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Today's "To-Do" List

Review the Electricity Contract When Buying and Selling Property

When is the last time the line item "Review the Electricity Contract" was placed on your "To Do" list during the due diligence phase of a facility purchase?

Over 75 percent of commercial properties have switched from the utility default rate (or Price to Beat), so chances are very good that the building your firm may acquire, sell, or manage is under a competitive electricity contract. To that point, the after-effects of Hurricane Katrina and Rita left us with an unprecedented volatile and escalated electricity market. The ramifications of many contracts signed in late 2005 and early 2006 have increased prices, drastically altering the operating income of properties. The following discussion centers on the important aspects of managing your electricity strategy as it relates to the acquisition and disposition of commercial space.

While all facets of the commercial real estate industry have changed over the years, the building you may purchase or manage will most likely have a competitive electricity contract in place. As stated above, electricity contracts signed toward the end of 2005 and early 2006 were typically at prices much higher (as much as 80 percent) than the market had previously seen. Certain types of variable rate contracts fared even worse. Prior to this time period, in a generally rising market, most contracts held prices lower than later market conditions. Over the last few years, as each contract expired, the new contract was typically at a higher rate. Regardless of the price on the contract, there are a couple of key areas you should know in regards to the contracts on properties with which you may be involved.

Know what you are moving into or buying

The existing electricity contract can prove either to be a benefit or, conversely, a burden. If the contract includes a competitive price, real-estate-friendly assignment language and bi-lateral recourse, then the property has benefits and will provide advantages for you. On the other hand, if the electricity contract has unattractive pricing,



significant contract impairments or supplier-centric language, the contract may place additional costs and restrictions onto either the owner or the buyer. The key is to understand the important economic as well as business aspects of the contract and whether the contract provides value or conversely, presents unacceptable limitations.

Know your options, know your exposure

Is the current contract assignable; are the business terms acceptable; is the price at, below, or above current market? If the buyer determines that its best interests are served by not accepting the assignment, the seller will most likely be held accountable for unwinding the contract, thus increasing its sales costs. Regardless of the contract price, the economic impact includes the remainder of the contract obligations, which could include the difference between the contract and market prices of projected electricity costs for the remaining term. The impact from an existing contract should be reviewed and understood early in the due diligence process.

Managing the process

With electricity, you have options. Options bring uncertainty and the unnerving question of whether or not “we did the right thing.” Make sure you are in control of the electricity procurement process. If you engage a firm

to work on your behalf, your due diligence should include research that provides you with insight into the energy experience and market knowledge of that firm as well as the individual. Find out when and how much the consultant is paid and what services are included. A list of qualifications and references will be helpful. Verify that the firm is respected for representing buyers’ interests only and will provide the types of ongoing services you desire. It is imperative that your consultant will negotiate both the business terms and the product type that best fits your risk profile. Finally, every business is different, so make sure your representative understands your business and how best to proceed with contract negotiations with your business requirements in mind.

The preceding information highlights just a few of the more important aspects of electricity contracts and their impact on business operations. Use this as a starting point for your electricity contract discussions.

Remember, don’t forget to put this on your “To Do” list.

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