

September Workshop – Scale up

26 September 2024 - Combined Energy Efficiency FI for public sector building
2nd session: The example of FI for ESCOs/Energy Performance Contracting

2nd Session

The example of FI for ESCOs/Energy Performance Contracting

Presenter: Robert Pernetta, EIB

Presentation: “Combined FI for ESCOs/Energy Performance Contracting”:

- Life cycle and financing of EPC project via FIs.
- Combination in a single and two operations for EPCs.
- State aid challenges for combined FIs for EPC.
- Examples and lessons learnt for EPC FIs:
 - in Marche, Italy for EPC in the health sector; and
 - for public building stock renovation in Slovenia and Czechia.

Note: The answers are provided by the Presenter.

Q: Please clarify the transfer of assets from the ESCO to the public authority?

A: Usually the boiler and sensors, etc. are owned by the ESCO and are transferred at the end of the contract. Common practice is to transfer them for one euro. If towards the end a new boiler is installed, then maybe there has to be a higher price. The local government at the end of the contract should own the boiler and sensors as they don't want somebody removing them.

Follow-up question: How would this work in the financing structure?

A: How this works under national law is very different. But it's also the ESCO has to get rid of the stuff from its balance sheet because it doesn't serve then as a collateral anymore to a bank because it's written off and they can't use it. So, it has to disappear from the ESCOs balance sheet and it should show up somewhere in the municipality's balance sheet. But in the countries I know, this transfer has never been a problem.

Q: Do you see potential for ESCOs to renovate SME production facilities?

A: Yes. In the public sector, the combination in two operations is easier because it's two known elements that have to be coordinated. If an ESCO is working in the commercial sector, it's easier to have a financial instrument in one operation. It depends on the country. In some countries most EPC is in the public sector. In some countries there are no public sector projects, but ESCOs still help optimise production. For example, a food processing company has a freezer and they need heat, they need hot water. So the ESCO would use the excess heat from the freezer to warm up the water. This is quite common in the food processing sector. The risk is higher because an SME is less financially secure than a local government. The counterparty risk is higher. Some banks struggle to finance ESCOs, but it's possible. I would say it's easier to have the ESCO managing the grant element in one operation.



Follow-up question: We're structuring an FI for the circular economy, with energy efficiency in SMEs and large companies. In our investment strategy, we have also this forfeiting of receivables from ESCO companies, and we were wondering whether we should keep this option if we're dealing with SMEs and private sector beneficiaries? These projects usually have a long repayment period when they deal with buildings and the private sector is not interested in such long repayment periods like in the public sector. Maybe for machines and some production facilities this could be possible, but there is very little chance we will have such projects in Bulgaria.

A: I would not exclude it. And maybe when you think about SMEs, you think about production. But for example, ESCOs work very well with hotels. For instance, turning down the air conditioning during the day but ensuring it's comfortably cool when the client arrives. ESCOs can do a lot there to generate savings. And with the hotel, you may agree to a much longer loan than with an SME which doesn't know what its market will look like in 3-4 years, whereas a hotel on the coast of Bulgaria could have a longer-term vision.

Follow-up: Yes, this is a very good example. It's just that the higher risk that the bank will assess would be a problem.

A: Yes, because they're exposed to two risks: the risk that building owner does not pay and the risk that the ESCO is not generating the savings and cannot pay back. Financing ESCOs is complex, and this is why guarantees are very good, better than a loan instrument.

Q: Could you please explain again how the level of grant/capital rebate is determined for two operations or a single operation?

A: Generally, in two operations, it's based on the initial high level energy audit. There you estimate how much grant you need for the project to be viable. We haven't done it yet for a single operation. The tendency in a single operation is not to require a detailed energy assessment from the financial intermediary when there are normally pre-set grant rates. These ESCOs go through a competitive tender procedure. So, even if you think you offer too much in grant, competition

between the ESCOs may reduce the fee the client has to pay, so the grant support through a single operation is passed on to the client.

For one operation, the ESCO takes a loan from a FI to finance the project. After project completion the capital rebate is equivalent to the part that needs to be financed by grant. What is very important here is to prove that this 40% grant element is passed on to the building owner. If the building owner is a public entity, the State aid problem is solved at the level of the building owner. The difficulty is how to address State aid at the ESCO level. De minimis is not a solution as an ESCO does one project and then has to wait three years to do the next one, so that wouldn't work.

Q: In Portugal, we recently launched a guarantee for the tourism sector covering loans to hotels. However, it seems that they find the process to get the capital rebate very complex with lots of requirements. How does it work in other countries? Was it very demanding to get the rewrite or did they use standards that were easy to provide and demonstrate? We launched the guarantee but we are still getting a lot of questions from the banks on the rebate. They want to ensure they can get it because that makes it interesting for them and their clients. Maybe you could elaborate a little on the requirements other countries use for the rebate. These might offer some flexibility on the requirements set by the entity that will pay the rebate.

A: Yes, I don't think we have examples of capital rebates so far because we are early in the programming period and we haven't had the auditors yet to check it - because you only know if something works when you have the audit findings at the end of the programming period. But we can look at the countries that already used capital rebates in national schemes for example, Germany and Poland. In Germany, you apply for the loan with a capital rebate and you need an energy advisor who helps you design the project or who approves it. When the project is implemented, the energy advisor confirms the project has been done in accordance with what was agreed. So, in Germany for example, they do not ask for a second energy audit. And that's quite important because if you get two energy auditors on the same building without anybody ever having changed the building, you can get very different results.



So, it's very important to check the eligibility upfront and only confirm that it is what was agreed on. If for example, the photovoltaic is a bit bigger or bit smaller, you also should have some leeway to say that this is now five square metres more but this doesn't make the project ineligible. So, don't be too strict. I think this should give sufficient comfort to the final beneficiaries. Also, the bank has a document the energy advisor confirms, which is all they need to trigger the capital rebate. Even if something is wrong, they have a paper and they're on the safe side.

Follow-up question: Is the company that provides the early analysis and the confirmation certified by any public entity? How? Do they pre-screen those entities or how do they ensure they are dealing with the right people?

A: In Germany and in Poland there are pre-approved, registered energy auditors. EPC is more complex and only a small group of people are qualified to do the energy audits. In some countries they are certified and listed. For example, in Belgium facilitators are also trained by a public authority. They have a “train the trainer”, to facilitate the programme. If there are too many complaints, they are struck off the list. But we have to separate a normal energy audit from helping someone through the complex issue of EPC.

Q: In Lithuania we don't have a big market for ESCO companies. In the projects you showed in the presentation, are the ESCO companies local or from other countries? How would you recommend to develop the ESCO market?

A: Some countries tell me we have only two problems with ESCOs. There is no demand and no supply. I can tell you what we tried in Latvia, but unfortunately the client changed their mind and there was never a procurement. You can get ESCOs interested in a market, so you have some ESCOs, but for a big renovation you need bigger ESCOs. There may be companies that do similar things but are not yet ESCOs (for instance, construction companies or facility managers looking for additional business), or companies from abroad. We prepared a pitch to foreign ESCOs and other interested parties. When they see a big pipeline of realistic projects, they will come. Particularly ESCOs from neighbouring countries.

So, when you want to create an ESCO market, don't present the most complex project as a pilot. Sometimes it seems that because a project is too difficult to do it with grants, we want to do it with an ESCO. It will fail. If you start with the easy things like lighting or that are heavy on equipment (boiler, photovoltaics), then ESCOs will come. If it's a historic building and there's hardly energy savings, nobody will look at it. In the Czech Republic there are projects with 70% grant intensity because it is a historic building that needs a lot of work. After 20 years of experience, they can cover historic buildings, but you shouldn't start with them.

Q: Does it make sense to bundle projects to address the problem of procurement?

A: Yes, and one example is the city of Ljubljana in Slovenia. They also used ELENA support and talked to ESCOs which said that they only give them renovation of buildings whereas what they are good at is energy management (installing sensors, provide energy savings, etc.). So, in the bundles:

- they added buildings to be renovated for which there was a grant;
- they allowed photovoltaics on roofs; and
- they added new buildings just for energy management. Then the bundle was attractive. Actually, the bundle was so big that the ESCOs struggled to manage it, so the next tenders were smaller. There have also been attempts to bundle projects with different building owners. I would advise against that because it adds massive complexity. It is better to bundle in one city, with one building owner.



Follow-up question: What happens if savings are not achieved?

A: If the savings are not achieved (usually this happens in the first or second year), the ESCO does not get the whole fee – which is why it is important to allow the ESCO to over achieve energy savings. Then they are motivated for the whole period to achieve more savings. In the Czech Republic, over 20 years, one project failed and several didn't generate enough savings in the first years. A question is why the energy savings were not achieved. If the ESCO gives instructions to the building user but the user does not follow them, the ESCO cannot achieve energy savings. Another example is that changes made to the building later may not allow the ESCO to achieve savings anymore. This is the disadvantage of having very long contracts, because sometimes you don't know what will happen in 20 years, e.g. will there be enough kids to fill the whole school or will part of the building be used for a different purpose?

Follow-up question: Is there a need for a separate FI targeting specific needs of the ESCOs or should they go for commercial financing or loan support under ERDF?

A: An ESCO is like any other company. Instead of creating a new instrument just for ESCOs, it would be easier to open eligibility to ESCOs, maybe even provide incentives for fund managers to choose them. Avoid discrimination against them. Try to not exclude them in the tenders or in how the programme is written. A lot of ESCOs belong to big groups so if only SMEs are eligible for the FI, you may exclude large ESCOs. Eligibility could be for SMEs and large enterprises only if the project is implemented through EPC. Also, an Equity FI would be good for an ESCO.

Q: Do you see any constraints from GBER in relation to supporting ESCOs?

A: Yes. It is difficult to do a combination in one operation, especially in a more developed region. The new GBER allows FIs for ESCOs, but it doesn't allow the integration of grants. It is also limited to SMEs, so it does not really work for comprehensive renovation. And for articles 38A and 38B, the grant can only go to the building owner or the building tenant, and the ESCO is not the building owner.



www.fi-compass.eu
contact@fi-compass.eu
© EIB (2025)

European Commission
Directorate-General
Employment, Social Affairs & Inclusion
B-1049 Brussels

European Investment Bank
EIB Advisory
fi-compass
98-100, boulevard Konrad Adenauer
L-2950 Luxembourg