Financing

Once a sufficient number of Participants have entered into GSAs and have accepted the results of their IGAs, the Program anticipates that the Pennsylvania Economic Development Finance Authority (**PEDFA**) will issue bonds in an amount sufficient to pay the construction costs of all of the Participants' projects together with the costs of the financing and Program costs. The net proceeds of the bonds will be deposited with the trustee under the bond indenture, in separate construction accounts for each project. Each project will be fully funded, and its construction account cannot be applied to any other project. Participants must sign off on construction draws. The Issuer will assign Participants' financing payments to the Trustee to secure payment of the bonds, and after the projects are complete, the trustee will apply those payments to pay principal and interest on the bonds. Each Participant will negotiate an individual repayment schedule that is consistent with the useful lives of the CMs it selects and that meets its fiscal needs, and the bond payment schedule will aggregate those repayment schedules. Each Participant is obligated only for its own payments, and is not at risk for the default of other participants.

Additional funding for projects may be available to Participants through their local utility's Act 129 Energy Efficiency and Conservation Program, through tax credits available for solar projects, or other sources of grants or low cost funding. The Program will work with Participants to help meet the requirements of these programs and integrate them with bond financing.

With certain exceptions, Local Government Unit Debt Act (**Debt Act**) requires local government units to obtain voter approval for issuance of debt, unless the aggregate amount of debt of the government unit is below a multiple of its borrowing base (which is defined with respect to its average tax revenues). If debt is incurred to fund capital improvements in the form of a lease from a Pennsylvania chartered authority the multiple of the borrowing base is raised by 100 percent of the borrowing base. This amounts to doubling the limit for school districts, and a smaller percentage increase for other governmental units (which have a higher threshold to begin with). By structuring the Participant payment obligation in the Program as a lease obligation to PEDFA, we can allow government units to take advantage of the higher debt limits.

Participant obligations can also avoid the requirements of the Debt Act in their entirety if the bond repayment obligations are made subject to appropriations. Because debt under the Debt Act excludes "current obligations for the full payment of which current revenues have been appropriated," obligations that are only payable to the extent of current annual appropriations do not count as debt. Governmental units frequently enter into such agreements, and they are routinely used to support the issuance of bonds. "Subject to appropriations" debt is viewed as bearing somewhat more risk than general obligation debt, and therefore requires somewhat higher rates – a premium that increases as the underlying rating of the obligor goes lower.

Because structuring Participant debt as lease debt may have benefits for some Participants, the Program will use a financing lease as the standard structure for Program debt obligations. We will work with Participants to resolve any issues regarding credit and debt issues, and expect that a "subject to appropriations" will be available as an option for Participants who find that a more advantageous choice.

Further Information

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Or visit the Program web page on FREE's website:
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Pennsylvania Sustainable Energy Finance Program

Pennsylvania Sustainable Energy Finance **Program**

The Pennsylvania Treasury Department has partnered with the Foundation for Renewable Energy and Environment (**FREE**), with financial support from the West Penn Power Sustainable Energy Fund, to develop a prudent, market-based investment vehicle that promotes energy and water efficiency, clean energy generation, economic development and environmental improvement. To achieve this goal, FREE has established a Sustainable Energy Finance Program (the **Program**) that will provide technical and legal assistance, as well as low-cost capital, for energy improvement projects by municipalities, universities, schools and hospitals – the so-called "**MUSH**" sector (including counties and governmental agencies). Under the Program, participating organizations in the MUSH sector (**Participants**) will receive free energy audits from energy service companies, or "**ESCOs.**" Once potential projects have been identified and the Participants have decided to proceed, bonds will be issued to finance the improvement work. By aggregating the projects in a single financing, the Program will provide Participants with better financing terms than would be available individually. The energy and water cost savings from the projects will be used to support repayment of the bonds.

An ESCO wishing to participate in the Program must prequalify and agree to a common set of legal documents and performance standards relating to project design, savings guarantees, compliance verification, and corrective actions if necessary. The principal features of the Program are as follows:

1. FREE will seek letters of intent from potential Participants to assure that there is an adequate Participant pool, both for financing and to assure the ESCOs of Participant opportunities.
2. FREE will pre-qualify a pool of ESCOs who demonstrate appropriate financial capacity, expertise, and relevant experience, and agree to participate within Program rules. This pool will be open, allowing for the qualification of additional ESCOs throughout the Program.
3. FREE will assist each Participant with procurement of a guaranteed savings agreement (GSA) through a process that complies (for government entities) with the Pennsylvania Guaranteed Energy Savings Act (the Act) and includes preparation of preliminary and investment grade audits. Water and energy savings will be considered.
4. Financing will be accomplished through the issuance of bonds supported by financing leases from each Participant. Payments under each Participant's lease will be less than the guaranteed savings under that Participant's GSA.

Who Can **Participate**?

1. **Types of Organization.** Eligible organizations include governmental and non-profit organizations that are eligible for tax-exempt financing. These include:
   - Counties
   - Local governments
   - Municipal authorities such as sewer and water authorities
   - School districts
   - Public universities
   - Correctional facilities
   - Non-profit hospital and health facilities
   - Private schools and universities
2. **Types of Projects.** The Program encourages deep retrofits of existing facilities that take advantage of the low-cost, long-term financing available through the Program. Conservation measures may include lighting; buildings; envelope improvements, such as windows and insulation; HVAC systems; advanced building controls and water savings measures. The Program will work with Participants to include cogeneration facilities, solar generation, energy storage equipment, and microgrids.
3. **Size of Projects.** The Program is generally structured for projects involving two million dollars or greater in capital cost for retrofits. It can accommodate a limited number of smaller projects of one-half million dollars or greater.
4. **Participant Credit.** The Program is generally available to Participants that have previously issued their own bonds or would be eligible to do so. The Program may be able to provide financing for Participants that do not meet this standard but are otherwise financially stable.

Prequalification of ESCOs

FREE's prequalification process for ESCOs is built upon a comprehensive request for qualifications (**RFQ**) issued to a wide group of potential ESCO Participants. The responses are evaluated for financial strength, experience and track record, as well as administrative criteria including agreement to use Program documentation and carrying required insurance. The Program does not recommend particular ESCOs but provides a list of those who have met Program criteria. The qualification Program is open ended and if a Participant has selected a particular ESCO with which it hopes to work, that ESCO can seek qualification at any time.

The Procurement **Process**

The Act permits state agencies and local governmental units to use a flexible procurement process in which the governmental Participant issues an RFP and selects an ESCO based on criteria of its choosing. The Program will assist governmental Participants with a procurement process designed to comply with the Act while achieving the objectives of the Program:

1. **The Participant issues an RFP for ESCOs.** The selection criteria include a requirement that the ESCO has passed the prequalification process for the Program. The proposals should not expire in less than six months.
2. **The Participant selects one ESCO to proceed with a preliminary audit.** That audit identifies conservation measures (**CMs**) for the Participant that the ESCO expects will meet the Program's savings guarantee requirement. If the Participant is happy with the results of the audit, it makes the results of the audit public and selects the ESCO for award. If not, it can ask in turn for a preliminary audit from a next-preferred proposer. A Participant is also free to decide after reviewing a preliminary audit not to proceed further in the Program.
3. **A Participant wishing to proceed enters into a GSA with the ESCO.** The GSA provides for the ESCO to produce an Investment Grade Audit **(IGA)** and a proposal to then construct the CMs associated with the IGA (as well as offer a performance guarantee). If the IGA fails to project savings that are equal to at least 90 percent of those described by the ESCO's preliminary audit, the Participant may elect not to proceed further with the Program without incurring any costs. The GSA is described in more detail below.

The Program has reviewed the "**PlanCon**" process applicable to certain school district improvement projects, and the Taxpayer Relief Act which limits budget increases by certain governmental units. Neither of these considerations should interfere with participation in the Program.

With respect to PlanCon, Act 24 of 2011 amended the Pennsylvania School Code at Section 703 to only require Pennsylvania Department of Education approval of construction projects that are seeking reimbursement from the commonwealth. Since no state subsidy is required for the energy efficiency measures contemplated by the Program, compliance with the PlanCon process is not required.

The Taxpayer Relief Act is designed to keep local property taxes low. School districts that keep property tax rates the same or keep any increase below an inflation index are awarded an allocation of revenue from the gaming fund. The Program will be budget neutral or better for a school district, as the expenses will not be greater than the guaranteed savings, and we anticipate that in most cases the savings will be greater than the guarantee. There should be no impact on school districts under the Taxpayer Relief Act from participation in the Program.

The **Guaranteed** Savings Agreement

1. **Investment Grade Audit Provisions.** The Guaranteed Savings Agreement provides for completion of an IGA and delivery by the ESCO of a firm pricing proposal for a menu of energy conservation measures. In addition to providing for savings equal to at least 90 percent of those identified in the preliminary audit, the ESCO's firm proposal must guarantee savings from those measures that exceed the financing cost under the Program. The Program will assist Participants in evaluating proposed conservation measures, including providing its estimate of the financing cost and benchmark energy and water escalation rates by which to measure savings. If the ESCO's IGA and proposal meet this standard after discussion and negotiation, the Participant must either accept the proposal or pay costs of the IGA in accordance with the GSA.
2. **Construction Provisions.** If the Participant accepts the ESCO's proposal, the parties attach it to the GSA, which then serves as a firm, fixed price construction contract for the accepted CMs. The construction provisions are transparent and give the Participant typical protections afforded to an owner in a construction contract. Construction commences when the bond financing is completed, and payments are made from bond proceeds against auditable milestones with the approval of the Participant. Upon completion, CMs are subject to acceptance testing to ensure that they are capable of achieving the guaranteed savings.
3. **Monitoring and Verification.** Following acceptance, the ESCO performs regular monitoring and verification (**M&V**) in accordance with the GSA to assure that savings are achieved. If it appears that savings are falling short, the ESCO is committed to use its best efforts to remedy the performance failure, and failing that it must pay for the shortfall. The ESCO will provide quarterly and annual reports to the Participant to document its performance against the guarantee. FREE offers to continue to play a role in assisting Participants in reviewing the monitoring reports for the first several years after the energy conservation measures are placed in service. FREE charges a fee for this continuing service, which can be wrapped into the financing. Whether or not FREE assists individual Participants, a separate Program Agreement will require that ESCOs and Participants provide copies of the M&V reports to FREE, and that FREE prepare aggregate reports to Treasury, the Program sponsor and the bond issuer that document achievement of Program goals.

Benefits of the SEF Program

- Pre-Contract Audit Provided at No Cost to Participants
- Investment Grade Audit is then performed on the basis of the Participant's priorities and must offer self-financing improvements which total at least 90% of the savings quoted in the Pre-Contract Audit
- All Program Costs are Paid within the Bond Issue
- Project Pooling Means Economies of Scale for Document and Rating Costs
- No Cross Collateralization or Risk Associated with Participation by Other Participants
- Customized and Serialized Financing Optimization
- Economic Development Benefits Include Significant PA Job Creation & Use of PA Vendor Supply Chain