

Illinois Commerce Commission  
Report and Recommendations Regarding  
On-Bill Financing Programs



October 2016

## Executive Summary

Public Act 96-0033, which took effect July 10, 2009, added Sections 16-111.7 and 19-140 to the Public Utilities Act (“PUA”). These new sections require, respectively, electric utilities or gas utilities serving more than 100,000 customers on January 1, 2009 to provide on-bill financing (“OBF”) programs. The OBF programs allow utility customers to purchase cost-effective energy efficiency measures with no required initial upfront payment, and to pay the cost of those products and services over time on their utility bill.

Included in each OBF Section of the PUA is a requirement that an independent evaluation of utilities’ OBF programs be conducted after three years of program initiation and completed within four years of program initiation to evaluate the effects of the measures implemented pursuant to the program and the overall operation of the program, including, but not limited to, customer eligibility criteria and whether the payment obligation for permanent energy efficiency measures that will continue to provide benefits of energy savings should attach to the meter location. The OBF Sections further direct the Illinois Commerce Commission (“Commission”), following the evaluation, to submit a report to the Governor and General Assembly summarizing the results of the information contained in the evaluation as well as recommending whether to continue the program in its current form, continue the program with modification, or discontinue the program.

This Report was prepared pursuant to the Commission’s reporting requirement under Sections 16-111.7(g) and 19-140(g) of the PUA.

The program evaluation was completed by the Cadmus Group. The evaluation examined several aspects of each program. In broad terms, the key reviews were

whether the programs are cost-effective or likely to be in the future; whether loans should be tied to the meter<sup>1</sup> or left unsecured; the characteristics of loan applicants – including the characteristics of persons who received loans as compared to those denied them; and the potential increase in program participation if underwriting requirements are altered. The Cadmus Group provided the Commission with several recommendations for pilot programs, future evaluations, and which test should be used to evaluate cost-effectiveness.

The program evaluation found that the OBF programs were cost-effective under an incremental Utility Cost Test and marginally cost-ineffective under an Incremental Total Resource Cost Test. The Program Evaluator recommended the Incremental Utility Cost Test as the more appropriate measure of cost-effectiveness for these OBF programs. The Commission recommends that the OBF programs continue with modifications.

The Commission recommends that Sections 16-111.7 and 19-140 be amended to:

- 1) authorize the Commission to order further program evaluations at the request of interested parties;
- 2) authorize the utilities to collect funds not to exceed 1% of the Commission-authorized budget to pay for further evaluations;
- 3) authorize the Commission to have the discretion to modify existing programs;
- 4) authorize the Commission to monitor the interest rate and financial components of the OBF programs, and
- 5) authorize the Commission to review and modify multifamily programs within a utility's OBF program.

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<sup>1</sup> The statutes currently require the facility owner to pay the remainder of a loan in full if service is discontinued. If the loans are tied to the meter, a new facility owner or service recipient would assume the loan obligation.

## Introduction

Public Act 96-0033 was signed into law on July 10, 2009. It expanded the Public Utilities Act (“PUA”) by adding Sections 16-111.7 and 19-140. These provisions require electric and gas utilities that served more than 100,000 customers on January 1, 2009 to provide on bill financing (“OBF”) programs. As part of each section, an evaluation of the programs is to be completed after four years of implementation and the Commission is to submit a Report to the Governor and General Assembly recommending to either continue the programs without modification, continue the programs with modification, or to discontinue the programs.

The OBF programs allow utility customers to purchase energy efficiency products and measures (e.g., furnaces) with no required initial payment, and to defray the cost of those products and services over time through payments on their utility bill. In effect, the utility acts as an intermediary between the lender and the customer, collecting the loan payments as part of each participating customer’s monthly bill and then paying the sum of current balances due for all loans to the lender. In the event a customer fails to pay the loan, the utility continues to make the payments to the lender and attempts to collect the balances due from its customer. If the customer defaults, the default balances are spread among the utility’s other customers through an uncollectible expenses rider.

Public Act 96-0033 made the OBF programs available to residential and small commercial customers who own the premises where service is provided. Residential customer eligibility was limited to owners of single-family housing, duplexes, other residential buildings with 4 or fewer units, or condominiums. In order for energy efficient equipment to be eligible for program financing, the measure needed to be applied to or

replace an existing measure and the estimated energy savings determined at rates in effect at the time of purchase needed to be sufficient to cover the costs of implementing the measure. Three years after OBF programs were initiated, an independent evaluation of their effectiveness was to begin. The evaluation was to be completed no later than four years after the programs began. The Cadmus Group began the independent evaluation in June 2014 and submitted its report to the Commission in June 2015.

The OBF statutes were amended twice, in 2011 and again in 2013. On October 26, 2011, Public Act 97-0616 amended the original Act by changing the criteria for eligible measures. Under the amended statutes, a measure needed to replace or be attached to an existing measure and either 1) estimated savings based on rates in effect at the time of the loan needed to be sufficient to cover the costs of implementing the measure; or 2) the measure had to be included in a Commission-approved EE program and assessed as cost-effective under the definitions of the relevant EE statutes.

Public Act 98-0586 was signed into law on August 27, 2013. It further amended the OBF sections by increasing customer eligibility to include retail customers who own multifamily or mixed-use buildings with no more than 50 residential units. The customer was required to be a residential or small commercial customer and the repayment of loans could not be made through tenants' utility bills. Each utility could impose a per site loan limit not to exceed \$150,000 on the multifamily loans.

Public Act 98-0586 also amended the criteria for measure eligibility. It no longer required that financed measures replace or attach to existing measures. It also eliminated the requirement that a financed measure have energy savings based on rates at the time of installation that are sufficient to cover the costs of the measure. Under Public Act 98-

0586, any product or service that is included in a Commission-approved energy efficiency plan under Section 8-103 (for electric) or Section 8-104 (for gas) became eligible for financing, regardless of whether the measure was cost-effective.

Five utilities were required to implement OBF programs. Peoples Gas Light and Coke Company, North Shore Gas and Nicor Gas are natural gas utilities that have OBF programs. Commonwealth Edison Company has an electric OBF program and the Ameren Illinois Company has a program that offers OBF services to both its gas and electric customers. These utilities submitted a joint Request for Proposals (“RFP”) to lending institutions. Interested stakeholders provided input into the RFP process and its evaluation. AFC First was eventually selected through that RFP process.

The terms of the loans are that borrowed amounts for residential and small commercial customers range from \$500 to \$20,000. The loans are for three, five, or ten years. The loans are unsecured. Underwriting requires that customers have a minimum credit score of 640, no bankruptcies, foreclosures, or repossessions in the last seven years and no unpaid collection accounts, judgements, or liens of more than \$2500. Depending on the utility, the customer must also be in good standing. For higher loan values, income verification and debt-to-income ratios are also considered.

The terms of the multifamily loans allow for loan amounts between \$500 and \$150,000. The loan terms are three, five, or ten years and the loans are unsecured. Multifamily property owners are eligible for these loans. To be eligible for the loans there is a minimum length of time in business requirement that varies with loan amount. For loans up to \$10,000, the time requirement is one year. For loans between \$50,001 and \$150,000, the time requirement is five years. Larger loans also require satisfactory

business credit reports and examinations of financial statements or tax returns. All multifamily loans require a personal guarantee of any owner with more than a 20% interest in the business. The guarantor's credit score must be at least 640 for the smaller loans and up to 700 for loans in excess of \$50,000.

In addition to reviewing the independent evaluation and submitting a Report to the Governor and General Assembly, the Commission took an additional step by establishing a docketed proceeding to allow interested parties the opportunity to provide comments on the evaluation report and to make suggestions on what should be included in the Commission's Report. The Commission has determined that the programs are cost-effective when evaluated by the Incremental Utility Cost Test ("UCT") but not cost-effective when evaluated by an Incremental Total Resource Cost Test ("TRC"). As explained below, the Cadmus Group, which conducted the evaluation, recommends the UCT as the more appropriate test of cost-effectiveness.

The Commission's overall recommendation is to continue the programs with modifications. The proposed modifications are intended to provide explicit language that allows the Commission the opportunity to address concerns raised by interested parties. In general, the statutes, in their current forms, do not provide explicit language authorizing the Commission to evaluate the programs or portions of the programs in the future. The statutes also omit explicit language authorizing the Commission to modify existing programs based upon the results of future evaluations.

The Commission recommends that the existing statutes be amended so as to:

- 1) authorize the Commission to order further program evaluations at the request of interested parties,

- 2) authorize the utilities to collect funds not to exceed 1% of the Commission-authorized budget to pay for further evaluations,
- 3) authorize the Commission to modify existing programs,
- 4) authorize the Commission to monitor the interest rate and financial components of the OBF programs, and
- 5) authorize the Commission to review and modify multifamily programs within a utility's OBF program.

The remainder of this Report contains three sections. The first section summarizes the Evaluation Report provided by the Cadmus Group. The second section discusses the results of the cost-effectiveness tests performed as part of the program evaluations and the final section discusses the Commission's modifications.

## I. Evaluation Summary

The Cadmus Group ("Cadmus") was selected to conduct the independent evaluation of the utilities' OBF programs. As part of the evaluation process, Cadmus met with the various interested parties including representatives from each utility, the Commission's Staff, the Office of the Attorney General, and consumer and environmental groups. Based upon these meetings and directives from the Commission, Cadmus examined the cost-effectiveness of the programs, the levels of loan approvals, the expected participation levels if loan approvals had alternative underwriting criteria, the level of loan defaults, and the effects of attaching the loans to the meter rather than the customer.

Cadmus prepared three interim reports as part of the process. The first report was distributed to interested parties on February 12, 2014. This report included the results of interviews with program participants.

The second interim report was distributed on May 29, 2014. This report included the results of interviews with customers who were either denied loans or who were approved for loans but decided to decline the financing. Additionally, the results of interviews with EE retailers and surveys with contractors were also included. The third interim report, which was distributed on February 18, 2015, included the results of the cost-effectiveness study.

The Cadmus Group's evaluation examined the first three years of the program. It found that loans were offered in values ranging from \$500 to \$20,000 for residential or small commercial customers. The OBF programs also offers loans of up to \$150,000 to multifamily facilities. The loan tenors were three, five, or ten years.

For the residential and small commercial sectors, a minimum credit score of 640 is required. In total, 4,686 loan applications were reviewed. Of this number, fifty-one percent were rejected and another 14% were withdrawn by the applicant.

The most prevalent reason for loan rejection was a credit score below 640, accounting for 42.5% of all denied applications. Slightly over 90% of all loan denials occurred due to a credit score below 640, delinquent past or current credit obligations, or a current or past bankruptcy.

There is little information about the effectiveness of the multifamily programs. At the time of the evaluation the multifamily programs were relatively new. The multifamily loans were authorized in June 2013 and most utilities began implementing the new

requirements between January and March 2014. As of May 2014, no multifamily loans had been issued.

Under the original version of the Act, a measure was eligible if it replaced or attached to an existing measure and the value of the electric or gas savings estimated with the rates in effect at the time of the loan was greater than the measure cost. This definition is rather stringent because it requires that the savings over an alternative measure has to be sufficient to cover the total cost of the measure. In comparison, the Total Resource Cost test associated with the gas or electric EE programs requires that the values of savings from an EE measure have to be sufficient to cover the additional costs associated with the EE measure (i.e., must exceed the amount the participant pays in excess of the standard equipment cost to purchase the more efficient equipment).

Identifying eligible measures was difficult when the programs began. Some gas utilities could not identify any measures meeting eligibility requirements. As explained above, the statutes were revised in 2011 to allow any measure that was included in a Commission-approved EE program to be eligible for financing, provided it was cost-effective, and further revised in 2013 to allow any measure included in a Commission-approved EE program to be eligible, regardless of whether the measure is cost-effective. These changes in measure eligibility led to much higher levels of program participation. Overall, the three measure groups with the most loans are Gas Furnaces, Central Air Conditioning, and Insulation. Overall, 64% of all loans were for a single measure while the remaining 36% of loans had between two and five measures being financed. Most multi-measure loans were for projects with two measures.

One potential risk to the programs is nonpayment by customers. The utilities act as guarantors for the loans. If a customer does not pay, the utility attempts collection through the same means that it does for nonpayment of utility service. Service disconnection is a possibility and eventually a loan can be defaulted. If service is disconnected, a customer is required to pay the outstanding OBF loan amounts, the outstanding utility charges, and tariffed reconnection charges. If loans are defaulted, the costs are passed to other utility customers through an uncollectible expenses rider.

The evaluation of defaults found that very few occurred. In total, seven loans out of 1,750 were in default at the time the evaluation took place. Three of those seven defaults occurred because the customer died. Three loans were in default because a customer moved out of state and another was in default because a customer filed bankruptcy. The total value of the defaulted loans amounted to 0.16% of total loan volumes.

The Cadmus Group anticipates that the default rates will increase in the future as the loans mature. An estimate of a realistic default rate was not provided but the expectation of an increasing default rate comes from Cadmus's experience evaluating programs in other states. Additionally, in May 2014, when the evaluation was conducted, the programs were at their outset and most loans were only a few months into repayment. It is likely that some of those loans will default as they move from a few months old to a few years old.

## II. Cost Effectiveness

The evaluation report, conducted by the Cadmus Group, evaluated cost-effectiveness through an incremental Utility Cost Test and through an incremental Total Resource Cost

Test. Although Cadmus performed both tests, it recommends the Incremental Utility Cost Test as more appropriate.

An incremental Utility Cost Test examines the incremental costs and benefits from the utility's perspective. The test measures cost-effectiveness from the utility's perspective. In doing so, only incremental costs incurred by the utility are included in the analysis. Similarly, only incremental benefits that accrue to the utility are considered. Costs such as processing loans or marketing the program are considered. The costs of collection efforts for delinquent payments and write offs for defaulted loans are also included since a utility bears these costs. Benefits such as the avoided costs associated with buying less energy are also considered. Under the incremental Utility Cost Test, the OBF programs were determined to be cost-effective with each utility having a test value between 1.27 and 3.13<sup>2</sup>.

An incremental Total Resource Cost Test considers incremental costs and energy-related benefits to both the utility and the loan recipient. The TRC test evaluates whether the incremental costs to the utility and the participant are higher or lower than the value of the incremental energy benefits to the utility and the participant. This tests would include the administrative, marketing and collections costs borne by the utility. It would also include the incremental measure cost and finance charges borne by the utility's customer. These costs would be compared to the value of energy savings to both the utility and the loan recipient. An interesting point is that, ignoring administration costs, defaults do not alter the TRC test. The reason is that the defaults simply shift debt on a

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<sup>2</sup> Table 71, Evaluation Report page 82.

dollar for dollar basis from the loan recipient to the utility (and its other customers). The incremental Total Resource Cost Test values ranged from 0.62 to 0.89, depending on the utility. These initial TRC estimates are skewed as a result of the programs incurring initial administrative costs associated with relatively few initially eligible measures and should improve over time.

The Program Evaluator recommended the Incremental Utility Cost Test as the more appropriate measure of cost-effectiveness for these OBF programs. The Program Evaluator argued that the OBF by itself is not an EE program and, therefore, the UTC is a more appropriate test than is the TRC test, which considers related EE program costs.

### III. Commission Recommendations

The five recommendations that the Commission provides primarily involve giving the Commission explicit authority to monitor and amend the programs as issues arise. The current statutes provide no explicit guidance to address future concerns that may arise with the programs. The only directions provided regard how to establish the programs initially and to begin evaluating the programs after three years of operation.

The Commission notes that these programs are now approximately five years old and likely to continue for many years and perhaps decades. The Cadmus Group evaluation found that defaults are likely to increase in the future. Some interested parties advocated for a lower threshold credit score or alternative eligibility criteria. The Commission is of the opinion that it can examine these and other aspects of the programs in the future if it deems it necessary to do so; however, the Commission recommends that it be granted explicit authority to do so.

The current statutes provide little express authority or direction to the Commission. For example, there are no explicit mechanisms for the Commission to order future pilots to investigate the efficacy of potential program changes. There are no explicit mechanisms for the Commission to order further evaluations to determine if the programs continue to be effective. There is no explicit provision authorizing additional request for proposals to determine if new lenders can provide more favorable terms. Additionally, there is no explicit provision to allow the Commission to modify programs in the future.

In a related concern, the statutes were previously expanded by the General Assembly to increase program eligibility to multifamily housing units. This expansion became effective after the program evaluation began. There is some evaluation of multifamily aspects of the programs but that evaluation is of programs that were in their infancy. The current statutes do not provide for any follow-up evaluations of these multifamily programs.

For these reasons, the Commission recommends that Sections 16-111.7 and 19-140 be amended to authorize the Commission to make adjustments to the programs as may be needed. The Commission recommends that the statutes be amended so as to:

- 1) authorize the Commission to order further program evaluations at the request of interested parties;
- 2) authorize the utilities to collect funds not to exceed 1% of the Commission-authorized budget to pay for further evaluations;
- 3) authorize the Commission to modify existing programs;
- 4) authorize the Commission to monitor the interest rate and financial components of the OBF programs; and
- 5) authorize the Commission to review and modify multifamily programs within a utility's OBF program.