



The Solutions Network

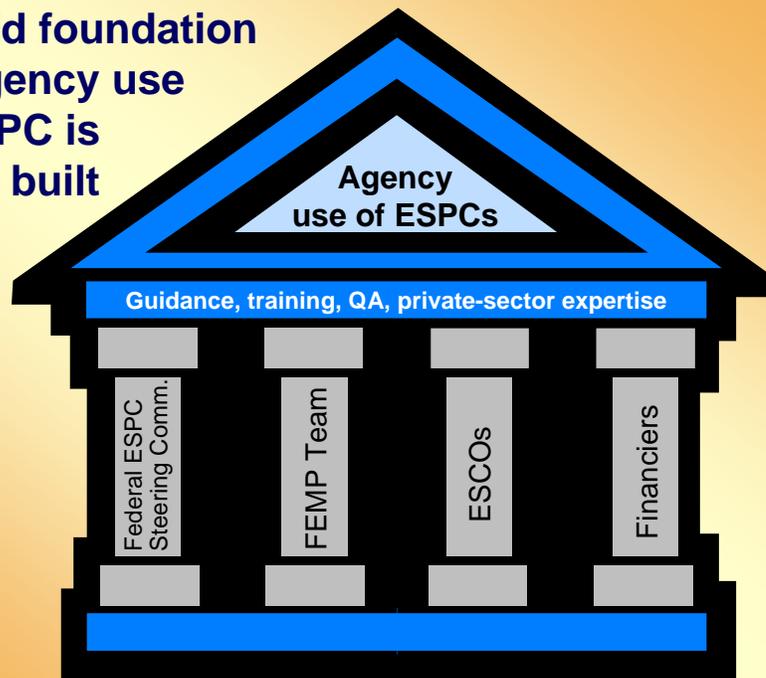
Rochester, New York

## New Concepts: ESPC Financing Cost Reduction

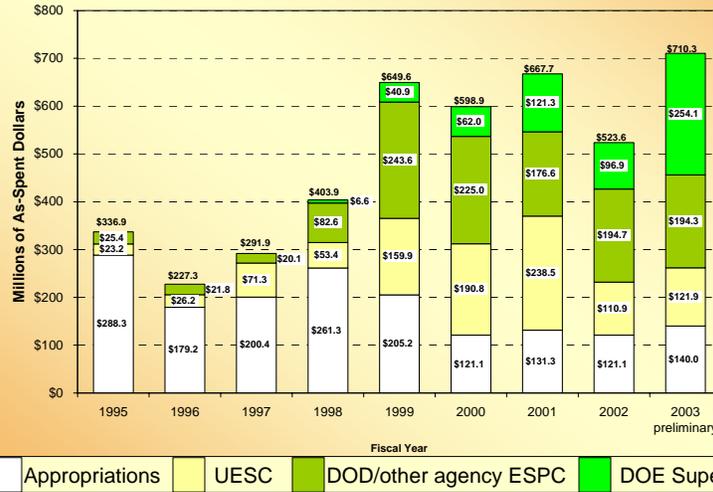
Skye Schell, Acting Director  
Federal Energy Management Program  
Alternative Financing Track, Session 1  
Monday Aug 9, 2004; 10:30 am – 12:00 noon

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**A solid foundation  
for agency use  
of ESPC is  
being built**

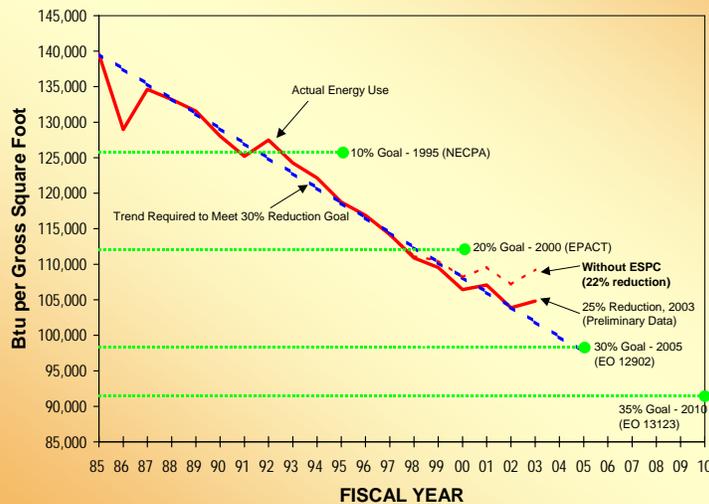


# More than 50% of federal EE project funding comes from ESPC



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# ESPC is a major contributor to E-reduction goals



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## Fortunately ESPC authority could be back this fall



- ESPC authority lapsed 10/1/2003, but continues to have strong bipartisan and bicameral support
  - House and Senate of 106<sup>th</sup> & 107<sup>th</sup> Congresses passed energy bills with permanent ESPC, but Senate unable to pass conference versions
- Congressional Budget Office (CBO) Scoring
  - Bump in road: Up-front price tag has limited options (legislative vehicles, term of extension possible)
- Defense Authorization Bill (HR 4200, SA 2400)
  - Includes extension to 9/30/2005 of existing ESPC authority (plus water) for all agencies; could become law this fall

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### Influences we are dealing with...



## The time is ripe for ESPC financing cost reduction



- Identified long ago as a fertile area for program improvement
- Watchdogs independently agree
- Plan to implement initial recommendations as part of DOE IDIQ mods
- Proactive, head-on approach will:
  - strengthen case for permanent ESPC authority
  - expand agency participation in program

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## Recommendations came from a task force that did its homework



- ESPC financing cost reduction task force
  - Began fact-finding in mid-2002
    - Sources: Firms financing the lion's share of ESPCs, ESCOs, other agency financing programs, state ESPC programs, Wall Street, institutional investors, Dept. of Treasury
- Short term — Do what we do now better
  - Contract changes focused on transparency, standardization, increased bidding

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## FEMP's process of roll-out is inclusive and measured



- 3/23-24/04 Advanced ESPC Workshop
  - Verified agency interest in better financing
- 4/19-21/04 ESPC Transition Workshop
  - FEMP team discussion of first-draft IDIQ mods
- 6/21/04 Second-draft IDIQ mods to DoD and ESCOs
- 6/29/04 Stalled-ESPC-Projects Workshop
  - FEMP and DOE ESCO discussion of second draft
- 7/23/04 Third-draft IDIQ mods to ESCOs
- Today
- 8/11/04 FEMP and DOE ESCOs reconvene

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## The IDIQ mods will be ready when ESPC comes back



- Hiatus: 10.5 mo so far, ~13 before over
- FEMP is committed to doing everything it can to help preserve ESCO and agency human resources and investments in stalled projects
  - Assistance in moving stalled ESPC projects forward using other authorities
  - Having the IDIQs up and running the day ESPC comes back to life

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## In a nutshell — what is being proposed for DOE Super ESPC



- Increased competition
  - ESCOs obtain 3 bids on financing
    - Treasury index to float and be locked at award
    - Premium over index and up-front costs are “held firm” by bidders for a specified period of time
- Increased transparency
  - Government sees the bids
- Better understanding of risk
  - Government, ESCO, financier all on same page
- Better goal congruence
  - All parties motivated to achieve award in “held-firm” period

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## Proposed process — constructive input welcome



- What: 3 financing bids, evaluation, and selection
- When: prior to final proposal submission
- How: standardization of documents and process
  - “Investor Deal Summary (IDS)”
    - Basis for soliciting bids
    - ESCO develops, government reviews, ESCO shops to financiers
  - “Standard Financing Offer (SFO) Sheet”
    - Defines required content of standard offer
    - Financiers submit, ESCO & government evaluate, ESCO recommends a selection, government agrees
- Result: final proposals based on better financing

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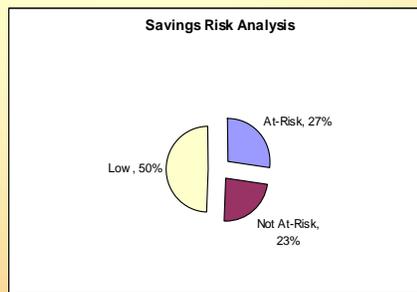
# The IDS quickly educates the investor on repayment risk



## Example Guaranteed Savings/Payments Risk Analysis

Risk Analysis	Savings/Payments	%
At-Risk	\$238,273	27%
Low	\$430,516	50%
Not-at-Risk	\$200,873	23%
Total	\$869,662	100%

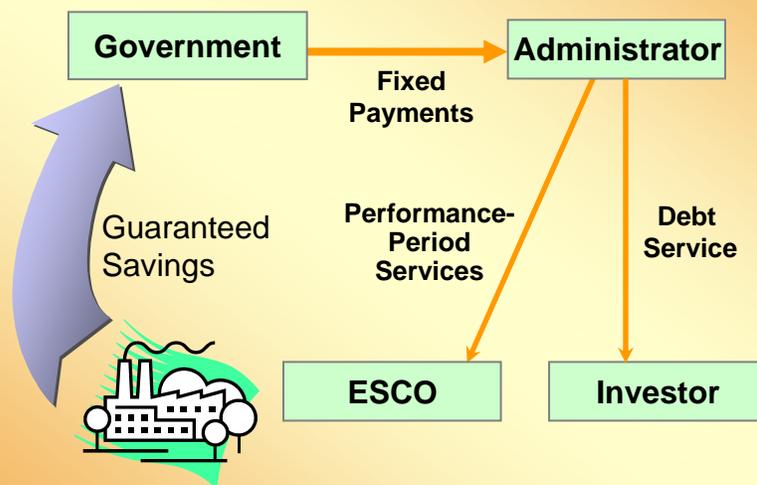
Investor can readily see the low overall risks associated with this project



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# Investors insist on “first dibs” to minimize defaults on debt service



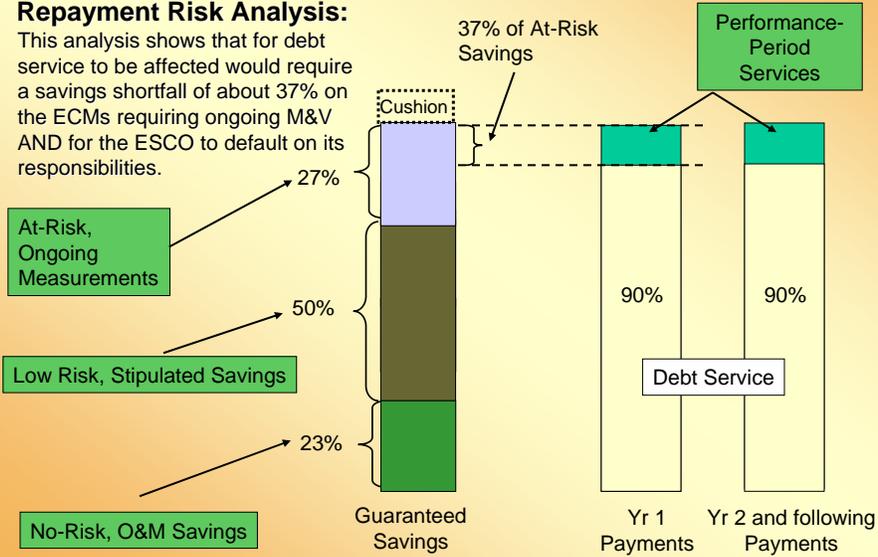
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## When projects are fully understood investor risk is often revealed to be modest

### Repayment Risk Analysis:

This analysis shows that for debt service to be affected would require a savings shortfall of about 37% on the ECMs requiring ongoing M&V AND for the ESCO to default on its responsibilities.



## Why financing costs will be reduced



- Open access — more financiers can play
- More financiers — more investor pools tapped
  - More investors will be willing to participate
    - Can price risk after reading an IDS (rather than a bookshelf)
- More investors — more competition for investments
- Better program-wide information to inform markets
  - Statistics on withheld government payments, ESCO defaults, etc.
- Better program-wide support to agencies
  - Watchdogs want it, agencies need it, all cost-saving strategies (P4s, annual-in-advance payments, etc.) considered on all projects
- Interesting aggregation opportunities beyond what any single ESCO can do

## Competitive ESPC financing is good for everybody



- Agencies — Pay less for the same project or benefit from a larger one
- ESCOs — Larger and more comprehensive projects can cash flow
- Financiers — Opportunity to bid on and finance more projects, expanded placements overall
- Investors — Expanded investment opportunities
- Benefits to all parties — transparent financing (helps secure permanent ESPC authority)

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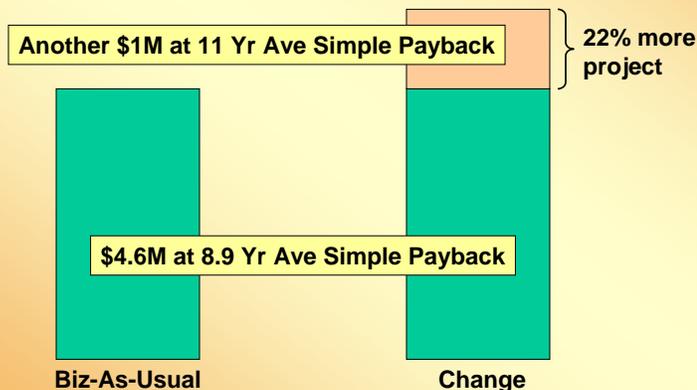
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## Better financing means more project, more renewables, etc.



Baseline: typical \$4.6M, 17 yr term DOE Super ESPC project

Change: 25% reductions in interest rate premium over Treasuries (250 → 187.5 basis points) and ratio of up-front financing procurement costs over financed amount (9.84% → 7.4%)



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## Advanced ESPC training is opportunity to learn more



- FEMP course: Advanced ESPC and Financing
  - In-depth treatment of understanding the “ESPC deal,” pricing, financing, and M&V
- Training is open to agencies
- To be offered twice in FY 05

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## Contacts for more information



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