2003 Energy

Introduction

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VISN 7

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Why Energy Saving Performance Contracting

- Upkeep of Eight Medical Centers
  - 197 Buildings
  - 8 Million Square Feet
- Scarce resources for installation of energy efficient equipment and the maintenance and repair of existing systems.
- Reduce Energy consumption by 35 % by 2010.

VISN 7 Energy Savings Performance Contracting Overview

- DOE Super ESPC Program
- ESCO
  - AMERESCO
- Technical Support
  - Oakridge National Laboratory

Project Scope

- Initial Audit
- ECM Selection for Detailed Assessment
  - 10 year simple payback or less
  - Facility Condition Assessment D's and F's
- Lights, Chiller Upgrades, Motor Replacements, EMS Upgrades, Water Conservation
- M&V
  - Operating and Maintenance by VA personnel.
  - Minimizes performance period expenses
  - Medical Facilities must maintain and show records of scheduled maintenance. Therefore M&V not viewed as cost burden to VA.

Contract Cost Details

- 36 Measures
- Contract Price
  - $22,318,932
- Contract Savings Per Year
  - $1.8 Million
- Simple Payback 10.62 Years
- Financed Payback 97 Months after buy down
- Interest Rate 5% (3.5 Prime + 1.5 Added)

Funding Sources

- Medical Care
  - Operating Funds
    - $1.8 Million Annual Payment from utility savings for 8 years
  - Capital Funds
    - $5 Million Buy Down (Cost Avoidance of Non-recurring Maintenance Projects)
  - Third Party Finance Funds
    - $13,849,789

Buy Down Funds

- Funds Prior to Award
  - Saves interest charges
  - Owner risk viewed as greater during construction period
  - Value judgment based on Risk/Savings
- Funds After Award
  - ESCO/Bank carries cost during construction
  - Increased interest charges
  - Owner minimizes risk and payments to ESCO which can serve as incentive to finish work on time.

Prepayments/ Termination Fees

- When
  - Changes in Scope
    - Infrastructure changes (continuing minor improvements, facility closures, etc.)
  - Termination for Convenience
    - Partial (by ECM) or whole

Why Prepayments Matter to Owner

- Flexibility to use excess funds, thereby not losing them in an appropriation or fiscal cycle.
- Term of contract can be shortened therefore which allows 100% of energy savings to be realized in the owners annual operating budget.
- Allows for termination of partial or whole ECM’s as a result of changes.

Impact of Prepayment to ESCO/Financer

- Finance costs are a pass through expense to the ESCO making prepayment a neutral issue for the ESCO.
- The financer or investor assumes contract will go full term. Early payoffs may result in investor loss if principal payoff cannot be reinvested at an interest rate at or above the contract rate.

Termination Fees

- Fixed Termination Fees (varies 5% ±)
- Make-Whole
  - Considered to lower investor risk. Owner can use as basis to lower basis points added to lending rate.
  - Use by Government has not been widely used.
    - When interest rates are low, risk to owner is low.
    - When interest rates rise, risk increases and pre-payment penalty can be higher than fixed rates if future rates fall below contract rate.
- VISN 7 used make-whole as interest rate (3.5% prime) had significantly dropped and were at all time lows. Basis points were lowered by 50 points by lender.

Termination Fees (Cont.)

- Defeasance Option
  - Allows for placing pre-payment funds during performance of contract into an account by the third-party financier, to be reinvested at a fixed rate, until such time the accrued balance matches remaining principal. At that time the defeasance account is used to pay off the contract terms.
- Included in VISN 7’s contract

Project Financial Decisions

- Planning
  - ESPC can cover wide range of measures.
  - Decision makers must be involved with development
  - Technical input critical to ensure savings are realistic based on actual equipment/systems operations and condition
  - Select ECM’s that benefit energy and have been planned for replacement

Project Financial Decisions (Cont.)

- Compare cost of proposed list of ECM’s to normal capital spending from appropriated sources.
- Select ECM’s that have low risk in becoming obsolete prior to anticipated payback terms due to building improvements, technology changes, etc.
- Consider Buy Down option to reduce finance cost and shorten term of contract.
  - VISN 7 was able to reduced duration as an average to 50% of the useful life of the ECM’s. Thereafter, 100% of savings will benefit operations and or budget planning of future capital needs.

Project Financial Decisions Summary

- Financing projects will cost you, the owner, money. Don't over extend your organization.
  - The more you finance, the more it costs you.
  - Set selection criteria to avoid projects that have high cost and low energy savings benefits.
  - Make use of upfront Buy Down to minimize amount financed
  - Consider finance rates when determining overall scope and size of ESPC. Higher rates add cost and reduce the number of ECM's that can be accomplished.
  - Select pre-payment/termination strategy based on interest rates at time of contract award.