



**U.S. Department of Housing and Urban Development
Public and Indian Housing**

Special Attention of: Notice PIH 2006-06
Public Housing Agencies;
HUD Directors of Public Housing; Issued: February 1, 2006
PIH Program Center Coordinators;
Public Housing Division Directors; Expires: February 28, 2007
Regional Directors

CORRECTED NOTICE

This notice is corrected to provide that until such time as the regulation found at 24 CFR 990.185 may be changed, the period for freezing the rolling base is limited to 12 years. A PHA wishing to enter into performance contracts dependent on freezing the rolling base for a period greater than 12 years must request a waiver.

Subject. Guidance on Energy Performance Contracts with terms up to 20 years

1. Purpose. This Notice provides guidance on subtitle D – Public Housing, Section 151 (2) (B) of the recently enacted Energy Policy Act of 2005 (PL 109-58). This guidance is in accordance with the Public Housing Operating Fund Program final rule in the Federal Register on September 19, 2005 (79 FR 54983) and the Revisions to the Public Housing Operating Fund Program; Corrections to Formula Implementation Date Notice (Correction Notice) published in the Federal Register on October 24, 2005 (70 FR 61366).

This is a correction to the Notice published January 19, 2006. Until such time as the regulation may be changed, the period for freezing the rolling base is limited to 12 years. Public Housing Authorities (PHAs) wishing to enter into contracts exceeding 12 years but not to exceed 20 years may request a waiver of the regulation.

2. Applicability. This Notice applies only to the Public Housing Program.

3. Effective Date. The procedures described in this Notice are effective immediately, applying to energy contracts awarded after the issuance date of this Notice. Existing energy performance contracts are not eligible to be extended.

4. Background. On August 8, 2005, President Bush signed into law the Energy Policy Act of 2005. Subtitle D – Public Housing, Section 151 amends Section 9(e)(2)(C) of the United States Housing Act of 1937 by adding a new paragraph (iii), which states: “Term of Contract – The total term of a contract described in clause (i) shall not exceed 20 years to allow longer payback periods for retrofits, including windows, heating system replacements, wall insulation, site-based generation, advanced energy savings technologies, including renewable energy generation, and other such retrofits”.

The Department encourages PHAs through its support of the Energy Policy Act of 2005 to employ innovative approaches to achieve programmatic efficiency and reduce utility costs particularly as PHAs transition to asset management. As stated in the Energy Act of 2005 the

contracting period is intended to enable longer payback periods for energy conservation measures (ECMs) such as heating, windows, energy savings technologies, e.g., cogeneration, and renewable energy technologies. In concert with the Department's Energy Action Plan, HUD provides energy conservation guidance, outreach, training and technical assistance to PHAs and residents. In addition, PHAs are provided maximum flexibility in program administration, specifically related to lowering utility consumption and costs in the most efficient and cost effective ways possible. Energy and water conservation is a critical component of asset management because energy and water costs represent 23 percent of public housing operating expenditures. PHA transition to asset management is expected to result in greater accountability, more effective use of resources including utilities, and better quality housing.

Regulations at 24 CFR § 965.305 and 24 CFR § 990.185 describe permissible funding options for accomplishing cost-effective energy audits and ECMs. 24 CFR § 965.305 states that the cost of accomplishing ECMs shall be funded from operating subsidy of the PHA to the extent feasible. 24 CFR § 990.185 states that if a PHA undertakes ECMs that are financed by an entity other than HUD, the PHA may qualify for incentives available in 24 CFR § 990.185.

5. Energy Performance Contract (EPC). An EPC is one of several means available to Housing Authorities for financing and implementing capital energy improvements and services. EPCs are offered by qualified Energy Services Companies (ESCOs) or other appropriate contractors. The energy consumption and cost savings produced by the energy project must be sufficient to cover all project related costs (including such elements as financing, ongoing maintenance, monitoring and verification service, audit services and resident education on energy conservation) over the contract term. The ESCO assumes the performance risks for the ECMs implemented, and the ESCO's compensation is tied to the measured performance of the integrated package of services delivered by the ESCO.

The ESCO conducts an energy audit of selected facilities to determine the potential for saving energy through high-efficiency equipment replacements, building upgrades and improved management systems. Based on the audit results, the ESCO makes recommendations that, when implemented, will generate enough energy and cost savings to pay for the entire cost of the project over the term of the contract.

The contract period is not limited to ESCO energy performance contracts. Under 24 CFR § 990.185, "If a PHA undertakes energy conservation measures that are financed by an entity other than HUD, the PHA may qualify for incentives available under this section. The energy conservation measures may include, but are not limited to: Physical improvements financed by a loan from a bank, utility, or governmental entity; management of costs under a performance contract; or a shared savings agreement with a private energy service company." The contract period may also apply to a PHA acting in a manner similar to the role of an ESCO for an energy project financed by a loan from a bank, utility or governmental entity.

6. Energy Incentives. Under an EPC the ESCO or PHA may propose one or both of the following energy incentives provided that the incentives do not overlap, i.e., applying to the same equipment. A principal advantage to the use of HUD's incentives is that the use of energy savings in lieu of capital or operating funds allows housing authorities to direct their Capital

Funds to more emergent as well as long-term modernization efforts and Operating Funds to operational and management expenses or emergencies.

Frozen Rolling Base: Under 24 CFR 990.185, a PHA may request that HUD freeze its rolling base to generate savings and allow the PHA to retain 100 percent of the savings from the decreased energy consumption for the term of the contract. Until such time as the regulation may be changed, the period for freezing the rolling base is limited to 12 years. PHAs wishing to enter into contracts exceeding 12 years but not to exceed 20 years may request a waiver of the regulation. Such requests must be submitted through the local Field Offices to the Assistant Secretary for Public and Indian Housing for final approval. Under the provisions of the Energy Policy Act of 2005 and an approved waiver, HUD may freeze a PHA's rolling base consumption level (RBCL) for the period of the contract agreement not to exceed up to 20 years.

With the HUD-approved EPC in place, the RBCL used in computing the PHA's Utility Expense Level (UEL) payments will be based on pre-EPC RBCL. When actual savings are realized, the PHA must use at least 75 percent of the cost savings as payments to the contractor or bank loan in accordance with 24 CFR § 990.185. The PHA may use the remaining portion of the cost savings for HUD-approved eligible operating expenses and/or to prepay the contract.

Add-on Subsidy. In this case, the PHA receives an additional subsidy as an add-on to its total operating subsidy eligibility as described in 24 CFR § 990.185. The additional subsidy is for amortization of the loan for the energy conservation measures and other direct costs related to the energy project during the term of the contract.

A PHA may use the add-on subsidy to install the ECM(s) directly, pay a contractor to install the ECM(s), or enter into an EPC to have an Energy Services Company (ESCO) purchase and install the ECM(s). In addition to receiving the add-on subsidy, the PHA is able to retain 75 percent of the cost savings in accordance with 24 CFR § 990.170. In case of the add-on subsidy, the RBCL is not frozen but continues to be calculated following 24 CFR § 990.180.

When insufficient funds are available to fully fund operating subsidy eligibility, the Department funds operating subsidy eligibility, including the energy loan amortization add-on, at a prorated amount.

7. Life Cycle Costs. ESCOs shall include life cycle cost analyses when developing an EPC. When selecting and proposing equipment, appliances or energy systems to replace obsolete or unreliable systems, ESCOs shall take into account the useful life of the equipment under consideration including replacement costs. Life cycle cost analyses permit PHAs to consider long-term economic impact of purchase decisions. This information is particularly crucial when considering the project costs over a 20-year life-cycle period. Life cycle cost analyses also assist PHAs in development of appropriate asset maintenance schedules and reducing associated operating costs by identifying potential future repairs.

Specifically, PHAs shall require and ESCOs shall include such life cycle cost factors as appropriate to include: initial purchase price; estimated useful life of the equipment, operating and maintenance costs, assuring persistence of savings, managing rate risk, and energy costs

adjusted by energy efficiency factors. The ESCO shall consider in its calculations of cost, projected and actual savings, the useful life of the equipment, and the replacement cost of the equipment during the life of the contract. This value consideration is especially important to the PHA when the proposed term of the contract is up to 20 years and the useful life of the equipment is less, e.g., estimated useful life of a standard refrigerator is 12 years.

With proper preventative maintenance and routine repairs of minor components, furnaces and boilers can be expected to perform 15 to 25 years; high efficiency air conditioning and central chillers 15 to 25 years; lighting systems 20 years; toilets and faucets 15 to 25 years; and refrigerators 10 to 12 years. Projects of 12 years and less in duration terminate before most retrofits reach the end of their useful lives (EUL). Projects that extend up to 20 years, however, will require some equipment to be replaced midterm. If the equipment is replaced by public funds, the PHA may not retain any further energy savings from that equipment. EPC language shall address replacement as appropriate.

More important for 20-year terms than for 12-year terms will be the need for savings to persist over the entire term of the energy project. Over the life of the contract, the PHA is required to obtain an annual independent audit of the consumption and cost savings related to HUD-approved saving incentives in order to ensure compliance with contract provisions and projected savings. Cost of the annual audit is an eligible operating expense. HUD will review audit results during assessments of PHA operations.

Maintenance is also an important contributor to the persistence of savings and the life of equipment. Many older boiler and chiller systems use outside services contracts and incur large demand charges for energy. Retrofits savings to eliminate these charges are eligible for capture and use for further investing in retrofit technologies. Replacing an old steam boiler system, for example, reduces the need for specialty contractors and eliminates costly staff overtime hours for equipment failures during winter. PHAs should consider having the ESCO provide training for PHAs in the area of maintenance and routine repairs or provide maintenance and routine repairs of equipment installed by the ESCO as part of the performance contract.

8. Asset Management. Asset management is a management model that emphasizes property-based management as well as long term and strategic planning. Energy projects that may extend up to 20 years clearly involve a long term, strategic planning component. Terms in the energy audit and energy services agreement shall include savings contribution, equipment costs and savings broken out by individual project. The breakout of equipment cost, utility type and savings contribution is in keeping with 24 CFR § 990.170 (f) (1), which requires PHAs to keep utility records at the project level.

9. Approval Process. The regulation at 24 CFR 965.308 requires that PHAs must obtain HUD approval of solicitations for energy performance contracts prior to issuance and must obtain HUD approval of the contracts prior to award. These HUD approvals are needed for a PHA to qualify for the incentives, including the contract period, described in Section 6 of this Notice. HUD approval of these incentives is based on many factors, including that 1) payments under the contract can be funded from reasonably anticipated energy cost savings, 2) the contract period does not exceed 20 years, and 3) supporting life cycle cost analyses documentation is complete.

PHAs must comply with HUD procurement regulations in 24 CFR § 85.36, which specifically require under 24 CFR 85.36(c) that all procurement be done in a manner that provides full and open competition. Regulations at 24 CFR 965.308 require that EPCs be procured through competitive proposals unless services are available only from a single source.

A 20-year contract poses some risk to HUD's Operating Fund if the unit inventory under contract changes. If unit inventory changes due to demolition or disposition for units for which a frozen rolling base or energy loan amortization add-on has been approved, HUD will make the appropriate adjustments. Further guidance on this will be issued in the future.

10. Other Considerations: EPCs shall be required to issue competitive quotes for financing and evaluate quotes based on total interest payments, capitalized interest, securitization, and other factors.

11. Level of Effort: Field Offices can expect to spend more review and approval time with 20-year projects to ensure risk is properly managed. HUD's EPC procedures and training are available at <http://www.hud.gov/offices/pih/programs/ph/phecc/epperformance.cfm>.

If in-house expertise is not available, HUD recommends that housing authorities consider hiring qualified engineering and financial consultants for assistance in their review of contract provisions, investment grade audit reports, Measurement & Verification (M&V) plans, and annual monitoring reports to mitigate risk and ensure long-term success.

12. Information Contact. Inquiries about this Notice should be directed to the Management and Occupancy Division of the Office of Public Housing and Voucher Programs, John Miller 202-708-0614 extension 4237, john_h_miller@hud.gov.

/s
Orlando J. Cabrera, Assistant Secretary for
Public and Indian Housing

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