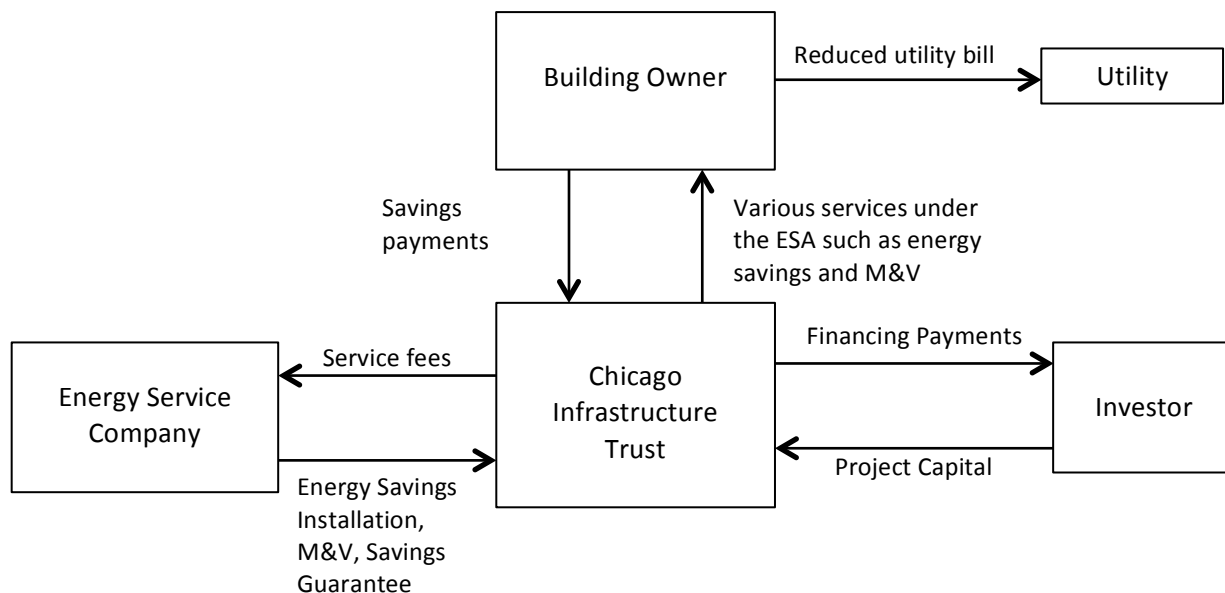




Energy Savings Agreements

The Chicago Infrastructure Trust (CIT) is able to structure the financing of energy efficiency projects using energy savings agreements (ESA) as a means of implementing such projects without upfront capital investment by building owners. Properly structured, such transactions may be treated as service contracts (and not leases or other debt obligations) for accounting purposes (as further described below) without an impact on the building owner’s credit rating.¹ Moreover, projects benefitting governmental and nonprofit building owners may be financed by CIT with tax-exempt or other tax-advantaged (e.g., qualified energy conservation bonds) debt.

ESA transactions are structured similarly to project financings utilizing power purchase agreements. That is, CIT, as project owner, undertakes the development, acquisition and construction of the project and the building owner’s obligation is limited to the energy savings produced by the project. The building owner has no payment obligation if the project does not reduce energy costs. CIT subcontracts its obligation to procure the project to one or more energy service companies (ESCO) under an energy performance contract (EPC) and the ESCO guarantees that certain savings will be achieved in each year over the term of the transaction. Guaranteed savings amounts must at least equal the cost of capital used to finance the transaction, certain costs incurred to measure and verify savings during the term, and other transaction costs. Below is a basic diagram of the ESA transaction structure.



¹ Credit rating agencies generally view the ESA structure as having no negative impact on the off-taker’s credit rating because the transaction is structured to reduce the off-takers energy expenditures.

The analysis of whether an ESA contains a lease (and potentially an “on balance sheet” capital lease) as opposed to a service contract involves an analysis of all the facts and circumstances under current U.S. GAAP accounting (FASB Accounting Standard Codification (ASC) 840 (formerly FAS 13)). The basic analytic framework employs two elements: (1) whether the arrangement involves specific property, plant and equipment (PPE); and (2) whether the arrangement conveys the right to control the use of the PPE. For most ESA transactions, it is assumed that the arrangement will involve certain agreed upon PPE and, thus, only the second element of the analysis is discussed below. If the arrangement conveys the right to control the use of the PPE, the arrangement will be treated as a lease for accounting purposes. The determination of whether an arrangement conveys the right to control the use of the PPE depends on three factors. If one of the three factors is satisfied, the arrangement will be considered a lease.

Factor 1: The purchaser has the ability to operate the PPE or direct others to operate the PPE in a manner it determines, and the purchaser obtains or controls more than a minor amount (i.e., 10% or more) of the PPE’s output.

Factor 2: The purchaser has the right to control physical access to the PPE and the purchaser obtains or controls more than a minor amount (i.e., 10% or more) of the PPE’s output.

Factor 3. It is remote that another party(ies) other than the purchaser will control more than a minor amount of the PPE’s output and the price that the purchaser will pay for the output is neither contractually fixed per unit of output or equal to the current market price at the time of output.

The terms of the ESA described below are structured to avoid lease treatment by, among other things, failing to satisfy each of these factors.

Some of the key terms and conditions common to ESA transactions include the following:

Project Ownership. CIT owns the project. The building owner may not claim depreciation, tax credits or similar rights related to the project or the energy savings realized thereby. CIT also has the obligation to maintain and insure the assets. Insurance and maintenance costs will be included in the transaction costs to be paid from savings payable under the ESA (and guaranteed by the ESCO under the EPC). Alternatively, a building owner may undertake CIT’s obligation to maintain and insure the assets if such costs are reflected in the amount of the savings payable by the building owner. Building owners are precluded from removing or otherwise altering the project components.

End of Term Disposition. At the end of the ESA term, the building owner has the option to purchase the project at its fair market value. If the building owner does not exercise this option, CIT may remove or abandon the project assets. Such an option is necessary to establishing the desired accounting treatment.

Site Access and Project Control. The building owner grants CIT and its subcontractors access to the building under a license, easement or other appropriate mechanism in order to perform the ESA services. In addition, CIT has the ability to make additional improvements for the purpose of increasing savings.

Fixed Payment Obligation. The building owner pays a fixed percentage of energy savings (i.e., a fixed amount per unit of output) achieved by the project. If the project delivers savings in excess of amounts necessary to repay the investor and pay other transaction costs, CIT receives the “upside” in accordance with such percentage. The payment mechanism may be structured in a variety of ways depending on investor requirements. For example, savings payments may be made in advance on the basis of anticipated savings, subject to later reconciliation.

Monitoring and Verification; Annual Reconciliation. The ESCO, on behalf of CIT, will calculate the actual energy savings achieved by the project on a periodic basis (typically, once per year) and produce a report that identifies any amounts payable by the building owner or the ESCO.

Defaults and Remedies. Upon a building owner default, CIT may (i) sue to enforce the terms of the ESA, (ii) terminate the ESA and remove or disable the project assets, (iii) terminate the ESA and abandon the project assets; or (iv) terminate the ESA and elect to be paid a liquidated damages amount.

Dispute Resolution. Disputes with respect to the calculation of savings are subject to resolution by an independent engineer to avoid potential litigation risk and cost.

Financial Reporting. Investors will typically require the building owner and the ESCOs to provide periodic financial reports as a means of monitoring their investment.

Transaction Term. ESA terms typically range from 5 years to over 20 years depending on a variety of factors including available project cash flow, investor restrictions and statutory limitations.

EPC. In addition to undertaking the construction of the project and guaranteeing savings, the ESCO will be obligated to insure the assets during construction. Depending on the financial strength and experience of the ESCO, some investors may require a project completion guaranty and or credit enhance of the savings guaranty (e.g., an energy savings bond) in order to support the expected project cash flows.