Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Capital Budget Committee

HB 1777

Brief Description: Authorizing the use of performance-based contracting for energy services and equipment.

Sponsors: Representatives Doglio, Fitzgibbon, Duerr, Lekanoff, Stearns, McEntire, Ramel and Pollet.

Brief Summary of Bill

- Authorizes state agencies and school districts to independently enter into performance-based contracts for energy equipment and services under certain conditions.

Hearing Date: 2/20/23

Staff: Dawn Eychaner (786-7135).

Background:

Performance-Based Contracting for Energy Conservation Projects.
Municipalities, including cities, counties, and port districts, may negotiate performance-based contracts with companies that offer water conservation, solid waste reduction, or energy equipment and services.

Performance-based contracts for energy conservation have payment terms that are:
- set as a percentage of the annual energy, water, or solid waste cost savings or benefits achieved through conservation that are attributable to the contract; or
- guaranteed by the service provider to be less than the annual energy, water, or solid waste cost savings or benefits attributable to the contract.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

A state agency or school district may work through the Department of Enterprise Services (DES) to develop and finance energy conservation projects, enter into performance-based contracts for energy services, and contract to sell energy savings from a conservation project.

Conservation projects may be funded through the DES Energy Savings Performance Contracting process through utility savings, capital funding, grants, or loans. "Conservation" includes reduced: energy consumption; energy demand; energy cost; greenhouse gas emissions; and reduced use or cost of water, wastewater, or solid waste.

<u>Certificate of Participation Program</u>.
Real property and major equipment acquisitions for state agencies and local governments may be financed through the Certificate of Participation (COP) programs administered by the Office of the State Treasurer (OST). The COP programs combine borrowing into larger offerings to reduce the overall cost of financing. For state projects, debt incurred under COP programs does not fall under the state debt limit.

The OST has adopted policy guidance for COP program financing for energy upgrade projects, which outlines the requirements for a project with an energy service company to be included in a COP program financing as either a personal property project (equipment) or a real property project (real estate).

Under the COP program, the OST executes a financing contract agreement between OST and the agency when the COP program issuance occurs. State agencies may use financing contracts to provide all or part of the funding for conservation projects.

The OST has adopted policy guidance defining a financing contract for state agency agreements as meeting at least one of the following criteria:
- The present value of the lease payments is greater than 90 percent of the fair market value of the property as estimated at the beginning of the lease term.
- The lease term is greater than 75 percent of the useful life of the property.
- The lease includes a bargain purchase option that is not based on fair market value.
- The lease provides for the transfer of ownership of the property to the agency.

Except for financing contracts entered into by state and regional universities, the State Finance Committee approves the form of all financing contracts of the state.

<u>Clean Buildings Performance Standard</u>.
In 2019 the State Energy Performance Standard (Standard) for commercial buildings was established. The Standard requires the Department of Commerce (COM) to establish rules for energy performance standards for covered buildings, collect data on compliance, and report on outcomes. With certain exemptions, there are two tiers of covered buildings under the Standard:
- A Tier 1 covered building is a commercial building where the sum of nonresidential, hotel, motel, and dormitory floor areas exceed 50,000 gross square feet, excluding the parking garage area.

- A Tier 2 covered building is a commercial building that is greater than 20,000 gross square feet and less than 50,000 gross square feet or a multifamily residential building greater than 20,000 gross square feet.

Dates of compliance with the Standard are phased in based on building size. Owners of Tier 1 covered buildings must come into compliance with the Standard between 2026 and 2028, and owners of Tier 2 covered buildings must come into compliance with the Standard in 2031. COM may impose administrative penalties for building owners who fail to document compliance with the Standard by the compliance deadlines. The penalty may not exceed $5,000 plus an amount based on the duration of the continuing violation and the size of the building. COM may also adopt rules to impose a penalty, of up to 30 cents per square foot, on Tier 2 building owners who fail to demonstrate compliance with the energy management and benchmarking requirement.

Summary of Bill:

Either independently or through the Department of Enterprise Services, state agencies and school districts may finance energy conservation projects at public facilities, enter into performance-based contracts for energy services, and contract to sell energy savings from a conservation project.

State agencies and school districts may contract with entities for energy equipment or services provided to the agency or school district under the following conditions:
- The contract must include terms that transfer ownership of the energy equipment from the state agency or school district to the entity;
- The entity is responsible for cost-savings and performance guarantees through the terms of the contract;
- The value of energy equipment or services at the time of contract execution may exceed the fair market value of property leased by the agency or school district, and this must be considered cost-effective; and
- At the end of the financing term of the contract, equipment ownership must be transferred back to the state agency or school district at no residual value.

State agencies and school districts may use financing contracts as well as performance-based contracts to provide all or part of the funding for conservation projects.

The expected value of energy equipment and services at the time of contract execution that are provided through a performance-based contract may exceed the fair market value of property leased or owned by the state agency or school district and still be deemed cost-effective.

Appropriation: None.

Fiscal Note: Requested on February 10, 2023.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.