

ENERGY CONSERVATION FINANCING FOR LOCAL GOVERNMENTS

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House Bills 4990-4994 (each reported from committee as H-1)

Sponsor: Rep. Al Pscholka

Committee: Local Government

Complete to 12-2-15

Analysis available at
<http://www.legislature.mi.gov>

BRIEF SUMMARY: The bills would allow local government officials to improve energy conservation, utilizing financing that includes lease-purchase agreements.

FISCAL IMPACT: Collectively, the bills would authorize an additional financing method for energy conservation projects, increase the maximum financing period for energy conservation projects, and expand the types of energy conservation improvement projects that could be implemented (see the summary below). The fiscal impact to a local unit of government would depend on the local project circumstances, structure of 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 the officials within local units of government to use 'tax exempt lease purchase agreements' to make energy improvements.

THE CONTENT OF THE BILLS:

The bills would amend various acts to allow local government officials to improve energy conservation, utilizing financing that includes lease-purchase agreements, and to expand the uses for which that financing could be applied. Each of the bills would go into effect 90 days after it was enacted into law.

House Bill 4990 (H-1) amends the Home Rule City Act (MCL 117.5f);

House Bill 4991 (H-1) amends the General Law Village Act (MCL 68.36);

House Bill 4992 (H-1) amends the Home Rule Village Act (MCL 78.24b);

House Bill 4993 (H-1) amends 1986 RS 16 concerning townships (MCL 41.75b); and

House Bill 4994 (H-1) amends Public Act 156 of 1851 concerning counties (MCL 46.11c).

Under the acts, local government can provide for energy conservation improvements to its facilities and pay for them from operating funds (or the local general fund) or from savings resulting from energy conservation savings.

A detailed description of the bills follows.

Lease-purchase agreements. All of bills specify 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.

Each 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.

Each 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 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. Now under each of the statutes, a legislative body may provide for energy conservation improvements to their facilities. Each bill would retain this provision; allow for the acquisition or financing of energy conservation improvements; and, extend the provision to also include *infrastructure* improvements.

Also under each of the statutes, energy conservation improvements may include, but are not limited to, improvements for heating, fenestration, and roofs, as well as for insulation, heating or air conditioning controls, and for closing entrances or exits. Each of the bills would retain these provisions, and extend them to include *ventilation, information technology improvements associated with an energy conservation improvement, and municipal utility improvements associated with an energy conservation improvement.*

Lease-purchase agreements. Currently, a legislative body may acquire its energy conservation improvements by installment contract, or it may borrow money and issue notes, or it may 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. Each bill would retain these provisions. Further, each bill specifies (1) the legislative body could acquire *finance, or refund* its energy conservation improvements, and (2) that an *installment contract would include a lease-purchase agreement* (as described above).

Currently an installment contract or notes issued can extend for up to 10 years. Each of the bills would extend the life of the contracts or notes from 10 to *20 years from the date of installation of the energy conservation improvement.*

Finally, each of the bills 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.

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. This bill will enable local government officials to use a new financing option that is already available to state officials.

Response:

The Michigan Department of Treasury, which has taken no position on the bills, 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:

Sterling National Bank supports the bills. (10-28-15)

Johnson Controls supports the bills. (10-28-15)

The Michigan Townships Association supports the bills. (10-28-15)

The Michigan Association of Counties supports the bills. (10-28-15)

The Michigan Municipal League supports the bills. (10-28-15)

Branch County supports the bills. (10-28-15)

The Department of Treasury has no position on the bills. (10-28-15)

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.