

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 1012

SPONSOR: Governmental Oversight and Productivity Committee and Senator Garcia

SUBJECT: Guaranteed Energy Performance Savings Contracting

DATE: March 30, 2001

REVISED: \_\_\_\_\_

|    | ANALYST       | STAFF DIRECTOR | REFERENCE  | ACTION              |
|----|---------------|----------------|------------|---------------------|
| 1. | <u>White</u>  | <u>Wilson</u>  | <u>GO</u>  | <u>Favorable/CS</u> |
| 2. | <u>Cooper</u> | <u>Yeatman</u> | <u>CA</u>  | <u>Favorable</u>    |
| 3. | _____         | _____          | <u>AGG</u> | _____               |
| 4. | _____         | _____          | <u>AP</u>  | _____               |
| 5. | _____         | _____          | _____      | _____               |
| 6. | _____         | _____          | _____      | _____               |

## I. Summary:

The Committee Substitute (CS) establishes the “Guaranteed Energy Performance Savings Contracting Act.” It provides legislative intent stating that investment in energy conservation measures can reduce the amount of energy consumed and produce immediate and long-term savings. It amends s. 489.145, F.S., as follows:

- Expands the types of energy conservation measures that agencies may purchase through guaranteed energy performance savings contracting.
- Redefines “energy cost savings” as meaning a reduction in the cost of fuel, energy, and operation and maintenance that is created by the use of an energy conservation measure.
- Permits agencies to utilize third party financing to pay for energy conservation projects.
- Increases the time frame for agencies to pay for an energy conservation measure from 10 to 20 years.
- Provides that an agency is not required to pay for the preparation of an energy cost savings report, unless the energy conservation measure is installed.
- Requires a contractor to provide an annual reconciliation of the guaranteed energy cost savings to the agency, and if a shortfall occurs, the contractor is liable.
- Requires agencies to submit guaranteed energy performance savings contracts to the Comptroller for approval.

This CS substantially amends section 489.145 of the Florida Statutes.

## II. Present Situation:

**Overview of the Guaranteed Energy Savings Program--**In 1994, the Legislature enacted the Guaranteed Energy Savings Program.<sup>1</sup> The program permits agencies, defined as meaning, “. . . the state, a municipality, a school district or school board, or another political subdivision,” to enter into guaranteed energy savings contracts, under specified circumstances.<sup>2</sup>

The purpose of a guaranteed energy savings contract is for a qualified provider<sup>3</sup> to significantly reduce the energy or operating costs of an agency-owned building or hospital. A “guaranteed energy savings contract” is defined as:

[A] contract for the evaluation and recommendation of energy conservation measures, including the design and installation of equipment to implement one or more of such measures. The contract may cover repair or replacement of existing equipment in a state-owned building or a state-owned hospital, professional fees, and financing charges to be paid from the energy savings less agreed-upon inflation factors, and maintenance services if applicable.<sup>4</sup>

An “energy conservation measure” is a training program or facility alteration that reduces energy consumption or operating costs and includes:

- Insulation of the building structure and systems within the building.
- Storm windows and doors, caulking or weatherstripping, multiglazed windows and doors, heat-absorbing, or heat-reflective, glazed and coated window and door systems, additional glazing, reductions in glass area, and other window and door system modifications that reduce energy consumption.
- Automatic energy control systems.
- Heating, ventilating, or air-conditioning system modifications or replacements.
- Replacement or modifications of lighting fixtures to increase the energy efficiency of the lighting system without increasing the overall illumination of a facility, unless an increase in illumination is necessary to conform to the applicable state or local building code for the lighting system after the proposed modifications are made.
- Energy recovery systems.
- Cogeneration systems that produce steam or forms of energy such as heat, as well as electricity, for use primarily within a building or complex of buildings.
- Energy conservation measures that provide long-term operating cost reductions and significantly reduce Btu consumed.<sup>5</sup>

In order for an agency to consider entering a guaranteed energy savings contract, it must first obtain a report from a qualified provider, which estimates the anticipated reduction in energy or

<sup>1</sup>Ch. 94-112, L.O.F., codified at s. 489.145, F.S.

<sup>2</sup>Section 489.145(1)(a), F.S.

<sup>3</sup>A “qualified provider” is a licensed engineer, architect, or contractor, who is experienced in the design, implementation, or installation of energy conservation measures through guaranteed energy savings contracts. Section 489.145(1)(e), F.S.

<sup>4</sup>Section 489.145(1)(d), F.S.

<sup>5</sup>Section 489.145(1)(b), F.S.

operating costs.<sup>6</sup> The agency may then enter the contract only if it finds that the amount it would spend on the energy conservation measures is unlikely to exceed its savings in energy and operating costs for 10 years from the date of installation.

The qualified provider must be selected in compliance with s. 287.055, F.S., which sets forth competitive bidding requirements for agencies wishing to procure professional architectural, engineering, or surveying and mapping services. However, if fewer than three firms are qualified to perform the required services, the competitive bidding requirements in s. 287.055(4)(b), and s. 287.057, F.S. do not apply. The agency must publicly notice the meeting in which it intends to award the contract.

The contract must contain the following:

- A written energy guarantee by the qualified provider that the energy or operating cost savings will meet or exceed the cost of energy conservation measures.
- A statement that at least 10 percent of the price must be paid within two years from the date of complete installation and acceptance by the state, that the remaining costs are to be paid at least quarterly, not to exceed a 10 year term, and that the savings are guaranteed to the extent necessary to make payments for the systems.
- A requirement that the qualified provider provide a 100 percent project value bond to the state for its faithful performance.
- A statement that the term of any contract expires at the end of each fiscal year, but may be automatically renewed, subject to the agency making sufficient annual appropriations based upon realized savings.
- A statement that the contract does not constitute a debt, liability, or obligation of the state.<sup>7</sup>

**The Guaranteed Energy Savings Program in Practice**--Representatives from the Department of Management Services (DMS) have indicated that the state could realize substantial savings if energy performance contracting became widespread. The program, however, is rarely utilized because, according to the DMS, s. 489.145, F.S. is vague and oft times subject to conflicting interpretations.

Only three state agencies have managed to enter guaranteed energy performance contracts. The Department of Corrections (DOC) has contracts providing for lighting changes, and the installation of chillers and solar systems. The total savings anticipated is \$15 million over ten years.<sup>8</sup> The Department of Transportation has a contract to replace heating and cooling systems, and lighting. It is estimated that a \$5.97 million savings will be realized over the life of the 10-year contract, which constitutes a 40 percent return on investment. The Department of Highway Safety and Motor Vehicles (DHSMV) is in the process of obtaining approval for an

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<sup>6</sup>Section 489.145(2), F.S.

<sup>7</sup>Section 489.145(2) and (3), F.S.

<sup>8</sup>According to the DMS, it took 16 months for the first DOC contract to be approved. The DOC estimates that it lost a total of \$2.56 million in energy savings that would have been realized with more rapid approval.

energy performance contract which is estimated to result in a savings of \$2.6 million over ten years that will payback the \$2.6 million project cost.<sup>9</sup>

The DMS specifically identified the following problems with existing law:

- Little incentive is provided for an agency to pursue an energy savings contract. If an agency saves money as a result of energy conservation upgrades, the end result may be having its budget reduced in the next fiscal year, or having any savings not expended by the fiscal year's end revert back to the general revenue fund.
- Finalizing guaranteed energy performance contracts involves excessive time.
- Unlike similar federal law, the Florida law does not allow any savings in excess of the guaranteed amount to be shared with the qualified provider, and thus, the Florida law fails to give the provider any incentive to maximize the cost savings.
- The 10-year repayment term limitation is too short for large-scale energy conservation measures, such as boilers, chillers, and HVAC systems.
- The law is not clear as to what occurs if a savings shortfall or excess occurs.
- The law appears to permit only one contract between the agency and the provider. It does not clearly allow the agency to enter another contract for the purpose of financing the project. Thus, the provider, who unlike the agency cannot secure tax-exempt financing, must secure the financing. As a result, interest rates are higher and less savings are generated.
- The law provides only for a simple payback method of calculating energy savings, rather than also accounting for the cost of maintenance, present value of money, or salvage value.<sup>10</sup>

### III. Effect of Proposed Changes:

The CS amends s. 489.145, F.S., to establish the “Guaranteed Energy Performance Savings Contracting Act.” Legislative findings are provided, which state that the investment in energy conservation measures for agency facilities can reduce energy usage and produce immediate and long-term savings, and that it is the policy of the state to invest in energy conservation measures.

The CS amends the following definitions:

- The definition of “agency” is amended to eliminate school districts and school boards.<sup>11</sup>
- The definition of “energy conservation measure” is amended to include additional methods such as renewable energy systems (solar, biomass, or wind systems), devices that reduce water consumption and sewer charges, storage systems (fuel cells and thermal storage), generating technologies (microturbines), and any other repair,

<sup>9</sup>According to the DMS, it has taken the DHSMV over four years to obtain approval to move forward on this contract, and the department estimates that this delay has cost the department over \$1 million in lost savings.

<sup>10</sup>Section 255.255, F.S., creates a Building Life Cycle Cost (BLCC) analysis that the DMS believes would be more effective if included in s. 489.145, F.S. The BLCC is the sum of the reasonably expected fuel costs over the life of the building, as determined by the department, that are required to maintain illumination, power, temperature, humidity and ventilation and all other energy-consuming equipment in a facility, and the reasonable costs of probable maintenance, including labor and materials, and operation of the building.

<sup>11</sup>Chapter 97-384, L.O.F., amended s. 235.215, Florida Statutes, to enact changes that are similar to this CS for school districts, community colleges, and state universities.

- replacement, or upgrade of existing equipment. It also includes equipment purchased for the purpose of being used in construction.
- The definition of “energy savings” is amended to mean a measured reduction in the costs of fuel, energy consumption, and stipulated operation and maintenance.
  - The term “guaranteed energy savings contract” is changed to “guaranteed energy performance contract.” The definition is amended to require the contract to not only cover the design and installation of the equipment, but also the operation and maintenance of the equipment where applicable. The contract must provide for an annual accounting of actual savings, and indicate any finance charges incurred by the agency over the life of the contract.
  - The term “qualified provider” is changed to “guaranteed energy performance savings contractor.” Excepting technical changes, the definition remains the same.

The CS requires an agency to obtain a report from a guaranteed energy performance savings contractor that summarizes the costs of the energy conservation measure, and estimates the amount of savings that will accrue if the measure is implemented. The agency and contractor may enter a separate agreement to pay for the report; however, the agency need not pay for the report, unless the report indicates that the energy cost savings will be equal to or greater than the cost of the energy conservation measure and the measure is installed.

The CS provides that the agency may enter a guaranteed energy performance savings contract if it finds that the cost of the energy conservation measure will not likely exceed the amount to be saved in energy cost savings for up to a 20 year period (current law provides for a 10 year period). The CS requires that this determination be made based on the life cycle cost calculations provided in s. 255.255, F.S.

Under the CS, the guaranteed energy performance contract may provide for financing, including tax exempt financing by a third party. The third-party financing contract may be separate from the guaranteed energy performance contract. It must include provisions that the third party financier is not granted rights or privileges that exceed the rights and privileges of the guaranteed energy performance savings contractor. In calculating the amount the agency will finance, the agency is permitted to reduce that amount by grants, rebates, or capital funding; however, when calculating the life cycle cost, the agency may not apply grants, rebates, or capital funding.

The CS amends the provisions permitted or required to be in a guaranteed energy performance savings contract as follows:

- It requires that the annual savings be guaranteed in writing by the contractor to the extent necessary for the agency to make annual payments in satisfaction of the contract.
- It permits the contractor’s written guarantee to include letters of credit, insurance policies, or corporate guarantees.
- It requires the contract to provide that all payments may be made over time, but may not exceed 20 years from the date of installation and acceptance by the agency.
- It requires the contractor to provide an annual reconciliation of the cost savings, and if there is a shortfall in expected savings, the contractor is liable.
- It permits the contract to provide for an allocation of any excess savings among the parties.

- It requires the contract to provide that any excess savings may not be used to cover shortfalls in future years.

The CS specifies that the Department of Management Services may, within available resources, provide technical assistance to state agencies contracting for energy conservation measures, and engage in other activities to promote such contracting. It permits the Office of the Comptroller to develop model contracts and related documents for use by state agencies, and requires state agencies to submit contracts to the office for its approval.

The CS takes effect on October 1, 2001.

#### **IV. Constitutional Issues:**

##### **A. Municipality/County Mandates Restrictions:**

None.

##### **B. Public Records/Open Meetings Issues:**

None.

##### **C. Trust Funds Restrictions:**

None.

#### **V. Economic Impact and Fiscal Note:**

##### **A. Tax/Fee Issues:**

None.

##### **B. Private Sector Impact:**

Companies that provide energy conservation measures and equipment may have increased business opportunities under the provisions of this CS.

##### **C. Government Sector Impact:**

This CS should have a positive fiscal impact on state and local governments. Under the CS, any cost incurred by the agency for the energy conservation measure would be paid for with savings resulting from the reduction in energy cost. If projected energy cost savings fall short of expectations, the contractor must pay for the shortfall. If projected energy cost savings exceed expectations, the excess may be allocated among the parties. Thus, the CS should have the effect of creating an incentive for agencies to procure guaranteed energy performance contracts and for contractors to maximize the potential energy savings.

#### **VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

The DMS indicates that widespread utilization of guaranteed energy performance contracts should have numerous benefits, including:

- reduced indoor air quality problems;
- increased productivity and reduced absenteeism of employees working in the improved facility;
- enhanced local economy by the creation of jobs with the energy contractor during the period of construction or renovation;
- reduction or elimination of costs associated with the maintenance and repair of aging or obsolete energy-consuming equipment; and
- creation of an incentive for energy contractors to develop highly efficient improvements by linking their compensation to the savings achieved through their work.

Section 235.215, F.S., authorizes school districts, state community colleges, and state universities to enter into energy performance-based contracts with energy performance contractors.

**VIII. Amendments:**

None.