Third-party financing for energy efficiency investments

Background
Maintaining the Federal Columbia River Power System, or FCRPS, and providing low-cost power requires substantial financial investments.

Ensuring continued access to financial capital is critical to BPA’s ability to continue to make system investments and deliver long-term value to the region. By statute, BPA is authorized to issue bonds directly to the U.S. Treasury and this provides the principal means for BPA to obtain needed financial capital.

However, there are strict limits on how much BPA can borrow from the Treasury, so BPA uses other authorities to obtain indirect access to private financial markets to finance necessary system investments. BPA calls these approaches “third-party financing” because another entity issues debt to capital markets to obtain the funds for project construction and implementation, and BPA commits to provide the third party with payments or other financial support in amounts sufficient to assure that the third party repays the debt over time.

BPA is proposing to use third-party debt to support the Energy Efficiency Incentive, or EEI, portion of Energy Efficiency’s capital budget. If implemented, this will be an important tool to help BPA supplement its access to financial capital from the U.S. Treasury. It will assure that BPA’s limited U.S. Treasury financing ability remains available for other purposes where third-party debt approaches are unavailable, such as financing investments in federally-owned hydroelectric projects.

The proposal will require substantial customer outreach, contract development and the resolution of a number of issues in short order to enable the proposal to launch in fiscal year 2016.

Key points
The way customers interact with BPA’s energy efficiency program will not change.
Regardless of the funding mechanism, customers will still have an Energy Conservation Agreement, or ECA, and will conduct energy efficiency activities and report them to BPA as they do currently.

Customers will receive their payments from a trustee bank.
Currently, payments to customers for their energy efficiency activities originate from BPA. BPA will continue to manage the documentation and other interactions regarding payments, but customers will receive the payments from a trustee bank, which holds the funds received by the third party from its debt issuances.

Customers’ payments will not change.
Third-party financing will not change the amount of the payments that customers receive for their energy efficiency activities.

Access to capital is strategically critical.
Third-party financing is a vital tool to enable BPA’s continued access to capital and to help ensure BPA
has the financial resources necessary to maintain its infrastructure for the region.

A third-party will be added as a signatory to Energy Conservation Agreements. Currently each ECA is a two-party agreement between the customer and BPA. Under third-party financing, each ECA will be a three-party agreement. Language will be added to each ECA to identify the terms applicable to the customer, BPA and the third party.

Description of the financing model

Third-party financing for energy efficiency investments would be supported by BPA-backed bonds, with BPA providing amounts to cover debt service. A third party would issue the bonds (tax-exempt to the extent possible) with proceeds from the bonds used to provide EEI funding to BPA’s customers. The total cost to BPA would be similar to using Treasury borrowing since the interest rate on third-party financing should be comparable to Treasury borrowing rates.

Under the third-party financing model, each customer would sign a new ECA, to start Oct. 1, 2015. As stated above, these ECAs would also be signed by BPA and the third party providing the financing. Customers would continue to conduct and report efficiency measures as they do now, and BPA would continue to design program specifics and approve invoices. The key implementation difference is that customers would receive their payments from a trustee bank instead of from BPA.

In addition to the three-party contract, BPA and the third-party bond issuer would also sign a two-party contract committing BPA to make payments to “acquire” the energy savings from the third party. The acquisition payments from BPA will include amounts to pay debt service on the bonds.

Questions and answers

Why is BPA going to use third-party financing for energy efficiency now?

BPA is pursuing third-party financing for energy efficiency to conserve its limited access to U.S. Treasury borrowing authority. BPA proposed and decided that it would pursue third-party financing in its Capital Investment Review and further explained this direction during its Energy Efficiency Post-2011 Review.

Why move away from U.S. Treasury borrowing?

Preserving and enhancing the Federal Columbia River Power System is one of BPA’s top priorities, and BPA requires significant capital investment for this aging infrastructure. Estimates show BPA’s projected capital needs will exhaust its Treasury borrowing authority by 2027 under the current financial structure. This estimate includes the assumption of third-party financing for energy efficiency starting in fiscal year 2016. If Treasury borrowing authority were exhausted, BPA would be forced to finance capital projects with current revenue, or to cut capital investments.

To help ensure BPA preserves its access to capital, BPA is financing investments through means other than Treasury borrowing authority where prudent. Energy efficiency is one programmatic area where this approach makes sense.

How will third-party financing be affected by the changes proposed in the Post-2011 Review, such as funding energy efficiency as an expense?

If BPA transitions to expense funding for energy efficiency, third-party financing would continue to serve as a funding bridge for as long as necessary. The
third-party financing program could be reduced or eliminated if another funding mechanism were employed, but it would still be an important near-term tool in the agency's access to capital strategy. Until such a decision is made, it is important to capture the benefits that third-party financing provides in conserving BPA's Treasury borrowing authority.

**Wouldn't funding energy efficiency as an expense be better than third-party financing?**

Not necessarily. Funding EEI as an expense rather than as a capital investment would save interest costs over the long-term but would entail significant near-term power rate increases. Also, this approach would not provide additional access to capital beyond what would be provided by third-party financing.

**How do conservation billing credits relate to third-party financing?**

Customers that choose billing credits would provide their own capital funding and would not receive an initial allocation of EEI funds, thus reducing the total to be borrowed through third-party financing. BPA is proposing to offer billing credits starting in October 2015, pending the outcome of a public review of the issue.

**Would customers pursuing billing credits still sign an ECA with third-party financing?**

Yes. Doing so would allow the customer to be eligible for distributions through BPA's unassigned account or bilateral transfers of EEI funds from other customers.

**How does this program differ from previous third-party financing efforts?**

In 1994, BPA pursued a third-party financing program for energy efficiency called the Conservation and Renewable Energy System, or CARES. This program relied on the third-party entity to act as the program administrator, which proved to be challenging. The arrangement now being proposed maintains BPA's role as program administrator, making the third party responsible only for helping to arrange the financing. There would be no change to customers in how they implement their energy efficiency programs.

**When will customers see the new third-party Energy Conservation Agreements?**

The existing ECAs will expire in September 2015. Starting early in 2015, BPA plans to share draft third-party contracts with customers for review, and eventually, signing. BPA anticipates that contract review and signing will begin in the spring of 2015.

**Will customers have a choice of whether to sign a three-party contract?**

Starting in 2016, customers will be expected to sign a contract using third-party financing if they want funding under BPA's EEI program. Special consideration will be given to federal agencies that cannot sign such agreements.

**Who will the third-party financing entity be?**

BPA has asked Energy Northwest to consider serving as the regional third party for this program and anticipates Energy Northwest's final response in early 2015. Other options for third-party financing of the EEI are under consideration. Under this program, BPA would cover the third party's administrative costs.

**What is the cost of third-party financing for energy efficiency compared to U.S. Treasury borrowing?**

Funding energy efficiency investments through third-party tax-exempt municipal bonds is expected to be roughly equivalent to U.S. Treasury borrowing in terms of interest rate costs. The third-party debt will have BPA financial support and will therefore receive BPA's strong third-party debt credit rating, which will be reflected in comparatively low interest expense.
An illustration of the financing mechanism

Next steps in the process

Winter 2014–2015 ............ Identify third-party issuer

Winter – Spring 2015 ...... Customer review and comment period for draft three-party ECA

Spring – Fall 2015 ............ Sign final contracts

Oct. 1, 2015 .................. Contract implementation

BPA’s Power Services account executives and energy efficiency representatives will gather feedback and communicate regularly with customers about important dates and developments throughout the process. BPA customers may contact their AEs or EERs for additional information.