Industrial Revenue Bonds and the Impact on Local Communities and Solar Developers

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Kentucky is in the midst of a potential solar boom with over 30 projects filed with the Electric Generation and Transmission Siting Board (Siting Board), which could result in over $3 billion of capital investment in the Commonwealth. Obtaining a construction certificate from the Siting Board is one of many approvals required for a solar project. Part of the approval process at the Siting Board is to evaluate the economic impact of the project on the local community. This involves discussion of jobs, purchases from the local community, the multiplier effect of the capital investment and property taxes.

Property tax policy is still evolving for these merchant projects as none have yet become operational, but there is guidance from the Department of Revenue (DOR) on the topic, and project developers are analyzing potential property tax liability as the projects continue through the development cycle. Industrial Revenue Bonds (IRBs) have long been the economic development tool to provide property tax incentives in Kentucky and are common. IRBs have been widely used by Kentucky's bourbon, auto manufacturing and other industries. In connection with the issuance of an IRB, the project owner transfers the project assets to the county where the project is located. The owner then enters into a lease for those assets, which by statute exempts those assets from local taxes. The new wave of solar projects is no different as the generation of electricity meets the statutory definition of an "industrial building" and are considered manufacturing under Kentucky law. Securing an IRB for a solar project provides long-term certainty on this operating expense. It also provides a modest reduction in property tax liability. Most developers will be entering into a payment in lieu of taxes agreement (PILOT) that requires payment of 100% of school taxes and negotiated amounts to the county general fund. These benefits allow developers to competitively price electricity in the regional wholesale market and find an offtake partner that adds to

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the long-term viability of these projects.

Some have raised concerns that these developer benefits come at a significant detriment to the local county, but that is not the case as manufacturing equipment has never been taxed locally throughout the state. Unlike many projects that qualify for IRBs, solar projects are almost entirely comprised of manufacturing equipment. Under current DOR guidance, the posts driven into the ground, the racking system, the solar panels, the trackers that change the tilt of the panels, the inverters, the cabling connecting most of the project and the transformers are all considered manufacturing equipment. In Kentucky, manufacturing equipment is only subject to state-level property taxes, thereby not generating any local tax revenue regardless of an IRB or other incentives. The cost and installation of these items could easily comprise 90% of the total cost of a project. So, a $100 million project (which would be close to a 100 MW project) would only have $10 million of the project subject to local taxes. In the early years of such a project, that $10 million of project value could generate approximately $100,000 per year in local (including school) tax revenue but as depreciation factors are applied over time, the amount could be reduced to only $10,000.

PILOT agreements being discussed before fiscal courts across the Commonwealth are promising annual payments of $1,000 to $1,500 per MW that don't reduce over time, which would likely be greater (and maybe materially greater) than the local taxes generated from the project if an IRB were not approved. Why would a developer enter into a structure that would require more payments to the local community? The reasons are many:

- It reduces rate and valuation risk and provides a great deal of certainty over the life of a 30-year project.
- It demonstrates a willingness to be a good corporate citizen of the local community, which is allowing these projects to be built.
- It reduces the state-level property taxes that the project will pay as the project is only taxed on the leasehold interest in the assets rather than the full asset value.

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IRBs for solar projects are a great example of a government incentive that results in a win-win for the project and the local community. The project has an overall lower tax liability with long-term certainty, and the local government receives more tax revenue than if the incentive were not approved. That revenue remains constant over the life of the project.

For more information, please contact Brian Zoeller, Daniel Mudd, or any attorney with Frost Brown Todd's Renewables industry team or Tax practice group.

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