

OPINION

Reducing property taxes a key to profitability of renewables

Traditional property tax models are wrong for most renewable energy assets, but assessors have largely failed to keep pace with this shift – and aren't incentivized to do so.

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The following is a Viewpoint by Tom Bernard, Executive Director, Tax and Trevor Mason, Senior, Tax, at Ernst & Young LLP.

The market environment for renewable energy has improved significantly in recent years. New technologies, lower prices and greater business and consumer acceptance are driving adoption at a rapid pace.

Today, solar and wind are considered key elements in the nation's energy mix, and as the market has matured, new opportunities to enhance profitability have also evolved, underpinned by several key developments.

First, renewable asset costs are declining. Since 2010, for example, the industry has seen a 60% cost decline in installed utility-scale solar. In that same time frame, the cost of installed utility-scale wind generation has fallen 33%.

A second factor is the federal tax credits that are still available for renewable energy, in addition to incentives offered at the state level. These incentives have helped spur investment in new and improved technology, including battery storage, leading to greater efficiency and lower costs. In fact, many experts believe that lithium-ion batteries will be more cost effective than

natural gas peaker plants within a decade, and the combination of renewable power and battery storage will overtake open-cycle gas turbine plants to meet peak loads.

As storage technology continues to improve, and prices fall, battery deployment will increase dramatically over the next few years and drive demand for renewables even higher.

Powerful option that few consider

There is a third, less well-known, factor that can help renewable energy companies improve their bottom lines.

Historically, state and local property tax assessment models are predicated on the idea that costs rise each year, due to inflation and equipment expenses. These models often aren't applicable to specialized property such as renewable energy facilities, where costs are actually falling (technology manufacturing companies have faced this issue for years).

In addition, state and local jurisdictions often fail to incorporate federal tax credits into their assessments, which should reflect fair market value, or the price a willing buyer and a willing seller would agree on. These credits and grants include the 30% Investment Tax Credit for solar (currently being stepped down); the 10-year Production Tax Credit for wind; and the Section 1603 30% cash grant, which has since expired.

After the first year that the asset receives its tax credit or cash grant, that value is no longer present and should be deducted from the assessment — but often isn't.

For example, after the 2009 American Recovery and Reinvestment Tax Act was passed, which implemented the Section 1603 grant, a number of new wind farms were constructed to take advantage of the grant. Some of those facilities may still have this grant effectively included in their value.

A handful of states, including Arizona, Utah, Oregon and New Mexico, have rules in place that allow renewable energy companies to deduct federal tax incentives from their ad valorem valuations. But most jurisdictions don't, requiring companies to pursue relief through tax appraisal appeals. Unless these incentives are removed from the appraised value, the asset is likely overvalued and the higher tax cost makes it difficult to be profitable.

In short, traditional property tax models are wrong for most renewable energy assets, but assessors have largely failed to keep pace with this shift — and aren't incentivized to do so.

That presents a major opportunity for renewable companies to make their case with state and local assessors and reduce their property taxes to more accurately reflect their proper valuations, which can have a positive impact on costs — and profits — for years to come.

Property taxes are a huge burden for renewables

Property taxes play an outsized role in ongoing expenses for the renewables space because, unlike traditional generation companies, renewable companies pay no fuel costs. In fact, property tax is typically the largest fixed cost for solar and wind companies.

As a result, the savings from more accurate assessments can be significant. While savings vary from jurisdiction to jurisdiction, reducing tax liability is a critical element in the long-term viability and competitiveness of these assets.

Property taxes aren't just important at the beginning of the renewable project life cycle. Asset valuations and tax implications should be thoroughly reviewed at every stage — from development to operations to decommissioning — to identify opportunities for engagement with assessing entities. For example, there is also the opportunity for relief by removing

embedded intangibles, such as software costs, from the valuation.

Despite the benefits of seeking property tax relief, many renewable-company executives tend to take tax assessments at face value — either because they are unaware of the opportunity to lower their liabilities, or they underestimate the impact that valuation model changes could have on their profitability.

One reason is that many renewable-company leaders — primarily from backgrounds in infrastructure development, private equity or foreign energy companies — simply don't have in-depth experience in valuing energy facilities for property tax purposes. This can be especially true among small and mid-sized renewable companies.

Jurisdictions willing to rethink paradigm

It is true that assessors — and the elected officials they represent — don't like the idea of a jurisdiction's tax base being reduced. A different paradigm can be challenging, and acceptance often takes time. But in our experience, when assessors and officials see the data, they understand why their existing tax valuation models don't work for renewables, and are typically willing to make the necessary adjustments for these facilities.

However, it's important for renewable-energy companies to work with tax officials early and make a strong case for proper valuations. Left unsettled, the issue of valuations — and their impact on local or state revenues — can become a political discussion rather than an economic one, making it difficult for companies to have their assessments lowered.

The next decade promises to be a transformative one for renewable energy, with growth in solar and wind, and breakthroughs in the economic competitiveness of both renewable power and storage technology.

But as renewable energy companies expand their market share,

property taxes will remain their largest fixed cost and biggest challenge to sustained profitability. Understanding each asset's valuation and applying the often-complex rules around property tax fairness — throughout the project's life cycle — will be critical to the industry's continued success.