

Office of ENERGY EFFICIENCY & RENEWABLE ENERGY

UESC Best Practices: Obtaining the Best Financing Deal

May 3, 2019





The Choice: Energy Waste or "Free" Infrastructure

Federal Government Energy Consumption (FY17):

- 287,383 billion Btu consumption (adjusted) in goal subject buildings
- @ 3.074 billion sq. ft. average energy use intensity (EUI) is 93,482 Btu/gsf.

FEMP Assistance Helps Lead the Federal Government in Reducing the Energy Intensity of its Facilities by 49% Since 1975



The Choice, Continued: Scenarios & Savings

Energy Savings Scenarios:

- Scenario 1: Typical 20% retrofit savings. (Example: Forrestal HQ): lighting, controls, HVAC and pumps.
- Scenario 2: Deep Retrofit, 40% retrofit savings (Example: GSA Hart Dole) all of the above, plus a comprehensive design that allows for de-lamping, right sizing equipment, some renewable energy integration.
- Scenario 3: Deep Retrofit 60% retrofit saving. (Example: GSA New Carrolton): all of the above, plus GSHP, high % PV generation...

Savings:

Percentage Savings	Energy Saved (Billion BTU)	Resulting EUI (BTU/GSF)	Investment needed (\$B)	GHG Saved/yr (CO2 – tons/yr)
20%	62,219	74,786	\$18.3	6.2M
40%	124,438	56,089	\$36.5	11.5M
60%	186,657	37,393	\$54.7	17.2M

Financing Cost—Why Do We Care?

...because it's a component of the cost stack.



*Data from DOE IDIQ ESPC projects awarded in FY14-15 (Figures may not add to exactly 100% due to rounding.)

- Average project interest rate = ~4.25%. UESC likely lower...
- Average project investment = \$20M

Financing Cost—Why Do We Care?

- ✓ The cost of financing pales in contrast to the cost of not acting.
- ✓ Rates continue to be historically low—this is an ideal time to use performance contracts to meet mission, energy and resilience related objectives.
- ✓ This is a better deal for the US taxpayer vs. allowing energy waste to continue—and not converting that waste into new infrastructure.

Financing Cost—Why Do We Care? Continued

- New infrastructure equals improved resilience—vs. aged and failing equipment replaced.
- Additional resilience benefits from CHP, microgrids, storage, controls...all possible with UESCs



Components of the Interest Rate

- Index interest rate usually largest component
 - Represents the prevailing cost of money in the financial markets
 - Changes day to day
 - Any standard index can be used (e.g., like-term U.S. Treasury Securities)

Web sources for rates

- <u>www.bloomberg.com</u>
- <u>www.federalreserve.gov/releases/h15/current</u>



The Premium

• Premium covers

Lender's costs

(legal fees, administration, etc.)

- Lender's perception of risk
- Financiers' pricing decisions are based on three broad risk categories:
 - 1) Contract Risk
 - 2) Project Risk
 - 3) Participant Risk

	Premium	
	Index	
To	otal Interest Rate	Ś

Determinants of Interest Rate Spreads

Contract Risk

- Terms & Conditions
- Termination/cancellation language in TO



Determinants of Interest Rate Spreads, Cont'd

Project Risk

- Evaluation of Economics & Technology
- Equipment Manufacturer
- Energy Savings Guarantees
- Performance Assurance requirements.
- Operation & Maintenance
- Project Size
- Project Term: Construction & Performance Period

Determinants of Interest Rate Spreads, Cont'd

Participant Risk

- Utility Risk
 - Utility Credit Quality
 - Utility Experience
 - Documentation: "Market" Master Purchase Agreements (MPAs)

– Agency Risk

- Payment History
- Acceptance Risk
- T for C Risk
- Optimal government contracting

Credit Quality and Experience

- Not all Utilities created equal credit quality and experience are a consideration
- Majority of Utilities are investment grade credit or have parent corporation's guarantee
- Non-investment grade Utilities considerations
 - Letter of credit
 - Prime subcontractors as credit/experience backstop for performance risk

"Market" Master Purchase Agreements

- Executed MPAs between financier and Utility in place
- Not all MPAs created equal
- Prior to acceptance: 100 percent recourse to the Utility
- Post acceptance: investment grade credit or equivalent for performance shortfalls and in the event of a default

AGENCY LATE PAYMENT ISSUES have resulted in higher spreads or the loss of investors over the years.

- Agencies should pay on time.
- Direct funds to the "right place." Even though Agencies have acknowledged the Notice of Assignment they, at times, pay the Contractors directly. This misdirection requires a payment search and results in late payment receipt by investors.

Agency Late Payment Issues, Continued

AGENCY LATE PAYMENT ISSUES have resulted in higher spreads or the loss of investors over the years.

- Agency and Prime Contractors personnel need to be responsive during a late payment collection process.
- Comply with the Prompt Payment Act and pay interest on late payments.

Competition Can Cut Financing Costs

Competition cut interest rate premiums in half



Same Projects for 27% Less

- Using post-reform financing rates, the sum of payments for the average project* is 27% lower than with prereform rates.
 - *Average project is calculated from all DOE IDIQ ESPC awards, excluding ARRA-funded projects.





Competition and Financing

- Utilities typically use third party finance companies (instead of internal funding) and enters into Master Purchase Agreements.
- Utilities should compete the financing and receive at least three financing bids from qualified finance companies
- Recommend using standard forms such as the Investor Deal Summary (IDS) and Standard Financial Offer (SFO).

Competition and Financing, Continued

- Give each of the financiers adequate time (at least two weeks) to respond.
- Understand the details of the TO financial schedules, the SFOs, check the calculation of construction-period interest and other elements of the Financing Procurement Price (FPP).
- Confer with the FEMP team, as needed.

Compare Offers with Investors' Deal Summary

- Establishes a common basis for solicitations
 - Utility can solicit offers from financiers using the IDS (the same form and information in every solicitation)
 - Every potential offeror gets exactly the same information
 - Ensures that all the offers are based on the same parameters

Required content

- All financial info
- Risk, Responsibility, and Performance Matrix
- Key target dates
- M&V/performance assurance info
- See Attachment IDIQ J-11 for a template

SFO (Standard Financing Offer)

- The financiers use the SFO, with all of its required content, to submit their offers so that they're all comparable and the Utilities have the information they need to select the best offer.
- Required SFO contents:
 - Narrative description of financing package
 - Period of time that offer will be honored
 - Itemization of total amount financed
 - Other terms

• See Attachment IDIQ J-12 for a template.

After analysis of offers and selection of a financier, the Utility should prepare a selection memorandum describing:

- Number of offers solicited and received
- Rationale for selecting the financier
- Reasons why the selection is the best value for the Government
- Whether any interest rate locks or hedge costs are included in the proposals, and the terms and costs of such.

If the financier with the lowest total interest and other financing costs is not selected, the Selection Memorandum shall describe the Contractor's reason for selection, and how price reasonableness was established. This process may be subject to audit by the ordering agency.

Things to Watch Out For

- Were the bids reasonably competitive—if an outlier—ask them to get another bid from a financier likely to be competitive
- Ideally, the utility should provide all IDS/SFOs/Financier responses to you—so you can verify a competitive process and a satisfactory selection
- Watch for fees—make sure cost justifiable
- Utilities incur costs obtaining competitive financing
 - -The utility's financing costs should be included in the project costs and listed as a line item on the pricing summary sheet

I'd Like a Second Set of Eyes on This

• FEMP's extensive team

- Tracy Niro, FEMP Utility Program Manager
- Karen Thomas and the NREL team
- Your Project Facilitator and FEMP FPE
- Bob Slattery and the ORNL team

• FEMP database:

- Complete for ESPCs
- Spotty for UESC
 - Please help us build our data base.
 - Consider eProject Builder

How to Maximize Investment & Value

 Pursue rebates and other incentives from utilities, state public benefit programs, etc. (see FEMP's Web site: FEMP → Project Financing → Energy Incentive Programs)

• Make One-Time Payments:

- Reduce the financed amount
- Reduce financing costs
- One-time savings from avoided expenditures
- Construction-period savings/payments
- Pay it off sooner: Make annual payments at beginning of contract year
 - This is permitted because savings must be greater than payments on an annual basis

Payment Strategies to Reduce Interest Costs



For further information:

- please consider FEMP UESC training
- talk with the FEMP Utility team
- talk with the utilities and financiers--many here today!
- drop me a line: <u>schuyler.schell@ee.doe.gov</u>