



Options for Program Capital

Windsor Efficiency PAYS[®]

Released by

Sonoma County Regional Climate Protection Authority

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On behalf of the
Town of Windsor, California

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This “Options for Program Capital” is offered to provide all interested RFP bidders information regarding potential Program Design changes related to the flow of program capital. These potential changes are designed to:

- Preserve an “offer that works” for all program participants (Town of Windsor customers, the Town of Windsor, and potential bidders), and
- Provide alternative structures for the provision of program capital that could simplify the Capital Provider’s role within the program.

It is not possible to know how specific information contained within this document might be relevant to any one bidder’s proposal; bidders are encouraged to use the index of questions below to help guide any review of this document.

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Q.B.1: Please summarize the original Windsor Efficiency PAYS® Pilot Program needs for capital.

A: Based on an interest rate of 7 percent or less, current Town of Windsor water utility rates, and expected measure applicability in Windsor homes, the Windsor Efficiency PAYS® pilot anticipates that measures costing at least \$2,000,000 will be installed in 2,000 homes in one year. All measures will provide participants with immediate net savings (a key component of the PAYS® offer that works) and their payments will be no longer than either the measure's warranty period or 75 percent of the measure's estimated useful life, whichever is shorter. The upper limit set for the pilot's capital requirements is \$4,000,000.

To avoid the need for pre-payments to Contractors, we planned to make payments to Contractors on a 15-day payment cycle. Since multiple specialized contractors might work on a home, we required the Appliance Vendor to complete its work within 10 days of referral. This would enable us to pay the Appliance Vendor, the Lead Contractor, and the Certification Agent at the same time. Landscaping Contractors were also encouraged to complete their work within 10 days of referral, but that may not be possible in many cases.

To avoid Windsor having to make payments to the Capital Provider before starting to collect from participants and to give participants time to realize savings, we required a 45 day waiting period prior to the start of Windsor's bi-monthly payments to the Capital Provider, so that the first payment would be made 105 days from the date the Capital Provider made funds available for a project and interest could accrue. Windsor would make payments to the Capital Provider every 60 days, but since there were two customer billing cycles within every two-month billing period, payments would be made to the Capital Provider every 30 days.

Because of different measure lives, we originally required payment periods of 2, 5, and 10 years; and 15 years if Landscaping – the single most important water conservation measure for the Town of Windsor – can be offered.

We required bidders to bid one interest rate or different interest rates for the different terms and the maximum period of time that their bid interest rate(s) would be in effect. Interest rates were fixed for that period or until the Capital Provider offered 90 days notice that it needed to increase its bid rate(s) – whichever was longer.

Our original plans required that up to \$4,000,000 be available in 23 draws during the year at a rate of 7 percent or less. The loans would involve 4 different terms, or a total of 92 possible loans at multiple interest rates.

Q.B.2 What was the perceived benefit of this to Capital Providers?

A: During our preliminary conversations with prospective Capital Providers in April 2011, there seemed to be interest in providing capital for a low-cost, utility-based efficiency program (i.e., without loan guarantees, expensive rebates, or high operating costs) with a guaranteed repayment of principal and interest designed to get most Sonoma residents, both renters and building owners, to invest large amounts of their own money in climate change upgrades to their residences.

Large Capital Providers were especially interested if this approach could be taken to larger cities to supplement successful commercial Property Assessed Clean Energy (PACE) programs or where such programs were not operating.

Instead of multiple loans at different interest rates to 2,000 separate residences, we reduced the number of loans to a maximum of 92 with only one payer who could guarantee repayment regardless of collections.

Since the Town of Windsor is guaranteeing capital repayment with the additional backing of the Sonoma County Water Agency, we saw the Capital Provider's risk to its principal and interest as effectively zero. While we understand concerns that there is no guarantee of customer participation, which would mean staffing and set-up costs would go unreimbursed, based on results from 10 programs in 4 states we did not share those concerns and considered this to be a perceived risk rather than a real risk. We thought interest in "an offer that works" would be sufficient for Capital Providers to risk staff time because of the potential community benefits (i.e., significant economic activity, job creation, more disposable income for residents, less demand for limited resources, and the first significant participation rate for a California climate change effort).

Q.B.3 How could the Program Design simplify participation for the selected Capital Provider and require the Capital Provider to process fewer transactions? Do you have any clear alternatives to share with us before we consider submitting a proposal?

A: As offered in "Notes of Windsor Efficiency PAYS® Pre-Submittal Capital Providers Meeting," Program Design discussions have identified possible alternatives that would simplify participation for the selected Capital Provider and require the Capital Provider to process fewer transactions. There are now three options in total (including the new options numbers 2 and 3 below) we can offer to bidders to make program participation easier. We are confident we can offer a program with Options 1 and 2.

OPTION 1: The original RFP requirements (as summarized in the answer to Q.B.1) would still be preferred. Bidders would bid the interest rates they would charge for capital and the maximum term the rates would be guaranteed to be in effect under the original RFP terms. However, based

on the December 14, 2011, Pre-Submittal Meeting in Santa Rosa, we understand bidders see potential challenges with Option 1. We are leaving it available because while the two new options below should make things easier for the Capital Provider, they transfer risk and hassle to the other parties (i.e., Contractors, Windsor, or the Certification Agent).

OPTION 2: This new option involves three changes to the original RFP:

- a. Increase pay period length: One change we can offer is to reduce the number of transactions by slightly increasing the length of each pay period for the program to 20 days from 15. This means the Certification Agent would draw funds from the Capital Provider every 20 days to pay Contractors, Suppliers, and itself for completed projects. The number of payments would drop from 23 to 17 and the number of separate loans would drop from 92 to 68 — a more than 25 percent reduction.
- b. Increase minimum loan term: Another change we can offer is to eliminate the 2 year loans by changing CFLs to a 5 year payment term. This could reduce the number of loans (i.e., “buckets”) from 4 every 20 days to 3. Instead of 68 buckets, there would only be 51 buckets, reducing the original estimate of 92 buckets by 45 percent.
- c. Use longest loan term: A third change to the Program Design would allow the Capital Provider to make one loan every 20 days based on the longest payment term (i.e., 15 years, if Landscaping is a measure; 10 years if it is not). Windsor would repay the Capital Provider using an amortization schedule based on this longest term. There would be two scheduled pre-payment opportunities (occurring when surcharges end for 5- and then 10-year measures). These pre-payments would trigger revision of the amortization schedules, recalculated using the original interest rate.

In combination with the above two changes, this would limit the number of transactions to 17 loans each with only two pre-payments. Since the payments to the Capital Provider and from the participants are fixed, we should be able to create a system that removes the hassle of tracking different interest rates by the Capital Provider. However, this would require the Program Team to manage participant surcharges separately from Windsor’s payments to the Capital Provider to ensure Windsor has sufficient funds to make all payments and the two pre-payments. We are confident that if a bidder submits a bid using Option 2, we can still make an offer that works to Windsor’s customers.

OPTION 3: Under this new option, a bidder could require Windsor to make interest-only payments during the first 13 months and then consolidate all funds into only 3 loans with 5 year, 10 year, and 15 year durations and no pre-payments using its original bid interest rate. Windsor would make payments every 60 days with its first payment 60 days after the end of the interest-only period. This would reduce the original 92 loans to 3 loans and 3 amortization schedules with no pre-payments.

If the Capital Provider wanted more frequent payments in Option 3, it could stipulate in its proposal that there would be two 5-year, 10-year, and 15-year loans. The two loans for each payment duration would be paid on different, alternating 60-day cycles so that Windsor would pay approximately half of the funds every 30 days in order to better coordinate with its collections.

There are two obvious problems with Option 3:

- a. The fixed interest rate bid by the Capital Provider must be good for 13 months when amortization is calculated. Participants will have purchased measures during the first 12 months based on the bid interest rate and their payments must be fixed.
- b. The addition of an interest-only period either increases participants' payment terms by up to a year (i.e., past the warranty or expected measure life period) or requires higher payment amounts to cover the additional interest costs (i.e., making fewer measures cost effective). Unless the interest rate is **significantly lower** than 7 percent, it is unlikely that any measures will qualify with an increased cost for capital necessitated by Option 3.

SUMMARY: This pilot requires at least one Capital Provider bid. The Program Team hopes one or more potential bidders submit a proposal to be the Capital Provider. Program measure cost effectiveness with either of the first two Options will be assured if the bid interest rate is 7 percent or lower.

Bidders may offer proposals to provide capital for one or more of these three Options. Bidders with interest rates for Option 1 will receive preference over bidders bidding similar interest rates for Options 2 or 3. Bidders with proposals for interest rates for Option 2 will receive preference over bidders bidding similar interest rates for Option 3.

The Program Team requests that any bidder submitting a proposal based on Option 3, if possible, also submit a bid based on either Option 1 or 2 because unless their bid interest rate is well below 7 percent, even with a Windsor water utility rate increase, it will be a challenge to qualify any measures for an offer that works.

Q.B.4: Are there any changes in the Program Design that will impact the Certification Agent, Suppliers, and Certified Contractors?

A: Yes. Capital Providers have asked us to reduce the number of cash streams that have to be managed. This will impact the program responsibilities for the Certification Agent, Suppliers, and Certified Contractors.

The first change will be an increase in the length of the pay period for the program from 15 to 20 days. This means the Certification Agent would draw funds from the Capital Provider every 20 days to pay Contractors, Suppliers, and itself for completed projects.

The second is a requirement that Suppliers sell CFLs with a 5-year warranty so that participants can pay for them over a 5-year payment term, similar to residential on-demand hot water re-circulator pumps and refrigerators. This will eliminate the only measure with a 2-year payment stream and make it easier for Capital Providers to bid.

This will almost certainly result in at least some program participants requesting replacement of one or more program-installed CFLs within the 5-year surcharge term (e.g., any CFL used more than four hours per day may exceed the 8,000 to 10,000-hour useful life of the CFL – 4 hrs X 365 days X 5 Years = 7,300 hours). There must be no limit or penalty to participants for the number of replacements they require as long as they do not damage the CFLs. However, Suppliers may require that participants seeking a second replacement have their utility verify that the CFL being replaced does not work, is unbroken, and was a program-installed CFL.

This change will require higher bid prices. Suppliers will be paid upfront for the CFLs at their bid price, which will include the risk that some CFLs will need to be replaced. Bidders are encouraged to include in their bid price all or a portion of the cost of a second CFL dropped-shipped to the participant.

This approach will allow CFLs to be a program measure only if a supplier is able to bid CFLs with a 5-year warranty for no more than six dollars – twice the cost noted in the original RFP (i.e., “The average unit price assured to qualify CFLs for the pilot is \$3.00 and assumes 25-percent of CFLs are dimmable”). As long as CFLs average no more than \$6 per replacement with up to 25 percent being dimmable and have a 5-year warranty, this measure should provide all customers with savings to provide immediate positive cash flow and be even more profitable for Suppliers if the CFLs they sell are rated for 8,000 to 10,000 hours.