Federal Utility Partnership Working Group Meeting

Biloxi, MS May 5-6, 2009

Financing -Limited Lending Issues

Market/Pricing Update

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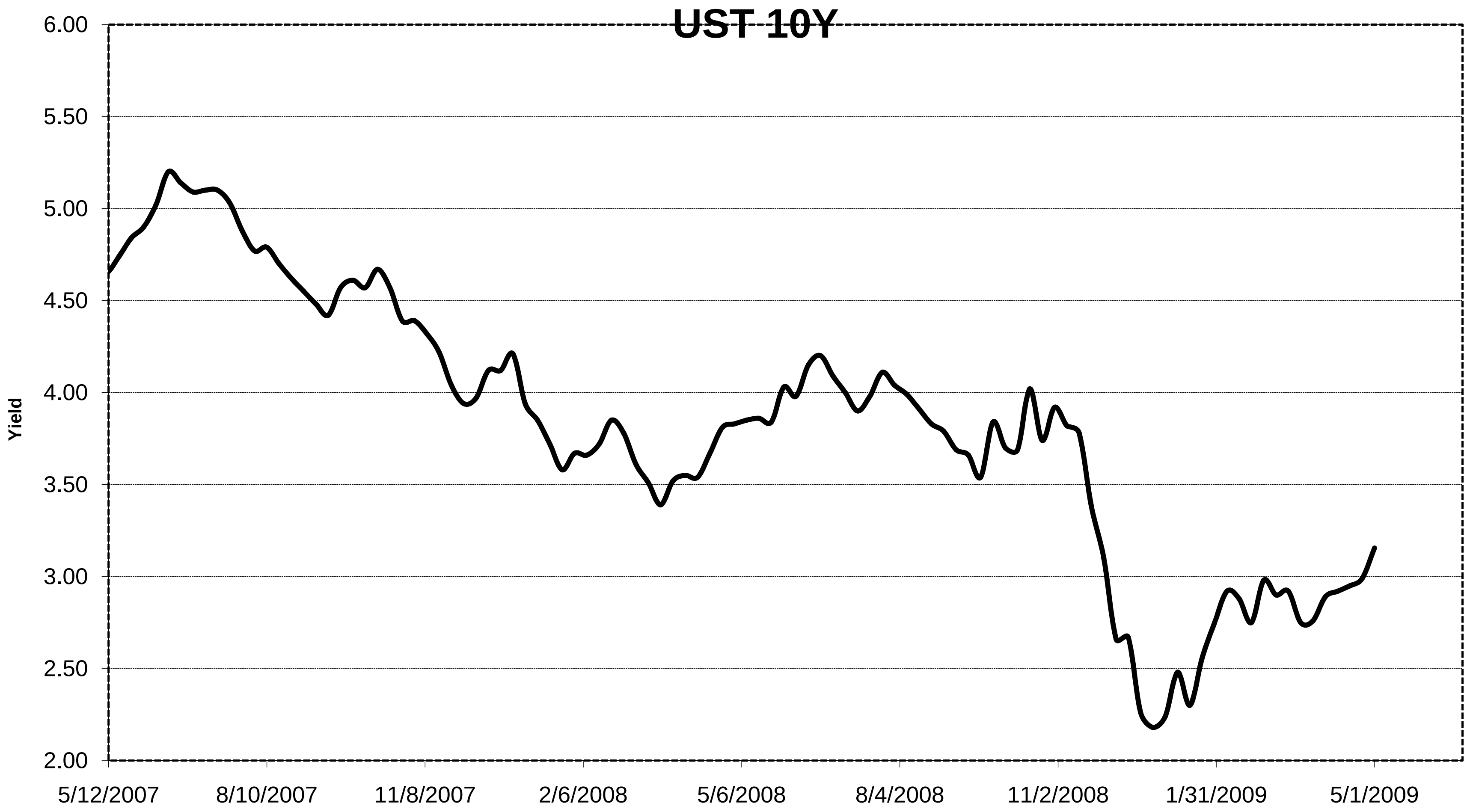
MARKET DISRUPTION: WHAT IT MEANS FOR UESC

- Flight to quality – looking for quality credits/structures
- Debt and equity providers are not willing to take speculative risk
  - More focus on the “deal”
  - Investment grade construction and performance guarantees for ongoing obligations
- Higher spreads – see compression in 2009?
- Generally good news for UESC (and other federal programs)
  - Quality credits and strong track record

US TREASURY MARKET

- UESC typically priced as credit spread to US Treasuries
  - UST/base rate (3.00%) + credit spread (3.50%) = finance rate (6.50%)
- Sustained US Treasury rally (2 years)
- Murky outlook for 2009
- 10-year UST yield recently hit its high mark for 2009
  - Investors moving away from risk-free securities in search of yield
  - Will the Government continue to absorb supply to keep borrowing costs low?

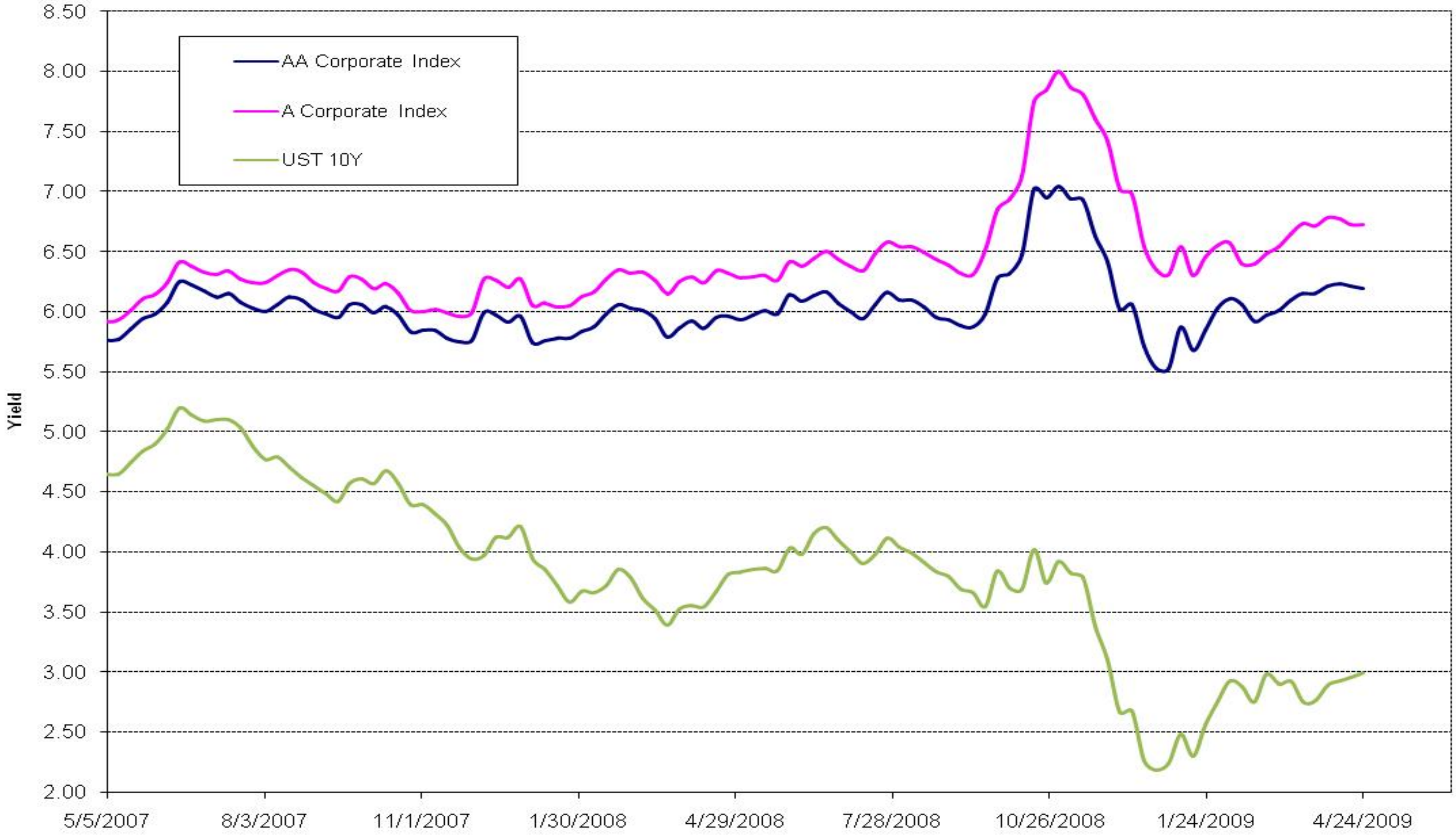
10-YEAR US TREASURY – 2 YEAR HISTORY



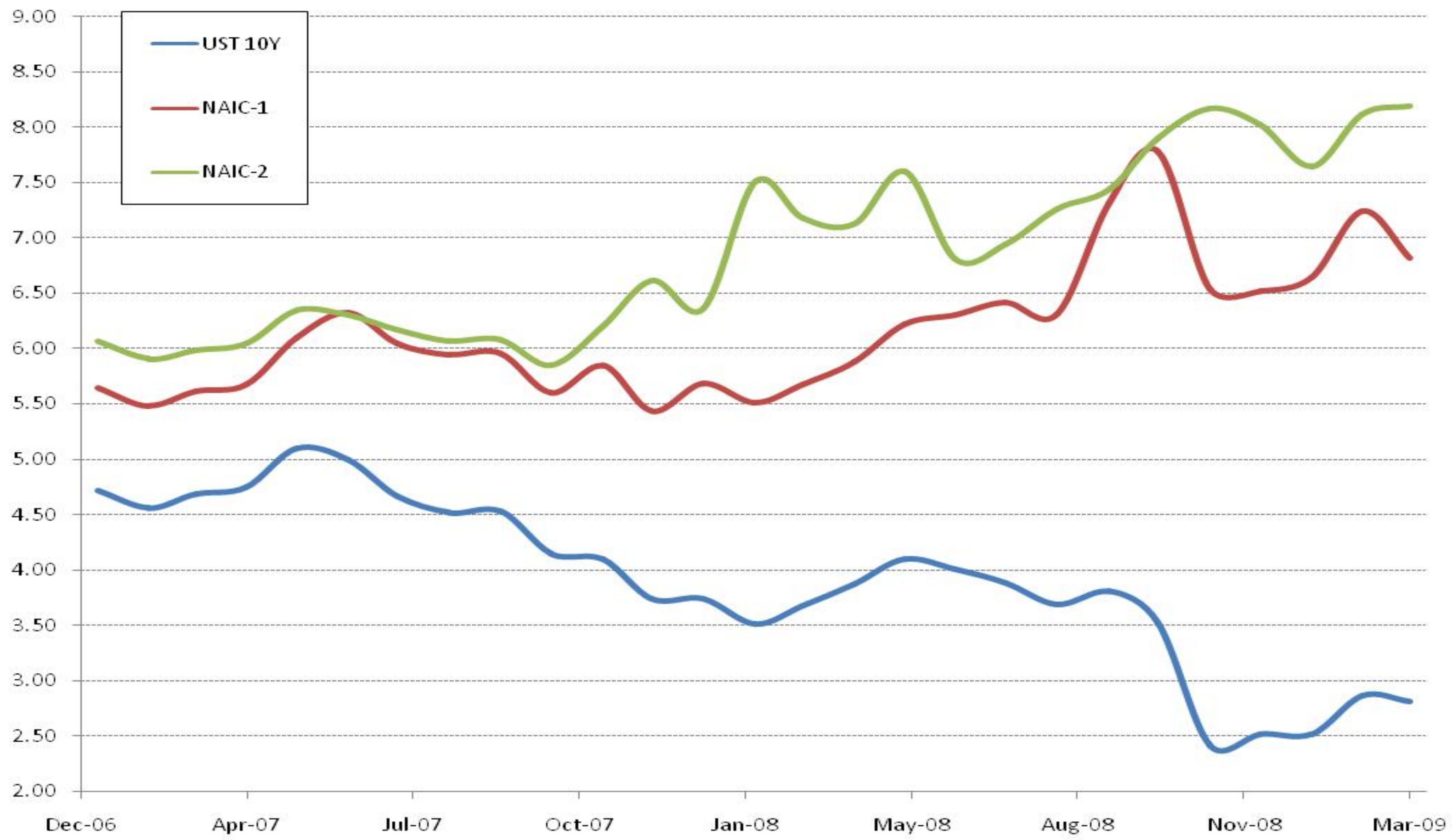
CREDIT SPREADS

- Why are finance rates higher today?
- US Treasury rally not the whole story – significant widening of credit spreads since 2007
- NAIC and Standard & Poor's rated transactions/entities
  - S&P "A" or better rating: spreads have widened as much as 200+ bps in one year and 300+ bps over two years.
  - S&P "BBB" rating: spreads have widened as much as 200+ bps in one year and 400+ over two years.
- Expect that spreads will continue to level out in 2009

AA & A CORPORATE INDICES



NAIC-1 & NAIC-2 vs. UST 10Y



NAIC-1 SPREADS – 10 YEAR WAL

DATE	RANGE		1YR PRIOR	
	LOW	*HIGH*	*LOW*	*HIGH*
Feb-08	175	225	85	100
Mar-08	175	225	85	100
Apr-08	175	225	85	100
May-08	175	250	95	105
Jun-08	185	275	115	150
Jul-08	190	315	125	150
Aug-08	225	300	125	160
Sep-08	275	425	125	160
Oct-08	350	500	125	165
Nov-08	350	475	150	200
Dec-08	350	450	150	190
Jan-09	350	475	175	215
Feb-09	400	475	175	225
Mar-09	375	425	175	225

NAIC-2 SPREADS – 10 YEAR WAL

DATE	RANGE		1YR PRIOR	
	LOW	*HIGH*	*LOW*	*HIGH*
Feb-08	250	550	110	160
Mar-08	250	450	105	155
Apr-08	250	400	105	155
May-08	250	450	105	145
Jun-08	250	310	115	145
Jul-08	260	350	120	180
Aug-08	290	425	130	180
Sep-08	300	425	130	180
Oct-08	375	500	150	190
Nov-08	500	650	170	250
Dec-08	500	600	250	325
Jan-09	500	600	225	300
Feb-09	450	600	250	550
Mar-09	500	575	250	450

CONCLUSION

- Rates will continue to be higher than 2007 levels, but credit spreads will likely flatten and compress in 2009 for investment grade credits
  - US Treasury yields likely to rise
- Investors will still demand tight structures – not as much flexibility in terms
- UESC market attractive because it provides returns above traditional US Government obligations
  - Large and diverse project pipeline – geographic and agency distribution
  - Strong track record – high quality investment opportunity

THANK YOU

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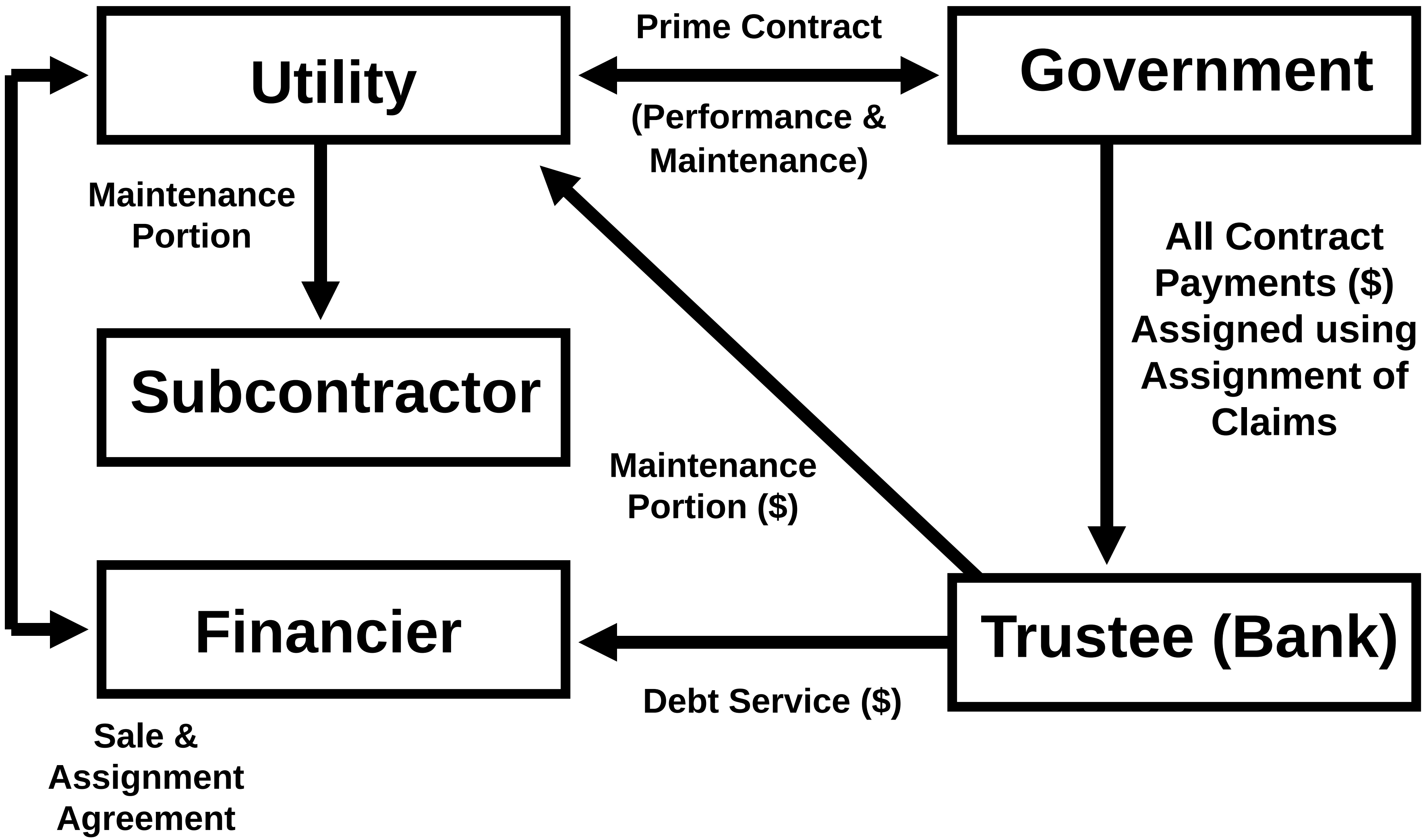
UESC Financing Contractual Structure



THANK YOU

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Financing Forum: Risk to Utilities and Investors

FUPWG 2009 Biloxi

Risks to Utility

- **Risks to Utility should be analyzed in two separate periods of project:**
  - Construction Period
  - Permanent Period
- **Key Legal Document is "Sale and Assignment Agreement"**
  - Delineates "Assignment" of payment stream from the government to the lender
  - Thus, only passing through the utility
  - "Sale and Assignment" occurs at close of financing

Risks to Utility

- **Construction Period Risks** – *Exist for utility since Financing for the Project has closed.*
- Construction Cost Overruns
    - Firm fixed price quote; difficult to get change order
  - Equipment Performance and Engineering Liability
    - Contingent on Government Acceptance
    - Utility shifts risk down to subcontractors and vendors
  - Construction Delays – Built-in time hedge
    - Liable for added costs to construction loan
  - Default of Subcontractors – Inability to finish job
- **Construction Period Mitigants** – *Surety Bond*
  - Held by utility (backed by Bonds from subcontractors)
    - Covers ability to complete project if contractor defaults

Risks to Utility

- **Permanent Term Risks** – *Very Minimal*
  - US Government is the borrower (obligor)
  - Sale and assignment clause “assigns” payment stream to investor and does not involve utility thereafter
  - Risks are minimal since commitment is from government to make debt service payments
- **Permanent Term Mitigants**
  - *Security of Government to make payments regardless of savings stream from project*

Risks to Utility

- **Permanent Term** – *Other Issues*
  - One year warranty period after construction complete
    - If problems with project during 1 year period, utility is expected to repair and replace all systems under warranty
  - Problems with projects after 1 year warranty period
    - Expected to be solved by the “good faith” relationship between the utility and the government
    - Area wide Agreement puts focus on delivery of energy as core business; energy efficiency projects are part of a service the utility provides

Risks to Investor

- **Risks to Investor should also be analyzed in two separate periods of project:**
  - Construction Period
  - Permanent Period

Risks to Investor

- **Construction Period Risks** – *Focus is on ability of utility to deliver the project it has promised.*
  - – Delays in construction can cause permanent period payment stream to be extended.
    - Utility is liable interest to lender in any delayed acceptance period
  - – Default of utility (not to finish project), though highly unlikely, would be covered by surety bond
    - Strength of Areawide makes this a unlikely scenario
    - Default of sub-contractors covered by surety bonds
  - – Termination for Convenience (TOC) which is the likelihood that government will buy out contract

Risks to Investor

- **Permanent Term Risks** – *Very Minimal*
  - Sale and assignment clause "assigns" payment stream to investor at start of construction of project
  - Risk of payment is minimal based on commitment from government to make debt service payments
  - Termination for Convenience (TOC)
    - Possible with more stimulus money available
- **Permanent Term Mitigants**
  - *Security of Government to make payments*
  - *Payments are not based on savings resulting from project*
  - *TOC Fee associated with amortization schedule*
    - *Also, TOC not typical with UESC projects*

FUPWG

Biloxi, MS

May 2009

How to Get the Lowest Interest Rates

- Interest rate is determined by:
  - Base rate relative to market rate (Treasury Note or SWAP rate)
  - Increases for contract terms/risks (adder)
  - Increases for interest rate fluctuations (hedge)
- Escrow accounts are the main type of financing structure used during construction
- Ultimately, pricing and terms are set by comparing a project's overall risk and return to similar projects in the private sector

How to Get the Lowest Interest Rates

- Performance Risk

  - Financial Strength of ESCO or Utility
  - Energy Savings Guarantee Requirements

- Termination for Convenience and Non-appropriation Contract Language

- Project Requirements

  - Term and Size Financing
  - Fixed Rates
  - Set Actual Rate and Deal Economics at or near Award

How to Get the Lowest Interest Rates

- Bundle projects
- Keep the financing term under statute authority
- Insure the Government Contract has desirable Termination and Non-Appropriation language
- Fixed interest rates at Task Order award
- Provide limited, Option A, energy savings guarantees
- Work only with companies with very highest (investment grade) credit ratings

How to Get the Lowest Interest Rates

- Lenders price to the risks assumed

- Lenders' primary concern is on-time or repayment of their investment

- Lenders make their return over time

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