

Millcreek Township Water Authority

Erie Water Works Lease Proposal

Questions to be Answered

1. Is the current EWW rate structure sustainable?
2. What is the current financial condition of EWW?
3. Is EWW's business model financially sound and sustainable?
4. What are the risks to the MTWA assets?

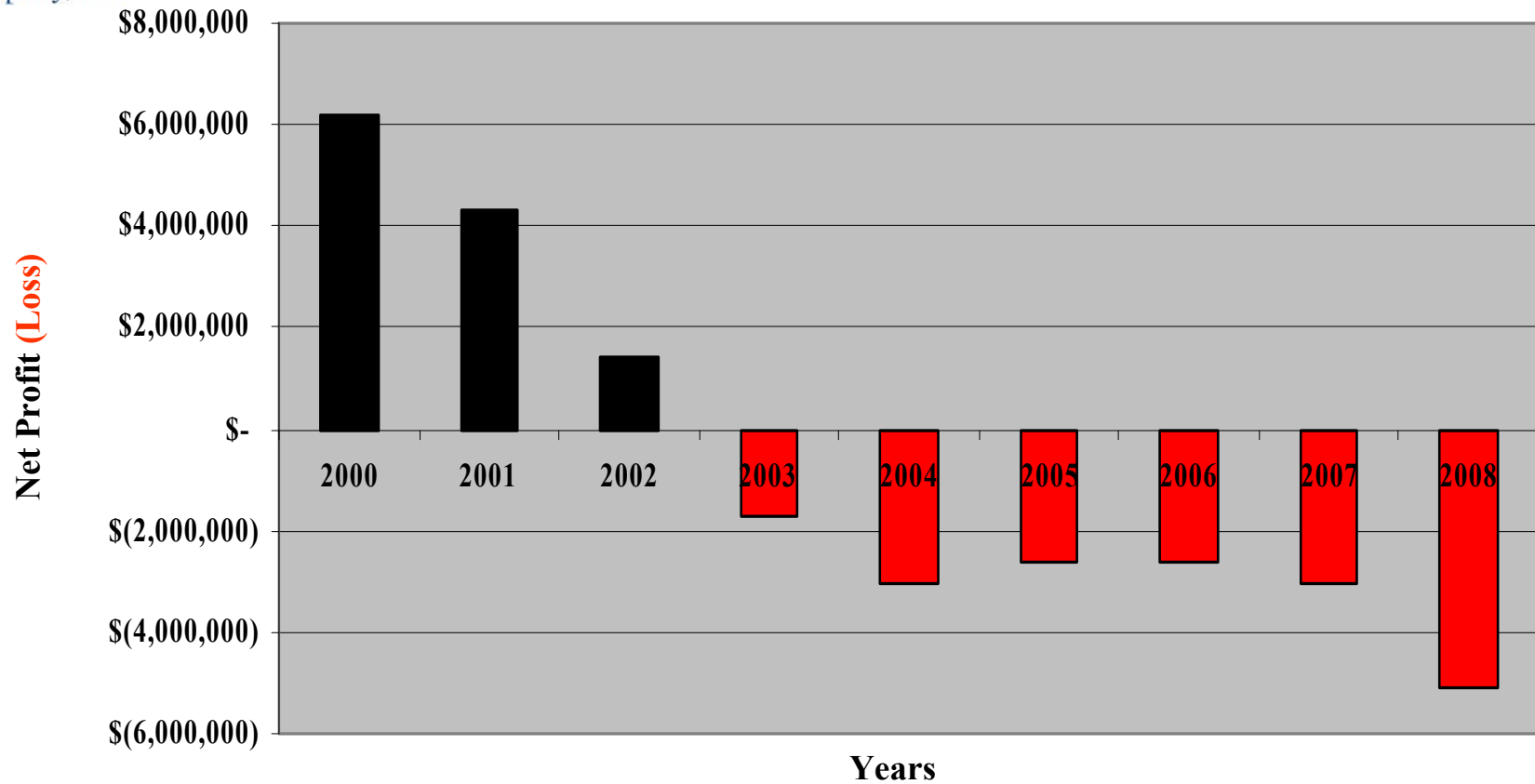
Scope of Analysis

- Past financial performance of EWW
- EWW current financial condition

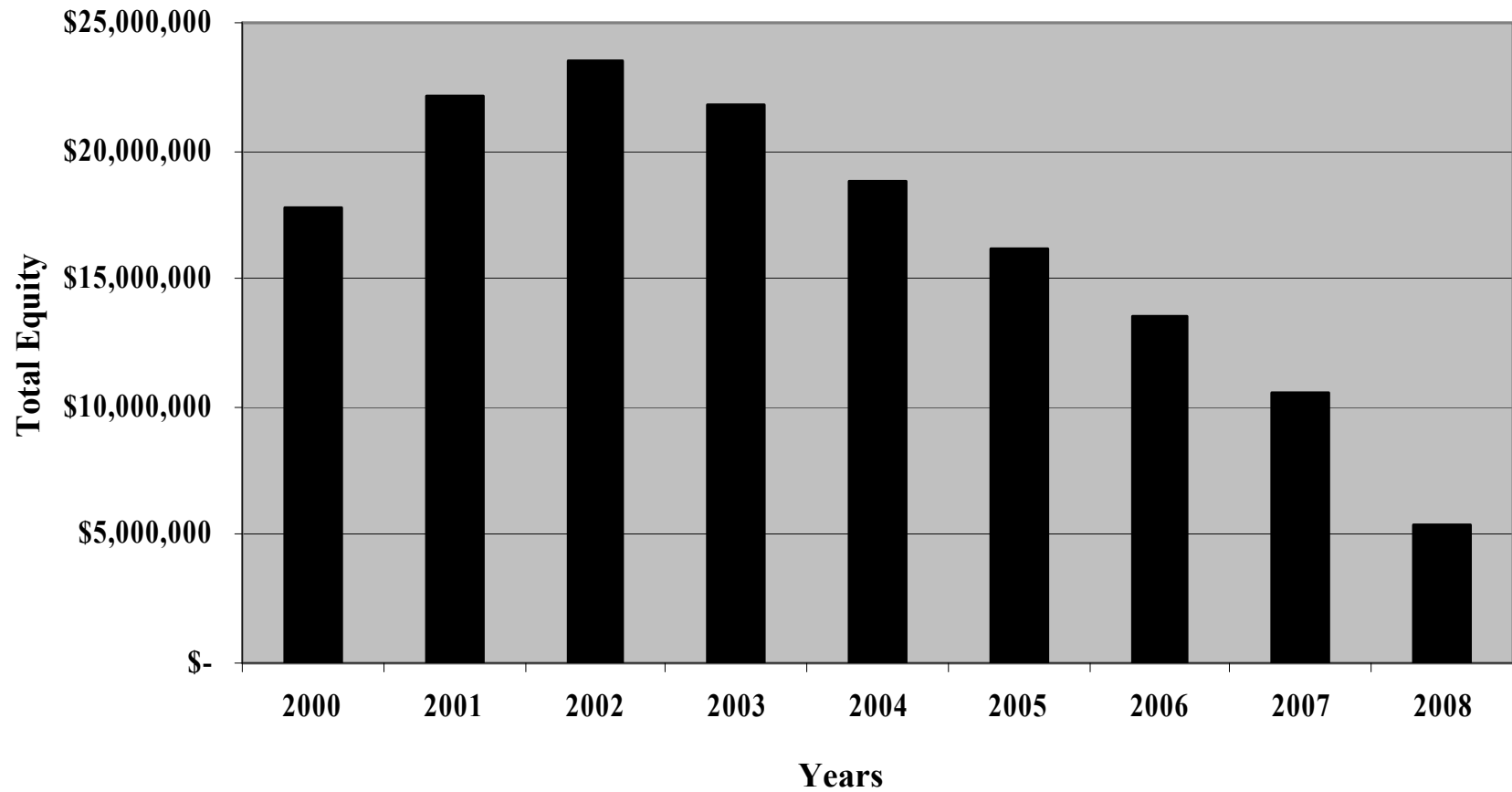
EWW Historical Net Profit (**Loss**) and Total Equity

<u>Year</u>	<u>Net Profit (Loss)</u>	<u>Total Equity</u>
2000	\$ 6,208,236	\$ 17,801,727
2001	4,319,566	22,121,293
2002	1,400,034	23,521,327
2003	(1,690,479)	21,830,848
2004	(3,017,685)	18,813,163
2005	(2,634,994)	16,178,169
2006	(2,630,336)	13,547,833
2007	(3,036,618)	10,511,215
2008	(5,065,575)	5,445,640

EWW Historical Net Profit (Loss)



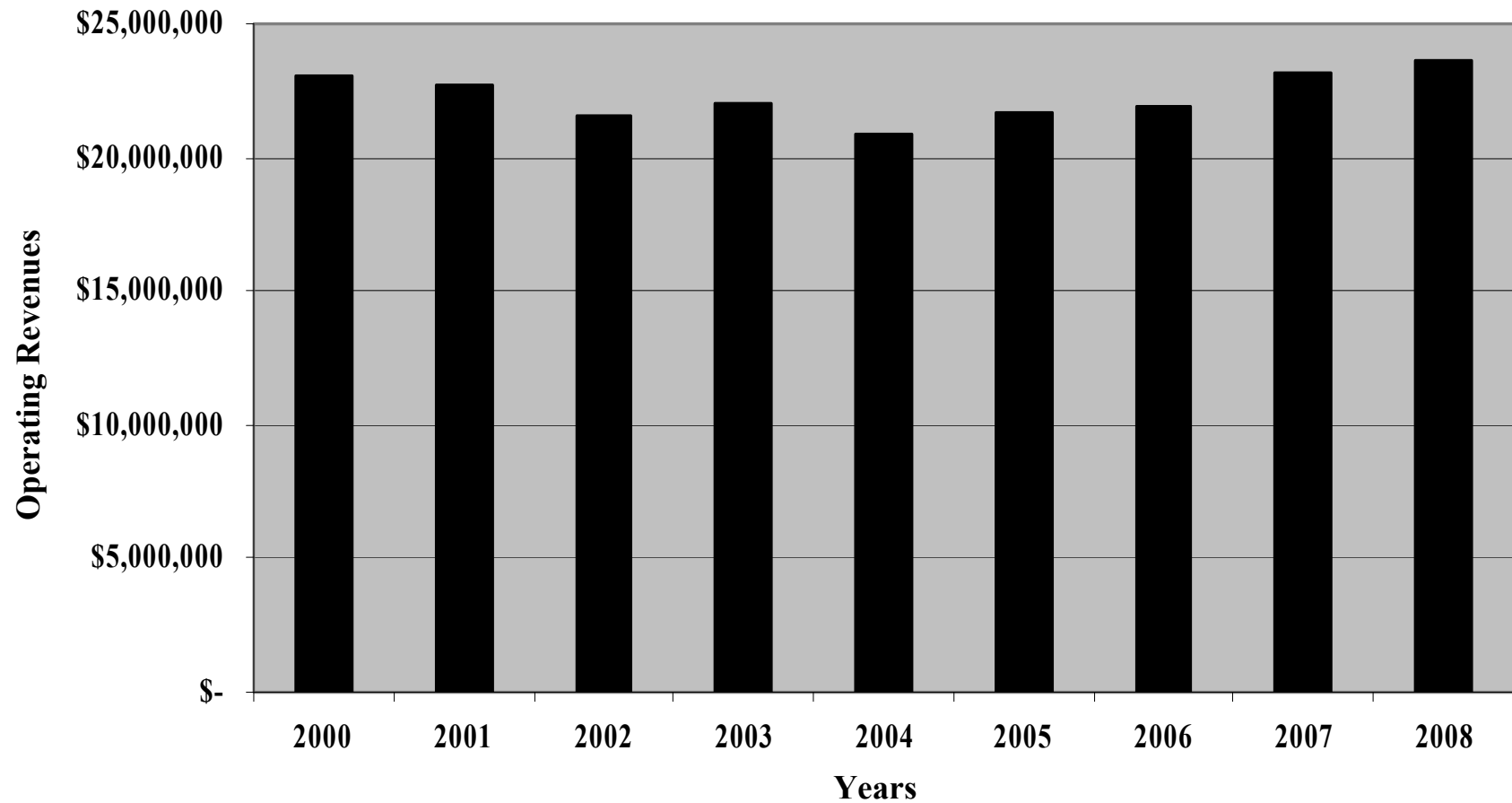
EWW Total Equity



EWW Historical Operating Revenues

<u>Year</u>	<u>Operating Revenues</u>
2000	\$ 23,044,900
2001	22,745,800
2002	21,547,000
2003	21,993,400
2004	20,829,600
2005	21,686,700
2006	21,910,900
2007	23,206,500
2008	23,655,800

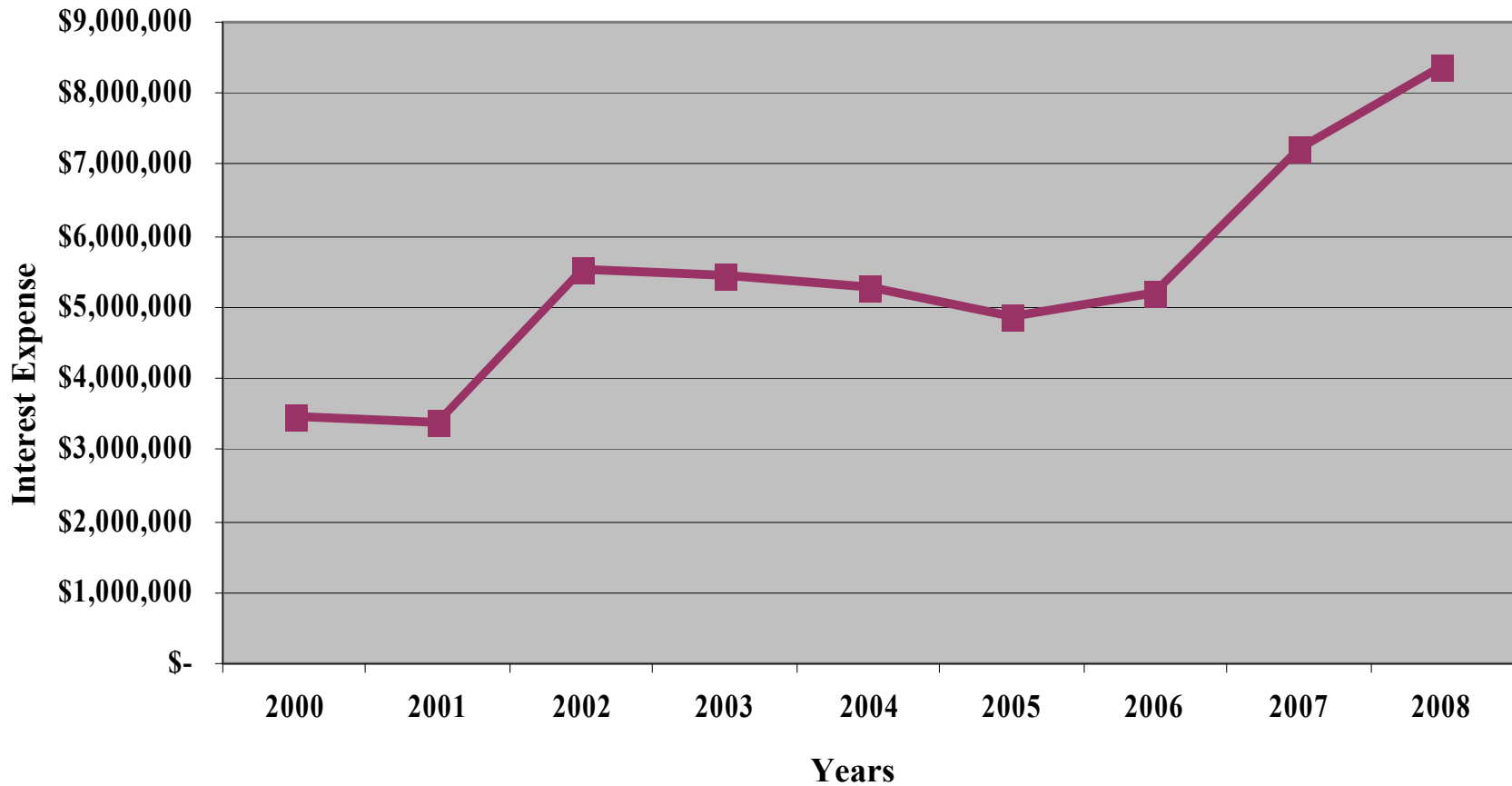
EWW Historical Operating Revenues



Interest Expense as a Percentage of Operating Revenues

Year	Interest Expense	Operating Revenue	Percentage
2000	\$ 3,462,100	\$ 23,044,900	15.02%
2001	3,397,100	22,745,800	14.94%
2002	5,547,400	21,547,000	25.75%
2003	5,429,800	21,993,400	24.69%
2004	5,278,400	20,829,600	25.34%
2005	4,867,800	21,686,700	22.45%
2006	5,186,000	21,910,900	23.67%
2007	7,225,400	23,206,500	31.14%
2008	8,385,900	23,655,800	35.45%

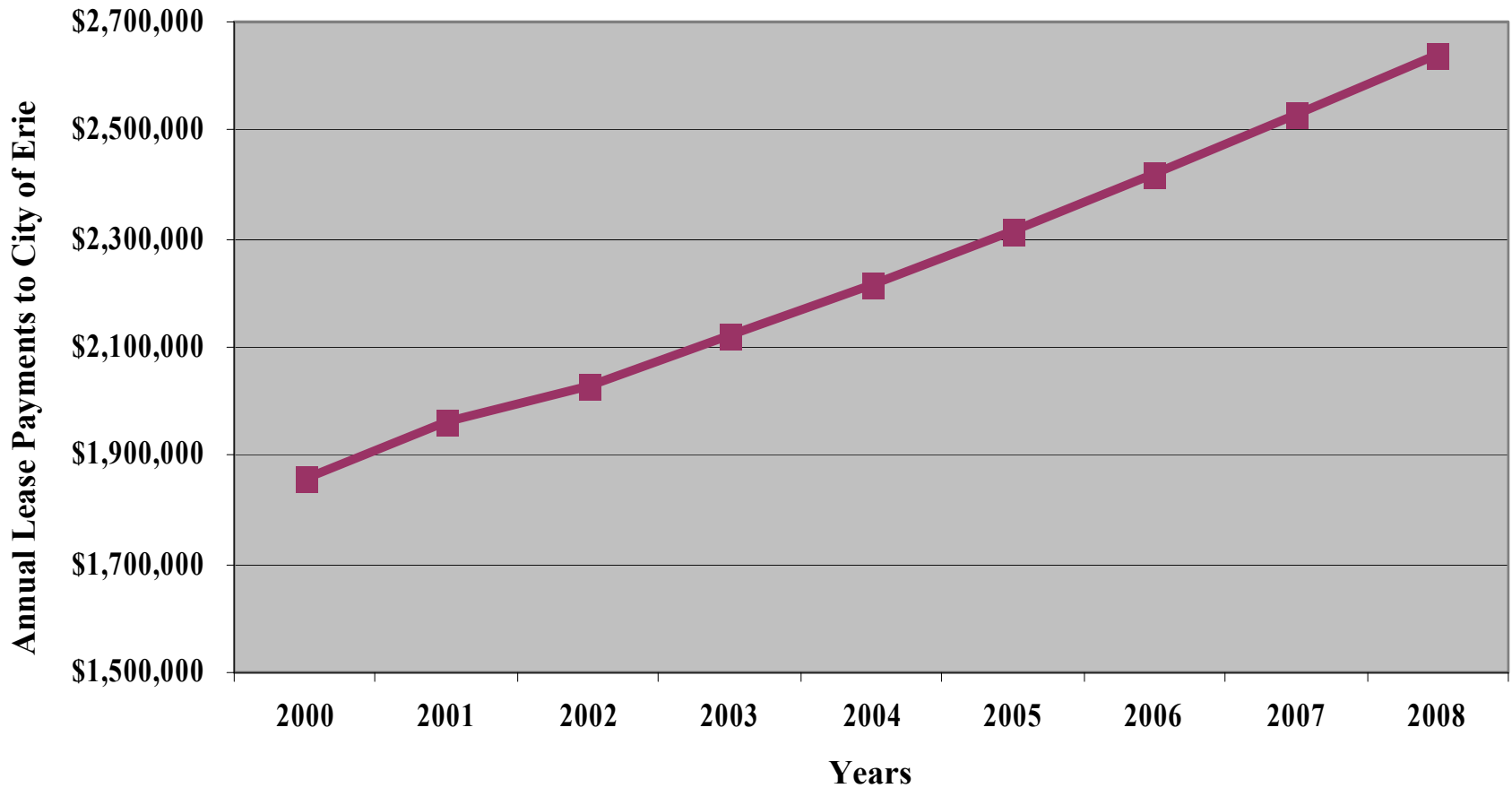
EWW Historical Interest Expense



EWW Historical Annual Lease Payments and Operating Revenue

Year	Annual Lease Payments to City of Erie		Operating Revenue		Lease Payments as a Percentage of Operating Revenues
2000	\$	1,857,600	\$	23,044,900	8.06%
2001		1,963,700		22,745,800	8.63%
2002		2,028,600		21,547,000	9.41%
2003		2,119,800		21,993,400	9.64%
2004		2,215,200		20,829,600	10.63%
2005		2,314,900		21,686,700	10.67%
2006		2,419,100		21,910,900	11.04%
2007		2,528,000		23,206,500	10.89%
2008		2,641,700		23,655,800	11.17%

Annual Lease Payments to City of Erie

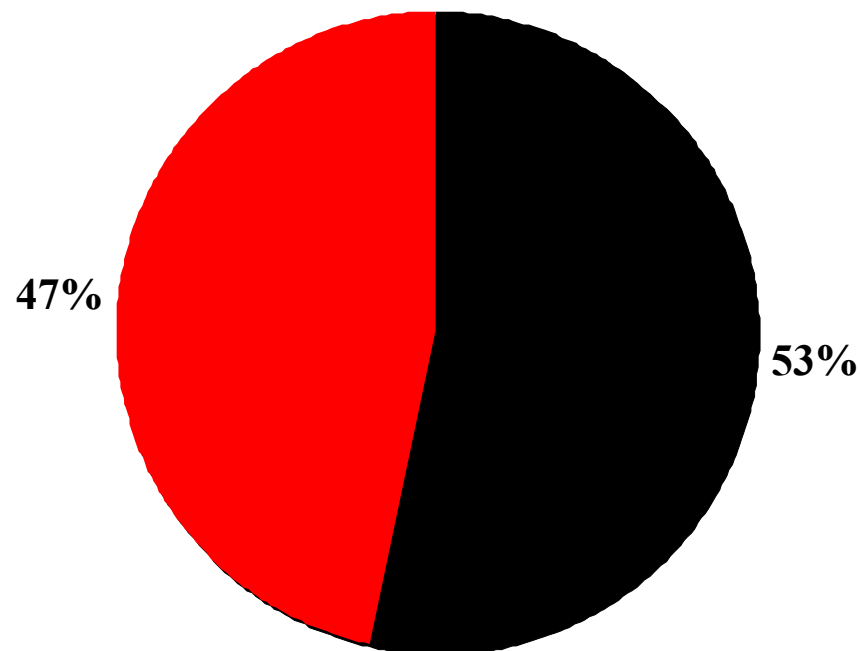


Analysis of 2008 EWW Expenses Compared to Revenues from EWW Customers

2008 Expense Analysis

■ Interest Expense & Lease Payment

■ Other Expenses



2004 Water Cost of Service Study

Year	Projected Revenue from Customers	Actual Revenues from Customers	Shortfall
2005	\$ 23,403,653	\$ 21,686,700	(\$ 1,716,953)
2006	24,444,800	21,910,900	(2,533,900)
2007	25,658,595	23,206,500	(2,452,095)
2008	27,385,154	23,655,800	(3,729,354)
			(\$ 10,432,302)

City of Erie Lease Key Terms

- 1991 Original Lease
 - \$6,000,000 signing bonus (**borrowed money**)
 - \$1,250,000 annual payment increasing 4.5% per year (**borrowed money**)
 - EWW assumes \$30,000,000 in City debt
 - On termination in 2015, all assets returned to City, including assets paid for by EWW as well as existing assets

- 2001 Lease Extension
 - \$6,750,000 signing bonus (**borrowed money**)
 - Extends term to 2030 with rent increases of \$200,000 every 5 years
 - Lease can be extended to 2040 conditioned upon payment of signing bonus to City of Erie

City of Erie Lease Key Terms

- 2004 Lease Extension
 - EWW exercises lease extension options, extending lease to 2040
 - EWW pays \$1,717,503 signing bonus

- 2008 Lease Extension
 - \$2,500,000 signing bonus (**borrowed money**)
 - Lease extended to 2050
 - Lease payments in 2041-2045 are \$4,600,000
 - Lease payments in 2046-2050 are \$4,800,000

Water Assets at December 31, 1991

Decade	Cost	Percentage	Accumulated Depreciation	Percentage	Book Value
1900	\$ 994,688.00	2.04%	\$ 994,688.00	4.29%	\$ -
1910	589,793.00	1.21%	589,793.00	2.54%	-
1920	1,300,099.00	2.66%	753,434.07	3.25%	546,664.93
1930	3,998,960.00	8.19%	3,739,074.81	16.13%	259,885.19
1940	246,966.00	0.51%	172,468.78	0.74%	74,497.22
1950	19,115,214.00	39.15%	8,525,235.98	36.80%	10,589,978.02
1960	2,055,199.00	4.21%	1,346,238.88	5.81%	708,960.12
1970	9,970,212.00	20.43%	5,121,050.86	22.10%	4,849,161.14
1980	3,421,355.00	7.01%	1,773,950.25	7.65%	1,647,404.75
1990	7,121,084.00	14.59%	160,665.25	0.69%	6,960,418.75
Total	\$ 48,813,570.00	100.00%	\$ 23,176,599.88	100.00%	\$ 25,636,970.12

Water Assets at December 31, 1991

Decade	Cost	Percentage	Cumulative Percentage	Accumulated Depreciation	Percentage	Cumulative Percentage
1900	\$ 994,688.00	2.04%	2.04%	\$ 994,688.00	4.29%	4.29%
1910	589,793.00	1.21%	3.25%	589,793.00	2.54%	6.83%
1920	1,300,099.00	2.66%	5.91%	753,434.07	3.25%	10.08%
1930	3,998,960.00	8.19%	14.10%	3,739,074.81	16.13%	26.21%
1940	246,966.00	0.51%	14.61%	172,468.78	0.74%	26.95%
1950	19,115,214.00	39.15%	53.76%	8,525,235.98	36.80%	63.75%
1960	2,055,199.00	4.21%	57.97%	1,346,238.88	5.81%	69.56%
1970	9,970,212.00	20.43%	78.40%	5,121,050.86	22.10%	91.66%
1980	3,421,355.00	7.01%	85.41%	1,773,950.25	7.65%	99.31%
1990	7,121,084.00	14.59%	100.00%	160,665.25	0.69%	100.00%
Total	\$ 48,813,570.00	100.00%		\$23,176,599.88	100.00%	

City of Erie Lease and Extensions

Signing Bonuses.....	\$ 16,967,503
(January 1, 1991 to December 31, 2009)	
Lease Payments	
(1991-2009).....	36,329,452
(2010-2050).....	167,177,059
Assumed Debt at April 1, 1991.....	<u>30,000,000</u>
	<u><u>\$ 250,474,014</u></u>

Value of City Water Assets at Date of Lease (4/1/1991)

- Book Value
 - Per Erie City consultant (12/31/90) **\$ 25,088,000**
 - Per City Asset Schedule (12/31/91) **\$ 25,637,000**

- Outstanding Debt
 - Assumed in 1991 by EWW per Lease **\$ 30,000,000**

- Value at date of Lease (04/01/91) **Not much**

What are you paying?

- Total Lease payments (1991-2050)
 - EWW payments to City (incl. bonuses) **\$ 220,474,014**

- Net Bond Borrowing for Projects
 - (1991 – 2009) **\$ 174,000,000**

Rental of House

- Rent house from owner
- Assume and pay mortgage
- Pay owner annual rental payments
- Pay periodic signing bonuses
- Pay for a period of time which far exceeds useful life of asset
- Assume obligation to repair and rebuild
- Return asset to owner at end of lease term in good condition

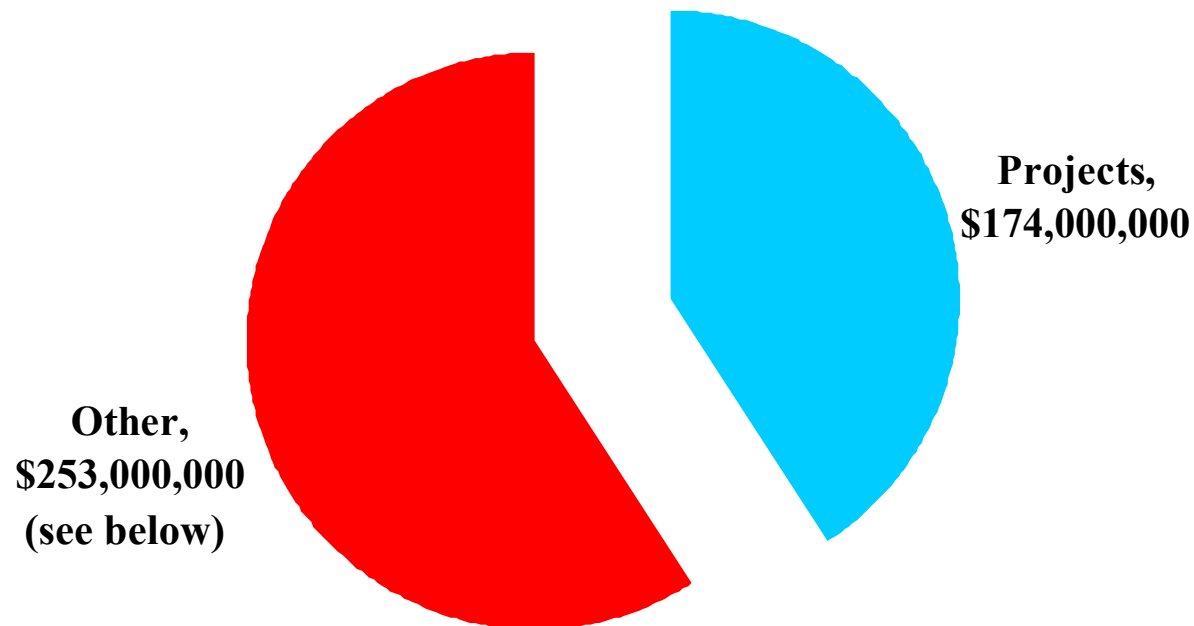


Car Lease



Usage of EWW Net Bond Proceeds

Total \$427,000,000



Note: Other includes refinancing, remarketing, signing bonuses, rental payments to City of Erie, SWAP termination payments, debt issuance costs, and borrowed working capital at inception of lease

Signing Bonuses and Lease Payments Borrowed

- **≈ \$19,171,000** Paid with Bond proceeds
 - Date fully Paid – 2043
 - Interest and Costs through 2043 **≈ \$11,000,000**

- True Total Cost **≈ \$30,000,000++**

1991 Bond Indenture Coverage Requirements

- Section 3.02 (C) (2)
 - Requirements must be met prior to the issuance of any new bonds
 - Provision contains a two-year look back prior to year of bond issuance
 - Five-year forward look (includes year of issuance)

1991 Bond Indenture Coverage Requirements

- EWW's Revenues and Receipts must cover the sum of the following
 1. EWW's Operating Expenses
 2. City of Erie Lease Payment
 3. Undischarged Existing City Debt payments and;
 4. 120% of the maximum annual Debt Service Requirements of outstanding bonds and additional bonds to be issued

1991 Bond Indenture Coverage Requirements

- EWW to be in compliance with the requirements of Section 9.01 of the indenture
- Uncertain EWW is performing analysis required
- Possible non-compliance

Rate Coverage Ratio Contained in Section 9.01 of the 1991 Indenture at December 31, 2008

	<u>Section 9.01</u>
Operating Revenues	<u>\$ 25,149,466</u>
Operating expenses (exclusive of City Lease payments and depreciation)	14,239,322
City lease payments	2,641,721
Depreciation	6,002,079
Water revenue bond debt service	7,971,022
20% coverage of water revenue bond debt service	1,594,204
Existing debt - Pennvest Zebra Mussel Project	<u>185,412</u>
	<u>32,633,760</u>
Deficiency	<u><u>\$ (7,484,294)</u></u>
Ratio	<u><u>0.77</u></u>
Minimum Ratio Required Under 1991 Indenture	<u><u>1.00</u></u>

City of Erie Lease Covenant Ratios at December 31, 2008

	Lease Covenant	
	1	2
Operating revenue	\$ 23,655,808	\$ 23,655,808
Non-operating revenues	1,493,658	-
	<u>25,149,466</u>	<u>23,655,808</u>
Operating expenses (exclusive of City Lease payments and depreciation)	14,239,322	14,239,322
City lease payments	2,641,721	2,641,721
Depreciation	6,002,079	6,002,079
Water revenue bond debt service	7,971,022	7,971,022
20% coverage of water revenue bond debt service	1,594,204	1,594,204
Pennvest debt service	615,188	615,188
	<u>33,063,536</u>	<u>33,063,536</u>
Deficiency	<u>\$ (7,914,070)</u>	<u>\$ (9,407,728)</u>
Ratio	<u>0.76</u>	<u>0.72</u>
Minimum Ratio Required Under the Lease	<u>1.00</u>	<u>1.00</u>

SWAP Termination Losses

Year	Gain (Loss)
2006	\$ 1,274,000
2007	(437,000)
2008	2,171,700
2009	(4,355,000) (1)
Net Loss	\$ (1,346,300)

(1) Does not include interest and fees of **≈ \$4,100,000**

If these amounts were included, net loss from SWAP termination losses **≈ \$5,446,300**

Conclusions

- Significant deterioration of Equity
- 5 year history of losses
- No economic basis for City lease payments or bonuses
- Noncompliance with debt service and rate coverage requirements in Bonds and Lease
- Borrowing money for non-capital items
- Substantial losses on swap agreements

Conclusions

- Failure to act on revenue shortfalls
- EWW business model is unsustainable
- Significant rate increases can be expected
- No guarantee of protection from future City mandated payments

Consequently, we do not recommend accepting EWW's proposal at this time