

Going Green: Managing Risk for Facility Owners, ESCOs and Property Management Companies

NAESCO MIDWEST REGIONAL MEETING

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Importance of Performance Contracting

- Marketing
- Ideology
- Aspiration
- Rating system
- Risk averse
- Ignores risk management
- Minimal opportunity
- Performance
- Economics
- $M + V$
- Contract
- Risk adjusted C/B
- Aggressively manages risk
- Greater opportunity

Performance, Not Aspiration: Economic

- Economic performance:
 - Appropriate financing—debt, equity, blend, cost of money (subsidy)
 - Appropriate understanding of the business objectives of the various parties
 - Risk adjusted cost/benefit analysis—ROI, simple payback, increased NOI, avoided costs and indirect benefits if quantifiable
 - LCA as directly linked to some economic assessment
 - M + V protocols established by contract
 - Nonperformance leads to contractual remedies

Performance, Not Aspiration: Building

- Building Performance
 - Actual measureable and verifiable building performance determined by contract
 - Only the measureable and verifiable attributes are of interest; eliminates ideological baggage
 - Only better building performance can aid larger issues of climate change
 - Separate rating system theatrics from performance

Crucial Differences in Risk Structures

- Role of architect minimized; engineers/facilities mgrs vital
- Usually existing building; usually tax-exempt financing
- Owner and ESCOs require real understanding of project financing
- Owner and ESCOs require real understanding of legal complexities appropriate for each project
- Success based on teamwork combined with a transparent, risk-adjusted cost-benefit analysis
- Design/build delivery combined with required control
- Measurement and verification is absolutely vital

Risk as Opportunity

- ESCOs have managed the risk for performance for almost 40 years
- They know how to properly assess the risk and reward relationships given the economic context
- Motivated by return and a real business case, not an imaginary business case
- As an industry, this experience makes ESCOs perfect to deliver the outcomes for responsibly going green
- Only by increasing the scope of ESCO activity can any real dent be made in transforming the existing building marketplace as an adaptation or mitigation task

Risk as Liabilities

- Confusion of marketing with performance
 - Mismatched expectations created by active participation in marketing of green rating systems
 - Rating systems presented as proxies for performance
 - Unsophisticated owners (both public and private) looking to rating systems as adequate assurance of performance
 - Must keep rating system contractual and other responsibilities separated fully
 - Transaction costs for rating systems need to be carefully addressed and kept transparent

Risk as Liabilities

- Do not allow architects to take a role in the decision-making since they are unfamiliar with the business models at work in ESCOs and lack the business, financial and technical knowledge to deliver the contractually required outcomes
- Do not make the mistake of allowing owners to think that architects or LEED consultants should take on the role of owner's representative to guide the process; they do not bear the risk of failed financing or performance, nor the transaction costs borne by others
- Vendor solutions rather than building performance solutions

Risk as Liabilities

- Increased expectations from owners can lead to increased litigation resulting from disappointment
- LEED legislation creates a real risk complication since this is an additional cost to be borne by the project and can provide traction for suit for failures to achieve certifications
- LEED EB has been generally very document intensive and unwieldy; who bears the cost for the documentation and failures in documentation
- Design professional insurance coverage at risk when linked to delivery of USGBC rating system products
- Certifications may take excessive amounts of time

Risk as Liabilities

- Rating system activity does not make the financial case better; may make it worse since underwriting for the additional risk for failure to certify or run afoul of legislation of local code increases uncertainty
- LEED EB may create legal exposures when dealing with regulatory compliance such as the prerequisite for asbestos or PCBs
- Many points for LEED EB are onerous documentation exercises for the benefit of the USGBC and/or could lead to value decreases—see productivity points
- Best to keep rating system issues totally separate

Risk as Liabilities

- LEED EB requirements intertwined with standard performance contracting will substantially increase the scope of work to be delivered; a lighting retrofit project with a LEED EB requirement will have a prerequisite for fundamental building commissioning for building assemblies and systems
- LEED EB cannot serve as a substitute for ESCO work, but this is the perception that is being marketed
- Could lose many of the gains obtained by educating lawmakers if they are misinformed about the limits of rating systems acting as proxies for real performance

Performance Gap

- Substantial gaps between promised performance and actual performance of many “green” buildings; UFAD leakage rates of 150%
- Very little post-occupancy evaluation of building performance in energy, IEQ, or savings
- Poor data sets and extremely poor methodological work; not investment grade
- Common mischaracterization of cost and performance data as definitive to buttress marketing campaigns
- Architectural profession not driven by building performance; serious lack of building science HR

Caveat Emptor

- Covert ideological agendas and social engineering are often at play
- Most green consultants believe that the market is not to be trusted; misunderstand basic economic issues
- First adopters are driven by proselytizing, social engineering or desire for regulatory capture
- Market will shake out the players without good fundamentals in the next few years
- More truly independent research needs to be done
- The bundle of values claimed for green is difficult if not impossible to monetize unless done as a performance contract

Final Thoughts

- Due diligence in a time of market confusion and uncertainty makes it difficult to acquire credible information to make strategic decisions
- We are experiencing a “green bubble” like the “tech bubble”; objective information will be crucial to decision-making
- ESCOs need to redouble their efforts to ensure that the new enthusiasm for going green does not end up limiting their opportunities through market confusion
- Short-term thinking by ESCOs, especially those that are subsidiaries of product vendors, could be harmful