Responses to Questions from CTF TFC Members on the Second Amendment to the Mexico Private Sector Energy Efficiency Program

Prepared by the Inter-American Development Bank (IDB)

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We would like to thank the governments of Germany and the United Kingdom for their questions. Please find below our responses.

Question by Germany

> ***With the proposed amendment CTF financial resources will not rank pari passu with IDB resources any more. We would like to know, if IDB assumes that this will imply higher risk for CTF resources and if so, whether and how this will be reflected in the financial terms. So far "Guarantee Fee not less than 20 to 50 basis points" are intended, which seems to be pretty low to us.***

While a number of risks will be shared between CTF and IDB, the proposed change implies that the CTF will be taking a higher level of risk than the IDB: Performance risk will be first absorbed by the overcollateralization provided by equity investors, and then by the CTF, in a second-loss position. Pricing will reflect this, as the price range for the CTF guarantee is expected to be between 130 and 170 bps, instead of the floor pricing specified on the proposal that was originally approved (negotiations are currently at an advanced stage).

Please note however that the program expects to have multiple bond issuances over the next few years, and conditions in the financial markets may change, requiring consistent adjustments to pricing of follow-up issuances too. Keeping this in mind, we foresee that the pricing in the future might be outside of the 130-170 bps range, but never under 100 bps.

Questions by the United Kingdom

> ***Could IDB elaborate on exactly how the credit enhancement mechanism will work?***

The source of payment that will serve as a guarantee for the Bond will be the receivables arising from the clean energy project performance contracts (once operation and maintenance costs are discounted). The receivables will be overcollateralized at least 20% to absorb the first losses; there will be a reserve fund covering three months of interest, and the energy savings should maintain a 2x debt service coverage ratio. During the warehousing phase the CTF will come as second loss, and when the bonds are issued the Bond will have the IDB and CTF guarantees to cover second losses.

The CTF guarantee would be called in the event that (i) a project fails to achieve its saving target and replacement of such project cannot be accomplished; and (ii) the resources available in the SPV accounts are insufficient to pay the interest and principal on the payment date. In this case, the master servicer will give IDB 30 days advance notice in the event of insufficient funds to pay the debt service. Once the guarantees have been executed, the CTF

may be reimbursed through recovery of the receivables placed in trust with the Issuer Trust. The reimbursements will be subordinated to investors.

> ***How will IDB determine what is an "unnecessary level of subsidy" to institutional investors when structuring the bonds?"***

We would like to clarify that there are no subsidies provided (in terms of concessional pricing) to institutional investors. Through the proposed financing mechanism any level of concessional pricing (and therefore subsidy), if determined as needed, would be directed to the ESCOs originating the EE projects. This would mitigate the incremental cost created by the transaction costs of the proposed financial structure, and by the required additional CTF and IDB guarantees (which would otherwise hinder the financial viability of the underlying EE investments). The final pricing level of the CTF guarantee would be determined based on (i) market references, and (ii) financial modeling, if concessionality was needed.

Bond investors benefit only indirectly, as the participation of the CTF —i.e., sharing some of the risks with IDB, and taking on some other risks that IDB and other lenders/guarantors cannot take on— makes the whole structuring and bond issuance possible. This allows credit enhancing the bonds in order to achieve risk profiles, as determined by credit rating agencies, that make them acceptable and eligible for institutional investors.