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COUNCIL OF THE CITY OF PHILADELPHIA
PUBLIC HEARING
COMMITTEE ON FINANCE

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Room 401, City Hall
Philadelphia, Pennsylvania
Tuesday, December 7, 1999
11:00 a.m.

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990810 - An Ordinance constituting the Third Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1998 ("1998 General Ordinance") authorizing the director of Finance, on behalf of the City, to enter into a Qualified Swap Agreement, as defined in the 1998 General Ordinance, with respect to the City's Gas Works Revenue Bonds (1998 General Ordinance), First Series B of 1998 ("Series 1998B Bonds); applying eh provisions of Section 4.02 of the 1998 General Ordinance, including the grant therein of a security interest in Gas Works revenues, to such Qualified Swap Agreement; covenanting to make the payments under such Qualified Swap Agreement in accordance with the provisions of the 1998 General Ordinance and confirming the covenants of the City in the 1998 General Ordinance with respect to such Qualified Swap Agreement; authorizing the Director of Finance and other officers of the City to take such other actions as may be necessary or appropriate to enter into such Qualified Swap Agreement and to effectuate the transactions contemplated thereby; and providing that this ordinance is supplemental to the 1998 General Ordinance and that the provisions of the 1998 General Ordinance, to the extent not modified, amended or suspended by this Ordinance, are applicable.

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PRESENT:

COUNCILWOMAN JANNIE BLACKWELL, Chairwoman
COUNCILWOMAN MARIAN TASCO, Vice Chair
COUNCILMAN JAMES KENNEY
COUNCILMAN MICHAEL NUTTER
COUNCILMAN BRIAN O'NEILL
COUNCILMAN W. THACHER LONGSTRETH

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VINCENT VARALLO ASSOCIATES, INC.

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I N D E X



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Bill No. 990810

CHAIRWOMAN BLACKWELL: Good morning. We're now ready to begin our finance hearing. We're here to have and get information and our public hearing is regarding 990810. And with that, we will formally begin our public hearing and thank all who are in attendance. I'll ask the clerk to read the title of the bill.

THE CLERK: Bill No. 990810, an ordinance constituting the Third Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1998, authorizing the director of Finance, on behalf of the City, to enter into a Qualified Swap Agreement, as defined in the 1998 General Ordinance, with respect to the City's Gas Works Revenue Bonds, First Series B of 1998, applying eh provisions of Section 4.02 of the 1998 General Ordinance, including the grant therein of a security interest in Gas Works revenues, to such Qualified Swap Agreement; convenanting to make the payments under such Qualified Swap Agreement in accordance with the provisions of the 1998 General Ordinance and confirming the covenants of the City in the 1998 General Ordinance with respect to such Qualified Swap Agreement; authorizing the Director

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of Finance and other officers of the City to take such other actions as may be necessary or appropriate to enter into such Qualified Swap Agreement and to effectuate the transactions contemplated thereby; and providing that this ordinance is supplemental to the 1998 General Ordinance and that the provisions of the 1998 General Ordinance, to the extent not modified, amended or suspended by this Ordinance, are applicable.

CHAIRWOMAN BLACKWELL: Thank you very much. Having a quorum present, to my left, Councilwoman Marian Tasco, vice chair; to my right, James Kenney; and his right, Councilman Michael Nutter. I'm Jannie Blackwell for the record, and with that, we thank you for coming and would ask that you identify yourself for the record and proceed. It has also been suggested, Mr. Reid, that -- I don't think your testimony is very long -- that you read your entire testimony into the record.

MR. NADOL: Excuse me, that I not read?

CHAIRWOMAN BLACKWELL: That you do read. SO would you identify yourselves are for the record and proceed.

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MR. NADOL: Good morning, Chairman Blackwell, Members of the Committee. I'm Michael Nadol, N-A-D-O-L, Director of Finance for the City. With me is Whitney Reid, the City Treasurer; Ben Haler, President and CEO of the Philadelphia Gas Works, and we also have a number of other people who have been involved in this proposed transaction with us here today to answer questions should the Committee have any that we need there assistance with. We appreciate this opportunity to testify today regarding Bill 990810, which would authorize the Director of Finance on behalf of the City to enter into a Qualified Swap Agreement as defined in the 1998 General Ordinance with respect to the City's Gas Works Revenue Bonds.

This proposed Qualified Swap transaction would be designed to net approximately $8 million for PGW by better optimizing Gas Works debt structure. After thorough review and analysis, we believe that this transaction based on a proprietary J.P. Morgan product, represents a reasonable and prudent strategy for generating significant additional resources to augment PGW's capital improvement program. Because the City Treasurer has

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taken the lead for the Administration in the structuring of this proposed transaction, I will now ask Whitney Reid to further detail this initiative for the Committee.

CHAIRWOMAN BLACKWELL: Thank you very much.

MR. REID: Thank you. I'm Whitney Reid, City Treasurer.

CHAIRWOMAN BLACKWELL: Excuse me one moment, Mr. Reid, before you begin, let me also note that Councilman Brian O'Neill is also here. Thank you.

MR. REID: In this proposed transaction, J.P. Morgan would pay PGW for the right to swap variable rate debt for a certain portion of PGW's existing fix rate debt in the event that certain interest rates on short-term tax-exempt debt were to rise above a specified level at some point in the future.

Specifically, PGW would sell an option to J.P. Morgan for which it would receive a non-refundable payment of approximately $8 million. The option would be based upon PGW's Series 1998B Bonds, currently outstanding in the principal amount of $103 million. The option would give J.P. Morgan the right to compel PGW to enter into a swap at a future point in time, pursuant to which PGW would receive a fixed rate of 5.01 percent from J.P. Morgan and would pay a variable rate of The Bond Market Association Municipal Swap index, hereto referred to as TBMA, plus 50 basis points in return. The TBMA is a weekly index comprised of a number of short-term, tax-exempt bonds, and is the industry standard for such transactions. The 5.01 percent rate represents the current average interest rate on the Series 1998B Bonds. Because PGW would be receiving 5.01 percent from J.P. Morgan and paying 5.01 percent to the Series 1998B bondholders, PGW would effectively be left paying the variable rate based on TBMA index in the event that the swap occurs.

J.P. Morgan would not be permitted to exercise this option to compel PGW to enter into the swap, until a pre-specified trigger point is reached. That trigger point would occur if TBMA were to average 7 percent over a period of six consecutive months. Once the trigger point is crossed, J.P. Morgan retains the right to exercise



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the option at any time thereafter for the remaining term of the Series 1998B Bonds which goes to the year 2028. TBMA has reached a average of 7 percent for a consecutive six-month period only once during the 18 years that it and its predecessor indices have been maintained. I've enclosed charts that clearly depict the TBMA index over the past 18 years. Currently, TBMA is approximately 3.60 percent.

Under this proposed agreement, the only potential cost for PGW would be incurred if this trigger is actually reached and J.P. Morgan exercises its option to complete the Swap. In an environment of extraordinarily high interest rates, where TBMA exceeds 5.01 percent, such a Swap could require PGW to pay more in debt service than its current fixed rate payments. However, under this proposed agreement, the amount of debt linked to this option would decline as principal on the bonds is paid off over time.

Moreover, this risk to PGW is effectively hedged by the various short-term reserves and cash balances that the utility maintains. In other words, if a period of much higher interest rates were indeed to occur, PGW would expect to attain higher interest earnings of its short-term assets - thereby offsetting higher interest payments on any variable rate short-term debts. Because of this matching and balancing effect, the rating agencies are typically comfortable with an issuer having between 10 and 20 percent of its outstanding debt in a variable rate mode. In this proposed transaction, a maximum of only $103 million out of PGW's more than $900 million in outstanding bonds would be positioned to convert to a variable rate mode if the swap were to be exercised, a level well within accepted ranges.

Finally, if the trigger were crossed and J.P. Morgan exercised its option, J.P. Morgan would not be permitted to subsequently reverse its option. As a result, once the option is exercised, PGW would continue to maintain this debt in a variable rate mode even if interest rates were later to drop down from levels high enough to invoke the trigger. Given that historical interest, TBMA levels have often been well below the 5.01 percent fixed rate debt to be swapped, as is currently the case, over the long-term, PGW's debt service might actually



average less than is currently paid even if the swap option is exercised.

In closing, we believe that this transaction represents an excellent opportunity to improve PGW's overall debt structure in accordance with accepted industry practices, better matching the utility's outstanding debt to its short-term assets. In turn, this initiative will generate approximately $8 million up front for use in augmenting important capital improvement projects to better serve Philadelphia's neighborhoods. Consequently, the administration respectfully requests your support for Bill No. 990810. In addition, in order to meet the current plan of finance schedule, we would also request suspension of the rules so that this matter may be considered at the next scheduled session of City Council.

Thank you for your attention, and we would be happy to answer any questions at this time.

CHAIRWOMAN BLACKWELL: Thank you very much.

Mr. Nadol and Mr. Haler, do you have any further testimony you wanted to make at this time?

MR. HALER: Just two points,



Councilwoman Blackwell. As Councilwoman Tasco well knows, the cash flow of the Gas Works is such that we do not see the revenue from heating season until later in the winter. We have a $25 million bond issue debit service due in early January when we have historically the least amount of cash that we would have during the course of the year. Because of it has been a warm fall, very much mirroring last year, I need to point out to Council that this $8 million will be very, very useful to us; we need the money. Once the cash comes in during the winter in the spring and this $8 million will be dedicated to infrastructure replacement throughout the City, ours is an old system with old pipes and we know we must be very aggressive about replacing them. So this $8 million, once it is helpful getting us through this cash crunch period in early January once replenished by regular revenues will be dedicated to infrastructure replacement.

CHAIRWOMAN BLACKWELL: Do you know where this infrastructure replacement will take place and can you get us a plan for that or a copy of what streets you want to do?

MR. HALER: Yes. We have an engineer



now working on criteria for the optimum blocks that we would replace. We have our regular capital program, and this would augment that and this program would give us the optimum blocks that are the highest candidates for replacement in this season.

CHAIRWOMAN BLACKWELL: Thank you. Let us also note for the record that that Councilman Thacher Longstreth is also here as part of this Committee meeting.

In 1998, PGW restructured part of its debt. Why are we doing this now, just a year later? Why is it important that we do this restructuring now?

MR. HALER: In 1998 we did a refinancing. This product was not presented to us at that time. Basically, as I understand it, this product is based on the needs of other borrowers who have high amounts of variable rate debt and are looking for insurance in the event, in fear that interest rates might go up. It's important to note that they're not betting that interest rates will go up; they just want the insurance to do it.

J.P. Morgan presented this product to us



and we've been discussing it over the last six months or so, but this was not something available and presented to us at this time.

CHAIRWOMAN BLACKWELL: What do they gain, what does J.P. Morgan gain?

MR. HALER: They get a commission in the transaction between us and the and the counterpart.

CHAIRWOMAN BLACKWELL: They get a commission -- we get 8 million.

MR. HALER: Yes.

CHAIRWOMAN BLACKWELL: They get a commission now, or how does that --

MR. HALER: When the transaction completed, they will get a commission. And then if the third -- if the trigger point takes place that the bond market money market rate is at 7 percent for six months or more, then the counterpart, the other party has the right to require us to make this swap. It may never happen, but at least we have the insurance, from their point of view, in case it does.

CHAIRWOMAN BLACKWELL: They get a commission then if the market goes to 7 percent?

MR. HALER: I believe they just get it



at the closing of the agreement with us because the swap may never take place.

CHAIRWOMAN BLACKWELL: Okay.

MR. NADOL: Just to follow up to Mr. Haler's comments on your earlier question, I would also note with regard to the 1998 transaction that the 1998 ordinance authorizing that transaction did contemplate this kind of swap and did include provisions that would authorize and enable the City to go forward with this type of swap. So it is an option that was placed on the table through the 1998 ordinance, and since that time, the specific product has become available and has been assessed and analyzed by the treasurer's office and City's financial advisors and legal counsel.

CHAIRWOMAN BLACKWELL: In early February 2000, PGW's payment to the City is due debt service payments are due. Does PGW expect a cash crisis in February? Will PGW have difficulty in meeting cash requirements then?

MR. HALER: PGW has always paid the City the 18 million which, as you pointed out, begins with over a four-month period starting in February. Last year, because of the warm weather and because



the City's financial position was strong, the City allowed PGW to defer the payments until late May, early June, at which time PGW paid the City $18 million plus some $300,000 interest earnings. We may in a position that we have to ask Director of Finance in February if we can defer some or all of those payments. Our intention is to make the payment. Our intention is to make it in the months that are required, but the agreement does allow for a deferral if necessary. It really depends on how warm winter is going to be. If there's a warm winter, we do not have a lot of cash. If we have a normal or colder winter, we should not have the problem.

CHAIRWOMAN BLACKWELL: Thank you. I will defer my other questions to Members of the Committee.

Councilman Kenney and Councilman Nutter.

COUNCILMAN KENNEY: Could you layperson's terms explain the upside to PGW and the risk and the upside to J.P. Morgan and their potential risk?

MR. REID: I'll start with the upside for PGW. The transaction, as I described, is a



contingent swap transaction. The contingency is the trigger point which is a period of six consecutive months of TBA rates being above 7 percent. Until that point, no swap takes place. There's an up-front payment we've valued at approximately $8 million in today's dollars. So nothing has changed going forward. Once we do hit the trigger point, the trigger point is crossed, then you now have entered into swap which changes the debit configuration slightly. As I stated in my testimony, effectively what you've done is you've converted a fixed-rate payment into a variable rate. And as we know, variable change; they go up and they go down. So at that point then you've converted a percentage of the outstanding debt of PGW into variable rate mode, which we've talked to industry, specifically insurance and credit rating agencies about that, and they're comfortable with the percentage levels we're envisioning here. So the upside is that we're receiving -- there's an opportunity for an up-front payment here. And then going forward that we've converted a portion of the fixed-rate debt into a variable rate. As I noted in my testimony, that is -- you can say variable rates



go higher, that could be a downside. But we've looked at that in total looking at all the outstanding debt and looking at the operating balances that my office manages for PGW, and as I stated in my testimony, those cash balances are invested in short-term investments which will track the rise and fall of the TBMA index that we'd be paying if and when it went over the 5.01 percent that we would be receiving. So that would effectively offset or hedge that risk exposure to high variable interest rates.

COUNCILMAN KENNEY: Is J.P. Morgan betting $8 million that the interest rates are going to go above 7 percent?

MR. REID: No, they're not.

COUNCILMAN KENNEY: What are they doing?

MR. REID: Effectively, what an entity like J.P. Morgan would do, is in a swap transaction like this they're not just doing this with us; they're doing this with many other entities in the United States as well as entities around the world. The swap market has grown from its infancy from the early nineties into a multi-million dollar industry. So essentially, what they're going to do, they stand



in the middle as almost a broker with us on one side and a counter-party on the other and they're just affecting the trade. And as Ben has indicated, they would receive a commission for that or another word for that would be a sales charge or something to that effect.

COUNCILMAN KENNEY: Your testimony indicates that this variable rate trigger hasn't been reached in 18 years?

MR. REID: Yes.

MR. NADOL: I think it's been reached once in that period.

MR. REID: I'm sorry. I stand corrected. I stated it has been reached once. If you look at the chart that I included --

COUNCILMAN KENNEY: The question I have, not being too facile with the actual markets and how they work, but the issue is that since that trigger only been trigger once in 18 years, is this a non-deal when it comes to J.P. Morgan's ability to broker something that's not going to happen or is unlikely to happen?

What you're telling me is unless the trigger hit, nothing changes. So if the trigger has





only been hit once in 18 years, whey would J.P. Morgan, despite the fact that $8 million to them is probably not a lot of money, why would they be paying a $8 million up-front fee to participate in a circumstance that is very unlikely, at least statistically unlikely to happen?

MR. NADOL: I think probably the same reason that you or I would buy homeowners' insurance or life insurance policy. It's not so much that they expect that this will happen or that they're betting this will happen, it's that as part of a larger multi-million dollar portfolio they're trying hedge certain extreme scenarios to kind of smooth out any worst case scenarios in the context of their much larger book of business.

Now, I don't want to suggest that it's impossible that interest rates would rise to the point where this trigger would be crossed. It is possible. I think it's not likely in the foreseeable future, given current interest rate environments where TBMA has been well below 4 percent. But it is possible over the course of the long sweep of this transaction that that trigger could be reached.





A point I would like to make is that even if that trigger is crossed, it's not necessarily a bad thing for us. Swapping this percentage of the Gas Works overall debt portfolio into variable rate mode is really a reasonable thing to do, and in fact, in some respects might be considered a best practice in terms of overall debt management. It's something that the City has done before, not through this kind of swap mechanism, but through issuance of new money bond issues. It's something that has been done with the water department's revenue bonds where a certain portion, again, comparable levels of our water utility's overall debit in is in a variable rate mode. Being in a variable rate mode, as Whitney has testified, even if that happens is not a bad thing. We would pay more in periods of high interest rates, but that would be balanced by higher earnings that we'd expect on our short-term assets and we would benefit in saved money to the extent that these short-term variable rate interest rates subsequently might drop down below the 5 percent rate.

COUNCILMAN KENNEY: What's the life of the bonds in this deal as it exists?





MR. NADOL: They were initially 30-year bonds issued in 1998.

COUNCILMAN KENNEY: So the worst cast scenario is the interest rates pop up above 7 percent and stay there for a long period of time?

MR. NADOL: That would be the worst case

scenario.

COUNCILMAN KENNEY: And just let me ask you one related question. Mr. Haler, maybe you can ponder it and get back to us. Can you give us an idea as to how many years of mild weather will it take to -- I know we're not in necessarily terrific financial shape right now. In the last three years, I'd say three years, we've had what have been uncharacteristically mild winters and we're having -- I mean, when you're sitting in short sleeves in December, it seems there may be some climatic change that's going on here. How many years of these type of winters consecutively are we going to wind up in a situation where -- what we're doing right now delaying payments to the City. At what point in time is there no money to pay the City?

MR. HALER: I don't think that would be the outcome. The outcome ultimately would be a





request for a rate hike and that is something that the Gas Commission and the Gas Works is trying to avoid because we want to stay competitive with surrounding areas and we know it's important, particular residential customer. The answer to your question is I don't know. I do not know how long, whether you measure it in months or years, how many more of these kinds of winters we have with our current expense structure. What we are doing is trying to reduce our costs as quickly as we can to try and stay within this change in climate.

COUNCILMAN KENNEY: This is the third or fourth mild winter?

MR. HALER: Third.

COUNCILMAN KENNEY: We're in the midst of our third or in the midst of our fourth?

MR. HALER: We're in the midst of our third. Prior to that there was one normal winter and then I believe the winter prior to that was warmer as well.

COUNCILMAN KENNEY: Is there some way extrapolate or your people give us a doomsday global warming scenario that would give us some idea as to what we're facing over the next decade.





MR. HALER: Yes.

COUNCILMAN KENNEY: Thank you, Madam Chair.

CHAIRWOMAN BLACKWELL: Thank you, very much.

You mentioned the mains and you'll try to get a list of what streets that might include.

Will this money be narrowly used for that or will be used a cash flow problem that might exist?

MR. HALER: Well, we would very much like to have the transaction done in December so that it is there in January. But that money would be the early part of January. But that money will be replenished as our revenue comes in the later part of the winter when we have a heating season and that money, the $8 million will be used exclusively for infrastructure replacement on top of the regular budgeted amount that the Gas Commission has approved and is before Council. This is an incremental $8 million additional commitment to below-ground infrastructure.

CHAIRWOMAN BLACKWELL: Councilman Nutter.

COUNCILMAN NUTTER: Thank you, Madam



Chair. Good morning, gentlemen.

In reading through the materials which I think as Councilwoman Blackwell mentioned, the testimony was just a couple pages and then a couple charts. I did not see any materials that projected any schedule of either debt service, savings, or possible costs as a result of this transaction. Why is there no schedule that shows that?

MR. REID: I'll answer that. In contemplating the transaction, looking at debt service going forward, we have to look at the probability of the swap being exercised. We don't have an idea of the probability of that happening going forward. In going back to earlier testimony --

COUNCILMAN NUTTER: But you can anticipate on a year-by-year basis what would happen if the option was exercised in a 1 and then you have the next 27 years and what the possibilities are either way, couldn't you?

MR. REID: I guess you could look at a couple different scenarios, but the essence of the transaction was not going for cost savings and things of that nature. The structure that we've



envisioned here is beneficial to the PGW and their overall debt structure, and in addition to that --

COUNCILMAN NUTTER: You project some savings out of that, right?

MR. REID: That wasn't part of the analysis. We looked at the overall debt structure as it relates to the ratio of fixed and variable rate and also the up-front payment for the needs as described. As far as savings, I mean, you can run some scenarios to a look at that, but if you look at the chart that will show the variable rate, you can see it bounces around. And to project that, I mean, you can do that, but --

COUNCILMAN NUTTER: Again, I have two pages of testimony, you make the case that -- or you in combination with Mr. Nadol make the case that this is good for the company, you recognize there might be risk, you also recognize that there could be benefit of lower debt service. I'm just asking you the question of what are those numbers? If you're going to put it in your testimony and make that the basis of the transaction, I think I have a right to ask you what the numbers are.

MR. REID: Yes, sir. I agree with you.





Projected effects on debt service relate to whether or not the variable rate is above 5.01 percent or below 5.01 percent. These are just projections. I mean, we have nothing concrete as far as probabilities of this being above or below. We can go historically and look at where rates on and a lot of the analysis was done on that.

COUNCILMAN NUTTER: So you're saying that we should do the transaction, take the $8 million and basically just wait and see what happens versus an environment that has an affixed cost scenario where we know what's going to happen?

MR. REID: Well, we looked on at -- the analysis we did do, we looked the structure of the debit.

COUNCILMAN NUTTER: I'm sorry, the what?

MR. REID: The debt service structure of the outstanding debt. And we looked at fixed versus variable rate. We also looked at the probability of the swap being exercised. As far as rates being hire or lower, again, we looked at the entire asset and liability structure of PGW. We looked at, at that point the asset side, which shows the cash balances and operating funds which would track the



variable rate as it moved up and as it moved down which would effectively, as I testified, hedge and offset mitigate a lot of the risks you would incur in a higher interest rate environment.

COUNCILMAN NUTTER: Maybe I'm not being particularly clear. But on Page 2 of the testimony it reads, "In an environment of extraordinarily interest rates where TBMA exceeds 5.01 percent, such a swap could require PGW to pay more in debt service than its current fixed rate payments."

My question is, what's the number or what are your projections?

If you tell me that you're about to engage in on a transaction that might result in higher debt service payments, I'd like to know what they are versus a structure that has a fixed rate and I know what it is. That's all I'm asking.

MR. NADOL: In very round numbers, this is roughly a $100 million chunk of debt. Again, in very round numbers, for every 1 percent of the fix rate that we end up paying, you're looking at another million in debt service.

COUNCILMAN NUTTER: What's the current debt service an on $103 million.





MR. NADOL: I don't have the number at my finger tips. The 5.01 percent rate is a blended rate. There' re a few different maturities within this series, but it's approximately $5 million.

COUNCILMAN NUTTER: Total?

MR. NADOL: For the series of bonds that would be included in this qualified swap.

COUNCILMAN NUTTER: So you have a total of $5 million in debt service from now to 2028; is that your testimony?

MR. NADOL: On average, yes. Like many bond issuances, the actual payments are leveled out, but, yes, that's about right.

COUNCILMAN NUTTER: I'm sorry, I'm not understanding your response. Is that 5 million between now and 2028 or is it 5 million on average a year from now to 2028?

MR. NADOL: Approximately 5 million a year.

COUNCILMAN NUTTER: Five million a year?

MR. NADOL: Correct.

COUNCILMAN NUTTER: That wasn't clear.

MR. NADOL: I apologize.

COUNCILMAN NUTTER: So what happens with



this transaction and what are you estimates on what debt service payments end up being now through 2028 if you end up in a variable rate environment in they exercise the option in a 1, you've got 27 years to count for.

MR. NADOL: In the swap -- if the trigger point for the swap had been reached last week and then this week we were in the interest rate environment in which we do currently find ourselves, the Gas Works would actually be saving money in its debt service payments because at the levels of their able rate debt, and we around 6.3 percent for the TBMA index, you add the additional one-half of the 1 percent, the addition 50 basis point, a premium that's built into the structure of this transaction and we would be paying at an interest rate of approximately 4.1 percent.  On an annual basis --

COUNCILMAN NUTTER:  That's for right now.  In 2028 and all I'm asking you for, if your testimony is that PGA could find itself paying higher debt service on the $103 million on the fixed rate that you're paying now, which we know, someone has to be able to produce a schedule somewhere of various scenarios based on various rates and various





variables, if you will, to give us a sense of the essence of the transaction.  That is all I'm asking. Now, what I got here yesterday was two pages of testimony, I got a nice chart and another chart. Doesn't answer any of the questions that I have about the transaction.

MR. NADOL:  We could certainly submit supplemental testimony outlining different scenarios.

COUNCILMAN NUTTER:  Based on your testimony, did you think that that was not important or that no one would wonder?

MR. NADOL: I think what is different with this transaction from, say, for example, a refinancing that we might bring to the Finance Committee along with some other issuance of City debt is that in a refinancing we know throughout the period of the bonds precisely what the debt service has been and what it will be for each payment that's required.

COUNCILMAN NUTTER: So now am I anticipating your testimony is going to be that in this particular transaction you don't know?

MR. NADOL: In this case we would





propose to assume a position where some of the debt could go into a variable rate mode where, correct, we don't have crystal balls, we don't know what the specific interest rates at some point in the future might be. What we do know is what they have historically been in the past, and that kind of historical data was submitted along with our testimony and shows that in most years of the last 20 years with the exception of one extreme peak at a time when the overall interest rates for consumers and the like were above 20 percent. With the exception of that one extreme period, being in variable rate mode would have probably saved the Gas Works money or incurred relatively manageable cost in the range of -- worst case scenario based on the last 20 years of experience would be a couple million dollars a year in additional debt service. We would also note that in that environment where the rates would be higher than we find them to be today, we would expect comparable increases in our short-term interest earnings associated with the Gas Works various cash reserves and other short-term assets. So in terms of helping City Council understand the risks, we certainly could submit more



detailed hypothetical scenarios for you, but I think we have submitted is what we know, which is what the past has been and what our exposure would be in the event that things change in the future.

COUNCILMAN NUTTER: Mr. Nadol, you know as well as I do that's why they have the little asterisk down at the bottom of the prospectus that says something like historical performance is no indication of what may happen in the future, right?

MR. NADOL: Absolutely true. And that's why we look to the matched short-term assets to make us comfortable that if something different from the past, if some new paradigm, some new economic world were to develop in the decades ahead because this is a long-term deal, we felt comfortable with that because that risk is effectively hedged by the short term assets. We would see increased earnings comparable to any increased debt service payments that might come about in such a future scenario. Again, as Whitney testified, that's the same kind of approach that the rating agencies take in looking at variable rate debt. If you look nationwide, municipal bond issuers quite commonly issue 10 to 15 to even 20 percent of their debt in a variable rate





mode. And because of just that kind of matching, phenomenon, it's considered a prudent and some degree even optimal way to structure your debt.

COUNCILMAN NUTTER: I understand, and I appreciate you attempt to respond to the question. I do have to say, though, that you can understand maybe on this side of the table at least for myself that -- and I haven't many opportunities to use the word paradigm. I'm still looking that. But in the current environment with at least in my opinion the shakiness of the finances of this particular entity, you might understand or appreciate a sense of discomfort that I might have in going forward in a transaction that is, I think in your words, unusual, new, different, maybe growing in certain places. But we have some current problems here that give me a sense of discomfort about this, but we can talk about that later.

What is the principal purpose of this transaction if it's not savings?

MR. HALER: It's not savings.

COUNCILMAN NUTTER: That's what I said, if it's not savings, then what is it.

MR. HALER: The principal purpose is to





get $8 million in a warm winter when we need it. And $8 million that needs to be reinvested in the infrastructure.

COUNCILMAN NUTTER: So this is a plan or a scheme put together to deal with a cash flow problem.

MR. HALER: That is why we are interested in it. If somebody offers you $8 million with minimal risk and that risk is left as hedged, it's a good thing to look at.

COUNCILMAN NUTTER: Minimal risk is from your perspective?

MR. HALER: To PGW, yes, sir.

MR. NADOL: I think the fact that the Gas Works has not had any variable rate debt, does not currently have any variable rate debt, presents an opportunity. Again, if you look at standard industry practices, if you look at good financial practice, it's not only appropriate, but --

COUNCILMAN NUTTER: Mr. Nadol, I'm not sure that you want to get into a good financial practices discussion with me and a Finance Committee hearing about PGW.

MR. NADOL: My point would be that this



opportunity to look at having some of the debt structured for the Gas Works in a variable rate mode is a reasonable thing to do. It's something to which we've alerted the rating agencies that this is something that's being considered and they've let us know that they're comfortable with it. It's a reasonable thing to do. Then you look at, okay, we're interested in having some of the Gas Works overall debt portfolio in a variable rate mode. To the extent that we do that, what do we get out of it. And this particular mechanism gives the City, gives our Gas Works an opportunity to get an up-front payment out of that restructuring that as

Mr. Haler has testified would be useful in accelerating some their neighborhood infrastructure programs.  That's the combination of some of the Gas Works operational and service-related immediate interests and the opportunity to achieve some of those through what we've evaluated and find to be a responsible financial transaction seems to make sense to us and that's why we are proposing it today.

COUNCILMAN NUTTER:  I'm slightly confused by one of your statements because there



seems to be now a mixing or, I guess, discussion about dual use of the $8 million.  I've heard about the need to do neighborhood infrastructure improvements, which I think my recollection is that those are usually done with capital dollars, and then I'm hearing cash flow problem which I assume is an operating revenue issue.  So what is going on with these dollars?  And don't you normally do your neighborhood improvement projects out of your capital budget which I believe is also sitting in this Committee about 52, $56 million?

MR. HALER:  Yes.  The capital budget includes a line item for the replacement of old pipe.  And at such time as Council passes it, that appropriation will be dedicated to replacing pipe. However, we have a system that was created in 1846. We have pipe in the City that was laid prior to the beginning of this century.

COUNCILMAN NUTTER: Mr. Haler --

MR. HALER: Please, I have to answer your question.

COUNCILMAN NUTTER: Do me a favor. I know about the pipes in the ground. I've been a customer of PGW for a long time. I don't need a



history of pipes in the ground. I understand the system is old. I asked a question. I was left with the impression that the money was for neighborhood infrastructure improvements. Then there was an impression that it was operating cash flow purposes. What I want to know is, is it for one, is it for the other, is it for both, and how do you do that? I don't need to know about the age of the system.

MR. HALER: This will be for both. It was originally presented contemplated as a means of getting additional money for additional pipe replacement. In the meantime --

COUNCILMAN NUTTER: What's the split between the capital side and operating side?

MR. HALER: Please let me finish the answer. Maybe I can help you with this. The answer is it is used for both. Initially, we wanted to do this because it gave us additional money for additional pipe replacement. Now, with a warm winter, we would like to have the cushion of the $8 million available in the beginning of January when we are at our lowest in cash and when a debt service payment is due, then as the money -- if we spend any of it, it is replenished by the revenue that comes



in in the end of January, February, March and will be available for its intended purpose which is infrastructure replacement.

COUNCILMAN NUTTER: How does the money that comes in later on in the year end up replacing dollars that was supposed to be used for capital expenditures.

MR. HALER: This is not bonded debt. The capital money that is in the capital program is bonded debt and is not used for operations. This money can be used as revenue to the company and can therefore be used for its purpose. It can be used stationary. It can be used to hire people. We believe it's most prudent use is to increase the replacement of pipe, and therefore it can do that.

It's revenue to the company. It's not bonded debt. It does not come from a bond issue.

COUNCILMAN NUTTER: So take you can take the 8 million in, your testimony is that you would like to use it, if possible, for neighborhood infrastructure improvement but you'll hold it aside, see what January and February are like; if you need it for cash flow purposes, you use it for that; if you don't need it for cash flow purposes, you might



put it into the 1947 pipes?

MR. HALER: The money --our lowest point of revenue is early January and we would not be able to replace pipe in the winter. We can only do the replacement when the ground thaws, if it ever freezes. So it would be available to us when the construction season starts.

COUNCILMAN NUTTER: Has the City ever pursued one of these transactions?

MR. HALER: Not to my knowledge.

COUNCILMAN NUTTER: Any particular reason?

MR. HALER: I don't think financially the industry had a need for it. This is now a hedging mechanism for J.P. Morgan. It come to us with $8 million to do it. It's a recent phenomena.

COUNCILMAN NUTTER: Tell me again all involved in this transaction.

MR. HALER: J.P. Morgan, Joan Stern is our counsel. Public Financial Management is, as they always are, our financial advisor.

COUNCILMAN NUTTER: You've been working on this transaction for how long?

MR. HALER: They brought it to us



earlier in the year, I think it was brought to my attention maybe three months ago, maybe a little bit longer.

COUNCILMAN NUTTER: And they pitched it to us?

MR. HALER: To the Gas Works, yeah.

MR. REID: A little history to this, my office regularly receives proposal, presentations for different types of investment alternatives, funding alternatives, and things of that nature. J.P. Morgan presented this particular transaction to us in the early summer and they did it in a context initially of any debt to any issuer of the City. It wasn't particularly to PGW at that time. We started analyzing some of the outstanding debt and then we came to that conclusion.

COUNCILMAN NUTTER: Are you recommending this product for the City's portfolio.

MR. REID: I'm sorry, could you repeat the question?

COUNCILMAN NUTTER: Are you recommending this particular product for the City's debt.

MR. REID: We've looked at a number of alternatives. At this time, no.





The proposals that we've received historically related to swaps and things of that nature, did not involve the component of the option. And if you look at this from just the swap standpoint, we proposed a number of times just to enter into swaps to convert -- we could easily just convert the fixed-rate date into variable rate. We can do that overnight. Of course, with City Council approval. But we can do that overnight. What is intriguing about this particular proposal is the sale of the option to enter into that swap agreement, and that's essentially what is bearing the approximate $8 million up-front payment. And that is, as Mr. Haler testified, a recent phenomenon. That's something we've see here just in the recent past.

COUNCILMAN NUTTER: So the short answer to the question is that the City is not contemplating looking at this particular product at this point in time for its own debt portfolio?

MR. REID: The answer to the question, the City is always evaluating different proposals and presentation and various ideas that are presented to us, but at this time we are not looking





at any other debt besides the PGW debt proposed here.

COUNCILMAN NUTTER: The source of the $8 million is directly from J.P. Morgan?

MR. REID: Yes, sir.

COUNCILMAN NUTTER: What are the fees on this transaction?

MR. REID: The fees involved in this transaction would be related to advisory work and also legal counsel work.

COUNCILMAN NUTTER: I understand what they're for; I asked what they were.

MR. REID: The dollar amounts I can't give you. At this time, I do not know.

COUNCILMAN NUTTER: I didn't hear the rest your answer.

MR. REID: I don't know what they are at

this time.

COUNCILMAN NUTTER: You don't know what they are at this time?

MR. REID: Correct.

COUNCILMAN NUTTER: At some future point in time will you know what they are?

MR. REID: Yes, I will, sir. Yes.



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COUNCILMAN NUTTER: Could you share those for with the Committee?

MR. REID: Yes.

COUNCILMAN NUTTER: Thank you.

Thank you, Madam Chair. I appreciate it.

CHAIRWOMAN BLACKWELL: Thank you very much. Certainly, the Chair and the Committee would like to receive a list of those fees. We promised Councilman O'Neill -- Councilwoman Tasco, did you have one question or we can to defer to Councilman O'Neill.

Yes, sir.

COUNCILMAN O'NEILL: Are swaps common? I got the impression that this is something that the finance markets are comfortable with.

Well, let me ask one question at a time.

Are they common, would you say?

MR. REID: Yes, sir, very common.

COUNCILMAN O'NEILL: Have we ever done any in the City.

MR. REID: We have done a -- we did a swap in 1990.

COUNCILMAN O'NEILL: And how did that



turn out??

MR. REID: Let me just go back and repeat the answer again. We did a swap in 1990 bond series, they were GO Bonds.

COUNCILMAN O'NEILL: So we've done it once?

MR. REID: Yes, sir. We might have done it -- 1990, and that was done at the time the bonds were issued. This is done, as you understand, after the bonds have been issued. That particular bond issue was refunded and the swap was unwound.

COUNCILMAN O'NEILL: So we've never really done it the way we're talking about doing it here?

MR. REID: This particular kind of transaction, no, sir.

COUNCILMAN O'NEILL: Has anyone?

MR. REID: Any other issuer in the --

COUNCILMAN O'NEILL: Any other city, any other government agency?

MS. STERN: Good morning, Members of the Committee. With your permission, could I answer that question?

CHAIRWOMAN BLACKWELL: Sure. Would





yourself?

MS. STERN: For the record, my name is Joan Stern. I'm from Blank, Rome, Comisky & McCauley and I'm acting as special counsel in connection with the swap transaction. Just to you just a little bit of context about use of swaps, the more common use of them is a fairly recent phenomenon. And as we have written new bond ordinances for the City, we have incorporated provisions that allow for swaps that set the priority of payment for swap payments, so this is something that was never, for instance, in the 1975 general ordinance for the Gas Works or for water or the airport, as we've replaced the general ordinances when we've restructured the debt, we've incorporated these provisions. So in 1998 when we did the new general ordinance for the Gas Works, we put all of the provisions we're doing -- this is called the qualified swap because the provider, which is Morgan Guaranty Trust Company which is the bank that affiliated with J.P. Morgan, has to have a double A or higher rating. So that's the context against which this supplemental ordinance is coming in because it's already been built into the general



ordinance.

To answer your particular question. The state of New Jersey did an option in swap transaction for one series of its pension bonds. It did a $2.8 billion pension bond issue in 1997. And in 1998, again, it adopted a bond resolution that built in provisions for swaps and they actually contemplated doing them at the time they did the original bond issue and decided not to. A year later --

COUNCILMAN O'NEILL: If I may mention, is that the issue that Governor Whitman almost lost her election over?

MS. STERN: It was certainly an issue --

COUNCILMAN O'NEILL: It had more to do with that than auto insurance.

MS. STERN: It was done during the gubernatorial election. But they did do an option and swap transaction for one series of those pension bonds in 1998. It's not exactly like this, but it involves the sale of an option and the option gives the option-holder the right to trigger a swap. The particular trigger in that situation is a date, you know, within a certain set of dates the option can





be triggered. Here, the trigger is a threshold of interest rate, an interest rate index being at a certain level for a certain number of months. But it has been done before, and there are swaptions done in the corporate world and in the municipal world all the time. That's the name that they've made up for them.

COUNCILMAN O'NEILL: In the municipal world, are there been swaps that have been done like this?

MS. STERN: I'm sorry?

COUNCILMAN O'NEILL: Have there been any swaps in that have swaps like this in the municipal world.

MS. STERN: Yes.

COUNCILMAN O'NEILL: Can we get a couple examples of them? I don't need them right now, but by tomorrow. I just want to get a flavor -- I mean, first of all, we started out as it's common and it seems like it's very recently common if it is common. I'm not saying it's a bad deal. In fact, it looks like a good deal. I'm sorry we need it for the things we need it for and not things we'd like to have it for probably. But it seems like if it's





been done, it's been done very recently.

The second question is, I think I understand why we can get $8 million for this, that Morgan isn't gambling at all. They're sort of being the insurance broker somewhere in here with us and somebody else who wants to hedge something of theirs they're willing to pay for it. I don't have to know, and I'm not sure Morgan has to tell anyone what is that is their portfolio that's being hedged, but to help us understand it better in layman terms, could any of you give us a hypothetical? Morgan has a broad portfolio. There's something in that portfolio that they want to hedge against something else happening, they're willing to pay us or have somebody else, however the do the 8 million. Could we see what the other side of this might be to have it make more sense to us why someone would pay $8 million? Because we know they're not gambling. It's not something somebody put odds on and somebody said, well, it's worth $8 million because we think this might happen. They may think this may never happen, but their level of risk playing is such that it's still worth $8 million even though it may never happen just to prevent that even remote possibility.





What would a for-instance? Again, I don't need to know the company, the municipality, or whatever, just give us a flavor for what's on the other side of the transaction like this that makes the two sides come together and work out indirectly through Morgan this insurance? If my question understandable.

MR. REID: Sure, I'll take a stab at that. I mean, the industry as we're describing here is a growing industry. You'll find that it's more prevalent in the corporate world where swaps are put on and taken off quite readily. The municipal world is a growing industry that is well past infancy. It's growing as issuers become more sophisticated and these tools are available.

The easiest way to look at the provider, in this case, J.P. Morgan, or anybody that runs a swap book for that instance is to just say, you know, we're in a swap, we're receiving a fixed rate, we're paying a variable rate. The easiest way to look at it is that someone on the other side is doing just the opposite.

COUNCILMAN O'NEILL: Could you explain that? That's all I'm looking for.





MR. REID: That's number 1. So we're receiving fixed and we're paying floating at whatever rates. The best thing, first off, is to assume someone's on the other side paying fixed and receiving variable and those payments are going right through J.P. Morgan in this instance right to the folks on either side.

COUNCILMAN O'NEILL: What might that other side look like that's paying fixed and receiving variable? Just give me real hypothetical rather than just terms that describe it. What makes this so interesting to someone else that this kind of money gets involved in the hedging?

MR. REID: Let me go back again. Someone on the other side would look -- again, we're receiving fixed and paying variable. Someone on the other side is paying fixed and receiving variable. They may be on their side may be betting that, you know, rates going to take a different -- they have a different outlook on rates than we would. In the instance of this with the option --

COUNCILMAN O'NEILL: We're not getting anywhere with this question.

MR. REID: Well, I want to back. I want



to go to the option where we are selling the option and J.P. Morgan is buying the option. In that instance you can, again, look at someone taking the opposite trade which then they would have protection against high interest rates because at that point as variable rates increased above 7 percent hit the trigger point, they would then pick up the upside of that which means they would start tracking that variable rate and they would then move up with that rate.

COUNCILMAN O'NEILL: So someone out there has a variable rate?

MR. REID: Right.

COUNCILMAN O'NEILL: It looks real good right now.

MR. REID: Right.

COUNCILMAN O'NEILL: They're willing to spend somewhere in the neighborhood of $8 million. On the flip side, the mirror image of what we're doing, even though they don't think maybe that these numbers are going to go over 7 percent. It's worth it to them to spend the money if somebody's willing to give them insurance. We're giving them insurance.



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MR. REID: Exactly.

COUNCILMAN O'NEILL: We're getting paid as -- Morgan is the broker in this. I understand that. So we just have to assess our risk the way they just assessed theirs. Someone was actually willing to pay for what we're giving up and receiving that money for.

MR. REID: Exactly. And they're hedging -- they're buying insurance against higher interest rates.

COUNCILMAN O'NEILL: Somebody's trying to get out of the position we're in because they want something more that we're in after this. I'm sorry, not to confuse the issue more, but the position is we're at 5 percent. But the position we'll be in next week if we do this, someone is paying $8 million or some high number to be in the position we're today rather than the one they're in.

MR. REID: Correct.

MR. NADOL: If I may, in all likelihood, that person has a different overall mix of debt.

COUNCILMAN O'NEILL: I agree. It's got

to go something pretty significant.

MR. NADOL: As we've outline at this





point in time the Gas Works has no variable rate debt in their portfolio and that makes this kind of transaction attractive because having a certain --

COUNCILMAN O'NEILL: I mean, they could be brokering for themselves. They could just be insuring their own portfolio.

MR. NADOL: Right, but there may be another party out there who has too much variable rate date who perhaps had their variable rate debt at the optimal levels of around 10, 15, up to 20 percent but then because they retired some of their fixed rate debt and paid it off or because their short term assets that were matched to that variable rate debt for one reason or another might have decline that there may be another party out there who find themselves out of balance and wishes to get into the kind of position that we're seeking to get into.

COUNCILMAN O'NEILL: I understand. I'm starting to get a pretty good picture of it and I understand there's risks on both sides when people do it.

If this transaction had somewhere in it -- I mean, we're at 5. The number is at 3 point



something that has to go to 7. If we were to ask Morgan for a buy out -- maybe "buy out" is not the right word. But an escape clause. For instance at some point at 6.0, 6.5, we could negotiate this, obviously. We want to get out of this. They gave us 8 to get into it. What would they charge us to get out of it if we were getting anywhere near -- not our 5 percent but this 3.65 was inching in a seriously wrong direction? I'm trying to get a feel insurance part of this.

In response to Councilman Nutter's questions about what all these different scenarios are, the worst case, I'm may be comfortable with paying 20 million when it gets to 6 or 6 and a half to get back to where I was today. I don't know. Does that come up in these transactions? It seems like they can place real numbers on almost anything.

MR. REID: Certainly. Yes, they do. We've incorporated in the agreements, and we do this as a matter of practice, where we can unwind the transaction. As you noted, there is a cost to that or there could be actually a benefit to us depending where interest rates are. This particular swap will maximize its value when it's around the trigger





point. That's where it's going to maximize its value. Actually, that number, that rate 7 percent or above, that's where it's going to maximize its value. But going forward, we keep open the option to manage this transaction.

COUNCILMAN O'NEILL: So we can't get out of this for a price at some point?

MR. REID: We could very well get out of it if we so choose, if the economic conditions so dictate it.

COUNCILMAN O'NEILL: Explain to that to me in a little more detail. I was only assuming we would do it if economic conditions dictate it.

MR. REID: What scenario?

COUNCILMAN O'NEILL: And what would it cost us, yes.

MR. REID: Well, you could easily start with the number of $8 million, and that's based on --

COUNCILMAN O'NEILL: We certainly would have to give that back.

MR. REID: Right. And that's based on the current interest rate environment where TBMA is currently at 3.6 or approximately 3.6 percent. As



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rates were to increase, the value of the option to J.P. Morgan at that point would increase at well. So if rates were to fall, then the value of the option would decrease. And that's based on the likelihood of it being exercised purely.

COUNCILMAN O'NEILL: What's the percentage where it gets exercised right now? Or they can exercise it, I should say.

MR. REID: The trigger point is 7 percent for a period six consecutive months, an average of 7 percent.

COUNCILMAN O'NEILL: So let's say there was six-month period where it was in the high 6s. We weren't too confident that it was going to go down, but we're fairly sure it might go up. What does it cost us to get out of this at this point? I know we've got to give the 8 back.

MR. REID: At that point, it's a matter of a couple different things. To be honest with you, I don't know what the numbers would be, but I can put it in sort of context of what it would be. The first thing is the amount of principal outstanding. The $8 million and current rates -- I'm sorry, current rates and the principal amount

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outstanding, the $103 million contribute to the value and also time to maturity contribute to the value. So as you get closer to the end of the life of the bonds, and say that the trigger has not been reached and as you get closer, the value of that option decreases.

COUNCILMAN O'NEILL: When you're giving us chart showing possible negative scenarios, which is what Councilman Nutter, I believe, asked for. After the trigger, could you show us some scenarios of just what the cost would be to get out of this if we chose prior to those triggers? It doesn't have to be exact, but as close as you can. Just give me a framework to better understand this.

The last question has nothing to do with this, financing, it has to do with the question about bad winters or good winters depending on whether you're the Gas Works or the general population. Is there anything going on in the industry technology- wise, policy-wise, to try to get a more seasonal balance of gas use whether it be industrial commercial, individuals where I'm using gas in the summer for air conditioning so it's not just the electric company getting that.

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MR. HALER: There are two things, I think, to respond to your question. Yes, you want to get as much summer usage as you can, and traditionally there's very, very little. The gas just flows through the pipes. Gas air-conditioning has become more popular in the recent years. The convention center uses it. The city municipal buildings use it, but I'm not convinced that that's going to balance up the demand compared to what you must earn the winter. Our cost structure is based on an average winter that's measured in something degree days, and I'm not sure you'll get enough air-conditioning and alternative use to offset the loss in the winter. What has become available to us and we're doing it this year is that you can buy weather insurance where well pay -- in this case it's the insurance policy. We will pay money that depending on how far below the average temperature of the winter heating season, they will pay you in our particular case up to $10 million if we have a winter that is similar or identical to last year. So that is a relatively new product. Other utilities, and we have not done this, and the commission is now trying to move toward this with

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caution and some concern, but other hedging mechanisms that help us in case it becomes abnormally warm again with other mechanisms to assist in bringing in revenue similar to insurance but a little bit more sophisticated than the simple insurance policy which we have for the first time this year.

COUNCILMAN O'NEILL: On a technology standpoint, aren't there some things in development or are in experimental use generating power within building or communities that are natural gas driven.

MR. HALER: With deregulation of electricity, there has interest but there have not been any -- nothing has been signed in the electrical generation using natural gas. You would have mini-generator that would use gas. There is interest in this. And this, of course, because of air-conditioning, the electric load is higher in the warmer months and that means that you would be able sell more gas. That is true. But we have not get even one signed off.

COUNCILMAN O'NEILL: But things are moving sort of towards that?

MR. REID: Yes.

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CHAIRWOMAN BLACKWELL: We're going to have a final question from Councilwoman Tasco. Gentlemen, we're going to ask you to make note of the various questions because we're not going to be able to move on this legislation today because I don't think you would have gotten much support due to the questions. So we're going to ask you to get ready, bring these back responses tomorrow when we have follow-up hearing at one o'clock tomorrow. So Please bring your responses and then we can continue after Councilwoman Tasco finishes her questions. Then we can continue with any other questions that we might have. So please be prepared to respond to those issues. Thank you.

Councilwoman Tasco.

COUNCILWOMAN TASCO: The question I have is in view of the plan to increase the amount for the replacement main program, don't you think it requires an amendment to the fiscal year 2000 capital budget that has to be approved by the Gas Commission and Council, and when do you plan to do that?

MR. HALER: With the money in hand, we will come back with that requesting that approval.

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COUNCILWOMAN TASCO: As you know, during our preliminary discussion about this, I raised many questions similar to Councilman Nutter relative to the money, if it's being really to generate additional income for PGW or is it really going generate money for gas mains. If we use the $8 million in the interim, we have a warm winter, and you get to the spring and your revenue is lower than you planned, how plan to recapture this money for main replacement?

MR. HALER: In the worst case scenario where we have absolutely no revenue in which to replace -- if the money is spent in the early part of January and we have no money to replace it when the revenue comes in later in the winter, we'll have a lot of serious problems that will transcend. It is our commitment that we will replace the money insofar as we are able with the revenue that comes in and dedicate it to infrastructure replacement.

COUNCILWOMAN TASCO: How would that impact on your overall budget?

MR. HALER: It would be a wash. We'd have the revenue coming in from the payment of the swap and we would have the payment expense for the additional main replacement.

COUNCILWOMAN TASCO: But if you don't capture the revenue --

MR. HALER: Then we won't spend it. Our intention is to capture it from the revenue that comes in, as you know, in the late winter and into the spring, if we have to spend it. Our preference, of course, is to simply have it as cushion.

COUNCILWOMAN TASCO: So it would be just better to say that we're using this swap as a mechanism to generate additional funds for PGW and just not add to the main --

MR. HALER: No, I can't say that. This money will be dedicated for infrastructure replacement.

COUNCILWOMAN TASCO: I have a question that Councilman O'Neill asked which triggered in my mind, what are you doing in terms of future proposals to generate the use of gas for air conditioning? Is that a consideration on the marketing table for PGW?

MR. HALER: Yes. In fact, you have before or will have before you a request to change the tariff to make our air conditioning rates more

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competitive. Mr. White is not here, but Craig White, the head of marketing and gas supply, can go into that with greater detail. I believe he intends to testify for that Commission at such time a hearing is held on that. They are actively trying to market air-conditioning. They have intended symposiums, they have tried to increase the presence of the industry. Because glass air-conditioning sound like a contradiction in terms, we still have a lot of education of engineers to perform where they gas is a source of energy for air-conditioning, and we have taken people to our convention center to prove that it works and works quite effectively.

COUNCILWOMAN TASCO: Thank you.

CHAIRWOMAN BLACKWELL: All right, let me --

COUNCILMAN O'NEILL: Madam Chair, I don't want characterize Councilman Nutter's questions or what he expects tomorrow. I think I know what it is. I just want over 29 years where the terms of the bonds are. It's going to cost us in each year. I know it slides down if we want to get out of this at some point in time, something triggers our wanting to get.

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CHAIRWOMAN BLACKWELL: Is it clear Councilman O'Neill is requesting? Is it clear the information you need to give on financial forecast for Councilman Nutter?

If we're clear, then this Committee hearing will be recessed until 1 o'clock tomorrow. Thank you.

(Hearing recessed at 12:30 p.m.)

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C E R T I F I C A T I O N

I HEREBY CERTIFY that the foregoing proceedings of the Council of the City of Philadelphia of December 7, 1999, were reported fully and accurately by me, and that this is a correct transcript of the same.

RE: COMMITTEE ON FINANCE

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Lisa C. Bradley, RPR
and Notary Public