

The Basics of Community Solar Projects and Their Application to Multifamily Projects

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I. Introduction

In recent years, the share of energy produced in the United States through solar photovoltaic (PV) technology has increased exponentially. In 2008, installed solar capacity totaled a mere 0.34 gigawatts, but that figure has now reached 134 gigawatts.[1] One particular type of solar facility that has contributed to this dramatic growth is community solar projects (CSPs).[2] The U.S. Department of Energy's National Renewable Energy Laboratory defines a community solar project as a "distributed solar energy deployment model that allows customers to buy or lease part of a larger, off-site shared PV system."[3] The owner or developer of a CSP receives payment from customers "subscribing" to the CSP in exchange for certain economic, environmental, and social benefits (as more fully discussed in Section II).

The attraction of the CSP model is its ability to make solar energy accessible to consumers who may not otherwise be able to install PV technology on their property due to insufficient solar resource, [4] lack of viable rooftop space, lack of property ownership, or insufficient capital to fund a PV project. These issues often arise in multifamily housing developments where tenants do not own the buildings they reside in but still have an unmet demand for access to renewables and the economic, environmental, and social benefits they bring. This article will provide a basic overview of CSPs generally, the value of CSPs to multifamily developments specifically, and certain legal and regulatory issues associated with CSPs that all stakeholders should understand.

II. CSP Basics and Value Proposition

As noted above, many individuals and organizations that desire to incorporate PV technology into their property are unable to do so because they lack the solar resource, viable rooftop space, property

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ownership, and/or capital to fund a PV project. In fact, a majority of rooftops in the U.S. are unsuited to solar installations.[5] Even where rooftops are feasible for an installation, many individuals and organizations lease their residential or commercial space. As such, they are likely unable to force or negotiate an installation with the owner of their property. The CSP model solves this problem by developing the project off-site, with potential locations being (among others) vacant or blighted land, landfills or any otherwise unproductive land with sufficient surface area to host a CSP. Consumers are then able to subscribe to that off-site CSP rather than navigating installation on their own property.

Additionally, it simply may be economically infeasible for many consumers to undertake the construction, maintenance, and operation of a rooftop or on-site solar project. CSPs present an opportunity for consumers of all income levels to receive the full benefits of a renewable energy source by allowing them to purchase or lease a smaller subsection of a larger solar facility. This allows them to capture certain economies of scale while still receiving the economic, environmental, and social benefits derived from a CSP.

So, what specifically are the economic, environmental, and social benefits of a CSP? Environmental and social benefits include: (a) an increase in the production of renewable energy, (b) a reduction in the carbon footprint of the CSP operator and subscribers, (c) expanding the overall availability of solar energy—particularly to low-income consumers, and (d) an increase in the ability of local communities to provide for their own energy needs.

Economic benefits from CSPs are also robust and include: (a) bill credits received from the project, (b) revenue from consumer subscriptions, (c) the right to sell renewable energy certificates (RECs), (d) various federal and state tax incentives, and (e) the ability to market to investors an increased focus on environmental, social, and governance (ESG) values/standards. While revenue derived from consumer subscriptions is self-explanatory, below is a brief description of the other economic benefits.

Bill Credits

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Consumers receiving electricity from CSPs can receive credits on their utility bill in proportion to the electricity delivered to them. Where a PV system is located on-site, and the owner of the PV system and the consumer of the electricity produced by the PV system are the same, the electricity generated is delivered directly to the consumer. The local utility then "pays" for any electricity produced in excess of the electricity consumed by the customer. This concept is known as "net metering."[6]

However, CSPs are generally located off-site, so the electricity produced is not delivered directly to the consumer. Instead, the CSP owner interconnects the project to the local utility's distribution grid and delivers power to the local utility. Then, the utility pays the CSP owner in the form of bill credits for any energy the CSP produces, and the CSP owner distributes the bill credits to subscribers in proportion to their purchased or leased area of the CSP. This indirect method of receiving utility bill credits is referred to as "virtual" net metering.[7] In return for the bill credits, the subscribing individuals or entities pay a subscription fee to the CSP owner in conformance with the terms of their subscription agreement. This fee is typically either paid through monthly installments in relation to the amount of electricity generated and constitutes the primary revenue stream for CSPs.

RECs and SRECs

Another revenue stream for CSP owners is the sale of RECs and SRECs[8] (solar renewable energy certificates) in states that have an active REC market.[9] A REC is a market-based instrument which represents the property rights to the environmental, social, and other non-energy-based attributes of renewable energy generation. [10] A REC is issued when one megawatt-hour (MWh) of electricity is produced and delivered to the grid from a renewable source, such as a CSP,[11] and a SREC is issued for every MWh of electricity produced from solar energy resources. In turn, RECs and SRECs can be sold on the renewable energy market either to utilities attempting to meet state-mandated renewable portfolio standards or to consumers (both individuals and organizations) wishing to establish that their energy usage is tied to renewable energy

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sources. Organizations often pursue such purchases to show an increased corporate focus on ESG matters or to satisfy existing ESG corporate mandates.

Tax Incentives

Federal and state tax incentives can also make CSPs drastically more economically attractive for project developers. For example, the Inflation Reduction Act of 2022 (IRA)[12] has recently extended and expanded two important tax credits for CSPs—the Section 48 Energy Investment Tax Credit (ITC) and the Section 45 Production Tax Credit (PTC). [13], [14] The ITC reduces the federal income tax liability of a project owner by a base credit rate of 6% of the qualified costs of a solar-generating system installed during the tax year.[15] The base ITC rate of 6% is increased to an alternative rate of 30% if certain prevailing wage and apprenticeship requirements are met. [16], [17] The PTC, on the other hand, allows owners and developers of solar-generating systems to claim an inflation-adjusted per-kilowatt-hour (kWh) tax credit for electricity generated by renewable energy sources and sold by the taxpayer to an unrelated person during the taxable year for a period of 10 years after a facility is placed into service.[18]

In addition to the base and alternative two-tiered tax credit structure, the IRA also provides for additional bonus credits on top of the ITC and PTC for projects located in energy communities, those that satisfy the domestic content requirement, and those that are located in low-income communities. CSPs that satisfy the domestic content requirement are eligible for a 10% increase in value of the ITC (e.g., an additional 10% to the 30% ITC) or 10% in value of the PTC (e.g., an additional 0.3 ¢/kWh to the 2.6 ¢/kWh PTC).[19] Similarly, projects sited in an energy community are eligible for an additional 10% increase in value of the ITC or PTC (e.g., an additional 10% to the ITC or an additional 0.3 ¢/kWh to the PTC). [20]

Finally, CSPs that meet the requirements of a qualified solar facility can get an additional 10% ITC bonus for projects located in a low-income community or on Indian land or a 20% bonus if they are classified as qualified low-income residential building projects or

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qualified low-income economic benefit projects.[21],[22] When combined, the IRA creates bonuses or add-on credits that can potentially push the ITC up to 70% of a project's qualified costs or 3.2¢/kWh in the case of the PTC. Furthermore, CSP developers may realize additional cost savings through the Modified Accelerated Cost-Recovery System (MACRS), which allows them to fully depreciate the cost of their PV system in as little as five years.[23]

Most states offer their own unique tax credits for both developers and producers of renewable energy. The multiplicity and variety of state tax credits places them beyond the purview of this article, but entities interested in developing or subscribing to a CSP should review local tax credits available in their jurisdiction.

Environmental, Social, and Governance

Finally, through the purchase of RECs/SRECs—or by developing or participating in CSPs—organizations have an opportunity to demonstrate an increased focus on ESG corporate values/standards. Such efforts allow organizations to demonstrate a commitment toward increased production of renewable energy, a reduction in their carbon footprint, and the support of local communities. For the multifamily industry, there is also the ability to demonstrate a commitment to providing low-income residents with the benefits of solar power at a reduced cost and potentially even no cost. In turn, the foregoing can all be used to retain current investors and attract new investors, which increasingly demand that the companies in which they invest demonstrate tangible efforts to further ESG values/commitments.

III. Use of CSPs for Multifamily Housing Projects

The CSP model can be effectively incorporated into multifamily housing projects in a variety of ways to provide both tenants and owners with some of the benefits detailed above. However, an important initial consideration in determining how to pursue a CSP for a given multifamily project is whether it will be located on-site or off-site.

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On-site projects generally involve rooftop PV installations, which require sufficient roof space to accommodate the project. For such projects, the property owner can act as either a CSP host or a behind-the-meter project host. By acting as a CSP host, the owner receives payment from either an electric utility or third party in return for allowing such utility or third party to install and operate a rooftop system on the owner's property through a lease. The CSP host could then subscribe to the third party's CSP, allowing it to receive benefits associated with a CSP without having to pay for the cost of installation or maintenance. Alternatively, by acting as a behind-the-meter project host, the owner would develop its own on-site system that contributes directly to the building's electricity supply. A behind-the-meter project allows the property owner to directly benefit from the energy cost savings and to pass those savings on to its residents.

Off-site projects could be located anywhere within the local electric utility's service area that has sufficient solar resources. For off-site CSPs, a primary concern of the property owner is likely whether their building is master-metered or multi-metered.[24] For master-metered buildings, the property owner could subscribe to an existing CSP and receive credits towards the building's utility bill. Alternatively, the owner could purchase land off-site, develop their own PV system and apply the credits obtained to their master-metered building. As with an on-site, behind-the-meter project, the property owner would then decide how to best pass these cost savings to the residents. For multi-metered buildings, the property owner may either (1) choose to develop their own off-site CSP and work to get residents to subscribe in return for credits on their utility bill; or (2) sign up for bill credits at an existing CSP on behalf of their residents and then distribute credits accordingly.

The above options constitute some of the more common methods and pertinent considerations for incorporating a CSP into a multifamily housing project. However, in determining the most effective and efficient model for incorporating a CSP, owners will need to consider their own unique circumstances and tailor an approach that works best for them. Among other factors, property owners will need to consider the minimum size of the CSP or CSP

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subscription necessary to benefit their property, the available square footage on their property for such a project (or the cost of purchasing property off-site), and the level of demand among their tenants for such a program. All of these factors play an important role in deciding how to best incorporate a CSP into a multifamily housing project.

Legal and Regulatory Issues Associated with Multifamily Community Solar Projects

A. Legal Issues

Multifamily CSPs present a number of unique legal issues that potential owners/developers should consider. First, there are recurrent issues that must be handled when drafting subscription agreements (also referred to as power purchase agreements), which are the contracts entered into between the CSP owner and subscriber. If the CSP is directly owned by the multifamily property owner, and the subscribers are residents, then the subscription agreements will be with tenants and need not be opened up for negotiation. However, if the subscription agreement is between a multifamily property owner desiring solar energy and a third-party CSP owner, then the contract may be open for negotiation. If the multifamily property owner is a CSP host, then the property owner would also need to negotiate a lease or similar agreement with the utility or third-party CSP owner that will install, repair, and maintain the CSP on the multifamily property.

Particular attention should be paid to the ability to terminate and/or assign subscription agreements, as there may be tension between CSP owners (and their financiers) concerned with the overall stability and integrity of the CSP portfolio and subscribers who may wish to terminate or assign their interest in the CSP. In addition, multifamily owners/developers must consider whether existing encumbrances on their property (e.g., easements, declarations, ground leases, zoning approvals, and/or mortgages and associated loan agreements) create prior approval rights or other barriers to installation. That review is most applicable for on-site CSPs, but it may also be relevant for building a CSP off-site or contracting with

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third-party CSP owners that provide the solar energy from off-site.

Moreover, to the extent that a multifamily project is part of a joint venture seeking to capitalize on tax credit structures, a property owner should engage in a careful review of the operating and partnership agreements controlling what can and cannot be done by the property-owning entity, and the property owner should consult its own tax counsel. Finally, given that multifamily projects are residential in nature, a review should be conducted as to residential leasing laws to make sure that subscription agreements or other flow-down benefits to tenants do not run afoul of laws in the state where the property is located.

Moving away from contract-specific issues, there are also legal issues associated with locating CSPs. While it is true that CSPs may be located anywhere with sufficient solar resources, there are issues that can arise with the siting and permitting of these projects. One unique issue is the fact that many states include in their CSP-enabling legislation a requirement that CSPs be located within a certain distance from their subscribers. This limitation can result in competition for suitable sites within acceptable proximity to the customer base, which, in turn, can result in lengthy permitting delays. Additionally, CSP developers must be aware of local zoning restrictions and keep in mind that zoning authorities may not allow CSPs to be sited on agricultural or other specific types of land.

B. Regulatory Issues

There are some fairly broad regulatory issues that potential CSP owners/developers should be aware of. First and foremost, community solar is largely a creature of state policy. As such, the CSP model may not be viable in states which have not passed enabling legislation.[25] For example, not all states allow for virtual net metering—a policy that must be implemented in a deregulated market or expressly enacted through state legislation. In states that lack the ability to virtually net meter, CSP developers may find it difficult to locate investors or subscribers for the program because they will be unable to receive any bill credits from an off-site generating facility.

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Second, many states that do have enabling legislation for CSPs set program and project caps for community solar.[26] Most program caps are capacity-based and limit the number of CSPs in the state to a certain number of MWs produced.[27] Most states with enabling legislation also set a cap on the capacity of individual CSPs (ranging from anywhere between 1 MW to 5 MW). It is important for potential CSP developers to check the status of varying program or project caps for the state in which the project will be located. A CSP may not be feasible if the state is close to capacity under its program cap or if the project cap limits the usefulness of the contemplated CSP.

Third, all CSPs need to be interconnected to the local utility grid and obtain utility approval for net metering through an interconnection agreement. Interconnection costs can be unique to each property, and the policies and application process for interconnection can vary widely from state to state, with lead times being lengthy. Additionally, many CSPs seek locations that are both suitable for solar development and close to potential customers. This combination of high demand and long lead times for interconnection can result in significant project delays if the relevant state has not adopted policies prioritizing the interconnection of CSPs.

Finally, CSP developers will need to be careful to design their project in a way that avoids subjecting it to regulation by the Securities and Exchange Commission (SEC). In *SEC v. W.J. Howey Co.*, the Supreme Court set forth the current test for determining if an offering constitutes a security[28] and, therefore, must be registered with the SEC. While the offering of a subscription to a CSP may arguably trigger its consideration as a "security" under the *Howey* test, the SEC has issued a No-Action Letter to a CSP developer reasoning that the subscribers to a CSP have no expectation of profit, but rather were purchasing a system for generating electricity for their own personal use.[29] Nonetheless, it is important for any CSP developer to structure and market their program in a way that makes it clear subscribers are not profiting from an "investment" through the CSP, but only receiving electricity for personal use.

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Conclusion

Stated succinctly, community solar is a burgeoning opportunity for owners and developers of multifamily housing projects to provide lasting, positive impact on the environment and communities served, while also creating substantial economic benefits. To be sure, there are significant regulatory barriers in some jurisdictions and important legal considerations to weigh, but many of those issues can be overcome through careful and deliberate planning, research, and advocacy.

For more information, please contact the authors of this article or any attorney with Frost Brown Todd's Multifamily and Renewables teams.

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[1]*See* Solar Energy Industries Association, *Solar Industry Research Data*, available at https://www.seia.org/solar-industry-research-data (last accessed January 17, 2023).

[2] E.g., in early 2022, the Biden administration announced a target of 25 gigawatts of community solar by 2025. *See* U.S. Department of Energy, *DOE Sets 2025 Community Solar Target to Power 5 Million Homes* (last accessed January 17, 2023).

[3] Nat'l Renewable Energy Lab., *Community Solar* (last accessed January 17, 2023).

[4] Solar resource refers to the amount of solar energy which reaches a specific location.

[5] The Department of Energy has estimated that only 22-27% of rooftops are suitable for solar PV installations. *See* Paul Denholm & Robert Margolis, Nat'l Renewable Energy Lab., *Supply Curves for Rooftop Solar PV-Generated Electricity for the United States* 4 (2008)

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[6] Nat'l Renewable Energy Lab, *Net Metering* (last visited February 23, 2023).

[7] There are several different models for how bill credits may be distributed to subscribing consumers. The model described above is the most common. However, another common model is one where the utility pays all of the bill credits to the project owner who then sells the bill credits to subscribing consumers at a discounted rate. This results in a net offset on their utility bill.

[8] SRECs are issued for every MWh of electricity produced from solar energy resources. However, SREC markets are currently only active in 11 jurisdictions. Potential CSP developers should check to see if their jurisdiction has an active SREC market. *See* Lori Bird, Jenny Heeter & Claire Kreycik, Nat'l Renewable Energy Lab., *Solar Renewable Energy Certificate (SREC) Markets: Status and Trends* (2011), For a map of states that have Renewable Portfolio Standards with specific solar carveouts, *see* DSIRE, *Renewable Portfolio Standards (RPS) with Solar or Distributed Generation Provisions* (2017), *available at* https://s3.amazonaws.com/ncsolarcen-prod/wp-content/uploads/2019/07/RPS_carveout_4.pdf

[9] Generally, states which have enacted Renewable Portfolio Standards have active REC markets for entities needing to meet those standards. For a map of states which currently have Renewable Portfolio Standards, *see,* DSIRE, *Renewable and Clean Energy Standards* (2022), *available at* https://ncsolarcen-prod.s3.amazonaws.com/wp-content/uploads/2022/11/RPS-CES-Nov2022.pdf.

[10] U.S. EPA, *Renewable Energy Certificates (RECs*), available at https://www.epa.gov/green-power-markets/renewable-energy-certificates-recs (Last updated on February 5, 2023).

[11] U.S. EPA, *Shared Renewables*, available at https://www.epa.gov/green-power-markets/shared-renewables (Last updated on November 21, 2022).

[12] Pub. L. 117-169.

[13] All references to "Section" are to sections of the Internal Revenue Code of 1986, as amended.

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[14] 26 U.S.C. § 48.

[15] Eligible property includes, but is not limited to, (a) solar PV panels, (b) installation costs, (c) step-up transformers, and (d) energy storage devises. *See* 26 U.S.C. § 48(a)(6).

[16] All laborers and mechanics involved in the construction of the project or the maintenance of the project for five years after project completion are paid wages at rates not less than prevailing wages. Projects must also ensure that a percentage of total labor hours are performed by qualified apprentices. The percent of hours increases over time to a maximum requirement of 15% in 2024 and thereafter.

[17] *See* 26 U.S.C. § 48(a)(10) and 26 U.S.C. § 48(a)(11).

[18] 26 U.S.C. § 45. The current tax credit is set at base 0.5 cents/kWh for projects over 1 MW or an alternative 2.6 cents/kWh for projects that either (1) are under 1MW or (2) meet prevailing wage and apprenticeship requirements.

[19] 26 U.S.C. § 45Y(g)(11)(C).

[20] 26 U.S.C. § 45(b) (11)(B).

[21] See 24 CFR § 5.2003 and 26 U.S. Code §142(d)(2)(B).

[22] The low-income bonus is only available to projects using the ITC.

[23] I.R.C. § 168(I)(1). MACRS creates an accelerated asset depreciation schedule which allows the entire cost of PV system to be depreciated in the first five years.

[24] Multi-metered buildings have one utility meter for each resident, with each resident being responsible for their own utility bill. Master-metered buildings have a single meter for the entire building, with the building owner typically paying the utility bill.

[25] As of 2022, 22 states (California, Colorado, Connecticut, Delaware, Hawaii, Illinois, Massachusetts, Maryland, Maine, Minnesota, North Carolina, New Hampshire, New Jersey, New Mexico, Nevada, New York, Oregon, Rhode Island, South Carolina, Virginia, Vermont, and Washington) and the District of Columbia have passed some form of community solar enabling legislation. *See*

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U.S. EPA, *Shared Renewables*, *supra* at footnote #11.

[26] As of May 2022, at least 19 states and Washington, D.C., included caps on their community solar programs. *See* Jenny Heeter, *et* al., Nat'l Renewable Energy Lab., *Status of State Community Solar Program Caps* v (2022).

[27] For example, Maryland currently has a program cap set at 583 MW or approximately 1.5% of the state's peak demand. *See id.* at 15-16.

[28] 328 U.S. 293 (1946). The *Howey* test states that an offering constitutes a security when the buyer (a) invests their money (b) in a common enterprise (c) regarding which he has been led to expect profits, and (d) which will accrue "solely from the efforts of a promoter or a third party." *Id.* at 298-299.

[29] Office of the Chief Counsel Division of Corporation Finance Securities and Exchange Commission, *Re: CommunitySun, LLC* (August 29, 2011), http://www.sec.gov/divisions/corpfin/cf-noaction/2011/communitysun082911-2a1.htm.

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