507	33,436	—	Varies (6)	6.70% - 10.20%	July 2021
Bank term loan	1,402	25,365	26,767	—	4.50 %	4.50 %	April 2022
Solar asset-backed notes	3,848	95,003	98,851	—	4.40% - Class A	4.40 %	July 2024
					5.38% - Class B	5.38 %	July 2024
Note payable	—	38,328	38,328	—	12.00 %	12.00 %	December 2018
Total non-recourse debt	18,883	761,349	780,232	13,512			
Total debt	\$265,883	\$761,349	\$1,027,232	\$ 13,918			

As of December 31, 2016, debt consisted of the following (in thousands, except percentages):

	Carrying Values, net of debt discount			Unused Borrowing Capacity	Annual Contractual Interest Rate	Interest Rate	Maturity Date
	Current	Long Term	Total				
Recourse debt:							
Bank line of credit	\$—	\$ 244,000	\$244,000	\$ 3,406	Varies (1)	3.96% - 5.75%	April 2018
Total recourse debt	\$—	\$ 244,000	\$244,000	\$ 3,406			
Non-recourse debt:							
Line of credit (Aggregation Facility)	—	245,200	245,200	9,300	Varies (3)	2.93% - 3.39%	December 2020
Term Loan and Term Loan B	116	42,870	42,986	—	Varies (4)	6.00 %	December 2020 and December 2021

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Term Loan A	616	146,387	147,003	5,000	Varies (5)	3.64	%	December 2021
Bank term loan	1,074	21,249	22,323	—	LIBOR + 2.25%	2.86	%	September 2022
Bank term loan	7,286	23,802	31,088	1,032	Varies (6)	6.25% - 9.94%		July 2021
Bank term loan	1,331	26,565	27,896	—	4.50	% 4.50	%	April 2022
Solar asset-backed notes	3,730	97,565	101,295	—	4.40% - Class A	4.40	%	July 2024
					5.38% - Class B	5.38	%	July 2024
Note payable	—	36,232	36,232	—	12.00	% 12.00	%	December 2018
Total non-recourse debt	14,153	639,870	654,023	15,332				
Total debt	\$ 14,153	\$ 883,870	\$ 898,023	\$ 18,738				

- (1) Loans under the facility bear interest at LIBOR +3.25% per annum or the Base Rate +2.25% per annum. The Base Rate is the highest of the Federal Funds Rate +0.50%, the Prime Rate, or LIBOR +1.00%.
- (2) Loans under the facility bear interest at LIBOR +2.75% per annum for the initial four-year period for LIBOR loans or the Base Rate +1.75% per annum for Base Rate Loans.
- (3) Loans under the facility bear interest at LIBOR +2.50% per annum for the initial three-year revolving availability period, stepping up to LIBOR +2.75% per annum in the following two-year period.
Term loan under the facility bears interest at LIBOR +5.00% per annum for the first three-year period, stepping up (4) to LIBOR +6.50% per annum thereafter. Term loan B under the facility bears interest at LIBOR +5.00% per annum.
- (5) Loan under the facility bears interest at LIBOR +2.75% per annum, stepping up to LIBOR +3.00% per annum on the fourth anniversary.
- (6) Loans under the facility bear interest at LIBOR +5.50% per annum for contracted SRECs and LIBOR +9.00% per annum for uncontracted SRECs.

Bank Line of Credit

The Company has outstanding borrowings under a syndicated working capital facility with banks for a total commitment of up to \$250.0 million. The working capital facility is secured by substantially all of the unencumbered assets of the Company, as well as ownership interests in certain subsidiaries of the Company.

Under the terms of the working capital facility, the Company is required to meet various restrictive covenants, such as the completion and presentation of audited consolidated financial statements, maintaining a minimum unencumbered liquidity of at least \$25.0 million in the aggregate as of the last day of each calendar month and maintaining a modified interest coverage ratio of 2.00 or greater, measured quarterly as of the last day of each quarter. The Company was in compliance with all debt covenants as of June 30, 2017.

As of June 30, 2017, the balance under this facility was \$247.0 million with a maturity date in April 2018. As of June 30, 2017, the Company's cash balance was \$211.3 million and as such, the Company does not currently have the funds required to fully repay the debt. As this facility has a three year term, the Company is in the process of negotiating refinancing options and plans to extend the maturity date of the facility. Although there is no assurance that the Company will be able to do so, the Company believes that it is probable that it will be able to extend or otherwise refinance the facility prior to maturity.

Syndicated Credit Facilities

Each of the Company's syndicated credit facilities contain customary covenants including the requirement to maintain certain financial measurements and provide lender reporting. Each of the syndicated credit facilities also contain certain provisions in the event of default which entitle lenders to take certain actions including acceleration of amounts due under the facilities and acquisition of membership interests and assets that are pledged to the lenders under the terms of the credit facilities. The Company was in compliance with all debt covenants as of June 30, 2017.

Term loan due in April 2024

In May 2017, a subsidiary of the Company entered into an arrangement for senior secured credit facilities that was syndicated with various lenders. The credit facilities totaled \$202.0 million and consisted of a \$195.0 million delayed draw term loan facility and a \$7.0 million revolving debt service reserve letter of credit facility. The amount outstanding at June 30, 2017 was \$121.5 million. The facilities are non-recourse to the Company and are secured by net cash flows from Customer Agreements and solar renewable energy credits ("SRECs"), less certain operating, maintenance and other expenses which are available to the borrower after distributions to tax equity investors. Prepayments are permitted under the delayed draw term loan facility.

Line of credit (Aggregation Facility) and Term Loan

As of June 30, 2017, certain subsidiaries of the Company have an outstanding balance of \$261.8 million on secured credit facilities agreements, as amended, with a syndicate of banks. The facilities include a revolving aggregation facility ("Aggregation Facility"), a term loan ("Term Loan") and a revolving debt service reserve letter of credit facility. The facilities are non-recourse to the Company and are secured by net cash flows of certain subsidiaries from Customer Agreements, less certain operating, maintenance and other expenses which are

available to the borrowers after distributions to tax equity investors. Term Loan prepayment penalties range from 0% - 1% depending on the timing of the prepayment.

Term Loan A and Term Loan B

As of June 30, 2017, certain subsidiaries of the Company have an outstanding balance of \$165.7 million on secured credit facilities agreements with a syndicate of banks. These facilities include a senior term loan (“Term Loan A”) and a subordinated term loan (“Term Loan B”). In addition, the credit facilities also include a working capital revolver commitment and a revolving debt service reserve letter of credit facility which draws are solely for the purpose of satisfying the required debt service reserve amount if necessary. The facilities are non-recourse to the Company and are secured by net cash flows of certain subsidiaries from Customer Agreements, less certain operating, maintenance and other expense which are available to the borrowers after distributions to tax equity investors. Prepayments are permitted under Term Loan A and Term Loan B at par without premium or penalty.

Bank Term Loans

Bank term loans due in September 2022

As of June 30, 2017, a subsidiary of the Company has an outstanding balance of \$12.8 million on a non-recourse loan. The loan is secured by substantially all of the assets of a subsidiary including this subsidiary’s membership interests and assets in its investment funds. The loan contains certain provisions in the event of default which entitles the lender to take certain actions including acceleration of amounts due under the loan. The Company was in compliance with all debt covenants as of June 30, 2017.

As of June 30, 2017, a subsidiary of the Company has an outstanding balance of \$21.0 million on a secured, non-recourse loan agreement. The loan will be repaid through cash flows from a lease pass-through arrangement previously entered into by the Company. The loan agreement contains customary covenants including the requirement to maintain certain financial measurements and provide lender reporting. The loan also contains certain provisions in the event of default which entitles the lender to take certain actions including acceleration of amounts due under the loan. The Company was in compliance with all debt covenants as of June 30, 2017.

Bank term loan due in July 2021

As of June 30, 2017, a subsidiary of the Company has an outstanding balance of \$33.4 million on a secured credit agreement. The facility is non-recourse to the Company and is secured by substantially all of the assets of the subsidiary, including its rights in and the net cash flows from the generation of contracted and uncontracted SRECs by certain subsidiaries. The facility contains customary covenants including the requirement to provide lender reporting. The Company guarantees the delivery of SRECs on the subsidiary’s underlying contracts in the event of a delivery shortfall pursuant to the SREC contracts with counterparties. The Company does not guarantee payments of principal or interest on the loan. The credit facility also contains certain provisions in the event of default which entitles the lender to take certain actions including acceleration of amounts due under the facilities. The Company was in compliance with all debt covenants as of June 30, 2017.

Bank term loan due in April 2022

As of June 30, 2017, a subsidiary of the Company has an outstanding balance of \$26.8 million on a term loan. The loan is secured by the assets and related cash flow of this subsidiary and is non-recourse to the Company’s other assets. The Company was in compliance with all debt covenants as of June 30, 2017.

Solar Asset-Backed Notes

As of June 30, 2017, a subsidiary of the Company has an outstanding balance of \$98.9 million on solar asset-backed notes (“Notes”) secured by associated customer contracts (“Solar Assets”) held by a special purpose entity (“Issuer”). As of June 30, 2017 and December 31, 2016, these Solar Assets had a carrying value of \$177.4 million and \$181.8 million, respectively, and are included under solar energy systems, net, in the consolidated balance sheets. The Notes were issued at a discount of 0.08%.

In connection with the transaction, the Company modified two lease pass-through arrangements with an investor. The modified lease-pass through arrangements require the majority of the cash flows generated by the

Solar Assets to be passed on to the Issuer through monthly lease payments from the Fund investor. Those cash flows are used to service the monthly principal of the Notes and interest payments and satisfy the Issuer's expenses, and any residual cash flows are retained by the Fund investor and recorded as a reduction in the remaining financing obligation. The Company recognizes revenue earned from the associated Customer Agreements in accordance with the Company's revenue recognition policy. The assets and cash flows generated by the Solar Assets are not available to the other creditors of the Company, and the creditors of the Issuer, including the Note holders, have no recourse to the Company's other assets. The Company was in compliance with all debt covenants as of June 30, 2017.

Notes Payable

As of June 30, 2017, a subsidiary of the Company has an outstanding balance of \$38.3 million on a note purchase agreement with an investor for the issuance of senior notes. On the last business day of each quarter, commencing with March 31, 2014, to the extent the Company's subsidiary has insufficient funds to pay the full amount of the stated interest of the outstanding loan balance, a payment-in-kind ("PIK") interest rate of 12% is accrued and added to the outstanding balance. As of June 30, 2017 and December 31, 2016, the portion of the outstanding loan balance that related to PIK interest was \$11.5 million and \$9.5 million, respectively. The senior notes are secured by the assets and related cash flows of certain of the Company's subsidiaries and are non-recourse to the Company's other assets. The Company was in compliance with all debt covenants as of June 30, 2017.

Note 7. Derivatives

Interest Rate Swaps

The Company uses interest rate swaps to hedge variable interest payments due on certain of its term loans and aggregation facility. These swaps allow the Company to incur fixed interest rates on these loans and receive payments based on variable interest rates with the swap counterparty based on the one or three month LIBOR on the notional amounts over the life of the swaps.

The interest rate swaps have been designated as cash flow hedges. The credit risk adjustment associated with these swaps is the risk of non-performance by the counterparties to the contracts. In the six months ended June 30, 2017, the hedge relationships on the Company's interest rate swaps have been assessed as highly effective as the critical terms of the interest rate swaps match the critical terms of the underlying forecasted hedged transactions. Accordingly, changes in the fair value of these derivatives are recorded as a component of accumulated other comprehensive income, net of income taxes. Changes in the fair value of these derivatives are subsequently reclassified into earnings, and are included in interest expense, net in the Company's statements of operations, in the period that the hedged forecasted transactions affects earnings.

The Company recorded an unrealized loss of \$3.7 million and \$4.5 million for the three and six months ended June 30, 2017 respectively, net of applicable tax benefit of \$2.4 million and \$2.9 million, respectively. The Company recorded an unrealized gain of \$0.2 million and an unrealized loss of \$5.6 million for the three and six months ended June 30, 2016 respectively, net of applicable tax benefit of \$3.6 million for the three and six months ended June 30, 2016. The Company recognized interest expense on derivatives into earnings of \$0.3 million and \$0.9 million for the three and six months ended June 30, 2017, respectively, net of tax expense of \$0.2 million and \$0.6 million, respectively. The Company recognized interest expense on derivatives into earnings of \$0.1 million and \$0.6 million for the three and six months ended June 30, 2016, respectively, net of tax benefit of \$0.4 million for the three and six months ended June 30, 2016. During the next twelve months, the Company estimates that an additional \$2.1 million will be reclassified as an increase to interest expense. There were no undesignated derivative instruments recorded by the Company as of June 30, 2017.

At June 30, 2017, the Company had designated derivative instruments classified as derivative assets as reported in other assets of \$0.3 million and derivative liabilities as reported in other liabilities of \$5.3 million in the Company's balance sheet. At December 31, 2016, the Company had designated derivative instruments classified as derivative assets as reported in other assets of \$1.6 million in the Company's balance sheet. At June 30, 2017, the Company had the following derivative instruments (in thousands, other than quantity and interest rates):

Type	Quantity	Maturity Dates	Hedge Interest Rates	Notional Amount	Fair Market Value
Interest rate swap	1	8/31/2022	1.27% - 1.29%	\$16,563	\$315
Interest rate swap	1	9/30/2022	2.37%	\$12,610	\$(243)
Interest rate swaps	4	4/30/2024	2.16% - 2.25%	\$96,544	\$(909)
Interest rate swaps	2	10/31/2024	2.62% - 2.69%	\$62,633	\$(1,297)
Interest rate swaps	4	10/31/2028	2.17% - 2.18%	\$125,100	\$(43)
Interest rate swap	1	9/30/2031	3.23%	\$9,905	\$(231)
Interest rate swaps	5	7/31/2034	2.48% - 3.04%	\$144,379	\$(1,223)
Interest rate swaps	5	7/31/2035	2.56% - 2.95%	\$132,432	\$(1,428)

Note 8. Lease Pass-Through Financing Obligations

The Company has five ongoing transactions referred to as "lease pass-through arrangements." Under lease pass-through arrangements, the Company leases solar energy systems to Fund investors under a master lease agreement, and these investors in turn are assigned the leases with customers. The Company receives all of the value attributable to the accelerated tax depreciation and some or all of the value attributable to the other incentives. The Company assigns to the Fund investors the value attributable to the investment tax credit ("ITC") and, for the duration of the master lease term, the long-term recurring customer payments. Given the assignment of the operating cash flows, these arrangements are accounted for as financing obligations. In addition, in one of the lease pass-through structures, the Company sold, as well as leased, solar energy systems to a Fund investor under a master purchase agreement. As the substantial risks and rewards in the underlying solar energy systems were retained by the Company, this arrangement was also accounted for as a financing obligation.

Under these lease pass-through arrangements, wholly owned subsidiaries of the Company finance the cost of solar energy systems with investors for an initial term of 20 – 25 years. The solar energy systems are subject to Customer Agreements with an initial term not exceeding 20 years. These solar energy systems are reported under the line item solar energy systems, net in the consolidated balance sheets. As of June 30, 2017 and December 31, 2016, the cost of the solar energy systems placed in service under the lease pass-through arrangements was \$494.0 million and \$494.9 million, respectively. The accumulated depreciation related to these assets as of June 30, 2017 and December 31, 2016 was \$59.8 million and \$50.8 million, respectively.

In 2015, the Company entered into a lease pass-through arrangement and in connection with this arrangement, the Company agreed to defer a portion (up to 25%) of the amounts required to be paid upfront under the arrangement through a loan between an indirect wholly owned subsidiary of the Company and a subsidiary of the Fund investor. The loan is collateralized by the related cash flows assigned to the Fund investor. There is a legal right to offset the loan if an event of default has occurred. Therefore, the lease pass-through financing obligation related to this arrangement is recorded net of the loan. As of June 30, 2017 and December 31, 2016, the loan amount was \$21.9 million and \$23.2 million, respectively.

Note 9. VIE Arrangements

The Company consolidated various VIEs at June 30, 2017 and December 31, 2016. The carrying amounts and classification of the VIEs' assets and liabilities included in the consolidated balance sheets are as follows (in thousands):

	June 30, 2017	December 31, 2016
Assets		
Current assets		
Cash	\$108,039	\$120,728
Restricted cash	3,574	1,680
Accounts receivable, net	27,547	20,771
Prepaid expenses and other current assets	235	242
Total current assets	139,395	143,421
Solar energy systems, net	2,237,670	1,920,330
Other assets	2,159	1,481
Total assets	\$2,379,224	\$2,065,232
Liabilities		
Current liabilities		
Accounts payable	\$22,196	\$14,873
Distributions payable to noncontrolling interests and redeemable noncontrolling interests	13,213	10,654
Accrued expenses and other liabilities	1,471	782
Deferred revenue, current portion	27,468	25,827
Deferred grants, current portion	3,623	3,644
Long-term non-recourse debt, current portion	10,331	8,616
Total current liabilities	78,302	64,396
Deferred revenue, net of current portion	416,635	396,858
Deferred grants, net of current portion	103,310	105,390
Long-term non-recourse debt, net of current portion	161,689	50,367
Other liabilities	2,337	—
Total liabilities	\$762,273	\$617,011

The Company holds a variable interest in an entity that provides the noncontrolling interest with a right to terminate the leasehold interests in all of the leased projects on the tenth anniversary of the effective date of the master lease. In this circumstance, the Company would be required to pay the noncontrolling interest an amount equal to the fair market value, as defined in the governing agreement of all leased projects as of that date.

The Company holds certain variable interests in nonconsolidated VIEs established as a result of five lease pass-through Fund arrangements as further explained in Note 8, Lease Pass-Through Financing Obligations. The Company does not have material exposure to losses as a result of its involvement with the VIEs in excess of the amount of the financing liability recorded in the Company's consolidated financial statements. The Company is not considered the primary beneficiary of the VIEs.

Note 10. Redeemable Noncontrolling Interests and Equity

The changes in redeemable noncontrolling interests, total stockholders' equity and noncontrolling interests were as follows (in thousands):

	Redeemable Noncontrolling Interests	Total Stockholders' Equity	Noncontrolling Interests	Total Equity
Balance — January 1, 2017	\$ 137,907	\$ 672,961	\$ 251,225	\$ 924,186
Exercise of stock options	—	529	—	529
Issuance of restricted stock units, net of tax withholdings	—	(2,099)	—	(2,099)
Shares issued in connection with the Employee Stock Purchase Plan	—	1,145	—	1,145
Stock based compensation	—	11,416	—	11,416
Contributions from noncontrolling interests and redeemable noncontrolling interests	75,169	—	231,123	231,123
Distributions to noncontrolling interests and redeemable noncontrolling interests	(7,666)	—	(19,527)	(19,527)
Cumulative effect of adoption of new ASUs	—	2,996	—	2,996
Net income (loss)	(42,333)	37,848	(133,842)	(95,994)
Other comprehensive loss, net of taxes	—	(3,569)	—	(3,569)
Balance — June 30, 2017	\$ 163,077	\$ 721,227	\$ 328,979	\$ 1,050,206

The carrying value of redeemable noncontrolling interests was greater than the redemption value except for six and four Funds at June 30, 2017 and December 31, 2016, respectively, where the carrying value has been adjusted to the redemption value.

Note 11. Stock-Based Compensation

Stock Options

The following table summarizes the activity for all stock options under all of the Company's equity incentive plans for the six months ended June 30, 2017 (shares and aggregate intrinsic value in thousands):

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at January 1, 2017	12,897	\$ 5.94	7.49	
Granted	4,585	5.03		
Exercised	(207)	2.49		
Cancelled	(524)	7.82		
Outstanding at June 30, 2017	16,751	\$ 5.68	7.75	\$ 32,028
Options vested and exercisable at June 30, 2017	7,961	\$ 5.40	6.34	\$ 18,378

Restricted Stock Units

The following table summarizes the activity for all restricted stock units (“RSUs”) under all of the Company’s equity incentive plans for the six months ended June 30, 2017 (shares in thousands):

	Number of Awards	Weighted Average Grant Date Fair Value
Unvested balance at January 1, 2017	4,106	\$ 6.87
Granted	2,887	5.10
Issued	(538)	6.15
Forfeited	(644)	5.79
Unvested balance at June 30, 2017	5,811	\$ 6.13

Employee Stock Purchase Plan

In the quarter ended June 30, 2017, the Company modified the Company's 2015 Employee Stock Purchase Plan ("ESPP") by increasing the offering period to 24 months with four six month purchase periods and increasing the maximum number of shares an eligible employee can purchase during a purchase period to 10,000 shares. Each purchase period begins on the first trading day on or after May 15 and November 15 of each year. Employees may purchase a limited number of shares of the Company’s common stock via regular payroll deductions at a discount of 15% of the lower of the fair market value of the Company’s common stock on the first trading date of each offering period or on the exercise date. Employees may deduct up to 15% of payroll, with a cap of \$25,000 of fair market value of shares in any calendar year.

Stock-Based Compensation Expense

The Company recognized stock-based compensation expense, including ESPP expenses, in the consolidated statements of operations as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Cost of operating leases and incentives	\$ 1,110	\$ 632	\$ 1,861	\$ 839
Cost of solar energy systems and product sales	156	117	270	198
Sales and marketing	807	1,890	2,724	3,508
Research and development	186	149	335	246
General and administration	3,256	2,050	6,199	3,856
Total	\$ 5,515	\$ 4,838	\$ 11,389	\$ 8,647

Note 12. Income Taxes

The income tax expense rate for the three and six months ended June 30, 2017 was (31.0)% and (19.7)%, respectively. The income tax expense rate for the three and six months ended June 30, 2016 was (5.2)% and (2.3)%, respectively. The differences between the actual consolidated effective income tax rate and the U.S. federal statutory rate were primarily attributable to the allocation of losses on noncontrolling interests and redeemable noncontrolling interests, which assumes a hypothetical liquidation of these partnerships as of the reporting dates.

The Company sells solar energy systems to investment Funds. As the investment Funds are consolidated by the Company, the gain on the sale of the assets has been eliminated in the consolidated financial statements. These transactions are treated as intercompany sales and any tax expense incurred related to these sales prior to fiscal year 2017 was deferred. As described in Note 2, Summary of Significant Accounting Policies – Recently Issued Accounting Standards, ASU 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, requires entities to recognize income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. As a result, a reporting entity would recognize the tax expense from the sale of assets in the seller’s tax

jurisdiction when the transfer occurs, even though the pre-tax effects of the transaction are eliminated in the consolidated financial statements. Any deferred tax asset that arises in the buyer's jurisdiction would also be recognized at the time of the transfer. As the Company sells solar energy systems to Funds, the Company will record the current tax effect of the gain on the sale as well as a deferred tax asset related to the Company's increased tax basis in the partnership as a result of the sale. As a result of the adoption of ASU 2016-16, the Company recognized in retained earnings the reversal of the net prepaid tax assets of \$378.5 million previously recorded for the tax deferral, and recognized gross a deferred tax asset of \$378.2 million at January 1, 2017.

The Company adopted ASU 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, on January 1, 2017. As a result of the adoption, the Company has increased its federal and state deferred tax assets by \$3.3 million for the cumulative unrecognized federal and state gross windfall net operating loss carryover at December 31, 2016 of \$8.6 million and \$6.8 million, respectively, with an offsetting adjustment to retained earnings of \$3.3 million.

Uncertain Tax Positions

As of June 30, 2017 and December 31, 2016, the Company had \$1.5 million of unrecognized tax benefits related to an acquisition in 2015. In addition, there was \$0.4 million and \$0.3 million of interest and penalties for uncertain tax positions as of June 30, 2017 and December 31, 2016, respectively. The Company does not have any tax positions for which it is reasonably possible that the total amount of gross unrecognized benefits will increase or decrease within the next 12 months. The Company is subject to taxation and files income tax returns in the United States, and various state and local jurisdictions. Due to the Company's net losses, substantially all of its federal, state and local income tax returns since inception are still subject to audit.

Net Operating Loss Carryforwards

As a result of the Company's net operating loss carryforwards as of June 30, 2017 and December 31, 2016, the Company does not expect to pay income tax, including in connection with its income tax provision for the six months ended June 30, 2017 until the Company's net operating losses are fully utilized. As of December 31, 2016, the Company's federal and state net operating loss carryforwards were \$571.3 million and \$524.9 million, respectively. If not utilized, the federal net operating loss will begin to expire in the year 2028 and the state net operating losses will begin to expire in the year 2024.

Note 13. Commitments and Contingencies

Letters of Credit

As of June 30, 2017 and December 31, 2016, the Company had \$11.2 million and \$6.2 million, respectively, of unused letters of credit outstanding, which carry fees of 2.50% - 3.00% per annum and 2.50% per annum, respectively.

Non-cancellable Operating Leases

The Company leases facilities and equipment under non-cancellable operating leases. Total operating lease expenses were \$3.2 million and \$2.9 million for the three months ended June 30, 2017 and 2016, respectively, and \$6.3 million and \$5.6 million for the six months ended June 30, 2017 and 2016, respectively.

Certain operating leases contain rent escalation clauses, which are recorded on a straight-line basis over the initial term of the lease with the difference between the rent paid and the straight-line rent recorded as a deferred rent liability. Lease incentives received from landlords are recorded as deferred rent liabilities and are amortized on a straight-line basis over the lease term as a reduction to rent expense. Deferred rent liabilities were \$2.7 million and \$2.9 million as of June 30, 2017 and December 31, 2016, respectively.

Capital Lease Obligations

As of June 30, 2017 and December 31, 2016, capital lease obligations were \$17.3 million and \$23.0 million, respectively. The capital lease obligations bear interest at rates up to 10% per annum.

Warranty Accrual

The Company accrues warranty costs when revenue is recognized for solar energy systems sales, based on the estimated future costs of meeting its warranty obligations. Warranty costs primarily consist of replacement costs for supplies and labor costs for service personnel since warranties for equipment and materials are covered by the original manufacturer's warranty (other than a small deductible in certain cases). As such, the warranty reserve is immaterial in all periods presented. The Company makes and revises these estimates based on the number of solar energy systems under warranty, the Company's historical experience with warranty claims, assumptions on warranty claims to occur over a systems' warranty period and the Company's estimated replacement costs.

Guarantees

The Company guarantees one of its investors in one of its Funds an internal rate of return, calculated on an after-tax basis, in the event that it purchases the investor's interest or the investor sells its interest to the Company. The Company does not expect the internal rate of return to fall below the guaranteed amount; however, due to uncertainties associated with estimating the timing and amount of distributions to the investor and the possibility for and timing of the liquidation of the Fund, the Company is unable to determine the potential maximum future payments that it would have to make under this guarantee.

ITC and Cash Grant Indemnification

The Company is contractually committed to compensate certain investors for any losses that they may suffer in certain limited circumstances resulting from reductions in ITCs or U.S. Treasury grants. Generally, such obligations would arise as a result of reductions to the value of the underlying solar energy systems as assessed by the Internal Revenue Service (the "IRS") or U.S. Treasury Department. At each balance sheet date, the Company assesses and recognizes, when applicable, the potential exposure from this obligation based on all the information available at that time, including any audits undertaken by the IRS. The Company believes that this obligation is not probable based on the facts known as of the filing date of this Quarterly Report on Form 10-Q. The maximum potential future payments that the Company could have to make under this obligation would depend on the difference between the fair values of the solar energy systems sold or transferred to the Funds as determined by the Company and the values the IRS would determine as the fair value for the systems for purposes of claiming ITCs. ITCs are claimed based on the statutory regulations from the IRS. The Company uses fair values determined with the assistance of an independent third-party appraisal as the basis for determining the ITCs that are passed-through to and claimed by the Fund investors. Since the Company cannot determine how the IRS will evaluate system values used in claiming ITCs, the Company is unable to reliably estimate the maximum potential future payments that it could have to make under this obligation as of each balance sheet date.

Litigation

The Company is subject to certain legal proceedings, claims, investigations and administrative proceedings in the ordinary course of its business. The Company records a provision for a liability when it is both probable that the liability has been incurred and the amount of the liability can be reasonably estimated. These provisions, if any, are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Depending on the nature and timing of any such proceedings that may arise, an unfavorable resolution of a matter could materially affect the Company's future consolidated results of operations, cash flows or financial position in a particular period.

In July 2012, the U.S. Treasury Department and the Department of Justice (together, the "Government") opened a civil investigation into the participation by residential solar developers in the Section 1603 grant program. The Government served subpoenas on several developers, including Sunrun, along with their investors and valuation firms. The focus of the investigation is the claimed fair market value of the solar systems the developers submitted to the Government in their grant applications. The Company has cooperated fully with the Government and plans to continue to do so. No claims have been brought against the Company. The Company is not able to estimate the ultimate outcome or a range of possible loss at this point in time.

On April 13, 2016, a purported shareholder class action captioned *Pytel v. Sunrun Inc., et al.*, Case No. CIV 538215, was filed in the Superior Court of California, County of San Mateo, against the Company, certain of the Company's directors and officers, the underwriters of the Company's initial public offering and certain other defendants. The

complaint generally alleges that the defendants violated Sections 11, 12 and 15 of the Securities

22

Act of 1933 by making false or misleading statements in connection with the Company's August 5, 2015 initial public offering regarding the continuation of net metering programs. The plaintiffs seek to represent a class of persons who acquired the Company's common stock pursuant or traceable to the initial public offering. Plaintiffs seek compensatory damages, including interest, rescission or rescissory damages, an award of reasonable costs and attorneys' fees, and any equitable or injunctive relief deemed appropriate by the court. On April 21, 2016, a purported shareholder class action captioned Mancy v. Sunrun Inc., et al., Case No. CIV 538303, was filed in the Superior Court of California, County of San Mateo. On April 22, 2016, a purported shareholder class action captioned Brown et al. v. Sunrun Inc., et al., Case No. CIV 538311, was filed in the Superior Court of California, County of San Mateo. On April 29, 2016, a purported shareholder class action captioned Baker et al. v. Sunrun Inc., et al., Case No. CIV 538419, was filed in the Superior Court of California, County of San Mateo. On May 10, 2016, a purported shareholder class action captioned Nunez v. Sunrun Inc., et al., Case No. CIV 538593, was filed in the Superior Court of California, County of San Mateo. On June 10, 2016, a purported shareholder class action captioned Steinberg v. Sunrun Inc., et al., Case No. 539064, was filed in the Superior Court of California, County of San Mateo. The Mancy, Brown, Baker, Nunez and Steinberg complaints are substantially similar to the Pytel complaint, and seek similar relief against similar defendants on behalf of the same purported class.

On April 21, 2016, a purported shareholder class action captioned Cohen, et al. v. Sunrun Inc., et al., Case No. CIV 538304, was filed in the Superior Court of California, County of San Mateo, against the Company, certain of the Company's directors and officers, and the underwriters of the Company's initial public offering. The complaint generally alleges that the defendants violated Sections 11, 12 and 15 of the Securities Act of 1933 by making false or misleading statements in connection with an August 5, 2015 initial public offering regarding the Company's business practices and its dependence on complex financial instruments. The Cohen plaintiffs seek to represent the same class and seek similar relief as the plaintiffs in the Pytel, Mancy, Brown, Nunez, Steinberg and Baker actions.

On September 26, 2016, the Baker, Brown, Cohen, Mancy, Nunez, Pytel and Steinberg actions were consolidated.

On May 3, 2017, a purported shareholder class action captioned Fink, et al. v. Sunrun Inc., et al., Case No. 3:17-cv-02537, was filed in the United States District Court, Northern District of California, against the Company and certain of the Company's directors and officers. The complaint generally alleges that the defendants violated Sections 10(b) and 20(a) of the Exchange Act of 1934, and Securities and Exchange Commission Rule 10b-5, by making false or misleading statements in connection with public filings made between September 15, 2015 and March 8, 2017 regarding the number of customers who canceled contracts after signing up for the Company's home-solar energy system. The plaintiff seeks compensatory damages, including interest, attorney's fees, and costs, on behalf of all persons other than the defendants who purchased the Company's securities between September 16, 2015 and May 2, 2017. On May 4, 2017, a purported shareholder class action captioned Hall, et al. v. Sunrun Inc., et al., Case No. 3:17-cv-02571, was filed in the United States District Court, Northern District of California. On May 18, 2017, a purported shareholder class action captioned Sanogo, et al. v. Sunrun Inc., et al., Case No. 3:17-cv-02865, was filed in the United States District Court, Northern California District of California. The Hall and Sanogo complaints are substantially similar to the Fink complaint, and seeks similar relief against similar defendants on behalf of a substantially similar class.

On June 29, 2017, a shareholder derivative complaint captioned Barbara Sue Sklar Living Trust v. Sunrun Inc. et al., was filed in the United States District Court, Northern District of California, against the Company and certain of the Company's directors and officers. The complaint generally alleges that the defendants violated Section 14(a) of the Exchange Act of 1934 by making false or misleading statements in connection with public filings, including proxy statements, made between September 10, 2015 and May 3, 2017 regarding the number of customers who cancelled contracts after signing up for the Company's home solar energy system. The Plaintiff seeks, among other things, damages in favor of the Company, certain corporate actions to purportedly improve the Company's corporate governance, and an award of costs and expenses to the putative plaintiff stockholder, including attorneys' fees.

Note 14. Earnings Per Share

The computation of the Company's basic and diluted net income per share are as follows (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Numerator:				
Net income attributable to common stockholders	\$25,122	\$32,643	\$37,849	\$45,777
Denominator:				
Weighted average shares used to compute net income per share attributable to common stockholders, basic	105,093	101,969	104,568	101,621
Weighted average effect of potentially dilutive shares to purchase common stock	2,254	2,799	2,343	2,873
Weighted average shares used to compute net income per share attributable to common stockholders, diluted	107,347	104,768	106,911	104,494
Net income per share attributable to common stockholders				
Basic	\$0.24	\$0.32	\$0.36	\$0.45
Diluted	\$0.23	\$0.31	\$0.35	\$0.44

The following shares were excluded from the computation of diluted net income per share as the impact of including those shares would be anti-dilutive (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Warrants	1,251	1,251	1,251	1,251
Outstanding stock options	13,712	8,060	13,712	8,060
Unvested restricted stock units	1,256	1,328	1,256	1,328
Total	16,219	10,639	16,219	10,639

Note 15. Related Party Transactions

An individual who previously served as one of the Company's directors until March 2017 has direct and indirect ownership interests in Enphase Energy, Inc. ("Enphase"). For the three months ended June 30, 2017 and 2016, the Company recorded \$3.0 million and \$1.4 million, respectively, and \$4.4 million and \$14.4 million for the six months ended June 30, 2017 and 2016, respectively, in purchases from Enphase and had outstanding payables to Enphase of \$2.7 million and \$0.4 million as of June 30, 2017 and December 31, 2016, respectively.

Item 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The discussion in this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), which statements involve substantial risks and uncertainties. Forward-looking statements generally relate to future events or our future financial or operating performance. In some cases, you can identify forward-looking statements because they contain words such as “may,” “will,” “should,” “expects,” “plans,” “anticipate,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “potential” or “continue” or the use of these words or other similar terms or expressions that concern our expectations, strategy, plans or intentions. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about:

- our ability to finance solar energy systems through financing arrangements with fund or other investors;
- our ability and intent to establish new investment funds;
- our dependence on the availability of rebates, tax credits and other financial incentives;
- determinations by the Internal Revenue Service or the U.S. Treasury Department of the fair market value of our solar energy systems;
- the retail price of utility-generated electricity or electricity from other energy sources;
- regulatory and policy development and changes;
- our ability to maintain an adequate rate of revenue growth;
- our industry’s continued ability to cut costs associated with solar service offerings;
- our strategic partnerships and expected benefits of such partnerships;
- the sufficiency of our cash, investment fund commitments and available borrowings to meet our anticipated cash needs;
- our need to raise capital and finance our operations from new and existing investors;
- our ability to refinance existing debt;
- the potential impact of interest rates on our interest expense;
- our business plan and our ability to effectively manage our growth;
- our ability to further penetrate existing markets, expand into new markets and our expectations regarding market growth (including, but not limited to, expected cancellation rates);
- our expectations concerning relationships with third parties, including the attraction and retention of qualified channel partners;
- the impact of seasonality on our business;
- our investment in research and development;
- our expectations regarding certain performance objectives; and
- the calculation of certain of our key financial and operating metrics and accounting policies.

These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in the section titled “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment, and new risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all 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 we may make. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements. We undertake no obligation to update publicly any forward-looking statements for any reason after the date of this Quarterly Report on Form 10-Q to conform these statements to actual results or to changes in our expectations, except as required by law.

You should read this Quarterly Report on Form 10-Q and the documents that we reference in this Quarterly Report on Form 10-Q and have filed with the Securities and Exchange Commission (the “SEC”) as exhibits to this Quarterly Report on Form 10-Q with the understanding that our actual future results, levels of activity, performance, and events and circumstances may be materially different from what we expect.

Overview

We provide clean, solar energy to homeowners at a significant savings compared to traditional utility energy. We have been selling solar energy to residential customers through a variety of offerings since we were founded in 2007. We, either directly or through one of our solar partners, install a solar energy system on a customer’s home and either sell the system to the homeowner or, as is more often the case, sell the energy generated by the system to the homeowner pursuant to a lease or power purchase agreement (“PPA”) with no or low upfront costs. We refer to these leases and PPAs as “Customer Agreements.” Following installation, a system is interconnected to the local utility grid. The home’s energy usage is provided by the solar energy system, with any additional energy needs provided by the local utility. Unless the solar energy system is connected to a battery, any excess solar energy that is not immediately used by the homeowners is exported to the utility grid using a bi-directional utility net meter, and the homeowner generally receives a credit for the excess energy from their utility to offset future usage of utility-generated energy.

We offer our solar service offerings both directly to the homeowner and through our solar partners, which include sales and installation partners, and strategic partners, which include retail partners. In addition, we sell solar energy systems directly to customers for cash. We also sell solar energy panels and other products (such as racking) to resellers. As of June 30, 2017, we provided our solar services to customers in 22 states, plus the District of Columbia, and sold solar energy panels and other products to resellers throughout the United States. Approximately half of our cumulative systems deployed are in California.

We compete mainly with traditional utilities. In the markets we serve, our strategy is to price the energy we sell below prevailing local retail electricity rates. As a result, the price our customers pay to buy energy from us through our solar service offerings varies depending on the state where the customer lives, the local traditional utility that otherwise provides electricity to the customer, as well as the prices other solar energy companies charge in that region. Even within the same neighborhood, site-specific characteristics drive meaningful variability in the revenue and cost profiles of each home. Using our proprietary technology, we target homes with advantageous revenue and cost characteristics, which means we are often able to offer pricing that allows customers to save more on their energy bill while maintaining our ability to meet our targeted returns. For example, with the insights provided by our technology, we can offer competitive pricing to customers with homes that have favorable characteristics, such as roofs that allow for easy installation, high electricity consumption, or low shading, effectively passing through the cost savings we are able to achieve on these installations to the homeowner.

Our ability to offer Customer Agreements depends in part on our ability to finance the purchase and installation of the solar energy systems by monetizing the resulting customer cash flows and related investment tax credits (“ITCs”), accelerated tax depreciation and other incentives from governments and local utilities. We monetize these incentives under tax equity investment funds which are generally structured as non-recourse project financings. From inception to August 3, 2017, we have established 32 investment funds, which represent financing for an estimated \$5.7 billion in value of solar energy systems on a cumulative basis. We intend to establish additional investment funds and may also use debt, equity and other financing strategies to fund our growth.

Investment Funds

Our Customer Agreements provide for recurring customer payments, typically over 20 years, and the related solar energy systems are generally eligible for ITCs, accelerated tax depreciation and other government or utility incentives. Our financing strategy is to monetize these benefits at a low weighted average cost of capital. This low

cost of capital enables us to offer attractive pricing to our customers for the energy generated by the solar energy system on their homes. Historically, we have monetized a portion of the value created by our Customer Agreements and the related solar energy systems through investment funds. These assets are attractive to fund investors due to the long-term, recurring nature of the cash flows generated by our Customer Agreements, the high credit scores of our customers, the fact that energy is a non-discretionary good and our low loss rates. In addition, fund investors can receive attractive after-tax returns from our investment funds due to their ability to utilize ITCs, accelerated depreciation and certain government or utility incentives associated with the funds' ownership of solar energy systems. From inception to August 3, 2017, we have formed 32 investment funds. Of these 32 funds, 27 are currently active and are described below. We have established different types of investment funds to implement our asset monetization strategy. Depending on the nature of the investment fund, cash may be contributed to the investment fund by the investor upfront or in stages based on milestones associated with the design, construction or interconnection status of the solar energy systems. The cash contributed by the fund investor is used by the investment fund to purchase solar energy systems. The investment funds either own or enter into a master lease with a Sunrun subsidiary for the solar energy systems, Customer Agreements and associated incentives. We receive on-going cash distributions from the investment funds representing a portion of the monthly customer payments received. We use the upfront cash, as well as on-going distributions to cover our costs associated with designing, purchasing and installing the solar energy systems. In addition, we also use debt, equity and other financing strategies to fund our operations. The allocation of the economic benefits between us and the fund investor and the corresponding accounting treatment varies depending on the structure of the investment fund.

We currently utilize three legal structures in our investment funds, which we refer to as: (i) lease pass-throughs, (ii) partnership flips and (iii) joint venture ("JV") inverted leases. We reflect lease pass-through arrangements on our consolidated balance sheet as a lease pass-through financing obligation. We record the investor's interest in partnership flips or JV inverted leases (which we define collectively as "consolidated joint ventures") as noncontrolling interests or redeemable noncontrolling interests. These consolidated joint ventures are usually redeemable at our option and, in certain cases, at the investor's option. If redemption is at our option or the consolidated joint ventures are not redeemable, we record the investor's interest as a noncontrolling interest and account for the interest using the hypothetical liquidation at book value ("HLBV") method. If the investor has the option to put their interest to us, we record the investor's interest as redeemable noncontrolling interest at the greater of the HLBV and the redemption value.

The table below provides an overview of our current investment funds (in millions, except number of funds and MW Deployed):

	Lease Pass-Through Owner entity consolidated, tenant entity not consolidated	Consolidated Partnership Flip Single entity, not consolidated	Consolidated Joint Ventures JV Owner and tenant entities consolidated	Inverted Lease Owner and tenant entities consolidated
Consolidation				
Balance sheet classification	Lease pass-through financing obligation	Redeemable noncontrolling interests and noncontrolling interests	Redeemable controlling interests and controlling interests	Noncontrolling interests
Revenue from ITCs	Recognized annually over 5 years as the recapture period elapses	None	None	None
Method of calculating investor interest	Effective interest rate method	Greater of HLBV or redemption value	Greater of HLBV or redemption value	Pro rata
Liability balance as of June 30, 2017	\$ 145.1	N/A	N/A	N/A
Noncontrolling interest balance (redeemable or otherwise) as of June 30, 2017	N/A	\$411.1	\$74.2	\$ 6.8
Number of funds (as of June 30, 2017)	5	17	5	1
MW deployed (as of June 30, 2017)	129.5	572.8	149.1	20.7
Carrying value of solar energy systems, net (as of June 30, 2017)	\$ 434.3	\$1,630.6	\$525.6	\$ 81.5
Contributions from third-party fund investors (through June 30, 2017)	\$ 508.0	\$1,405.1	\$388.4	\$ 86.3

For further information regarding our investment funds, including the associated risks, see “Risk Factors—Our ability to provide our solar service offerings to homeowners on an economically viable basis depends in part on our ability to finance these systems with fund investors who seek particular tax and other benefits”, Note 8, Lease Pass-Through Financing Obligations, Note 9, VIE Arrangements and Note 10, Redeemable Noncontrolling Interests and Equity to our consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q.

Key Operating Metrics

We regularly review a number of metrics, including the following key operating metrics, to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions. Some of our key operating metrics are estimates that are based on our management's beliefs and assumptions and on information currently available to management. Although we believe that we have a reasonable basis for each of these estimates, we caution you that these estimates are based on a combination of assumptions that may prove to be inaccurate over time. Any inaccuracies could be material to our actual results when compared to our calculations. Please see the section titled "Risk Factors" in this Quarterly Report on Form 10-Q for more information. Furthermore, other companies may calculate these metrics differently than we do now or in the future, which would reduce their usefulness as a comparative measure.

During the fourth quarter of 2016, we reviewed our key operating metrics to ensure our reported metrics remain aligned with how we currently operate our business. Based on our growing operating experience, unique business model and industry trends, we modified our method for calculating Megawatts Booked and replaced Estimated Retained Value and Estimated Nominal Contracted Payments Remaining with Gross Earning Assets. We believe these changes will provide investors with improved indicators of performance and trends and are better aligned with our current sales compensation and key operating objectives. As a result of this modification, the presentation of Megawatts Booked for periods prior to December 31, 2016 in the tables below has been recast to reflect the updated calculation methodology. In addition, we have now modified the definition of Gross Earning Assets to explain that in calculating Gross Earning Assets we deduct estimated cash distributions to our cash equity financing providers, similar to how we exclude estimated cash distributions to investors in consolidated joint ventures.

Megawatts Booked represents the aggregate megawatt production capacity of our solar energy systems, whether sold directly to customers or subject to an executed Customer Agreement, for which we have confirmation that the systems have reached NTP, net of cancellations.

Megawatts Deployed represents the aggregate megawatt production capacity of our solar energy systems, whether sold directly to customers or subject to executed Customer Agreements, for which we have (i) confirmation that the systems are installed on the roof, subject to final inspection or (ii) in the case of certain system installations by our partners, accrued at least 80% of the expected project cost.

Gross Earning Assets represents the net cash flows (discounted at 6%) we expect to receive during the initial 20-year term of our Customer Agreements for systems that have been deployed as of the measurement date, plus a discounted estimate of the value of the Customer Agreement renewal term or solar energy system purchase at the end of the initial term. Consistent with industry standards, we use a discount rate of 6%. We consider a discount rate of 6% to be appropriate and consistent with recent market transactions that demonstrate that a portfolio of residential solar homeowner contracts is an asset class that can be securitized successfully on a long-term basis, with a coupon of less than 5%. We calculate the Gross Earning Assets value of the purchase or renewal amount at the expiration of the initial contract term assuming a 10-year renewal at a contract rate equal to 90% of the customer's contractual rate in effect at the end of the initial contract term. After the initial (typically 20-year) contract term, our Customer Agreements provide customers the option to renew their contracts for the remaining life of the solar energy system typically at a 10% discount to then-prevailing power prices.

Gross Earning Assets excludes estimated cash distributions to investors in consolidated joint ventures and estimated operating, maintenance and administrative expenses for systems deployed as of the measurement date. In calculating Gross Earning Assets, we deduct estimated cash distributions to our cash equity financing providers. In calculating Gross Earning Assets, we do not deduct customer payments we are obligated to pass through to investors in lease pass-throughs as these amounts are reflected on our balance sheet as long-term and short-term lease pass-through obligations, similar to the way that debt obligations are presented. In determining our finance strategy, we use lease pass-throughs and long-term debt in an equivalent fashion as the schedule of payments of distributions to lease

pass-through investors is more similar to the payment of interest to lenders than the internal rates of return (IRRs) paid to investors in other tax equity structures.

Gross Earning Assets Under Energy Contract represents the net cash flows during the initial (typically 20 year) term of our Customer Agreements (less substantially all value from SRECs prior to July 1, 2015), for systems deployed as of the measurement date.

Gross Earning Assets Value of Purchase or Renewal is the forecasted net present value we would receive upon or following the expiration of the initial Customer Agreement term (either in the form of cash payments during any applicable renewal period or a system purchase at the end of the initial term), for systems deployed as of the measurement date.

Gross Earning Assets is forecasted as of a specific date. It is forward-looking, and we use judgment in developing the assumptions used to calculate it. Factors that could impact Gross Earning Assets include, but are not limited to, customer payment defaults, or declines in utility rates or early termination of a contract in certain circumstances, including prior to installation.

Factors that could impact Gross Earning Assets include, but are not limited to, customer payment defaults, or declines in utility rates or early termination of a contract in certain circumstances, including prior to installation.

	For the Three Months Ended June 30, 2017 2016	
MW Booked (during the period) (1)	88	69
MW Deployed (during the period)	76	65

(1) MW Booked for the three months ended June 30, 2016 has been recast to reflect the updated method of calculating MW Booked as discussed above.

	As of June 30, 2017 2016	
Cumulative Megawatts Deployed (end of period) (1)	1,027	721

(1) The Cumulative Megawatts Deployed may not equal the sum of all MW deployed each year due to rounding.

	As of June 30, 2017 2016	
	(in thousands)	
Gross Earning Assets Under Energy Contract	\$1,229,176	\$992,380
Gross Earning Assets Value of Purchase or Renewal	664,860	506,880
Gross Earning Assets	\$1,894,036	\$1,499,260

The tables below provide a range of Gross Earning Asset amounts if different default, discount and purchase and renewal assumptions were used.

Gross Earning Assets Under Energy Contract:

	As of June 30, 2017				
	Discount rate				
Default rate	4%	5%	6%	7%	8%

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(in thousands)

5%	\$1,410,090	\$1,297,574	\$1,197,798	\$1,109,069	\$1,029,943
0%	\$1,448,635	\$1,332,299	\$1,229,176	\$1,137,507	\$1,055,791

30

Gross Earning Assets Value of Purchase or Renewal:

	As of June 30, 2017				
	Discount rate				
Purchase or Renewal rate	4%	5%	6%	7%	8%
	(in thousands)				
80%	\$885,334	\$716,097	\$581,152	\$473,191	\$386,535
90%	\$1,012,721	\$819,189	\$664,860	\$541,382	\$442,265
100%	\$1,140,107	\$922,280	\$748,568	\$609,574	\$497,994

Total Gross Earning Assets:

	As of June 30, 2017				
	Discount rate				
Purchase or Renewal rate	4%	5%	6%	7%	8%
	(in thousands)				
80%	\$2,333,969	\$2,048,395	\$1,810,328	\$1,610,698	\$1,442,327
90%	\$2,461,356	\$2,151,487	\$1,894,036	\$1,678,889	\$1,498,056
100%	\$2,588,742	\$2,254,579	\$1,977,744	\$1,747,081	\$1,553,786

Critical Accounting Policies and Estimates

There have been no material changes to our critical accounting policies and estimates during the six months ended June 30, 2017 from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the SEC pursuant to the Exchange Act.

Results of Operations

The results of operations presented below should be reviewed in conjunction with the consolidated financial statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(in thousands, except per share data)			
Revenue:				
Operating leases and incentives	\$65,337	\$45,394	\$113,435	\$79,934
Solar energy systems and product sales	72,511	77,144	128,530	141,347
Total revenue	137,848	122,538	241,965	221,281
Operating expenses:				
Cost of operating leases and incentives	47,114	38,608	91,450	76,708
Cost of solar energy systems and product sales	60,938	61,600	110,369	119,112
Sales and marketing	32,784	43,716	64,460	86,904
Research and development	3,710	2,373	6,706	4,836
General and administrative	25,230	23,614	49,851	46,862
Amortization of intangible assets	1,051	1,051	2,102	2,103
Total operating expenses	170,827	170,962	324,938	336,525
Loss from operations	(32,979)	(48,424)	(82,973)	(115,244)
Interest expense, net	16,602	13,063	31,879	24,578
Other expenses (income), net	208	30	683	(502)
Loss before income taxes	(49,789)	(61,517)	(115,535)	(139,320)
Income tax expense (benefit)	15,453	3,210	22,791	3,210
Net loss	(65,242)	(64,727)	(138,326)	(142,530)
Net loss attributable to noncontrolling interests and redeemable noncontrolling interests	(90,364)	(97,370)	(176,175)	(188,307)
Net income attributable to common stockholders	\$25,122	\$32,643	\$37,849	\$45,777
Net income per share attributable to common stockholders				
Basic	\$0.24	\$0.32	\$0.36	\$0.45
Diluted	\$0.23	\$0.31	\$0.35	\$0.44
Weighted average shares used to compute net income per share attributable to common stockholders				
Basic	105,093	101,969	104,568	101,621
Diluted	107,347	104,768	106,911	104,494

Comparison of the Three Months Ended June 30, 2017 and 2016

Revenue

	Three Months Ended June 30,		Change	
	2017	2016	\$	%
	(in thousands)			
Operating leases	\$47,034	\$32,980	\$14,054	43 %
Incentives	18,303	12,414	5,889	47 %
Operating leases and incentives	65,337	45,394	19,943	44 %
Solar energy systems	28,078	35,878	(7,800)	(22)%
Products	44,433	41,266	3,167	8 %
Solar energy systems and product sales	72,511	77,144	(4,633)	(6)%
Total revenue	\$137,848	\$122,538	\$15,310	12 %

Operating Leases and Incentives. Operating lease revenue increased by \$14.1 million, due to both an increase in solar energy systems under Customer Agreements being placed in service in the period from July 1, 2016 through June 30, 2017, and a full quarter of revenue recognized in the second quarter of 2017 for systems placed in service in the second quarter of 2016 versus only a portion recognized in the second quarter of 2016. Revenue from incentives increased by \$5.9 million primarily due to an increase in solar renewable energy credits ("SRECs") revenue as a result of the sales under contracts whereby the revenue recognition had previously been deferred until minimum levels of deliveries were met, assuring there would be no potential penalties due to the customer.

Solar Energy Systems and Product Sales. Revenue from solar energy systems sales decreased by \$7.8 million compared to the prior year due to softer customer demand in our retail sales channel. Product sales increased slightly by \$3.2 million, compared to the prior year period primarily due to an increase in volume of products sold, offset by industry-wide price decreases.

Operating Expenses

	Three Months Ended June 30,		Change	
	2017	2016	\$	%
	(in thousands)			
Cost of operating leases and incentives	\$47,114	\$38,608	\$8,506	22 %
Cost of solar energy systems and product sales	60,938	61,600	(662)	(1)%
Sales and marketing	32,784	43,716	(10,932)	(25)%
Research and development	3,710	2,373	1,337	56 %
General and administrative	25,230	23,614	1,616	7 %
Amortization of intangible assets	1,051	1,051	—	— %
Total operating expenses	\$170,827	\$170,962	\$(135)	— %

Cost of Operating Leases and Incentives. The \$8.5 million increase in cost of operating leases and incentives was primarily due to the increase in solar energy systems placed in service in the period from July 1, 2016 through June 30, 2017, plus a full quarter of expenses recognized for systems placed in service in the second quarter of 2016 versus only a partial quarter of such expenses related to the period in which the assets were in service in 2016. This resulted in an \$8.3 million increase in depreciation and amortization of solar energy system equipment costs and initial direct costs.

The cost of operating leases and incentives decreased to 72% of operating lease and incentives revenue during the three months ended June 30, 2017, from 85% during the three months ended June 30, 2016. This reduction in cost compared to revenue relates to a higher proportion of incentives and SREC revenue in the three

months ended June 30, 2017, which have minimal corresponding costs. Additionally, leased systems installed by us bear an allocation of costs, such as warehouse rent and utilities, information technology, administrative and product planning costs, that are expensed during the construction and installation phase as these costs do not meet the criteria for capitalization under Accounting Standards Codification (“ASC”) 360 Property, Plant, and Equipment. These costs decreased during the three months ended June 30, 2017 from the prior year period due to a reduction in the proportion of solar energy systems installed directly by us compared to integrated partners. These costs can fluctuate depending on the volume of megawatts installed directly by us for systems under an operating lease, and are not necessarily proportional to the increase in revenue generated by our entire fleet of leased systems. As such, the cost of operating leases and incentives as a percentage of operating lease and incentives revenue can vary from period to period.

Cost of Solar Energy Systems and Product Sales. The \$0.7 million decrease in cost of solar energy systems and product sales was primarily due to a decrease in the sales of solar energy systems discussed above.

Sales and Marketing Expense. The \$10.9 million decrease in sales and marketing expense was primarily attributable to the decrease in our use of certain third party lead generation and direct mailer provider services as we continue to generate more leads internally.

General and Administrative Expense. The \$1.6 million increase in general and administrative expenses primarily relates to hiring of personnel to support the growth of our business.

Non-Operating Expenses

	Three Months Ended June 30,		Change	
	2017	2016	\$	%
	(in thousands)			
Interest expense, net	\$16,602	\$13,063	\$3,539	27 %
Other expenses (income), net	208	30	178	593 %
Total interest and other expenses, net	\$16,810	\$13,093	\$3,717	28 %

Interest Expense, net. The increase in interest expense, net of \$3.5 million was related to additional borrowings entered into in late 2016 and in the three months ended June 30, 2017.

Income Tax Expense

	Three Months Ended June 30,		Change	
	2017	2016	\$	%
	(in thousands)			
Income tax expense	\$15,453	\$3,210	\$12,243	381 %

The increase in tax expense primarily relates to an increase in our deferred tax liabilities related to partnerships, depreciation expense and capitalized indirect costs. The increase in our deferred tax liabilities was offset by the adoption of Accounting Standards Update (“ASU”) 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, which netted prepaid tax assets of \$378.2 million against deferred tax liabilities. Given our net operating loss carryforwards as of December 31, 2016, we do not expect to pay income tax, including in connection with our 2017 income tax provision, until our net operating losses are fully utilized. As of December 31, 2016, our federal and state net operating loss carryforwards were \$571.3 million and \$524.9 million, respectively. If not utilized, the federal net operating loss will begin to expire in the year 2028 and the state net operating losses will begin to expire in the year 2024.

Net Loss Attributable to Noncontrolling Interests and Redeemable Noncontrolling Interests

	Three Months Ended		Change	
	June 30, 2017	2016	\$	%
	(in thousands)			
Net loss attributable to noncontrolling interests and redeemable noncontrolling interests	\$(90,364)	\$(97,370)	\$7,006	(7)%

The decrease in net loss attributable to noncontrolling interests and redeemable noncontrolling interests was primarily a result of funds past the deployment stage and being allocated income or lower loss under the HLBV method, which generally allocates more loss to the noncontrolling interest in the first several years after fund formation, offset by the addition of eight investment funds since June 30, 2016.

Comparison of the Six Months Ended June 30, 2017 and 2016

Revenue

	Six Months Ended		Change	
	June 30, 2017	2016	\$	%
	(in thousands)			
Operating leases	\$82,096	\$58,307	\$23,789	41 %
Incentives	31,339	21,627	9,712	45 %
Operating leases and incentives	113,435	79,934	33,501	42 %
Solar energy systems	48,697	66,070	(17,373)	(26)%
Products	79,833	75,277	4,556	6 %
Solar energy systems and product sales	128,530	141,347	(12,817)	(9) %
Total revenue	\$241,965	\$221,281	\$20,684	9 %

Operating Leases and Incentives. Operating lease revenue increased by \$23.8 million, due to both an increase in solar energy systems under Customer Agreements being placed in service in the period from July 1, 2016 through June 30, 2017, and due to a full half year of revenue recognized in 2017 for systems placed in service in the first half of 2016 versus only a portion recognized in the first half of 2016. Revenue from incentives increased by \$9.7 million due to an increase in ITC revenue, which relates to solar energy systems in lease pass-through funds being placed in service in the prior year as we recognize revenue from the monetization of these ITCs annually over five years on each anniversary of a solar energy system's permission-to-operate date. Additionally, the increase was due to an increase in SREC revenue as a result of the sales under contracts whereby the revenue recognition had previously been deferred until minimum levels of deliveries were met, assuring there would be no potential penalties due to the customer.

Solar Energy Systems and Product Sales. Revenue from solar energy systems sales decreased by \$17.4 million compared to the prior year due to softer customer demand in our retail sales channel. Product sales increased slightly by \$4.6 million, compared to the prior year period primarily due to an increase in volume of products sold, offset by industry-wide price decreases.

Operating Expenses

	Six Months Ended		Change	
	June 30, 2017	2016	\$	%
	(in thousands)			
Cost of operating leases and incentives	\$91,450	\$76,708	\$14,742	19 %
Cost of solar energy systems and product sales	110,369	119,112	(8,743)	(7)%
Sales and marketing	64,460	86,904	(22,444)	(26)%
Research and development	6,706	4,836	1,870	39 %
General and administrative	49,851	46,862	2,989	6 %
Amortization of intangible assets	2,102	2,103	(1)	— %
Total operating expenses	\$324,938	\$336,525	\$(11,587)	(3)%

Cost of Operating Leases and Incentives. The \$14.7 million increase in cost of operating leases and incentives was primarily due to the increase in solar energy systems placed in service in the period from July 1, 2016 through June 30, 2017, plus a full half year of expenses recognized for systems placed in service in the first half of 2016 versus only a portion of such expenses related to the period in which the assets were in service in 2016. This resulted in a \$17.4 million increase in depreciation and amortization of solar energy system equipment costs and initial direct costs, offset by a decrease of \$3.6 million in costs associated with building and maintaining solar energy systems subject to Customer Agreements due to a reduction in the proportion of solar energy systems installed directly by us compared to integrated partners.

The cost of operating leases and incentives decreased to 81% of operating lease and incentives revenue during the six months ended June 30, 2017, from 96% during the six months ended June 30, 2016. This reduction in cost compared to revenue relates to a higher proportion of incentives revenue in the six months ended June 30, 2017, which have minimal corresponding costs. Additionally, leased systems installed by us bear an allocation of costs, such as warehouse rent and utilities, information technology, administrative and product planning costs, that are expensed during the construction and installation phase as these costs do not meet the criteria for capitalization under ASC 360 Property, Plant, and Equipment. These costs decreased during the six months ended June 30, 2017 from the prior year period due to a reduction in the proportion of solar energy systems installed directly by us compared to integrated partners. These costs can fluctuate depending on the volume of megawatts installed directly by us for systems under an operating lease, and are not necessarily proportional to the increase in revenue generated by our entire fleet of leased systems. As such, the cost of operating leases and incentives as a percentage of operating lease and incentives revenue can vary from period to period.

Cost of Solar Energy Systems and Product Sales. The \$8.7 million decrease in cost of solar energy systems and product sales was due to a decrease in the sales of solar energy systems discussed above.

Sales and Marketing Expense. The \$22.4 million decrease in sales and marketing expense was primarily attributable to the decrease in our use of certain third party lead generation and direct mailer provider services as we continue to generate more leads internally.

General and Administrative Expense. The \$3.0 million increase in general and administrative expenses primarily relates to hiring of personnel to support the growth of our business.

Non-Operating Expenses

	Six Months Ended		Change	
	June 30, 2017	2016	\$	%
	(in thousands)			
Interest expense, net	\$31,879	\$24,578	\$7,301	30 %
Other expenses (income), net	683	(502)	1,185	(236)%
Total interest and other expenses, net	\$32,562	\$24,076	\$8,486	35 %

Interest Expense, net. The increase in interest expense, net of \$7.3 million was related to additional borrowings entered into in late 2016 and in the six months ended June 30, 2017.

Income Tax Expense

	Six Months		Change	
	Ended June 30, 2017	2016	\$	%
	(in thousands)			
Income tax expense	\$22,791	\$3,210	\$19,581	610%

The increase in tax expense primarily relates to an increase in our deferred tax liabilities related to partnerships, depreciation expense and capitalized indirect costs. The increase in our deferred tax liabilities was offset by the adoption of ASU 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, which netted prepaid tax assets of \$378.2 million against deferred tax liabilities. Given our net operating loss carryforwards as of December 31, 2016, we do not expect to pay income tax, including in connection with our 2017 income tax provision, until our net operating losses are fully utilized. As of December 31, 2016, our federal and state net operating loss carryforwards were \$571.3 million and \$524.9 million, respectively. If not utilized, the federal net operating loss will begin to expire in the year 2028 and the state net operating losses will begin to expire in the year 2024.

Net Loss Attributable to Noncontrolling Interests and Redeemable Noncontrolling Interests

	Six Months Ended June		Change	
	30, 2017	2016	\$	%
	(in thousands)			
Net loss attributable to noncontrolling interests and redeemable noncontrolling interests	\$(176,175)	\$(188,307)	\$12,132	(6)%

The decrease in net loss attributable to noncontrolling interests and redeemable noncontrolling interests was primarily a result of funds past the deployment stage and being allocated income or lower loss under the HLBV method, which generally allocates more loss to the noncontrolling interest in the first several years after fund formation, offset by the addition of eight investment funds since June 30, 2016.

Liquidity and Capital Resources

As of June 30, 2017, we had cash of \$211.3 million, which consisted of cash held in checking and savings accounts with financial institutions. We finance our operations mainly through a variety of financing fund arrangements that we have formed with fund investors, borrowings, cash generated from our sources of revenue and more recently, proceeds from secured credit facilities agreements with a syndicate of banks for up to \$542.0 million in committed facilities and \$59.8 million secured, non-recourse loan arrangements. Our principal uses of cash are funding our business, including the costs of acquisition and installation of solar energy systems, satisfaction of our obligations under our debt instruments and other working capital requirements. As of June 30, 2017, the balance under our working capital facility was \$247.0 million with a maturity date in April 2018. As of

June 30, 2017, our cash balance was \$211.3 million and as such, we do not currently have the funds required to fully repay the debt. As this facility has a three year term, we are in the process of negotiating refinancing options and we expect to extend the maturity date of the facility. Although there is no assurance that we will be able to do so, we believe that it is probable that we will be able to extend or otherwise refinance the facility prior to maturity. Our business model requires substantial outside financing arrangements to grow the business and facilitate the deployment of additional solar energy systems. The solar energy systems that are operational are expected to generate a positive return rate over the term of the Customer Agreement, typically 20 years. However, in order to grow, we will continue to be dependent on financing from outside parties. If financing is not available to us on acceptable terms if and when needed, we may be required to reduce planned spending, which could have a material adverse effect on our operations. While there can be no assurances, we anticipate raising additional required capital from new and existing investors. We believe our cash, investment fund commitments and available borrowings as further described below will be sufficient to meet our anticipated cash needs (other than the repayment of our working capital facility expected to be refinanced) for at least the next 12 months. The following table summarizes our cash flows for the periods indicated:

Six Months Ended
June 30,
2017 2016

(in thousands)

Consolidated cash flow data:

Net cash used in operating activities	\$(33,457)	\$(98,413)
Net cash used in investing activities	(361,190)	(345,680)
Net cash provided by financing activities	399,604	447,449
	\$4,957	\$3,356

Operating Activities

During the six months ended June 30, 2017, we used \$33.5 million in net cash in operating activities. The driver of our operating cash inflow consists of payments received from customers. During the six months ended June 30, 2017, our operating cash outflows were \$28.0 million from our net loss excluding non-cash and non-operating items. The \$28.0 million includes a final cash payment of \$8.8 million related to the Clean Energy Experts, LLC ("CEE") acquisition as discussed in Note 3, Acquisitions of our Form 10-K for the year ended December 31, 2016. Changes in working capital, other than inventory, resulted in a net cash outflow of \$15.8 million. Changes in inventory resulted in a cash inflow of \$14.6 million.

During the six months ended June 30, 2016, we used \$98.4 million in net cash in operating activities. The primary driver of our operating cash inflow consists of payments received from customers. During the six months ended June 30, 2016, we had an increase in deferred revenue of approximately \$3.3 million relating to upfront lease payments received from customers and solar energy system incentive rebate payments received from various state and local utilities. This increase was offset by our operating cash outflows of \$79.3 million from our net loss excluding non-cash and non-operating items. Changes in inventory resulted in a cash outflow of \$16.8 million. Changes in working capital, other than deferred revenue and inventory, resulted in an outflow of cash of \$5.5 million.

Investing Activities

During the six months ended June 30, 2017, we used \$361.2 million in cash in investing activities. Of this amount, we used \$356.7 million to acquire and install solar energy systems and components under our long-term Customer Agreements, and \$4.5 million for the acquisition of office equipment.

During the six months ended June 30, 2016, we used \$345.7 million in cash in investing activities. Of this amount, we used \$332.5 million to acquire and install solar energy systems and components under our long-term Customer Agreements, \$8.2 million for the acquisition of office equipment, leasehold improvements and furniture, and \$5.0 million for additional purchase consideration for the acquisition of CEE.

Financing Activities

During the six months ended June 30, 2017, we generated \$399.6 million from financing activities. This was primarily driven by \$282.0 million in net proceeds from fund investors, \$109.7 million in proceeds from non-recourse debt, net of repayments and debt fees, and \$13.2 million from state grants, net of recapture, offset by \$5.3 million in payments for capital lease obligations.

During the six months ended June 30, 2016, we generated \$447.4 million from financing activities. This was primarily driven by \$234.2 million in net proceeds from fund investors, \$206.3 million in proceeds from debt, net of debt issuance costs and repayments, including repayment of asset-backed notes, and \$9.1 million from state grants, net of recapture.

Debt and Financing Fund Commitments

Debt Instruments

For a discussion of the terms and conditions of debt instruments and changes thereof in the period, refer to Note 6, Indebtedness, to our consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

Investment Fund Commitments

As of June 30, 2017, we had undrawn committed capital of approximately \$273.9 million which may only be used to purchase and install solar energy systems. We intend to establish new investment funds in the future, and we may also use debt, equity or other financing strategies to finance our business.

Contractual Obligations and Other Commitments

The following table summarizes our contractual obligations as of June 30, 2017 (in thousands):

	Payments Due by Period				Total
	Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 Years	
	(in thousands)				
Contractual Obligations:					
Debt obligations (including future interest)	\$50,548	\$399,143	\$470,142	\$262,954	\$1,182,787
Distributions payable to noncontrolling interests and redeemable noncontrolling interests	13,212	—	—	—	13,212
Capital lease obligations (including accrued interest)	9,145	8,826	392	10	18,373
Operating lease obligations	8,737	12,160	5,510	2,333	28,740
Total contractual obligations	\$81,642	\$420,129	\$476,044	\$265,297	\$1,243,112

Off-Balance Sheet Arrangements

We include in our consolidated financial statements all assets and liabilities and results of operations of investment fund arrangements that we have entered into. We do not have any off-balance sheet arrangements.

Recent Accounting Pronouncements

See Note 2, Summary of Significant Accounting Policies, to our consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks in the ordinary course of our business. Our primary exposure includes changes in interest rates because certain borrowings bear interest at floating rates based on LIBOR plus a specified margin. We sometimes manage our interest rate exposure on floating-rate debt by entering into derivative instruments to hedge all or a portion of our interest rate exposure in certain debt facilities. We do not enter into any derivative instruments for trading or speculative purposes. Changes in economic conditions could result in higher interest rates, thereby increasing our interest expense and operating expenses and reducing funds available for capital investments, operations and other purposes. A hypothetical 10% increase in our interest rates on our variable rate debt facilities would have increased our interest expense by \$1.3 million for the six months ended June 30, 2017, which has not changed materially from \$1.5 million since December 31, 2016.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our “disclosure controls and procedures” as of the end of the period covered by this Quarterly Report on Form 10-Q, pursuant to Rules 13a-15(e) and 15d-15(e) under the Exchange Act.

In connection with that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective and designed to provide reasonable assurance that the information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms as of June 30, 2017. The term “disclosure controls and procedures,” as defined in Rules 13a-151 and 15d-151 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

See Note 13, Commitments and Contingencies, to our consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors.

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information in this Quarterly Report on Form 10-Q, including the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations”

and our consolidated financial statements and related notes, before making a decision to invest in our common stock. The risks and uncertainties described below may not be the only ones we face. If any of the risks

actually occur, our business, financial condition, results of operations, cash flows and prospects could be materially and adversely affected. In that event, the market price of our common stock could decline, and you could lose part or all of your investment.

Risks Related to Our Business and Our Industry

We need to raise capital to finance the continued growth of our residential solar service business. If capital is not available to us on acceptable terms, as and when needed, our business and prospects would be materially and adversely impacted. In addition, our business is affected by general economic conditions and related uncertainties affecting markets in which we operate. Volatility in current economic conditions could adversely impact our business, including our ability to raise financing.

Our future success depends on our ability to raise capital from third parties to grow our business. To date, we have funded our business principally through low-cost tax equity investment funds. If we are unable to establish new investment funds when needed, or upon desirable terms, the growth of our solar service business would be impaired. Changes in tax law could affect our ability to establish such tax equity investment funds or impact the terms of existing or future funds.

The contract terms in certain of our existing investment fund documents contain various conditions with respect to our ability to draw on financing commitments from the fund investors, including conditions that restrict our ability to draw on such commitments if an event occurs that could reasonably be expected to have a material adverse effect on the fund or, in some instances, us. If we were not able to satisfy such conditions due to events related to our business, a specific investment fund, developments in our industry, including tax or regulatory changes, or otherwise, and as a result, we were unable to draw on existing funding commitments, we could experience a material adverse effect on our business, liquidity, financial condition, results of operations and prospects. If any of the investors that currently invest in our investment funds were to decide not to invest in future investment funds to finance our solar service offerings due to general market conditions, concerns about our business or prospects or any other reason, or materially change the terms under which they were willing to provide future financing, we would need to identify new investors to invest in our investment funds and our cost of capital may increase.

In addition, our business and results of operations are materially affected by conditions in the global capital markets and the economy. A general slowdown or volatility in current economic conditions, stemming from the level of U.S. national debt, currency fluctuations, unemployment rates, the availability and cost of credit, the U.S. housing market, inflation levels, negative interest rates, energy costs and concerns over a slow economic recovery could adversely affect our business, including our ability to raise financing.

There can be no assurance that we will be able to continue to successfully access capital in a manner that supports the growth of our business. Certain sources of capital may not be available in the future, and competition for any available funding may increase. We cannot be sure that we will be able to maintain necessary levels of funding without incurring high funding costs, unfavorable changes in the terms of funding instruments or the liquidation of certain assets. If we are unable to continue to offer a competitive investment profile, we may lose access to these funds or they may only be available on less favorable terms than those provided to our competitors or currently provided to us. If we are unable to arrange new or alternative methods of financing on favorable terms, our business, liquidity, financial condition, results of operations and prospects could be materially and adversely affected.

The solar energy industry is an emerging market that is constantly evolving and may not develop to the size or at the rate we expect.

The solar energy industry is an emerging and constantly evolving market opportunity. We believe the solar energy industry will take several years to fully develop and mature, and we cannot be certain that the market will grow at the rate we expect. For example, we have experienced increases in cancellations of our Customer Agreements in certain geographic markets during certain periods throughout our operating history. Any future growth of the solar energy market and the success of our solar service offerings depend on many factors beyond our control, including recognition and acceptance of the solar service market by consumers, the pricing of alternative sources of energy, a favorable regulatory environment, the continuation of expected tax benefits and other incentives and our ability to provide our solar service offerings cost-effectively. If the markets for solar energy do not develop at the rate we expect, our business may be adversely affected.

Solar energy has yet to achieve broad market acceptance and depends in part on continued support in the form of rebates, tax credits and other incentives from federal, state and local governments. If this support diminishes, our ability to obtain external financing on acceptable terms, or at all, could be materially adversely affected. These types of funding limitations could lead to inadequate financing support for the anticipated growth in our business. Furthermore, growth in residential solar energy depends in part on macroeconomic conditions, retail prices of electricity and homeowner preferences, each of which can change quickly. Declining macroeconomic conditions, including in the job markets and residential real estate markets, could contribute to instability and uncertainty among homeowners and impact their financial wherewithal, credit scores or interest in entering into long-term contracts, even if such contracts would generate immediate and long-term savings. Market prices of retail electricity generated by utilities or other energy sources could decline for a variety of reasons, as discussed further below. Any such declines in macroeconomic conditions or changes in homeowner preferences would adversely impact our business.

Our ability to provide our solar service offerings to homeowners on an economically viable basis depends in part on our ability to finance these systems with fund investors who seek particular tax and other benefits. Our solar service offerings have been eligible for federal investment tax credits (“ITCs”), U.S. Treasury grants and other tax benefits. We have relied on, and will continue to rely on, tax equity investment funds, which are financing structures that monetize a substantial portion of those benefits, in order to finance our solar service offerings. If, for any reason, we were unable to continue to monetize those benefits through these arrangements, we may be unable to provide and maintain our solar service offerings for homeowners on an economically viable basis.

The availability of this tax-advantaged financing depends upon many factors, including:

- our ability to compete with other solar energy companies for the limited number of potential fund investors, each of which has limited funds and limited appetite for the tax benefits associated with these financings;
- the state of financial and credit markets;
- changes in the legal or tax risks associated with these financings; and
- non-renewal of these incentives or decreases in the associated benefits.

The federal government currently offers a 30% ITC (the “Commercial ITC”) under Section 48(a) of the Internal Revenue Code of 1986, as amended (the “Code”), for the installation of certain solar power facilities owned for business purposes. The depreciable basis of a solar facility is also reduced by 50% of the tax credit claimed. Similarly, the federal government currently offers a 30% investment tax credit (“Residential ITC”) for the installation of certain solar power facilities owned by residential taxpayers. The Commercial ITC was set to step down to 10% and the Residential ITC was set to expire at the end of 2016. However in December 2015, Congress passed legislation extending both the Commercial and Residential ITC for an additional five years with a ramp down from 30% to 26% for solar property commencing construction in 2020 and then further to 22% for solar property commencing construction in 2021. Current law provides that the Commercial ITC will be 10% for both (i) solar property commencing construction after 2021 and (ii) solar property which commenced construction during or prior to 2021 but which is placed in service after 2023, and the Residential ITC will expire after 2021.

Potential investors must remain satisfied that the funding structures that we offer will make the tax benefits associated with solar energy systems available to these investors, which depends on the investors’ assessment of the tax law, the absence of any unfavorable interpretations of that law and the continued application of existing tax law and interpretations to our funding structures. Adverse changes in existing law or interpretations of existing law by the Internal Revenue Service (the “IRS”) and the courts could reduce the willingness of investors to invest in funds associated with these solar energy systems. Moreover, if corporate tax rates are reduced, there will be less appetite for tax benefits overall, which will reduce the pool of available funds, and certain benefits (such as depreciation) will have less value, requiring additional cash to be paid to investors to meet return demands. Accordingly, we cannot assure you that this type of financing will continue to be available to us. New investment fund structures or other financing mechanisms may also become available, and if we are unable to take advantage of these fund structures and financing mechanisms, we may be at a competitive disadvantage. If, for any reason, we were unable to finance our solar service offerings through tax-advantaged structures or if we were unable to realize or monetize Commercial ITCs or other tax benefits, we may no longer be able to provide our solar service

offerings to new homeowners on an economically viable basis, which would have a material adverse effect on our business, financial condition and results of operations.

If the Internal Revenue Service or the U.S. Department of the Treasury makes determinations that the fair market value of our solar energy systems is materially lower than what we have claimed, we may have to pay significant amounts to our fund investors and our business, financial condition and prospects may be materially and adversely affected.

We and our fund investors claim the Commercial ITC or the U.S. Treasury grant in amounts based on the fair market value of our solar energy systems. We have obtained independent appraisals to determine the fair market values we report for claiming Commercial ITCs and U.S. Treasury grants. The IRS and the U.S. Treasury Department review these fair market values. With respect to U.S. Treasury grants, the U.S. Treasury Department reviews the reported fair market value in determining the amount initially awarded, and the IRS and the U.S. Treasury Department may also subsequently audit the fair market value and determine that amounts previously awarded must be repaid to the U.S. Treasury Department or that excess awards constitute taxable income for U.S. federal income tax purposes. With respect to Commercial ITCs, the IRS may review the fair market value on audit and determine that the tax credits previously claimed must be reduced. If the fair market value is determined in these circumstances to be less than what we reported, we may owe our fund investors an amount equal to this difference, plus any costs and expenses associated with a challenge to that valuation. We could also be subject to tax liabilities, including interest and penalties. If the IRS or the U.S. Treasury Department further disagrees now or in the future with the amounts we reported regarding the fair market value of our solar energy systems, or if we receive an adverse outcome with respect to the Department of the Treasury Inspector General investigation discussed elsewhere in this “Risk Factors” section and in the section entitled “Item 1. Legal Proceedings” elsewhere in this Quarterly Report on Form 10-Q, it could have a material adverse effect on our business, financial condition and prospects. For example, a hypothetical five percent downward adjustment in the fair market value of the solar energy systems related to approximately \$269.0 million in U.S. Treasury grants that we have received since the beginning of the U.S. Treasury grant program through December 31, 2014, would obligate us to repay approximately \$14.0 million to our fund investors. Two of our investors are currently being audited by the IRS, both of which involve a review of our fair market value determinations of our solar energy systems. If these audits result in an adverse finding, we may be subject to an indemnity obligation to these investors. Since the Company cannot determine how the IRS will evaluate system values used in claiming ITCs, the Company is unable to reliably estimate the maximum potential future payments that it could have to make under this obligation as of each balance sheet date.

We have historically benefited from declining costs in our industry, and our business and financial results may be harmed not only as a result of any increases in costs associated with our solar service offerings but also any failure of these costs to continue to decline as we currently expect. If we do not reduce our cost structure in the future, our ability to continue to be profitable may be impaired.

Declining costs related to raw materials, manufacturing and the sale and installation of our solar service offerings has been a key driver in the pricing of our solar service offerings and, more broadly, homeowner adoption of solar energy. While historically the prices of solar panels and raw materials have declined, the cost of solar panels and raw materials could increase in the future, and such products’ availability could decrease, due to a variety of factors, including trade barriers, export regulations, regulatory or contractual limitations, industry market requirements and changes in technology and industry standards. Any such cost increases or decreases in availability could slow our growth and cause our financial results and operational metrics to suffer. For example, in the past, we and our solar partners purchased a significant portion of the solar panels used in our solar service offerings from manufacturers based in China or containing components from China. Additionally, Suniva, Inc., a U.S.-based solar panel manufacturer, recently filed a petition for global safeguards with the U.S. International Trade Commission, which included requests for the imposition of tariffs on solar cells and the establishment of a minimum price for solar modules imported into the United States. If successful, such a tariff could adversely affect our costs since these tariffs are reflected in the purchase price of the solar panels and components we and our solar partners purchase. The U.S. government has recently imposed antidumping and countervailing duties on solar cells manufactured in China. In addition, we may face other increases in our operating expenses, including increases in wages or other labor costs, as well as marketing,

sales or branding related costs. In addition, we are investing heavily in building our direct-to-consumer capabilities after our 2014 acquisition of the residential sales and installation business of Mainstream Energy Corporation, as well as its fulfillment business, AEE Solar, and its racking business, SnapNrack, which we refer to collectively as Mainstream Energy Corporation (“MEC”). These investments included significantly increasing our installation capacity through the opening of new branches,

43

increasing our hiring in construction and in associated management personnel, and increasing brand and sales and marketing expenses.

We may continue to make significant investments to drive growth in the future. Increases in any of these costs could adversely affect our results of operations and financial condition and harm our business and prospects. If we are unable to reduce our cost structure in the future, it could have a material adverse effect on our ability to be profitable and on our business and prospects.

We rely on net metering and related policies to offer competitive pricing to homeowners in all of our current markets, and changes to net metering policies may significantly reduce demand for electricity from our solar service offerings. As of June 30, 2017, a substantial majority of states have adopted net metering policies. Net metering policies are designed to allow homeowners to serve their own load using on-site energy generation. Electricity that is generated by a solar energy system and consumed on-site avoids a retail energy purchase from the applicable utility, and excess electricity that is exported back to the electric grid generates a retail credit within a homeowner's monthly billing period. At the end of the monthly billing period, if the homeowner has generated excess electricity within that month, the homeowner typically carries forward a credit for any excess electricity to be offset against future utility energy purchases. At the end of an annual billing period or calendar year, utilities either continue to carry forward a credit, or reconcile the homeowner's final annual or calendar year bill using different rates (including zero credit) for the exported electricity.

Utilities, their trade associations, and fossil fuel interests in the country are currently challenging net metering policies, and seeking to either eliminate it, cap it, or impose charges on homeowners that have net metering. For example, in October 2015 the Hawaii Public Utilities Commission issued an Order that eliminates net metering for all new customers. In its place, the Commission created an interim tariff that sets a reduced rate for the credit customers receive when they export power, and a tariff for non-exporting systems. The cap for the interim tariff was recently increased, and we are offering our BrightBox energy storage system to customers in Hawaii. All existing net metering customers and customers who submitted net metering applications before October 12, 2015 are grandfathered indefinitely under the old rules. We will continue to build and service these systems. In addition, in early 2016 we ceased new installations in Nevada in response to the elimination of net metering by the Public Utilities Commission of Nevada ("PUCN"). However, in September 2016, the PUCN issued an Order grandfathering in customers under the prior net metering rules who had installed a solar energy system or had submitted a net metering application prior to December 31, 2015. Furthermore, in June 2017, the governor of Nevada signed legislation, AB 405, which restores net metering at a reduced credit — starting at 95% of the retail rate and declining as solar penetration increases — and grandfathering new customers for 20 years at the net metering rate in effect at the time they apply for interconnection. As another example, in December 2016, the Arizona Corporation Commission ("ACC") issued a decision to eliminate net metering and reduce export rates for new solar customers. The specific rate changes applicable to Arizona solar customers may be determined in utility rate cases taking place in 2017. In Arizona Public Service Company's ("APS") current rate case, intervenors have agreed upon a settlement, which the ACC can choose to accept, reject or amend. The Administrative Law Judge in such APS rate case issued a Recommended Order and Opinion ("ROO") adopting the solar-related provisions in the settlement, and the ACC is scheduled to issue a ruling on the ROO in August 2017. A settlement process is also underway to determine rate changes applicable to Tuscan Electric Power and UNS Electric customers. In addition, New Hampshire issued its net metering order in June 2017, which removes a previously existing 100 MW cap on net metering and grandfathers in customers under existing rates until 2040. Some states set limits on the total percentage of a utility's customers that can adopt net metering. For example, South Carolina has a net metering cap. New York and New Jersey currently have no net metering cap, however, these states have caps that trigger commission review of net metering policies. These policies could be subject to change in the future, and other states we serve now or in the future may adopt net metering caps. If the net metering caps in these jurisdictions are reached without an extension of net metering policies, homeowners in the future will not have access to the economic value proposition net metering allows. In addition, if overall solar consumer demand in South Carolina grows as expected in the coming year and the cap is not increased or otherwise extended, the South Carolina net metering cap may be reached. Our ability to sell our solar service offerings may be adversely impacted by the failure to extend existing limits to net metering or the elimination of currently existing net metering policies. The

failure to adopt a net metering policy where it currently is not in place would pose a barrier to entry in those states. Additionally, the imposition of charges that only or disproportionately

impact homeowners that have solar systems, or the introduction of rate designs such as the “unbundled” rates mentioned above, would adversely impact our business.

Electric utility statutes and regulations and changes to statutes or regulations may present technical, regulatory and economic barriers to the purchase and use of our solar service offerings that may significantly reduce demand for such offerings.

Federal, state and local government statutes and regulations concerning electricity heavily influence the market for our solar service offerings. These statutes and regulations relate to electricity pricing, net metering, incentives, taxation, competition with utilities, and the interconnection of homeowner-owned and third party-owned solar energy systems to the electrical grid. These statutes and regulations are constantly evolving. Governments, often acting through state utility or public service commissions, change and adopt different rates for residential customers on a regular basis and these changes can have a negative impact on our ability to deliver savings to homeowners.

Utilities, their trade associations, and fossil fuel interests in the country, each of which has significantly greater economic and political resources than the residential solar industry, are currently challenging solar-related policies to reduce the competitiveness of residential solar energy. Any adverse changes in solar-related policies could have a negative impact on our business and prospects. For example, in early 2016, we ceased new installations in Nevada as a result of the elimination of net metering (which was thereafter amended by the PUCN to grandfather in customers who had installed a solar energy system or submitted a net metering application prior to December 31, 2015). In June 2017, the governor of Nevada signed legislation, AB 405, which restores net metering at a reduced credit — starting at 95% of the retail rate and declining as solar penetration increases — and grandfathered customers for 20 years.

We face competition from traditional energy companies as well as solar energy companies.

The solar energy industry is highly competitive and continually evolving as participants strive to distinguish themselves within their markets and compete with large utilities. We believe that our primary competitors are the established utilities that supply energy to homeowners by traditional means. We compete with these utilities primarily based on price, predictability of price, and the ease by which homeowners can switch to electricity generated by our solar service offerings. If we cannot offer compelling value to homeowners based on these factors, then our business and revenue will not grow. Utilities generally have substantially greater financial, technical, operational and other resources than we do. As a result of their greater size, these competitors may be able to devote more resources to the research, development, promotion and sale of their products or respond more quickly to evolving industry standards and changes in market conditions than we can. Furthermore, these competitors are able to devote substantially more resources and funding to regulatory and lobbying efforts.

Utilities could also offer other value-added products or services that could help them compete with us even if the cost of electricity they offer is higher than ours. In addition, a majority of utilities’ sources of electricity are non-solar, which may allow utilities to sell electricity more cheaply than us. Moreover, regulated utilities are increasingly seeking approval to “rate-base” their own residential solar businesses. Rate-basing means that utilities would receive guaranteed rates of return for their solar businesses. This is already commonplace for utility scale solar projects and commercial solar projects. While few utilities to date have received regulatory permission to rate-base residential solar, our competitiveness would be significantly harmed should more utilities receive such permission because we do not receive guaranteed profits for our solar service offerings.

We also face competition from other residential solar service providers. Some of these competitors have a higher degree of brand name recognition, differing business and pricing strategies, and greater capital resources than we have, as well as extensive knowledge of our target markets. If we are unable to establish or maintain a consumer brand that resonates with homeowners, or competes with the pricing offered by our competitors, our sales and market share position may be adversely affected as our growth is dependent on originating new homeowners. We may also face competitive pressure from companies who offer lower priced consumer offerings than us.

We also compete with companies that are not regulated like traditional utilities but that have access to the traditional utility electricity transmission and distribution infrastructure. These energy service companies are able to offer homeowners electricity supply-only solutions that are competitive with our solar service offerings on both price and usage of solar energy technology while avoiding the long-term agreements and physical installations that our

current fund-financed business model requires. This may limit our ability to attract homeowners, particularly those who wish to avoid long-term contracts or have an aesthetic or other objection to putting solar panels on their roofs. We also face competition from purely finance-driven nonintegrated competitors that subcontract out the installation of solar energy systems, from installation businesses (including solar partners) that seek financing from external parties, from large construction companies and from electrical and roofing companies. In addition, local installers that might otherwise be viewed as potential solar partners may gain market share by being able to be the first providers in new local markets. Some of these competitors may provide energy at lower costs than we do. Finally, as declining prices for solar panels and related equipment has resulted in an increase in consumers purchasing instead of leasing solar energy systems, we face competition from companies that offer consumer loans for these solar panel purchases. As the solar industry grows and evolves, we will continue to face existing competitors as well as new competitors who are not currently in the market (including those resulting from the consolidation of existing competitors) that achieve significant developments in alternative technologies or new products such as storage solutions, loan products or other programs related to third-party ownership. Our failure to adapt to changing market conditions, to compete successfully with existing or new competitors and to adopt new or enhanced technologies could limit our growth and have a material adverse effect on our business and prospects.

Regulations and policies related to rate design could deter potential homeowners from purchasing our solar service offerings, reduce the value of the electricity we produce, and reduce the savings that our homeowners could realize from our solar service offerings.

All states regulate investor-owned utility retail electricity pricing. In addition, there are numerous publicly owned utilities and electric cooperatives that establish their own retail electricity pricing through some form of regulation or internal process. These regulations and policies could deter potential homeowners from purchasing our solar service offerings. For example, utilities in states including Arizona, Massachusetts, Utah and New Hampshire are seeking rate design changes to “unbundle” rates, and utilities in additional states such as New York may potentially follow suit. This form of “unbundling” can include changing rates to charge lower volume-based rates – the rates charged for kilowatt hours of electricity purchased by a residential customer – raising unavoidable fixed charges that a homeowner is subject to when they purchase solar energy from third parties, and levying charges on homeowners based on their point of maximum demand during a month (referred to as “demand charge”). These forms of rate design would adversely impact our business by reducing the value of the electricity our solar energy systems produce and reducing the savings homeowners receive by purchasing our solar service offerings. These proposals could continue in other market states. In addition to changes in general rates charged to all residential customers, utilities are increasingly seeking solar-specific charges (which may be fixed charges, capacity-based charges, or other rate changes). Any of these changes could materially reduce the demand for our products and could limit the number of markets in which our products are competitive with electricity provided by the utilities. As mentioned above, in December 2016, the ACC issued a decision to eliminate net metering and reduce export rates for new solar customers. The specific rate changes applicable to Arizona solar customers may be determined in utility rate cases taking place in 2017. In APS's current rate case, intervenors have agreed upon a settlement, which the ACC can choose to accept, reject or amend. The Administrative Law Judge in such APS rate case issued a ROO adopting the solar-related provisions in the settlement, and the ACC is scheduled to issue a ruling on the ROO in August 2017. A settlement process is also underway to determine rate changes applicable to Tuscan Electric Power and UNS Electric customers. As another example, in early 2016, we ceased new installations in Nevada in response to the elimination of net metering by the PUCN, which decision was amended by the PUCN in September 2016 to grandfather in customers who had installed a solar energy system or submitted a net metering application prior to December 31, 2015 under the prior net metering rules. In June 2017, the governor of Nevada signed legislation, AB 405, which restores net metering at a reduced credit — starting at 95% of the retail rate and declining as solar penetration increases — and grandfathered customers for 20 years. Our business currently depends on the availability of utility rebates, tax credits and other financial incentives in addition to other tax benefits. The expiration, elimination or reduction of these rebates and incentives could adversely impact our business.

Our business depends on government policies that promote and support solar energy and enhance the economic viability of owning solar energy systems. U.S. federal, state and local governmental bodies provide incentives to

owners, distributors, installers and manufacturers of solar energy systems to promote solar energy. These incentives include the ITCs, as discussed above, as well as other tax credits, rebates and other financial

incentives, such as system performance payments and payments for solar renewable energy credits (“SRECs”) associated with solar energy generation. Some markets, such as New Jersey and Massachusetts, currently utilize SRECs. SRECs can be volatile and could decrease over time as the supply of SREC-producing solar energy systems installed in a particular market increases. We rely on the incentives listed above to lower our cost of capital and to incent investors to invest in our funds, all of which enables us to lower the price we charge homeowners for our solar service offerings. These incentives have had a significant impact on the development of solar energy but they could change at any time, especially in light of the recent change in administration, as further described below. These incentives may also expire on a particular date (as discussed above with respect to the ITC), end when the allocated funding is exhausted, or be reduced, terminated or repealed without notice. The financial value of certain incentives may also decrease over time.

The current administration’s proposed environmental and tax policies may create regulatory uncertainty in the solar energy industry and may lead to a reduction or removal of various clean energy programs and initiatives designed to curtail climate change. Such a reduction or removal of incentives could diminish the market for solar energy. The current administration has also made public statements regarding reducing the corporate tax rate, expensing capital costs and imposing a border adjustment tax on imported goods. A reduction in the corporate tax rate and the expensing of capital costs could diminish the capacity of potential fund investors to benefit from tax incentives, and could require additional cash to be distributed to such fund investors in lieu of tax benefits. In addition, a border adjustment tax on imported goods could increase our cost inputs. In addition, the current administration also made public statements regarding overturning or modifying policies of, or regulations enacted by, the prior administration that placed limitations on coal and gas electric generation, mining and/or exploration. Any effort to overturn federal and state laws, regulations or policies that are supportive of solar energy generation or that remove costs or other limitations on other types of energy generation that compete with solar energy projects could materially and adversely affect our business.

Our business model also relies on multiple tax exemptions offered at the state and local levels. For example, solar energy systems are generally not considered in determining values for calculation of local and state real and personal property taxes as a result of applicable property tax exemptions. If solar energy systems were not excluded, the property taxes payable by homeowners would be higher, which could offset any potential savings our solar service offerings could offer. For example, in the state of Arizona, the Arizona Department of Revenue has determined that a personal property tax exemption on solar panels does not apply to solar panels that are leased (as opposed to owned) and has subjected our leased solar panels to personal property taxes. While we are challenging that determination, an adverse outcome will subject us and other solar companies to an increase in personal property taxes. If we pass this additional tax on to our customers in the form of higher prices, it could reduce or eliminate entirely the savings that these solar panels would otherwise provide to the homeowner. Although we are involved in ongoing litigation challenging the Arizona personal property tax determination, there can be no assurances that this litigation will be resolved in a manner that is favorable to us or other solar companies. If this litigation is not resolved in a manner that is favorable to us and other solar companies, it will adversely impact our operations in Arizona. If we decide to pass the tax cost on to our customers, such price increase could adversely impact our ability to attract new customers in Arizona, and the savings that our current Arizona customers realize could be reduced or eliminated by the additional tax imposed, which will make our solar service offerings less attractive to those customers and could increase the risk of default from those customers. In addition, South Carolina counties do not currently assess property tax on residential solar energy systems, although state law does not provide for an explicit exemption. In general, we rely on certain state and local tax exemptions that apply to the sale of equipment, sale of power, or both. These state and local sales tax exemptions can be changed by the state legislature and other regulators, and such a change, for example if South Carolina were to begin assessing property tax on residential solar energy systems, could adversely impact our business.

We are not currently regulated as a utility under applicable laws, but we may be subject to regulation as a utility in the future or become subject to new federal and state regulations for any additional solar service offerings we may introduce in the future.

Federal, state and municipal laws do not currently regulate us as a utility. As a result, we are not subject to the various regulatory requirements applicable to U.S. utilities. However, any federal, state, local or otherwise applicable regulations could place significant restrictions on our ability to operate our business and execute our business plan by prohibiting or otherwise restricting our sale of electricity. These regulatory requirements could include restricting our sale of electricity, as well as regulating the price of our solar service offerings. If we were subject to the same regulatory authorities as utilities in the United States or if new regulatory bodies were established to oversee our business, then our operating costs could materially increase.