

12/29/88

Statement of Need and Reasonableness

Institutional Energy Loan Program (IELP)

I. The Commissioner of the Minnesota Department of Public Service presents herein facts and justifications establishing the need and reasonableness of the proposed rules governing the Institutional Energy Loan Program. Minnesota Statutes, section 216C.09 empowers the commissioner to adopt rules necessary to implement this program. Funds were allocated for this program in Laws of Minn. 1988, Chapter 686, Sec. 38 from monies received by the state under United States vs Exxon Corp., 561 F. Supp 816 (D.D.C. 1983). Distribution of these funds was contingent upon approval of this program by the U. S. Department of Energy. A state plan amendment to the State Energy Conservation Plan program outlining the intent for use of these funds was submitted to the U.S. Department of Energy and approved in June of 1987.

II. Impact on small business

The proposed rules create a voluntary program of financial assistance to Minnesota public and private schools and hospitals and units of local government to implement energy conservation improvements and, as such, have no direct effect on small business. Rules covering programs such as this are exempted from Minnesota Statutes Section 14.115 (1988) by subd. 7(b) which exempts rules which do not directly affect small businesses.

### III. Need and Reasonableness of each Rule Provision

A. Proposed part 7605.0010 states the purpose of the proposed rules. This part is needed to introduce the proposed rules and its reasonableness is self evident.

#### B. Definitions

Proposed part 7605.0020 defines terms which have distinct meanings when used within the context of these rules.

Subpart 1 is needed as an introductory and explanatory sentence regarding the use of the definitions. Its reasonableness is self evident.

Subpart 2 defines "applicant". Providing a shorthand term to refer to those institutions eligible to participate in this program is needed and reasonable to make the rule more readable. The entities included in this definition are those specified in the legislative advisory commission order dated August 20, 1986, on which the allocation of funds in Laws of Minnesota 1988, Ch. 686, Art. 1, Sec. 38 is based.

Subpart 3 defines "building". This definition is needed to identify those buildings which are eligible under this program.

It is necessary to specify separate to make clear that, when a building is referred to in the rule, all parts of the building, including wings and additions, are implied. This is reasonable because, by doing so, the department will be able to integrate the data base for this program with its existing data bases, which are organized by building.

It is reasonable to require that a building be owned and operated by an applicant because the purpose of this program is to provide a benefit to the applicant by enabling it to invest in energy saving capital improvements. Such an investment should provide a significant net benefit over the useful life of an improvement through lowered energy costs. To do so, however, an applicant must remain the beneficiary of those reduced energy costs to recoup its investment. While present ownership and operation do not guarantee that an applicant will remain the beneficiary over the useful life of an improvement, an applicant, as owner, does control any decision affecting its status as beneficiary.

Subpart 4. Defines "commissioner". It is needed and reasonable to provide a shorthand term to make the rule more readable.

Subpart 5. defines "conservation measure". This definition is necessary to specify the types of projects that are eligible. It is reasonable because, by broadly including any measure that is primarily intended to reduce energy consumption or allow the use

of an alternative energy source, it allows applicants to choose the technologies most suited to their individual needs. It is reasonable to require that a measure have the primary intent specified because, as a program implemented under the SECP plan, it must conform to the purpose of that program, which is to promote the conservation of energy (cite SS 420.1 a).

Subpart 6. defines "hospital". This definition is necessary to give specific meaning to a general term. It is reasonable because it limits eligibility to facilities legally authorized by the state to operate as a hospital.

Subpart 7. defines "lender". This definition is necessary to specify the entities which may sell a loan participation to the commissioner under this program. It is reasonable because it provides for a broad range of lending institutions from which an applicant may borrow funds, thereby facilitating access to the program. At the same time, as the commissioner does place funds at risk, it limits eligibility to entities which lend funds as a normal business activity and, therefore, will presumably act prudently and in accordance with generally accepted commercial lending practices.

Subpart 8. defines "Payback". This definition is needed to give specific meaning to a general term and is reasonable because it applies the most commonly used meaning, within the context of

energy cost savings analysis, and is consistent with standard practice within the energy auditing field.

Subpart 9. defines "Project". It is needed and reasonable to provide a shorthand term to make the rule more readable.

Subpart 10. defines "School". It is needed to give specific meaning to a general term. It is reasonable because, given limited program funds and the variety and number of institutions called "schools", it encompasses institutions that are legally authorized to provide a program of education and that can be considered to be primarily devoted to that purpose, while excluding institutions such as day care centers and sunday schools that do not clearly have that primary intent.

#### C. Loan Eligibility Criteria

Subpart 1 establishes that the Commissioner will approve applications and participate in loans that comply with these rules for conservation measures that have a payback of ten years or less. It is necessary, in part, to identify with whom this authority and responsibility rests. It is reasonable because the commissioner is given this duty under Minnesota Statutes, section 216C.09 (m). It is necessary to set a payback limit to provide a test of a measure's economic feasibility. Given limited program funds, it is reasonable to do so to maximize the effect of those funds.

A ten year payback is reasonable because it is consistent with limits in related funding programs for the same applicant group, thereby facilitating interaction between programs.

Subpart 2 identifies eligibility limitations for projects. It is necessary to prevent an applicant from receiving double funding for a project, while allowing funds to be used for cost over-runs or additional project related work, provided the project continues to meet program requirements. It is reasonable because it will prevent misuse of funds while allowing the least restricted access to funds, consistent with other eligibility requirements.

Subpart 3 describes the prior approval condition of the program. A loan may not be awarded for a project already contracted for or begun. It is necessary to prevent an applicant from obligating itself to pay for a project in anticipation of funds from this program before having that project reviewed and approved. It is reasonable to protect the applicant from possible financial hardship if the project is rejected in review.

Subpart 4 sets eligibility limitations based on useful life. It is needed to prevent funding of a measure with a payback that exceeds the useful life of the measure or the building in which it is installed. This limitation is reasonable because, in such cases, the measure could not be expected to repay the original

investment and is, therefore, not a prudent use of program funds.

Subpart 5 addresses the ineligibility of new construction except as a necessary part of a conservation measure for an existing building. It is needed and reasonable to comply with SECP program rules (420.12).

D. Loan Limits

This part limits the use of program funds issued for an applicant under this program to a maximum of 50% of the loan principal or \$200,000, whichever is less. The Department of Public Service staff and the program advisory committee concluded that the lesser of a 50% participation cap or a \$200,000 limit was necessary and reasonable to achieve the goal of spreading program funds to a large number of projects while still providing sufficient inducement to invest. With the 50% cap, an applicant can halve the interest rate offered by a lender. Additionally, as the commissioner will rely on the lender to assess the credit risk of a loan, the 50% cap, in leaving the lender at risk for a substantial portion of the loan, assures reasonable diligence in the performance of its duties.

E. Application Contents

Proposed part 7605.0050 describes the contents of a loan application and procedures for applicants to use in order to

apply for a loan. Subpart 1 states that applicants shall submit an application to the commissioner on a form provided by the commissioner. This subpart is necessary and reasonable to identify the recipient of applications and to provide a consistent format for all applications to simplify review and data entry. This subpart also states that each application must have an original ink signature by an authorized official of the applicant, must have the authorized official's title and must be dated. It is necessary and reasonable to have this requirement to ensure that a responsible official is aware of the application and proposed projects, and he/she has, in a capacity as an authorized official, approved of the application.

Subpart 2 prescribes the contents of an application. A through G are needed to identify the applicant and to identify basic information about the proposed project. It is reasonable to require this information because it is needed to determine eligibility and to maintain public records. Subpart 2 (H) is needed to assure that the governing body of the applicant has specifically affirmed its intent to enter into a loan contract and is mindful of and accepts its responsibilities in doing so. It is reasonable to assure that the governing body of the applicant has given its informed consent to this obligation.

Subpart 3 prescribes the technical support materials that must be submitted with an application. This information is necessary and reasonable to allow DPS staff engineers to determine if measures proposed satisfy program requirements. This subpart requires that all analyses be submitted on a form provided by the commissioner. This is necessary to assure that technical support materials are presented in a standard format containing all relevant data and using appropriate calculation procedures. It is reasonable to do so to assist the applicant in preparing the application and to simplify technical review. This subpart further requires that, for a measure expected to cost more than \$25,000, the analysis be performed by a registered engineer or architect. This is needed to assure that measures requiring substantial investment have been analyzed and deemed feasible by a person who, it can reasonably be assumed, is competent to do so. While it would be desirable if all projects funded under this program were analyzed by an engineer or architect, the expense of this level of expertise (at minimum \$300 to \$500) may be prohibitive for lower cost projects. It is reasonable set a threshold for this requirement to balance the desire for expert analysis with that for broad program participation. A \$25,000 threshold is reasonable because the cost of an analysis above that level, 1% to 2% of project cost, should not be a significant barrier to participation.

Subpart 4 requires that an application contain five assurances. The first and second are needed to assure that the proposed measures will be properly installed and maintained. It is reasonable to do so because the lack of proper installation or maintenance could significantly shorten the useful life of a measure and, thereby, reduce or negate the potential benefit of the investment. The third is necessary to ensure that a potential impediment to timely implementation of a measure has been addressed. It is reasonable, given limited funds, to direct those funds to measures that are most likely to be implemented in a timely manner. The fourth and fifth assurances are necessary and reasonable to ensure that public entities have met applicable legal requirement in entering into debt.

Subpart 5 describes the procedure to be followed if incomplete applications are submitted. The Commissioner will notify an applicant of specific deficiencies in an application so that the applicant has the opportunity to correct them and participate in the program. The 30 day limit on submitting corrections to an application is needed to prevent the administrative problem created by an unlimited number of pending applications, which remain unprocessable for an indefinite period of time. It is reasonable because 30 days is adequate time to correct deficiencies and because applicants retain the option of reapplying if they so choose.

#### D. Application Review

Subpart 1 outlines the administrative review of an application. It is needed to explicitly state that the items required by the rules will be checked by the Commissioner and, implicitly, that deficiencies found are subject to the actions outlined in subpart 3. It is reasonable because the Commissioner is responsible to see that the requirements of these rules are met.

Subpart 2 outlines the items that the Commissioner will review regarding technical analysis of the projects for which funds are requested. It is reasonable because it is the Commissioner's responsibility to check that the technical analysis upon which project feasibility is based is sound to assure that only projects that meet program guidelines receive funds.

Subpart 3 outlines the procedures for rejections and resubmissions. It is necessary that an applicant be notified of any modifications made to the application and all options available to correct problems with the application. The subpart explains that if only some of the measures are deemed acceptable by the Commissioner, the applicant may withdraw the rejected measures. This is reasonable because, if the rejected measures are not able to be modified for resubmission for technical or administrative reasons, it allows the applicant to receive a loan for the accepted measures without having to resubmit a new application.

E. Lender

This part requires that a participation agreement be executed between the lender and the commissioner and specifies contents of the agreement. This agreement is necessary and reasonable to protect the commissioner's interest in the loan. This part also limits participation to loans made after execution of the participation agreement. This limitation is reasonable because the purpose of the program is to enable investment in conservation projects. Projects for which a loan has already been made do not require that stimulus.

Specific requirements of the agreement are enumerated in clauses A through Q. Clause A covers two requirements of the loan agreement between the lender and the applicant. These requirements are needed to monitor compliance with and enforce the provisions of these rules. It is necessary to include these requirements in the loan contract because the commissioner will not have any direct contractual relationship with the applicant. These requirements are reasonable to allow the commissioner to assure that funds are being used for the purposes of the program.

Clauses B through E pertain to collateral, surety and insurance and are necessary and reasonable to protect the commissioner's financial interest in a loan.

Clauses F and G pertain to the lender's duties. These requirements are necessary to assign specific duties with respect to a loan, and are reasonable to protect the commissioner's

financial interest in the loan.

Clauses H, L and M are need to require the commissioner's prior approval of certain actions with respect to a loan, and are reasonable to protect the commissioner's financial interest.

Clauses I and N are needed to provide the commissioner access to information pertaining to a loan, and are reasonable to allow the commissioner to determine that requirements of the agreement are being met and to allow the commissioner to assess the impact of a potential default on the program fund.

Clauses J and K are needed to set maximum limits on interest and amortization. Clause J is reasonable because it prevents a lender's from charging exorbitant interest on its portion of a loan, thereby reducing the benefit to the applicant gained by the commissioner's participation. Clause K is reasonable because it balances the cash flow needs of both the applicant and the revolving loan fund.

Clauses O and P are needed to stipulate the method of division of payments collected. They are reasonable because they balance the financial interests of the lending parties.

Clause Q is needed and reasonable to allow the commissioner to enforce the requirements of these rules. The need for and reasonableness of this provision is further discussed under Part 7605.0080, subpart 2.

## Reports and Monitoring

Proposed part 7605.0080 prescribes the various reports required of loan recipients by the commissioner. Subpart 1 introduces the proposed part. The need and reasonableness of this introductory subpart is self-evident.

Subpart 2 requires that an annual project status report be submitted. This report is needed to assure the commissioner that the loan funds are being used for the purpose set forth in the application and that implementation is proceeding in a timely manner. The time period July 1 through June 30 is reasonable because it conforms with the fiscal year of cities, counties and public school districts, which are expected to be the majority of applicants. The July 31 due date provides a reasonable period of time in which to expect completion and submission of a simple report form.

The specific information required by this subpart is needed by the commissioner to determine that the project is actually in progress and the loan funds are being properly used, and to have early notification of any loan recipients having difficulties with project implementation. This provision is reasonable because the Commissioner must have some method of verifying that funds are correctly used and because, if informed, the

commissioner may be able to offer assistance not only to the loan recipient involved, but may be able to solve in advance potential problems for future loan recipients.

The subpart continues by stating that if at any time the loan recipient fails to substantially comply with the start and end dates given in the approved loan participation application, and if the loan recipient cannot reasonably justify its lack of progress, the loan may be declared in default. This part is needed as a remedy if a loan recipient is not using the loan as intended. It is reasonable to have such a remedy to effectively dissuade loan recipients from using loan funds for unintended purposes (e.g. arbitrage). This remedy is reasonable because it provides for recovery of loan funds when appropriate, while allowing for justifiable deviations from the estimated timelines.

Subpart 3 requires that a semi-annual financial report be submitted. These reports are needed to assure the commissioner that funds are, in fact, being disbursed as work proceeds on the project. This is reasonable because it keeps the Commissioner informed of expenditures on a timely basis, but, as a simple report of total funds expended, does not burden the loan recipient with complex paperwork.

Subpart 4 requires that a final report be submitted to the commissioner within 60 days of project completion.

This report is necessary and reasonable for the same reasons given for the two preceding report. In addition, final reports are needed and reasonable to provide data to evaluate the program's effectiveness.

Subpart 5 requires that an annual energy report be submitted. This report is needed to provide to the commissioner actual energy data on which to evaluate the effectiveness of the program. It is a reasonable requirement because the goal of the program is to conserve energy and reduce energy costs for loan recipients. Annual energy reports provide data to assess whether that goal has been met and continues to be met. A minimum of three years of these reports is needed and reasonable to give a minimum amount of information with which to assess the impact of the project.

For the reasons stated above; the commissioner believes that each of the proposed parts is reasonable to effectively administer the financial assistance program to distribute loans for the purpose of energy conservation retrofit in schools, hospitals and public buildings. It is further believed that the proposed rules are reasonable and necessary to effect the purpose and intent of the statutory authorization.