HOME ENERGY SAVINGS PROGRAM
A PAY-FOR-PERFORMANCE RESIDENTIAL ENERGY EFFICIENCY PILOT

FINANCIAL GUIDANCE TO BIDDERS SEEKING PORTFOLIO FINANCE

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I. About Auria Capital

Auria Capital is a leading institutional financial advisor and boutique investment bank specializing in energy and infrastructure projects. The employee-owned firm has a dedicated practice of advising global clients in their need to raise capital, make investments or divest assets, companies and technologies. This guidance document was prepared by Auria in collaboration with National Grid and NYSERDA for the Home Energy Savings Program, as a guidance document on the financial considerations for the Energy Efficiency market providers.

II. Introduction

This financial guidance document was prepared to assist potential Portfolio Managers ("Bidders") in preparing their financing plans supporting their proposals to deliver Home Energy Savings program, a residential Pay for Performance (P4P) program. Ultimately, the document aims to provide guidance for Bidders to frame and present impactful, encompassing and well-rounded proposals, which will aid the RFP scoring committee in their selection of bid responses based, among other considerations, on the assessment and understanding of Bidders' financial backgrounds, delivery methods and operative models. **Bidders must follow the submission directions in the RFP; this document is for guidance purposes only.**

III. Financing a Portfolio on a Long-Term Basis

1. P4P Financial Parameters

The cornerstone of attracting private capital participation centers around assessments of financial risks embedded in the P4P program design. Bid responses to the RFP, incorporating the input from the Bidder and their third-party equity investors, lenders and needs of customers (as further explained herein), to varying degrees, will reflect the collective understanding of those financial risks.

In that regard, it should be noted that a key risk of the P4P program, when evaluating it from a financial perspective, lies in the Bidders' ability to deliver, with a certain level of confidence, the mix of proposed energy efficiency measures, the assumed levels of customer participation and the energy savings potential reflected in the Bid Package Workbook. These assumptions will form the basis upon which projected future cash flows under the P4P contract will be calculated and realized. These projected cash flows, consequently, give Bidders an idea on: (i) the source of investment needed for the upfront customer acquisition and installation costs of energy efficiency system upgrades (ii) expected customer upfront payments and/or payments through agreement with customers or any other financial arrangement the selected Portfolio Manager works out with the customers for the services provided (iii) performance payments from utility and NYSERDA for deliverable energy savings; and (iv) a risk-adjusted return to the investors commensurate with their assessment of the level of the financial risk.

2. Performance and Customer Base Parameters

Based on the performance and customer-base parameters, Bidders should estimate their operating expenses of administering the P4P program, reported in their Bid Response, and any necessary working capital to support the initial customer acquisition operations. In certain circumstances, working capital may be required in the future as a result of customer non-payments. Bidders would be wise to consider how the "portfolio" nature of the P4P program may provide the benefit of absorbing certain fixed costs and working capital needs as they are being spread over the entire customer base.

IV. Sources & Uses of Funds: Framework

In order to prepare the financial response to the RFP, the Bidder can perform iterative analyses weighing proposed long-term revenue streams from customers and National Grid, the confidence in the realizable energy savings from the mix of technology choices to be offered to customers, and the proposed financing plan which may include any upfront payments collected from customers. Factoring in the above elements will help the Bidders assess the cost of capital, financing options and equity returns requirements.

This process will balance the interests of different stakeholders in the P4P program, each with distinct evaluation criteria for their respective participation:

- The level and type of the funding commitment the Bidders and their investors will propose will be a function of realizable customer acquisition and long-term energy savings.
- Customers' participation will depend upon their anticipation of lower future utility bills, increased home health and comfort, their financial ability to make upfront payments, and/or the Bidders' capabilities to provide low to no-upfront customer payment options in conjunction with longer-term energy savings agreements or any other financial arrangement the Portfolio Manager offers the customers for the services provided.
- National Grid and NYSERDA will "participate" by selecting Bidders and committing to provide long-term revenues based on the criteria laid out in the RFP and support in program administration.

V. Sources of Funds: Bidders Financial Package

Bidders should evaluate the options of securing the requisite financing to implement the P4P program from three different sources:

1. Upfront Payments from Customers

Bidders should weigh and satisfy conflicting objectives when modeling the level of upfront payments that can be received from customers.

For example, to meet the budget requirements for the purchase and installation of energy efficiency equipment and provide for working capital needs, higher projected upfront payments from customers, on one hand, would reduce the amount of financing a Bidder should secure. Such a scenario would result in lower financing cost and, consequently, a lower or more competitive bid value ($ cost /MMBtu of savings provided) proposed by the Bidder as part of the Bid Package Workbook. It might, however, also lower the level of customer enthusiasm to participate in the program.

The opposite holds true if, in preparing a financing plan, the Bidder were to assume little or no upfront customer payments. This scenario would require more funding, leading to higher financing costs and/or potentially a higher bid value ($ cost/MMBtu of savings provided) proposed by the Bidder as part of the Bid Package Workbook. The level of customer participation in this case, however, can be assumed to be higher.

Bidders should, therefore, strike a delicate balance when making assumptions about upfront payments from customers.

2. Debt Financing

Financing could, in part, be explored through either recourse or non-recourse loans by Bidders.

In providing a recourse loan, a bank would evaluate the financial strength of the borrower and its ability to repay the loan regardless of whether the projected cash receipts from customer and/or P4P performance payments will be realized. The loan repayment risk to a bank will, therefore, not be tied directly to the success of the P4P pilot program but rather be a function of the borrower's overall ability to repay the loan. The cost of the financing will, consequently, depend on the Bidder's financial strength and history.

In contrast to the corporate credit scenario, a bank could consider extending a loan based only on the "certainty" that the projected cash flows under the P4P pilot will be realized and available to repay the loan. In relying solely on the projected cash flows as a source for the loan repayment, a bank may agree not to seek recourse to the borrower's balance sheet and financial ability to repay the loan. The bank will propose an interest rate on the loan and loan fees commensurate with the level of risk that the bank perceives when evaluating the risk of repayment from the proposed P4P cash flows.

In addition, given the different risk profile of a loan that is structured as a corporate or a non-recourse credit, the loan amount will vary accordingly. Under a non-recourse loan, the debt amount will be sized based upon targeted debt service coverage ratios ("DSCR"). DSCR will be established based upon the bank's risk assessment of the realization of the projected cash flows. The higher the perceived risk, the higher the DSCR requirements will be, i.e., the loan amount will be smaller given the same level of cash flow available for debt service under the P4P program. In contrast, the borrowing capacity available to a Bidder utilizing a corporate loan facility will be solely a function of the strength of the Bidder's balance sheet and credit history.

The choice and/or availability of either type of bank financing (recourse vs. non-recourse) will impact the cost of the financing that Bidders may include in their responses to the RFP. Typically, a recourse loan, if available, will be a cheaper option for a Bidder to consider.

3. Equity Investment

After subtracting funds available from customer upfront payments and bank loans to fund total project costs, the amount of equity financing required will be a plug figure.

VI. Uses of Funds

During the implementation phase of the P4P pilot program, expected use of funds, will be deployed, but not limited to, paying for the three following capital outlays:

1. Equipment Procurement and Installation Costs

The financing plan should reflect a package of efficiency measures that the Bidder expects to offer to its customers. For some Bidders, the package could include a range of equipment that optimizes efficient energy consumption, addresses whole home energy efficiency, energy bill costs etc. The Bidders selection and implementation of whole home energy efficiency measures and 'packaged' approach of "high performance" equipment will have to be weighed against the costs of installation and, the available financing sources, and the earnings potential through the P4P Program.

2. Working Capital Considerations

The selected Portfolio Manager may incur marketing, administrative, contracting and implementation expenses as they sign up customers to participate in the program. Bidders will have to give financial consideration to the size and scope of customer outreach efforts.

3. Financing Costs

Taking into account the financing terms, the cost of borrowing payable during the rollout phase of the P4P pilot program, e.g., loan fees and interest payments before customer and P4P payments commence, if applicable, should be factored into the uses of funds.

VII. P4P Pilot Program Cash Flows

During the “operating phase” of the program, P4P payments and customer payments to the selected Portfolio Managers will support the cash flow necessary to repay any debt financing and provide a risk-adjusted return on the equity investment. The long-term revenues required from the customers and/or the P4P program are, therefore, a function of the Bidder’s proposed capital structure and the energy savings performance of the Bidder’s portfolio.

VIII. Bidders’ Response to the RFP

In their response to the RFP, Bidders should clearly identify their proposed sources and uses of funds, and the nature of the financing plan describing any contemplated third-party debt and equity sources. To the extent available, Bidders should also provide proposed financing terms and the status of securing the necessary third-party funding or the process of obtaining approvals for internally sourced company funds.

It is equally important to provide the information that would help the RFP selection committee to evaluate the financial health of the Bidder, to the extent a Bidder would have to rely on internal funds and/or working capital to support certain aspects of the P4P pilot program under any unforeseen delays or other unexpected challenges.