

ENERGY USER NEWS

NEWS FOR BUILDING MANAGERS & ENGINEERS

VOL. 18 NO. 9 • SEPT 1993

Focus on Cash Flow to Persuade Management to Fund Energy Projects

By NEIL H. ZOBLER

DANBURY, Conn.- In today's tough economic environment, convincing management to install cost saving, energy efficient equipment when no capital expenditure dollars are available can be a frustrating experience. Management's common response is that "it's not in this year's budget."

The reality usually is, however, just the opposite! Management may be looking at the capital budget when the payment is already built into the operating budget (in other words, buried in your utility payment!). The question now becomes, how can you access these operating dollars without conflicting with the company freeze on capital spending? The answer is: focus on the project's positive cash flow and not on its Return On Investment!

There is no question that Return On Investment (ROI) is a powerful installation argument. In fact, the EPA Green Lights Program dedicates part of its manual to this specific area. Most business owners understand the financial logic of return on investment. And, IF your company happens to have available cash for investment, this sales argument will be warmly received!

Today, however, governmental spending cuts make headlines and corporate directives are aimed at cost reduction measures without increasing capital spending. Today it may be "politically incorrect" to invest capital dollars in energy saving equipment, in spite of the validity of savings and financial arguments. You may be singing a beautiful investment and environmental tune, however, you may be singing to a

Neil Zabler is president and cofounder of Catalyst Financial Group Inc., an investment banking firm that creates and arranges energy-based finance programs for utilities, manufacturers, and equipment vendors. 203-790-4177

deaf ear!

So, what do you do when your company just doesn't have the capital dollars in their budget to invest?

Some people believe that timing is everything. In today's economic environment, talking about how much money the energy project will put into your company's "pocket" (positive cash flow savings) is a timely justification which will be more warmly received than a request to spend money (albeit "invest" with a great ROI!).

The simple, practical answer to this dilemma is to consider financing the installation and pay for the financing out of the cost savings of the project. In this manner, you are able to assign a portion of the monthly savings to cover the servicing of the financing vehicle, and put the balance back into the bank account! For example, if installing a lighting retrofit will reduce the utility bill by \$3,500 a month, and the cost of a 48 month financing is \$2,000 a month, then by installing the lighting you will have generated \$18,000 a year of positive cash flow! (\$1,500 for 12 months). If you really wish to underscore the cash impact of this installation, you could say that, based on current load and cost per Kw hour, our hypothetical project will generate \$72,000 of available cash savings within the first four years, after which it will generate \$42,000 per year, and all without your company "investing" a dime!

You know that this "positive cash flow" argument will receive careful management consideration.

Finding a financing source willing to underwrite energy projects may be another challenge. There are, however, a few specialized financial groups dedicated to understanding and providing practical alternative financing solutions to these pressing installation needs. Generally speaking, financing alternatives fall into the following

categories:

Finance Lease (lease/purchase): A rental agreement backed by the full faith and credit of the lessee ("borrower"). Finance leases are easily recognized by their "bargain purchase options" (typically \$1.00) which may be exercised by the lessee at the end of the lease term. **True Lease:** Similar to a Finance Lease, this long term rental agreement has a true "fair market value" purchase option which may be exercised by the lessee at the end of the lease term. Because the final decision to purchase the leased equipment is deferred until the end of the lease contract, monthly rental payments are usually expensed for tax purposes. **Shared Savings Agreements:** The installing company/finance source installs the equipment and receives payments from the end-user/host company based on the energy savings produced by the equipment. There are two types of agreements, "fixed" and "true" shared savings contracts. "Fixed" shared savings contracts define the savings based on engineering studies or one-time verifications of savings at the time of project completion and the savings-based payment is not subject to change following project acceptance by the customer. "True" shared savings contracts require the savings be verified periodically and the saving-based payment is subject to change. Shared Savings Agreements are considered by many to be "off balance sheet financing".

In summary, positive cash flow is a powerful, contemporary argument to install energy saving equipment and is guaranteed to attract your management's attention. However, should your company have a "we don't finance anything" policy, you can always revert to the Return On Investment argument!

Whether your company finances the energy equipment or pays for it outright, installing the project makes winners of both your company and the environment! ☺