HOUSE BILL REPORT
HB 1777

As Amended by the Senate

Title: An act relating to authorizing the use of performance-based contracting for energy services and equipment.

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 History:

Committee Activity:

Capital Budget: 2/20/23, 2/22/23 [DP].

Floor Activity:

Passed House: 3/1/23, 96-0.
Senate Amended.
Passed Senate: 4/11/23, 47-2.

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.

HOUSE COMMITTEE ON CAPITAL BUDGET

Majority Report: Do pass. Signed by 28 members: Representatives Tharinger, Chair; Callan, Vice Chair; Hackney, Vice Chair; Steele, Ranking Minority Member; Abbarno, Assistant Ranking Minority Member; Sandlin, Assistant Ranking Minority Member; Alvarado, Bateman, Cheney, Christian, Couture, Dye, Farivar, Fosse, Kloba, Leavitt, Maycumber, McClintock, McEntire, Morgan, Mosbrucker, Orwall, Peterson, Reed, Rule, Shavers, Stearns and Waters.

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.

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.

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.

Certificate of Participation Program.
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 the 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.

Clean Buildings Performance Standard.
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. The 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. The 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.
- 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.

EFFECT OF SENATE AMENDMENT(S):

<u>The Senate amendment:</u>

- <u>defines "energy as a service" as a performance-based contract for energy services entered into by a state agency, school district, public university, or municipality that may include the provision of energy equipment that is owned and operated by a third party;</u>
- <u>authorizes state agencies, school districts, public universities, and municipalities to enter into energy as a service contracts. Such contracts may include the development of conservation projects that require the ownership of energy equipment to be held by other persons or entities, energy as a service contracts, and contracts to sell energy savings to local utilities or the Bonneville Power Administration;</u>
- <u>permits, rather than requires, contracts to include terms transferring ownership of the equipment from the state agency, public school district, public university, or municipality, to the third party contractor; removes language designating items in excess of fair market value to be cost-effective; and removes the requirement that equipment be transferred back to the state agency or school district at no residual value;</u>
- <u>requires state agencies, school districts, public universities, and municipalities to ensure that an energy as a service contract does not directly result in the loss of any position of employment by state or school district employees and requires training to be offered to employees in the preventative maintenance of energy equipment and services;</u>
- <u>requires state agencies, school districts, public universities, and municipalities to coordinate with the Department of Enterprise Services (DES) before entering into an energy as a service contract in order to analyze the cost-effectiveness of the proposed contract and requires the entered-into contract to be more cost-effective than other available alternatives;</u>
- <u>stipulates that any direct financial grants or incentives received on behalf of the state agency, school district, public university, or municipality will be passed on to that</u>

entity;

- designates performance-based contracts entered into by state agencies, school districts, public universities, and municipalities that include the purchase of real or personal property as subject to statutory requirements for financing contracts;
- requires the DES to report to the Legislature and Governor by June 30, 2031, on the implementation of the act, including the number of performance-based contracts issued and the effectiveness of the contracts;
- states a legislative intent to consider findings in the DES report and extend the expiration date of the act if performance-based contracts are achieving legislative objectives; and
- expires the act on June 30, 2033, with the stipulation that contracts entered into under authority granted by the act may remain in effect after this expiration date.

Appropriation: None.

Fiscal Note: Available.

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

Staff Summary of Public Testimony:

(In support) This bill started with a constituent who met with a school district representative who wanted to upgrade lights and realized that the overall need to update all of their district buildings was greater than the initial project. The Clean Buildings Performance Standard (Standard) will require that every tool be available to agencies to help them comply, and this is one of those tools. The state does not own Xerox machines; the service providers come in and service the machine. This bill allows agencies to enter into agreements with private Energy Service Companies (ESCOs) who put forward the capital funding needed to help the building be more efficient, meet the energy savings targets, and manage the maintenance of those systems. This policy will help promote private-public partnerships to manage efficiency upgrades that buildings need to make, and the long-term contract stretches out the payments for the capital upgrades. The ESCOs have a successful history working with the Department of Enterprise Services (DES) on many kindergarten through grade 12 and local government and state agency projects over the years. The DES Energy Savings Performance Contracting Program (Program) is working well right now and is a cost-effective way to make energy improvements and manage risk. However, the amount of deferred maintenance exceeds the capacity of the Program to fully address the needs, particularly with the Standard driving a need for more energy projects. This will not require capital allocations, as payments would be made through a services contract. This is another tool to reduce the state's carbon footprint. The Program has been successful, but the program needs to be modernized and expanded.

(Opposed) None.

Persons Testifying: Representative Beth Doglio, prime sponsor; Brian Solan; and Tony Usibelli, Usibelli Consulting.

Persons Signed In To Testify But Not Testifying: Lisa Parshley, City of Olympia; and Ash Awad, McKinstry.