



Q3 2022 Earnings Call November 2, 2022 Transcript

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Presenters

Patrick Jobin, Senior Vice President, Finance & Investor Relations
Mary Powell, Chief Executive Officer
Danny Abajian, Chief Financial Officer
Edward Fenster, Co-Founder & Executive Co-Chair

Q&A Participants

Brian Lee – Goldman Sachs
Julien Dumoulin-Smith – Bank of America
Andrew Percoco – Morgan Stanley
Colin Rusch – Oppenheimer
James West – Evercore ISI
Mark Strouse – JPMorgan
Maheep Mandloi – Credit Suisse
David Peters – Wolfe Research
Kashy Harrison – Piper Sandler
Philip Shen – ROTH Capital Partners
Joe Osha – Guggenheim Partners
Sophie Karp – KeyBanc

PATRICK JOBIN

Thank you operator. Before we begin, please note that certain remarks we will make on this call constitute forward-looking statements. Although we believe these statements reflect our best judgment based on factors currently known to us, actual results may differ materially and adversely. Please refer to the Company's filings with the SEC for a more inclusive discussion of risks and other factors that may cause our actual results to differ from projections made in any forward-looking statements. Please also note these statements are being made as of today, and we disclaim any obligation to update or revise them.

On the call today are Mary Powell, Sunrun's CEO and Danny Abajian, Sunrun's CFO. Ed Fenster, Sunrun's co-founder and co-executive chair, is also on the call today and will be participating in the Q&A session that follows the prepared remarks.

And now let me turn the call over to Mary.

MARY POWELL

Thank you, Patrick.



Wow, what a quarter it has been, I have been looking forward to this call to update you all on what this team has accomplished. We have more than delivered what we said we would – significantly exceeding our guidance on Net Subscriber Value, beating the midpoint of our volume guidance despite disruptions from hurricanes, and achieving a scale of over \$5 Billion in Net Earning Assets. Sunrun is now serving 760,000 customers – plus nearly 10,000 households in our multi-family housing projects, which are poised to expand significantly under the Inflation Reduction Act, providing incredible socio-economic and clean energy benefits. All of this while continuing to lead on innovation -- for instance, just yesterday we announced our latest partnership on leveraging our clean energy assets to build a more sustainable and resilient solution for Puerto Rico.

The macroeconomic environment presents tremendous opportunity for us as our 'clean energy as a subscription' model allows customers to leverage, and stack, the latest innovative energy technologies to power their homes and cars while providing them an opportunity to save money. At the same time, the macroeconomic environment has provided an opportunity for us to demonstrate the power of quick decisive action and stellar execution as we laser focus on profitable growth.

In the quarter, we delivered strong results and continued to execute on making Sunrun even faster, better, and stronger in all dimensions of the fundamentals.

First, we are delivering record cost efficiency and expanding Net Subscriber Value, even as we invest in innovation and differentiation.

We grew installation volumes in Sunrun's direct business sequentially at a growth rate 3x the rate of headcount additions, as installation crew efficiency increased by nearly 30%. I am tremendously proud of what our team is doing in the field each and every day for our customers.

We also maintained strong overhead cost discipline, with G&A expenses declining more than 6% compared to last year, and reaching an all-time low of approximately \$1,100 per new customer, a 20% improvement year over year, showing the benefits of our scale and disciplined approach to sustainable growth.

We have been adapting to higher interest rates and strategically adjusting pricing as necessary, while still providing a strong customer value proposition. This is against a backdrop of rapidly accelerating utility prices and a long term trend of deteriorating reliability, particularly in California.

As a result of our team's strong execution, we delivered significantly improved Net Subscriber Value in Q3 of over \$13,000, exceeding guidance, even when excluding the benefit from the passage of the Inflation Reduction Act and we are guiding to continued increases in our margins for Q4.

Second, we are driving strong profitable growth. We grew new installations by 17% year-over-year, deploying 256 megawatts, exceeding the midpoint of our guidance. We achieved this despite devastating hurricanes in Puerto Rico and Florida that allowed many of our existing customers to power through safely, but impacted sales and installation activities for a number of weeks. Clearly, if not for the hurricanes, volumes would have hit the top end of the range. We are on track to deliver approximately 25% growth for the full year.

Third, we continue to innovate and increase our differentiation. Just this week the board of the Puerto Rico Electric Power Authority approved a groundbreaking virtual power plant contract. Sunrun has continued to lead in the deployment of virtual power plants, adding recurring sources of cash flow we can share with our customers – and most importantly, helping to increase the reliability and affordability of the entire electric system. This is another postcard from the future of the tremendous opportunity in front of us to embrace radical collaboration and to increase the efficiency and reliability of our energy systems around the country.

This quarter was a powerful demonstration of the value of our existing networked solar and battery systems, providing more than 1 *gigawatt-hour* of energy back to California's grid system cumulatively over 8 days, helping to prevent rolling blackouts during the recent heatwave. We also provided more than



350,000 hours of backup power to thousands of customers in Puerto Rico and Florida during grid outages following the hurricanes.

We also were excited during Q3 to celebrate the unveiling of Lunar Energy, a clean energy technology company that Sunrun invested in to accelerate whole-home electrification. Lunar's first product will be an integrated, next-generation combined battery, inverter and software offering. We are excited by its launch in 2023.

Our electric vehicle charger has also been very well received by our customers. We are benefiting from – and helping enable – the transition to electric vehicles by providing our customers the ability to run their vehicles on renewable, independently-generated affordable energy. Customers who drive electric vehicles need larger systems. These solar and battery – and EV – resources are incredibly valuable for homeowners and the energy system alike.

Our Ford partnership continues to deliver strong initial results. Approximately 1,000 orders for the Ford Charge Station Pro have been placed thus far – with thousands of additional initial conversations – and a high mix of customers want the additional bidirectional home backup capability. Installs are continuing to ramp.

Shifting gears, let's talk about some policy updates.

On the Federal side, we were of course thrilled to see Congress take bold action to address climate change by passing the Inflation Reduction Act and effectively extending the Investment Tax Credit for ten years and reinstating it back to the 30% level. We were also very encouraged to see the focus on expanding solar to more low-income communities, multi-family properties, and to encourage the adoption of electric vehicles. We believe Sunrun will be uniquely positioned as the leading national provider of solar and storage energy subscription offerings to expand our clean energy services and make it accessible to even more communities.

As I mentioned in my opening comment, we also see tremendous opportunity in the legislation to build even greater socio-economic impact through our work with multifamily housing. Today, I am proud that Sunrun already serves nearly 10,000 households in low-income multifamily housing and we want to dramatically increase the impact we can make in these communities.

On California's pending NEM proceeding, there isn't much to update beyond the chatter everyone is hearing that we may see a new proposed decision within a few weeks. Californians have spoken loud and clear over the last year that they care passionately about their ability to generate, store and use their own clean energy, without being penalized for doing so. Further, repeatedly over the last year we have seen the value these customers, and their clean energy technology, are providing to all other customers of the grid by sharing their energy back with the grid during some of the highest priced periods, and when the grid was literally at a potential point of failure. Therefore, we remain steadfast in our hope that the Commission's forthcoming revised proposal will not just continue to support this consumer-led revolution, but in fact accelerate it. With more radical collaboration between distributed energy resources and utilities, we can demonstrate a more durable, resilient, cost-effective and clean energy grid for all. Keeping solar accessible to all communities in California is imperative for the state to achieve its clean energy goals. Accelerating distributed solar and storage is also critical for California's economy and for grid reliability. For all of these reasons, we do remain hopeful of a reasonable structure so that the entire grid can benefit from advances in technology and customer generated, stored and shared energy.

On trade, we continue to navigate the dynamic environment. The current bureaucratic process from the Customs and Border Patrol continues to cause delays in the timely release of modules currently sitting at the ports, for us and many in the industry, following the implementation of the WRO and subsequent UFLPA regulations. We continue to source high-quality modules and are maintaining adequate supply for current needs, although we would like faster action to reduce import delays.



We support UFLPA enforcement that prevents any forced labor content from entering the United States, while also facilitating legitimate trade without unnecessary delays, so that industry can deploy clean energy, meet consumer demand, and help the United State achieve its climate goals. There is no time to waste.

Sunrun has the right strategy and the right team in place to navigate these uncertain times, our value proposition continues to increase as utility rates escalate rapidly and consumers demand affordable, clean and predictably-priced energy. Whether continued interest rate increases or a recession, Sunrun's opportunity to deliver value to our customers and our financial partners remains incredibly strong.

As always, before turning it over to Danny, I want to express my appreciation for the the team I work with every day, and all the Sunrun employees working so hard to create a company that is faster, better and stronger for our customers and communities, setting the highest standards for ourselves, putting people front and center, analyzing mistakes (even when winning) and crushing it on the fundamentals of sustainable profitable growth, customer obsession and innovation. Never has our cause felt more urgent, I so appreciate the Sunrunners and customers who are so key to all that we can achieve together.

Over to you, Danny.

DANNY ABAJIAN

Thank you, Mary.

Today I will cover our operating and financial performance in the quarter along with an update on our capital markets activities and outlook.

Turning first to the results for the quarter. In the third quarter, Customer Additions were approximately 35,800, including approximately 25,500 Subscriber Additions. Our Subscriber Additions were 71% of our total Customer Additions in the period, hovering around prior levels during the year. Our recent sales activities, and the benefits from the tax credit adders in the Inflation Reduction Act, which are only available to the solar subscription model, indicate the mix of Customer Additions is likely to shift toward Subscribers more significantly in the quarters ahead. Solar Energy Capacity Installed was approximately 256 megawatts in the third quarter of 2022, a 17% increase from the same quarter last year. Our Q3 installations exceeded the midpoint of our guidance range. Excluding installation downtime owing to Hurricanes Fiona and Ian late in Q3, we would have been close to the high end of our guidance range.

We saw strong customer demand for our products and services in Q3. While we are still adding customers to our pipeline, the increased pace of installations is allowing us to gradually work down our pipeline, which is slightly over one quarter at the end of Q3, down slightly from the prior quarter. We aim to manage sales and installation activities to maintain a pipeline that optimizes our resource planning and customer experience.

We have now installed over 47,000 solar and battery systems. We expect that as we introduce additional battery suppliers and work through our pipeline, battery installations will grow rapidly in the quarters ahead and attachment rates will increase meaningfully. However, current battery supply conditions and longer install cycle times have resulted in lower battery attachment expectations in the near future. Today we are prioritizing allocation of batteries in key markets where they are needed the most for grid reliability concerns.

We ended Q3 with approximately 760,000 Customers and 640,000 Subscribers, representing 5.4 Gigawatts of Networked Solar Energy Capacity, an increase of 21% compared to the prior year. Our Subscribers generate significant, recurring revenue with most under 20- or 25-year contracts for the clean energy we provide. At the end of Q3, our Annual Recurring Revenue, or ARR, stood at \$969 million with an average contract life remaining of over 17 years.



In Q3, Subscriber Value was approximately \$43,400 and Creation Cost was approximately \$30,200, delivering a Net Subscriber Value of nearly \$13,300, compared to our prior guidance of over \$10,000.

Total Value Generated, which is the Net Subscriber Value multiplied by the number of Subscriber Additions in the period, was \$338 million in the quarter.

The significant adjustments we made to pricing over the last six months are driving the majority of our margin expansion from prior quarters. In addition, this quarter, our Subscriber Value reflects the benefit of a 30% tax credit as opposed to 26%, provided by the passage of the Inflation Reduction Act. Excluding this extra tax credit value, Net Subscriber Value still significantly exceeded our prior guidance of over \$10,000. Systems placed in service in Q1 and Q2 also benefited from the retroactive increase to the tax credit to January 1, 2022, but we opted not to recast prior quarters' Net Subscriber Values nor to reflect this benefit in our Q3 result.

The magnitude of Net Subscriber Value increase from Q2 to Q3 is significant. If you look at this on an unlevered IRR basis, instead of NPV, the increase equates to an improvement in unlevered IRR of over 200 basis points.

We remain vigilant in optimizing overall sales activities and adjusting our pricing and product mix to deliver profitable growth through a rising interest rate environment. These moves are already producing positive results which you can see in Q3. We will continue to evaluate our customer offering based on incumbent utility rate changes, inflation and the interest rate environment.

Turning now to Gross and Net Earning Assets and our balance sheet.

Gross Earning Assets were \$11.5 billion at the end of the third quarter. Gross Earning Assets is the measure of cash flows we expect to receive from customers over time, net of operating and maintenance costs, distributions to tax equity partners in partnership flip structures, and distributions to project equity financing partners, discounted at a 5% unlevered capital cost.

Net Earnings Assets were nearly \$5.1 billion at the end of the third quarter, an increase of \$465 million or over 10% from the prior quarter. Net Earning Assets is Gross Earning Assets, plus cash, less all debt.

Although we did not recast prior Net Subscriber Values as previously mentioned, Net Earning Assets benefited from the retroactive tax credit increase by approximately \$40 million in Q3, with more expected in upcoming periods. Even excluding this benefit, we saw strong growth in Net Earning Assets driven by our Net Subscriber Value improvement.

We ended the quarter with \$956 million in total cash, an increase of \$93 million from the prior quarter.

We continue to maintain a robust project finance runway. As of today, closed transactions and executed term sheets provide us with expected tax equity capacity to fund, at a 30% tax credit, over 340 megawatts of projects for Subscribers beyond what was deployed through the third quarter. Sunrun also had over \$700 million in unused commitments in its \$1.8 billion non-recourse senior revolving warehouse loan available at the end of the quarter to fund nearly 300 megawatts of projects for Subscribers. This strong capital runway allows us to be selective in timing our capital markets activity.

Turning now to our outlook.

Demand for our offering remains resilient, as we provide customers with affordable, clean and reliable energy. We are prioritizing strong unit margins by optimizing our sales mix and increasing pricing, even while we deliver robust growth. We now expect growth in Solar Energy Capacity Installed to be approximately 25% for the full year. We expect Net Subscriber Value to increase sequentially in Q4 and Total Value Generated to be greater than \$1 billion for the full year 2022, an increase from our prior guidance of greater than \$900 million.

We will provide views on 2023 on our Q4 earnings call after we finalize our annual operating plan. At this point, our focus is on delivering profitable growth, efficient operations and strong unit margins, while



navigating a rising interest rate environment. Put simply, with inflation and increasing interest rates, and pending regulatory resolution in California, a focus on a disciplined strategy is paramount. Our discipline has served Sunrun well for the last 15 years, and we believe will serve the company, and our stakeholders, well in the current economic paradigm.

Turning briefly to our capital markets activities and outlook.

While the pace of interest rate increases has been unprecedented in recent history, we have anticipated the resulting higher financing costs and raised prices against rapidly increasing utility rates. We remain in a strong position to respond to further volatility in interest rates, as inflationary effects continue to attract customers to our product – one that improves the financial health of households by lowering electricity costs and providing long-term price certainty.

We currently observe our capital costs in the mid-six to mix-seven percent area. Consistent with this cost of capital range, we now expect advance rates on our newly deployed portfolios to be between 75 and 85 percent of contracted Subscriber Values, which are discounted at a 5% rate. This advance rate range is a decline from our previously indicated ranges of 85 to 95 percent last quarter, and 95 to 100 percent at the start of the year. As a reminder, the numerator in advance rate includes proceeds received, net of fees, from all sources – including tax equity and project-level non-recourse debt.

As you may recall, several years ago we used to report Subscriber Value and Gross Earning Assets figures using a 6% discount rate and updated it to 5% when we saw capital costs fall below 4%. We generally prefer not to update the discount rate frequently to enable ease of comparison across quarters. Instead, we provide advance rate ranges that reflect current interest rates, which allows investors to gauge the obtainable net cash unit margins on our deployments.

If capital costs remain elevated heading into 2023, we may adjust the discount rate assumption in our metrics, and update our advance rate range accordingly.

As we've shared before, we regularly enter into interest rate swaps to hedge capital costs on our newly installed customers. We are principally exposed to interest rate fluctuations between customer origination through shortly after installation. Upon installation, our systems are financed with project-level non-recourse debt financing. Nearly all of this financing is insulated from near-term interest rate fluctuations, as our debt is either fixed-coupon, long-dated debt securities or floating-rate debt that has been hedged with interest rate swaps. We ended Q3 with over 90% of our project-level debt with effectively fixed interest rates, with \$2.6 billion in fixed-rate securitization debt and \$3.1 billion of floating-rate commercial bank debt benefiting from long-term fixed rate swaps.

Our playbook for navigating difficult and rapidly changing capital markets conditions is one I passionately developed leading our project finance efforts for over a decade prior to assuming the CFO role. The longstanding relationships we have cultivated with many capital providers in multiple markets, our reputation as a high-quality sponsor, and the consistently strong payment performance trends of our customers through multiple economic cycles, makes me confident we will continue to deliver the capital necessary to fuel growth both in expansionary and recessionary times.

With that, let me turn it back to Mary.

MARY POWELL

Thanks, Danny.

I could not be more confident in the strength of the Sunrun team to execute on our mission and adapt to the changes around us. We have an enormous opportunity ahead of us to become the trusted, beloved provider of clean, affordable and reliable energy across America, and will continue to focus all efforts on operating efficiently and growing profitably while building for massive scale to lead the market forward.



Before we open the line for questions, I want to again express my deep and sincere appreciation for the big-hearted, ambitious team of employees at Sunrun, the customers we are blessed to serve and the many partners who work with us every single day to deliver on our mission.

With that, Operator, let's open the line for questions.

Operator

We have a first question from the line of Brian Lee with Goldman Sachs. Please go ahead.

Brian Lee

Hey, everyone. Good afternoon. Thanks for taking the questions. Kudos on the solid execution on the quarter.

Mary Powell

Thanks, Brian.

Ed Fenster

Hey, Brian. Thank you.

Brian Lee

Hey. Two questions kind of interrelated. But I guess, first off, you mentioned several times throughout the discussion about the ITC bonus adders. I know the ink is almost not even dry yet, but can you kind of walk us through the upside scenarios and sort of maybe how your discussions with your tax equity partners are evolving now in this landscape? Maybe how the economics actually show up for you, whether it's higher subscriber value. Is it just more customer growth with the increased tax equity capacity?

Just trying to understand the puts and takes as you take advantage of potentially 20 or 30 percentage points more of ITC.

Danny Abajian

Yeah. I guess Ed will start and I'll layer on.

Ed Fenster

Sure, Brian. So, I think, absolutely, we expect to raise tax equity financing against the adders. As you're aware, there are a few buckets of adders for customers in certain low-income census tracts for systems that benefit significantly from American made equipment and from systems deployed in what are considered energy communities, which is a definition that relates to the percentage of people in a place that work for energy industry companies and/or related unemployment metrics.

The regulations have not yet been written on exactly how all that is going to qualify. And so, we're redescending to provide estimates for the exact sort of average investment tax credit percentage that we will achieve other than we are expecting that it can be significantly increased above 30. It would manifest in the reported financials as an increase in subscriber value through a greater upfront tax equity contribution.

Brian Lee

Okay. Great. That's super helpful.

And then, I guess, just related to that--I know maybe you don't want to give the exact number, but if I back out the price increases you were articulating over the past couple quarters, it seems like the ITC 30 percent adjustment added maybe \$1,500 or so to the reported subscriber value this quarter. So, it would've been maybe 11 to \$12,000. Still well ahead of guide. Is that the right way to think about it?

You already sort of answered this, but once you have clarity on the ITC adders, is it just going to be sort of a fluid assumption each quarter on that ITC portion of subscriber value? Are you going to try to fix it at some sort of average level that you're targeting? Just trying to understand how much more upside you get from that potential adjustment. Thanks.

Danny Abajian

Yeah. On the first part of the question, I'll take that. The ITC adders add about--greater than \$1,000 per customer. So, I think you're probably doing the right math there in thinking through it. And just the extra 4 percent benefit, just as a reminder, the folks who might not be as familiar, is calculated on fair market value, which is meaningfully less than contracted subscriber value for folks trying to do that similar math.

Ed Fenster

Sure. On the second part of the question, I can take that. I think we need to understand, first, what the qualification--the exact qualification criteria are. And then, I think once we're active selling in the marketplace and have some experience with it, we'll be able to update folks with a view of how it's trending and where it might go. But I think that's preliminary.

I think it's--that's still probably a couple of quarters in the future before we'll be at the place where, one, we know what the rules are, and two, we've established a track record that we can easily forecast against and share with folks.

But again, it is our expectation that between those several adders, we could move the tax credit significantly above 30. Some of the adders are easier to operationalize quickly. Maybe the energy communities or the low-income communities, as an example. Some may be a slow build over time.

For instance, the use of American-made equipment, it's our expectation that between the ITC adder for American-made equipment and some of the direct manufacturing subsidy in the IRA, we will see an increase in American-built products. Obviously, that also doesn't happen overnight. But over a 10-year period, it could be very significant.

Brian Lee

All right. Thanks for all the color.

Operator

Thank you. We have next question from the line of Julien Dumoulin-Smith with Bank of America. Please go ahead.

Julien Dumoulin-Smith

Hey. Good afternoon. Thanks for taking the time. I appreciate it. So, just running with Brian's thought process here a little bit further, how does that 13,000 evolve, right? Basically, how do you think about that, not just in the next quarter where you have a lot of visibility, but really going into next year? You've got pricing, you've got this ITC, you got REX as a mix. Just talk about that a little bit further. And then, ultimately, related, I'll just throw it in at the same time, how do you think about providing some more explicit cash guidance? Good liquidity updates today, but just more explicit cash conversation and conversion.

Danny Abajian

Right. Yeah. On the first part of that, the greater than 13,000, again, we've said increased sequentially over Q4. We haven't, obviously, on this call, guided 2023 and including the component of adders we just went through, a little bit premature to talk specific numbers to have a little trend into Q1.

But again, increasing sequentially in Q3. There will be, obviously, the 30 percent level carrying into Q4 and primarily the rest is driven by pricing increases we have already made that have yet to make its way into realization on install. So, that's kind of the picture for the balance of the year. And remind me, your second question was on cash. So, on cash generation, I think we remain--we continue to--obviously, we're guiding to improving subscriber margins. We provided the advance rate guidance. I think those two taken together give a good picture on kind of cash unit margins. As far as overall cash guidance into next year, again, we'll continue to play out the year, see some of the supply chain and policy noise resolve, and I think we'll have more picture of that going into next year.

Mary Powell

Yeah. And the only thing I would layer on--it's Mary. The only thing I would layer on top is as you can see and what we've been talking about is Sunrun getting faster, better, stronger and focused on crushing it on

the fundamentals. So, absolutely, as we think about the next quarter, the next year, that is going to continue to be our focus. And as usual, we'll talk more about 2023 on our next call.

Julien Dumoulin-Smith

Got it. But no cash guidance per se or just explosive affirmation about future cash needs right now?

Danny Abajian

No.

Julien Dumoulin-Smith

Okay. All right. Fair enough. We'll leave it there. Thank you, guys.

Operator

Thank you. We have the next question from the line of Andrew Percoco with Morgan Stanley. Please go ahead.

Andrew Percoco

Great. Thanks so much for the time.

Just a follow-up on the two prior questions a little bit on pricing power. So, obviously, you're benefiting from some of these prior pricing actions that you've taken in the third and fourth quarter. You provided a pretty helpful slide in your investor presentation just showing kind of where you guys price versus some of the incoming utilities.

Can you just provide an update on where that stands today after these pricing changes? And how much headroom is left if you continue to see interest rates rise or talent costs rise as well?

Mary Powell

Yeah, great question. I mean, again, we provide our customers now a significant range of savings. So to your--directly to your question, we're providing savings now. We continue to see utility rates rising. We continue to see pressure on energy costs. So, we continue to believe we provide a really strong value proposition and continue to always look strategically at where we can make changes.

So, the other thing I would just make sure to make a point on is we have to keep in mind that the customer value proposition is multifaceted. I mean, we are selling peace of mind, we are selling long-term price certainty, and that is really valued. And we also are selling the ability to power through outages. And this is all against the long-term trajectory of utility rates, which are continuing to rise.

And also are in so many states we sell in not just our utility rates continuing to rise, but there is so much fear that has been embedded in customers because they also feel like they don't know what's coming next, what the next increase is going to be or in some states, frankly, if they're going to have reliable power. So, we think all of that continues to give us room to navigate as needed.

Andrew Percoco

Understood. That's very helpful. And then one more on just panel availability. Where do you guys stand today in terms of panel availability? And if the UFLPA issues aren't resolved in the coming weeks and months, could it be a headwind to the '23 growth despite the strong kind of tailwinds on the fundamental side from the customer demand standpoint?

Ed Fenster

Yeah. So, on the last call, we said we had a dip below. So, if I track through the history, it was greater than 100 days. We had said on the last call less than 100 days. The number today is around 60 days of supply. And just to frame that up, that compares to a normal target of around 75 days. So, we are close to our target.



We continue to see equipment come in on the module side. So, we don't have concerns with addressing the demand. And we've--looking forward, planned our procurement source from multiple geographies and planned our procurement in line with the volume we expect to see deliver through the business.

Andrew Percoco

Great. Thanks so much. I'll leave it there.

Operator

Thank you. We have next question from the line of Colin Rusch with Oppenheimer. Please go ahead.

Colin Rusch

Thank you so much. Guys, can you talk a little bit about the strategy around the virtual power plant? Obviously, there's an awful lot of value that you guys are providing in certain geographies. Can you talk about strategy for exchanging that offering and how you price that?

Mary Powell

Yeah. Thanks for the question. We are so excited. And I know as you saw and we highlighted, we just announced our contract in Puerto Rico, which, again, we're just thrilled about because it's just so important from a grid reliability and stability perspective for residents in Puerto Rico. But it also is yet another, as I said, postcard from the future of what is possible, candidly, all over the United States of America.

So, we're really pleased to continue leading in the context of this kind of innovation and leveraging our energy assets, particularly the combination of clean stored energy assets around the country to provide significant value. From a--being consistent with our overall comments that we've always talked about relative to grid services, we've always seen that it can add close to \$2,000 per subscriber of net present value over the life of the asset.

So, again, it's really valuable because it provides real value to the customers who are participating in the programs. And it also then provides value to Sunrun in the context of aggregating and leveraging those assets from a grid perspective. And again, we've had so many examples of that.

And also, just in this quarter as well, we also announced the ISO New England program. But I would say no greater example of the value here to the grid than what we just went through in California in the context of the heat wave when there were absolutely record prices. And our customers were providing energy back to the grid and saving every other customer that is a grid customer money because of the value provided.

So, again, yes, it's an area I've talked a lot about. I have a lot of passion about it, radical collaboration. Let's get to a better improved grid for all. So, we expect that to continue to accelerate in the coming years.

Colin Rusch

Thanks so much. And then with the IRA pass and all the different elements that you can stack up here and the movement on electricity prices, can you talk a little bit about where you're at in terms of potentially adding incremental geographies and how you go about deciding where to expand into?

Ed Fenster

Yeah. We continuously evaluate our go-to-market strategy. From a geographic standpoint, we've, first and foremost, looked at the opportunity where we're already operating and the overlap between what we preliminarily believe to be the geographies or the census tracts that might qualify for the adder. So, definitely have an early leg up there in terms of go-to market, taking advantage of the opportunity to serve those communities where we already operate. And then, we constantly monitor markets for potential entry.

I'd say the factors we look for are obviously geographic resource, local subsidy, utility power prices in those areas so we could deliver a compelling value proposition. As far as the IRA and its impacts to potential changes in geography or opening up more geographies, we'll probably talk about that more as the guidance becomes more clear.

Colin Rusch

Okay. Thanks so much, guys.

Operator

Thank you. We have next question from the line of James West with Evercore ISI. Please go ahead.

James West

Hey. Good afternoon, everyone.

So curious, Mary, you talked about the supply chain for batteries still being a bit challenged in attachment rates, not being where you would expect them to be as the supply chain kind of comes into more of a balanced situation. I'm curious, new customers, as you're acquiring them and they're not attaching batteries because they don't have them, are they doing the work for batteries later? Is there opportunity to go back? How was that process playing out?

Or are they just saying, just give me solar? I want solar and we'll batteries some other time.

Mary Powell

Yeah. Great question.

So, again, it also really harkens to why we're so excited about Lunar and our investment there, which definitely is looking more strategic every single day. So, we're really excited about having that next-generation storage inverters, software solution that will also help us unlock that customer demand.

So, yes. We view that we could be at an attachment rate that is obviously significantly higher than we are if and when we get to having a lot more supply. That said, the desire for solar energy is, again, still very compelling for so many customers. And so, in many cases, we absolutely do keep track. If a customer says, hey, I really want to have storage later, we obviously maintain that relationship so that we can provide it when it becomes available.

So, yes, as it becomes available, we expect to see a very significant uptick in our attachment rate. And then yes, over time, it provides opportunity to go back and add it on to existing customers.

James West

Okay. That makes perfect sense then. Secondarily for me, I know California signed a new law requiring online automated permitting platforms similar to the SolarAPP that you guys have worked with for years. Are there movements like that afoot in other states at this point?

Mary Powell

Well, I think really speaking to SolarAPP, I know Secretary Granholm at DOE has been a real proponent of the SolarAPP and has been initiating conversations about it all over the country. So, yes, we were encouraged by California passing that legislation. And yes, we're seeing--those kinds of changes provide nice incremental improvements in the process to again help bring down the timeline and the cost of the time from the customer signing to the time of installation.

So, we saw that as positive movement in that direction. And again, are really also very pleased and supportive of the efforts at the national level to also agitate around greater adoption of the SolarAPP.

James West

Got it. Thanks, Mary.

Operator

Thank you. We have next question from the line of Mark Strouse with JPMorgan. Please go ahead.

Mark Strouse

Yes. Good afternoon. Thanks for taking our questions.

I might be splitting hairs here a bit, but I just want to make sure I'm not missing anything. With the volume growth for the year, approximately 25 percent--I believe on the last call, you were saying 25 percent or greater. Is that just a function of the hurricane? Or are you signaling something else there?

Danny Abajian

Yeah. I think I would say, generally, we provide guidance we're comfortable with, particularly in this climate. Looking at the recent hurricane that did imply there in the remark is a few megawatts of impact in the quarter. And looking out at the balance of the year, it's a Q4, right? Weather can be more volatile in the quarter.

So, just kind of taking into account normal seasonal effects. I don't think there's a demand implication in there.

Mary Powell

Yeah. And again, just to hit that point, again, these weren't your average hurricanes because, of course, we always do anticipate some weather impacts in the context of our work and our planning. But the level of devastation, as I think you all know, in Florida, I mean, again, this was an event that really sort of took our folks out of any activities for about--for a few weeks in both jurisdictions with a lot of growth, in particular happening in Puerto Rico.

Mark Strouse

Of course. Yeah, that makes sense. And then just given your scale, given your operational history, I think you can probably speak to this better than your peers. Just any comment that you can talk about with your trends in default and delinquency rates.

And then, Danny, I mean, as you're talking to your capital providers, is that something that is--do you think that you're getting credit for improvement in those trends or stabilization of those trends? Or do you think that there's room to go there? Thank you.

Danny Abajian

Yeah. I think generally, from a total macro picture, I think there's plenty of room to go there. It's an asset class that has been around for the last 15 years. We do offer a product that goes out as much as 25 years. So, we'll continue to season into that 25-year period, and we'll continue--our expectation is that we'll continue to generate good performance data at the project level.

And as far as looking at the most recent trends, we're not seeing anything out of the ordinary as far as default rate trends go. So, nice and boring there from a credit underwriting perspective in the capital markets. I think we'll continue to participate with increasing deal size in the capital markets, which will kind of deepen relationships, bring more people into the space over time as we continue frequent access into the market.

So, I think generally, we view that trending positively over a long period of time.

Operator

Thank you. We have next question from the line of Maheep Mandloi with Credit Suisse. Please go ahead.

Maheep Mandloi

Hey. Thanks for taking the questions.

First, I just wanted to catch up on slide 13 where you kind of broke down the advanced rates. Just doing the math, it seems like there's still the advantages available of the creation (inaudible). So, just wanted to understand how should we think about that next year, say, rate increase a little bit over year? And this probably goes back to the previous question on cash needs. Just trying to tackle it from a different point of view here. Thanks.

Danny Abajian

Yeah. I had a little bit of trouble hearing you. So, let me take a shot at the question and if I don't answer it as you asked, feel free to jump in.

But yeah, advance rates, we did take that down from the prior range of--down to a new range of 75 to 85. That is consistent with the 6.5 to 7.5 percent range for cost of capital, which we see in the current interest rate environment, which reflects longer-term borrowing costs, which I've already taken a view on in this rate hike cycle kind of where the fed is going to end up on very short-term borrowing costs.

So, we look at kind of the 7- to 10-year longer-term borrowing costs. And again, the advance rate guidance we provided fully reflects that, obviously, within a range. We do see a little bit of price difference between the markets we access being the commercial bank market and the ABS market. And we kind of have had developed pretty deep access to both markets and navigate the interest rate environment from a credit spread perspective and capital availability perspective. Overall, have a good tone of the liquidity in each market and are kind of crafting the most advantageous solution based on where markets are at point in time.

Now, as far as outlook for next year, we look at that every day. And as we've said, we've become very dynamic on looking at interest rates day by day, week by week, looking at utility inflation and adjusting the business and the unit margins to continue to deliver strongly through different rate environments.

Ed Fenster

Yeah, and this is Ed. I just might mention a week ago, we did look at the sort of future interest rates market. And the way it's pricing, the market anticipates there being less than a 20 percent chance of long-term rates increasing more than 100 basis points. And against that backdrop, we feel good about the advance rate estimates that we have provided in the stack.

Maheep Mandloi

Got it. And the advance rate, if I look at the proceeds, that's way above the creation cost, and that's probably kind of contributing to the higher cash generation guidance for the full year. But just to understand for next year, as you get higher tax credits, would it be fair to assume that the advance sales would be way above the creation cost even for next year?

Danny Abajian

Yeah. With the average--the level of average tax credit going up, the advance rate should go up as should the subscriber value reflecting the higher tax credit value.

Maheep Mandloi

Got you. I'll take the rest offline. Thanks.

Danny Abajian

Thank you.

Operator

Thank you. We have next question from the line of David Peters with Wolfe Research. Please go ahead.

David Peters

Yeah. Hey. Good afternoon.

Just to kind of piggyback on the last question. Just now you're saying 75 to 85 percent, that's reflecting kind of the current environment. But just, to the extent things were to, I guess, get worse and understanding you have pricing power, but I don't think it's a one-for-one offset. I guess, where is the line in the sand where it's, I guess, harder to fund sort of the robust growth that you guys have without other forms of capital?

Danny Abajian

Yeah. It's dependent on--where do things go on rates is dependent on where do things go on inflation. That's also impacting utility rates and general price for goods going up, right? So, as we think about--if you

zoom out and look at the long-term picture of long-term interest rates and utility rates, you'll see a very high correlation, and we'd expect that to continue.

So, as Ed mentioned, the market right now puts a low probability of rates going much higher from here. And I think with the fed's announcement today, we saw long-term interest rates remain pretty flat on the day. Now, we'll see how things evolve over the next few days as the market digests it, but that's been so far the initial reaction.

And we see many leading indicators if we just parse through economic data, not looking at official CPI data, but a lot of more leading indicators suggest that inflation is soon to be on a downward path. And it seems to match with what we're seeing in kind of the rates market and those probabilities that Ed mentioned.

David Peters

Okay. Thanks. And then just--I think you touched on this in the prepared remarks, but just the growth in net earning assets quarter-over-quarter, how much of that was driven by the higher ITC? I think some of that was a catch-up going back to prior periods. I'm just trying to get a sense of what that growth was kind of ex that step up?

Danny Abajian

Yeah. There's--about \$40 million is related to the onetime benefit from the ITC realization of assets we placed into service prior to the quarter. And the remainder of that would be the higher net subscriber values, the higher pricing delivering into installs, which further deliver into the metric. I'd say those are the 2 primary contributing factors. Obviously, with Q3, we also delivered that at the higher ITC level into the metric.

David Peters

All right. Okay. Thank you.

Operator

Thank you. We have next question from the line of Kashy Harrison with Piper Sandler. Please go ahead.

Kashy Harrison

Good afternoon, all. And thanks for taking the questions.

Danny, I wanted to dig into something you mentioned in the prepared remarks surrounding the strategic focus for next year. Sounds like you're more focused on disciplined capital allocation by maximizing unit margins, just given the uncertain market environment.

So, one, is that a fair characterization of the focus next year? And then, two, can you dig into some of the decisions you expect to make to maximize margins? Is that cost reduction? Is that a continuation of higher pricing? Any color there would be great.

Danny Abajian

Yeah. It's--yeah, definitely prioritizing the strong unit margins. We obviously--the guidance is approximately 25 percent growth in volume for the year. We still want to generate robust growth in volume. And as we've kind of said consistently over the years, we view long-range industry growth trend at 15 to 20 percent a year. And our view on that hasn't changed.

But within that, we're absolutely prioritizing the stronger unit margins. So, I don't know, Mary, if you want to play around anything there?

Mary Powell

No. I think it just gets back to sort of what I've talked about in terms of crushing it on the fundamentals. So, we feel like we're in a really good position, really good place in terms of demand, really good place in terms of our leadership on innovation.

And again, we see that we still have some continued headroom. But yeah, it's that focus on crushing it on the fundamentals of strategic profitable growth, customer obsession, innovation, and growing.

Kashy Harrison

That's helpful. Thank you.

And then, just maybe as my follow-up. Just going back to slide 13 on the presentation, it's very helpful. Thank you.

I was wondering if you could maybe just touch on working capital. I know that's one of the more notoriously difficult things to forecast. But maybe just conceptually, how you think--how should we be thinking about changes in working capital in normal times and then maybe in recessionary periods as well? I'm trying to think of a way to model the drag or benefit you might have in any given year. Thank you.

Danny Abajian

Yeah. I would say there are probably two primary items to cover there, the first of which is backlog. So, the guidance we gave--sorry. The information we provided was we were trending towards two quarters a couple of quarters ago. We brought that down closer to one quarter. I think it's come in probably incrementally by a couple of weeks as we reported out this quarter.

So, there is about a quarter's worth or slightly in excess of a quarter's worth of customer backlog. And as the business grows and the size of the--sheer size of the backlog grows and we start spending dollars on installations and permits and lots of the soft costs, you see working capital consumption that way, which we've seen through the business given the pretty robust growth rates we've seen recently.

And then somewhat related to that, the second item is--it's really inventory. We've had a pretty substantial rise in the inventory balance that we've carried to support that growth. And we've also talked about just supply in general through the supply chain. If we look over the three quarters, points we were carrying excess inventory balance more than our targets, and that's been a driver of working capital, cash consumption in the business in the recent past.

Kashy Harrison

Thank you.

Operator

Thank you. We have next question from the line of Philip Shen with ROTH Capital Partners. Please go ahead.

Philip Shen

Hi, everyone. Thanks for taking my questions.

Given the rising rate environment, it appears demand for loans may be slowing down meaningfully, and this could result in a much slower-than-expected first half of next year for the overall industry. With the slowing of loans, clearly, a lease could be a beneficiary there.

Can you talk through how you might expect demand for your lease business to accelerate ahead, especially with the ITC adders? And then can you comment on how--whether or not you think the lease versus loan mix shifts dramatically in the coming two years in favor of lease?

Mary Powell

Yeah. I mean, I'll take it at a high level, and then I'd love, Danny, for you to add on.

But yeah. So, I think we see it the way you see it. So, the reality is the Inflation Reduction Act provides incentives that really are best monetized through the leasing model for customers, right? Because a lot of customers don't have the tax appetite to be able to take advantage of those benefits. So, fundamentally, we do believe that model is really well suited for that.

I mean the other thing is, as you probably noticed in my remarks, I mean, I really think of it as somebody who went solar probably 14 years ago originally and then a couple of times since, it's like--the power of it is so much really energy as a subscription service model, where, again, it's really such a low friction, low stress way for customers to get the most advanced technology in their homes in an affordable rate.

So, yes, we do see some trends in that direction, and we're--we'll be thinking about it a lot as we think about next quarter and what our guidance will be for next year. But with that, Danny, I'd love for you to add on.

Danny Abajian

Yeah, I'd just to add more color on the kind of the near-term view before those adders take effect. If you just look at observing publicly available data on lease pricing, I think we have a strong belief. We've been adjusting our pricing significantly ahead of loan pricing getting adjusted. And that's factored into the mix shift--or the mix--the relative mix we see in the business today, looking back.

And over the last three quarters, we've been in the 70 to 75 percent range, plus or minus a couple of percentage points quarter-over-quarter. And we do have a forward view that given the catch-up in pricing and the higher APRs, we'd expect to see on loans going forward that the mix would shift meaningfully towards the leasing model or the subscription model over the coming few quarters.

Philip Shen

Great. Thanks, guys.

And then, as a follow-on there, historically, the--for the overall industry loan versus lease mix has been maybe 70 percent loan, 25, 20 percent lease, with the balance being cash. In a couple of years, could we see that maybe 50-50? Or do you think that's too far of a stretch? Or could we even completely invert it in a few years' time?

Of course, a lot depends on where rates go. But knowing what you know now, could we see 50-50 in two years? Thanks.

Mary Powell

Yeah. I mean, again, from a high-level perspective, I think it is a super compelling value proposition. When you think about really that notion catching on across America of, like, wow, I can really roll in all of these different products and innovation and do it in a subscription kind of model.

So, I've always felt like, frankly, just putting aside some of the other trends we've seen, it's just--it's a very compelling model. And again, our customers who understand it are compelled by it. And it seems like, again, if you really parse the data, so much of the data is related to what the salesperson is selling kind of ties so much to what the consumer ultimately buys.

So, I don't think we're at the point where we want to put a stake in the ground of what the percentages are going to be in the future. But we absolutely see that this is a very compelling business model and value proposition for customers to, again, aggregate a lot of technology because again, Sunrun's--we're not just in the business of solar. We're in the business of solar, EV charging, storage, providing more sophisticated controls through devices like the SPAN panel.

So, again, I think as we move more and more in that direction, that model, there's very--there's a lot of compelling features for it.

Philip Shen

Great. Thanks, Mary. I'll pass it on.

Operator

Thank you. We have next question from the line of Joe Osha with Guggenheim Partners. Please go ahead.

Joe Osha

Hi. Thanks. Two questions.

First, kind of following on Phil's question there, I'm thinking about this potential shift from loan to lease PPA. Typically, in ABS markets, we've seen third-party price kind of 50, 60 bps outside of loans, but things are changing. So, I'm just wondering how you all think about given what Phil mentioned and then other impacts of the IRA. How do you think about how we might see those transactions priced relative to loan going forward? And then I have a follow-up.

Danny Abajian

Yeah. I think there are probably some technical factors. If you look at the loan product and the way it's priced--it's been priced, I think a lot of the investors in that asset class look to the prepayment rates and the prepayment speeds of those loans, which, as you'd imagine, with mortgage rates going up and all interest rates going up, those prepayment rates we'd expect to have fallen as the incentive to refinance a solar loan has also fallen, which might drive relative value differences for somebody investing in a loan offering, right?

So, that's on the one hand, the dynamics you'd probably see on the loan side. And if you look at credit spreads for loan securitizations, they have widened. Now, there's just general widening in the market. And we'd probably say at this point, they might have widened relatively more than we'd expect for leases.

We have also talked about the fact that we do have access both to the ABS market and the commercial bank market and relative liquidity dynamics and fundamentals might differ at points in time. So, we are driving the best possible cost of capital at all points as we seek to term out our deployed portfolios into the market.

Ed Fenster

Yeah. And I think the one thing, Joe, I might add to that--it's Ed--is that I think in the commercial bank market, if you were pricing a transaction today, including hedging costs, it would have a fixed handle on it, which would be inside of where the ABS market is.

So, I think there are two questions at hand, right? One is, how are loans and leases financing in the ABS market? And there's the secondary question of, is that even the market that you want to be executing in right now?

The other thing I would mention, obviously, is the pretax cost of tax equity is below the senior debt cost for either product. And so when you think about the weighted average cost of a lease or a loan, you don't want to forget that component either.

Joe Osha

Yeah, that's a good point, especially on the debt versus the ABS market. Thanks.

And actually, Ed, you kind of neatly anticipated my second question. I mean, there's so many things about--he always does that. It's amazing. So many things changing just in terms of the functioning and just the plumbing of the tax equity market given direct pay and transferability and all this kind of stuff.

So, where do you think the tax equity IRRs are headed here when all is said and done? That is to say IRRs to tax equity investors. Could they compress?

Danny Abajian

I don't think that--tax equity IRRs haven't moved very much in the almost 20 years I've been aware of the market. There are a few reasons for that. The first one is the pricing isn't risk-based. It's principally that there is a requirement that you provide a pretax return in the safe harbor and that drives an after-tax return that is typically higher than actually what the asset itself would demand. So, that mutes it.

There's also the fact that accelerated depreciation becomes more valuable when interest rates are higher because it's basically a tax equity investor deferring their income tax bill into the future. So there are--it's sort of got a component that becomes more valuable in a high interest rate environment.

And then, obviously, in most high interest rate environments, banks are making more money, there's more supply of tax equity. So, all of that is that play as well.

In terms of transferability, I mean, for sure, that's going to add to the supply in the market. Our sense right now is we would predominantly likely continue traditional tax equity because in the tax equity traditional market, you get a little bit more than basically a dollar for your investment tax credit because you're providing depreciation value. In a transferability world, there is no depreciation benefit. So, presumably, someone will pay you less than a dollar per investment tax credit.

And so, I think that the superior unit economics will be in the sort of the traditional market. But for particular--but potentially for off the beaten path projects or novel structures, transferability might be of interest to people.

Joe Osha

Excellent. Thank you.

Operator

Thank you. We have next question from the line of Sophie Karp with KeyBanc. Please go ahead.

Sophie Karp

Hi. Thank you for taking my question. Congrats on the solid trend here.

Mary Powell

Thank you, Sophie.

Sophie Karp

So, a couple of questions here. First, I wanted to go back to Lunar, right? Could you maybe give us the investment thesis on Lunar? Is that--is the equipment that the company will provide in any way superior to what the competition already has on the market or is planning to have on the market? And why does it make sense for you, particularly to invest rather than be a stay in kind of technology agnostic?

Mary Powell

Yeah. I mean, I'm just really bullish on this investment. So, thank you for the question.

Really, from a--it is definitely a next-generation technology without a shadow of a doubt. So, for us, it really felt like a way to broaden and deepen basically our access to really good strong technology for this electrification revolution that's happening around us, right?

So again, we really saw it as not switching to one provider because that's not our plan at all with Lunar. We saw it as a really good strategic investment like on its own, even if we couldn't ourselves utilize what they're producing. But the happy coincidence is, guess what, we actually do get to utilize what they're producing.

So, we see it as really strong from two perspectives, like just as a stand-alone investment thesis to have such a high-caliber team that is developing technologies for whole home and transportation technology electrification deployment is really powerful. And then because we have so many customers and we have so much demand, the idea of also getting the opportunity to onboard another technology into our suite is just really exciting.

So, again, we have great partnerships with other storage vendors in this space. We value those. We expect to continue to want those and to develop them. But we just see consumer demand growing so much that there is a place for, again, more technology to be available for our consumers. We love that. We



believe very strongly in Kunal and his team, and we're really excited about their product road map and what other technology might become available to us.

So, it's a real win-win, particularly as we look to '23 and '24 where there's still going to probably be some constraints in the environment. We're really thrilled that we're going to have proprietary access to the technology that Kunal and his team are developing.

Ed Fenster

Yeah, I think maybe just going back to when we decided to start the company, we had spent years providing feature requests to inverter battery, electrification manufacturers, and hadn't really felt like the features and specifications that we really wanted that we knew would lower our cost and increased customer demand were really being acted upon.

And so, the thesis was, yes, that we could by virtue of installing and having all of the customer relations that we have, have a better view into really how to specify and establish these products. And so, the goal certainly was to create a differentiated product.

In addition, as Mary mentioned, obviously, we felt like more battery supply, particularly for us, is better. And Lunar is competing against a number of companies that operate in very high-margin areas. So it's a good stand-alone investment. So, we felt like for all those reasons, it was a very interesting move for us to make, particularly in light of having a good partner and management team identified.

Sophie Karp

Amazing. Thank you. My other question is on the kind of capital allocation. Given where--given dislocation that we see in the equity markets and some of debt markets and where your debt trade, for example, does it make sense to buy it back?

Danny Abajian

Yeah. I think there's--obviously, we've talked about the interest rate environment, the inflationary environment. I think we just prioritize the strength of our balance sheet and liquidity in this period of time over the--relative to the trading levels on the convert and that opportunity there.

Mary Powell

Thank you.

Patrick Jobin

I think that ends the queue. Appreciate everyone joining.

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