

Financing ESCOs in Transition Economies

Background

The EBRD is committed to developing more efficient uses of energy within its countries of operations. One way of promoting energy efficiency improvements is through Energy Service Companies (ESCOs).

An ESCO is normally a private company which assesses the potential for energy savings in a public or private client's facilities and subsequently designs and implements energy-saving measures. ESCO guarantees energy savings; its remuneration is directly tied to the energy savings achieved. It may finance or assist in arranging financing for the operation of an energy system by providing a savings guarantee. ESCOs operate under an energy performance contracting (EPC) arrangement, whereby the ESCO implements a project to deliver energy efficiency, or a renewable energy project, and uses the stream of income from the cost savings, or the renewable energy produced, to repay the costs of the project. The EBRD takes a broad definition of an ESCO and can finance projects that may deviate from the classical definition.

Why does the EBRD believe in the ESCO concept?

ESCOs have strong transition impact as a private sector instrument to deliver energy savings and offer a win-win solution to end-users and project developers.

- ESCO projects are self-financing as the investment cost is repaid from energy savings.
- ESCO projects can offer an off-balance sheet financing solution to clients which may face debt constraints.
- ESCO projects can offer turn-key solutions which lower the implementation risk of the project.
- ESCO projects may offer ways to segregate credit risk from technical and performance risk.

Project experience and lessons learned

ESCOs are fairly well established in Western Europe and the US, but in the Bank's countries of operations the ESCO sector is relatively underdeveloped, largely due to low energy prices, weak legal and regulatory frameworks, administrative barriers, and low awareness and scepticism of the end-users.

The Bank has been a pioneer in financing ESCO projects in its countries of operations. At the end of

2004, it had financed 15 ESCOs, mostly under Multi-Project Facilities (with Honeywell, Landis and Gyr [now Siemens] and Dalkia). These ESCOs have experienced mixed fortunes and were not always "pure" ESCO projects. This is due to a variety of factors, the main one being regulatory obstacles still hampering energy performance contracting in many of the Bank's countries of operations.

More recently the Bank has been promoting the ESCO concept for public sector facilities, such as schools and hospitals, to kick-start the market by demonstrating the effectiveness of this form of financing and by removing some of the barriers to project development.

What can the EBRD offer?

- A. The Bank can assist in developing ESCO projects and structuring them by attracting **technical assistance** funds from bilateral or multilateral donors.
- B. The Bank can provide **bespoke financial solutions** for ESCO projects, in particular:
 - The Bank can provide debt, equity, or guarantees. Debt can be on a limited recourse basis (without recourse to the parent company), but the Bank will require a technical guarantee. The Bank does not bear ESCO under-performance risk. Debt maturity will match the Energy Performance Contract (EPC), and loans in local currency are possible in several countries, including Bulgaria and Russia.
 - Buying the receivables from ESCO projects (forfeiting) or risk-sharing with another forfeiting institution is also possible.
 - The Bank can finance "start-up" ESCOs with a credible sponsor and provided it has a clear and credible equity exit route for its equity (e.g. a put option with the sponsor).
 - Normally the minimum financing requirement for the Bank is €3 million, but if projects are bundled under multi-project facilities (e.g. like Dalkia) or equity funds, projects can be of a smaller size. For smaller projects, the Bank can also provide a credit line to a partner bank dedicated to ESCO-type projects.

Project examples

Energy Alliance

The EBRD pioneered the first private ESCO in Ukraine, facilitating long-term lease-finance of electricity and co-generation equipment to Ukrainian industrial companies. In 2004, the EBRD signed a US\$10 million loan with the company. Energy Alliance provides a full-service solution to its clients, which benefit from lower energy costs over time. One of Energy Alliance's sub-projects is with an edible oil producer, where power is generated by using peels of sunflower seeds as fuel – a natural by-product, which otherwise would have to be disposed of elsewhere.

EETEK

The EBRD is an anchor investor in the Dexia-FondElec Energy Efficiency and Emissions Reduction Fund, which is a €71 million regional fund focusing on energy efficiency investments throughout the Bank's region. Many investments have been made through a wholly-owned Hungarian ESCO called EETEK, which has developed from a small engineering consultancy firm to a full-service ESCO specialising in project design, implementation and financing. Sub-projects range from a municipal street lighting project to the leasing of co-generation engines and comprehensive outsourcing projects with industrial clients.

Prometheus

The EBRD is an investor in this leading player in the Hungarian ESCO market and subsidiary of Dalkia. The company provides the full scope of energy services with performance guarantees, managing over 350 contracts. Prometheus targets mainly district heating companies and public buildings. Since the Bank's first pioneering investment in Prometheus the ESCO market has seen significant growth in Hungary

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