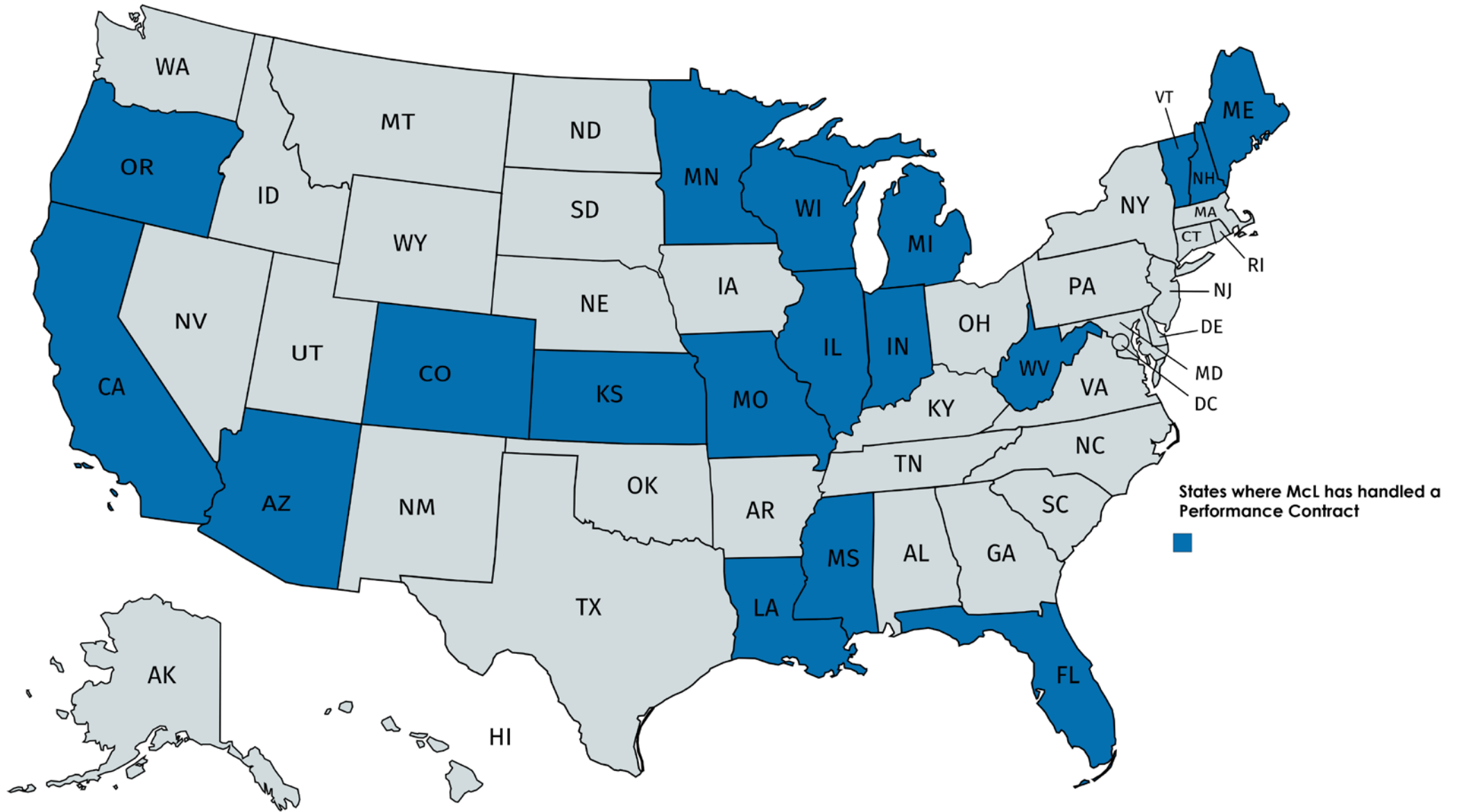


A Closer Look at Performance Contracts

- **Edward McLiney**
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- www.mcliney.com



McLiney And Company has handled more than 300 performance contact financing in the highlighted States

Who is Looking out for the School District when considering a Performance Contract?

- ESCO?
 - No, their goal is a successful project
- Underwriter/Purchaser?
 - No, required to deal with you “fairly”
- Bond Attorney?
 - Yes, making sure the projects is handled legally
 - No, not there to advise on feasibility
- Municipal Advisor (licensed)?
 - Yes, have a fiduciary obligation to the School District

When considering a Performance Contract get your financing team involved as soon as possible.

That team should include:

- Local Attorney, Examine the Performance Contract
- Bond Attorney, Give an opinion all that the issue was handled legally
- Municipal Advisor, to Examine ESCO's numbers and Market the issue

The above experts will help make the financing as smooth as possible.

What is being financed?

Project Cost Breakout





| | | | | |
|--|----|-----------|-----------|----------|
| Project Subtotal Cost | | \$ | 4,363,350 | |
| Subtotal Cost Breakdown: | | | | |
| Capital Planning and Comprehensive Energy Audit Development | \$ | 160,000 | | |
| Engineering - Final Scope Development and Final Design Review | \$ | 226,859 | | |
| Energy Conservation Measures Subcontractor and Equipment Cost | \$ | 2,743,132 | ← | 54.33% |
| Project Management | \$ | 316,763 | | |
| Performance Assurance, Startup and Training | \$ | 131,104 | | |
| Equipment and Performance Warranty | \$ | 115,499 | | |
| General Conditions (job site, cleaning, office material, etc.) | \$ | 107,400 | | |
| Project Contingency | \$ | 437,914 | | |
| Payment & Performance Bond, Insurance, Permits and Fees | \$ | 108,580 | | |
| B&O Tax | \$ | 16,099 | | |
| Project Cost Subtotal | | \$ | 4,363,350 | |
| OH | \$ | 411,470 | | |
| Profit | \$ | 274,313 | | |
| Total | \$ | 5,049,133 | | |
| Soft Costs | | \$ | 2,305,000 | ← 45.67% |

Basic Information:



| | Annual Energy Savings | Annual O&M Savings | Issue Size |
|--------|-----------------------|--------------------|----------------|
| ESCO A | \$1,575,000 | ➔ \$551,000 | ➔ \$30,712,500 |
| ESCO B | 1,549,000 | 131,000 | 25,480,000 |
| ESCO C | 1,557,000 | 80,000 | 24,061,227 |

Additional Items to Review:

| Financial Summary | |
|---|--|
| Program Cost | \$1,767,908 |
| Rebates | \$50,000 |
| Down Payment | |
| Amount Financed | \$1,717,908 |
| Annual Program Savings | \$115,347 |
| Simple Payback | 15.33 Years |
| Annual Interest Rate | 2.75%  |
| Desired Finance Period | 18 Years |
| Actual Finance Period | Years |
| Payments per Year | 4 |
| Total Interest Payments | \$465,897 |
| Energy Escalation | 3.0%  |
| Operational Escalation | 3.0%  |
| Service Escalation | 3.0%  |
| <input type="checkbox"/> Include Construction Interest in Cashflow | |
| <input type="checkbox"/> Also include Escrow Interest Earned | |

Item Missing: Cost of Issuance

Pay attention to the ESCO Cash Flow:

Below is an example pro-forma for the large project estimate.

| YEAR | Construction | 1.0 | 2.0 | 3.0 | 4.0 | 5.0 | 6.0 |
|---------------------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| PROGRAM BENEFITS | | | | | | | |
| Utilities Savings | \$ 393,750 | \$ 1,575,000 | \$ 1,630,125 | \$ 1,687,179 | \$ 1,746,231 | \$ 1,807,349 | \$ 1,870,606 |
| Operational Savings | | \$ 551,250 | \$ 560,897 | \$ 570,713 | \$ 580,700 | \$ 590,862 | \$ 601,202 |
| Capital Avoidance Savings | | | | | | | |
| Rebates | \$ - | | | | | | |
| Annual Total Benefits | \$ 393,750 | \$ 2,126,250 | \$ 2,191,022 | \$ 2,257,892 | \$ 2,326,931 | \$ 2,398,211 | \$ 2,471,808 |
| Cumulative Benefit | \$ 393,750 | \$ 2,520,000 | \$ 4,711,022 | \$ 6,968,914 | \$ 9,295,845 | \$ 11,694,056 | \$ 14,165,864 |
| PROGRAM COSTS | | | | | | | |
| Project Down Payment | | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Financing Payments | \$ - | \$ 2,034,113 | \$ 2,143,571 | \$ 2,209,018 | \$ 2,276,590 | \$ 2,346,360 | \$ 2,418,402 |
| Ongoing Energy Services | \$ - | \$ 92,138 | \$ 47,451 | \$ 48,874 | \$ 50,341 | \$ 51,851 | \$ 53,406 |
| Annual Gross Costs | \$ - | \$ 2,126,250 | \$ 2,191,022 | \$ 2,257,892 | \$ 2,326,931 | \$ 2,398,211 | \$ 2,471,808 |
| Cumulative Costs | \$ - | \$ 2,126,250 | \$ 4,317,272 | \$ 6,575,164 | \$ 8,902,095 | \$ 11,300,306 | \$ 13,772,114 |
| CASH FLOW | | | | | | | |
| Net Program Benefit | \$ 393,750 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Cumulative Net Benefit | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 |

| 7.0 | 8.0 | 9.0 | 10.0 | 11.0 | 12.0 | 13.0 | 14.0 | 15.0 | TOTAL |
|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| \$ 1,936,077 | \$ 2,003,840 | \$ 2,073,974 | \$ 2,146,563 | \$ 2,221,693 | \$ 2,299,452 | \$ 2,379,933 | \$ 2,463,231 | \$ 2,549,444 | \$ 30,784,447 |
| \$ 611,723 | \$ 622,429 | \$ 633,321 | \$ 644,404 | \$ 655,681 | \$ 667,156 | \$ 678,831 | \$ 690,710 | \$ 702,798 | \$ 9,362,678 |
| | | | | | | | | | \$ - |
| | | | | | | | | | \$ - |
| \$ 2,547,801 | \$ 2,626,268 | \$ 2,707,295 | \$ 2,790,968 | \$ 2,877,374 | \$ 2,966,608 | \$ 3,058,764 | \$ 3,153,941 | \$ 3,252,242 | \$ 40,147,125 |
| \$ 16,713,664 | \$ 19,339,933 | \$ 22,047,228 | \$ 24,838,196 | \$ 27,715,570 | \$ 30,682,178 | \$ 33,740,942 | \$ 36,894,883 | \$ 40,147,125 | |
| \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| \$ 2,492,792 | \$ 2,569,610 | \$ 2,648,937 | \$ 2,730,858 | \$ 2,815,462 | \$ 2,902,838 | \$ 2,993,081 | \$ 3,086,288 | \$ 3,066,215 | \$ 38,734,134 |
| \$ 55,008 | \$ 56,659 | \$ 58,359 | \$ 60,109 | \$ 61,913 | \$ 63,770 | \$ 65,683 | \$ 67,654 | \$ 69,683 | \$ 902,897 |
| \$ 2,547,801 | \$ 2,626,268 | \$ 2,707,295 | \$ 2,790,968 | \$ 2,877,374 | \$ 2,966,608 | \$ 3,058,764 | \$ 3,153,941 | \$ 3,135,898 | \$ 39,637,032 |
| \$ 16,319,914 | \$ 18,946,183 | \$ 21,653,478 | \$ 24,444,446 | \$ 27,321,820 | \$ 30,288,428 | \$ 33,347,192 | \$ 36,501,133 | \$ 39,637,032 | |
| \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 116,343 | \$ 510,093 |
| \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 510,093 | |

ESCO A Cash Flow:

Below is an example pro-forma for the large project estimate.

| YEAR | Construction | 1.0 | 2.0 | 3.0 | 4.0 | 5.0 | 6.0 |
|---------------------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| PROGRAM BENEFITS | | | | | | | |
| Utilities Savings | \$ 393,750 | \$ 1,575,000 | \$ 1,630,125 | \$ 1,687,179 | \$ 1,746,231 | \$ 1,807,349 | \$ 1,870,606 |
| Operational Savings | | \$ 551,250 | \$ 560,897 | \$ 570,713 | \$ 580,700 | \$ 590,862 | \$ 601,202 |
| Capital Avoidance Savings | | | | | | | |
| Rebates | \$ - | | | | | | |
| Annual Total Benefits | \$ 393,750 | \$ 2,126,250 | \$ 2,191,022 | \$ 2,257,892 | \$ 2,326,931 | \$ 2,398,211 | \$ 2,471,808 |
| Cumulative Benefit | \$ 393,750 | \$ 2,520,000 | \$ 4,711,022 | \$ 6,968,914 | \$ 9,295,845 | \$ 11,694,056 | \$ 14,165,864 |
| PROGRAM COSTS | | | | | | | |
| Project Down Payment | | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Financing Payments | \$ - | \$ 2,034,113 | \$ 2,143,571 | \$ 2,209,018 | \$ 2,276,590 | \$ 2,346,360 | \$ 2,418,402 |
| Ongoing Energy Services | \$ - | \$ 92,138 | \$ 47,451 | \$ 48,874 | \$ 50,341 | \$ 51,851 | \$ 53,406 |
| Annual Gross Costs | \$ - | \$ 2,126,250 | \$ 2,191,022 | \$ 2,257,892 | \$ 2,326,931 | \$ 2,398,211 | \$ 2,471,808 |
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| CASH FLOW | | | | | | | |
| Net Program Benefit | \$ 393,750 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Cumulative Net Benefit | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 |

| 7.0 | 8.0 | 9.0 | 10.0 | 11.0 | 12.0 | 13.0 | 14.0 | 15.0 | TOTAL |
|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
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| \$ 611,723 | \$ 622,429 | \$ 633,321 | \$ 644,404 | \$ 655,681 | \$ 667,156 | \$ 678,831 | \$ 690,710 | \$ 702,798 | \$ 9,362,678 |
| | | | | | | | | | \$ - |
| | | | | | | | | | \$ - |
| \$ 2,547,801 | \$ 2,626,268 | \$ 2,707,295 | \$ 2,790,968 | \$ 2,877,374 | \$ 2,966,608 | \$ 3,058,764 | \$ 3,153,941 | \$ 3,252,242 | \$ 40,147,125 |
| \$ 16,713,664 | \$ 19,339,933 | \$ 22,047,228 | \$ 24,838,196 | \$ 27,715,570 | \$ 30,682,178 | \$ 33,740,942 | \$ 36,894,883 | \$ 40,147,125 | |
| \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| \$ 2,492,792 | \$ 2,569,610 | \$ 2,648,937 | \$ 2,730,858 | \$ 2,815,462 | \$ 2,902,838 | \$ 2,993,081 | \$ 3,086,288 | \$ 3,066,215 | \$ 38,734,134 |
| \$ 55,008 | \$ 56,659 | \$ 58,359 | \$ 60,109 | \$ 61,913 | \$ 63,770 | \$ 65,683 | \$ 67,654 | \$ 69,683 | \$ 902,897 |
| \$ 2,547,801 | \$ 2,626,268 | \$ 2,707,295 | \$ 2,790,968 | \$ 2,877,374 | \$ 2,966,608 | \$ 3,058,764 | \$ 3,153,941 | \$ 3,135,898 | \$ 39,637,032 |
| \$ 16,319,914 | \$ 18,946,183 | \$ 21,653,478 | \$ 24,444,446 | \$ 27,321,820 | \$ 30,288,428 | \$ 33,347,192 | \$ 36,501,133 | \$ 39,637,032 | |
| \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 116,343 | \$ 510,093 |
| \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 393,750 | \$ 510,093 | |

Be cautious of the following terms and the “saving” associated with each:

- Capital Avoidance Savings
- Operational Avoidance
- Operational Savings
- Operational and Maintenance Savings

Why? Because, Energy Savings are guaranteed, not the above listed “savings”.

Have the ESCO document where those saving will be achieved.

Marketing the Issue:

The Effect of the Tax Law Change on Taxable Equivalent Yields for Banks, 3% Tax Exempt Yield

| Before Tax Law Change | After Tax Law Change |
|-------------------------------|-------------------------------|
| 35% Tax Bracket | 21% Tax Bracket |
| $(1 - .35 = .65)$ | $(1 - .21 = .79)$ |
| $3\% / .65 = \mathbf{4.62\%}$ | $3\% / .79 = \mathbf{3.80\%}$ |

Today a bank needs to receive a **3.65%** tax exempt yield to equal the same benefit they received on a **3%** yield before the tax law change. ($4.62\% \times .79 = 3.65\%$)

Effect of a **.65%** difference on a 15 year \$5,000,000 issue.

| | 3% | 3.65% | Difference |
|----------------|-------------|-------------|------------|
| Annual Payment | \$418,833 | \$438,867 | \$20,034 |
| Total Payments | \$6,282,500 | \$6,583,005 | \$300,505 |

Typical MA Fee for a \$5,000,000 Issue= \$32,250

Miscellaneous Points:

- Having an ESCO will not improve the marketability of your issue
- Don't sign an "Expression of Intent" letter written by the ESCO where ESCO identifies fund source
 - Do you (You MA) agree with source?
 - End up paying for engineering and no project
- Do your own RFP when considering a ESCO
- Have your attorney examine the Performance Contract
 - Written by the ESCO for the ESCO
 - 150-200 pages long
 - Many have Algebraic Equations to calculate saving
 - List of items that disqualify the guarantee

Any Questions?