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Solar Energy Is Viable For Office Properties

Kevin J. Moore

SILLS CUMMIS & GROSS P.C.

Correcting Five Common Misconceptions To The Contrary

In this article, "solar energy" means the use of photovoltaic modules and their associated hardware, a "system," to generate electricity from sunlight. Office property owners have been much more reluctant than retail and industrial property owners to take advantage of the additional income available to them from solar energy. In the author's experience, this reluctance seems to stem from five common misconceptions. These misconceptions are: (1) an office building owner's tenants typically purchase the electricity for their space directly from the local public electric utility and the office building owner passes the electricity cost for the common areas on to its tenants as part of CAM; therefore, solar energy will not provide any revenue to the office building owner; (2) nontaxable REITs cannot take advantage of the federal tax incentives afforded to the owners of systems; (3) there is no room on the typical office building roof for a system; (4) a system will damage the roof and void the roof warranty; and (5) systems cannot be financed. This article attempts to correct these misconceptions and provide methods for office property owners to take advantage of the additional income that solar energy can provide to them.

Kevin J. Moore

I. Tenants Purchase Their Electricity Directly From The Utility, So There Is No Profit For The Owner

The first misconception is that because an office building owner's tenants typically purchase the electricity for their space directly from the local public electric utility and the office building owner passes the electricity cost for the common areas on to its tenants as part of CAM, solar energy will not provide any revenue to the owner. This misconception is based on the incorrect assumption that a building/system owner's profit from solar energy comes from the sale of electricity and/or savings on electricity costs. In reality, the building/system owner's profits come from the state incentives which the system owner receives because of the system's generation of electricity. These state incentives, which take the form of renewable energy credits, tariff payments from the local utility, tax incentives or grants are referred to as the "Environmental Attributes" of the system. These Environmental Attributes include Solar Renewable Energy Certificates ("SRECs") in New Jersey and Solar Carve-Out Renewable Generation Attributes in Massachusetts, which the office building/system owner sells either directly or indirectly to public electric utilities to meet their state renewable energy portfolio standard or RPS requirements.

Accordingly, the office building/system owner can enter into power purchase agreements ("PPAs") with its tenants. In these PPAs the building/system owner retains the Environmental Attributes of the System and in order to incentivize the tenants to enter into the PPAs, sells the tenants electricity generated by the system at a 10 to 20 percent discount from the price charged by the local public electric utility. In the PPAs the building/system owner also obtains the value of any "net metering" credits[1] that the tenants obtain because of the electricity generated by the system. Finally, the building/system owner can also charge the local electric utility rate for the electricity that the system generates for the common areas of the building, include it in CAM and make a further profit from the electricity generated by the system.

II. A Nontaxable REIT Cannot Take Advantage Of The Federal Tax Incentives

While the state solar energy incentives create the building/system owner's profit, the federal tax incentives permit the building/system owner to recover its capital investment in the system in a very short period of time, at least until the end of 2011. Specifically, Section 1603 of the American Recovery and Reinvestment Tax Act of 2009, as extended by Section 707 of the Tax Relief, Unemployment Insurance Reauthorization, and Job creation Act of 2010, permits a building/system owner, who is a federal taxpayer, to take a federal tax grant, the "1603 Grant," equal to 30 percent of the cost of a system, as a cash payment. The 1603 Grant is paid to the building/system owner on the system's completion, provided that construction of the system commences on or before December 31, 2011 and the application for the 1603 Grant is received

***Kevin J. Moore** is a Member of the Firm's Real Estate Department. He focuses on solar energy law, redevelopment, land use, affordable housing, incentives, and commercial real estate law. The views and opinions expressed in this article are those of the author and do not necessarily reflect those of Sills Cummis & Gross P.C.*

before October 1, 2012.

Additionally, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 permits the building/system owner to depreciate 100 percent of its capital investment in the system, less half of the value of the 1603 Grant, in one year for federal income tax purposes, provided that the system is placed in service on or before December 31, 2011. If the system is placed in service after December 31, 2011 but before January 1, 2013, the building/system owner can depreciate 50 percent of its capital investment in the system in one year for federal income tax purposes. Since the 1603 Grant and the bonus depreciation are based on the Federal Tax Code, a nontaxable REIT cannot directly take advantage of these federal tax incentives. However, there are two methods for a nontaxable REIT to indirectly obtain these incentives.

Using the first method, the nontaxable REIT forms a taxable REIT. The nontaxable REIT then leases its roof, parking lot and/or available land space to the taxable REIT. The taxable REIT then installs and operates the system on its leasehold interest. The taxable REIT owns the system and the Environmental Attributes of the System. The taxable REIT, therefore, receives the Section 1603 Grant equal to 30 percent of the cost of the System and is able to take the accelerated one-year bonus depreciation on 85 percent of value of the system. The taxable REIT is also able to sell the Environmental Attributes of the System. Additionally, the taxable REIT sells the electricity that the System generates by entering into PPAs with the nontaxable REIT's tenants for the sale of electricity at a discounted rate for their leased space and with the nontaxable REIT for the sale of electricity, at the rate charged by the local electric utility, for the common areas of the building. Thus, through the nontaxable REIT, the building/system owner is able to minimize its capital investment in the system and obtain the revenue from the sale of the Environmental Attributes of the System. The taxable REIT will also retain any net metering credits generated by the system.

Using the second method, the nontaxable REIT leases portions of its roof, the air space over its surface parking areas, the roofs of its parking decks and/or any open land on its property to a solar developer through a site lease. The solar developer will then install and own the system on its leasehold interest. In exchange for its leasehold interest, the solar developer will pay roof rent to the nontaxable REIT, provide discounted electricity to the nontaxable REIT for its common areas and enter into PPAs with the nontaxable REIT's tenants. This method generates substantially less income for the building owner than the first method but requires no capital investment and is virtually risk free.

III. There Is No Room On The Roof

Many office building owners think that because of the size of the typical office building roof and the amount of HVAC equipment on the roof, there is no room for a system of sufficient size to be economically viable. However, there are many technological solutions to this problem, including Solyndra® solar modules, the creative arrangement of solar modules, "carport" solar modules that go over parking lots, curtain wall solar modules, ground-mounted systems[2] and combinations of multiple forms of these technologies.

IV. The System Will Damage The Roof And Void The Warranty

Roof Damage.

Many office building owners fear that a system will damage their roofs and void their roof warranties. However, unless placed in areas that experience exceptionally high winds, most systems are ballast systems that rely on the weight of the system to hold it in place. Accordingly, there are no intrusions into or holes made in the roof. Additionally, even in areas that experience high winds, intrusions can be made in the roof without causing leaks or damaging the integrity of the roof.

Roof Warranty.

In order for the installation of a system to be economically viable, the roof of the building must be in good condition. This means that the roof must be relatively new. The roofing industry was one of the first industries to become aware of solar energy. Accordingly, many roof warranties provide procedures to install a system and keep the warranty in place. The building owner should incorporate these warranty provisions in its Engineering Procurement and Construction Agreement ("EPC Agreement") with its installer if it is going to own the system or in its site lease with its solar developer if it's not going to own the system.

V. Systems Cannot Be Financed

Finally, while it is true that many commercial lenders will not finance a system secured only by a security interest in the system, there are many alternatives. First, if the building owner has equity in its building, most commercial lenders will finance a system if the owner provides a first or second mortgage on the building on which the system is located to the lender. Second, many integrator/installers provide construction financing secured only by the system and are willing to wait to be repaid until the owner receives its 1603 Grant. Third, some installers also provide permanent financing secured only by the system. Fourth, many public electric utilities provide system financing secured only by the system in conjunction with long-term fixed-price contracts for the sale of the Environmental Attributes generated by the system. Fifth and finally, if the building owner chooses not to own the system, solar developers do not include financing contingencies in their site leases and PPAs because they self-finance their ownership and construction of systems by raising private or public equity, rather than through debt.

Conclusion

As can be seen from the foregoing, in actuality, solar energy can provide a valuable additional profit center to office building owners.

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[1] The electric systems of both the tenants and of the building owner for the common areas will remain connected to the local electric utility's electric distribution system. When the system generates more electricity than the tenants require, the excess electricity goes into the electric distribution system of the electric utility and the tenants' electric meters run backward. The electric utility then credits the tenants' electric bills for the value of the excess electricity. This is called net metering. Conversely, when the system generates less electricity than required by the tenants, the electric utility provides the electricity required to meet the excess demand.

[2] In New Jersey, the area of solar modules is excluded by law from the impervious coverage limits of local zoning ordinances and state environmental and stormwater regulations.