Canadian Industry Program for Energy Conservation

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INNOVATIVE FINANCING: AN INTRODUCTION

FEBRUARY 2002

Innovative Financing
for Energy Efficiency Projects

"Energy Performance Contracting (EPC)," "Energy Services Contract" and "Guaranteed Energy Savings" are relatively common financing terms that all mean the same thing – once an energy efficiency project is completed, the resulting savings pay for it over time. No matter what it is called, this type of contract is an innovative and creative way for companies, including those in the industrial sector, to finance large energy efficiency projects without paying cash up front.

Although the concept is simple, such a contract normally requires a lot of detail, which means that it can take some time to put in place. However, if contractors are confident that the equipment they install will result in energy savings, they may be willing to wait for payment until these savings occur. This can result in a win-win situation for contractors who can offer their products and installation services to a company that might not otherwise be able to undertake the project at that time.

Traditionally, companies make financing decisions based on rules for rates of

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return, return on investment and payback periods that apply to all types of company projects, including energy projects. These rules do not necessarily take into consideration environmental concerns or money saved in the future beyond the acceptable payback period. Manufacturing companies are in business to produce and sell products, and energy used for production has traditionally been seen as a cost of doing business rather than as a savings opportunity. However, as the cost of energy increases, more and more companies are looking for ways to reduce their energy bills and ultimately improve their bottom line. There are many ways to do this, but if financing the cost of energy-reduction projects is an issue, innovative financing techniques can play an important role.

With performance contracting, companies can use a different decision-making process. If the project is structured correctly, the company does not necessarily have to report the costs incurred as a debt on its balance sheet (an accounting practice called "off-balance sheet"). Therefore, traditional company project-financing rules may not apply. The actual performance contract can be treated as on- or off-balance sheet, depending on your company's rules and priorities. There are very specific rules and laws that determine what must be reflected on a company's balance sheet, so you should have your company's accountant and lawyer review the contract carefully if you wish the project to remain off-balance sheet.

Here are a few simple guidelines to keep in mind when considering off-balance-sheet financing:

- The contractor, not the company whose facilities are being modified, assumes all risks for the project, its financing and any savings that occur. In other words, if the project does not realize the predicted savings, the contractor(s) will not be paid. Payments are guaranteed not to exceed savings.
- The company makes no capital investment or capital commitment to the project.
- There is no agreement between the company and the contractor to make fixed monthly payments – the payment amount will vary depending on measured savings. Metering, if not already available in the company, is often installed as part of the contract. For example, if a company's monthly energy bill is usually $200,000 and the installed equipment reduces this to $150,000 in a given month, the contractor receives $50,000 that

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month. This continues until the project is paid in full, after which the company would then keep 100 percent of the energy savings. A company may also choose to share the savings with the contractor – this must be decided when initializing the contract. In this case, if savings are shared 50/50, the contractor and the company would both get $25,000 that month. Although this would extend the life of the contract, the company would begin to realize savings immediately.

- The monthly payments are considered expenses, in the same manner as other utility payments, and are therefore not recorded as debt.
- If the project is to remain off-balance sheet, no asset can accrue to the company at the end of the contract. To accomplish this, the contract should stipulate that the contractor must, in essence, "abandon" the equipment at the company's facilities at the end of the contract period or restore the plant to its original state. The contractor would have no interest in taking back the used equipment, as it would be of no value, and would not want to incur additional costs to re-install the original equipment. Therefore, this does not pose a risk to the company.

This brochure is intended as a simple introduction to an alternative financing concept. If your company is considering an energy project and is interested in performance contracting, you can approach contractors to see if they are familiar with the concept and receptive to its use. Performance contracting, especially in the industrial sector, is becoming more popular because it offers many advantages for all parties. If you and your contractor agree to pursue such a project, be sure to have the advice of your accountant and lawyer as you develop and finalize the contract.

To encourage energy efficiency and the reduction of greenhouse gas emissions, Natural Resources Canada's Office of Energy Efficiency has published case studies of performance contracting in industrial settings and many other examples from the public, education and health care sectors, where performance contracting has been used for several years. There are also publications on other financing methods that may provide alternatives for your company. Some of these are listed on the following page.

Learn More

Free Publications Available

Below you will find a number of documents that discuss financing methods in various sectors. These free publications can be ordered by calling 1 800 387-2000 toll-free, by faxing this form to (613) 947-4121 or by mailing this form to Natural Resources Canada, Office of Energy Efficiency, 580 Booth Street, Observatory Building, 2nd Floor, Ottawa ON K1A 0E4.

Publication Title	Qty.	Cat. No.
Industrial Case Studies and Other Industrial Information		
❑ *Tax Incentives for Business Investments in Energy Conservation and Renewable Energy*	___	**M92-159/1998**
❑ *DuPont Canada Turns to Energy Performance Contracting: Innovative Financing Case Study*	___	**M27-01-1653E**
❑ *Energy Performance Financing Drives Project at Ford Canada*	___	**M27-01-1656E**
General Financing Publications from Sectors Other Than Industrial		
❑ *Barriers to Financing Energy Savings Projects*	___	**M92-92/1995E**
❑ *The Energy Innovators: Energy Performance Contracting Primer*	___	**M27-109/1993E**
❑ *Financing Options for Energy Management Services*	___	**M27-01-547E**

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