Why Many Federal Energy Projects are Privately Financed

Michael E. Canes
Logistics Management Institute
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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?
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:

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

AAA Bond Yield Relative to Treasury 10-year Bond Yield

(Data source: St. Louis Federal Reserve)
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.)
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!