THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: January 23, 2026 **IBA Report Number:** 26-02

City Council Docket Date: January 27, 2026

Item Number: 333

Analysis of the Energy Performance Savings Contract and Financing Terms

OVERVIEW

On January 27th, Council will consider approval of an item from the Department of General Services (DGS) seeking approval of a construction contract and associated financing, collectively referred to as an Energy Savings Performance Contract (ESPC). This item, if approved by the City Council, would fund renovation of numerous City facilities, including libraries, recreation centers, streetlights, and other buildings. As part of the financing terms, the City would not be required to provide up-front cash for these upgrades. Instead, the City would finance these improvements, with the financing payments being offset by the estimated savings generated from a reduction in utility and maintenance costs the City is expected to derive from those improvements.

In this report, our Office provides additional background on this agreement, highlights areas of potential risk, and provides additional policy considerations for Council's review. **Our Office makes no recommendation either for or against the staff proposal.**

BACKGROUND

As detailed in the staff report, this item was developed by DGS staff over a number of years, beginning with energy audits and electrification studies in 2022. Most of this work was initiated in response to the adoption of the updated Climate Action Plan (CAP) and the Zero Emissions in Municipal Buildings and Operations Policy (ZEMBOP) in 2022, which called for eliminating all greenhouse gas emitting infrastructure in City facilities by 2035.

At that time, the idea to explore an ESPC was also conceived to meet the goals of these new policies while also working in the constraints of the City's budget. Funding for facility enhancements has long been a major gap in the overall capital financing needs for the City, and an ESPC could be used to improve various City facilities, in line with ZEMBOP and CAP goals, without requiring additional spending within the City budget.

In general, when building systems are older, they use more energy than newer, more efficient systems. When these systems are replaced, there are energy savings associated with that replacement, which in turn can be used to finance the cost of system replacement.

This is the basic premise behind staff's current proposal, with one major caveat. With a typical ESPC, the primary goal is energy efficiency, and most of a building's systems would be replaced on a like-for-like basis in regard to the fuel source. However, in order to meet the goals of the ZEMBOP and CAP, this proposal incorporates many upgrades that will *also* require switching the fuel source from natural gas to electricity. While this creates various benefits for some facilities, it will not necessarily create dollar savings, as natural gas is currently a less expensive source of energy than electricity. This led to DGS bundling numerous projects together, so that the timeline for payback based energy savings of some projects makes up for the lack of payback for others. Through this approach, staff are seeking to achieve numerous goals simultaneously: improving City facilities, achieving energy efficiency targets to ensure savings, and the elimination of natural gas use through electrification. It is important that Council understand these policy goals as it considers this proposal.

FISCAL/POLICY ANALYSIS

Our analysis includes three sections:

1) Implications of approving this proposal on the City's Debt Policy;
2) Various areas of risk or concern for Council to evaluate; and
3) Alternative scenarios for Council consideration if it does not move forward with staff's proposal.

Debt Policy Implications

The City's lease payments (i.e., debt service) under the proposed Equipment Lease Purchase Agreement are structured such that each payment is offset by anticipated energy costs savings. This generally results in a debt service payment schedule that increases annually over the 25-year financing term; an exception to this is the first two payments in FY 2029 ($14.9 million) and FY 2030 ($6.7 million) where one-time project rebates/incentives, escrow interest earnings, and accumulated savings from FY 2027 and FY 2028 are anticipated.

The City is expected to receive approximately $8.0 million in federal Investment Tax Credit rebates related to the installation of solar PV systems by FY 2030. Under the proposed financing terms, the City can apply the proceeds from the tax credit to pay down outstanding principal and re-amortize the loan, which will reduce annual debt service payments beginning in FY 2030. **As discussed later in this report (see "Risks/Concerns" below), receipt of this tax credit is not guaranteed. If the tax credit is not received, projected avoided energy costs will not fully offset debt service costs, as shown in the table below.**

Fiscal Year	Avoided Energy Costs (Projected)	Without Tax Credit		With Tax Credit	
		Debt Service	Net Savings	Debt Service	Net Savings
2028	6,749,215	-	-	-	-
2029	8,198,525	14,947,739	-	14,947,739	-
2030	6,700,000	6,700,000	-	6,518,000	182,000
2031	5,475,351	5,925,705	(450,354)	5,294,815	180,536
2032	5,694,438	6,162,812	(468,374)	5,506,678	187,760
2033	5,922,781	6,409,936	(487,155)	5,727,492	195,289
2034	6,160,791	6,667,523	(506,732)	5,957,654	203,137
2035	6,408,895	6,936,034	(527,139)	6,197,577	211,318
2036	6,667,541	7,215,953	(548,412)	6,447,695	219,846
2037	6,937,197	7,507,789	(570,592)	6,708,460	228,737
2038	7,218,353	7,812,070	(593,717)	6,980,345	238,008
2039	7,511,520	8,129,351	(617,831)	7,263,846	247,674
2040	7,817,236	8,460,212	(642,976)	7,559,482	257,754
2041	8,136,061	8,805,261	(669,200)	7,867,794	268,267
2042	8,468,580	9,165,130	(696,550)	8,189,349	279,231
2043	8,815,407	9,540,484	(725,077)	8,524,740	290,667
2044	9,177,185	9,932,018	(754,833)	8,874,590	302,595
2045	9,554,584	10,340,459	(785,875)	9,239,545	315,039
2046	9,948,307	10,766,566	(818,259)	9,620,286	328,021
2047	10,359,090	11,211,136	(852,046)	10,017,524	341,566
2048	10,787,702	11,675,002	(887,300)	10,432,004	355,698
2049	11,234,947	12,159,034	(924,087)	10,864,502	370,445
2050	11,701,669	12,664,144	(962,475)	11,315,835	385,834
2051	12,188,750	2,425,252	9,763,498	11,786,856	401,894
Totals	**$197,834,124**	**$201,559,608**	**$(3,725,484)**	**$191,842,808**	**$5,991,316**

Assuming the City receives the full anticipated tax credit and projected energy cost savings are realized to fully offset debt service, the budgetary impact to the City is neutral. Nonetheless, the proposed financing is ultimately a long-term debt liability for which the fixed annual cost needs to be taken into account when evaluating the City's debt burden/capacity. The City's Debt Policy states that the City shall strive to maintain its Debt Ratio (total annual debt service payments as a percentage of total available general revenues) below 10%; when including pension and Other Post-Employment Benefits (OPEB) costs, the City should strive to maintain a percentage under 25%. These ratios, and the City's debt policy, help to avoid too much of the City's budget being consumed by fixed obligations, thereby limiting the City's flexibility to address other public service needs and priorities.

As shown in the table below, the City's projected Debt Ratios over the next five fiscal years, based on the debt issuance assumptions in the FY 2027-2031 Five-Year Financial Outlook, would remain below Debt Policy thresholds when including debt service associated with the proposed ESPC financing.

General Fund-Backed Debt Service *($ in millions)*					
	Forecast FY 2027	**Forecast FY 2028**	**Forecast FY 2029**	**Forecast FY 2030**	**Forecast FY 2031**
Existing Debt Service (Long-Term & Short-Term)	$ 110.0	$ 108.7	$ 91.8	$ 89.7	$ 88.9
Energy Savings Performance Contract Financing	-	-	14.9	6.5	5.3
FY 2028 Proj. LRB Issuance ($406.3M)	-	9.1	24.9	24.9	24.9
FY 2030 Proj. LRB Issuance ($271.4M)	-	-	-	6.1	16.7
Stormwater WIFIA Loan ($359.2M)	2.3	4.1	6.4	9.0	15.1
New Proj. Short-term Debt Service [1]	5.8	10.8	16.6	24.0	32.1
Totals	**$ 118.1**	**$ 132.7**	**$ 154.6**	**$ 160.2**	**$ 183.0**
Pension and OPEB Costs	$ 429.9	$ 436.2	$ 378.9	$ 374.9	$ 373.2
General Fund Revenue [2]	$ 2,217.4	$ 2,277.6	$ 2,347.5	$ 2,416.1	$ 2,503.2
Debt Ratios					
Debt Service Only - 10% Benchmark	**5.3%**	**5.8%**	**6.6%**	**6.6%**	**7.3%**
Inc. Pension/OPEB - 25% Benchmark	**24.7%**	**25.0%**	**22.7%**	**22.1%**	**22.2%**

[1] Short-term debt consists of General Fund-backed Equipment and Vehicle Financing Program (EVFP) leases, IT computer hardware leases, and Commercial Paper interest costs.

[2] Includes other operating funds currently being used for existing debt service (e.g. non-General Fund TOT).

However, the Council should be aware that the City's combined debt and pension/OPEB ratio is projected to reach the 25% threshold in FY 2028 irrespective of the proposed financing. This increase compared to projections in IBA Report 25-36, "IBA Review of the Mayor's FY 2027-2031 Five-Year Financial Outlook," is due to pension cost increases that were recently included in SDCERS' 2025 Actuarial Valuation Report, released earlier this month. The total debt/pension percentage decreases to 22.7% beginning in FY 2029 primarily due to a significant expected reduction in the City's pension payment and the final maturity of the City's Convention Center Expansion Bonds.

Risks/Concerns

Our Office has identified areas of potential risk with this item that the Council should evaluate during its consideration.

Potential for Energy Cost Savings to Not Materialize

As part of the development of this item, City staff and the consultant Willdan[1] developed a model that determined the City's estimated savings from improvements. In this model, staff and Willdan determined the total energy usage of all of the current buildings set to receive upgrades, and what the energy use would be following upgrades. This was then multiplied by the current blended

[1] Willdan is an Energy Savings Contractor that was previously procured by the City. They worked to develop the energy savings estimates and work scope and will also be the contractor to complete the improvements. It is worth noting that City staff also utilized an additional consultant, Tetra Tech, to evaluate Willdan's work.

utility rate for each project to determine total savings, both during construction and once the projects are completed. Once this savings amount was determined, savings in subsequent years were then grown at an average annual rate of approximately 4.08% to account for historical growth in energy costs.

Our Office analyzed this methodology to understand how sensitive these projections are, as generating the necessary level of savings for the overall ESPC to remain cost-neutral on an individual year basis as well as over the term of the financing arrangement will depend on how accurate those projections are. As shown in the table on page 3, and assuming the City receives the full estimated tax credits for solar and battery storage projects, the assumed average growth rate of 4.08% would achieve a savings of $6.0 million over the life of the financing arrangement. The "break-even" point, where a steady growth in energy rates would yield energy savings that match financing payments, is an average annualized growth rate of 3.75%. If the average increase in utility prices is *below* this point, the City would be spending more per year than it is now by entering into the ESPC. However, if the average increase in utility prices goes beyond this amount, the City would potentially save more money than currently estimated.

For reference, the average increase in utility prices for energy has varied, with utility prices for small commercial buildings increasing by an average of 5.1% a year over the past 9 years, while rates for larger commercial buildings have increased by 6.4%, and street lighting by 6.7%. Since all of these rates are higher than staff's current growth assumptions, and since a large portion of the energy savings is anticipated to come from street lighting, it appears that the current proposal's assumptions are reasonable.

It will nevertheless be important to measure energy savings over the course of this agreement, both on an annual basis as well as over the term of the agreement. While the total savings amount will be included in the budget, for the sake of transparency this should also be reported regularly from the perspective of the entire ESPC. **If Council approves this proposal, we recommend that it request the Department of General Services to report on the estimated energy savings and relevant debt payments annually, both as incorporated into the Proposed and Adopted Budget, and on the actual realized energy savings and debt payments during the Year-End Report each year.**

Impacts of Potential Loss of Tax Credits

The current proposal assumes the City will receive $8.0 million in tax credits, though these are not guaranteed and the potential to not receive that amount exists, especially if there are project delays. Securing this tax credit is vital to this proposal remaining cost neutral, since it allows the City to re-amortize the financing agreement to bring it in line with projected savings. As shown in the table on page 3, the current proposal will not achieve savings over the financing period without tax credits. This tax credit has strict deadlines, and meeting those deadlines is a major factor in the item being direct docketed to Council.

The full amount of tax credit receipts is not anticipated to be received until sometime in FY 2030, since construction of the eligible facilities must be completed prior to receiving payments. While the City is currently projected to meet all deadlines to receive this funding, it should be noted that this is a federal tax credit, and given the current volatile federal administration, there is some

potential uncertainty that tax credit funding will actually be provided. Without the tax credit, the average increase in utility costs would have to be approximately 4.25% or higher to maintain cost neutrality over the entire financing term.

Potential for Energy Efficiency Levels to Not Materialize
As mentioned, staff developed financial assumptions for energy savings that were used to right-size the portfolio and payback terms for financing arrangements. In order to estimate the utility savings, Willdan and the City performed Investment Grade Audits (IGAs) to project potential energy savings. As part of the ESPC agreement, Willdan guaranteed savings in terms of actual energy use avoided, as opposed to actual energy *costs* avoided. If the energy use avoided is not reached, Willdan will pay the City for the cost of that energy for the first three years following completion of construction, which would be used to defray the financing payments.

Additionally, as part of this package, Willdan agreed to perform the operations and maintenance activities of upgrades for a term of three years. Payments for these activities are already included in the financing package. This three-year timeframe coincides with the three-year guarantee that Willdan provided for the energy savings guarantee. However, as noted in the staff report for this item, once Willdan is no longer responsible for the operations and maintenance of the systems, they will no longer guarantee energy savings.

This could present an issue, as after the three-year Willdan operations and maintenance period, City staff will be required to ensure the newly installed systems are both working properly and maintained moving forward. While Willdan has committed to training City staff from DGS on how to operate the systems, DGS's Facilities Division is currently understaffed for the amount of maintenance work that is required today. Because these will be new systems, they should not require extensive maintenance, but given that most City facilities are running older systems, and because of staffing and cost constraints the Facilities Division for years has had to prioritize *reactive* maintenance as opposed to *preventative* maintenance, there is reason to doubt the City will be adequately staffed to maintain new systems in a way that maintains energy efficiency. Reprioritization of existing staff resources may not be sufficient to guarantee proper maintenance either, since most of the reactive maintenance currently conducted by DGS is emergency maintenance or otherwise necessary to keep existing facilities operational, which takes priority over more routine maintenance.

The ESPC agreement does provide an option to keep Willdan on contract to conduct operations and maintenance activities beyond the current three-year timeframe, but this would require both additional costs and potential meet-and-confer negotiations with the City's Recognized Employee Organizations that would otherwise perform that work.

Potential Construction Delays/Operational Impacts
One final area of risk relates to potential construction delays, as well as the aggressive timeline for completing improvements.[2] As part of the financing projections, City staff estimate that some energy savings will begin accruing before financing payments are due, which is an important

[2] Willdan will deliver the project in approximately 18 to 24 months. The project includes retrofits to 40 facilities and nearly 39,000 streetlights, plus solar and battery installations. The City must begin construction before July 2026 to qualify for federal solar Investment Tax Credits and complete installations by 2028.

aspect to this agreement as initial payments for this agreement are high due to the financing requirement to pay off accrued interest during the construction period. If construction activities are delayed, costs could result from delayed energy savings that could otherwise be used to cover early payments, continued interest accrual, and increased project costs. These will potentially be defrayed by keeping debt proceeds in an interest-bearing escrow account, whereby that interest will be used to defray initial payment costs. However, delays could still lead to the City having to make an outlay in the initial payment year of FY 2029 that is significantly higher than currently projected baseline costs.

The aggressive timeline to complete construction could also lead to significant operational impacts for certain City facilities. Given that timeline, it is likely that some facilities will need to be completely shut down potentially up to weeks or a month during renovations. Since the majority of these facilities are libraries and recreation centers, this will most likely require rotating outages since all work likely cannot all be completed during off-hours, and this may present inconveniences to City communities. Nevertheless, getting the repairs done as expeditiously as possible is necessary for the ESCP to remain cost neutral.

Alternative Scenarios for Council Consideration

While this report identifies areas of risk associated with the ESPC proposal, there also are risks associated with maintaining current business practices. These include the potential failure of existing City facilities without pre-approved capital replacement plans and identified funding, and the potential need for emergency repairs to existing facilities that could require both longer closures in order to make emergency repairs and more expensive repairs due to their emergency nature. Since system failures are not predictable, there is no precise way to estimate the potential additional costs for the business-as-usual scenario compared to this financing proposal.

We offer the following guidance should Council determine that staff's current proposal presents too much risk, or if Council wishes to pursue other policy priorities, such as maximizing budgetary savings, over goals like building electrification. As noted in the staff report, the most immediate consequence of not approving the proposal is the obligation to pay Willdan $735,000 for the work already done to complete IGAs. However, those IGAs would remain under the City's ownership, and could still be used to implement improvements on case-by-case basis.

Under this alternative approach, the City could prioritize projects that have the largest energy savings and finance them with General Fund-backed Lease Revenue Bonds (LRBs), completing remaining projects when future LRB funding becomes available. Alternatively, the City could attempt to procure its own contractor and run the projects simultaneously as regular Capital Improvement Program projects funded by LRBs.

This alternative, however, also carries risks and tradeoffs. LRB debt service is level and generally not structured to align with energy savings, which could make improvements more expensive to finance in the short term, even if there are more potential long-term savings. Construction costs could also increase, as some projects would likely need be reengineered and may require additional staff time to design, bid, and oversee the projects on a piecemeal basis.

CONCLUSION

The ESPC proposal brought forth by DGS seeks to achieve many policy goals, including the electrification of existing City facilities and energy efficiency upgrades, at no net additional cost to the City. Adoption of this proposal would move the City forward on a number of CAP and ZEMBOP goals. However, there are risks associated with this proposal, including the potential for energy efficiency savings targets not being met either due to lower than anticipated growth in energy costs, and the potential inability of the City to maintain new systems in an optimal manner to achieve those savings. While staff have attempted to mitigate against these risks, they exist and should be carefully weighed against potential benefits.

As noted in the staff report, there are also risks to rejecting the proposal and proceeding along a different path, although there are potential benefits to doing so as well. Council should weigh the different policy benefits and risks against its own set of policy preferences when making its ultimate decision.

If Council approves staff's recommendation, our Office recommends that Council also direct additional reporting be provided within the appropriate budget documents on an annual basis in order to improve transparency and oversight.

We would like to extend our thanks to staff from the Department of General Services and the Department of Finance for assisting us in reviewing this item.

Jordan More
Principal Fiscal and Policy Analyst

Baku Patel
Senior Fiscal and Policy Analyst

Jillian Andolina
Deputy Director

APPROVED: Charles Modica
Independent Budget Analyst