Legislative Analysis

ENERGY CONSERVATION FINANCING FOR LOCAL GOVERNMENT

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House Bill 6036 as reported from committee w/o amendment
Sponsor: Rep. Al Pscholka
Committee: Local Government
Complete to 12-13-16

Public Act 529 of 2016

BRIEF SUMMARY: House Bills 4990–4994, which were enrolled as Public Acts 119–123 in May of 2016 amended provisions in various acts applying to energy conservation financing by local government. House Bill 6036 would extend those changes to the Uniform Budgeting and Accounting Act. Energy conservation improvements may include heating, ventilation, or air conditioning systems, as well as information technology improvements, among other things.

FISCAL IMPACT: House Bill 6036 would authorize an additional financing method for energy conservation projects, increase the maximum financing period for energy conservation projects, and describe the types of energy conservation improvement projects that could be implemented (see the summary below). The fiscal impact on a local unit of government would depend on the local project circumstances, the structure of a lease agreement, and the alternative financing methods available. Authorizing the use of a lease-purchase agreement as an additional financing method has the potential to increase energy conservation improvement projects and thereby reduce overall costs for local units of government. While lease-purchase agreements don't normally have interest rates as low as bond financing, oftentimes they are a more cost-effective financing method than traditional commercial leases due to their tax-exempt nature. See ***Fiscal Information***, below, for additional information.

THE APPARENT PROBLEM:

When state government officials enter into 'tax exempt lease purchase agreements'—sometimes called TELPs—they do so to avoid incurring long-term debt. The TELP agreements are paid through annual appropriations that can be suspended if there is dissatisfaction with the purchase.

According to committee testimony, 47 states use TELP financing, including Michigan. Generally, TELP agreements span 15 years, but they cannot exceed the useful life of the item purchased. TELP payments are renewed annually during budget deliberations.

Legislation has been introduced to allow local units of government to use 'tax exempt lease purchase agreements' to make energy improvements.

THE CONTENT OF THE BILL:

The bill would amend the Uniform Budgeting and Accounting Act to allow local government officials to improve energy conservation, utilizing financing that includes lease-purchase agreements, and describe the uses for which that financing could be applied. The bill would go into effect 90 days after being enacted into law.

Under the bill, a local government could provide for energy conservation improvements to its facilities and pay for them from the local unit's general fund, or from the savings resulting from energy conservation, except as otherwise provided by law.

A detailed description of the bill follows.

Lease-purchase agreements. The bill specifies that an installment contract could include a lease-purchase agreement—a multi-year contractual obligation that provided for automatic renewal unless positive action were taken by the legislative body to terminate the contract.

The bill requires that payments under a lease-purchase agreement be considered a current operating expense subject to annual appropriations. In this way, the legislative body would be obligated only for those sums payable during the fiscal year of contract execution, or any renewal year thereafter.

Under the bill, the legislative body could make payments under a lease-purchase agreement from any legally available funds, or from a combination of energy or operational savings, capital contributions, future replacement costs avoided, or billable revenue enhancements that result from energy conservation improvements, provided the legislative body had determined that those funds were sufficient to cover (in aggregate over the full term of the contractual agreement) the cost of the energy conservation improvements.

The bill specifies that the lease-purchase agreement would terminate immediately, and without further obligation, at the close of the fiscal year in which it was executed or renewed, or at such time as appropriations (and otherwise unobligated funds) were no longer available to satisfy the obligations.

Ownership. During the term of the lease-purchase agreement, the local unit's legislative body would be the vested owners of the energy conservation improvements, and those local officials could grant a security interest in those improvements to the provider of the lease-purchase agreement. Upon termination of the agreement (and the satisfaction of the obligations of the legislative body), the provider of the lease-purchase agreement would be required to release its security interest.

Scope of energy conservation improvements. The bill would allow a local unit to provide for the acquisition or financing of energy conservation improvements to facilities or infrastructure owned or operated by the local unit. Those energy conservation improvements may include, but are not limited to, improvements for heating, ventilation, or air conditioning systems, fenestration, and roofs, as well as for insulation, heating, ventilation or air conditioning controls, and for closing entrances or exits. They may also include information technology improvements associated with an energy conservation improvement, and municipal utility improvements associated with an energy conservation improvement.

Reporting for proposed improvements. The bill would require the local unit's legislative body to determine before entering into a contract for energy conservation improvements: the name of each facility to which an improvement is being made and a description of the improvement; actual energy expended in the year before beginning the improvement; project costs and expenditures, including the total of all lease payments over the duration of the lease purchase agreement; and estimated energy savings, including projected savings over the duration of the contract.

Further, the bill would require the local unit to submit a report with all of this information to the Michigan Public Service Commission within 60 days of the completion of an improvement.

Lease-purchase agreements. Under the bill, a legislative body would be able to (1) acquire, finance, or refund its energy conservation improvements by installment contract, which may include a lease-purchase agreement, or (2) borrow money and issue notes, or (3) enter into contracts in which the cost of the energy conservation improvements are paid from a portion of the savings that result from the improvements.

The bill would allow that an installment contract or notes issued could extend for up to 20 years from the date of the final completion of the energy conservation improvements or the useful life of the aggregate energy conservation improvements, whichever is less.

Finally, the bill states that lease-purchase agreements would not be subject to the Revised Municipal Finance Act, and would not be a municipal security or a debt as those terms are defined in that act. Likewise, it would not limit the borrowing or bonding authority of a local unit as provided by law.

FISCAL INFORMATION:

Lease Purchase Agreements. Unlike traditional lease contracts, lease-purchase agreements allow the local unit of government to take title to the improvements when the lease is signed. Therefore, the interest paid is tax-exempt, allowing for lower interest costs than traditional financing methods. The payment obligations are limited to the current operating budget and are therefore not deemed a long-term debt obligation of the local unit. They are treated as multiple, renewable short-term leases. Despite not being considered a long-term debt obligation, a decision to not appropriate funds for the lease-purchase agreement would likely have a negative impact on the local unit's credit rating. Because payment obligations are limited to the current operating budget, oftentimes it is the savings from the energy conservation improvement projects that are used to cover the lease-purchase payments, assuming energy savings targets are met. It should be noted that any savings guarantee is usually independent of the obligation on the part of the local unit to repay the lease-purchase obligation. Under the bill, the local unit of government may grant a security interest in the energy conservation improvements to the provider of the lease-purchase agreement to assist in lowering overall financing costs. Presumably, the lessor could seek to recapture any assets secured by the security interest if the local unit of government failed to appropriate funds to make payments under the lease purchase agreement.

ARGUMENTS:

For:

The use of 'tax exempt lease purchase agreements' will enable local government leaders to make energy improvements to buildings without incurring long-term debt. Instead, TELP agreements for energy upgrades can be funded annually through the appropriation process, and if government leaders are dissatisfied with the service, then the vendor can be held accountable. HB 6036 will enable local government officials to use a new financing option that is already available to state officials.

Against:

The Michigan Department of Treasury, which took no position on HBs 4990–4994, points out that TELP agreements—in which local officials enter into annual purchase agreements with vendors who work in partnership with financing banks—do not guarantee vendor accountability for energy upgrades, because improvements to energy systems in local government buildings cannot be removed and reinstalled year-to-year.

POSITIONS:

Johnson Controls supports the bill. (11-30-16)

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