

Dear Clients, Colleagues, and Friends,

*Re: Insights on the Funding of Capital Projects*

Over the past several months, there has been a lot of discussion about the PA DEP's Chesapeake Bay Tributary Strategy and how its implementation will affect municipal ratepayers. Many municipalities will be facing significant costs to construct and operate the necessary facility improvements to meet the new water quality requirements. We have been working together with our clients and discussing treatment alternatives, cost scenarios, and implementation schedules. From these discussions and reading about other municipalities going through the same analysis, a key question is "How do we fund these construction projects?" Especially, since "free" money in the form of government grants is simply not there yet for most municipalities.

While every municipality's financial situation is different, each needs to take a hard look at how it will finance its projects. It may involve more unique funding scenarios, such as the use of connection/tapping fees, small municipal grant program monies, or other capital generating approaches. However, financing nearly always requires some sort of significant capital borrowing, either via public funding with low interest loans (e.g. PennVest or RUS) or private sector funding (e.g. bond issue or bank loan). But, which is the better borrowing approach? The answer is sometimes private sector lending and sometimes public funding, depending upon specific circumstances. Either way, determining which approach is better for you needs to take into account not only how the loan repayment schedule impacts user rates, but also, and just as important, how the administration of the loan program affects day-to-day management issues.

Reproduced on the reverse side of this letter is a brief comparison of the pros and cons of public sector financing through the PennVest loan program versus private financing (bond issue) that we have used to evaluate options for different situations. Perhaps you may find this information helpful in assessing your particular needs and situation.

It occurs to me that taking the time to approach your financial program using this type of analysis may be a good idea even if there wasn't this "Bay" issue to deal with. Maybe, it is just a good idea to understand your options whenever the need arises.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Steven C. Huntzinger'.

Steven C. Huntzinger, QEP  
Principal

## Advantages and Disadvantages PennVest Loan Versus Bond Issue

### PennVest Loan

#### Advantages

#### Disadvantages

1. Lower interest rate a possibility.	1. A 30 year financing term is a possibility, but still the exception.
2. Excellent program if borrower does not have access to conventional bond or bank financing.	2. A “wrap” structure of debt service is not permitted (see #3 under bond advantages).
3. Lower costs of issuing the debt as compared to bonds.	3. For projects over \$10 million, “value engineering” is required. This takes additional time and costs additional money.
4. Good for small projects (up to \$2 million) due to low financing costs.	4. Upon seeing the “value engineering” report, PennVest might require a change in the design issues.
5. No Debt Service Reserve Fund required.	5. There is extra engineering for additional administration and loan application.
6. The debt is “callable” at any time, without penalty.	6. There is a chance that PennVest will not fund the entire project. This will require a separate financing for the balance of the project.
7. No credit rating needed.	7. Since PennVest pays contractors’ bills only upon requisition each month after work is completed, a “cash flow” line of credit might be necessary so contractors are paid on a timely basis.
	8. The cost of a “final audit” is substantial.
	9. The interest rate could actually be higher than a bond issue.
	10. Contractors may bid higher prices due to the fact that they may not be paid on as timely a basis as under conventional financing.
	11. Many of the items above mean more time is needed for the PennVest process. Every month of delay means a higher project cost.

### Bond Issue

#### Advantages

#### Disadvantages

1. Entire project can be funded.	1. Costs of issuing the debt are higher than PennVest.
2. A financing term of 30-35 years is always possible. This will be a fixed rate.	2. Bonds are not “callable” for 5-10 years, depending on the size of the financing. However, this does not preclude a refinancing prior to the first “call” date, using the “advance refunding” technique.
3. A “wrap around” structure is possible whereby the debt service payments can be structured to be lower in the early years and higher in the later years when the other debt is retired.	3. A Debt Service Reserve Fund usually needs to be funded, although usually the borrower can reinvest it at a rate equal to the bond rate.
4. Depending on the PennVest interest rate(s), there is a real possibility that the bond rates will average out to be lower.	
5. There will always be enough cash to pay contractors’ bills as the full amount of borrowed funds are received at closing.	
6. Depending on the size of the bond issue, and other factors, there is a possibility of earning and retaining “arbitrage” during the construction period (i.e. if you are paying 4.25 % on the bonds and earning 5 % on the reinvestment, this advantage can lower the ultimate project cost).	
7. Since there is less administrative red tape and time, the project will probably be able to go out to bid earlier. Due to inflation, every month that can be saved translates into dollar savings.	