

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

**MEASURE**

2016 BR NUMBER 0967

HOUSE BILL NUMBER 535

RESOLUTION NUMBER \_\_\_\_\_

AMENDMENT NUMBER \_\_\_\_\_

**SUBJECT/TITLE AN ACT relating to economic development.**

**SPONSOR Representative Sinnette; York; Adkins; and Steele**

**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
<b>REVENUES</b>		(\$825,000)	(\$1.1 million)	(Indeterminable - Substantial)*
<b>EXPENDITURES</b>				
<b>NET EFFECT</b>		(\$825,000)	(\$1.1 million)	(Indeterminable - Substantial)*

( ) indicates a decrease/negative

**\*Beyond the upcoming biennium, the possible annual impact would include the costs of both KIRA incentives approved to a company, as well as the costs of the sales tax exemption, as discussed below.**

**MEASURE'S PURPOSE:** This bill amends the Kentucky Industrial Revitalization Act (KIRA) to extend the amount of time allowed for a company with an approved project to undertake supplemental projects, from 24 months to 60 months following the term of the approved project, and to receive additional incentives relating to the supplemental project over its 10-year term. The bill also reduces the number of current employees and the amount of minimum investment required for approval of a supplemental project, and allows start-up costs relating to certain idled equipment to be considered as eligible for recoupment through KIRA incentives. Incentives available through this program include income tax credits and state and local employee wage assessments.

The bill also exempts all materials, supplies, and repair or replacement parts purchased and used in operating and maintaining a blast furnace and related steel-making operations, as part of a KIRA supplemental project, from the state sales and use tax effective for purchases made on or after July 1, 2018 and during the supplemental project term.

**PROVISIONS/MECHANICS:** The bill amends KRS 154.26-010 to amend the definition of “supplemental project” and amends KRS 154.26-080 to establish the requirements for such projects. A new section of Subchapter 26 of KRS Chapter 154 is created to provide that costs incurred for the start-up of a blast furnace and related carbon steel-making operations, which were idled due to unfairly traded imports of steel, shall be considered eligible for recoupment through KIRA incentives. KRS 139.480 is amended to establish the sales tax exemption for materials, supplies, and repair or replacement parts purchased and used in operating and maintaining a blast furnace and related steel-making operations, as part of a KIRA supplemental project.

**FISCAL EXPLANATION:** This bill would result in a negative fiscal impact to the General Fund in the form of future revenues that will be foregone to provide financial incentives to a company that is at risk of closure or is unlikely to re-open without the substantial investment assisted by the incentives. Due to the requirements for a company to qualify for approval of a supplemental project, staff has identified only one company that may possibly qualify for additional KIRA incentives as a result of this bill. That company is AK Steel, which operates a steel production facility near Ashland.

**Recent legislation and events involving KIRA and the global steel market**

During the 2012 and 2014 Regular Sessions, legislation was enacted which made amendments to the KIRA program similar to those proposed in this bill. The fiscal note analysis prepared for the legislation filed in 2014 stated that proposals for various upgrades to the AK Steel facility in Ashland had been identified at that time as including a relining of the blast furnace.

Since that time, in December 2015, AK Steel idled the blast furnace at its Ashland Works resulting in the layoff of 590 employees. Currently, 334 employees remain at the facility for maintenance, as well as some steel processing and finishing operations not directly related to the blast furnace (namely the hot-dip galvanizing line). Various factors contributed to the idling, primarily the impact that imports of steel from other countries are having on market prices. Several trade cases are currently pending before the U.S. International Trade Commission, alleging that China and other countries are unfairly exporting subsidized steel at below-market prices, in a practice known as dumping, and that this dumped steel is negatively impacting the domestic steel industry. According to the company's SEC filings in 2015, in response to the sharp decline in market prices the company sought to reduce operating costs and position its blast furnaces in Michigan and Ohio for higher operating rates and capacity utilization by idling the Ashland furnace. Prior to the idling, the company's utilization across all three plants was at approximately 79% of capacity.

**Future possible investments and KIRA projects**

To qualify for incentives based on a supplemental project, which by definition must constitute an additional investment in a previously approved KIRA project, AK Steel would first need to re-start the Ashland blast furnace. Under HB 535, the start-up costs incurred in that re-start process would be eligible for recoupment through incentives. It is difficult to estimate the likely timeframe for a re-start, should it occur, due to the numerous factors affecting market prices, including but not limited to the outcome of the pending trade cases and any possible anti-dumping tariffs. According to AK Steel representatives, it is possible that the facility may be re-

started within this biennium, perhaps as soon as the 2<sup>nd</sup> quarter of fiscal year 2016-2017. If that occurred, based on the estimated level of start-up costs that may be eligible for recoupment, the amount of the resulting fiscal impact may be \$9 million. That amount could be claimed over the 10-year term of the agreement through income tax credits, however it would more likely be taken through employee wage assessments.

Assuming that staff and payroll levels after the re-start returned to the levels existing prior to the idling, the annual Kentucky resident payroll at the facility would be approximately \$27.8 million, with the impact of the 4% state wage assessment equaling \$1.1 million per year. Local wage assessments may also be allowed as part of a KIRA project, and to the extent any are granted they would also constitute a negative fiscal impact on the applicable local governments.

Following the re-start, the relining of the blast furnace, which was proposed in recent years, would likely still need to be performed for the facility to remain viable. In 2014, the company relined the bottom portion of the overall furnace, called the hearth, to address operational issues, at a cost of approximately \$19 million. At that time, according to the company's 2014 Annual Report, a reline of the furnace had not been performed in thirty years. By comparison, the company's Michigan blast furnace, which was acquired in 2014 for a cash purchase price of \$690.3 million net of cash acquired, had been completely rebuilt by the prior owner in 2007, and as a result is among the most efficient and productive blast furnaces in the world for its size.

According to various media accounts, and statements by steel industry analysts and company executives, the cost to reline a blast furnace ranges from \$150 to \$200 million. Based on the percentage of total investment which was determined to be eligible for recoupment in the company's 2004 KIRA project, the amount of blast furnace reline costs that may be approved for recoupment could range from \$120 to \$160 million. If HB 535 were enacted, and if AK Steel were awarded incentives for a supplemental project that included a blast furnace reline at that level of investment, not including other eligible upgrades and start-up costs, the company could be awarded up to 75% of the eligible costs as an incentive, or \$90 to \$120 million.

Regardless of the maximum amount of tax incentive approved in the supplemental project agreement however, if a company is not able to claim the incentives through tax credits (by virtue of having little to no tax liability), then the wage assessment on Kentucky resident payroll will serve to limit the actual amount of incentives claimed, and therefore the state fiscal impact. If Kentucky payroll remained at or near the \$27.8 million levels throughout the 10-year term of the project, the fiscal impact of the KIRA incentives on the General Fund would be approximately \$11 million.

#### Sales tax exemption

Regarding the sales tax exemption allowed by HB 535 and its impact, it should be noted that the purchase/use of some types of industrial materials and supplies used at the Ashland facility would already qualify for exemption from sales and use tax under existing law (*See*: KRS 139.470(10) and 139.480(21)). HB 535 would expand upon those existing exemptions to allow other types of materials and supplies, as well as repair or replacement parts, used in the on-going operations and maintenance of the steel-making operations as part of a supplemental agreement to also be exempt, for purchases made beyond the upcoming biennium and during the 10-year

term of the supplemental agreement.

To the extent that purchases not otherwise exempt under existing law become exempt under HB 535, it would result in a negative fiscal impact to the General Fund, which could be substantial. According to AK Steel representatives, based on the estimated cost of repair and replacement parts expected to be purchased and which would be exempted by this bill, the amount of the impact would be approximately \$1 million annually, beginning no sooner than fiscal year 2018-2019, which would be in addition to the impact of the KIRA incentives themselves. This would occur only if a supplemental project is approved, and would be beyond the upcoming biennium.

**DATA SOURCE(S): AK Steel representatives, SEC filings, and press releases; various press reports; LRC staff**

**PREPARER: Eric Kennedy NOTE NUMBER: 110 REVIEW: JRS DATE: 3/1/2016**