GESPC-U Lesson #103:
How to get to yes or no: The Decision-Making Factors

FYI: Terms and Acronyms can be found on the last page

Summary: What are some of the considerations and common misunderstandings that may influence the decision to enter into a performance contract.

In this lesson, we look a little deeper into some of the important considerations you will likely weigh while trying to decide if performance contracting is right for your situation.

Maybe your facilities have been limping along for years, despite their long-term issues. And now, those long-term issues have turned into immediate, or even emergency needs that simply have to be addressed.

Yet, the biggest challenge is still the same -- there isn’t enough funds in your budgets to take care of these crucial issues.
Along comes someone, maybe a colleague, a neighboring government entity, a presentation by the State Energy Office or the NC Chapter of the Energy Services Coalition, or perhaps an Energy Services Company (ESCO) salesperson, and they say, “you might want to consider energy performance contracting.”

Most may ask, “What the heck is it? How does it work? Where does the money come from? Where do I go get good reliable information on the process? Has anybody done this? and, how will I ensure that we get what I need fixed and at a fair value?”

Lesson 101 and 102 touched on a little history and the fundamentals but in this lesson, we will address these specific questions.

Performance Contracting is a means of finance, it’s a competitive procurement that includes a scope of work for implementation, construction and services all wrapped into one. For public entities it is accompanied by a contractual guarantee that the annual cost savings projected to accrue from the work of the project will cover all costs -- including the principle and interest of your upfront financing.

Where the upfront money comes from is another question. Funding relies on a 3rd party solution. It uses traditional financing methods such as issuing bonds (and there are lots of different kinds of bonds to consider), or a bank loan, or a type of lease. In NC this is typically a bank loan. But to be sure, the appropriate source to compare financial products and how they best fit your project is a registered municipal advisor; that’s their job.

Nevertheless, while these options all sound like new debt, and maybe they are; remember performance contracting is founded on a guarantee that the utility and maintenance cost savings will cover all repayment costs. So, the debt question is best left to a knowledgeable
accountant and your credit agency. In some states like NC this is the
decision of the State Treasurer.

Hopefully you now understand the concept. But there is still more to
know. Like whether performance contracting will solve your needs?
And, even more importantly, how do you get to the go/no go decision?

For starters, let’s review some foundational concepts. Almost every
state has a pretty unique enabling statute empowering, if not endorsing
the use of performance contracting. In NC this can found under GS
143-64.17. All enabling legislation can be found on the SEO website as
well.

Reading and understanding your statute and knowing its big picture
tenets is very important. Things like, what sorts of measures are
eligible, what the savings pay for, the contract term in years, can you
contribute appropriated funds, and if a guarantee of savings is required
just to mention a few. It may also provide basic required minimum
qualifications for energy service companies or ESCOs to participate as
prequalified providers. It may require a state agency with certifying
qualified providers. Additionally, does your statute charge a
department or agency with guiding the process, and if it does that
should be your next stop. For NC that agency is the State Energy Office
for both the certifying and the oversight.

The fact that there is performance contracting-specific legislation
should in and of itself provide a level of comfort, knowing that this
process has been well thought out and is indeed supported by your
state. Knowing that NC has a valuable resource to help governmental
units through the process should by first call if you are thinking about
doing a performance contract.
Armed with a knowledge of the concept and an understanding of the laws in your state – now you can start to explore if it is the right solution. And what do you need to know to determine if it’s right for you?

So, what else do you need to know? Well most want to know if the savings are real and can be relied on, will I get this stuff at a fair price and what happens if the savings don’t accrue?

Most of what we are talking about is black and white – devices using X amount of energy and replacing them with devices that use Y amount of energy will result in a savings -- as long as you use it in the same way for the same amount of time.

The performance contracting model provides a guarantee to protect you and when there are shortfalls the ESCOs write checks to cover the difference.

So, the guarantees are absolutely something you can count on.

Plus, it should be known – the building owner is not the only one worried about meeting the savings projections. ESCOs have reputations to protect, and it is in their best interest that their projects perform as guaranteed.

In order to confirm the guaranteed cost savings are achieved each year, the ESCO and you will develop a mutually agreeable Measurement and Verification process to document and demonstrate the cost savings each year of your contract. While the ESCO does provide a methodology about how energy savings will be measured and verified, the owner needs to have the wherewithal to understand the methods being used and the calculations. If the owner does not have this
expertise (most don’t) then it is recommended that you hire a 3rd party engineer to look after the owner best interests.

Remember, if the cost savings are not achieved in any year, as guaranteed, the ESCO will pay you the amount of the dollar savings shortfall so you can continue to meet your financial obligations.

What about some of the myths about what performance contracting is -- or isn’t?

There are a few that leap immediately to mind. “I don’t want someone from the outside to take over my facilities.” “I won’t risk having someone come in and make all the decisions and leave me with brands and operational strategies that we can’t live with.” But the truth is this is not how it works. As a facility owner -- these are your facilities and you do not lose control of your facilities if you enter into a contract -- you become a part of the decision-making process for all the decisions right down to the brand of product used. As part of the process, the owner and the ESCO will agree to Standards of Comfort. This will be discussed later in the IGA phase.

That truth can’t be emphasized strongly enough. Your organization will provide continuous oversight of all aspects of the project. Nothing will be done without the owner’s knowledge and mutual consent. It should be noted that if the owner chooses not to direct the ESCO, this could create issues and you will not get the project you want. Be prepared to spend time on this or any other project. Your time will be well spent.

So, then you arrive at the decision to enter into an energy performance contract – the contract will explicitly define these responsibilities. And if it doesn’t, you should see that it does. Understanding your contract with the ESCO and your respective responsibilities is very important --
and one you control by creating a very well written contract. You can even write into the document the review of subcontractors for the project, or the opportunity to recommend local subcontractors. Your legal department will need to be involved early in the process. In NC, a lawyer is required to provide a legal opinion of the contract documents as part of the final approval.

It has often been described this way, “If it was me – would I want to be in an oversight role with a single company – or with multiple companies and all the various aspects of procurement and design?” It is a whole lot easier if you are looking over one sole source for your project. In a performance contract you are looking to an ESCO to be that single source for everything from how devices get installed to proving how and whether the guaranteed savings are achieved.

Another recurring misunderstanding is related to the cost and pricing of performance contracting projects.

As public stewards of funds -- procurement officials are charged with making sure they pay a fair price for a scope of work and solicit multiple participants to respond. If you are working with a single source how do you make sure you get a fair price?

When the ESCO is selected, it’s by a means of competitive procurement. ESCOs have submitted a percentage of markup for everything from engineering and project management to overhead and profit. It is open and transparent, but most of all you are allowed to negotiate. I recommend that you take advantage of it.

And regarding subcontractors, systems and devices, the owner should be working alongside the ESCO to review and approve all solicitations, bids, vendor specifications, subcontract documents and costs.
Knowing you’re entering into a partnership and an agreement for full and open transparency can go a long way toward assuring that you’re making a sound business decision. But you have to take time to do your job and spend time making sure you are getting the best value for your money.

Hopefully these helpful insights have clarified some of the common misunderstandings and myths and boosted your confidence level that energy performance contracting may be the best solution for you, your facility and operational needs.

Once you feel comfortable with the information above, please open and complete the quiz below. Email your answers to Reid Conway at reid.conway@ncdenr.gov. If you have additional questions, feel free to include them as well.
Lesson 103 Quiz

1. Performance contracting has many facets. Name some of its key identifying attributes.

2. Where does GESPC funding come from? What are some forms of GESPC financing?

3. Since Dodd-Frank in 2010(?) Some ESCOs no longer provide financing for projects, nor can they provide financial advice. Who can public sector entities consult about the type of financing for a project?

4. Who best determines if the upfront financing for a project is debt or not?

5. What aspects of performance contracting are covered in your state’s enabling legislation?

6. What do end-users need to know to determine if GESPC is right for them and their project?

7. What happens if the savings are not achieved in any fiscal year?

8. Name a popular myth about GESPC?

9. How are ESCOs selected? How do ESCOs cost and price work in a performance contract?
Terms and Acronyms

3rd Party  3rd Party Engineer
COS       Council of State
DOA       NC Department of Administration
DPI       NC Department of Public Instruction
ECM       Energy Conservation Measure
ESA       Energy Services Agreement
ESC       Energy Services Coalition
ESCO      Energy Service Company could be interchangeable with QP
ESPC      Energy Saving Performance Contracting
GEPC      Guaranteed Energy Performance Contracting
GESPC     Guaranteed Energy Saving Performance Contracting
GS        General Statute
GU        Governmental Unit
IGA       Investment Grade Audit
IPMVP     International Performance Measurement and Verification Protocol
LGC       Local Government Commission (Housed in the Treasurer’s Office)
LGU       Local Governmental Unit
M and V   Measurement and Verification
OR        Owner’s Representative
OSBM      NC Office of State Budget and Management
PC        Performance Contracting
Pre-Bid   Meeting held prior to the bid opening
QP        Qualified Provider could be interchangeable with ESCO
QR        Qualified Reviewer
RFP       Request for Proposal
SEO       State Energy Office
UNC       Refers to the UNC System
USI       Utility Savings Initiative