WORKING DOCUMENT:
ANALYSIS OF THE IMPACT OF EUROSTAT NOTE on local authorities' investments in energy performance contracts (EPCs) for energy efficiency buildings renovation

RenoWatt is a one-stop-shop set up in 2014 by GRE-Liege. It helps local authorities to launch large scale energy efficiency projects. Thanks to the one-stop-shop so far 5 EPCs for almost € 60 million euros on behalf of 12 public authorities (including 1 hospital) have been successfully launched.

EPC financing is carried out by the public authority itself (debt or own capital). The Region does not guarantee any of the loans. As energy savings are guaranteed, the Region allows public authorities to realise EPC expenses on top of other expenses ("outside municipalities budgetary constraints").

On September 19, a clarification note from Eurostat was presented and the way EPCs are accounted on municipal budgets has been further addressed and clarified.

On the one hand the note contains some good news for the different Member States; all energy efficiency investments realized under an EPC framework can be recorded out of the government balance-sheet. On the other hand after a detailed analysis it seems that the note can have a serious negative impact on the level of the energy efficiency investment and its costs.

For instance, in the case of RenoWatt, by applying the new Eurostat guidance note, for the same level of energy efficiency, the total amount of interests would be 6 times higher. On top of this, the note would require to have minimum contracts of 20 years, which is considered to be a too long framework both for the public sector and the ESCOs.

Context of the Eurostat Guidance Note

On September 19th 2017, Eurostat published a new guidance note on the recording of energy performance contracts (EPC) in government accounts. This guidance note substitutes the previous guidance note published on August 7, 2015.

In particular, the guidance note clarifies that[1]

- if an EPC-contractor is bearing **the majority of the risks** and rewards associated with the use of an asset, the EPC-contractor shall be regarded as the economic owner of this asset;
- in the case above, EPCs can either be accounted for by using the **operating lease treatment or the buy and leaseback model**;

[1] Source: European Commission, Eurostat, Guidance Note September 19, 2017

- if the operating lease is used, this will be **applicable for both removable and non- removable assets;**

Analysis of the pros and cons of the Eurostat note

RenoWatt model is built under the operational lease model, the following note focuses on the conditions for an operational lease model to be deconsolidated :

- *In the case of operating lease, removable and non-removable assets can be included in the EPC*.
    - This is good news as **deep insulation works** can be considered in the deconsolidation if covered by EPC.
    - The **minimum pay-back period is 20 to 25-years** when insulation measures are combined with other basic energy efficiency measures.
- *The EPC contractor needs to bear the majority of the risks and rewards*
    - "The remuneration of the EPC contractor can only be determined by the energy savings achieved through the upgraded equipment….The capital expenditure (energy efficiency measures) undertaken by the EPC-contractor is paid back from the revenues it realises over the term of the contract. If the necessary savings cannot be achieved over the term of the contracts, the EPC contractor has to cover the gap." **It means that the length of the contract will need to be long enough to enable energy savings to cover the reimbursement of the energy efficiency investments.** As we talk about deep renovation investment, **EPC contracts will have a period over 20 years, which is way too long.**
    - "In order for the EPC contractor to bear the risk and rewards of the underlying asset, the EPC contractor cannot benefit from clauses such as a minimum revenue guarantee or similar arrangements in substance, entered with government." It means that **the ESCO needs to finance all the energy efficiency investments WITHOUT any guarantee from the government** / public institution. According to our researches, **the interest rate would raise from 1.3% if a public entity contracts the debt / gives a guarantee, to 7%** if an ESCO contracts the debt without any state guarantee. In the case of RenoWatt investments,
        - Taking into consideration that public authority would like to have a balance cash flow (energy savings finances the energy efficiency investments as well as the interest expenditures), this would have decreased the overall EPC contracts from € 59 million (€39 million in capex and €20 million in operational maintenance) down to € 38 million (€ 25 million in capex and €13 million in operational maintenance)
        - Only 37 sites would have been renovated (against 64 sites)
        - The interest expenditures would be multiplied by 6, i.e. 17.3 million higher than the current expenditures if RenoWatt initial investments were confirmed

Risks

Governments can choose whether the most important point is to deconsolidate EPC or not. However, as governments are more and more looking for alternatives to lower the level of their debt, this Eurostat guidance note, if not well understood, might have as consequence that all EPC needs to be contracted outside the state-debt. The consequences will be

- A higher costs for public authorities,
- A slowdown of the energy efficiency investments as such.

Conclusion

In conclusion, although at first sight, the Eurostat Note seems to be a nice "Christmas present" to the public authorities, **it needs to be analysed carefully**. The only winner in this context is the financial sector.

We **recommend that EPCs are considered as productive investment for a public authority** because the energy savings is guaranteed by the ESCO. We recommend however that the financing solution should not to be carried out by the ESCO but by the public authority.