EASY ACCESS TO ENERGY IMPROVEMENT FUNDS IN THE PUBLIC SECTOR

The simple choice for energy efficiency.

ENERGY STAR

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Financing Alternatives to Cash or Bonds

Are you postponing the installation of energy efficiency projects because the money is not in your current budget? Do you find yourself weighing the benefits of installing energy efficiency equipment today against the hassles and expense of requesting new or additional debt? Are energy efficiency projects being delayed because you are understaffed?

If you answered "YES" to any of these questions, you will be happy to know there are several simple, fast, legal, and well-tested financing alternatives that may address your concerns.

In the public sector, two of the most popular mechanisms for financing energy efficiency projects are performance contracts and tax-exempt lease-purchase agreements. A performance contract, while not a financing mechanism on its own, bundles performance guarantees together with one or more other components such as financing, equipment purchases, maintenance, measurement, verification, and others.

Both mechanisms provide effective alternatives to traditional debt financing, and both may allow you to pay for energy efficiency upgrades by using money that is already set aside in your utility operating budget. By spending only operating budget dollars, you may avoid the cumbersome capital budget process altogether. Both mechanisms allow you to draw on dollars saved from future energy bills to pay for new, energy-efficient equipment and projects today.

Tax-exempt Lease-purchase Agreements

A tax-exempt lease-purchase agreement, also known as a municipal lease, is closer to an installment-purchase agreement than a rental agreement. You will own the equipment after the finance term is over. One big benefit of a lease-purchase agreement is that the lessee's (borrower's) payment obligation may be arranged as a series of one-year renewable obligations that terminate if the lessee fails to appropriate the funds needed to make future lease payments. Because of this non-appropriation provision, neither the lease nor the lease payments are considered debt, and payments can be made from the energy savings in your operating budget.

Unlike issuing bonds, tax-exempt lease-purchase financing usually does not require a voter referendum because it is considered an operating rather than a capital expenditure due to the non-appropriation language. However, lenders will want to know that the assets being financed are of essential use, which will minimize the risk of non-appropriation. In fact, your organization may already be leasing equipment, and it may be surprisingly easy to add your energy project(s) to the existing leasing agreement, especially if your organization has a Master Lease (similar to a line of credit) in place with a lending institution.

Performance Contracting

Performance contracting is also an effective way to fund efficiency improvements, if savings can be easily measured and documented. Energy service companies (ESCOs) frequently assume the performance risk of the technologies they install and will often guarantee a certain level of energy cost savings that can be used to pay for new equipment and deferred maintenance. An ESCO may bundle in the financing needed to replace, repair, and maintain HVAC, control, and lighting systems as part of an energy performance contract. However, when evaluating performance contracts, your organization may benefit from separating the financing activity from the performance guarantees. By unbundling the financing from equipment performance, you may be able to take advantage of lower, tax-exempt interest rates or combine this financing with the financing of other projects. There are many types of Energy Performance Contracts (EPCs), including guaranteed savings, shared savings, Managed Energy Savings, and Efficiency-Services Agreements—each with its specific benefits and costs.

Table 1 summarizes the benefits of these two popular financing mechanisms and compares them against issuing bonds or paying cash. Remember that statutes vary from state to state, so be sure to ask your tax advisor to ensure that the lease agreement complies with state provisions.

Table 1: Financing Mechanisms

	CASH	BONDS	TAX-EXEMPT LEASE	PERFORMANCE CONTRACTS
Interest Rates	N/A	Usually the lowest tax-exempt rate	Low tax-exempt rate	Can be taxable or tax-exempt
Financing Term	N/A	May be 20 years or more	Up to 12 years is common and up to 20 years is possible large projects	Typically up to 10 years but may be as long as 15 years
Other Costs	N/A	Underwriting legal opinion, insurance, etc.	Usually none	May have to pay engineering costs if contract not executed
Approval Process	Internal	May require taxpayers' approval or public referendum. Bond counsel opinion letter required.	Internal approval needed; simple attorney letter required	RFP usually required; internal approvals needed
Approval Time	Current budget period	May be lengthy; process may take years unless you can piggy-back on an upcoming issue	Fast; generally within a couple of weeks after submitting all requested documentation	Fast; similar to the Tax-Exempt Lease
Funding Flexibility	N/A	Very difficult to go above the dollar ceiling	Payments may be arranged as a series of one-year renewable obligations based on savings. Also, a Master Lease can finance different assets under one agreement	Relatively flexible; an underlying Municipal Lease is often used
Budget Used	Either	Capital	Operating or Capital	Operating or Capital
Largest Benefit	Direct access if included in budget	Low interest rate because it is backed by the full faith and credit (taxing powers) of the public entity	May allow you to buy capital equipment using operating dollars	Provides performance guarantees which help approval process
Largest Hurdle	Securing enough money for available projects	Reluctance to issuing debt. Usually very time consuming	Identifying the project(s) to be financed	Identifying the project to be financed and selecting the ESCO

Starting Point

A good starting point is contacting your state's energy office to see if special programs are available for your organization (see www.naseo.org for your state's listing). Several states also have Green Banks, which are public or quasi-public financial institutions that use public funds to leverage private investment for energy projects.