

Getting Ahead of the Savings Curve: Utility Pay-For-Performance Program Design for Commercial Real Estate Customers

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The Challenge: Achieving Deep, Persistent Savings in Commercial Real Estate (CRE) Spaces

Driving Savings in a Hard-To-Reach Customer Segment

- Landlord-tenant split-incentive is when the payee is not the beneficiary
- Lease types, efficiency project payment structures, and utility meter types all influence how costs and savings are pushed to the tenant and owner/manager
- Business case differs between tenant and owner, and not always compelling to apply for a utility incentive

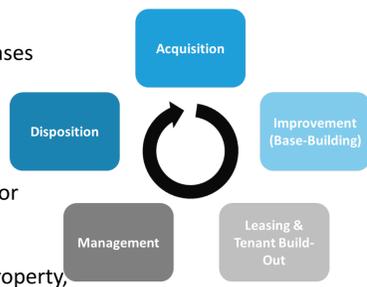
Status Quo For Efficiency Program Design

- Measure-based (deemed) savings approach, the estimated change in energy usage before and after an efficiency measure is put in place
- Utility incentives are paid out as one-time lump-sum deemed incentives for each piece of equipment or custom incentives for a predetermined dollar amount per unit energy saved
- One-and-done design fails to fully incentivize CRE customers to pursue projects with the deepest, most comprehensive, and most persistent energy savings

Barriers to Traditional Efficiency Programs for Commercial Real Estate Customers

Misaligned Investment Timelines

- Building life cycle begins when the owner purchases the building (acquisition). They implement base-building improvements, such as a lobby renovation or new tenant amenities
- Ongoing management provides an opportunity for increasing asset value by reducing operational expenses such as utility and maintenance costs. When an owner decides to sell/dispose of the property, the focus is strictly on selling (as opposed to investing any additional funds for improving) the asset.



Limited Project Scope - CRE customers prefer bundled, holistic energy efficiency projects that combine multiple measures implemented over time to minimize disruption to tenants and maximize non-energy benefits. Conventional utility incentives are assessed on a per-measure basis, which fails to appropriately value the positive spillover from the energy usage and cost savings across many measures.

Short-Term Savings - Incentive payments for replacing low-performing equipment and fixtures do not account for long-term savings and continuous improvement that result from ongoing, system re-tuning and maintenance. This does little to ensure that energy savings from new, efficient equipment or retro-commissioning efforts persist over time.

Difficulty Attributing and Verifying Savings - Prolonged measurement and verification process utilities require to pay out custom incentives, coupled with the uncertain risk for project cost savings, make it difficult to create a compelling case for efficiency in CRE spaces

The Solution: Design Pay-for-Performance Programs (P4P) For Commercial Real Estate

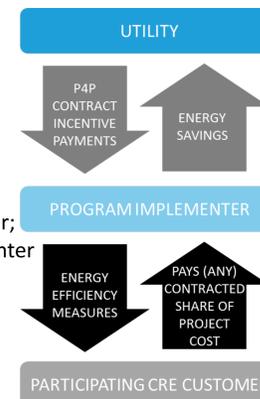
Pay-For-Performance Program Design

Standard-Offer Program - sets price per unit of energy saved (e.g. 5¢/kwh saved) paid to implementer or customer. Most simplistic process; can increase P4P program structure and reporting details for buildings to qualify for incentive funding.

Bidding Program - allows implementers or customers to submit competing bids for contracts that specify an amount of energy savings to be achieved, and pay the price offered by bidders for the energy savings as they occur.

Payment Structures

- **All Upfront** - captures the full incentive value when the measure is implemented
- **All Performance-based** - no upfront payment for measure implementation; payout is based on energy savings resulting from the measure
- **Partially upfront, partially performance-based** - implementer receives initial payment once measure is installed for customer; customer pays a share of resulting energy savings to implementer who also receives performance payments from utility
- **Energy service provider contract** - pays an energy service provider based solely on energy savings delivered



Utility Benefits

- **Capture deeper savings from holistic projects** - goes beyond the most common single-measure efficiency projects, and includes energy-saving operational and behavioral changes otherwise challenging to incentivize
- **Encourage persistent savings over time** - when utilities offer CRE customers a long-term P4P incentive opportunity, they ensure persistent energy savings as the customer works to earn their year-over-year incentive checks
- **Increase program cost-effectiveness** - reduces the overall administrative cost of capturing efficiency savings in hard-to-reach segments, such as CRE
- **Shift some non-performance risk to customer** - P4P shifts some of the risk of not achieving estimated savings from the utility to the customer

CRE Market Benefits

- **Capture a tangible and relatable stream of savings** - customer enrolls in program and captures value for all energy savings achieved, regardless of the source, and can treat the recurring P4P incentives as income on the balance sheets
- **Enable flexible and creative efficiency strategies** - no longer constrained accommodating specific efficiency improvements from a short-list of approved, incentivized measures or equipment, customers have flexibility to work with tenants and owners alike to determine priorities for comfort, sustainability, and/or value-add investments
- **Whole-building performance and deep energy retrofits** - deep energy retrofit can allow owner to charge higher rents, attract quality tenants, and reduce tenant turnover

Conclusions

- Although this is a risk-averse group of customers, by designing P4P programs to address barriers to conventional incentive programs, utilities can implement successful P4P programs that:
 - 1 Emphasize low- and no- cost efficiency measures that yield day-one energy savings
 - 2 Communicate in language that will resonate with CRE customers
 - 3 Address the decision-maker directly
- CRE will represent a large and important customer segment to tap for significant energy efficiency savings
- Utilities should lead with thoughtful and well-designed programs tailored to this market segment to build early trust among these customers and ensure high participation rates and reliable savings in years to come

Overcoming Pay-for-Performance Program Commercial Real Estate Challenges

Challenges to Implementing Pay-for-Performance

- **Limited pool of CRE customers** - low-energy usage CRE customers may have lower total P4P utility payouts than they would receive through conventional deemed rebates
- **Risk-averse Industry** - owners weigh the risk of investing in efficiency as they would when budgeting for any other capital investment
- **Unfamiliar Program Structure** - CRE customer only receives cost savings if the measure drives energy savings that translate to their energy bill and gets no up-front funding to offset the implementation costs. This risk may deter customer participation and decrease the overall cost-effectiveness of the program.

Strategies to Overcome Challenges to Pay-For-Performance

Address the upfront cost - To offset the risk of non-performance in capital-intensive efficiency measures, encourage CRE customers to begin their efforts with no- and low-cost efficiency measures that create energy cost savings and bring in energy usage savings from day one. Choose payment structures that enable program implementers to identify and implement low-cost and operational savings measures at no initial cost.

Communicate with language that resonates - Rather than promoting kilowatt hour savings, focus on how payments are forecasted and delivered to minimize risk and provide new long-term benefits to the customer

Obtain direct program buy-in - Identify and engage the building owner, present tailored business case to their building, and demonstrate proven success through P4P from other CRE leaders in local market. For tenants, emphasize non-energy benefits such as progress on corporate sustainability goals and improved tenant comfort/satisfaction leading to tenant retention and increased rental rates.

Tailor Pay-For-Performance to CRE Customers

- **Target CRE customers, with large portfolios of properties to reach scale** - use a portfolio approach to engage CRE customers
- **Align financial incentives for CRE actors, with long term time periods for participation and no-upfront-cost payment structures** - Longer timeframe gives CRE customers confidence that efficiency measures will pay off over performance period and allows owners to hedge risk of non-performance if occupancy or tenant behavior changes in single year of the program.
- **Identify strong program candidates:**
 - 1 High energy user, annual consumption >1M kWh
 - 2 High savings potential, 15-40% energy reduction
 - 3 Well-behaved, with consistent and reliable data
 - 4 Old, 3+ years past construction to ensure room for improvement
 - 5 High occupancy, consistently +75% full
 - 6 Commitment to funding capital improvements at the building
 - 7 Long-hold period, at least the length of the P4P program