How Your Company's Credit Rating Will Affect Your Electricity Costs

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If you are ready to pass this article by because financial issues are not part of your energy-related property operations concern—please don't! Every facilities professional with properties taking delivery of electricity in deregulated, or to be deregulated, territories has a direct need to understand and become involved with this issue. Soon, if not already, your company credit rating will have a direct effect on the cost of your electric commodity. And soon, I submit, you will be placed in a position of being forced to deal with this.

In concept the issue is very simple. Without competition there was only one provider possible, and no opportunity existed for a consumer to leave the provider with energy costs in arrears. A property might go many months without paying the bill, but the provider was reasonably safe in that there was no way for the consumer to escape ultimately paying or being cut off. And so, the provider utility was not particularly concerned with the creditworthiness of its consumers (in fact they were, but only behind the scenes).

Now, with open access and alternative providers, it is possible to incur past due charges and switch to a new provider leaving the old provider holding uncollected dollars. The old provider no longer has the option to shut off the power because the property has already switched to a new provider. This old provider was operating in a position of credit risk left over from the 'old days' of monopolistic guarantees.

It has been the case since the first day of deregulation that the al-

ternative providers are extraordinarily concerned with the credit rating of potential new clients. And that the actual credit rating holds a direct influence on the price of the commodity. These new providers are aware you can walk away, contract notwithstanding, and leave them unpaid for delivered electricity. Also, they have certain liabilities on their books that are better mitigated with clients of satisfactory credit rating. It is absolutely certain that many properties have been declined open access competitive rates because of poor credit.

HOW POOR IS "POOR?"

Poor in this case is not all so poor as one might imagine. You can buy a house at a favorable rate with the 'poor' credit rating that has resulted in declined service. And for good reason.

Take as example a larger property with an annual spend of four million dollars for electricity. This is consistent with the type of client desired by alternative providers. A proposal for open access energy is submitted to you with a term of three years, or potentially a contract value of approximately twelve million dollars. Now you see the full credit exposure and reason this is so much more heavily observed than in a house of a few hundred thousand dollars.

It is possible, depending upon how the provider acquires its energy, that it plan on buying contracts to serve your property. It may well become committed for many millions of dollars to lock-in a favorable rate over the term of the contract. It certainly does not want to do this for a consumer with a poor paying history and end up holding this expensive paper with no revenue on the consumer end.

Now, here is the truly difficult part. Many property owners are notoriously reluctant to provide information on their financial structure or partnership structure. It is not unusual for major properties to have their actual partnership information known only to their commercial bank, and a few select associates. There is in short no way to acquire sufficient information on the ownership of a property unless it is held by a public company.

A typical multi-tenant commercial property, regardless of Class A-B-C, will have several investors behind the scenes who created some form of partnership to acquire and hold the property, These entrepreneurial types like to take their money and invest it elsewhere, building

on their leverage. They normally pull all the money possible out of property, so they can invest elsewhere. These characteristics, and others (taxes), make them incredibly reluctant to reveal who they are and what their financial wherewithal may be.

Very few major multi-tenant properties in the United States do not fall into this category! Talk to your CFO. You may be told that credit is not a problem because of vendor references and such, but this does not apply. The alternate providers will look at past performance in bill paying, but you will be penalized in your commodity price, and possibly to the point of being declined due to the high dollar exposure involved.

Public companies too, unless in the financial services sector, do not normally hold sufficient credit for the very best pricing. So what is good credit? Have a chair, this may hurt a bit…

The starting point is a Moodys or Standard & Poors rating. These will only be a starting point. The credit department will want your annual report, your 10k and any other financial information available. Everything you cannot provide drives up the cost of your commodity.

YOU NEED AN 'A'

Essentially you need to have an 'A' in your rating. Three 'B's won't get you there, and a bbA will be a tough sell. The best price for your commodity discount starts with your having an AAA, and drops by several points by the time you get to lower but still acceptable credit.

So we have two separate issues to address, weak credit and concealed ownership information. Let's take the second first. One way you may be able to handle the issue of anonymity is to work with your commercial bank and have them issue what is basically a letter of credit. To do this you need a strong relationship because what you are asking the bank to do is assume the liability in the event you default on paying your energy bill.

Your bank will issue a letter to the energy provider stating the credit rating of your partnership, but without details. They will essentially become a co-signer with their own credit at play to satisfy the energy provider. As with any co-signer, you will have to have a very strong relationship before your bank will step up to this plate.

Failing this, and assuming you are adamant about not revealing the details of individual partners, you are left with posting a surety

bond. Typically the energy provider will want the bond to hold the value of one year's exposure. Depending on your relationship with your commercial financial partners, the cost of such a bond may outweigh the savings derived from the discounted energy. However if you have a strong relationship with your financial partners the bond may be quite inexpensive and a reasonable alternative to the credit issue.

This is one of the same approaches to use if you have less than ideal credit. A surety bond will serve to mitigate the risk. However here again, if your credit is a bit weak, what might such a bond cost? Considering that the discounts on retail energy today are in the low single digit range, the bond may be too expensive.

It is not difficult to see how the existing utility companies may begin to carry this concern to the residential market. In California, for example, there are a few alternative providers and no cost for switching your home account. One could easily leave the utility holding the bag for a few hundred dollars. Given this, we might consider someday looking at home utility service much as a credit card application, credit rating being an issue.

There are ways to deal with all these issues. Some involve buying financial derivatives, and these can work. However, you need to understand your business goals and appetite for risk when selecting which form of contract you may want. There are several choices and the wrong one can end up costing you money.

Across the country where deregulation has been implemented we are nearing the end of various rate freezes and CTC burn-offs. As we enter the truly open market in these areas and rates go up, the issue of who you deal with will become of immediate importance.

Addressing your approach to this credit issue is something to begin now, before going to the open market, as it will improve your ultimate discount.

ABOUT THE AUTHOR

Kevin D. Fraser is president and CEO of Fraser Limited. He has 20 years of real estate experience in facilities management, construction, design (mechanical/electrical/plumbing) and consulting. A recognized expert in building systems and energy management, Mr. Fraser has specialized in multi-site facility operations and review, with a focus on energy acquisition and energy project design.

Prior to joining PG&E Energy Services as a national director Mr. Fraser served as an international corporate real estate consultant for Ernst & Young Kenneth Leventhal. He has held facilities and administration management responsibilities for David Rockefeller, Prudential Insurance, John Portman & Associates, Pacific Park Plaza and Wind River Systems.

Mr. Fraser is credited with writing and releasing the nation's first true open market RFP for deregulated electricity. He has lead or participated in energy commodity and related services totaling billions of dollars and including the largest single energy services agreement in history. His experience includes representing the end user, intermediary, independent third party and supplier. Widely published in fields from healthcare, hospitality, real estate and energy, Mr. Fraser is also a prolific speaker who has addressed industry groups in excess of 1,000 participants.

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