

## Financing Ambitious Local Climate Objectives



D.2.2. Report on financial aspects of an overarching financing solution in the framework of FLC (Membership Card System - MCS)

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WP 2 – FLC Vehicle

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## 1 Introduction

The aim of the FALCO-project is to induce investments that go beyond business as usual by supporting potential investors with solutions that address persistent financial and non-financial barriers. Focus is on three types of investments:

- Energy efficiency measures for SME's;
- Renovation of private buildings (e.g. apartments / private houses / private schools / ...);
- Renovation of public buildings.

Based on financial and non-financial barriers project owners encounter, FALCO partners develop adapted solutions. The work to develop the solutions has been organised in 'breakthrough projects' (WP3 of the FALCO project). Before implementing the solutions, a due diligence exercise is being performed.

Apart from the individual solutions for each of the breakthrough projects, the FALCO partners are also working on overarching financing solutions that are able to strengthen the individual solutions (WP2 of the FALCO project). This deliverable describes the financial aspects of one of such overarching solutions under development: a Membership Card System (MCS).

In order to situate the MCS solution, the MCS summary description as provided in the barriers & solution matrix set out in deliverable D2.1 (see solution under paragraph 3.2.35) is copied in the text box below. In table 1 in deliverable D2.1, we indicated for which of the key barriers, the MCS could be (part of the) solution.

**Summary information on the MCS (source: FALCO deliverable D2.1)**

*The functioning of an MCS can be summarised as follows: (1) a member organisation agrees with (2) suppliers of products and services that its (3) members receive a reduction on the normal price and / or that the member organisation of the suppliers in question receive a fixed or variable contribution depending on the purchases of its members from these suppliers.*

*This is a way of generating savings on renovation costs and / or an additional income stream by bundling of purchasing power. This is a variant of a grouped purchasing schemes, which also use the bundling of purchasing power to increase their bargaining power with suppliers. However, in the case of the MCS the bargaining power is not linked to a purchase at a particular point in time, nor is object of the purchase standardised (as is often the case with grouped purchases). Hence, the MCS offers greater flexibility than a grouped purchase approach.*

*Well-known examples of this purchasing power bundling technique are: the benefits that book clubs, or credit card companies, negotiate for their members. For the affiliated suppliers, the advantage lies in the fact that the supplier is mentioned on a list of affiliated suppliers, can generate an additional turnover, and that the contribution to the member / member organization is made in function of the purchases made. Here too, there are a number of possible variants (e.g., modulation of contribution in function of a certain volume).*

*Remark: a deliverable 2.2 includes a more detailed description of the MCS as a possible overarching solution in support of the different financing solutions developed during the Falco project.*

Legal aspects of the MCS are worked out in Deliverable D2.3 of the FALCO project.

After some preliminary remarks, we first describe generic financial features of the MCS, after which we focus on specific features for the individual FALCO solutions. In Chapter 5, organisational aspects are described.

## 2 Preliminary remarks

The financing solutions developed within FALCO (hereafter referred to as FALCO solutions) will expand the energy renovation market. This means that these solutions will allow the renovation sector (and its suppliers) to enjoy additional revenues. The membership Card System (MCS) wants to capture part of the added economic value accruing to the renovation sector as a consequence of the FALCO financing solutions and use it to further increase the pace of energy renovation investments ... and hence, further increase the energy renovation market.

Below we start with presenting the key features of the MCS relevant for all FALCO financing solutions. Thereafter we describe the interactions between the MCS and each of the FALCO financing solutions individually.

## 3 Generic features of the MCS

**The MCS is an open and voluntary system** - All suppliers can (but must not) join the MCS and become a “Partner Supplier”. Renovators that use one of the FALCO solutions can (but must not) work with these Partner Suppliers. They can continue to work with suppliers that have not (yet) joined the MCS.

**Result-based contribution of Partner Suppliers** – Partner- suppliers commit to offer a rebate of x% on the sums invoiced to clients that use one of the FALCO solutions. In other words, Partner Suppliers only make a contribution to the MCS (e.g. in the form of a rebate) if and when they can issue an invoice. Furthermore, they only pay the rebate on the invoice financed via the FALCO solution. Hence, no fixed membership fee or contribution without the certainty of securing additional business. The MCS contribution is always linked to a (FALCO) financing solution.

**Contributions used to further develop the energy renovation market:** The contributions made by the Partner Suppliers are used to further accelerate the pace of energy renovation investments in the Flemish region. The way this is done can vary from the FALCO solution considered. For example, in the context of the ER2.0 solution the Partner Suppliers’ contributions will take the form of a rebate on the invoice issued to the ER2.0 client. Part of this rebate will accrue to the MCS, who can for example use this contribution to support energy renovation advisory services provided by energy houses.

**Modular design** – The idea of the MCS originated when developing the ER 2.0 solution. Nevertheless, using a modular approach it is possible to design an MCS that can accommodate the needs of and contribute to other (FALCO) financing solutions. Hence, the idea to design a Modular MCS which would first be linked to the ER 2.0 solution, and thereafter would gradually expand to encompass other (FALCO) financing solutions. Such expansion would further increase the bargaining power of the MCS (which is essential to secure a fair contribution from Partner Suppliers) and improve cost efficiency of the system (spreading fixed cost over a larger number of transactions).

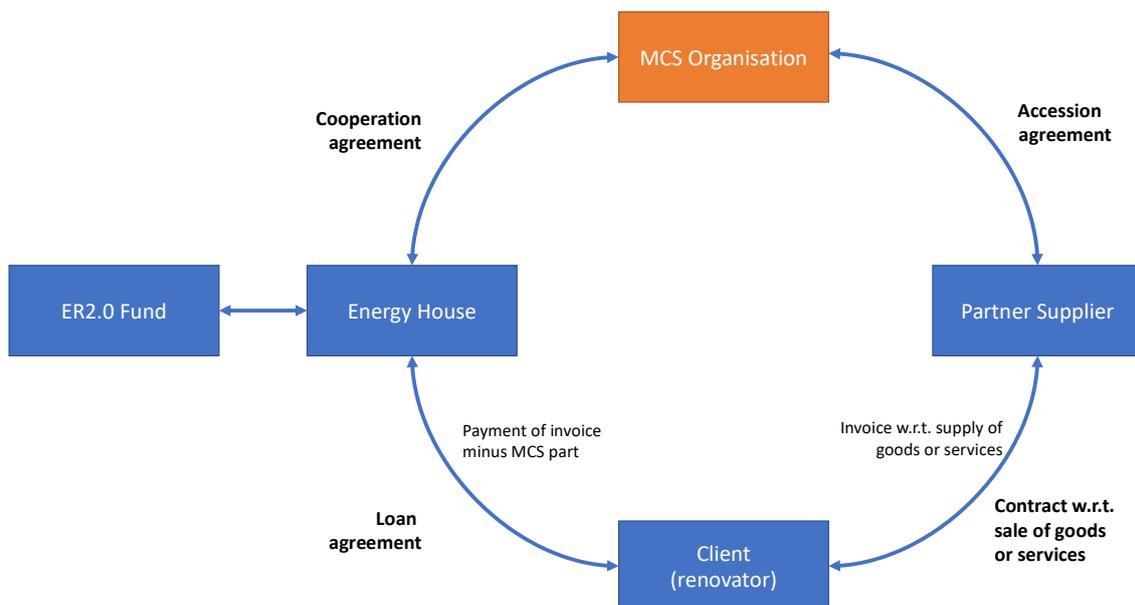
## 4 Specific features for individual FALCO solutions

Within FALCO, financing solutions for different breakthrough projects are elaborated. The financial solutions for each of the breakthrough projects are described in detail in deliverable D2.4 of the FALCO project. In the paragraphs below, we focus on how the Membership Card System can contribute to the effectiveness and efficiency of the financing solutions for each of the breakthrough projects.

### 4.1 ER2.0 Loan

#### 4.1.1 General outline

The MCS agrees with Partner Suppliers that the latter's clients that finance their energy-renovation purchases via a ER2.0 Loan receive a rebate. The MCS bundles the purchasing power of its ER2.0 borrowers to capture part of the economic value created for the Partner Suppliers via the ER 2.0 solution. These means can then be used to provide cheaper or additional ER2.0 Loans or to cover (part of) the advisory services provided by the energy houses



Obviously, as there is no obligation to work with Partner Suppliers, ER2.0 Clients will need to be encouraged to work with Partner Suppliers. Alternative approaches can be adopted hereto:

- We already indicated that the Partner Suppliers will offer a rebate;
- In addition, clients working could be deducted the cost of advisory services to the extent of the contributions received from partners;
- Additionally, or alternatively, a preferential interest rate or loan conditions for the ER2.0 Loan could be reserved for (the part of) supplies/services purchased with Partner Suppliers;

From an operational point of view, the processing of the Partner Suppliers' contribution by the Energy Houses only requires minor additional efforts. Indeed, upon the payment of the loan

sum, Energy Houses will need to verify whether the invoice submitted was issued by an ER2.0 Partner Supplier.

**Example:** suppose that the MCS Organisation and Partner Suppliers have agreed a rebate of 5% for ER2.0 Clients, and that the ER2.0 Loan agreement provides that the rebate will be split in equal parts between the MCS Organisation and the ER2.0 Client (each 2,5%). In that case, the process could be organised as follows:

- The Client Renovator purchases goods/services for a total value of 10.000 euro with Partner Supplier;
- The Partner Supplier grants a rebate of 5% of the invoice, so that the ER2.0 Client needs to pay 9.500 euro to the Partner Supplier;
- The ER2.0 Client submits the invoice for payment to the Energy House (releasing part of the money borrowed through the loan agreement);
- The Energy House pays 9.500 euro to the ER2.0 Client so that the latter can pay the Partner Supplier from whom he purchased the goods/services;
- The Energy House books 9.750 euro as a withdrawal of the loan account, and transfers half of the amount of the rebate to the MCS organisation (or may keep part thereof in accordance with the terms agreed between the energy house and the MCS).

#### 4.1.2 Contractual relations and cash flows

We distinguish the following contractual relations and cash flows

##### Agreement between MCS-organisation and Energy Houses

This agreement covers a.o. the following points:

- 1) The part of the rebate that accrues to the MCS organisation;
- 2) The compensation of the Energy Houses for advisory services to ER2.0 Clients.

##### Accession agreement between MCS-organisation and Partner Suppliers

To become a Partner Supplier, the candidate Partner Supplier will need to enter into an accession agreement with the MCS Organisation. In practice, said accession can be organised electronically (via website). The most important rights and obligations of parties under the agreement are as follows:

- 1) The Partner Supplier grants ER2.0 Clients a rebate of X%. Said rebate is justified by the fact that without the ER2.0 Loan the supplier would not have sold the goods or services purchased, so that it makes economic sense to transfer part of the benefits he receives thanks to the ER2.0 solution, in the form of a rebate.
- 2) The MCS (in consideration of the rebate):
  - a. Makes the participation of supplier to the MCS known to the ER2.0 Clients and ER2.0 target group;
  - b. Uses the contributions received to provide ER2.0 Clients with more advantageous loan conditions and/or support advisory services to ER2.0 Clients and or finance other interventions aimed at speeding up the energy renovation investments.

### Other agreements

Apart from the above-mentioned contractual relations that cover the main MCS arrangements, the following agreements will be impacted by these MCS agreement:

- Agreement between ER2.0 Client and Partner Supplier: this is the classic client/supplier relation: a purchasing agreement for the purchase of goods (mainly renovation materials) and/or for the supply of services with a (general) contractor. Partner Suppliers grant ER2.0 Clients a rebate agreed with the MCS on the goods/services purchased. \_
- ER2.0 Loan agreement between the Energy House and the ER2.0 Client: The loan agreement specifies the part of the rebate granted by the Partner Supplier that will accrue to the MCS.
- Outsourcing contract between MCS Organisation and third party service provider (optional) : The MCS organisation can outsource part of its operational activities to a third-party service provider. For example, it may be very efficient to entrust management of Partner Suppliers (from accession into termination) to an existing membership platform, thus avoiding the cost and time required to develop and manage a new member platform (benefits of scope). The outsourcing agreement outlines the framework / principles of the cooperation e.g.: the principle that all suppliers should be allowed access to the MCS as Partner Suppliers; the organisation of entry and exit rules & procedures; the accession agreement to be used; etc. The third-party service provider will be able to claim a fee from the MCS organisation in consideration of his services.

As a general rule, the third-party service provider doesn't receive any payment from Partner Suppliers (unless a limited fixed contribution to cover accession costs).

## 4.2 Other FALCO solutions

### 4.2.1 FALCO solution for SME

#### Short description of the financing solution

The FALCO solution developed for SMEs covers an EPC where energy efficiency is combined with investments in renewable energy. Two solutions have been worked out:

- a) In case an EPC can be set up with a group of networked SMEs project financed EPC is a possible solution. For project finance minimum investment volumes of at least 2 million euro are a prerequisite so pooling over different sites will be needed. Moreover, when energy efficiency is combined with investments in renewable energy bankability of the business case will improve.
- b) Alternatively, an ESCO performs the initial investment (on its own balance sheet) and enters into an agreement with the SME covering two components: a) a sale on instalment credit terms covering the investment and b) an EPC and/or maintenance contract; Upon commissioning/delivery of the investment the ESCO sell his accounts receivables in relation to the sale on instalment to a third-party investor (a financial institution or a forfaiting fund); the EPC and/or maintenance contract continues as before. This funding allows for relatively smaller investment projects – between 500k euro and 1 mio euro

#### Collecting contributions from Partner Suppliers

As with ER2.0, the Partner Suppliers' contributions could take the form of a rebate and could be collected in the same way as with the ER2.0 Loan. The ESCO that purchases goods or services from a Partner Supplier receives a rebate, that he forwards (in part) to the MCS organisation.

#### Use of collected contributions

The Partner Suppliers' contributions can be used for risk mitigating purposes. For example, to build a buffer, a sort of captive insurance, for ESCO's, with a view of creating trust between the ESCO, the SME (customer) and the third-party investor purchasing the accounts receivables from the ESCO. More specifically the contributions We consider the following risks:

- Counterparty risk: The risk that the SME would default on his obligations (mainly with regard to the sale on instalment). Reducing the counterparty risk should also allow to lower the risk premium (the discount on nominal value of the accounts receivables), so that in fine the net amount from the sale of accounts receivables accruing to the ESCO increases.
- Performance risk: the risk of the ESCO to compensate the SME customer in the event of an underperforming installation. This can reduce the impact of the realisation of the performance risk for the ESCO; for the SME this offers a guarantee that the performance contract is enforceable; for the third-party investor this reduces the counterparty risk of the SME not being able to pay back the investment.

The MCS can thus use the contribution to improve the FALCO solution.

#### 4.2.2 FALCO solution public sector real estate portfolio

##### Short description of the financing solution

Currently several financing options can be considered, a.o.:

- Option A: Financing from own resources;
- Option B: Financing (outside budget) by ESCO who takes out a loan and takes the investment on its own balance sheet) and also enters into an EPC / maintenance contract;
- Option C: Option B, but after a time the sale of a claim from ESCO to customer to third party (similar to FALCO solution for SMEs);
- Option D: Financing (outside budget) by third party (eg investment fund); ESCO does not participate in financing the investment but is limited to EPC and maintenance contract).

##### Collecting contributions from Partner Suppliers

As with the FALCO solutions above, the Partner Suppliers' contributions could take the form of a rebate and could be collected in the same or similar way as with the ER2.0 Loan, e.g. upon the issuance of the invoice for services/products acquired by the FALCO solution's client. Part of the rebate is forwarded to the MCS organisation.

##### Use of collected contributions

Collected contribution should be used for risk mitigating purposes, and/or reduce the cost of capital.

#### 4.2.3 FALCO solution for social housing

Because of the legal barriers that exist in financing renovation of social houses in Flanders, this breakthrough project will not be continued for the moment.

### 4.3 Additional points of attention, remarks and variants:

- The MCS is aimed at suppliers that sell products or services directly to the beneficiary of the FALCO solution (e.g. the renovator in the ER2.0 solution). Obviously, other economic actors may benefit indirectly (through the increased market) from the FALCO solution. It will often be difficult to capture the value with these indirect beneficiaries. This stems from the fact that it is more difficult to establish a direct link between the additional sales volumes and the FALCO solution (no direct link). Note however that for 1) large industrial producers of renovation materials and products (e.g. double glazing, insulation, plasterboard/gyproc, etc.) that 2) operate on a highly concentrated market (close to an oligopoly) and 3) assuming a stable market share, an increase of the size of the market is more likely to translate directly into a higher turnover and improved bottom-line. Hence, this type of investors may be willing to provide equity or debt funding required for the FALCO solutions. In this case, the latter's investment will generate a double dividend in the form of a *financial* return (i.e. the financial compensation for providing equity or debt) and an *economic* return (revenues from increased sales). As the return for double dividend investors is composed of financial and economic revenues, these investors may be willing to accept lower *financial* returns if this is sufficiently

compensated by higher *economic* returns. This could provide a cheap (below market) source of equity or debt for the FALCO solutions.

- The MCS could also be used outside a loan context. This would amount to a classic membership cards system, with for example yearly membership fees.
- The MCS could extend to offer a peer quality review (similar to ‘trip advisor’ ‘air bnb’) of Partner Suppliers whereby clients can evaluate Partner Suppliers. This could improve trust in the renovation sector.
- The renovators and/or Partner Suppliers could also be requested to pay a (small) annual fix fee which would complement the contributions by Partner Suppliers.
- MCS Partner Supplier affiliation could be linked/integrated to the affiliation with FLK-C, a new to be founded not-for-profit organisation (see also deliverable D2.3 for its articles of incorporation). The FLK-C, offers a stable environment (continuity) where public and private sector actors can join forces to tackle key challenges with regard to the financing of ambitious local climate action plans and accelerate the scale-up of tried and tested financing solutions;
- Additional revenues could be generated via Domestic offset projects, whereby the user of the FALCO solution transfers the right to claim to compensation rights to the MCS and the latter can sell these right for compensation purposes;
- On top of the rebate that FALOC clients are granted by Partner Suppliers, the MCS could provide for additional benefits, e.g.: better loan conditions, additional support/advisory services.

## 5 Organisational aspects

### 5.1 Ownership, strategic and operational management

The MCS could be organised within a separate legal entity performing all activities internally. Alternatively, The MCS organisation could work with third-party service suppliers who could cover part of the operational activities (partial outsourcing).

The *MCS Organisation* is the organisation that has legal ownership of the system and thus defines the strategic orientations of the MCS and provides high level guidance on how to organize operational. To ensure that the means collected by the MCS are completely used in support of an acceleration of energy renovation investments in the Flemish region the MCS Organisation will preferably take the form of a not for profit organization.

MCS ownership could be entrusted to the FLK-C, a not for profit organisation which focuses on the financing of local climate action plans.

Whereas all *operational activities could be organised by the MCS Organisation* it may be more cost- and resource-efficient to outsource part of the operational activities to one or more Third-party Service Providers (TSP). Indeed, collaborating with an existing renovation network may speed up the launch and uptake of the MCS.

For example, consider cooperation with:

- An energy renovation platform: For example, a B2B platform such as “Samen Klimaactief” (SKA) matching demand and supply for energy renovation services and products, could cover

the MCS Partner Suppliers administration (management of the accession and departure of members; keeping list of Partner Suppliers up to date; etc.). SKA's focus on climate change and the complementary/compatible of its B2B proposition, seem to indicate that a collaboration with SKA could offer considerable benefits of scale and scope. Note however that conditions and the form of a possible collaboration between SKA and the MCS need to be investigated more in depth (notably taking into account the pre-existing agreements within the city of Antwerp and the public procurement law). Note that alternatively, other platforms could be considered for the outsourcing of Partner Suppliers administration, for example: twizzi([www.twizzi.be](http://www.twizzi.be)); aannemersoffertes ([www.aannemersoffertes.be](http://www.aannemersoffertes.be)), etc.

- Energy Houses could in the context of the ER2.0 collect the Partner Suppliers contributions. Indeed, they need to check incoming invoices anyway and can for a limited additional effort perform the collection process.

## 5.2 Collaboration with Third-party Service Providers

Below we provide an overview of operational activities that could be outsourced to an energy renovation platform such as aforementioned Samen Klimaatactief platform and the Energy Houses.

### 5.2.1 Energy Renovation Platform

#### Specifications of outsourcing services

Below we provide an overview of the services that the MCS could outsource to a third-party Energy Renovation Platform such as Samen Klimaatactief. The table below indicates the type of services and provide an indication of whether the item is a 'must have' or a 'nice to have' service item. This list will be fine-tuned in consultation with the selected third-party Energy Renovation Platform.

The main service pertains to the management of the accession to and exclusion/termination of Partner Suppliers' membership via the existing platform's website provided by the third-party Service provider.

	<b>Must Have</b>	<b>Nice to have</b>
• Information MCS (General information + FAQ)	X	
• Electronic signing of the accession agreement Via one button on the website. The accession agreement will be supplied by the MCS Organisation	X (in the long term)	
• Posting a searchable list of Partner Suppliers on the platform's website (Including location/type of activity of each Partner Supplier) and keeping this most up-to-date	X	
• Membership suspension and termination of Partner Suppliers that do not comply with their duties under the accession agreement	X	

• Infrastructure for two-way communication between the MCS Organisation and the Partner Suppliers		X
• Information about Partner Suppliers (short description, link to website) - To be completed by individual Partner Suppliers		X
• Infrastructure for two-way communication between the MCS Organisation and potential users of FALCO solutions		X
• Infrastructure for quality system similar to 'trip advisor' peer reviews		X
• A separate webpage for each Client segment (e.g. one for private individuals in the context of ER2.0 Loan, and one for SME's solution).	X	
• Request for proposal (RfP) module allowing clients to send out RfPs to all or a selection of relevant (partner)suppliers and allow the latter to respond to these RfPs		X

### Compensation

In consideration of the services provided, the energy renovation platform compensation could cover following compensation elements (to be negotiated with selected third-party services provider):

- Start-up cost: compensation for adaptation of website;
- Fixed compensation per year: mainly fixed costs;
- Variable compensation (incentive): covering variable costs + margin (e.g. cost plus basis).

## 5.2.2 Energy Houses

### Specifications of outsourcing services

Below we provide an overview of the services that the MCS could outsource to Energy Houses. The table below indicates the type of services and provide an indication of whether the item is a 'must have' or a 'nice to have' service item. This list will be fine-tuned in consultation with the Energy Houses.

The main service pertains to the management of the collection process with regard to the Partner Suppliers contributions.

	<b>Must Have</b>	<b>Nice to have</b>
• Determination of the Partner Suppliers contribution that accrues to the MCS Organization (based on the analysis of the basis of the invoice)		X

<ul style="list-style-type: none"> <li>Channeling of contributions to the MCS minus the agreed upon part reserved for Energy Houses (example: compensation for the service for processing of rebate + result based compensation for the support of ER2.0 Clients in function of the amounts borrowed).</li> </ul>	X	
<ul style="list-style-type: none"> <li>Reporting with regard to the use of the contributions that accrue to the Energy Houses</li> </ul>	X	
<ul style="list-style-type: none"> <li>Infrastructure for two-way communication between the MCS organisation LVKS and potential users FALCO solutions</li> </ul>		X
<ul style="list-style-type: none"> <li>Flagging of irregularities in submitted invoices</li> </ul>	X	
<ul style="list-style-type: none"> <li>Link searchable list of Partner Suppliers (and request for proposal module)</li> </ul>	X	

### Compensation

In consideration of the services provided the Energy Houses compensation could cover following compensation elements (compensation package to be negotiated with the Energy Houses collectively):

- Start-up cost: compensation for adaptation of procedures
- Fixed compensation per year: mainly fixed costs
- Variable compensation (incentive): covering variable costs + margin (e.g. cost-plus basis)