NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE

BILL NUMBER: HB623 (PCCS- H623-PCCS4289-RUx-2)

SHORT TITLE: State Energy Conservation Program

SPONSOR(S): Rep. McMahan

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ()**

	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07
REVENUES					
EXPENDITURES		See Assumptions and Methodology			
General Fund					
Debt Service Requirement		$3,437,500	$6,837,650	$6,606,650	$6,375,650
Energy Savings		($3,437,500)	($6,837,650)	($6,606,650)	($6,375,650)
Net GF Impact		$0	$0	$0	$0

POSITIONS:

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Administration's State Energy Office, State Construction Office and Division of Purchase and Contract; Department of State Treasurer, and all State governmental units.

EFFECTIVE DATE: January 1, 2003 and applies to contracts entered into on or after that date.

BILL SUMMARY:
This bill amends the Guaranteed Energy Savings Contract law to make it applicable to State governmental units. Currently, the law only applies to local governments. Section 3 amends G.S. § 143-64.17 to outline the requirements for the evaluation of proposals in the case of a State governmental unit. Section 7 requires State governmental units to use guaranteed energy savings contracts when feasible. Section 8 outlines the guaranteed energy savings contract reporting requirements; authorizes local governmental units to use lease purchase and installment contracts to provide for acquisition, installation, or maintenance of energy conservation measures; authorizes State governmental units to finance the acquisition, installation, or maintenance of energy conservation measures; and outlines the existing statutes on inspection and compliance certification that are applicable to guaranteed energy savings contracts. Section 9 of the bill amends Chapter 142 of the General Statutes by adding Article 8 as the State Energy Conservation Finance Act. This article governs the authorization of finance contracts, the procedures for incurrence or issuance of financing contracts, the granting of security for financing contracts, payment provisions, the issuance of certificates of participation, the tax

status of the financing instruments, the authorization to enter into other agreements related to the financing contracts or certificates of participation, and the investment eligibility of the financing instruments. Section 11 exempts the solicitation and evaluation of proposals for guaranteed energy savings contracts from the provisions of the Public Contracts Article of Chapter 143, except that the guaranteed energy savings contracts are subject to the minority participation requirements of G.S. § 143-128.2 and the adjustment and resolution of State board construction contract claims requirements of G.S. § 143-135.3.

ASSUMPTIONS AND METHODOLOGY:
This bill allows State governmental units, which include the State or a department, an agency, a board, or commission of the State, including the Board of Governors of the University of North Carolina and its constituents, to enter into guaranteed energy savings contracts. As defined in the bill, a guaranteed energy savings contract is a contract for the evaluation, recommendation, or implementation of energy conservation measures, including the design and installation of equipment or the repair or replacement of existing equipment in which all payments, except obligations on termination of the contract before its expiration, are to be made over time, and in which energy savings are guaranteed to exceed cost.

The potential effect of expanding the statute to require State governmental units to evaluate the use of guaranteed energy savings contracts and to authorize them to use such contracts when feasible is to increase the use of such contracts. Increasing the use of guaranteed energy savings contracts potentially will (1) increase the resources required to evaluate the use of the contracts and whether expected savings were realized (State governmental units and the State Energy Office), (2) increase the resources required to process the procurement of third party financing (Purchase and Contract and the Dep't of State Treasurer) and the additional requisitions for the purchase of equipment and materials for the guaranteed energy savings measures (Purchase and Contract), (3) increase the resources required to review plans and specifications for those measures that involve renovations to State buildings as well as to supervise and inspect the renovation work (Office of State Construction), (4) decrease the State funded resources required for energy expenditures (State governmental units), and (5) increase the State's debt burden.

The Fiscal Research Division's –best estimate of the extent of the use of guaranteed energy savings contracts is based on the State's current repair and renovation needs as determined from a review of the Facilities Condition Assessment Program Report (FCAP) and the State's Six-Year Capital Improvement Plan (CIP). The Office of State Construction operates a Facilities Condition Assessment Program through which it maintains an automated inventory of all facilities owned by State agencies. As required by G.S. § 143-34.42, the inventory includes the location, occupying agency, ownership, size, description, condition assessment, maintenance record, parking and employee facilities, and other information to determine maintenance needs and prepare life-cycle cost evaluations of each facility listed in the inventory. The inventory is updated every three years. The CIP includes each agency's anticipated capital needs for each year of the six-year period. The CIP specifically identifies those requirements for repairs and renovations necessary to maintain the use of existing facilities. Each item in the CIP references the FCAP.

According to the *Inventory of Capital Improvement Requests for State Government, Six Year Summary for FY 2001-2007* prepared by the Fiscal Research Division in December 2001, there are approximately $1.2 billion in repair and renovation needs statewide, including the universities. The Office of State Construction has identified energy related projects in the most recent FCAP report totaling $30 million. We also believe these projects could qualify for financing under this bill. While we recognize that not all of these projects would qualify, we also recognize the possibility that there are projects that are not on the list that could qualify for financing under this bill. The bill allows up to $50 million in guaranteed energy savings measures to be financed at any one time. Our best estimate, therefore, is that there will be between $30 million and $50 million in guaranteed energy savings projects.

Debt Burden

The bill provides that the aggregate principal amount payable under the financing contracts cannot exceed $50 million at any one-time. At the request of Fiscal Research, the Department of State Treasurer developed a debt service schedule for $25 million of financing through certificates of participation that would be issued on June 1, 2003 and another $25 million on the same date in 2004. The simulation assumed that the debt would be repaid over 12 years and that the average interest rate would be 5.35% on the 2003 issue and 5.65% on the 2004 financing. This would result in gross debt service requirements of $3.4 million for FY04, $6.8 million in FY05, and then declining amounts in future years. The total interest payments over the life of the $50 million debt would be $17.8 million. Thus, the total debt service requirements would amount to $67.8 million over a 13-year period. Please note that the simulation assumes full utilization of the $50 million authorization and specific timing for the issuance of the financing instruments. While we estimate that there are, ***at a minimum,*** $30 million in repair and renovation projects that could qualify for financing under a guaranteed energy savings contract, at this point Fiscal Research has no way to predict how much of the authorization will be used and when the instruments will be issued.

This debt from the financing of the guaranteed energy savings measures would count as part of the State's debt burden and therefore ultimately impact the State's credit rating. Though it is anticipated that the energy savings will be sufficient to pay debt service costs, in the event actual savings are not sufficient to cover debt service or are not restricted to meeting the debt service requirements, the State would continue to have a limited liability for the debt. We cannot estimate how much the State’s debt burden and credit rating will be impacted by the guaranteed energy savings contracts.

Energy Savings

As noted above, we estimate that there will be between $30 million and $50 million in guaranteed energy savings measures at any one time. The debt service requirements over the repayment period on $50 million, assuming $25 million would be issued in each of the next two years, would amount to $67.8 million. By definition of a guaranteed energy savings contract, savings in the form of reduction in fuel costs, energy costs, or operating costs are expected to exceed the cost of implementing the measures. Therefore, assuming the full authorization is used, we expect that over the same 13-year period as the debt repayment, the total savings will exceed $67.8 million. On an annual basis, the savings should equal or exceed the annual debt service requirements. However, we cannot estimate the extent to which the annual savings will exceed the annual debt service requirement.

Adoption of Rules

The bill requires the Department of Administration, through the State Energy Office, to adopt rules for agency evaluation of guaranteed energy savings contracts after consulting with and obtaining the approval of the State Treasurer. The Department of Administration has an attorney on staff whose responsibilities include drafting rules. The Fiscal Research Division believes that the Department can factor the drafting of the rules into the workload priority for the attorney and would, therefore, not need any additional resources to fulfill this requirement of the bill.

Reporting Requirements

The bill requires State governmental units to report the contract terms to the State Energy Office and to annually report the status of the contract including any details required by the State Energy Office. The State Energy Office is responsible for compiling the information and reporting it to the Joint Legislative Commission on Governmental Operations and to the Local Government Commission. These new reporting requirements will increase the workload for the State Energy Office. However, without a better estimate on the use of the guaranteed energy savings contracts, we cannot estimate the extent of the increased workload or the number, if any, of additional positions that would be needed to satisfy the reporting and evaluation requirements.

The Fiscal Research Division notes that the State Energy Office estimates that it will need four additional positions and operating costs based on its assumption that the State Energy Office would have the responsibility for setting up the rules, developing a standard request for proposal, working with all of the State agencies and universities on the process, overseeing the contracts, subbing measuring and verifying tasks to a third party, monitoring those subcontracts, and performing quality checks on the construction and performance. The Fiscal Research Division believes that these responsibilities, other than the adoption of the rules, are beyond what the bill requires the State Energy Office to do. Thus, we cannot agree with its estimate that four additional positions and operating costs are needed.

Operating Resources- Purchase and Contract

As noted above, the projects that are potentially eligible for financing under this bill are projects that are currently on the State's repair and renovation list. Typically, repair and renovation projects are funded with State appropriations. Administering these projects is included in the normal responsibilities of Purchase and Contract (P&C). To the extent that the guaranteed energy savings projects are the same as the energy related projects on the State's repair and renovation list, this bill does not increase these responsibilities any more than if the projects were funded with State-appropriated repair and renovation funds. Therefore, Fiscal Research believes that no additional resources are needed for P&C to fulfill it responsibilities for processing requisitions for additional equipment and materials.

Operating Resources- Office of State Construction

Fiscal Research believes for the reasons noted below that no additional resources are needed for State Construction as it relates to administering guaranteed energy savings contracts.

First, as with P&C noted above, to the extent that the guaranteed energy savings projects are the same as the energy related projects on the State's repair and renovation list, this bill does not increase State Construction's responsibilities any more than if the projects were funded with State-appropriated repair and renovation funds because administering these projects are within the normal responsibilities of State Construction.

Second, as provided for in Section 3 of the bill, any cost incurred by the Department of Administration in the evaluation of proposals can be charged to the State governmental unit who requested the proposal and any costs paid by the State governmental unit shall be included in the cost of the proposal. Specifically, Section 3 amends G.S. § 143-64.17A by adding a subsection that provides that in the case of a State governmental unit, any proposal for a guaranteed energy savings contract shall be evaluated by a licensed architect or engineer who is either privately retained, employed by the Department of Administration, or employed as a member of the staff of the State governmental unit. The Department of Administration may charge the State governmental unit if the Department's services are used for the evaluation and the State governmental unit shall include the cost charged by the Department in the cost of the proposal. A qualified provider of a guaranteed energy savings contract must include, in calculating the cost of a proposal, any reasonable fees payable by the State governmental unit. **Thus, whether the Department of Administration participates in the evaluation of any proposals appears to be at the option of the State governmental unit.** Fiscal Research has no basis for estimating how often the Department will evaluate proposals. Further, any cost incurred by the Department may be charged to the State governmental unit and financed as part of the cost of the proposal.

Third, Section 8 of the bill adds G.S. § 143-64.17K which provides that the architecture and engineering powers and duties of the Department of Administration ***shall not*** apply except that a State Governmental unit may elect to have an inspection and certification by the Department of Administration under G.S. § 143-341(3)d. (Note that G.S. § 143-341(3)d requires the Department of Administration to supervise and inspect all work done and materials used in the construction or renovation of all State buildings and all community college buildings whose plans and specifications must be examined and approved under § 143-341(3)(a.2); and no such work may be accepted by the State or by any State agency until it has been approved by the Department.) Again, Fiscal Research has no basis for estimating how often the Department will supervise and inspect the work done and materials used in a guaranteed energy savings projects. Any cost incurred by the Department related to supervision and inspection may be financed as part of the cost of the proposal.

SOURCES OF DATA: Office of State Treasurer.

FISCAL RESEARCH DIVISION: (919) 733-4910

PREPARED BY: Marilyn Chism, David Crotts, Mona Moon

APPROVED BY: James D. Johnson

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