

**COMMONWEALTH OF KENTUCKY STATE FISCAL NOTE STATEMENT
LEGISLATIVE RESEARCH COMMISSION
2016 REGULAR SESSION**

MEASURE

2016 BR NUMBER **0269**

HOUSE BILL NUMBER **202/GA**

RESOLUTION NUMBER _____

AMENDMENT NUMBER _____

SUBJECT/TITLE **AN ACT relating to economic development incentives for the coal industry.**

SPONSOR **Representative Adkins**

NOTE SUMMARY

FISCAL ANALYSIS: IMPACT NO IMPACT INDETERMINABLE IMPACT

LEVEL(S) OF IMPACT: STATE LOCAL FEDERAL

BUDGET UNIT(S) IMPACT: _____

FUND(S) IMPACT: GENERAL ROAD FEDERAL RESTRICTED AGENCY _____ OTHER

FISCAL SUMMARY

FISCAL ESTIMATES	2015-2016	2016-2017	2017-2018	ANNUAL IMPACT AT FULL IMPLEMENTATION
REVENUES			(Indeterminable)	(Indeterminable)
EXPENDITURES				
NET EFFECT			(Indeterminable)	(Indeterminable)

() indicates a decrease/negative

MEASURE'S PURPOSE: This bill amends the Kentucky Business Investment (KBI) and the Kentucky Enterprise Initiative Act (KEIA) tax incentive programs to allow coal mining or processing companies to potentially qualify. Incentives available to companies through these programs include income tax credits and wage assessments, and sales and use tax refunds, respectively. Under the existing statutory terms of these programs, companies cannot qualify for incentives in relation to coal mining or processing activities.

PROVISIONS/MECHANICS: The bill amends KRS 154.31-010 and 154.32-010 to provide that a company undertaking coal mining or processing activities may qualify for incentives relating to investments in acquiring, constructing, expanding, rehabilitating, or equipping a facility in the Commonwealth.

FISCAL EXPLANATION: This bill would result in a negative fiscal impact on the state general fund in the form of future revenues that will be foregone or refunded in order to provide financial incentives/assistance to companies making certain facilities investments, to the extent that incentives are awarded to companies by the Kentucky Economic Development Finance

Authority.

Summary of programs

To qualify for KBI incentives, a company would be required to create and maintain a minimum of 10 new, full-time jobs for Kentucky residents; incur eligible facility costs of at least \$100,000; pay hourly wages of at least 125% of the minimum wage for 90% of the new employees (in enhanced incentive counties), or at least 150% of the minimum wage in all other counties; and generally provide the new employees with employee benefits equal to 15% of the required minimum hourly wage.

A company could be awarded incentives based on the amount of its approved investment costs, with the incentives being claimed in the form of income and limited liability entity tax credits or employee wage assessments over a 10-15 year period. A local government incentive may also be required, most likely in the form of an assessment against the employees' occupational license fees. To the extent that any local incentive is required, it would also constitute a negative impact on the applicable locality in the form of foregone revenues.

To qualify for KEIA incentives, a company would be required to invest at least \$500,000 in land acquisition, building materials, research and development equipment, or electronic processing equipment, as part of an approved facility project. The incentives would be claimed in the form of a refund of sales and use taxes paid on all eligible items purchased during the term of the project, which may be up to a 7-year period.

Discussion of coal industry and fiscal impacts

In order to gauge the potential effect of the changes proposed by HB 202/GA, it is important to examine Kentucky's coal sector and the potential investment and employment that may occur in the coming years.

Since 1990, Kentucky's coal sector has continued to diminish, when measured in terms of tons produced. However, over this time period production in each of the two Kentucky coal fields has been vastly different. Production in the eastern coal field has declined by 74% since 2000, while production in the western coal field has increased by 35%. Over time, these two divergent trends have led to the western Kentucky coal field becoming a more important part of Kentucky's coal sector. Beginning in 2013, production in the western Kentucky coal field eclipsed production in the eastern coal field. Previously, western Kentucky coal production had not exceeded production in the eastern coal field since 1960.

Simply put, while there has been a prolonged period of retrenchment in the eastern Kentucky coal field over the past 25 years, production in western Kentucky declined during the 1990s, but then experienced a resurgence over the past 15 years. Also, while employment in the eastern Kentucky coal field has declined by 66% since 2001, coal employment in western Kentucky increased by 37% (902 mining jobs) over this same time period. Overall, while the total coal mining sector in Kentucky has gotten smaller, the western Kentucky coal field has demonstrated (small) gains in output and employment, while the eastern Kentucky coal fields has experienced significant declines in output and employment.

Given the marked difference in the change in demand for eastern and western Kentucky coal, any potential qualifying investment for KBI or KEIA would likely occur in the western part of the state and would be linked to increases in employment and investment that might be undertaken.

Since there is no primary state-level data on capital expenditures for the mining sector, it is difficult to determine the extent to which companies with Kentucky coal operations might avail themselves of these two incentive programs. National data do exist for capital expenditures for the mining sector, but certain adjustments must be made to estimate the amount of capital expenditures attributable to coal mining. At the national level, capital expenditure data for the mining sector includes expenditures for the oil and gas subsector and for other types of mining besides coal mining.

National capital expenditures for mining equipment were estimated to be \$49.9 billion in 2013. This national estimate was adjusted (downward) to account for the percentage of total mining attributable to oil and gas production, and to account for the percentage of mining attributable to other mining types besides coal. The resulting estimate was that in 2013, capital expenditures in the US coal mining sector were equal to \$7.485 billion.

To estimate Kentucky's share of US coal mining capital expenditures, adjustments (reductions) were made to the national estimate based on Kentucky's relative share of total US production, western Kentucky's coal share of total Kentucky production, and the estimated decline in Kentucky coal production over the biennium.

Based on 2014 production data, Kentucky's coal sector accounts for approximately 7.8% of total US coal production, and western Kentucky coal production represents approximately 51% of the total coal mined in Kentucky. Also, based on the prevalent trends in the coal market, it is anticipated that Kentucky's coal sector will continue to shrink over the next biennium. Given these three factors, it is estimated that capital expenditures in Kentucky's mining sector could approach \$100 million in the near term. Assuming these capital equipment expenditures could qualify under KEIA, the potential sales tax impact could be -\$6 million.

Besides examining national data on capital expenditures for the mining industry, one can also examine industry reports to gauge the interest in investment in the coal industry in Kentucky. There is currently a proposal for a new mine project in the western Kentucky coal basin—known as the Buck Creek mine—which will be developed by Paringa Resources. Continual sampling in the proposed mining area has led the company to indicate the Buck Creek project will likely be a multi-stage development with the potential for a Buck Creek No. 1, No. 2, and No. 3 mine.

Original staging of the project suggested the larger (underground slope) No. 1 mine would be developed first. Based on published reports, the proposed mine has all the environmental permits in place and is in the process of finalizing funding in 2016, with construction starting within the next 12 months. The estimated capital expenditures (based on final bids) associated with the proposed Buck Creek No. 1 mine are \$105 million and include mine site development, infrastructure, a processing plant, a refuse disposal facility and an overland conveyor to a barge load-out facility on the Green River—approximately 2 miles from the project.

However, recent reports (February 2016) indicate the initial phase of the project will be smaller, but the total project may be larger than originally anticipated once mine No. 2 and mine No. 1 are completed. In December 2015, the scoping study for the No. 2 mine was completed, and this study found the coal for this proposed mine was located at a shallower depth compared to the No. 1 mine. With the coal closer to the surface, a simpler mining method (box-cut) can be used to extract the coal for the No. 2 mine, allowing this project to proceed with a lower capital expenditure up front (\$44 million for the No. 2 mine versus \$105 million for the No. 1 mine) which would allow for a faster payback, and would not hamper the continued development of the larger No. 1 mine—which is presently in the financing stage. The proposed plan is to develop the No. 2 mine first, but to simultaneously work on the No. 1 mine to have it “shovel-ready” as soon as possible once the No. 2 mine becomes operational.

Based on the proposed development timetable listed in Table 1, construction on the No. 2 mine will begin in the second quarter of CY 2017 and continue through the first quarter of CY 2018 (i.e., Q4 of FY 2017 through Q3 of FY 2018). Upon completion of this initial phase, construction will begin on mine No. 1, if current market conditions continue. Combined, these stages of the project will have an estimated capital expenditure amount of \$149 million.

TABLE 1
Proposed Development Timetable for Buck Creek Mine Complex

Calendar Year	2016				2017				2018			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
No. 2 Mine												
Technical Studies	X	X	X	X								
Secure Property	X	X										
Permits	X	X	X	X	X							
Construction						X	X	X	X			
Commercial Production										X	X	X
No. 1 Mine												
Construction*											X	X

* The construction timeline for the No. 1 mine extends from 2018Q3 to 2020Q1.

Based on the national estimates of capital expenditures in the mining industry, along with recent industry reports, **it appears HB 202 could have a negative fiscal impact in the upcoming biennium (\$2.64 million), and if the Buck Creek project moves forward, depending on the amount of the proposed capital investment (\$105 million) that would qualify under HB 202GA, the negative fiscal impact could be significant in future biennia.** Moreover, it is important to note the analysis does not account for any existing coal firms (most likely in western Kentucky) that may hire additional workers and/or make additional investments in the future, which would further add to the fiscal impact.

In summary, while it is difficult to ascertain with a great deal of certainty the fiscal impact of HB 202 GA, it appears the negative impact of this bill has the potential to exceed \$2 million in the upcoming biennium and may be even larger in the next 2-4 years.

DATA SOURCE(S): EIA-Coal Industry Annual; US Census Bureau-Annual Capital Expenditure Survey; Kentucky Quarterly Coal Report, PRNnewswire.com, Mining-technology.com

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