COUNCIL OF THE CITY OF PHILADELPHIA

PUBLIC HEARING BEFORE THE COMMITTEE ON FINANCE

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Room 400, City Hall
Philadelphia, Pennsylvania
Wednesday, June 9, 2004
9:50 a.m.

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Bill 040599 - Ordinance constituting the Sixth Supplemental Ordinance to the General Gas Works Revenue Board Ordinance of 1998, etc.

Bill 040600 - Ordinance constituting the Eighteenth Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1975, etc.

Bill 040328 - Ordinance authorizing the creation of a loan or loans to provide funds for and toward various capital municipal purposes, etc.

Bill 040153 - Ordinance approving the FY 2004 capital budget providing for expenditures for the capital purposes of the Philadelphia Gas Works, etc.

Bill 040559 - Ordinance amending the Ordinance approved July 12, 1968, as last amended and restated effective June 26, 2002 relating to pension benefits for employees working on behalf of PGW, etc.

PRESENT: COUNCILWOMAN JANNIE L. BLACKWELL, Chair
COUNCILWOMAN BLONDELL REYNOLDS BROWN, Vice-Chair
COUNCILMAN DARRELL L. CLARKE
COUNCILMAN FRANK DICICCO
COUNCILMAN W. WILSON GOODE, JR.
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6/9/04 - Committee on Finance Public Hearing

COUNCILWOMAN BLACKWELL: The Council Committee on Finance is called into session. We will ask those who are going to testify for PGW to please join the witness table.

Today we will hear testimony with regard to PGW bond ordinances, Bill No. 040599 and 040600.

We have a quorum. To my left, Councilman Brian O'Neill, Councilman Rick Mariano; to my right, Councilman DiCicco and Councilman W. Wilson Goode.

We will ask the clerk to read the title of the bills.

THE CLERK: Bill No. 040599, an ordinance constituting the Sixth Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1998 authorizing the Mayor and the City Controller and the City Solicitor, or a majority of them, to sell, either at public or private sale, Gas Works Revenue Bonds, Fifth Series, of the City of Philadelphia in one or more subseries to be issued to pay the cost of certain capital projects, and the cost of refunding or redeeming all or a portion of certain outstanding Gas Works Revenue Bonds and other project costs, as hereinafter more particularly described; and authorizing the application of proceeds of the Fifth Series Bonds for such purpose, authorizing the City to obtain credit enhancement for the Fifth Series Bonds, authorizing the City of Philadelphia to enter into qualified swap agreements or exchange agreements with respect to the Fifth Series Bonds; determining the sufficiency of Gas Works revenues, covenanting the separation of Gas Works revenue accounts and proceeds of the Fifth Series bonds from general accounts of the City, covenanting the payment of interest and principal on and specifying the purpose of the Fifth Series bonds, authorizing covenants and action in order that the Fifth Series Bonds shall not be arbitrage bonds; authorizing the Fifth Series Bonds to be issued in book-entry form and providing book-entry provisions to apply in such case; 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 superseded by this ordinance are applicable.

Bill No. 040600, an ordinance constituting the Eighteenth Supplemental Ordinance

6/9/04 - Committee on Finance Public Hearing

to the General Gas Works Revenue Bond Ordinance of 1975, authorizing the Mayor, the City Controller and the City Solicitor, or a majority of them, to sell, at either private or public sale, Gas Works Revenue Bonds, Eighteenth Series, of the City of Philadelphia in one or more subseries to be issued to pay the cost of refunding or redeeming all or a portion of certain outstanding Gas Works Revenue Bonds and other project costs as hereinafter more particularly described; and authorizing the application of proceeds of the Eighteenth Series Bonds for such purposes; authorizing the City of Philadelphia to obtain credit enhancement for the Eighteenth Series Bonds; authorizing the City of Philadelphia to inter into swap agreements or exchange agreements with respect to the Eighteenth Series Bonds; determining the sufficiency of project revenues; covenanting the separation of Gas Works revenue accounts and proceeds of the Eighteenth Series Bonds from the general accounts of the City of Philadelphia; covenanting the payment of interest and principal on and specifying the purpose of the Eighteenth Series Bonds; authorizing covenants and actions in order that the Eighteenth Series Bonds shall not be arbitrage bonds; authorizing the Eighteenth Series Bonds to be issued in book-entry form and providing book-entry provisions to apply in such case; and providing that this ordinance is supplemental to the 1975 general ordinance and that the provisions of the 1975 general ordinance, to the extent not modified, amended or superseded by this ordinance, are applicable.

COUNCILWOMAN BLACKWELL: The Chair thanks the clerk.

The Chair also notes that the vice-chair of the committee, Councilwoman Blondell Reynolds Brown, is also in attendance.

If there are no statements at this point, we would ask that you identify yourself and present your testimony.

MR. BOGDONAVAGE: Good morning, Councilwoman Blackwell, members of the finance committee.

COUNCILWOMAN BLACKWELL: Good morning.

MR. BOGDONAVAGE: My name is Joseph R. Bogdonavage. I'm the senior vice president of finance at PGW, and I'm here to testify on behalf of Bills No. 040599 and 040600. Accompanying me are

Joseph Golden, who is the controller at PGW, and other representatives of PGW to explain the capital expenditure program and the funding requirements that the Council Bill 040599 will satisfy by issuing the 2004 bonds. These bonds will be utilized for capital expenditures in fiscal years 2005 and 2006.

Bill 040599 also provides an aggregate principal amount of up to $18 million to pay the cost of redeeming the 1998 first series subordinate bonds.

Also, we have a representative from Black & Veatch, the engineering firm who performed the feasibility study, and they are available to answer any questions that may arise.

In addition, Council Bill 040600 authorizes the issuance of refunding bonds up to 75 million to refinance the major portion of PGW's outstanding 15 series bonds that were issued in 1994.

In my prefile testimony, I have included an overview and discussion of PGW's capital improvement program and the funding requirements that this bill will satisfy. We are in the process of issuing up to $150 million of new money issue bonds, the Fifth Series A and also the Fifth Series B refunding or redeeming bonds.

The requirements of the capital improvement program at PGW will be satisfied by the issuance of the new money issue 15 series A bonds. The majority of the proceeds of this bond sale will be used to replace cast iron mains in PGW's system, also to replace gas production facilities, and also the meter and regulating facilities in the AMR replacement program. The balance of the proceeds of the bonds will be used to pay for costs of other projects including computer-related equipment and vehicle replacements.

Councilwoman, we also have an amendment to the sixth supplemental ordinance that I think was handed out, and we would like to read into the record the amendment and the reason for it.

The sixth supplemental ordinance, we just wanted to make sure that the variable rate debt that we are contemplating issuing to save PGW interest costs would be included in the sixth supplemental ordinance, and I would just like to read that amendment into the record.

For purposes of calculating the sinking

fund reserve requirement for any series of the Fifth Series Bonds that are variable rate bonds as identified in the general ordinance, the debt service requirement attributable to such variable rate bonds shall be based on a rate per annum equal to 7 percent. That is the amendment.

If there are any other questions that I might answer at this time, I would be happy to. And, additionally, we would like to ask for a suspension of the rules so that the bill can be recorded out and approved at the second reading of City Council next week.

COUNCILWOMAN BLACKWELL: Thank you very much. I have several questions. I will ask maybe two in the interest of time and our schedule today.

What happens if PGW does not complete this bond issue by September of '04?

MR. BOGDONAVAGE: Councilwoman, probably one of two things that would happen. Obviously there would be some sensitivity to interest rates. The rates currently in the market are creeping upward. This would probably add additional interest costs to PGW and the rate bearers.

In addition to that, a delay may not

send the proper signal to the rating agencies which have downgraded PGW's bonds at least one notch in the past two months.

COUNCILWOMAN BLACKWELL: The 1975 and 1998 general ordinances require that PGW conform with specific requirements before those bonds are issued. In their evaluation of the PGW system, did Black & Veatch offer an opinion on those specific requirements.

MR. BOGDONAVAGE: Yes, they did, Councilwoman, and it was part of my prefile testimony, but I would be happy to opine on those.

Black & Veatch did render an opinion with regard to the rate covenant compliance for the '75 and 1998 general ordinances. The project revenues of the Gas Works revenues which are pledged as security for both the '75 and '98 ordinance bonds are currently and are projected to be sufficient to comply with the rate covenants set forth in Section 403 B of the '75 general ordinance and Section 403 B of the 1998 general ordinance.

In addition, they found that the system was in good operating condition.

COUNCILWOMAN BLACKWELL: Please explain

6/9/04 - Committee on Finance Public Hearing

the current governance structure of PGW and explain what impact, if any, the Public Utility Commission's rate-making authority will have on bond compliance?

MR. BOGDONAVAGE: Currently the structure for PGW's governance is that for rates, safety and customer service it falls under the Pennsylvania Public Utility Commission. In addition to that, the Philadelphia Gas Commission has approval of PGW's operating budget, and also they make recommendations on the capital budget, which is then forwarded to City Council.

The PUC does set rates and has provided PGW over the last two years almost $70 million in base rate increases. The PUC does have under its provision the ability to approve bonds being issued by the City of Philadelphia on behalf of PGW, and these bonds are approved bonds as per the bond ordinances.

COUNCILWOMAN BLACKWELL: What has PUC done with respect to PGW's rates?

MR. BOGDONAVAGE: PGW, as I pointed out, has filed for base rate increases over the last two years, granting just short of $70 million in base rates.

In addition, PGW did file in March of this year for the cash reconciliation clause mechanism for PGW. Those hearings have been completed and a final decision on the CRRC, the cash reconciliation clause, is pending probably in July of this year.

COUNCILWOMAN BLACKWELL: My understanding is that collections are up and the consumer -- it is looking pretty good in terms of the consumer not having to pay that tariff, that surcharge.

MR. BOGDONAVAGE: Councilwoman, you are correct. Currently, after nine months of our fiscal period, our collection rates have returned to historical levels. We are looking at about 92 percent of annual billings. If that was the case and the mechanism was approved by the PUC, at this point in time there would be no implementation of that and rate payers would not be paying any of that surcharge.

COUNCILWOMAN BLACKWELL: That's good news.

Thank you.

Are there questions?

Councilman DiCicco.

COUNCILMAN DICICCO: Thank you, Madam Chair, and good morning.

Actually, my questions are on behalf of Councilwoman Tasco, who is in route. She may not be here in time, so her staff person asked me to ask a few of these questions, so I apologize if they are not coming out as clear as she would have asked them, but I will repeat them the way they are written.

In last year's operating forecast PGW projected it would need to issue these bonds in December of 2004, but as per your testimony on Page 3, you indicate that the bonds must be issued by September 2004 or PGW will not be able to reimburse itself for capital expenditures made during this fall and winter, yet, according to the Black & Veatch independent engineer's report, Page 55-C, Table 13, Page 55-C, PGW will still have $40 million left in its capital improvement fund as of August 31 of 2004. So isn't it the other way around; that is, what is driving the accelerated timing of issuing the bonds in PGW's needs for cash to cover its operating expenses for the first two quarters of FY

'05?

MR. BOGDONAVAGE: Councilman, first, one of the reasons that we accelerated the issuance of the bonds was to take advantage of the interest rates that were in place earlier this year. Since then, my interest rates have migrated upward, but we accelerated the forward movement of the bonds to close earlier than we had anticipated to take advantage of the interest savings that would have accrued.

You are absolutely correct that in the Black & Veatch report there will be almost 35 to $40 million of proceeds available from the prior bonds, the bond sale of 2002. Those funds would be utilized to take care of our cash flow and working capital needs. The reason that we wanted to close this deal by September, as I pointed out, was for the interest rate considerations, but also to provide a hedge that we would have enough operating funds through the winter, and this is a result of the escalating natural gas price that PGW and most utilities are now paying in the marketplace.

Although we did have $40 million of proceeds available, we thought it was prudent to issue the bonds so that we have additional funding for liquidity.

COUNCILMAN DICICCO: Are those interest rates providing the savings that you expected? I mean, are they -- are they working to your advantage at this time?

MR. BOGDONAVAGE: At this time, Councilman, we had proposed a refunding of issue of about $75 million. That issue appears to be not in the best interest of the company right now to do. The savings on that original refunding issue have now evaporated due to the higher interest rates.

COUNCILMAN DICICCO: Forgive me for my ignorance, but why then would we still proceed on this schedule?

MR. BOGDONAVAGE: We were just asking Council to approve the ordinance, if we could, and rates have turned around when we went to price these bonds.

COUNCILMAN DICICCO: So it would give you the opportunity to do that --

MR. BOGDONAVAGE: That is correct.

COUNCILMAN DICICCO: -- by way of this ordinance, but not necessarily you would take that up; you would obviously be looking at the interest rates?

MR. BOGDONAVAGE: Absolutely.

COUNCILMAN DICICCO: So we are not locked in?

MR. BOGDONAVAGE: That is correct.

COUNCILMAN DICICCO: Next question: Why isn't PGW's cash flow improving sufficiently from its supposedly improved collection results and from the agreement it recently entered into to defer almost $60 million of gas purchase costs into FY '05 such that these bonds could be issued at a later time?

MR. BOGDONAVAGE: Currently, as the question had phrased, PGW's collections have improved. Unfortunately, even though we have the natural gas deferral storage deal that we have with one of our pipeline suppliers, natural gas prices continue to rise. We are paying almost $150 million on an annualized basis, higher than we did only a year ago for our natural gas supply. So I think as a prudent finance manager at the company, we wanted to make sure that the bonds were issued timely so we would have liquidity into the future to take care of additional natural gas price increases.

COUNCILMAN DICICCO: There are a whole lot of questions here. I just have one for myself in terms of collections.

Do you contract out with private companies to do collections? And is that on a commission basis, or is that -- how do you make those arrangements on collections?

MR. BOGDONAVAGE: We have probably about a half dozen firms that we do contract out. We put out our final accounts and written-off accounts, delinquent written-off accounts. They are placed with these six agencies. It is on a commission basis. They run anywhere from probably 10 to 30 percent based on the ability of the collection agency to collect up to what we had into the contract.

We have out on the street right now about $200 million of probably two- to three-year-old money. They have collected about 4 and a half to $5 million for us on those.

In addition to that, we have just recently also contracted with other collection agencies to put another $35 million on the street, and at this point in time they have collected about $1 million of that so far, but this goes out through a bidding process and also it is a purchase service so that we do meet with the administration and look at what collection agencies are available, look at their history of collections on our accounts; and at that point we make a determination on who would be utilized.

COUNCILMAN DICICCO: So none of these are companies that are paid, if you will, to make collections but for their commission, if they collect; is that correct?

MR. BOGDONAVAGE: That is correct.

COUNCILMAN DICICCO: Because I was told the other night by someone that their contract had been cut by about $200,000. Do you know of any collection companies that may fall into that?

MR. BOGDONAVAGE: I'm not aware of any and general counsel is not either.

COUNCILMAN DICICCO: Just for the record, I wanted to be clear on that. I didn't think that was your policy. I just wanted to double-check it. My guess is that the way it was presented to me was incorrect. They didn't explain it thoroughly.

I just have two more on behalf of Councilwoman Tasco.

As we all know, PGW rates continue to be the highest in the state. Even if you eliminate all of the costs associated with the CRP and senior citizen discount programs, which Black & Veatch show as $21 in a peak winter month according to Table 7 on Page C-35 of the Black & Veatch report, but this still doesn't account for the entire difference between PGW and the other utilities.

For example, PECO Energy has a pretty large low-income assistance program also and it should be buying gas from basically the same pipeline as PGW does, but its winter monthly gas bill is shown on the chart as only $235, close to $44 lower than PGW's bills. Why are PGW's rates so much higher than PECO's?

MR. BOGDONAVAGE: Councilman, trying to respond to the first part of the question on why the rates are so high, one of the things could be a timing issue. When Black & Veatch looked at the report, some of the commodity costs that were across the spectrum for the nine distribution companies in

Pennsylvania. At that point in time not all had filed for their fuel clause adjustments. I think the most recent study that we have seen, of the nine LDCs, local distribution companies, that PGW is purchasing its gas was the second best in the State of Pennsylvania.

I think when you were looking at the why are the costs so much higher, we do have a lot more costs embedded in our universal service charge than other customers to pay for both the low-income customers and also for the conservation programs that we run.

In addition to that, also included through there is the senior citizen discount. And PGW does have some significant fixed costs as identified by the $1 billion of debt that we have, so that our base rates are a little higher than some of the other local distribution companies.

COUNCILMAN DICICCO: Did you want to comment on that?

MR. WHITE: Yes, Councilman. My name is Craig White. I'm the acting chief operating officer.

I would like to point out that, as Mr.

6/9/04 - Committee on Finance Public Hearing

Bogdonavage indicated, there is a timing issue on the gas costs, so, therefore, there can be variations that are inconsistent. In the case of PECO and PGW, we could file ours at a time where rates are lower and PECO could be on a different cycle and therefore not filing theirs at a time when the rates are as low, and it can go the other way.

But the point I want to make is with respect to the three programs that you mentioned, the CRP program, the senior citizen discount, and our conservation works program, there is over a dollar in MCF in our rates that have to deal with those three programs. The typical customer uses a hundred MCF a year, so we are talking about a hundred dollars just for those three programs.

In addition to that, as Mr. Bogdonavage pointed out, to service our debt we are looking at about another dollar twenty, which when multiplied by a hundred MCF a year is another $20.

So when you look at those two combined, you can see that PGW's costs, absent those large programs -- now, granted, PECO does have a program, but you must recognize that their program is a combination of gas and electric program, and as it pertains to their gas customers, they only serve gas in the five surrounding counties, four surrounding counties, where they do not have the low-income issues that we have in Philadelphia.

So I think it cannot be -- it must be recognized that when we are talking about PECO versus PGW gas rates, their low-income programs are dealing with a different constituency than ours are. But removing all of those items that I mentioned makes PGW's rates very, very competitive or actually below most other companies. We have already thinned out most of our costs.

COUNCILMAN DICICCO: Mr. Bogdonavage, you mentioned something about -- I didn't quite hear -- second best in your testimony. What was that in reference to? The purchasing of --

MR. WHITE: Actually, I would respond to that. The Gas Supply Group works for me. And when we filed our last annual gas cost recovery filing, just to correct Mr. Bogdonavage, we were the third lowest in the state.

Now, there are times where we may be the fourth or fifth. There are about eight utilities in the State of Pennsylvania and PGW has routinely been in the top 50 percent even with some of the constraints we find ourselves in.

COUNCILMAN DICICCO: Madam Chair, I have one more question on behalf of Councilwoman Tasco.

Can you clarify exactly what Black & Veatch's assumptions are about the annual $18 million payment to the City. At Page C-58 they state that the City will not require the payment to be made for FY '04 and will grant it back for FY '05 through '08, but in Table 17 at Page C-61 of their report, they show the $18 million being paid every year through FY '09 but with a forbearance from the City only for FY '04.

Did you get that, or do you want me to repeat that?

MR. BOGDONAVAGE: I think I have it here, Councilman.

COUNCILMAN DICICCO: I know it is a quite lengthy, detailed question.

MR. BOGDONAVAGE: In the cash flow projections the Black & Veatch had prepared for PGW for the feasibility study, you are correct that the $18 million for the fiscal years 2004 through 2008 will not be paid by PGW. I think there may be some misunderstanding of how they accounted for it. Only in the 2004 year is the money not being granted back to PGW as project revenues. In the 2005, 6, 7 and 8 fiscal years, the $18 million is being granted back pending approval of City Council.

COUNCILMAN DICICCO: Which is the remaining part of the question. What is the current understanding of what the Mayor has agreed to? If PGW will, in fact, get relief from the $18 million payment for this fiscal year and the next four or five years, why would there still need to be a base rate increase?

MR. BOGDONAVAGE: Councilman, in the prior Black & Veatch report that was prepared for the 2002 bond issuance, the anticipation was about a 15 to $20 million increase in the two thousand -- just checking my memory -- of about $15 million in the fiscal year 2007. As a result of issuing additional bonds this year and also in 2006, the increasing debt service is requiring a $25 million revenue enhancement. And we didn't say it would necessarily be all in the base rate. There could be cost savings. The PGW could reduce in its own operating expenses. There could be revenue enhancements and/or a base rate increase. We are not predisposed to having a base rate increase at this time. Pending the approval of City Council action at this time, if, in fact, the $18 million is not going to be paid by PGW over that time span, it will take some of the pressure off that revenue enhancement that is needed in 2007.

COUNCILMAN DICICCO: Could you speak as to whether or not the Mayor has agreed to this?

MR. BOGDONAVAGE: It is my understanding through the finance director that the City administration is on board; however, absolutely City Council approval will be needed through the five-year plan to make this happen.

COUNCILMAN DICICCO: Thank you.

Thank you, Madam Chair.

COUNCILWOMAN BLACKWELL: You are welcome.

Are there any more questions for these witnesses with regard to these bond ordinances?

Are there any questions from members of the committee with regard to any of the other bills that were continued to today? That was 040153 dealing with the capital budget; 040328, dealing

6/9/04 - Committee on Finance Public Hearing

with municipal capital improvements; as well as 040559, the pension plan.

If there are no further questions, we will assume that testimony with regard to all five bills has been fully taken and that all that is left to do is to report them out of committee and enter into the stated meeting and then hopefully pass the ordinances.

As has been said yesterday when we continued these hearings, we do have some issues that we put on the table. We received documentation late, around 6:00, so we don't have them resolved. Therefore, we will be dealing with those issues and agreed to meet later and we will continue all five bills until tomorrow morning at 9:00.

We thank you all for your patience. All of those for rules, you are next, and, everyone else, we will see you later and/or tomorrow. Thank you very much.

(The hearing adjourned at 10:30 a.m.)

CERTIFICATE

I HEREBY CERTIFY that the foregoing proceedings of the Committee on Finance of the Council of the City of Philadelphia of June 9, 2004, were reported fully and accurately by me, and that this is a correct transcript of same.

Cynthia A. Whyte, RPR

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