Solar Energy Credit Pass-Thru to Unit Owners

Prepared by Ronald A. Kawahara, CPA, CVA, CPM, PCAM
Updated: February 2, 2015

Introduction

Maui County has the highest electrical rates in the nation. Currently, that rate averages $0.38/kwh for homeowner associations. Hawaii as a whole has more photovoltaic (PV) panels installed per capita than any other state in the nation. So, it makes a great deal of sense for associations to start the discussion on whether installing solar photovoltaic ("PV") systems make sense.

Can Unit Owners in a Homeowner Association Take Advantage of the Federal and State Solar Energy Tax Credits?

The answer is **YES.** The federal solar energy credit is 30% and the Hawaii credit is 35%, for a combined total of 65% of the cost of the installed PV system. Although some "experts" in the solar industry have publicly stated that these credits are not available to the association or the unit owners, this is not correct.

For the technically minded the pass-thru of federal solar energy credits can be found in IRS Revenue Ruling 82-108, *Energy Credit Allocations*, which discusses this matter in detail. In addition, the Hawaii Administrative Rules, Title 18, Chap. 235, *Renewable Energy Technologies; Income Tax Credit; Citations,* also discusses these pass-thru credits.

Can the Homeowner Association take the Solar Credit Instead of Passing it to the Unit Owners?

The answer is yes, but with a *caveat.* Simply stated, it makes no financial sense for a homeowner association to take the solar credit. From a practical standpoint, the credit should always be passed on to the unit owners. For example, if the PV system cost, say, $300,000, the total energy credit would amount to $195,000. It is highly unlikely that any homeowner association would incur an income tax liability of that amount.

Since an Association Cannot Take Advantage of the Solar Energy Credits Why Not Use a Power Purchase Agreement (PPA)?

A PPA is a contract between the Association and a third-party investor. The investor takes all of the solar energy credit and gets to depreciate the PV system over 5 years, Some Pros and Cons from an association standpoint are:

Pros:

- There is no out-of-pocket cost to the association since the owner/investor of the system pays for the entire cost. This eliminates the association's need to negotiate a complex array of calculations, financing issues and other considerations.

- The Association will receive substantial energy savings over the life of the contract.

- A typical PV installation for an association will likely cost several hundred thousand dollars. As a result, financial considerations will be of paramount importance. There are only three viable options if the association doesn't have the cash reserves:

    - A mortgage loan to finance all or part of the entire cost of the PV system. This will increase the unit owner's monthly maintenance fee. Ironically, even though the unit owners will receive the entire 65% of the federal and State solar energy credit, the same owners will pay an increased maintenance fee until such time as the association's energy savings exceed the remaining balance of the mortgage loan.

    - A special assessment may be very unpopular and be difficult to pass.

    - A combination of a mortgage loan, special assessment and any excess cash reserves.

Cons:

- Neither the association nor the unit owners will receive any of the federal and State solar energy credits.

- A typical PPA contract runs for 20 years during which time the association is legally bound to honor its terms. Technological improvements and falling PV panel prices may mean that the association may be stuck with old technology long before the contract expires.

- Under a PPA the association must continue to pay a percentage of the current monthly bill for the life of the agreement. As a result, the Association will always pay more over the 20-year contract than if the PV system was owned and installed by the association.

- The advantage of a PPA contract is almost always to the benefit of the owner/investor. The reason is that the entire cost of the PV system can be recovered in less than 5 years given the energy credits and bonus depreciation. In addition, the PPA is drafted to favor the owner/investor rather than the association because they put up the money and take most of the risk.

What is the Most Important Consideration in the Purchase of a PV System?

It's the Payback Period. The payback period for an association is usually less than 4 years after taking into account the 65% federal and State credits. The calculation only has two variables: the energy savings cost and the net cost of the system.

What Are the Other Considerations in Deciding Whether to Install a PV System?

Following, are some other considerations that should be taken into account when selecting a vendor:

- The warranty for the PV panels. Is it a manufacturer's warranty or a vendor's warranty, or both?

- What is the vendor's background? Is it a company that was in business well before PV installations became popular or is it a company that started business to take advantage of the construction boom in these types of installation? In other words, will the company still be in business to honor its guarantees during the 20-year life of the PV panels?

- A careful independent financial analysis should be performed to determine when the energy costs savings will materialize. There are various scenarios that must be taken into account including whether the association has cash reserves, the terms of the mortgage, the amount of a special assessment, payback period of the system, PPA considerations, etc.

- Associations that come under a master association must receive approval for the design of the system if it is being installed on a structure other than the rooftops.

References:

- IRS Revenue Ruling 82-108, *Energy Credit Allocations.*
- Federal Tax Coordinator, para. L-16414, *Lodging and Structural Component Requirements.*
- Federal Tax Coordinator, Appendix 10Q, IRS Information Letter 2011-0048 – *Energy Tax Credit.*
- Federal Tax Coordinator, Appendix 10T, IRS Notice 2013-70 – *Energy Tax Credit*.
- Federal Tax Coordinator, Appendix 4O, *Landmark, Inc. v. United States*, U.S. Claims Court Case.
- Federal Tax Coordinator, Appendix 6AC, Revenue Ruling 82-108, *Energy Credit Allocations*.
- Hawaii Administrative Rules, Title 18, Chap. 235, *Renewable Energy Technologies; Income Tax Credit; Citations.*
- Hawaii Form-342A, *Information Statement Concerning Renewable Energy Technologies Income Tax Credit for Systems Installed and Placed in Service on or After July 1, 2009* (***To be Claimed by…Condominium Apartment Associations***) [emphasis added].

DESTINATION MAUI INC.