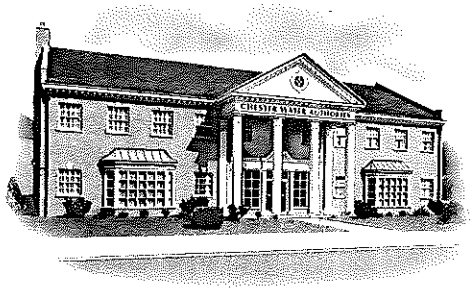

Chester Water Authority
P.O. Box 467
Chester, Pennsylvania 19016-0467
Tel: (610) 876-8185

July 30, 2018

VIA ELECTRONIC MAIL
Dennis M. Davin, Secretary
The Department of Community and Economic Development
Office of Chief Counsel
Commonwealth Keystone Building
400 North Street, 4th Floor
Harrisburg, PA 17120

Re: City of Chester's Negotiations with the Chester Water Authority

Dear Mr. Davin:

I write in my capacity as the Chairperson of the Chester Water Authority ("Authority"), a healthy municipal utility that provides life-sustaining water to 200,000 residents and businesses in southern Chester County, western Delaware County, and the City of Chester ("City"). I seek to address the attempts made by the City's Act 47 Recovery Coordinator to interfere with the Authority's current contract and ongoing negotiations with the City of Chester. These attempts are premised on the Recovery Coordinator's illegal and detrimental recommendation that the Authority's assets be sold to an investor-owned utility ("IOU") so that the City may receive several million dollars today, while Authority ratepayers will be obligated to pay billions of dollars back to the IOUs in the form of substantially higher water rates over generations. Simply put, the Recovery Coordinator's proposal would have ratepayers rather than the IOUs ultimately pay exorbitant amounts to finance the privatization of this public asset, and pay IOU shareholders' dividends, since the purchase price would be reimbursed to any IOU through future rate increases.

As you know, on March 14 and 15, 2018, the City and the Authority entered into an agreement (the "Standstill Agreement"), which the City adopted by Resolution, whereby both parties agreed that from March 15, 2018 until at least December 31, 2018, the parties would negotiate, in good faith, with a mutual goal of entering into a definitive agreement concerning future Authority operations ("the Standstill Period"). The parties agreed that during the Standstill Period, the City, its successors, and its agents would not attempt to take ***any actions*** that interfere with the operations of the Authority in any way. Further, the parties agreed that during the Standstill Period, neither party would negotiate or contract with any third party with regards to the transfer of any assets owned or managed by the Authority without the written

authorization of the other party. A copy of the Standstill Agreement is attached hereto for your reference.

In recent months, not only has the City's Act 47 Recovery Team taken steps that interfere with the City and the Authority's ability to comply with this Agreement, but the Recovery Coordinator's – Econsult Solutions – ***main recommendation*** in its May 2018 Financial Condition Assessment for the City of Chester (the "Assessment") to assist the City with its Act 47 Recovery is to sell off the Authority to an IOU. This recommendation – which is not even a legally viable option, as the City cannot unilaterally terminate and monetize the Authority – may leave the City ***worse off*** in both the short and long-term.[1]

- Monetization of the Authority has never been part of a single Recovery Plan for the City of Chester.
    - The City has been working with a Recovery Coordinator ***for decades***, yet Econsult's Assessment declared that the "potential monetization" of the Authority – an idea that was ***never considered*** in any previous Recovery Plan for the City – "is the ***only option*** [the Recovery Coordinator] can identify that could produce sufficient funds to allow the City to achieve long-term fiscal balance." Assessment, p. 12.
    - The Recovery Coordinator's Assessment alleges that monetization of the Authority is necessary because the City's condition is worse than the Recovery Coordinator realized. The Recovery Coordinator should be embarrassed, as should DCED. After decades of providing misguided advice to the City that has not improved its condition, the May 2018 Assessment proposes an ill-conceived "plan" to clean-up the follies of the Recovery Team's efforts since 1995 in a desperate and misguided attempt to get the City out of Act 47 status before the statutory deadline. The Recovery Coordinator cannot be permitted to push an agenda on the City that will not promote the City's long-term health, and which jeopardizes Authority ratepayers. Indeed, this agenda appears to be directed at the behest of IOUs and for the benefit of them, and the Act 47 consultants and law firms consistently hired by DCED who ultimately benefit from the transactional work inevitably flowing from their recommended courses of action.
    - Further, because a potential monetization of the Authority is not part of the City's Recovery Plan, the Recovery Coordinator has been acting outside the scope of its enumerated powers for at least over a year by its pursuit of a potential monetization of the Authority. *See, e.g.*, 53 P.S. §§ 11701.221(d)(3), (e); 53 P.S. § 11701.224.1.
- Monetization of the Authority as advocated by Econsult will ***harm*** City rate payers and businesses and lead to further erosion of the City's economy.

[1] I have enclosed the Authority's Comment to Econsult's Assessment for ease of reference and incorporate its content here.

- If the Authority's assets were to be monetized and sold to an investor-owned utility, as Econsult has proposed, residential Authority rate payers could see an increase in rates of more than 120% over present Authority rates. Commercial customers in the City could see an increase in rates of more than 116%, and industrial customers in the City see could see an increase of more than 207%.[2]

- Even if an IOU made the City a promise of a long-term rate freeze, that promise does not hold water. First, the Pennsylvania Public Utilities Commission ("PUC") is not bound to accept any promise of a rate freeze. Second, the PUC's policy is to implement standard tariff pricing for its large, regulated water utilities, which means that all customers of the utility will ultimately pay the same rates. As a result, approving a rate freeze in any one area would mean that customers served by an IOU in other areas would see the impact of the rate freeze as costs that should be paid by customers in the acquired system are shifted to other customer groups. While Authority customers could potentially enjoy the short-term benefit of constant rates for a period of time, ultimately, those lower rates would merge with the IOU's standard rates, which of course will be even higher in the future and would bear the additional costs resulting from any acquisition premium paid to acquire the Authority or to defer otherwise required rate increases in the Authority service area.

- Affordability is already a significant issue in the City, and monetization of the City's water authority would take from the needy in order to put money in the hands of an IOU's investors.

  - According to the US Census Bureau, the median household income in the City of Chester (2010-2016) is $27,217 and 36.9% of the population is in poverty.[3]

  - In a recent American Water Works Association Benchmarking Survey, at the 75th Percentile, water charges for water-only utilities represented 0.59% of the median household income. At the 25th Percentile, water charges represented 0.92% of median household income.[4]

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[2] *See* Chester Water Authority Comparative Rate Schedule, New Rates Effective July 1, 2016; *compare with* Pennsylvania-American Water Company, Rates Rules and Regulations Governing the Distribution and Sale of Water Service in Certain Municipalities and Territories Located Adjacent Thereto, Issued June 15, 2018, Effective July 1, 2018; Aqua Pennsylvania Inc., Rates and Rules Governing the Distribution of Water in Portions of Adams, Berks, Bradford, Bucks, Carbon, Chester, Clarion, Clearfield, Columbia, Crawford, Cumberland, Delaware, Forest, Juniata, Lackawanna, Lawrence, Lehigh, Luzerne, Mercer, McKean, Montgomery, Monroe, Northampton, Northumberland, Pike, Schuylkill, Susquehanna, Snyder, Venango, Warren, Wayne and Wyoming Counties, Issued December 15, 2017, Effective January 1, 2018; SUEZ Water Pennsylvania, Inc., Harrisburg, Pennsylvania, Rates, Rules and Regulations Governing the Distribution of Water, Issued March 28, 2018, Effective January 23, 2018.

[3] https://www.census.gov/quickfacts/fact/table/chestercitypennsylvania,PA/PST045217

[4] 2017 AWWA Utility Benchmarking; American Water Works Association; Denver CO; 2017; p. 74.

- Assuming a typical residential bill for a City customer is $35.15, the annual cost of water represents 1.55% of the median Household income in the City. By comparison, IOU rates represent 2.87% or more of the median household income.[5]

- Such an increase in rates would have an adverse effect on the City's fiscal health and could even bankrupt certain City businesses and residents.

- Based on current IOU rates, an IOU operating the Authority could receive ***$1 billion*** for its shareholders from Authority rate payers every twenty-three (23) years.

  - Any one-time payment the Recovery Coordinator believes the City could receive from monetizing the Authority pales in comparison to the money City ratepayers will pay back to an IOU in the long-term.

  - If the City needs money, it should not seek to monetize the Authority – with current IOU rates, the City could get a better rate for its constituents from a payday lender.

- The Recovery team should not be employing a strategy that deprives the City (and a large portion of Southeastern Pennsylvania) of a valuable, constitutionally-protected public trust asset that has been operating successfully for over 150 years.

  - The Recovery Coordinator should not be seeking to increase the rates of life-sustaining water for City residents and businesses in return for (i) a small amount of money in the City's general fund in the short-term, (ii) the loss of a valuable public trust asset that will be difficult, if not impossible to recover in the future, and (iii) ***decades*** of City rate payers and business putting their limited funds into the hands of an IOU's investors over the long-term. Such a plan ***does not set the City up for success.***

  - Further, the proposal, if acted upon, is fraught with legal issues that will lead to years of costly litigation, as the City may not unilaterally terminate or monetize the Authority.

    - As explained in detail in the Authority's Comment to Econsult's Assessment, the Authority is not an asset of Chester City, which makes up

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[5] *See* Chester Water Authority Comparative Rate Schedule, New Rates Effective July 1, 2016; *compare with* Pennsylvania-American Water Company, Rates Rules and Regulations Governing the Distribution and Sale of Water Service in Certain Municipalities and Territories Located Adjacent Thereto, Issued June 15, 2018, Effective July 1, 2018; Aqua Pennsylvania Inc., Rates and Rules Governing the Distribution of Water in Portions of Adams, Berks, Bradford, Bucks, Carbon, Chester, Clarion, Clearfield, Columbia, Crawford, Cumberland, Delaware, Forest, Juniata, Lackawanna, Lawrence, Lehigh, Luzerne, Mercer, McKean, Montgomery, Monroe, Northampton, Northumberland, Pike, Schuylkill, Susquehanna, Snyder, Venango, Warren, Wayne and Wyoming Counties, Issued December 15, 2017, Effective January 1, 2018; SUEZ Water Pennsylvania, Inc., Harrisburg, Pennsylvania, Rates, Rules and Regulations Governing the Distribution of Water, Issued March 28, 2018, Effective January 23, 2018.

21.3% of the Authority's customer and asset base. Rather, the Authority exists to provide access to clean and affordable water to present and future ratepayers throughout Southeastern Pennsylvania, particularly following the 2012 amendments to the Municipal Authorities Act, and as confirmed by the Pennsylvania Supreme Court's recent decision in *Pennsylvania Environmental Defense Foundation v. Commonwealth*, 161 A.3d 911 (Pa. 2017). *See* the Authority's Comment to Econsult's Assessment, attached hereto.

The negotiations between the City and the Authority intend to avoid these costly increases that could have devastating effects on City businesses and ratepayers. The City and the Authority seek a long-term solution that would keep the control of public water assets in public hands and potentially provide a long-term revenue stream to the City, which it has acknowledged will substantially aid it in balancing its budget and meeting its outstanding obligations in both the short and long-term. Such a solution should be exactly what the Department of Community and Economic Development is seeking for the City.

Further, the Authority is deeply concerned that Econsult's counsel attempted to interfere with the negotiations between the Authority and Chester City over a potential long-term solution.

Econsult has indicated that it plans to release a Final Recovery Plan for the City's consideration by August 20, 2018. The Department must not permit the Final Recovery Plan, Econsult, or other entities involved in the decades-long recovery process to suggest a course of action that would interfere with the negotiations between the City and the Authority or that would lead to potential litigation over the Recovery Coordinator's advocacy of an illegal course of action (the suggested unilateral monetization of the CWA by Chester City under threat of receivership by the Department). The Final Recovery Plan should permit the Authority and Chester City to honor their obligations and continue their good-faith negotiations under the valid and binding Standstill Agreement, without the threat of putting Chester City in receivership or in litigation over aspects of the Plan.[6]

The Authority suggests that the proposed Final Recovery Plan for the City of Chester state ***nothing more*** than that the parties may continue their good-faith negotiations during the Standstill Period. Any other Department recommendation could be construed as an improper request that the City take actions precluded by the valid Standstill Agreement, the Municipality Authorities Act, and/or the Pennsylvania Constitution. The Authority will not stand for that. It reserves all rights to take all necessary measures to protect present and future Authority rate payers, and to fulfill its obligations under Article I, Section 27 of the Pennsylvania Constitution.

[6] It is the parties intent to reach a definitive agreement during the Standstill Period that will satisfy the obligations of both parties and avoid needless, costly litigation.

Given the importance of this issue to all parties involved, particularly the constituents and beneficiaries of these public water assets (present and future Authority rate payers), we would appreciate a substantive response before August 6, 2018.

Very truly yours,

Cynthia F. Leitzell
Chairperson, Chester Water Authority

Standstill Agreement between the City of Chester and the Chester Water Authority

On March 14, 2018, the Chester City Council and the Mayor voted to enter into the attached "Standstill Agreement" and then presented it to the Chester Water Authority Board on March 15, 2018 for their consideration. The Chester Water Authority Board unanimously approved the agreement on March 15, 2018. Attached are:

1. Mutual Letter of Intent Agreement (3 pages) setting forth the terms of the Standstill Agreement and the date on which it expires, December 31, 2018.
2. Resolution of the City of Chester accepting the terms of the Standstill Agreement.

March 14, 2018

The Honorable Thaddeus Kirkland
Mayor, City of Chester
City Hall
1 Fourth Street
Chester, PA 19013

Cynthia F. Leitzell, CPA
Chairperson
Chester Water Authority
PO Box 467
Chester, PA 19016

City Council
City Hall
1 Fourth Street
Chester, PA 19013

Re: Mutual Letter of Intent regarding Chester Water Authority ("Letter of Intent")

This Letter of Intent memorializes discussions between representatives of Chester City government and representatives of Chester Water Authority concerning operational issues of the Chester Water Authority and provides the framework to continue those discussions with the mutual goal of entering into a definitive agreement (the "Definitive Agreement") between the City of Chester ("City") and the Chester Water Authority ("Authority") concerning future Authority operations.

1. The Chester Water Authority is organized and operates under the Pennsylvania Municipality Authorities Act, 53 Pa C.S.A. 5601 et. seq., as amended and supplemented to date ("Authorities Act").

2. Third parties have advised the City that since the City's predecessor government was the incorporator of the Chester Water Authority, the City has certain abilities under the Authorities Act at 53 Pa. C.S.A §5619 and 53 Pa. C.S.A. §5622 ("Sections 5619 and 5622") to unilaterally terminate the Authority's existence and/or to unilaterally acquire any project of the Authority. The Authority disagrees that the City can unilaterally terminate the Authority's existence or unilaterally acquire any project of the Authority for several reasons including inter alia, the unanimous passage of the law codified at 53 Pa. C.S.A. §5610(a.1) and §5612(a.1) as well as the July, 2017 Pennsylvania Supreme Court decision in *Pennsylvania Environmental Defense Foundation v. Commonwealth*, No. 10 MAP 2015 (June 20, 2017).

3. The City and the Authority are interested in amicably resolving their respective positions through a negotiated resolution rather than through resolution through contested litigation between them. Therefore, the City and the Authority hereby agree as follows:

a. The City and the Authority will negotiate towards a Definitive Agreement starting immediately and continuing until December 31, 2018 unless the parties by mutual written agreement agree to extend this deadline ("Standstill Period").

b. The City or its successors or agents will not take any action or attempt to exercise any rights, that the City claims under Section §5619 and/or Section §5622 of the Authorities Act (or any comparable law), or which otherwise interferes with the operations of the Authority during the Standstill Period.

c. The Authority agrees to not invite, accept, consider or agree to any proposal by any third party with regard to the transfer of any assets under the control of or managed by the Authority during the Standstill Period. During the Standstill Period, neither party shall negotiate or contact any third party with regards to the transfer of any assets owned or managed by the Authority without the written authorization of the other party.

d. In exchange for the consideration set forth herein in subparagraphs 3(b) and 3(c), the City and the Authority agree to negotiate in good faith towards a final Definitive Agreement which will contain provisions, inter alia, that:

i. Allow the customers and assets of the Authority located within the geographical boundaries of the City ("City Division") to be administered and operated independent of the customers and assets in the part of the Authority's service area, outside of the City ("Western Division"). The principal purpose of this division of operations would be to allow the City, in connection with the operations of the City Division, to take advantage of loan, grant, and in-kind assistance opportunities and programs with the federal government, state government and non-profit community-oriented organizations which programs would be otherwise unavailable to the City.

ii. Encourage increasing management efficiencies as part of this division of Authority operations into a City Division and a Western Division.

iii. Provide for all necessary party lawyers review and approvals, third party consents or judicial, regulatory or other approvals and conditions precedent to be satisfied before a scheduled closing date.

4. Promptly following the date hereof, the parties will at reasonable times and locations provide to the other access to information in their respective possession, or reasonably available to it, respecting the City Division as may be reasonably requested subject to executed Non-Disclosure Agreements, reasonably requested, negotiated and executed. The City and the Authority shall take appropriate steps to the fullest extent permitted by applicable law, to avoid disclosure of the transactions contemplated hereby to third parties, including but not limited to employees of the City and the Authority other than as may be necessary or appropriate to complete the transactions contemplated hereby or as agreed is required by counsel to the Authority and counsel to the City.

5. This Mutual Letter of Intent Agreement is legally binding on the parties to the extent set forth in this Letter of Intent and is subject to, among other things, negotiation, execution and delivery of a mutually satisfactory Definitive Agreement, due diligence in connection therewith, the respective parties' lawyers review and approvals, required consents and approvals of third parties, and approvals of such transactions and agreements by the

Authority's Board and the City's Council and Mayor's office and the Delaware County Court of Common Pleas. This Letter of Intent is, and the Definitive Agreement will be, further subject to the Authority obtaining financing from third parties, if needed but is otherwise legally binding upon the parties immediately upon the execution hereof and shall survive the termination hereof to the extent set forth herein. The City and the Authority intend, acknowledge and agree that this paragraph, Subparagraphs 3(a) through 3(d); and the Paragraphs numbered 6, 7 and 8 contained herein shall be a legally binding agreement between the City and the Authority and shall be enforceable against the City and the Authority in accordance with their terms and shall survive any termination of this Mutual Letter of Intent.

6. This Letter of Intent is, and the Definitive Agreement shall be, governed by the laws of the Commonwealth of Pennsylvania without regard to whatever laws might otherwise apply under applicable principles of conflicts of choice of laws. The Delaware County Court of Common Pleas shall be the exclusive venue for all action or proceedings related to this Mutual Letter of Intent.

7. Notwithstanding anything herein to the contrary the City and the Authority shall bear the respective fees and expenses (including, without limitation, all legal and accounting fees) relating to their compliance with this Letter of Intent, the transactions contemplated herein, the negotiations leading to same transactions and the preparation made for carrying the same into effect.

8. This Letter of Intent is an agreement to negotiate in good faith. The parties hereby intend, agree and acknowledge that in exchange for the consideration detailed herein, they are obligated to operate and negotiate in good faith as set forth in Paragraphs 3 and 4, and use their best effects to work towards a Definitive Agreement and develop all necessary supporting documentation during the Standstill Period.

9. The City and the Authority intend that this Letter of Intent agreement constitute a valid and legally binding agreement of each of them, enforceable against each of them in accordance with its terms. All necessary action(s) to authorize this Letter of Intent agreement and the consummation and performance of the transactions contemplated hereby has been duly, validly and effectively taken by each of them.

ACCEPTED this 14th day of March, 2018:

CITY OF CHESTER

By: The Honorable Thaddeus Kirkland
Mayor, City of Chester

Attest: _____
City Clerk, City of Chester

ACCEPTED this 15th day of March, 2018:

CHESTER WATER AUTHORITY

By: Cynthia F. Leitzell
Chairperson of the Board
Chester Water Authority

Attest: _____
Secretary, Board of Directors
Chester Water Authority

RESOLUTION

WHEREAS, because the City was the Incorporator of the Chester Water Authority, the City can unilaterally terminate the Authority's existence and/or unilaterally acquire any project of the Authority, and;

WHEREAS, the Authority has advised the City that it disagrees that the City can unilaterally terminate the Authority's existence or unilaterally acquire any project of the Authority, and;

WHEREAS, the City and the Authority are interested in amicably resolving their respective positions through a negotiated resolution rather than through contested litigation between them.

NOW, THEREFORE, THE COUNCIL OF THE CITY OF CHESTER DOES RESOLVE:

That the City of Chester hereby authorizes and directs the appropriate City officials to execute the attached three (3) page Mutual Letter of Intent between the City of Chester and Chester Water Authority and in doing so, the City agrees to be legally bound to the terms, conditions, and provisions set forth in the Mutual Letter of Intent. The Mutual Letter of Intent establishes a time period during which the City and the Authority are obligated to negotiate in good faith toward an amicable resolution of their respective positions as more specifically set forth in the three (3) page attachment. The appropriate City officials are authorized to take any actions necessary to carryout the intent and purpose of the Resolution. Any Definitive Agreement (as deferred in the Mutual Letter of Intent) shall require the approval of Council.

WE HEREBY CERTIFY that this Resolution passed Council this 14th day of March, A.D. 2018.

MAYOR

Attest: Carlita Thompson
CITY CLERK

Chester Water Authority
P.O. Box 467
Chester, Pennsylvania 19016-0467
Tel: (610) 876-8185

May 18, 2018

VIA ELECTRONIC MAIL
chesteract47@econsultsolutions.com

Stephen P. Mullin, Esquire
Econsult Solutions Inc.
1435 Walnut Street, 4th Floor
Philadelphia, PA 19102

Re: Comment to the City of Chester's Financial Condition Assessment

Dear Mr. Mullin:

The Chester Water Authority ("the Authority") files this Written Comment to the Financial Condition Assessment for the City of Chester (the "Assessment") to protect the interests of its ratepayers. Simply put, much of the information contained in the Assessment is inaccurate, misleading, or creates false inferences in order to justify an allegedly brand new recommendation that the Authority should be liquidated to satisfy short term liquidity needs of the City of Chester ("City"), and to divert attention from the Commonwealth's and its appointed Recovery Coordinator's decades-long failures in its oversight of the City.

The Assessment declares that the "potential monetization" of the Authority "is the ***only option*** [the Recovery Coordinator] can identify that could produce sufficient funds to allow the City to achieve long-term fiscal balance." Assessment, p. 12. The Assessment thereby advocates for a short term solution to long term issues the City has faced since it entered into Act 47 distressed status in April 1995[1] and suggests that the City should divest Southeastern Pennsylvania of a valuable public asset that serves rate payers across multiple counties and townships, in a race to pay down the City of Chester's debts before the City's deadline to exit Act 47 status.

A monetization of the Authority to pay down the City's debts will harm Chester City residents and Authority ratepayers in a manner that the Assessment does not adequately plan for or consider. The problems with the assessment are legion, so the Authority submits the following sampling of those problems:

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[1] In April 1995, the Commonwealth of Pennsylvania Department of Community and Economic Development ("DCED") declared the City to be "distressed" under the criteria set forth in the Pennsylvania Municipalities Financial Recovery Act, 53 P.S. § 11701.101, *et seq.*, as amended ("Act 47").

A Potential Monetization of the Authority Has Never Been Included in Any of the City's Recovery Plans.

- Although the City has been in Act 47 status since 1995, and has been in weekly (if not daily) contact with its Act 47 recovery team since that period, the potential monetization of the Authority has never been contemplated in ***any*** of the Recovery Plans (or Amended Recovery Plans) for the City of Chester.

- A potential monetization of the Authority appears to be a more recent topic forced upon the City by the DCED and the Act 47 consultants as they struggle to find any potential sources of cash outside of the City's or the Commonwealth's funding sources in order for the City to exit Act 47 status before the deadline.

- Because a potential monetization of the Authority is not part of the City's Recovery Plan, the Recovery Coordinator appears to have been acting outside the scope of its enumerated powers at least through the last year through its pursuit of a potential monetization of the Authority. *See, e.g.*, 53 P.S. §§ 11701.221(d)(3), (e); 53 P.S. § 11701.224.1.

    - For example, in April 2017, prior to any public discussions of a potential monetization of the Authority – and before Aqua Pennsylvania made its May 2017 public bid to purchase substantially all of the assets of the Authority – members of the City's Recovery Team met privately with employees of Aqua to discuss both Chester City's financial condition and the Authority. The Authority was not made aware of this meeting until it received information from the DCED pursuant to a Right-to-Know Law Request, and no members of the City were present at the Recovery Coordinator's April 2017 meeting with Aqua. *See* Exhibit A.

- Further, there is concern of a recent statewide strategy of the Commonwealth and the Act 47 consultants it employees to avoid expending Commonwealth resources for the benefit of the Commonwealth's distressed municipalities, and instead to appropriate the resources of successful municipal authorities.

    - The Authority, however, is not an asset of Chester City. Only 22% of the Authority's customer base is located in Chester City. Seventy-eight percent (78%) of the Authority's customers are in Western Delaware County and Southern Chester County. The Authority exists to provide access to clean and affordable water to present and future ratepayers throughout Southeastern Pennsylvania, particularly following the 2012 amendments to the Municipal Authorities Act, and as confirmed by the Pennsylvania Supreme Court's recent decision in *Pennsylvania Environmental Defense Foundation v. Commonwealth*, 161 A.3d 911 (Pa. 2017), discussed below.

The Recovery Team's Guidance Does Not Appear to Focus on the City's Long-Term Success.

- After decades of working with the City and being paid millions of dollars, the Recovery Team is turning to the assets of Chester Water Authority as a potential short-term monetary

solution to the long-term financial issues Chester City has faced. Based on the Assessment, it appears the Recovery Team has provided other short-sighted recommendations as well.

- For example, the Assessment indicates that the Recovery Team encouraged the City to borrow funds at a 7.5% - 8% interest rate, through the City's August 2017 Guaranteed Revenue Bonds. A 7.5% - 8% interest rate is higher than typical or advisable borrowing rate for a municipality or government entity.

- The principal amount of the Guaranteed Revenue Bond was $19,210,000. The City paid multiple fees known as a "Cost of Issuance" to complete the Bond transaction. These fees totaled approximately $569,000 and included a $288,000 placement fee, legal counsel fees, and trustee fees. There was also a discount of approximately $600,000 applied to the Bond. After deducting the discount and the Cost of Issuance from the Bond principal, the City received ***less than $18,000,000***. The City must pay back the full $19,200,000, however – with interest.

    - Further, the August 2017 Bond restructured $7,210,000 of existing debt the City owed from a 2004 borrowing and ***increased*** the interest rate the City owed on that debt from 7% to 7.5%, so that the City could receive immediate cash.

        - Although this Bond requires the City to pay much more money in the long-term, the Assessment states that the City's August 2017 Bond "made repaying a portion of the City's debt [in the short term] more manageable." Assessment, p. 4.

    - In August 2018, the City must begin redeeming the Bonds.[2] The Bonds are secured by "Pledged Revenues" that the City had previously placed in its General Fund and used to pay other obligations. Now, the Pledged Revenues are directly deposited with a trustee.

        - The Pledged Revenues include (i) Covanta Host Community Fees, (ii) Harrah's Revenues, and (iii) Harrah's Table Games Revenues. To the extent these revenues are insufficient to pay the debt service, the Bonds are payable from the unrestricted general revenues of the City that are legally available. This means that the City's previous streams of revenue are now being used to pay interest, principal, and other costs related to the Bonds.

        - Historically, these Pledged Revenues have accounted for approximately $17-$18 million of revenue to the City. This important revenue is now being deposited into a trust. From there, money is presumably deducted to pay off the principal and interest owed each year on the Bond. It is unclear whether

[2] The Bonds have mandatory and optional redemptions. The City *must* redeem a portion the bonds beginning in August 2018. The City has the option to redeem the bonds in August 2022, at 103% -- which means that the City will pay more in principal to redeem a Bond early (i.e., if a Bond was issued in 2017 at $1,000,000 the City may buy it back in August 2022 for $1,030,000). This does not include interest paid on the Bond between 2017-2022.

the City has access to the funds and the effect this will have on the City's cash flow.

- The Guaranteed Revenue Bonds were financed through a company based in Atlanta, Georgia.

- It is unclear whether the Recovery Team encouraged the City to seek financing at a lower interest rate from entities in Pennsylvania such as the Delaware Valley Regional Finance Authority (which can loan funds at 2% interest) or the Pennsylvania Infrastructure Investment Authority (PennVEST). This should be fully explored and vetted. In addition to offering lower interest rates, such entities may not include all of the costs and fees paid by the City in connection with its Guaranteed Revenue Bond.

- Under the Pennsylvania Environmental Rights Amendment ("ERA") to the Pennsylvania Constitution, both the Authority and the Commonwealth act as trustees for all constitutionally protected resources, such as water. As trustees, the Authority and the Commonwealth are entrusted with conserving and maintaining those resources for the benefit of the people, ***including generations yet to come***. *See PEDF*, 161 A.3d at 916 (citing Pa. Const. art. I, § 27).

  - It is unclear whether the DCED, a Commonwealth agency, appreciates its duties as a trustee in this regard. *See* Exhibit B (10/1/2017 Email from C. Houston).

The Authority Has Been Instrumental in Assisting City Entities with Receipt of Over $11 Million in Loans and Grants that have Benefitted the City.

- The Authority has assisted City entities with receipt of low interest loans and grants.

- For example, in January 2017, the Authority assisted a City entity with receipt of a $1 million grant through PennVEST.

- In April 2018, the Authority assisted a City entity with receipt of two (2) low interest PennVEST loans totaling $10.8 million.

- These grants and funds show that it is possible to assist the City with receipt of funds in a manner that better enables long-term success.

Monetization and/or Privatization of the Authority Would Likely Result in Increased Rates For Chester City Rate Payers and Businesses and Would Not Benefit the City in the Long Term.

- The Assessment states that "the key to securing the City's long-term fiscal health is expanding its economic base and therefore the growth of its own local tax revenues." Assessment, at 13.

- Monetization and/or privatization of the Authority, which would likely result in increased water rates to businesses and individuals, may have an adverse effect on the City's fiscal health and could even bankrupt certain City businesses that do not operate on a large profit margin.

- Monetization and/or privatization of the Authority could result in years of expensive litigation that could tie up the "quick funds" the Recovery Team seeks, and deplete any anticipated revenue before the litigation ends.

- Further, funds from a sale of the Authority ***cannot be used in the City's general fund.*** 53 Pa.C.S. § 5612(a.1) precludes money of an authority from being used for any purpose not directly related to the mission or purpose of that authority, and provides ratepayers with a cause of action against the recipient of that money to seek the return of any funds expended in violation of Section 5612(a.1). Article 1, Section 27 of the Pennsylvania Constitution as interpreted by the Pennsylvania Supreme Court includes similar restrictions.

The City of Scranton Executed a Parking Authority Deal Similar to the Deal Entered Into by the City of Chester.

- As the Assessment notes, the Recovery Coordinator has worked with the City of Chester "on a daily basis," yet the Recovery Coordinator alleges that the City "proceeded with an asset transaction with respect to the City's parking system without providing sufficient information to the Recovery Coordinator to determine the potential fiscal impact." Assessment, p. 12, 13.

- The City of Scranton implemented a parking authority deal similar to that entered into by the City of Chester to address defaults on revenue bond payments and bank debt held by the City of Scranton Parking Authority.

    - The Scranton transaction involved the execution of a 45-year lease concession agreement for daily management by a private company of all five of Scranton's parking garages, the management of the garage assets of the Steamtown Marketplace, and approximately 1,500 parking meters.

    - According to media reports, the benefit of the concession agreement to Scranton is significant in that it assisted in reducing the City's overall debt and it ensured proper management of the parking system. The agreement also provided for renovations to the parking garages and meters, increased efficiencies, and upgraded technologies.

- Further, it is difficult to imagine that the Act 47 team was not aware of the details of the City of Chester's deal. While not the ultimate decision-maker, the Recovery Coordinator influences City affairs and was instrumental in the creation of a CFO position within the City in 2016, when one did not exist before that period. *See* Assessment, p. 2. Indeed, records indicate that the Coordinator expressly facilitated the transition of a City Council member to that paid position.

The DCED and its Team Have Not Been Transparent.

- The Authority has had to resort to litigation through Right- to-Know Law requests in order to find out basic information related to communications the DCED and the Recovery Team have had about the Authority.

- Further, the Authority was forced to litigate its Right- to-Know Law requests to find out that the members of the City's Recovery Team met privately with employees of Aqua to discuss both Chester City's financial condition and the Authority in April 2017, before Aqua's May 2017 public bid to purchase the Authority. *See* Exhibit A.

    - To date, the DCED continues to deny the Authority access to public records requested in November 2017.

- The Assessment states the City had a balanced budget for 2017 and it projects a balanced budget for 2018, yet the Assessment alleges that the Recovery Coordinator has "serious doubt" the City has the "capacity to emerge from financially distressed status without dramatic action." Assessment, p. 11.

- Even though monetization of the Authority has never been included in a single Recovery Plan since the City entered Act 47 status in 1995, the DCED and the Recovery Team purport "[s]ince [the City's] the fiscal challenges are more severe than known when the 2016 Amended Recovery Plan was drafted, the City must also implement initiatives that go beyond what is outlined in the Plan." *Id.*

    - It is difficult to understand how, when a Recovery Team has been involved in the City's day-to-day strategic financial planning for ***decades***, the City's fiscal challenges could be "more severe than known."

    - It is worth looking into whether advice provided to the City, which included entering into numerous high-interest loans in an effort to receive quick cash, has contributed to the City's current financial condition.

    - Before the new Recovery Coordinator took over, the City had been on track to have a balanced budget. As the Assessment notes, "The City's fiscal condition improved following the opening of Harrah's Philadelphia Casino and Racetrack in 2008, and the City operated within budget for several years including establishing a revenue fund with excess revenues." Assessment, p. 1.

- The Assessment further asserts that "[g]aming related income, the City's primary revenue source, is expected to be flat." *Id.*

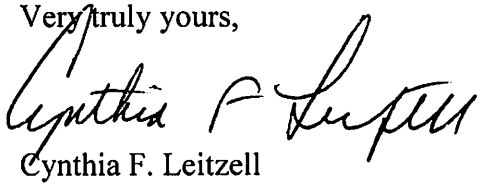
    - It remains to be seen whether the United States Supreme Court's May 14, 2018 decision to legalize sports gambling will lead to an impact on the revenue the City receives from Harrah's. If so, there is a chance the revenue would be collected by the

state (and spread throughout the Commonwealth) rather than by the City alone. This would certainly affect the City's ability to pay the Guaranteed Revenue Bonds.

The Authority serves its ratepayers in Chester City with the same sense of loyalty as it serves all of its customers throughout Southeastern Pennsylvania. As an entity that has thrived for over 150 years, the Authority has achieved success by operating in a manner that anticipates and plans for the needs of future customers. I hope the City of Chester's Recovery Coordinator is similarly considering the City's residents, both past and future, and advising the City in a manner that will give the City of Chester its best chance at long-term prosperity

Thank you for your consideration of these important issues.

Very truly yours,



Cynthia F. Leitzell
Chairperson, Chester Water Authority

EXHIBIT A

From: Schuller, Daniel J.
To: Dan Connelly
Cc: Lucca, Marc A.; Davis, William B.; Luning, Christopher; Mullin, Stephen (Mullin@ECONSULTSolutions.com); Queenan, Brooke (Queenan@EconsultSolutions.com)
Subject: RE: City"s Debt Balance
Date: Wednesday, April 26, 2017 6:26:15 PM
Attachments: image002.png
image003.png
image004.png

Thank you, Dan. We really appreciate the additional information. Hope your meeting with the City went well.

Looking forward to continuing our dialogue.

Best,

Dan

AQUA.

Dan Schuller
Strategy & Corporate Development
Aqua America, Inc.
762 W. Lancaster Avenue, Bryn Mawr, PA 19010
O: 610.645.4266 M:917.376.2875

From: Dan Connelly [mailto:DConnelly@fairmountcapital.com]
Sent: Tuesday, April 25, 2017 9:27 AM
To: Schuller, Daniel J.
Cc: Lucca, Marc A.; Davis, William B.; Luning, Christopher; Mullin, Stephen (Mullin@ECONSULTSolutions.com); Queenan, Brooke (Queenan@EconsultSolutions.com)
Subject: RE: City's Debt Balance

Dan,

It was nice meeting you and your team yesterday. We are interested in the discussions that are taking place regarding the Chester Water Authority and would like to be helpful where appropriate.

The city's outstanding debt balance entering this year was $18,929,027. That includes a portion of a 2009 borrowing that was issued through a County Authority. The city is obligated to pay 25% of the annual debt service on that issuance, so 25% of the outstanding amount is included in our summary.

The city is in the process of executing a borrowing of about $20 million to fund much of the past obligations that we discussed yesterday. We are targeting a July close on that issuance.

In addition to their debt liability, their unfunded pension liability is $61,239,939, which is based on the most recent actuarial report. We expect that unfunded liability to be larger when the next actuarial report is released sometime this summer.

The city also has a very large unfunded Other Post-retirement Employee Benefits liability, but they are not required to fund the same way they are required to fund the pension.

I hope this information is helpful. We look forward to being in touch with you in the future.

Dan

From: Schuller, Daniel J. [mailto:DJSchuller@aquaamerica.com]
Sent: Monday, April 24, 2017 7:51 PM
To: Dan Connelly
Cc: Lucca, Marc A.; Davis, William B.; Luning, Christopher
Subject: City's Debt Balance

Dan:

We enjoyed meeting you and your colleagues today and look forward to continuing the dialogue. Your insights on Chester really helped us to understand the dynamics in the City. We didn't understand the interactions between you and the municipal leaders prior to today's lunch. Sounds like every day is interesting.

When you get a chance, could you please send us the City's outstanding debt balance?

Thanks and best regards,

Dan

AQUA.
Dan Schuller
Strategy & Corporate Development
Aqua America, Inc.
762 W. Lancaster Avenue, Bryn Mawr, PA 19010
O: 610.645.4266 M:917.376.2875

EXHIBIT B

CATANIA & PARKER, L.L.P.
ATTORNEYS - AT – LAW

P.O. BOX 2029 ■ MEDIA, PA 19063
PHONE: (610) 565-8101 ■ FAX: (610) 565-7613

STREET ADDRESS:
230 N. Monroe St., 2nd Fl
Media, PA 19063

September 25, 2017

VIA ELECTRONIC MAIL
chhouston@pa.gov

Christopher C. Houston, Chief Counsel
Governor's Office of General Counsel
The Department of Community and Economic Development
Office of Chief Counsel
Commonwealth Keystone Building
400 North Street, 4th Floor
Harrisburg, PA 17120

RE: Fiduciary Obligations under the Environmental Rights Amendment

Dear Mr. Houston:

I write on behalf of the Chester Water Authority ("the Authority") as its solicitor.

In May 2017, the Authority received and rejected an unsolicited bid from an investor-owned utility ("IOU") seeking to purchase the Authority's assets pursuant to the Fair Value Act, 66 Pa. C.S. § 1329. Although the Authority ultimately rejected the May 2017 unsolicited bid, IOUs may still be communicating with various entities, possibly including the DCED or consultants hired by or under the supervision of DCED, about the Authority and its assets. Such communications should not be taking place without the Authority's involvement.

Under the Pennsylvania Environmental Rights Amendment ("ERA") of the Pennsylvania Constitution, both the Authority and the Commonwealth act as trustees for all constitutionally protected resources, such as water. As trustees, the Authority and the Commonwealth are entrusted with conserving and maintaining those resources for the benefit of the people, including generations yet to come. See Pennsylvania

Environmental Defense Foundation v. Commonwealth, 161 A.3d 911, 916 (Pa. 2017) (citing Pa. Const. art. I, § 27).

To ensure that both the Authority and the Commonwealth are fulfilling their respective roles as fiduciaries, it is critical that the Authority be made aware of and involved in any communications or discussions to which DCED is privy between a Commonwealth entity and any IOUs pertaining to the Authority or its assets. To that end, I suggest we meet or speak by phone to create a procedure to ensure an open line of communication about these issues.

I can be reached at (610) 565-8101 or fjc@fjccp.com. I look forward to hearing from you.

Very truly yours,

FRANCIS J. CATANIA

FJC\dml
cc: Chester Water Authority

From: Houston, Christopher [mailto:chhouston@pa.gov]
Sent: Sunday, October 01, 2017 9:35 AM
To: Francis Catania <fjc@fjccp.com>
Subject: RE: Chester Water Authority
Importance: High

Mr. Catania,

I apologize for the delay in responding to the attached letter. I do appreciate you reaching out to me regarding this matter; however, DCED does not have the duties and responsibilities of a trustee with regard to a sale of the assets of a municipal owned and operated public water system.

Again, thank you for bringing this matter to my attention.

Christopher C. Houston | Chief Counsel
Governor's Office of General Counsel
PA Department of Community & Economic Development
Office of Chief Counsel
Commonwealth Keystone Building
400 North Street, 4th Floor | Harrisburg, PA 17120-0225
Phone: 717-720-7328 | Cell: 717-579-1982 | Fax: 717-772-3103
Email: chhouston@pa.gov
dced.pa.gov | www.visitPA.com

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ATTORNEY WORK PRODUCT

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From: Denise Latch [mailto:dml@fjccp.com]
Sent: Monday, September 25, 2017 3:47 PM
To: Houston, Christopher <chhouston@pa.gov>
Cc: Francis Catania <fjc@fjccp.com>
Subject: Chester Water Authority

SENT ON BEHALF OF F.J. CATANIA, ESQ.

Mr. Houston:

Please see the attached letter. Thank you.

F.J. Catania, Esq.

Denise Latch
Assistant to Francis J. Catania, Esquire
Catania & Parker, LLP
230 North Monroe Street, Second Floor
Media, PA 19063
Phone: (610) 565-0100
Fax: (610) 565-7613

Please use the following mailing address:
PO Box 2029
Media, PA 19063

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FINANCIAL CONDITION ASSESSMENT OF THE CITY OF CHESTER

Date Filed:
May 4, 2018

REPORT PREPARED FOR:
The City of Chester, Delaware County

REPORT SUBMITTED BY:
Econsult Solutions and McNees Wallace and Nurick LLC
1435 Walnut Street
Philadelphia, PA 19102

ECONSULT SOLUTIONS
economics | policy | strategy

PURPOSE OF FINANCIAL CONDITION ASSESSMENT

Since 2015, the Commonwealth of Pennsylvania's Department of Community and Economic Development ("DCED") has engaged Econsult Solutions, Inc., Fairmount Capital Advisors, Inc., and McNees Wallace & Nurick LLC (collectively, the "Recovery Coordinator") to serve as the Recovery Coordinator for the City of Chester (the "City"). In this capacity, the Recovery Coordinator's responsibilities include monitoring the financial progress of the City, providing consultation and advice to the City's elected officials and administrative staff, periodically reviewing and updating the City's financial Recovery Plan, and monitoring the City's implementation of the Recovery Plan.

Act 199, which amended Act 47 and was enacted in 2014, provides that municipalities operating under a recovery plan shall be subject to a termination date five years from the effective date of the most recent recovery plan. For the City of Chester, the relevant recovery plan for this timeline is that which was adopted as of May 2013. Further, Act 199 requires that the Recovery Coordinator complete a report, prior to the end of the five-year period, stating the financial condition of the municipality and including one of the following findings: 1) conditions within the municipality warrant a termination of distressed status, 2) conditions are such that the municipality should be disincorporated, 3) conditions are such that the DCED secretary should request a determination of a fiscal emergency, or 4) a three-year extension plan is warranted. This Financial Condition Assessment report reflects the Recovery Coordinator's assessment as required by Act 199.

SUMMARY HISTORY OF FISCAL DISTRESS IN CHESTER

The City of Chester entered Act 47 distress status in 1995. The City adopted its original Recovery Plan in 1996 and adopted Recovery Plan amendments in 2006, 2013, and 2016. The City's fiscal condition continued to deteriorate from 1996 to 2006 when the City needed to obtain a deficit-funded loan to meet payroll and deliver basic services. The City's fiscal situation improved following the opening of Harrah's Philadelphia Casino and Racetrack in 2008, and the City operated within its budget for several years including establishing a reserve fund with excess revenues. However, the City then began to fall into distress again as personnel costs climbed, particularly in the police and fire ranks, due to historically bad interest arbitration awards. In addition, the City failed to pay its minimal municipal obligations ("MMOs") on the police, fire and non-uniform pensions in the years 2014 to 2016, leading to a severely underfunded pension situation, particularly with the Police and Officers & Employees (non-uniform) plans.

At the beginning of 2017, the City had accumulated approximately $28 million of unpaid obligations. In addition, the City had defaulted on its 2016 Tax and Revenue Anticipation Note. In January 2017, DCED issued an emergency $2 million loan and arranged an advance on gaming host revenues from Harrah's to the City to help with immediate cash flow needs. Addressing these

obligations and funding day-to-day operations left the City facing another cash deficit by the late summer of 2017. In August 2017, the City closed a debt issuance with a principal amount of $19.21 million, including a $12 million unfunded debt borrowing to address a portion of its outstanding liabilities. The unfunded debt issuance and financing of the past due obligations over a 10-year period made repaying a portion of the City's debt more manageable. However, by the end of 2017, over $17 million of past due pension MMO obligations remained without a clear plan for repayment. The City's legacy costs, which consist of debt, pension, and other post-employment benefits, continue to place enormous pressure on the City's finances, including both the month-to-month cash flow and the long-term liabilities.

SUMMARY OF PROGRESS ADDRESSING FISCAL CHALLENGES UNDER KIRKLAND ADMINISTRATION

As Mayor Kirkland's administration took office in January 2016, and with the adoption of an Amended Recovery Plan in 2016, the City and the Recovery Coordinator have cooperated in taking important steps to move the City in the direction of fiscal recovery. The City hired a full-time Chief Financial Officer ("CFO") and a deputy CFO, key Amended Recovery Plan recommendations, whose salaries are paid from a DCED grant. This has strengthened the City's finance, accounting, budget, debt and related functions, and has improved the ability of the City to understand and address its fiscal problems. In addition, with the assistance of the Recovery Coordinator, the City made significant progress toward financial stability by negotiating three labor agreements in compliance with the Amended Recovery Plan. Notably, the City and the Fraternal Order of Police ("FOP"), the labor union representing the City's police officers, took a critical first step to solving the pension crisis by enacting provisions in the new collective bargaining agreement, which increased employee contributions and reduced benefits. In addition, in 2017, the City took the following steps:

- Increased the resident earned income tax ("EIT") rate to 2.75 percent and reduced the non-resident EIT rate to 1.05 percent;
- Transitioned to a self-insured health benefits structure for its employees;
- Contributed $4.2 million toward its MMO;
- Took steps to address blight with the help of the PA Housing Alliance; and
- Reversed its multi-year trend of $4 million-plus annual deficits, with operating revenues basically equaling operating expenses.

DETAILED REVIEW OF THE LEGACY COSTS

At the beginning of 2017, the City had accumulated approximately $28 million of unpaid obligations including over $14 million in past due MMOs, $6.9 million of health insurance premium payments, $1.1 million of workers compensation premiums, and $2.3 million of other vendor

payments. In addition, the City defaulted on its 2016 Tax and Revenue Anticipation Note and did not immediately contribute its 2016 state pension aid to the pension fund.

Debt Issuance

In January 2017, DCED issued an emergency $2 million loan and arranged an advance on gaming host revenues to the City to help with immediate cash flow needs. Addressing these obligations and funding day-to-day operations left the City facing another cash deficit by the late summer of 2017.

On August 31, 2017, the City closed a debt issuance with a total par amount of $19.21 million. The issuance was comprised of a $12 million unfunded debt borrowing to address a portion of its outstanding liabilities and a $7.21 million refunding component that restructured a direct bank loan, which was issued in 2015. The unfunded debt component resulted in $10.8 million of proceeds after costs of issuance and the funding of required reserves. The debt issuance increased annual debt service by approximately $700,000 in 2018. The City's annual debt service obligations will be between $3.9 million and $4.0 million through 2025.

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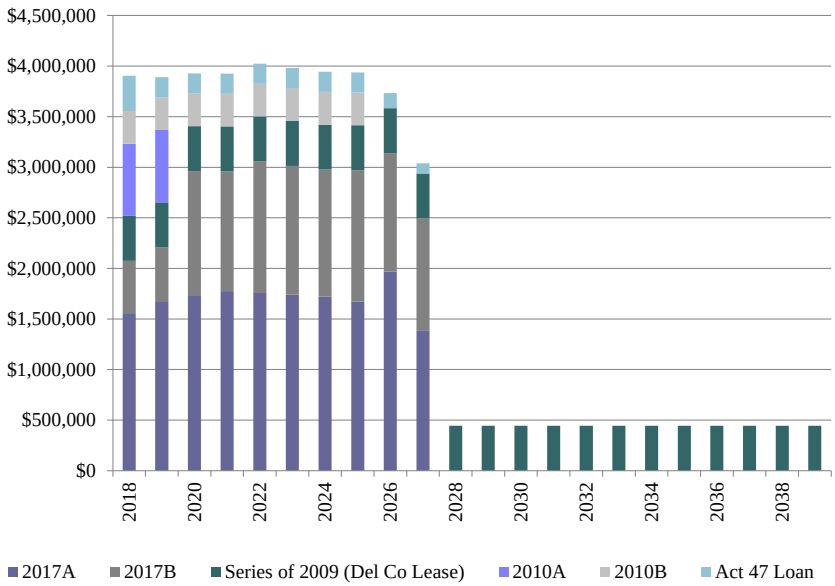
The following chart shows the City's annual debt service obligations from 2018 through 2039:

Table 1 – Annual Debt Service, 2018-2039



Source: City of Chester Finance Department (2018)

The unfunded debt issuance and financing of the past due obligations over a 10-year period made repaying a portion of the City's debt more manageable. However, by the end of 2017, over $17 million of past due pension MMO obligations remained without a clear plan for repayment. The City's legacy costs, which consist of debt, pension, and other post-employment benefits liabilities, will continue to place enormous pressure on the City's finances unless significant action is taken.

Pension Obligations

Chester administers three single-employer defined benefit pension plans: the Police Pension Fund, Paid Firemen's Pension Fund, and Officers & Employees Retirement System. These plans essentially cover all full-time employees.

The Police and the Officers & Employees' pension funds are severely underfunded and had unfunded actuarially accrued liabilities of approximately $57.9 million and $6.3 million, respectively, as of January 1, 2017. Police Pension Fund assets covered 31 percent of its fund's accrued liability, while Officers & Employee Pension Fund assets covered only 24 percent of its fund's accrued liability. The unfunded liability of the Police Pension Fund is actually much worse than it appears because the financial statements include pension receivables as plan assets. As noted above, the City owes approximately $17 million in MMO payments which must be taken into account when doing a true evaluation of the plan's assets.

Table 2 - Summary of Actuarial Data as of 1/1/17

Actuarial Categories	Fire	Police	Officers & Employees
Actuarial Accrued Liability	$37,679,820	$83,380,853	$8,350,535
Actuarial Value of Assets	$32,822,001	$25,498,629	$2,019,149
Unfunded Actuarial Accrued Liability	$4,857,819	$57,882,224	$6,331,386
Funded Percentage of Accrued Liability	87%	31%	24%

Source: Pension Actuarial Reports as of 1/1/17

The dangerously low funding levels are a result of increased benefit payouts and inadequate employer contributions. The following is a summary of the City's MMO over the past four years compared to actual contributions:

Table 3 – Pension MMO Contribution Summary, 2013-2017

MMO by Pension Plan	2013	2014	2015	2016	2017
Police	$2,906,548	$3,824,942	$5,408,043	$4,741,872	$5,235,369
Fire	$0	$207,303	$607,372	$118,972	$561,281
Officers & Other Employees	$606,847	$709,116	$1,032,155	$1,027,873	$754,857
Total	$3,513,395	$4,741,361	$7,047,570	$5,888,717	$6,551,507
State Aid	$1,491,594	$1,560,690	$1,497,759	$1,622,994	$1,766,478
City Contribution	$2,021,801	$0	$0	$0	$2,400,000
Outstanding Year-End Balance	$0	$3,180,671	$5,549,811	$4,265,723	$2,385,029

Source: City of Chester Financial Audits (2013-2015), City of Chester Financial Department (2013-2017)

The City and the FOP took a critical first step to solving the pension crisis by enacting provisions in the new collective bargaining agreement which increased employee contributions and reduced benefits. Still, the police pension fund faces an immediate funding emergency. The City's pension consultant estimates that actual assets in the fund are sufficient to cover approximately 12 months of benefit distributions. In 2018, the City began making monthly deposits of $500,000 into the fund; however, if the City does not identify a new funding source through revenue enhancement, expense reduction, or asset monetization, the fund's future is in serious jeopardy. If the police pension fund is depleted and no other revenue source is established, the City would have to pay the pension benefits from current General Fund revenues, which it cannot afford to do.

The critically low funding status of the Police Pension Plan and the potentially disastrous impact of its insolvency on the City's General Fund cannot be overstated.

Other Post-Employment Benefits

Other Post-Employment Benefits ("OPEB") include benefits other than pension that are provided to retirees including medical, prescription drug, dental, vision, hearing, life insurance, long-term disability, long-term care, death benefits, and any payments made to the retiree that are to be used for such coverage.

The new GASB rules require the use of accrual based accounting methods for disclosure of the liabilities related to OPEB costs. The accrual based accounting recognizes costs when benefits are earned, not when the benefit is actually paid.

Like most other governments, Chester uses a "pay-as-you-go" approach for funding OPEB costs. The table below illustrates Chester's enormous actuarially unfunded OPEB liability of $218 million.

Table 4 – City of Chester, OPEB Liability

Category	Amount
Actuarial Value of Plan Assets	-
Unfunded Actuarial Accrued Liability	$218,494,504
Annual OPEB Cost	$18,929,357
Pay-as-you-go Contribution for 2015	$5,016,917
Net OPEB Obligation Beginning of Year	$48,975,115
Net OPEB Obligation Year End	$62,887,555
Net Change in OPEB Obligation	$13,912,440

Source: City of Chester Financial Audits (2015)

Though the City is not required to pre-fund its OPEB obligation, this does not mean it is not a critical financial concern. The City has begun to address this liability with new provisions in the collective bargaining agreements that were ratified last year. The City must revisit these benefits again during the next round of contract negotiations, and act to limit or eliminate these benefits now for non-represented employees.

REVIEW OF OPERATING BUDGET

The City experienced severe operating deficits from 2013 through 2016. On August 12, 2016, the City adopted a new Amended Recovery Plan to replace the prior recovery plan. The Amended Recovery Plan reviewed the City's recent financial history and presented certain financial projections based upon the general pattern of revenues and expenditures of the City that show, absent any action by the City, cumulative operating budget deficits growing significantly larger over the course of the next five years, from approximately $16.3 million in 2016 to $37.4 million in 2020.

The Amended Recovery Plan has over 80 initiatives that would eliminate the projected deficits and set the City on a course to structural budgetary balance. The initiatives also address operational issues, such as the City's financial management infrastructure, and other underlying causes of Chester's financial distress, which are principally the City's inability to reverse the decades-long trend of tax base contraction. The Amended Recovery Plan includes recommendations to grow the City's economy, increase employment opportunities and stimulate the growth of its various tax bases to generate revenues and reduce costs including overtime costs. The following table shows the City's operating and fund balance results from 2013-2017 and the 2018 budget:

Table 5 - General Fund Operating Results, 2013-2017, 2018 Budget

	2013 Audited	2014 Audited	2015 Unaudited	2016 Unaudited	2017 Unaudited	2018 Budget
Revenues	$43,689,738	$43,064,682	$46,287,186	$45,300,071	$47,090,929	$47,729,679
Expenditures[1]	$45,916,833	$51,752,132	$54,219,894	$53,583,640	$47,086,384	$47,729,679
Surplus/(Deficit)	($2,227,095)	($8,687,450)	($7,932,708)	($8,283,570)	$4,545	$0
Beg Fund Balance	$4,088,224	$1,861,130	($6,826,320)	($14,759,028)	($23,042,598)	($12,238,052)
Debt Proceeds[2]					$10,800,000	
End Fund Balance	$1,861,130	($6,826,320)	($14,759,028)	($23,042,598)	($12,238,052)	($12,238,052)
End Cash Balance	$2,573,436	$1,025,731	$494,211	$100,000	$100,000	$100,000
End Accts Payable	$5,780,677	$13,655,207	$21,503,130	$27,979,552	$18,327,529	$18,327,529

Source: City of Chester Financial Audits (2013-2015), City of Chester Financial Department (2013-2018)

[1] Including net operating transfers [2] Unfunded Debt

2017 Financial Review and 2018 Budget

The implementation of the Amended Recovery Plan recommendations and other initiatives helped improve operating results in 2017; however, overall, the City fell short of the targets set forth in the plan. Assuming the full and timely implementation of the Amended Recovery Plan recommendations, the forecasts showed "surpluses" of $4 million to $5 million beginning in 2017, which would have been used to address the City's daunting levels of unpaid obligations. The City's estimated 2017 revenues were basically equal to expenses, which represented significant progress compared to previous years; however, the City failed to make headway in reducing its liabilities.

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Table 6 –General Fund Revenue and Expense Sources, 2017, 2018 Budget

Revenue	2018 Final Budget	2017 Budget	2017 Actual (Unaudited) [1]	% Change from 2017 Actual to 2018 Budget
Real Estate Taxes	$10,019,935	$9,734,675	$9,694,647	3.4%
Taxes - Act 511	$12,298,190	$12,238,813	$11,803,376	4.2%
Fines	$450,000	$800,000	$231,401	94.5%
Licenses and Permits	$1,748,000	$1,771,123	$1,355,013	29.0%
Interest, Rents and Royalties	$5,461,164	$6,356,200	$5,594,191	-2.4%
Intergovernmental Revenues	$9,089,385	$9,934,635	$7,777,573	16.9%
Charges for Services	$6,956,575	$8,042,450	$7,790,682	-10.7%
Reimbursements	$1,406,430	$1,567,100	$1,721,528	-18.3%
Other Revenue	$300,000	$900,000	$1,122,518	-73.3%
Total General Fund Revenues	$47,729,679	$51,344,996	$47,090,929	1.4%

Expenditures	2018 Final Budget	2017 Budget	2017 Actual (Unaudited)[1]	% Change from 2017 Actual to 2018 Budget
Salaries	$17,349,631	$16,485,957	$16,709,797	3.8%
Overtime	$1,714,000	$1,652,500	$2,136,021	-19.8%
Health Insurance	$8,816,599	$7,800,000	$8,422,706	4.7%
Other Benefits	$3,219,105	$4,157,560	$3,415,104	-5.7%
Pension	$7,051,761	$6,451,507	$4,166,478	69.2%
Total Employee Costs	$38,151,096	$36,547,523	$34,850,105	9.5%
Insurances	$1,070,269	$1,187,353	$1,158,598	-7.6%
Contract/Professional Services	$1,843,500	$1,988,706	$1,701,957	8.3%
Utilities	$703,322	$1,507,110	$1,201,010	-41.4%
Materials and Supplies	$135,250	$172,500	$259,679	-47.9%
Equipment and Maintenance	$597,500	$763,300	$558,916	6.9%
Other Expenses	$463,600	$355,200	$171,247	170.7%
Debt Service	$4,293,509	$3,477,554	$3,752,190	14.4%
Debt Reduction	-	$4,600,000	$2,685,801	
Total General Fund Expenses	$47,258,047	$50,599,247	$46,339,502	2.0%
Transfers	$471,632	$800,750	$746,881	-36.9%
Total Expenditures (incl. Transfers)	$47,729,679	$51,399,997	$47,086,384	1.4%
Surplus (Deficit)	-	-	$4,545	

Source: City of Chester Finance Department (2017-2018)

[1] Does not include debt proceeds

The City realized just over $47 million of General Fund revenue in 2017 and budgets $47.7 million for 2018. The following is a summary of key 2018 revenue sources and developments:

- In 2017, the City collected just under the $9.7 million in current and delinquent real estate tax revenue. The 2018 final budget anticipates over $10.0 million in real estate tax revenue as a result of an expected increase in aggregate assessment value established during the 2017 real estate assessment appeals process.

- As recommended in the Amended Recovery Plan, the City increased the resident earned income tax (EIT) rate to 2.75 percent and reduced the non-resident EIT rate to 1.05 percent in 2017. Delayed implementation of the new rates in 2017 created some uncertainty regarding the overall annual impact of EIT rate changes. Although the Amended Recovery Plan proposes a reduction of the resident EIT rate to 2.5 percent in 2018, the City and Recovery Coordinator believe it is prudent to maintain the increased rate to account for the unexpected loss of other revenue, particularly from the reduction in Covanta host fees. The 2018 non-resident EIT rate was reduced to 1.0 percent to comply with state law. The final 2018 budget takes 2017 year-to-date collections into consideration and assumes a modest increase in salary level to account for inflation resulting in roughly $10.3 million in anticipated EIT revenue.

- In 2017, the City collected over $1.6 million in other Act 511 taxes including local services tax (LST) and business privilege tax (BPT). Although BPT rates remain at the 2017 level, the 2018 budget reflects an anticipated continuation of the intensified business and development activity observed in 2017.

- Revenue from fines, licenses, and permits has historically been over-budgeted. As recommended in the Amended Recovery Plan, the City began the implementation of an electronic ticket issuing and tracking system in 2017 and has also engaged a third party vendor to further enhance parking enforcement and revenue. The Recovery Coordinator has not evaluated the proposal fully and cannot make a final conclusion on the overall financial impact to the City until data is available to review. In addition, the City will continue to receive blight assistance from the Housing Alliance of Pennsylvania, which will further improve code enforcement efforts. As a result of these changes, the final 2018 budget includes an increase in fines, licenses, and permit revenue above 2017 collections to $2.2 million.

- Casino land lease and Act 71 host fee payments represent the largest revenue source in the interest, rents, and royalties and intergovernmental revenue categories. As reflected in the 2018 budget, state gaming legislation will result in $10 million in total 2018 slot revenue while maintaining table revenue at approximately $1.4 million annually.

- A new Covanta agreement became effective July 1, 2017, and, due to a large reduction in the Delaware County Solid Waste tonnage fee, is expected to result in considerably less annual revenue. The 2017 fourth quarter Covanta host revenue payment reflecting the decreased DCSWA fee received in early January 2018 was $1.2 million, approximately

$180,000 less than 2016 fourth quarter Covanta host revenue. The final 2018 budget includes an anticipated $1.0 million reduction in annual Covanta host fee payments.

- In 2017, the City received roughly $1.7 million in reimbursement revenue. The City transitioned to a self-insurance worker's compensation plan in 2017 and received $540,000 in reimbursement revenue, just half of the budgeted amount. Reimbursement revenue was conservatively reduced to $1.4 million in the final 2018 budget.

The City had $46.3 million of expenses in 2017 and budgeted $47.7 million of expenses, including transfers, for 2018, which is due mostly to higher personnel and debt service costs. Personnel related costs are the most significant budget driver representing nearly 80 percent, or $38.2 million, of the operating budget. As outlined in the Amended Recovery Plan, the City's future financial stability is contingent upon the ability to significantly reduce personnel related costs. Substantial progress toward achieving this goal occurred with the 2017 negotiation of new International Association of Firefighters (IAFF), Teamsters, and FOP contracts in compliance with the Amended Recovery Plan. As a result, the City achieved savings relative to the baseline projections in the Amended Recovery Plan. However, because the contracts and the new police shift implemented in late 2017 were not in effect for a full year, the total impact of these contract changes is uncertain.

- The final 2018 budget includes $17.3 million in total salary expenses, of which $4.3 and $7.1 million are allocated to the fire and police departments, respectively. The City intends to increase the complement to roughly 95 officers in 2018, while also eliminating all vacant IAFF positions. In addition, positions that can be eliminated through attrition and efficiency improvements related to the enforcement and collection of fines have been identified.

- Overtime has historically been unpredictable and costly, reaching $4 million in recent years. The City vastly improved the management of overtime in 2017 and finished the year with just over $2.1 million in expenditures. The final 2018 budget further reduces overtime to $1.7 million. The process of closely managing and tracking 2018 police and fire department overtime has already started in early 2018.

- In 2017, the City transitioned to a self-insured health benefits structure for its employees. Under the new plan, the City pays premiums based on actual medical expenses incurred by its employees rather than a set monthly premium. Expenses under this structure will be more volatile and there is a risk of large unexpected expense spikes; however, the plan includes caps to manage these increases to an extent. In 2017, $8.4 million in health care expense was incurred. At the advice of its health insurance brokers, the City budgeted for a 5 percent premium increase from 2017 actual expenditures, though the dollar amount increase was slightly less than 5 percent due to lower employee headcount.

- The City closed on an unfunded debt borrowing on August 31, 2017. Net proceeds to operations totaled approximately $10.8 million, with a 7.5 percent coupon rate and an 8.0

percent yield. The bonds increased annual debt service by approximately $700,000 in 2018. Debt service in 2018 includes the repayment of $350,000 of the $2 million Act 47 loan balance.

SUMMARY OF CHALLENGES REMAINING

The City Council adopted, by ordinance, the Amended Recovery Plan in 2016. As such, the Amended Recovery Plan is to be adhered to as closely and timely as possible. Several important steps recommended within the Amended Recovery Plan have been taken to improve the City's fiscal condition. Though the City made progress in reversing the trend of operating deficits in 2017, it still fell well short of the bottom-line financial parameters set forth in the Amended Recovery Plan. To address the enormous level of unpaid obligations the City accumulated by running severe deficits year after year, the Amended Recovery Plan called for annual operating "surpluses" of $4 million to $5 million, which assumed that the Amended Recovery Plan recommendations adopted by the City County were implemented. Since several of the key recommendations from the Amended Recover Plan were not implemented in a timely fashion, the savings anticipated were never realized. Here are the Amended Recovery Plan recommendations that will still require action by City Council:

- Restructuring and consolidation of the fire service;
- Despite contracts that significantly reduced personnel costs, there are opportunities for additional personnel cost savings defined in the Amended Recovery Plan;
- Advancing economic development efforts, partially through the creation of an economic development committee;
- Realizing the maximum impact of other revenue sources such as weigh station fees.

The City's inability to achieve a stronger operating result in 2017 and the weakening prospects for achieving these results in the coming years casts serious doubt on the City's capacity to emerge from financially distressed status without dramatic action. In addition, operating budget challenges will worsen in years to come. The City's MMO is expected to increase by approximately $3 million in 2019. Gaming related income, the City's primary revenue source, is expected to be flat. It will be difficult for the City to rely on real estate tax millage increases to balance future budgets. The real estate tax collection rate is already very low and the City's taxing capacity is being pressured by the recent implementation of a significant Stormwater Authority fee, which is extracting several million dollars from the economic base beginning in 2018.

Since the fiscal challenges are more severe than known when the 2016 Amended Recovery Plan was drafted, the City must also implement initiatives that go beyond what is outlined in the Plan. The City must explore the monetization of municipal assets, including a potential transaction involving the Chester Water Authority, reconsider recommended reductions in resident earned income tax rate, and consider further workforce reductions. The City is currently exploring the

monetization - including the sale, lease, or some other monetization strategy - of the Chester Water Authority and has executed a parking monetization deal.

The Recovery Coordinator supports the City's efforts to enhance revenue through asset monetization strategies; however, the City has not provided sufficient communication and opportunities to review major initiatives. The City created a Stormwater Authority which proceeded to impose significant charges on citizens and businesses, which could overburden residents, hinder economic development efforts, and negatively impact the City's ability to collect current taxes and increase taxes in the future if necessary. The City has also proceeded with an asset transaction with respect to the City's parking system without providing sufficient information to the Recovery Coordinator to determine the potential fiscal impact.

Finally, and most importantly, the City has been negotiating with the Chester Water Authority regarding a potential monetization transaction, but the Recovery Coordinator has not had sufficient opportunity to examine any proposed terms and hence cannot assess the potential impact on the City's long-term fiscal health. On Monday, March 12, 2018, the City provided to the City's financial advisor, outside counsel and the Recovery Coordinator a copy of a three-page draft Mutual Letter of Intent between the City and the Chester Water Authority. The Recovery Coordinator expressed serious concerns about the contents of the Letter of Intent, because the Letter of Intent contains many provisions that restrict the ability of the City to consider its various options with respect to the water system and requires that negotiations between the entities be conducted with respect to one specified structure. That specified structure may or may not be the best approach for the City. At its public meeting on the evening of March 14, 2018, the City Council adopted a resolution approving the Letter of Intent in its then current form.

PLAN TO ADDRESS FISCAL CHALLENGES: RECOVERY COORDINATOR'S RECOMMENDATION

The Recovery Coordinator believes the best course of action moving forward is immediate collaboration with the City of Chester to generate a three-year exit plan to begin to address past obligations and the fiscal imbalance. The exit plan will include the following key recommendations:

- We reiterate our recommendation that the City retain and consult with a financial advisor and outside counsel of its choice as negotiations with the Chester Water Authority proceed. We also reemphasize that the City should keep the Recovery Coordinator informed as the process continues so that the Recovery Coordinator can evaluate the matters being negotiated for potential impact on future fiscal condition. As we have stated repeatedly over the past year, this potential monetization is the only option we can identify that could produce sufficient funds to allow the City to achieve long-term fiscal balance. The Recovery Coordinator recommends that DCED consider a grant to the City to help the City pay its advisors on the water transaction.

- The Recovery Coordinator believes that a three-year exit plan for the City is narrowly warranted. After very careful assessment, it is clear that termination of distressed status is

not warranted at this time; however, it is equally clear that the City could be facing a fiscal emergency within one to three years. Consequently, the Recovery Coordinator recommends that the City's fiscal condition be reviewed again on a quarterly basis during the three-year period to reassess if the conditions merit the declaration of a fiscal emergency at that time. The City's options for reversing its financial distress are limited and shrinking. Chester officials must adhere strictly to the Amended Recovery Plan and pursue additional corrective action to avoid future budget deficits and bankrupting its pension funds.

- Finally, and most importantly, the key to securing the City's long-term fiscal health is expanding its economic base and therefore the growth of its own local tax revenues. Chester must successfully implement a strategy to stimulate community and economic development and improve the overall quality of life for its residents and businesses. The City cannot continue to provide the current level of services to its residents without increasing the capacity of the tax base and generating more revenue. The City can boast regional competitive advantages including its riverfront location, easy accessibility, proximity to the Philadelphia and Wilmington markets, and prominent local institutions and businesses such as Widener University, Crozer-Keystone Medical Center, the Philadelphia Union soccer team and Talen Energy Stadium, and Harrah's Philadelphia Racetrack and Casino. The Recovery Coordinator has expertise in this area, is knowledgeable about DCED economic development programs and initiatives, and will continue to collaborate with the City on key economic development efforts.

The Recovery Coordinator and the City of Chester have effectively collaborated in the past to negotiate three labor agreements and execute an unfunded borrowing, while continuing to productively work together on a daily basis to manage cash and continually assess the fiscal condition of the City. The successful implementation of a three-year exit plan will require discipline. The Recovery Coordinator is dedicated to working with City officials to achieve a positive result.

PUBLIC NOTICE FROM
STATE COORDINATOR FOR CITY OF CHESTER

Econsult Solutions Inc., the coordinator (the "Coordinator") appointed by the Commonwealth of Pennsylvania under the Municipalities Financial Recovery Act (Act 47 of 1987, as amended) (the "Act") for the City of Chester, Delaware County, Pennsylvania (the "City), has prepared a report entitled Financial Condition Assessment (the "Report") pursuant to Section 255 of the Act. The Report states the financial condition of the City the City of Chester, and contains certain findings. The Coordinator is filing the Report with appropriate officials of the City on Friday, May 4, 2018. The Report is open for public inspection, as of Friday, May 4, 2018, at the City Clerk's Office in Chester City Hall, 1 Fourth Street, Chester, PA 19013, during normal business hours. The Coordinator hereby invites written comments on the Report from any and all persons and entities. Please submit such written comments on or before Saturday, May 19, 2018 by mail or email to: Stephen P. Mullin, Econsult Solutions, 1435 Walnut Street, 4th Floor, Philadelphia, PA 19102, chesteract47@econsultsolutions.com. Econsult Solutions Inc. will hold a public meeting on the Report at 7:00 pm on 22nd day of May, 2018 at the Council Meeting Room in Chester City Hall, 1 Fourth Street, Chester, PA 19013. The purpose of the public meeting is to receive public comments on the Report. If you are a person with a disability and wish to attend the meeting and require an auxiliary aid, service, or other accommodation to participate in the proceedings, please contact Marita Kelley, Pennsylvania Department of Community and Economic Development (DCED), 400 North Street, 4th Floor, Harrisburg, PA 17102, (717) 720-7301, to discuss how DCED may best accommodate your needs.

ECONSULT SOLUTIONS INC.

DCT, May 4, a-1