Pros & Cons of Guaranteed Energy Savings vs. Shared Savings Performance Contracts
(As of February 2013)

Guaranteed Energy Savings Contracts
In a performance-based, guaranteed energy savings contract, the Energy Services Company (ESCO) guarantees a specific reduction in energy use if required operations and maintenance procedures are followed and contractually specified operating schedules and control set points are adhered to, not necessarily tied to cost savings as utility rates and building operations may change over a defined length of time. If the guarantee is not met due to the failure of ESCO specified and installed equipment and software to reduce consumption, then the ESCO pays the owner the difference based upon agreed-upon contractual utility rates for the annual performance period. Normally the ESCO will investigate the reason for the performance failure and take steps to reduce or eliminate the consumption savings shortfall so that it does not re occur in future years.

Shared Savings Contracts
Traditional model. The ESCO provides financing as well as project development and implementation costs. The ESCO and owner agree upon the estimated consumption savings which are guaranteed. They also agree upon an estimated escalation of future utility costs over the term of the contract. The dollar value of measured consumption savings times actual utility rates using utility bill reconstruction may be divided between the Owner and the ESCO. A typical division of the value of future savings would be 85% for the ESCO and 15% for the Owner. The ESCO can define a payment structure where their sole compensation is a share of the utility cost savings, based on a percentage split. The ESCO would receive the largest share in the beginning due to its up-front investment; but, the ESCO share may decrease over time depending upon the term of the agreement and the escalation rates which actually occur during that term.

Managed Energy Savings Agreement (MESA. An Investment Fund pays the building owner's on-going utility bill directly and charges the building owner a fixed monthly fee.

OR the ESCO sells a portfolio of improvements to a third party ownership company. The Owner receives utility cost savings, remits a set percentage back to third party, and retains the balance. The project may be off balance sheet. The ESCO operates and maintains the improvements under a separate contract.

OR The equipment is financed and owned by the ESCO. The Owner continues to pay the utility bills and pays the ESCO a portion of the savings. Due to the large up-front investment, a greater percentage of savings goes to the ESCO.

The following table compares pros and cons of Guaranteed Energy Savings Contracts versus Shared Savings Performance Contracts.

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<tr><th>Pros</th><th>Cons</th></tr>
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ESCO provides financing as well as project development and implementation costs. The owner will still bear the interest rate risk because it is a pass through cost. Shared savings does not insulate owners from utility rate risk, as only a very foolish ESCO will assume a risk which they cannot control. ESCO will agree to a fixed share of savings, but the value of consumption savings increases as utility rates escalate.
Owner gets the immediate advantage of consumption savings without making capital investment or assuming debt.
Percentage distribution of the value of consumption savings is agreed upon in advance and documented in the contract.
ESCO agrees that Owner will not pay more for utilities than the Owner would have paid if there were no contract. Utility escalation is still a risk to both Owner and ESCO. Without a contract the Owner will face the full impact of rising utility rates. With a shared savings or guaranteed savings contract that risk will be mitigated to some degree due to lower consumption, but not eliminated.
If no consumption savings, Owner pays energy bill and owes ESCO nothing for that period.
Depending on agreement, if there is no dollar savings, ESCO is still responsible for meeting financial obligations associated with equipment purchase. There will almost always be dollar savings associated with consumption savings, the question is whether the value of those savings is sufficient to cover the ESCOs costs. Since ESCOs get a fixed percentage of savings, it is possible that the savings will not be sufficient to cover their costs, and they will take a loss.
Depending on the agreement, at end of the contract the equipment Ownership transfers to Owner. This is also true of guaranteed savings in terms of the ultimate outcome.
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ESCO may receive a higher percentage of the savings at the beginning of the contract term. This is very likely due to the higher cost of financing.
Owner may need to provide for savings measurement and verification and continuous commissioning to ensure that savings and equipment performance levels are achieved. This is actually more important in shared savings agreements as Owners are incentivized to claim consumption savings shortfalls so their payment obligation to the ESCO is lower.
ESCO financed projects are more expensive and less capital efficient and Owners have a strong incentive to challenge consumption savings to reduce payment obligations resulting in shared savings structure rarely being favored by Owners.
Shared savings contracts are more complex than guaranteed energy savings contracts.
Issues re “on” or “off” balance sheet treatment and other accounting requirements.
Owner’s share may be smaller than in a guaranteed savings contract.
May need to utilize innovative structures such as “split incentive”.
Owner will pay higher (non-tax exempt) interest rates by relying on ESCO financing which can be two to three times higher than tax exempt rates
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