UNDERSTANDING THE REACH AND LIMITS OF RPTL § 575-B AND THE STATE-MANDATED SOLAR AND WIND REAL PROPERTY ASSESSMENT MODELS

Hodgson Russ Renewable Energy Alert
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Newly-adopted New York Real Property Tax Law ("RPTL") § 575-b requires that solar and wind projects greater than one megawatt be assessed by the Discounted Cash Flow ("DCF") methodology using a model formula (the "Model") and discount rates established by the New York State Department of Taxation and Finance ("DOTF"). The draft of the Model is now out for public comment until October 1, 2021, with DOTF intending to finalize it by the October 15th deadline established in the enacting law. The law was enacted in response to widespread variation in methods of assessment for wind and solar projects, with the aim of providing certainty as to potential tax cost for developers and investors, informing the discussions on Payments-in Lieu-of Taxes ("PILOTs") as to the tax obligation, and reducing the potential for litigation. While a number of issues are resolved by the legislation, whether the Model, particularly as currently formulated, will achieve its goals is at best an open question.

What RPTL § 575-b Does

RPTL § 575-b settles a number of issues in the renewable energy and municipal assessment communities. First, it unquestionably resolves the issue of how the assessed value for solar and wind projects will be determined by commanding that the DCF be used, and by establishing both the Model and the applicable discount rate. Even though the New York Court of Appeals has long held the cost method was not appropriate where other acceptable methods were available, numerous assessors had insisted on employing the cost method. With DCF as the technique, the Legislature has recognized what it is that investors are paying for when acquiring these projects, a flow of future net benefits discounted to present value.

DOTF has published three variations of the DCF Model and associated discount rates: Large-scale solar (5 megawatts and larger), Value of Distributed Energy Resources ("VDER") Solar 1-5 megawatts, and Wind, 1 megawatt and larger. As required by the legislation, DOTF considered regional differences by incorporating the different NYISO zones, as well as the local utility. The solar Models also differentiate between fixed axis and tracker type systems. The Model utilizes earnings

before interest, taxes, depreciation, and amortization ("EBITDA"). The unlocked Model on the DOTF website does not currently supply details on the expense side, it is not clear therefore whether regional expense variations such as for labor costs are built into the Model, as on the revenue side.

The discount rates are pre-tax Weighted Average Cost of Capital ("WACC") calculations with different ratios between debt and equity for each of the three project types. The Models follow New York law by using the "assessor's formula," where the local full-value property tax rate is added to the DOTF-established discount rate to determine the rate to be used in valuing the property. The preliminary base rates are:

Large-Scale Solar: 7.16%

VDER Solar: 8.00%

Wind: 9.66%

Questions about implementation remain. For example, the Model states "Please note that the value of associated land is included in the model output." As assessors are required to provide both a total valuation and the land valuation in establishing the tax rolls, it is not clear how the Model is to be implemented. It is also unclear how community wind, which will qualify for the VDER revenues, is to be valued. Currently all wind over 1 MW is to use the wind model, but the assumptions for large-scale wind do not apply to community wind projects, which are no greater than 5 MW AC in size.

Going forward, the intent of the legislation is to have the Models and discount rates adjusted as appropriate, thus DOTF will at least annually publish updated versions. DOTF consulted with various stakeholders in establishing the Models and rates, and is authorized under the new legislation to redesign the annual reporting required under RPTL § 575-a for certain electric-generating facilities[1] to obtain information necessary for the development and maintenance of the Model and discount rates.

What RPTL § 575-b Does Not Do

Nothing in RPTL § 575-b changes the basics of New York real property tax assessment law, only the methodology required and the discount rate to be employed has been dictated. Assessments still cannot exceed fair market value, a limitation plainly stated in the State Constitution, art. XVI, § 2 ("Assessments shall in no case exceed full value."). As explained by the Court of Appeals, the "concept of 'full value' is typically equated with market value, or what 'a seller under no compulsion to sell and a buyer under no compulsion to buy' would agree to as the subject property's price."[2] Thus, the Model must produce values equal to what the market would pay for such systems.

The Legislature has given DOTF a difficult task. "Inasmuch as this approach [DCF] involves a number of speculative assumptions and complex calculations, it should be employed cautiously since any imprecision can cause gross inaccuracies in the resulting estimate of value."[3]

To give a simple example, the Model assumes a certain rate of degradation for solar panels. What if a particular system owner demonstrates that the system is degrading far faster than expected ("Energy production, in kilowatt-hours, as reported to NYISO" is collected annually on the certified RP-575-a form, so the production can be verified)? All other things being

equal, use of the Model would produce a value greater than what a buyer would pay for that system, violating the State Constitution. And it is not clear if a local assessor can deviate from the Model even when presented (and in agreement) with contradictory information confirming errors in applying the Model.

The Model is intended to alleviate one of the significant issues in developing renewable projects in New York, which is the inability to be sure of tax costs in those situations where a PILOT is not available. Assessors are not required to establish values until after projects are constructed or at least partially constructed, as of the taxable status date. Now developers and project buyers can utilize the Model to determine what the taxable valuation will be, absent significant disagreement on the Model inputs.

But the Model does not address financial viability of projects where a PILOT Agreement is not available from one or more jurisdictions or through the industrial development agency. Few if any energy-generating plants of any type in the state can afford to pay full taxes. Setting fair valuations will not address that situation, which presents a significant impediment to achieving New York's climate change goals. And if the valuation produced is greater than what the market will pay for project if it has to pay full taxes, then it does not represent fair market value of the real estate portion of the project.

Nor will the Model inform municipalities as to what is a fair PILOT. NYSERDA previously produced a PILOT tool which helped numerous communities and developers reach agreement based on an understanding of what projects can afford. At most, the Model establishes the outer limit of RPTL § 487 PILOTs, which cannot exceed full taxation. It does nothing to reign in anti-renewable communities or industrial development agencies.

Also problematic is that RPTL § 575-b does not mention standalone battery energy storage or other renewable energy projects; only wind and solar energy projects. However, solar + storage is increasingly popular, and the Model does not address energy storage integrated into solar projects.

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Overall, RPTL § 575-b aims to add a level of clarity to wind and solar energy project costs. It does not appear, however, that the preliminary Model and discount rates published will accomplish the goal. The discount rates are significantly lower than those used by investors evaluating projects, and the Model includes revenues which are not real property tax revenues (the goal of the Model is not to value the project; the goal of the Model is to value only the real estate portion of the project). The information provided by DOTF so far is somewhat scant as to how expenses were derived, but it appears that there is no allowance for curtailment, even though that is common in larger projects and the industry incorporates that loss of revenue in standard models. Similarly, the expense side seems to be lacking basic expenses such as customer acquisition costs for community solar and lease expense for all projects. And while the local property tax load is properly added to the discount rate, the state's recently-instituted mandatory host community program of $500 per megawatt for solar and $1,000 per megawatt for wind is apparently missing from the cost calculations (at least it is not defined as a part of the expense). Greater clarity on how the inputs were determined would help.

Hopefully refinements in the Model and discount rates will resolve these issues. If the Model is carried out as intended, solar and wind projects across the state will have more predictable assessment values.

If you have any questions about the rates published by DOTF, the impact on the new assessment model, and what these mean for taxation of wind or solar projects, or about renewable energy projects generally, please contact Daniel Spitzer (716.848.1420), Henry Zomerfeld (716.848.1370), or a member of our Renewable Energy Practice.

[1] *See* Hodgson Russ Renewable Energy Alert, "April 30 Deadline for Annual Report for Electric-Generating Facilities Approaching (And so are Changes to the New York Tax Rules for Renewable Projects)," April 7, 2021, *available from* https://www.hodgsonruss.com/newsroom-publications-13231.html.

[2] *Com. Holding Corp. v. Bd. of Assessors of the Town of Babylon*, 88 N.Y.2d 724, 729 (1996) (citing *Matter of Allied Corp. v. Town of Camillus*, 80 N.Y.2d 351, 356 (1992)).

[3] *Matter of Erie Boulevard Hydropower L.P. v. Town of Ephratah Bd. of Assessors*, 2003 WL 21172636 at *3 (Sup. Ct., Fulton Cnty., 2003), *aff'd* 9 A.D.3d 540 (3d Dep't 2004).