Why Many Federal Energy Projects are Privately Financed

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Presentation

- Background
  - Federal agency energy projects frequently are privately financed
  - Congress initiated this mechanism
- Yet federal borrowing rates are less than private
  - What is the annual cost?
- Why are agencies supportive of private financing?
- What alternatives might there be?
- Conclusions

Is this fiction or reality?

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Background

- Congress has empowered federal agencies to borrow directly from private sources to fund energy projects
  - Energy Service Performance Contracts (ESPCs)
  - Utility Energy Service Contracts (UESCs)
  - Power Purchase Agreements (PPAs)
- Primary legislative vehicles:
  - Energy Policy Acts of 1992 & 2005
  - Energy Independence & Security Act (EISA) of 2007
- Under the three contractual mechanisms, private parties provide energy efficiency and renewable energy to agencies
  - They also provide the financial wherewithal
  - Monies are repaid via savings over time

Magnitude of Federal Agency Energy Investments

- New ESPCs in FY16: $875 million
- New UESCs in FY16: $197 million
- New PPAs are not tracked
  - But US Armed services have each committed to install 1 gigawatt of renewable energy by 2025
  - Army has committed to $7 billion multi-year program
- Overall, federal agency investment in energy projects is running at least $1 – 1.5 billion per year

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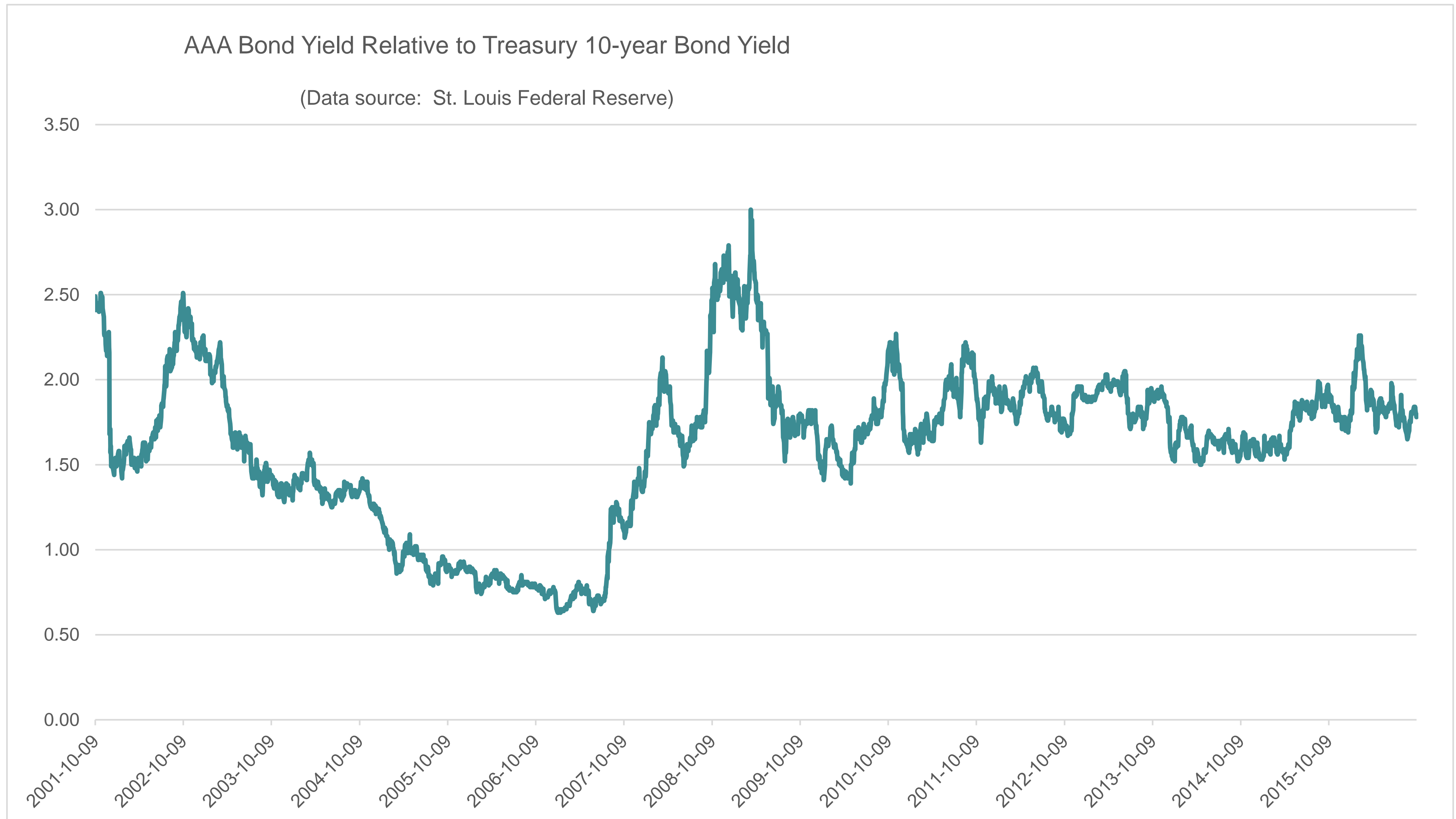
What is the interest rate differential between private and federal sources?



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Annual Cost of Federal v. Private Energy Borrowing

- Assume:
  - $1 billion per year in agency energy financing
  - 1.5% average interest rate differential
- Annual cost then is $15 million
  - At this rate of borrowing, the annual cost would amount to around $100 million/year after 7 years, $150 million after 10

Why are Agencies Supportive of Private Financing?

- The law
  - FEMP's General Counsel has ruled that it is illegal to finance agency energy projects through public monies (other than appropriations)
  - EISA states that either appropriations or private financing may be used; does not specifically preclude other means, but only mentions these two
- The color of money
  - From a single agency's perspective;
    - Tax breaks are available to private party energy investment that are not available if the agency does the investing. These "savings" partly offset the advantage of Treasury financing.
- Convenience
  - Annual appropriations are uncertain with respect to both timing and amounts, while private financing is always available if projects can be shown to pay for themselves
  - ESPC & UESC mechanisms are well understood and the Federal Energy Management Program (FEMP, a part of DOE) is prepared to assist agencies to implement them

Why is Congress Supportive Despite the Cost?

- Likes the idea of tapping private capital for public projects
  - In addition to energy projects, Congress has empowered HUD to tap private financial markets under the Rental Assistance Demonstration (RAD) program, which is expanding
- Congress fears that publicly financed, failed projects will leave the public holding the bag
  - Solyndra type failure

  - Policy makers will be blamed by voters
    - (Though could deal with this challenge through a small contingency fund to cover failed projects.)

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Alternatives

- Agencies could bundle their annual energy projects & finance through a federal borrowing entity
  - Precedent: The Resolution Funding Organization, which was established to fund the Resolution Trust Corporation
  - The Federal Financing Bank (FFB)
    - Finances agency borrowing at Treasury rate plus a small increment

- This approach is feasible but would require that a systematic approach be put in place to implement it

Conclusions – So Where are We?

- Apparently, Congress would have to modify EISA to allow agencies to use federal financing for energy projects
- Makes more sense from an overall Federal perspective (e.g., OMB, Treasury) than from an individual agency's
- Savings potential appears large (would build over time to perhaps $100-150 million annually)
- Not on the current policy horizon

What about the $20 bill? For now, looks like the temptation to pick it up is left to the birds!