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Risk Management in the

ENERGY MARKET

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RISK MANAGEMENT

in the Energy Market

ARE YOU SAVING ALL YOU CAN ON ENERGY EXPENSES?

by Karl J. Paloucek

As a chief engineer, you have a pretty good idea how volatile the energy market can be, and how much it fluctuates according to the seasons. Here in Chicago, we see extremes in both winter and summer that really can put a burden on energy expenses for the properties that you manage.

But ensuring that you're saving as much as you can on the energy your building consumes takes more than just being energy conscious, knowledgeable about the technologies that you use, and the systems that you employ — it takes strategy. And this is what we sat down to discuss with Azi Feifel, Chief Operating Of-

ficer for Prospect Resources in Skokie, Ill. It's Prospect Resources' mission to help its clients to maximize savings through the application of its energy procurement strategies, and its ability to customize that strategy to best suit the client's needs.

The basic concept for Prospect Resources' strategy should be familiar to many who are acquainted with dollar-cost averaging in the world of financial investment. In fact, this is exactly how Feifel asserts that clients should perceive energy procurement. "We say energy should be treated as a financial instrument," he says. "Your financial broker will always tell you to diversify,



Locking in to a fixed low rate for electricity may not be your ideal solution for reducing your electricity bills through the heat of summer. (Photo: Thomas B., Pixabay)

right? Spread the risk around. The energy markets — they're easily as volatile as the stock market, and oftentimes they're much more volatile." Natural gas is traded on the NYMEX exchange, and electricity is a forward market.

This is why, in Feifel's view, the common method of waiting for a day when energy rates might be low and locking into that rate for an extended period is misguided — and often costly. "If someone comes to you and says, 'Hey, today's a great day to lock [into a fixed rate] for the next 24 months,' well, really, you're betting on one day, and you're betting on one price," he explains. "There are over 250 days a year [to lock in] — what makes you think today's the best day?"

What Feifel and Prospect Resources suggest is going with an alternate strategy that may be more labor-intensive and may require relying on an outside firm to manage, but that ultimately

will pay off many times over in the long run. By employing the principal of dollar-cost averaging for your purchasing of gas and electricity, purchasing them in a layered and incremental fashion, Prospect Resources helps you to manage the risk and volatility, resulting in a lower average cost of energy over time.

Of course, it isn't just as simple as that — there are a number of other factors that go into calculating each client's needs. A whole set of data has to be gathered about the properties in question, the data aggregated, and the numbers crunched. "A couple of years ago, we hired a mathematician who, by chance, had worked for both Peoples Gas and for ComEd, doing data for them," Feifel says. "We didn't know that at the time. He created a regression model for us that helps us determine the best days in the year for hedging. Now, is it the only tool that we use? Of course not. But it's one of the things that we have in our kitbag. So, we collect the data, we have a lot of these automated reports that we get every day, then we sit around the table and make the best decisions possible."

Communication with the client also is essential — understanding both their needs and their comfort level. "We talk with them about risk, and about their level of risk tolerance — different properties, different facilities will often result in different levels of risk tolerance," Feifel says. "Also, we need to understand what their time horizon is, because the strategy changes based on how much flexibility we have. You will generally save more money as time goes on, but we obviously don't want to hedge beyond where you're thinking of selling the property. And then, the other thing, of course, is who's making decisions? We need there to be a decision maker that understands our strategy and is able make an educated decision whether to act upon our recommendation."

At the outset of a client conversation, Feifel suggests, the client will usually say that they're locked in until a given point. From there, Prospect Resources will start to produce a proposal that starts with that first available point "A" and goes into the future. Whether or not a client warms to the proposal just depends on the individual, their level of sophistication, and the appetite to try something different. "Sometimes they'll say, 'That's too complicated, you're going to call me too many times,' and sometimes they'll say, 'It sounds like a great idea — let's get started.'"

Like any client relationship, Feifel says, at the start, it's very much about earning the client's confidence, which can be challenging with a service that promises its greatest returns further down the road. But Prospect Resources is right there with the client from the beginning. "There's a lot more handholding at the beginning," Feifel explains. "As people begin to trust us more and more out into the future, a lot of them give us much more leeway to get creative all the while taking risk off of the table. I personally like it when our clients are engaged, and want to

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With gas costs ever escalating, high-efficiency equipment and calculated use are only part of the energy reduction strategies available to chief engineers. (Photo: Loïc Manegarium from Pexels)

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know, and want to understand. But at the beginning, people just need to have that warm-and-fuzzy feeling that what we're doing, even though it's foreign to them, is really something that can significantly benefit their operations."

One thing Feifel is careful to make very clear is that there are no guarantees that come with the hedging process offered by Prospect Resources. It just isn't realistic, in the same way that one can't expect guaranteed results investing in stocks or mutual funds. What they offer is risk management and budget assurance — as much of a safeguard as can be expected against the volatility of the energy market. The fact that PRI's strategies yield significant consistent savings, as opposed to locking in a single fixed price for longer terms, is a welcome bonus.

Prospect Resources accomplishes this, in part, through an analysis of what they can control for any given client, and how to weigh that against the ebb and flow of market activity. "There are a few things that are within my control," Feifel suggests. "I have the data, and I know what's happened in the past. But energy markets, they bow to no one. I have no control over the weather and world geopolitical events — both of those are major drivers that cause volatility and chaos in the markets.

"There's another thing that you can't control, and that's fear," he continues. "That unpredictability ... once the fear is there, people start acting irrationally. We actually make more money for our clients when the market is more irrational and more

risky, because they're protected against the bigger swings. But I can't protect you from irrationality driven by fear. Since we've started early enough, and we've done enough in advance, then, yes, our clients are generally insulated from it. But if you've been indecisive about when and how much to procure and if there are still positions that you haven't taken, the ensuing financial pain can be significant." Ultimately, Prospect Resources is able to help manage the risk so that fear is removed from the equation as much as possible.

Any chief engineer reading this definitely will want to have some idea of the savings they might expect by partnering with Prospect Resources on their energy purchasing. To do that, we first have to define what "savings" really means, in this context. "We define savings as, how have we done relative to what you would have done otherwise — relative to what the alternate strategy is?" Feifel explains. "We define savings as our strategy versus, usually, the 100 percent all-in, fixed-price lock. If you combine electricity and gas, over time, historically, we save people, on average, 16 percent against all-in, fixed-price lock. It's more muted in the near term. On electricity, we're saving people usually between six and 11 percent. With gas, anywhere between 15 and 22 percent. ... But it's not only the actual savings, Prospect Resources has also been able to reduce year to year price volatility by up to 60 percent."

According to Feifel, the trust that their clients place in them is critical, and in turn, they take great pains to remove themselves from any potential conflicts of interest. All suppliers are quoted with the same terms and in the end, their procurement advice

is not tied to financial gain. “The supplier will pay me a small commission on the electricity and natural gas used,” he says. “If you do a capital project and reduce your electricity usage by 20 percent, I’m going to earn 20 percent less — and nonetheless, I’ll help you with the project, because you’re my client. It’s important to me that you do well.”

As a consulting organization, Prospect Resources does charge a small management fee for each account it serves. “People sometimes say, ‘Is that the monthly fee?’” he says with a laugh. “And I’m going, ‘No, no — it’s the annual fee!’”

Prospect Resources ends up serving its clients as a full-service outsourced energy desk. They welcome the opportunity to help their clients with the gamut of energy initiatives, such as capital projects, renewables, and demand response programs. They also provide their clients with sophisticated, all-inclusive budgets that include energy and non-energy charges, as well as utilities and taxes.

For a consultation with Prospect Resources, you can reach out directly to Azi Feifel at Azi@prospectresources.com — let him know you saw the article in the Chief Engineer — email pri@prospectresources.com for general information, or call the main office in Skokie at (847) 673-1959. ■■

Above right: Through a dollar-cost averaging approach, Prospect Resources can significantly reduce your electrical energy costs over the long term.

Right: By layering your natural gas purchasing over time, you can reduce your long-term costs for firing your boilers through the Chicago winters.



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-Director of Operations Azi Feifel, Prospect Resources

