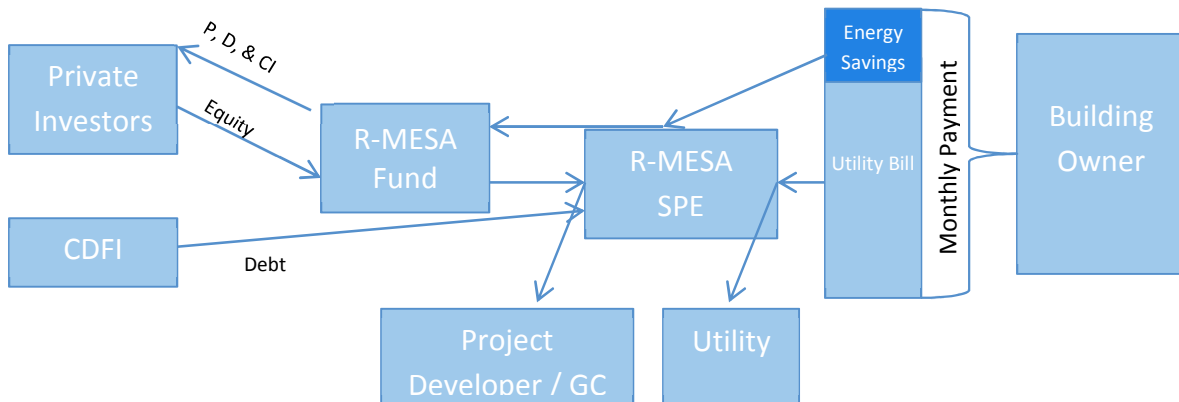


Investment Objective

The purpose of this investment vehicle is to provide stable and competitive returns to investors by mobilizing financing for residential energy efficiency (EE) improvements using an innovative application of managed energy services agreements (MESAs). This model creates measurable positive externalities such as direct job creation, increased energy security, reduced carbon emissions, increased comfort, improved air quality & health, as well as increased consumer savings/spending ability. Though this financial model is scalable for all socioeconomic strata, we plan to target low- to moderate-income multi-family residential housing with our first fund in order to maximize the social impact of the energy savings, demonstrate a viable resolution to the principal-agent problem between landlord and renter, and leverage tax breaks and subsidized capital investments that reduce risk and improve returns for private investors.

Principal Investment Strategy

The fund will invest in new residential managed energy services agreements (R-MESAs). The R-MESA works by establishing a special purpose entity (SPE) to take ownership of new energy efficiency-related capital investments in a single residential property and pay the property's monthly utility bills. The SPE structure enables energy efficiency to be treated as a service and an off-balance sheet transaction. The SPE is capitalized by the fund and finances the costs of efficiency improvements to the building. The residential property owner then makes fixed monthly payments to the SPE equal to their historical monthly energy expenses. Payments continue for a set term no longer than the lifetime of the installed energy efficiency equipment (e.g. 5-12 years) and are utilized by the SPE to pay utility bills and provide investors with a return on their investment. The SPE owns all environmental attributes (e.g. CO₂, EE Credits), government and utility grants/rebates, and tax incentives¹, which it will take full advantage of to defray costs and increase ROI. The SPE will renegotiate rates with electric and gas utilities whenever possible to increase its monthly margin. The R-MESA Fund will also seek to leverage the pre-established market access and funds of Community Development Financial Institutions (CDFIs)², which will provide up to 30-50% of the initial capital in the form of low-cost debt. The diagram below illustrates the structure and financial flows:

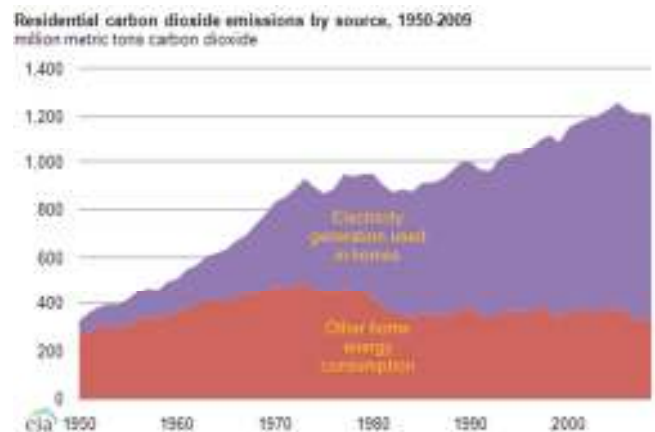


The Fund's Limited Partners will be paid back principal plus dividends (expected to be 8-9%), plus 25% of the carried interest (functionally understood in this model as the net lifetime savings of the energy efficiency improvements after the baseline returns have been taken). The Fund's General Partners will receive 2% annually in fees, plus an aggregate distribution of 25% of the carry, with the aforementioned hurdle rate of 8-9%.

Impacts

Property owners will benefit financially from the remaining 50% of the carried interest, stabilized utility payments, and, in the case of multi-family property owners, increased investment yield.³ Property residents will experience increased comfort, improved air quality & health, and increased savings/spending ability (presuming that a portion of carried interest is shared by the property owner).

Societal benefits also accrue with each R-MESA transaction. 7 energy auditing and construction jobs are created for every \$1 M spent.⁴ Carbon emissions are reduced for each kWh avoided, the exact amount based on generation source. Overall and peak energy demand growth is averted, improving energy security and infrastructure reliability.



Market Opportunity

The enormous energy efficiency opportunity in the U.S. – little less the world – has prompted significant discussion as well as innovative attempts at capture by both governmental and private sector players in recent years.⁵ McKinsey research indicates that energy efficiency is not only one of the cheapest ways to reduce carbon emissions, but actually an NPV positive investment in the vast majority of cases. They posit that the market has failed to capture this opportunity on its own due to several persistent barriers: the amount of up-front capital required, principal-agent problems, lack of knowledge, transaction barriers, high discount rates, fragmentation of the aggregate opportunity, and monitoring & verification challenges (to name a few).⁶

However, according to a 2011 report by Cap-E, The Energy Foundation, and ACEEE, the MESA model of financing has “gained recent traction” with commercial and multi-family property by addressing many of the aforementioned market barriers to EE while avoiding the pitfalls of other solutions (e.g. performance risk, cost recoveries from tenants, yield reductions).⁷ Our first R-MESA fund will therefore build on these successes but target the lower-income multi-family property owners who current MESA players are not serving, who have higher per square foot energy costs than higher income properties, and whose tenants will most benefit from the cost savings and quality of life improvements.

According to McKinsey, the low-income residential market contains 24 million single family, 16 million multifamily, and 5 million manufactured homes and represents an estimated \$46 billion total investment opportunity that will serve to reduce end-use energy consumption by 40% and save \$80 billion. 92% of the opportunity consists of shell upgrades (which we’ll focus on) and 8% in the HVAC system. The typical shell retrofit for an average low-income home will cost \$910 (vs. \$1,820 for single-family). 23% of the opportunity is in multifamily and 68% in single family homes.⁶ We plan to direct later R-MESA funds towards penetration of the single family residential market, which currently has no access to such advantageous EE financial models. Our investments will be focused primarily in regions with smart grid infrastructure and deregulated electricity markets in order to minimize the hassle of tracking energy savings while maximizing the potential for lowering electricity rates. In the next decade, we believe that the R-MESA model has the potential to scale residential EE widely enough to enable a securitized debt market and to capture the residential EE opportunity around the globe.

Risks to Investors

Risks to investors due to payment delinquency or default are low. Utility bill default risks, even among low to middle income, are much lower than in other energy loan projects. Studies by Bell et al. (2011)⁸ and Byrd and Cohen (2011)⁹ show residential on-bill financing default rates to be 0-2%. Since, unlike on-bill financing, R-MESAs won’t cause an increase in monthly payments, we anticipate default risk to be even lower. These low default rates are largely due to the fact that customers understand that non-payment of the bill can result in utility shut-off leading to further losses such as spoiled food and health risks inherent with lack of climate control. Such low default rates will mitigate the increased administrative and collections costs generated by targeting many customers with a single fund. Credit exposure can be further reduced by retaining title to the physical assets throughout the contract period or adding in a loss reserve.

To insulate investors against losses due to behavioral risks (i.e. building residence dramatically increasing average energy use after the agreement) or utility rate increases which reduce the energy savings spread, the R-MESAs will include a safety valve that allows for increasing the monthly payment in the event that increased energy usage or utility rates erode a certain percentage of the savings.

If the building transfers ownership, MESAs can either be assigned to the new owner or terminated. Additionally, since an SPE is used, risk is limited to the amount of investment for each individual deal. Capital from private investors would only be utilized on a project-by-project basis, further reducing risk. Some demand risk is possible, given that overall market penetration rates for residential EE linger in the 2% range.¹⁰ This risk will be minimized by our innovative financing model designed to break down market barriers to full penetration and through developing partnership relationships with a broad array of project developers and general contractors. Overall, the R-MESA fund would be cost-effective, have low risk, and offer an economically attractive return.

⁵ For example, the Treasury’s New Market Tax Credit for low-income area investment, the Federal Weatherization Assistance Program which provides grants for direct install of EE measures for low-income households, government loan programs such as USDA’s Rural Utility Service (RUS), and revolving loan funds set up by a number of forward looking states to extend ARRA investment in energy efficiency. US Treasury, USDA websites.

⁶ CDFIs are financial institutions which provide credit and financial services to underserved markets and populations. Projects such as Oregon MPOWER, Oregon Clean Energy Works, and the Kentucky MACED have already demonstrated how CDFIs can be used to provide financing for energy efficiency improvements. See citation 6.

⁷ According to Transcend Equity, which pioneered the MESA model for large multi-tenant commercial office portfolios, the increase in investment yield is driven by reduced initial capital invested in procuring assets, reduced ongoing capital expenditures (leading to increased cash flow), and increased sale value due to increased net operating income and elimination of retrade. (Transcend Equity Development Corporation - <http://www.transcended.com>).

⁸ “The Economic Benefits of Investing in Clean Energy,” Robert Pollin, James Heintz, and Heidi Garrett-Peltier, Department of Economics and Political Economy Research Institute (PERI) University of Massachusetts, Amherst (June, 2009).

⁹ Discussions of Property-Assessed Clean Energy (PACE) tax programs, which subordinated existing property debt to the PACE property-tax assessments, were largely closely in 2011 when FHFA and Fannie Mae pushed back on this disadvantageous capital structure.

¹⁰ McKinsey & Company Report: “Unlocking Energy Efficiency in the U.S. Economy.” July 2009.

¹¹ Kats, G., A. Menkin, J. Domm, and M. DeBold, 2011. “Energy Efficiency Financing – Models and Strategies.” Prepared by Capital-E for the Energy Foundation.

¹² Bell, C.J., S. Nadel, and S. Hayes, 2011. “On-bill Financing for Energy Efficiency Improvements.” Report by the American Council for an Energy Efficiency Economy.

¹³ Byrd, D. J., & R.S. Cohen, 2011. “A Roadmap to Energy Efficiency Loan Financing.” Memorandum to U.S. Department of Energy, April 29. New York, N.Y.: Progressive Energy Group.

¹⁴ Neme et al, 2011. “Residential Efficiency Retrofits: A Roadmap for the Future.”