
ENCOURAGE STATE AGENCIES TO USE THE MASTER LEASE PURCHASE PROGRAM AND ENERGY SAVINGS PERFORMANCE CONTRACTS

The Master Lease Purchase Program and Energy Savings Performance Contracts are two means by which state agencies can obtain low-interest financing to purchase capital equipment and make energy upgrades. The Master Lease Purchase Program, administered by the Texas Public Finance Authority, was established in 1992 to enable state agencies and institutions of higher education to finance capital equipment acquisitions through the state. Purchasing capital equipment through the Master Lease Purchase Program benefits the state by enabling an agency to have consistent and predictable capital expenditures. The program offers a low-cost mechanism for agencies to finance capital equipment throughout its useful life. However, agency participation has decreased during the past 10 years.

An Energy Savings Performance Contract is a mechanism by which an organization pays for energy-saving improvement projects with money gained through decreased utility expenditures. This tool has been available to Texas agencies and institutions of higher education since 1997. Up-front financing for public projects through Energy Savings Performance Contracts is available through LoanSTAR at the State Energy Conservation Office and through the Master Lease Purchase Program. Although Energy Savings Performance Contracts provide a cost-neutral or cost savings method to decrease energy use and utility bills, only one state agency, the Texas Facilities Commission, has entered into an Energy Savings Performance Contract during the past 10 years.

FACTS AND FINDINGS

- ◆ The number of Master Lease Purchase Program contracts managed by the Texas Public Finance Authority has decreased by 24.1 percent and the value of such contracts has decreased by 72.5 percent from fiscal year 2007 to 2017.
- ◆ In March 2018, the Texas Facilities Commission completed the first Energy Savings Performance Contract for a state agency since 2008. The project had guaranteed annual savings of \$485,134 and resulted in a further \$289,771 in rebates from the Austin Energy utility.

CONCERNS

- ◆ State agencies are not required to consider the Master Lease Purchase Program when financing purchases of capital equipment. This lack of consideration may result in the state not using the most cost-effective method of financing available.
- ◆ The Texas Public Finance Authority does not provide training consistently for state agency staff regarding the Master Lease Purchase Program; therefore, agencies may not be aware of this financing option.
- ◆ The State Energy Conservation Office has no consistent outreach or training strategies for educating state agency staff regarding Energy Savings Performance Contracts.
- ◆ Although the Texas Facilities Commission was authorized to reinvest savings from Energy Savings Performance Contracts in additional energy-related projects, other state agencies do not have this authority, which would increase the benefits of such a contract to the agency and could encourage agency participation.

OPTIONS

- ◆ **Option 1:** Include a rider in the 2020–21 General Appropriations Bill to require state agencies to participate in the Master Lease Purchase Program if it represents the most cost-effective type of financing when using lease-purchase methods to acquire capital assets. An agency requesting to enter a contract for another lease-purchase method first would have to present an analysis to the Legislative Budget Board comparing the cost of the Master Lease Purchase Program to the alternate method.
- ◆ **Option 2:** Include a rider in the 2020–21 General Appropriations Bill to require the Texas Public Finance Authority to provide outreach and training to state agency staff regarding the Master Lease Purchase Program.
- ◆ **Option 3:** Include a rider in the 2020–21 General Appropriations Bill to require the State Energy Conservation Office to provide outreach and training

to state agency staff regarding Energy Savings Performance Contracts.

- ◆ **Option 4:** Include a rider in the 2020–21 General Appropriations Bill to authorize state agencies to reinvest savings generated from Energy Savings Performance Contracts into additional capital improvement or deferred maintenance projects.

DISCUSSION

The Seventy-first Legislature, Regular Session, 1989, authorized the Texas Public Finance Authority (TPFA) to develop a capital equipment financing program for state agencies based on recommendations from the Select Interim Committee on Capital Construction, which was charged with researching capital spending and financing options. The 15-member committee, which consisted of lawmakers, representatives from the legal and financial communities, and others, found that the state was paying too much for capital equipment financing through vendors. It recommended establishing a master lease purchase pool to combine capital purchases and finance them through the state to receive lower interest rates. Following authorization for the development of a capital equipment financing program, TPFA developed the Master Lease Purchase Program (MLPP), which began financing projects in 1992.

OVERVIEW OF MASTER LEASE PURCHASE PROGRAM

MLPP is available to state agencies and institutions of higher education. It can be used to finance capital equipment purchases that cost more than \$10,000 and have a useful life of at least 3.0 years. Equipment that costs less than \$1,000 can be purchased if it is bundled into a purchase of at least \$10,000, and each item must cost at least \$100. Common uses of MLPP include information technology and vehicle purchases.

MLPP is incorporated into the capital budgeting process for agencies. When agency staff have determined that they need to make a capital acquisition, they must request capital budget funding from the Legislature in the General Appropriations Act. Agencies most often request appropriations to purchase capital equipment outright. However, an agency may request appropriations for another method of obtaining equipment such as through a lease or a lease-purchase agreement, which means lease payments are made through a vendor toward the eventual acquisition of the item. Agencies also can request appropriations to use MLPP, which acts as a lease-purchase agreement through the

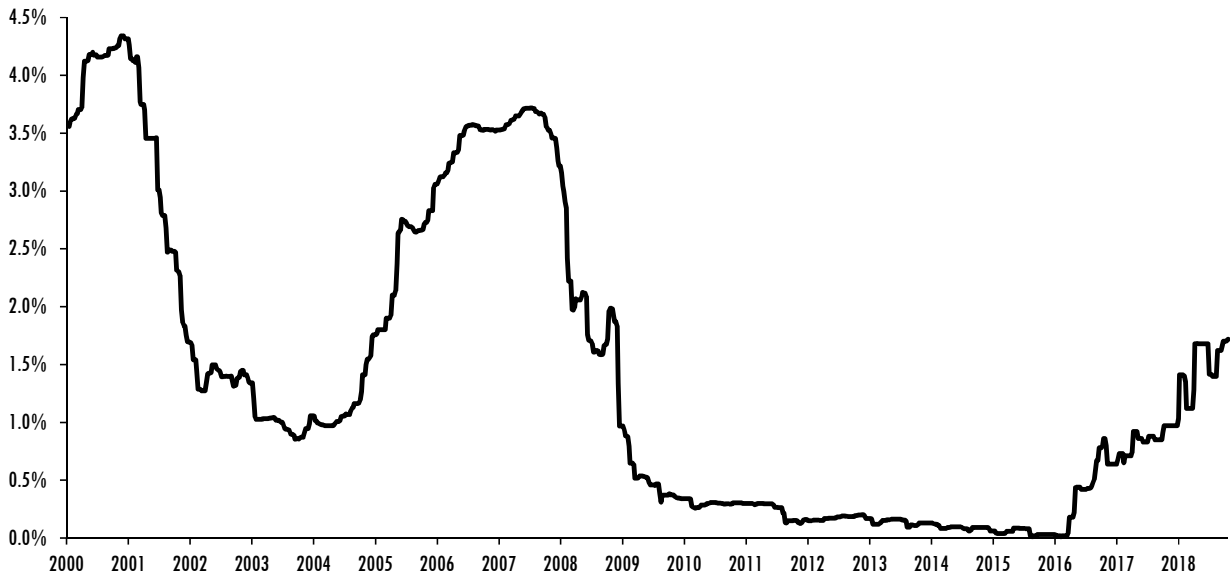
state. The Legislature determines appropriations for capital equipment and can decide whether the item is purchased outright or through MLPP.

When an agency has determined that it would like to finance a capital acquisition through MLPP, it follows a process prescribed by TPFA, which includes making a resolution authorizing the use of MLPP. If the planned purchase is more than \$250,000 or is for 5.0 years or more, the agency also must receive authorization from the Bond Review Board before it can use MLPP. After signing a Master Lease Purchase Agreement, the agency will use procurement procedures to acquire the equipment from a vendor. When the agency has completed the procurement process, it submits a lease supplement to TPFA, which provides the financing to pay the vendor and obtain the equipment's title. TPFA then returns the lease supplement to the agency, which obtains the equipment. The agency makes lease payments to TPFA each February 1 and August 1 until the equipment is fully paid, and then the agency receives the title.

TPFA finances this program through the issuance of commercial paper, which is a short-term note that can be issued for a maximum of 270 days, although most issuances are for a period of 30 days or less. TPFA uses commercial paper for MLPP financing because it has a lower interest rate than other financing mechanisms such as bonds. MLPP has a variable interest rate because it relies on commercial paper, which is reissued continuously with an interest rate that changes based on market conditions. **Figure 1** shows the interest rates for MLPP commercial paper since January 2000.

TPFA issues tax-exempt commercial paper, which has a lower interest rate than taxable commercial paper and can be used only for public projects based on Internal Revenue Service rules. As of fiscal year 2018, MLPP carries ratings from Standard & Poor's of A-1+, Moody's of P-1 (Prime-1), and Fitch's of F1+, which enables it to obtain the best rates for commercial paper. TPFA must have liquidity for MLPP, which means it must have a balance available to cover the value of outstanding commercial paper if new buyers were not available to cover reissuances. TPFA obtains this liquidity through the Comptroller of Public Accounts, which, as of fiscal year 2018, provides \$100.0 million in liquidity based on the program's needs. As of fiscal year 2018, TPFA estimated that it had \$34.4 million in outstanding MLPP contracts drawing on that liquidity.

FIGURE 1
MASTER LEASE PURCHASE PROGRAM COMMERCIAL PAPER INTEREST RATE
JANUARY 2000 TO OCTOBER 2018



SOURCE: Texas Public Finance Authority.

The cost to an agency for using MLPP is based on the interest rates available for commercial paper, although initial agency payments are for 6.0 percent interest, which is the sum of an assumed 5.0 percent interest rate and a 1.0 percent administrative fee. TPFA will rebate the difference between the 5.0 percent assumed interest rate and the actual interest rate and any interest earnings on the balance held by TPFA against the next biannual lease payment. Since fiscal year 2000, the actual interest rate has not exceeded 5.0 percent and frequently has been significantly lower. TPFA uses the 1.0 percent administrative fee to pay costs of issuance related to MLPP, including liquidity, credit rating, remarketing, and agent fees. A portion of the fee also may be used to cover associated agency administrative costs, including staff.

MASTER LEASE PURCHASE PROGRAM UTILIZATION

MLPP represents the most cost-effective option for agencies to obtain capital equipment in some instances. Using cash to pay for capital equipment often is preferred because it is administratively simple, does not result in debt, and does not generate additional costs such as interest or issuance fees. However, it may be advantageous to finance certain priority capital equipment purchases. Financing can enable agencies to obtain capital equipment when it is needed to provide critical public services within resource constraints. Significant up-front costs can impede the purchase of equipment. For

example, an agency that is self-funded through fees but needs to make a large acquisition can use MLPP to finance the equipment throughout its useful life without needing to change fees temporarily or decrease other expenditures to offset the purchase. Financing capital equipment also enables an agency to maintain a more consistent and predictable level of capital budget expenditure, as items are paid for throughout their useful lives instead of all at once in large sums whenever the need arises.

According to TPFA, and supported by a Legislative Budget Board (LBB) analysis of comparable private market rates, MLPP sometimes offers better interest rates than private financing. Because TPFA finances purchases with tax-exempt commercial paper, MLPP often has a more competitive rate than private sources and enables an agency to pay for equipment progressively with the lowest available interest rates. In addition, MLPP enables for prepayment with no additional fees, which may not be the case with private financing, according to TPFA. As a result, agencies that lease or lease-purchase capital equipment through a vendor without comparing the total costs to MLPP may be paying more than necessary. For example, the Texas Alcoholic Beverage Commission (TABCO) paid a private vendor \$29,970 for a three-year lease of computer equipment that would have cost \$29,280 before any rebates with MLPP.

After considering rebates to the agency based on the actual MLPP commercial paper interest rates, the equipment would have cost \$27,262, which is 9.0 percent less than the private vendor lease cost. TABC's lease agreement included return and disposal services, which are not covered by MLPP because the agency would own the assets following completion of MLPP payments.

Although MLPP can provide a lower interest rate than private options, that is not always the case. For example, the Texas Health and Human Services Commission (HHSC) entered into a contract for computer hardware acquisition and leasing services for health and human services agencies for a period of four years beginning September 1, 2015. This contract replaced the previous lease agreement and covered approximately 55,000 units, including desktop, laptop, and tablet computers. This lease agreement offered a number of benefits to the agencies, including flexibility in refresh schedules and optional return services from the vendor. Including these additional services, the contract offered a more cost-effective option than MLPP. For leases of three years, the total cost of leasing was less than the cost of the equipment. For leases of four years, the cost of a standard desktop computer was \$622.08 compared to \$682.93 that the agency would have paid using MLPP for four years with the initial 6.0 percent interest and administrative rate. After considering the rebates based on the actual MLPP interest rate for payments during the first three years of the lease-purchase agreement, one desktop computer would have cost \$627.16. This calculation does not include the rebate for the fourth year of the potential MLPP purchase that would occur during fiscal year 2019.

Despite the potential benefits of MLPP, its use has decreased during the past decade. **Figure 2** shows the decrease in MLPP by the number and value of new contracts that TPFA processes each fiscal year and the total number and value of contracts that TPFA manages, including new and ongoing contracts. The number of MLPP contracts that TPFA manages has decreased by 24.1 percent and the value of such contracts has decreased by 72.5 percent from fiscal year 2007 to 2017. The number of contracts that TPFA manages decreased to 310 during fiscal year 2015 and since has risen, but the total value of contracts continued to decrease. According to TPFA, the increase in the number of new contracts during fiscal years 2016 and 2017 does not represent a trend of increased use of MLPP but is due to projects at two institutions of higher education. TPFA managed 538 contracts with a total value of \$35.8 million

during fiscal year 2017. Seven agencies received appropriations for MLPP for the 2018–19 biennium, including HHSC, the Texas Department of Agriculture, and the Texas School for the Deaf. Institutions of higher education using MLPP include the Texas State Technical College System and Midwestern University.

Several factors have contributed to the decrease in participation. Before fiscal year 2008, the most common type of equipment financed through MLPP was for energy retrofit and construction projects. Since 2008, no state agency has used MLPP to finance a new Energy Savings Performance Contract (ESPC). Requirements for using MLPP also have changed. During the first biennium following its establishment, the Seventy-second Legislature, General Appropriations Act (GAA), 1992–93 Biennium, Article V, General Provisions, Section 144, directed the use of MLPP to its full extent, stating:

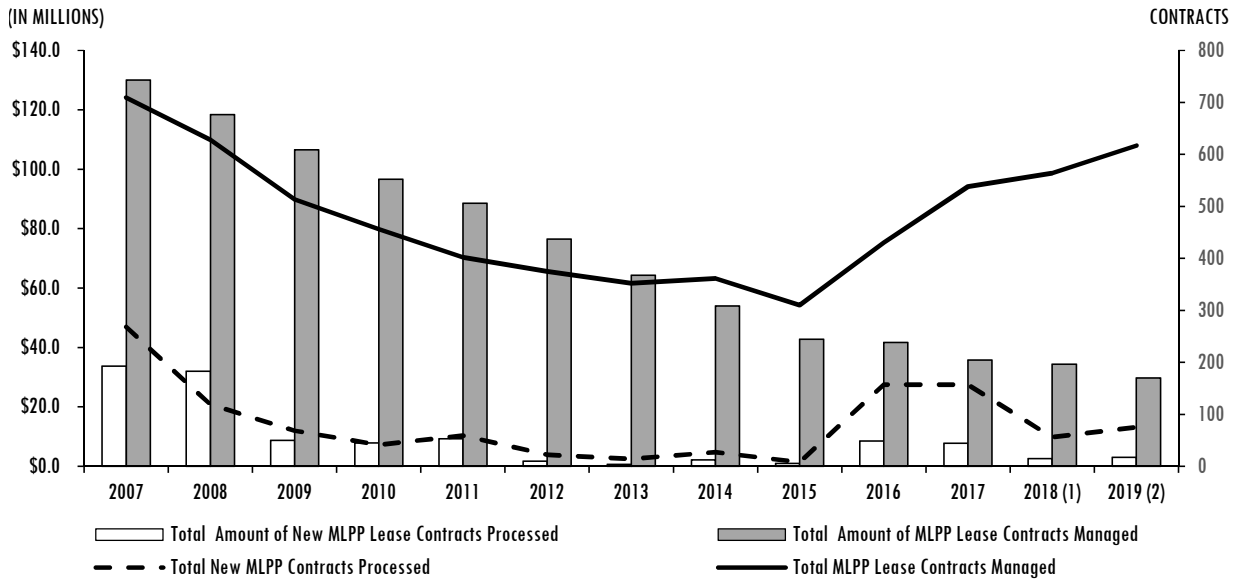
It is the intent of the legislature that master lease financing be used to the extent possible to replace general revenue funding. For that purpose, the Comptroller of Public Accounts is directed to reduce appropriations made in the Act from the General Revenue Fund for the acquisition of information resource technologies and capital equipment to the extent that master lease financing can be used for the purposes of the appropriation. Master lease proceeds are hereby appropriated in an amount equal to the general revenue reduction provided for under this provision.

The Seventy-third Legislature, GAA, 1994–95 Biennium, amended the rider to require agencies to use MLPP when it was the most cost-effective method of financing through a lease-purchase method for capital acquisition. The Seventy-sixth Legislature, GAA, 2000–01 Biennium, removed this rider.

Agencies may not be aware of MLPP as a financing option for capital equipment. Although TPFA sometimes communicates with state agencies regarding MLPP and responds to agency questions, it has not provided training consistently to agencies to inform them of how to use the program as a financing mechanism and when it is a good option. State agencies, therefore, may have chosen less cost-effective financing options because they were not aware of or familiar with MLPP when evaluating financing methods for capital equipment.

Option 1 would include a rider in the 2020–21 General Appropriations Bill to require state agencies to participate in

**FIGURE 2
MASTER LEASE PURCHASE PROGRAM CONTRACTS
FISCAL YEARS 2007 TO 2019**



NOTES:

- (1) Amounts for fiscal year 2018 are estimated.
- (2) Amounts for fiscal year 2019 are budgeted.
- (3) MLPP=Master Lease Purchase Program.

SOURCE: Texas Public Finance Authority.

MLPP to the extent that the program is the most cost-effective type of financing when using lease-purchase methods for acquiring capital assets. This rider would reinstate the requirement to use MLPP that was included in the GAAs from fiscal years 1994 to 1999. Adding this requirement would ensure that agencies are not using alternative financing mechanisms when the state could be saving money through TPFA’s program. To ensure that agencies are considering MLPP when seeking to make lease-purchase agreements, agencies would be required to present to LBB an analysis comparing the cost of their chosen lease-purchase contracts to MLPP before entering into contracts.

Option 2 would include a rider in the 2020–21 General Appropriations Bill to require TPFA to provide outreach and training to agencies about using MLPP for capital equipment financing. According to TPFA staff, state agency staff may not be aware of MLPP or may be reluctant to use the program due to the variable interest rate. The variable interest rate enables TPFA to maintain low interest rates, which means agencies that do not consider MLPP may be spending more than necessary for capital equipment purchases. TPFA has the financial knowledge and experience to know when MLPP

can be used effectively. Requiring TPFA to explain the program’s uses, benefits, and process to state agencies could help to ensure that capital equipment is being purchased in the most cost-effective manner. This option would equip agency staff with the knowledge to compare MLPP to other financing mechanisms and determine which is most cost-effective.

OVERVIEW OF ENERGY SAVINGS PERFORMANCE CONTRACTS

One type of project that can be funded through MLPP is an Energy Savings Performance Contract (ESPC). ESPCs are financing arrangements that enable organizations to pay for energy-saving or water-saving projects using money saved on utility bills due to the resulting efficiency improvements. Projects funded through ESPCs require the contractor to guarantee utility savings equal to or greater than the cost of completing the project during a specific period to ensure that resulting upgrades generate no cost to the state. By statute, ESPCs must have a payback period (i.e., the time it takes for the guaranteed savings to equal or exceed the project costs) of 20 years or less.

ESPCs have been available to institutions of higher education and state agencies since 1997. The State Energy Conservation Office (SECO), a division within the Comptroller of Public Accounts, oversees ESPCs for state agencies by providing guidelines and approving contracts, and the Texas Higher Education Coordinating Board (THECB) oversees ESPCs for institutions of higher education. Local governments and school districts are responsible for overseeing their own projects.

Although SECO administers the ESPC program for state agencies, it is up to each agency to determine whether to pursue an ESPC. Agencies follow SECO's guidelines to complete the ESPC, as do institutions of higher education, according to THECB. SECO's guidelines require the entity completing an ESPC to:

- form an internal selection process that includes staff from various departments to formulate a strategy;
- conduct a preliminary utility audit to identify viable projects;
- issue a request for qualifications (RFQ);
- select an energy services company (ESCO) to complete the project;
- negotiate and approve the utility assessment report (UAR);
- receive a completed UAR, a measurement and verification plan, a sample periodic utility savings report, and a proposed contract from the ESCO;
- have a third party review the submitted documents; and
- execute the contract, oversee construction and commissioning, review annual savings reports, and pay the contractor.

Agencies and institutions use the savings from decreased utility bills to pay the costs of ESPCs. However, such contracts require up-front financing to initiate the projects. Up-front financing for ESPCs can come from MLPP, bond proceeds, vendor financing, or any funding available to an agency. The Texas LoanSTAR (Saving Taxes and Resources) revolving loan program, administered by SECO, is available specifically to fund ESPCs and other energy-saving projects for governments in Texas. Funds available to the program come from the General Revenue–Dedicated Account No. 5005, Oil Overcharge, and federal funding and must equal

or exceed \$95.0 million at all times. State agencies, public school, public institution of higher education, local government, and publicly tax-supported hospital facilities are eligible to apply for LoanSTAR funding and to repay the loans, including interest, using energy savings from projects financed this way.

When the State Auditor's Office (SAO) audited the ESPC program during fiscal year 2008, it reported that seven institutions of higher education and two state agencies had entered into 15 ESPCs with a total cost of \$203.1 million. All nine entities had utilized MLPP to finance all or part of the ESPCs. Four entities had additional sources of financing, including LoanSTAR or funding from Proposition 8, 2001, which authorized TPFAs to issue up to \$850.0 million in General Obligation bonds repayable from General Revenue Funds for construction and repair projects. The SAO report noted that ESPCs had decreased energy consumption, lowered utility costs, and financed needed capital improvements to state facilities. However, SAO found that contracting practices needed improvement to ensure that each contract includes the required amount of guaranteed savings from the contractor to cover the cost of the project. Of the 15 ESPCs that state agencies and institutions had entered into, 13 did not have the required amount of guaranteed savings from the contractor to repay project costs. Following this audit report, the guidelines for approving ESPCs were revised to require SECO and THECB to verify that ESPCs contain the required amount of guaranteed savings.

ENERGY SAVINGS PERFORMANCE CONTRACTING UTILIZATION

Since the SAO audit, only one state agency has participated in an ESPC. The Texas Facilities Commission (TFC) issued an RFQ for an ESPC during fiscal year 2015 and entered into an ESPC to perform upgrades to lighting, power conditioning, water systems, and other utility cost-reduction measures in four Austin buildings: Thomas Jefferson Rusk, William P. Hobby Jr., Central Services, and Brown-Heatly. These upgrades were completed in March 2018 at a total contract cost of \$3.6 million. According to TFC staff, the guaranteed savings built into the contract included \$349,563 per year in electricity, \$4,988 in natural gas, \$67,650 in water, and \$62,933 in other savings. The ESPC also led to \$289,771 in rebates from Austin Energy for light-emitting diode, known as LED, lighting installation. Not including the rebate or measurement and verification fees, the payback period for the project is 8.3 years, and most of the upgrades

have an estimated useful life of 20 years, providing the project an estimated yield of \$9.6 million in savings.

TFC's experience was unique because it was able to work with SECO to finance the ESPC with federal funding from the U.S. Department of Energy (DOE). This type of funding, which typically is not available to agencies, provided additional benefits to TFC. Because the project costs were covered by federal funding, the agency was authorized to reinvest its utility savings into other energy savings projects that were not included in the ESPC. TFC has used these savings to address deferred maintenance projects. Based on the success of the ESPC, TFC issued another RFQ in April 2018 for an ESPC in another nine buildings that will be financed using LoanSTAR funds.

ESPCs can offer a cost-neutral or cost savings method to upgrade energy and water systems and lower utility costs for participants. However, a number of factors may prevent state agencies from using this financing mechanism effectively. ESPCs can be technical, which requires a sufficient number of agency staff with the specialized skill set to oversee the contract, including that all calculations are correct and that the project is being executed properly. According to SECO staff, agencies also may be reluctant to enter into ESPCs because they believe they will not retain the savings that the project generates after covering the contract costs. Although all agencies are authorized to use utility savings to pay for an ESPC, none but TFC have been authorized to reinvest additional savings into other energy efficiency projects.

From fiscal year 2009 to September 2018, 11 institutions of higher education have entered into 16 ESPCs, and another institution submitted an ESPC for review in August 2018. At a total cost of \$189.8 million, these ESPCs are estimated to achieve \$252.3 million in savings achieved through building automation; upgrades to lighting, mechanical systems, heating, ventilation, and air conditioning; and other energy savings work. None of these projects were financed using MLPP; projects were paid for with available cash or financed through other means, such as bonds. According to THECB, institutions of higher education have little difficulty entering into ESPCs.

DOE offers resources intended to help state energy offices develop successful ESPC programs. DOE recommends best practices such as leadership through a state energy office, project oversight and technical assistance, and education and outreach. Texas' ESPC program follows some of these practices through the work of SECO, which offers support

and guidelines to agencies to complete an ESPC, but it remains the agency's responsibility to implement and oversee the projects. SECO staff network with agency utility managers at the State Agency Energy Advisory Group's monthly meetings, but they do not promote available ESPC resources consistently.

Option 3 would include a rider in the 2020–21 General Appropriations Bill to require SECO to provide outreach and training to agencies about ESPCs, which could increase the use of this method to help the state lower utility bills and complete needed upgrades. Outreach could be targeted to the best candidates for ESPCs, which include agencies with large utility bills that operate their own facilities and have more control over efficiency efforts and utility expenditures. This outreach would increase agencies' knowledge and access to technical assistance, in keeping with DOE best practices. In addition to providing information about ESPCs at State Agency Energy Advisory Group meetings, SECO could reach out to agencies that do not attend the meetings. Outreach also could focus on identifying deferred maintenance projects that could be addressed by ESPCs in a cost-neutral or cost savings method. SECO could provide outreach and training to the Department of Information Resources (DIR) to identify areas where energy savings resulting from an ESPC project could pay the cost of upgrading technology resources. Technology upgrades can lead to decreased energy use and lower utility bills, but SECO has not worked with DIR to evaluate such projects.

The Eighty-fifth Legislature, GAA, 2018–19 Biennium, Article I, TFC, Rider 10, authorized TFC to invest ESPC savings in additional energy savings projects, but other agencies do not have this authority. The Texas Government Code, Chapter 2166.406, governs agencies' entry into ESPCs. The statute stipulates that the Legislature bases the utility appropriations for an agency on the sum of the guaranteed savings provided in the ESPC and the agency's anticipated utility expenditures. Agencies do not have authority to use savings beyond those needed to pay for the ESPC to invest in additional projects. This limitation may decrease agencies' willingness to participate, because the current structure authorizes agencies to utilize savings only for the ESPC upgrades. Therefore, agencies do not benefit directly from savings that exceed project costs, and they must use agency administrative resources to manage the ESPC.

Option 4 would include a rider in the 2020–21 General Appropriations Bill to authorize all state agencies to reinvest savings generated from ESPC projects into additional capital

improvement projects during the biennium. This ability would align with DOE best practices that suggest authorizing agencies to include other capital improvement projects within the scope of an ESPC. This option would incentivize agency participation by authorizing them to use energy savings that exceed the contract cost to pay for additional capital improvement projects such as deferred maintenance. More agencies may be incentivized to utilize an ESPC to address energy-related and other capital projects.

FISCAL IMPACT OF THE OPTIONS

Option 1 would require agencies to participate in the MLPP to the extent that the program is the most cost-effective type of financing when using lease-purchase methods for acquiring capital assets. This option could be implemented using existing agency resources and could result in cost avoidance because it requires agencies to utilize the most cost-effective financing measure.

Option 2 would require TPFA to provide training and outreach regarding MLPP, and Option 3 would require SECO to provide training and outreach regarding ESPCs. No significant fiscal impact is anticipated from these options, because any additional workload could be managed within existing staff and resources.

Options 3 and 4 together could increase agency participation in ESPCs, which would result in decreased utility bills. Agencies could use these savings to address additional capital projects during the biennium. These options could result in cost savings to the state across the lifetime of these projects.

The introduced 2020–21 General Appropriations Bill does not include any adjustments as a result of these options.