



Water System Monetization Update

MFRAC Meeting
September 28, 2021

Presentation Overview



- Last week, the Commonwealth Court ruled that the City of Chester has the statutory ability to obtain the assets of the Chester Water Authority
- Many people have questions about the Receiver's position on monetizing the water system and there is a great deal of interest regarding what has happened and what will happen next
- This presentation will provide the Receiver's current thoughts regarding monetization of the water system



What Does “Monetization” Mean?

- Monetization means converting an asset into cash or income
- Pennsylvania communities have monetized their water or sewer system assets to place money into underfunded pension funds and other uses
 - For example:
 - In 2013, the City of Allentown signed a 50-lease of the City’s water and sewer system to the Lehigh County Authority. Allentown received an up-front payment of approximately \$210 million and annual payments of \$500,000 adjusted for inflation
 - In 2016, the City of Scranton sold its public sewer utility to Pennsylvania American Water for \$195 million
- Monetization of water and sewer system is occurring nationwide, not just in Pennsylvania

Why is the Receiver Considering Monetization the City's Water System?

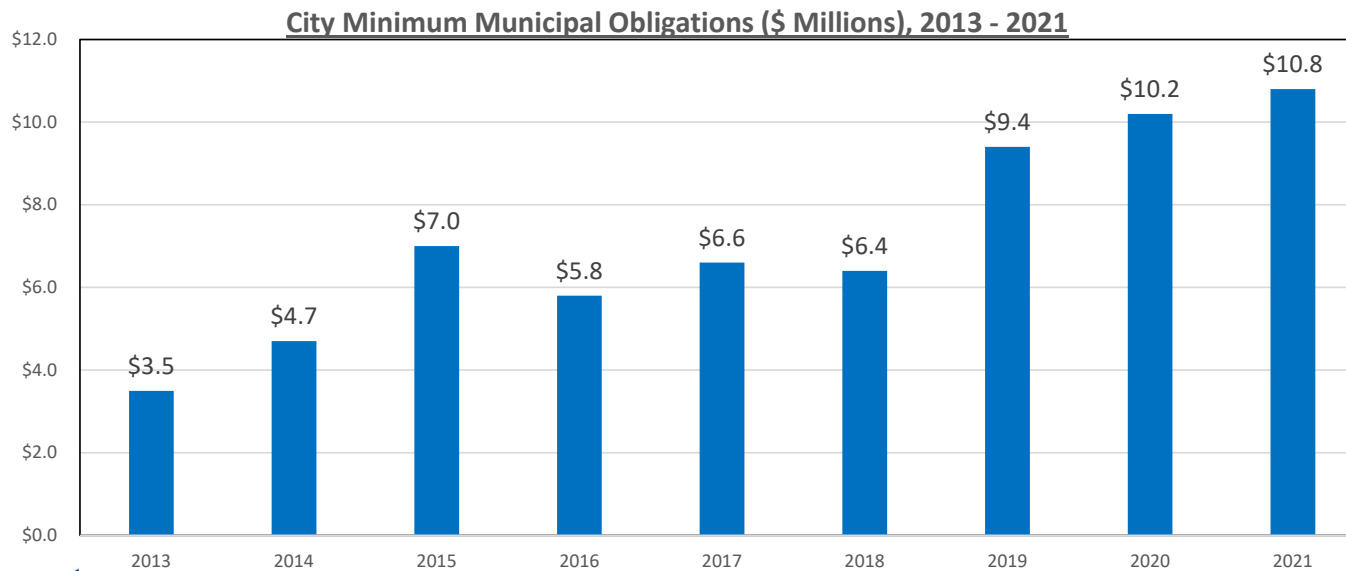


- At the May 25, 2021, MFRAC meeting, the Receiver's Chief of Staff discussed the City's massive retiree benefit liabilities – both pensions and retiree health care
 - That presentation concluded that there is no way to truly fix Chester's retiree benefit situation – or Chester's long-term financial health – without both reducing the unaffordable costs of the pension and retiree health care benefits and a substantial cash infusion into the plans
- The City simply cannot afford to pay for these retiree benefits and provide vital and necessary services to its residents
- At end of August, the City's police pension fund had a little less than \$2 million in cash available for monthly benefit payments – that is approximately four months' worth of benefits payments
- The following slides provide more background on the City's unaffordable retiree benefit costs

City Pension Cost Growth



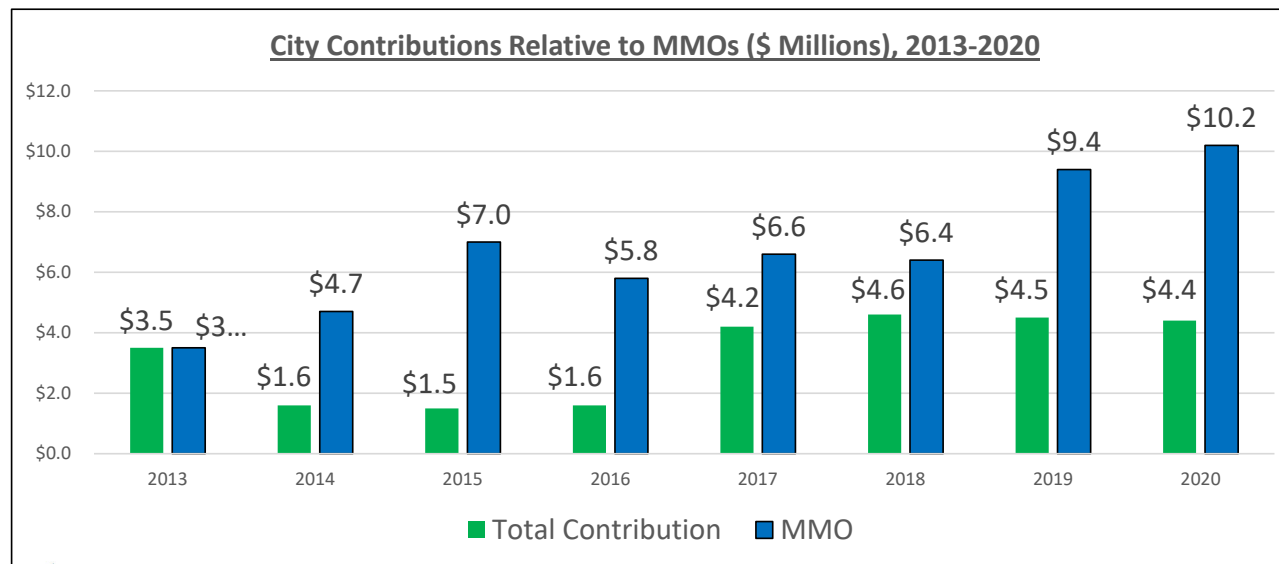
The City's combined annual contributions to its pension funds (called Minimum Municipal Obligations or MMOs) for its three pension funds has more than tripled since 2013.





How Did Things Get So Bad in the Pension Funds?

- The City fell behind on its MMO payments in 2014 and has never been able to catch up (not the “true” MMO)



How Did Things Get So Bad in the Pension Funds? (Continued)



- The benefits offered to police employees are far richer than what Chester can afford and far richer than the standards established in Pennsylvania's Third Class City code
 - Police officers hired before 2/1/17 can retire with 20 years of service regardless of age and can accelerate their retirement date by purchasing pre-employment military time **resulting in officers retiring in their 40s**
 - Police officers hired before 2/1/17 receive a benefit starting at 50% of final pay and **increasing to 70%** with 25 years of service, plus any service increment. Those hired after receive a benefit of 50% of the higher of final monthly salary or highest annual average during any five preceding years
 - The pension benefit calculation for police officers hired before 2/1/17 included overtime which enables officers to **work large amounts of overtime** before retirement resulting an elevated pension benefit. Overtime is not counted in the pension benefit for officers hired after that date
 - In 2020, three police officers ages 44, 45, and 42 entered the DROP program with pensionable salaries of \$210,874, \$207, 414 and \$143,311 respectively. **Under the current benefit provisions, their pensions will be \$108,073, \$103,707 and \$71,652.** The median household income for Chester in 2019 was \$32,403
 - The City had an unusually high number of **disability pensions** and until recently, disability pensions were paid at a higher rate (**100% of last 12 months salary**) than non-disability pensions, creating an incentive to retire on disability



City's True Pension Situation

- Although many Pennsylvania cities have underfunded pensions, as of 1/1/2019, Chester's situation is the worst among Pennsylvania cities. The following table reflects the funding percentages of the plans in the 1/1/19 valuation.

	Police	Fire	O&E	Total
Liabilities	\$83,195,607	\$39,891,425	\$8,028,817	\$131,115,849
Assets	\$27,992,535	\$33,275,475	\$2,674,647	\$63,942,657
Unfunded Liability	-\$55,203,072	-\$6,615,950	-\$5,354,170	-\$67,173,192
Funded %	33.6%	83.4%	33.3%	49%

- However, the problem is even worse than what appears in the 1/1/2019 valuations because those calculations treat the MMO contributions that the City did not make in prior years and still owes as if that money was already in the plan because they are "receivables" due to the plan.**
- In the above table, the police pension plan appears to have \$27,992,535 in assets as of 1/1/2019 with a funding percentage of 33.6%. However, almost all of those assets are "receivables." Excluding the receivables, as of 12/31/2019, the police pension plan's funding percentage was closer to 3%.
- Excluding receivables, which is a more accurate reflection of reality, the annual City pension payment for 2021 would be **\$2 million more than originally provided - \$12.8 million rather than \$10.8 million.** The City simply cannot afford this.



City's True Pension Situation

- By the end of 2021, we plan to contribute more than \$10 million to the City's three pension funds – more than the City contributed in 2019 and 2020 combined
 - However, even at that level, the contribution will only bring the City current on its police pension payments through 2016
 - Note: Every dollar spent on pension is one less dollar that can be spent on capital projects or operations
- The City continues to pay pension benefits at a level it simply cannot afford with police officers leaving the City in their early 40s with six-figure pensions
- The only way to get off this treadmill of rising contributions and flat or falling funding levels is to address the unaffordable benefit costs and make a large one-time contribution to the plans

Basic Facts on Chester’s Retiree Health Care Situation



- In addition to pension benefits, the City also provides many of its employees and retirees with very rich retiree health care plans which the City must pay for (these benefits are referred to as “other post-employment benefits” or OPEB)
 - As of February 2021, there were 178 retired employees on the City’s retiree health care plans
- While the City has put aside some money for pension liabilities (albeit not nearly enough), it has not put aside any for retiree health care liabilities and pays claims from the City’s general fund as they are received.
- As of the 12/31/2018 retiree health care valuation, the City has an unfunded retiree health care liability of \$232.9 million which is close to 3.5 times greater than the City’s unfunded liability for employee pensions at the same point
 - The following table has the OPEB liabilities by employee group as of 12/31/2018

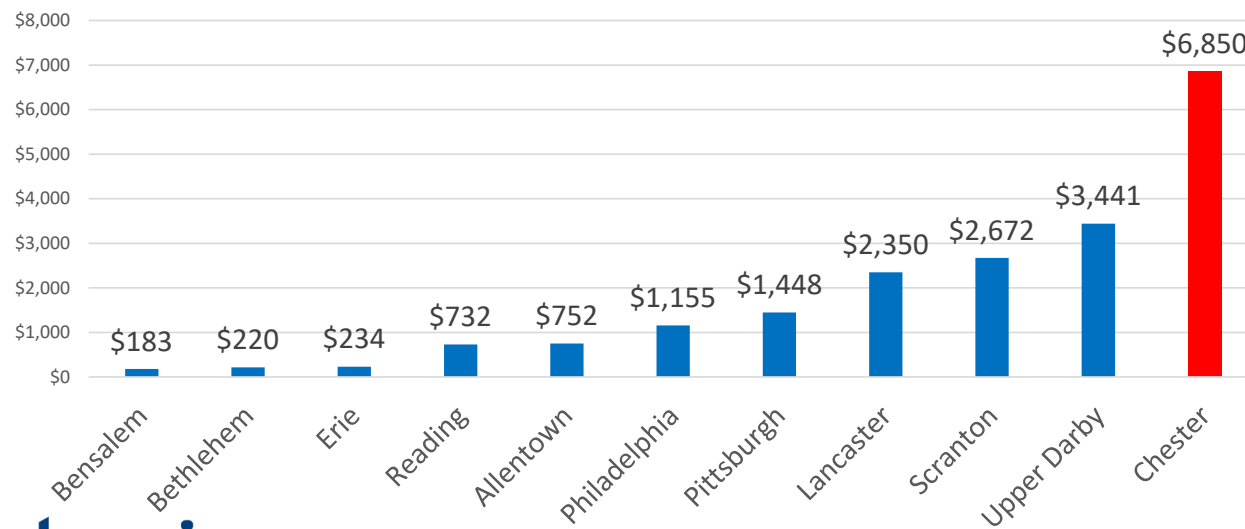
Group	OPEB Liabilities in Millions
Police	\$135.7
Fire	\$66.7
O&E	\$30.5
TOTAL	\$232.9

Putting Chester's Retiree Health Care Liabilities in Context



Chester's per capita OPEB liability (liability divided by population) is significantly higher than the OPEB liability of the 10 largest Pennsylvania municipalities.

Per Capita OPEB Liability of 10 Largest PA Municipalities + Chester



Rich City Retiree Health Care Benefits



Co-pay (In-network)	Chester Retiree Plan With Most Retirees in it	PEBTF REHP Choice PPO	PEBTF REHP Basic PPO
Retiree Premium Contribution	None	After 7/1/05, but before 7/1/07 – 1% gross salary On/after 7/1/07 – 3% gross salary (non-Medicare); 1.5% gross salary (Medicare)	After 7/1/05, but before 7/1/07 – 1% gross salary On/after 7/1/07 – 3% gross salary (non-Medicare); 1.5% gross salary (Medicare)
Office Visit	\$5	\$20	\$20
Specialist Visit	\$5	\$45	\$45
Deductible	\$0	\$400 single/\$800 family	\$1,500 single/\$3,000 family
Out of Pocket Maximum	\$500 person/\$1,000 family	\$8,550 single/\$17,100 family	\$8,550 single/\$17,100 family
Emergency Room	\$100	\$200	\$200
Urgent Care	\$25	\$50	\$50

Rich City Retiree Health Care Benefits



Co-pay	Chester Retiree Plan With Most Retirees in it	PEBTF REHP Prescription Drug Plan (CVS Mail Order)	PEBTF REHP Prescription Drug Plan (Rite Aid Mail Order)
Generic Prescription (30-day supply)	\$1	\$15	\$15
Formulary Brand Drug (30-day supply)	\$3	\$40, plus difference between brand and generic, if one exists	\$40, plus difference between brand and generic, if one exists
Non-Formulary Brand Drug (30-day supply)	\$3	\$80, plus difference between brand and generic, if one exists	\$80, plus difference between brand and generic, if one exists
Generic Prescription (90-day supply)	\$1	\$22.50	\$30
Formulary Brand Drug (90-day supply)	\$3	\$60, plus difference between brand and generic, if one exists	\$80, plus difference between brand and generic, if one exists
Non-Formulary Brand Drug (90-day supply)	\$3	\$120, plus difference between brand and generic, if one exists	\$160, plus difference between brand and generic, if one exists

Why Monetize the Water System?



- Because it is the only asset that the City has that has the potential to raise enough money to address the pension and retiree health care liabilities that the City has
- Note: The City also has parking assets which are much lower in value. Prior to Receivership, the City entered into a contract to monetize those assets; however, the Receiver believes that contract is not in the best interests of the residents of Chester. The parking contract will be a subject of a future MFRAC presentation.

What Does the Recovery Plan Say About Monetization of the Water System?



- Initiative ASM01 of the Amended Recovery Plan states as follows:
 - The Receiver hereby directs the City to continuing litigating to repossess and sell the assets of the Chester Water Authority. Furthermore, subject to the next paragraph, the Receiver authorizes the City to continue with the RFP process (in compliance with any court order).
 - The City will consult with the Receiver regarding all material steps to be taken by the City with respect to the water system. The City must obtain the prior written consent of the Receiver prior to accepting a proposal under the RFP process and/or prior to consummating any transaction regarding the water system. The City must obtain the prior written consent of the Receiver prior to accepting any proposal related to the resolution of the outstanding litigation regarding the water system.

Bids Received by the City



- The City has received three bids for the water system
 - Pennsylvania American Water has bid \$425,000,000
 - Aqua America has bid \$410,000,000 including an \$11.8 million advance irrespective of the litigation outcome
 - The CWA itself has offered \$60,285,000



Independent Valuation of CWA

- Last year, the Receiver asked PFM Financial Advisors (“PFM”) to evaluate and compare the bids received by the City to purchase the CWA assets. PFM conducted its own independent analysis and due diligence of the proposals received without influence from any other party. PFM was not involved in the bidding process.
- PFM found that “based on commonly utilized valuation methodologies, PFM would expect CWA’s up-front fair market value to be in the range of \$385 million to \$400 million.” PFM notes that these values did not factor in a buyer’s additional strategic value multiplier. (PFM City of Chester Water System Bid Analysis. December 1, 2020)

Commonwealth Court Decision



- On September 16, 2021, an *en banc* panel of the Pennsylvania Commonwealth Court ruled that the City of Chester has the statutory ability to obtain the assets of the Chester Water Authority
- However, the Commonwealth Court also noted that, although it found that the City in general has the power to obtain the CWA's assets, it did not rule on the extent to which the City could actually exercise that power
 - This means that the litigation about whether the City can actually sell the water system will continue
 - The CWA has asked the Pennsylvania Supreme Court to hear the matter. The Pennsylvania Supreme Court has the discretion to decline to hear the matter, in which case the Commonwealth Court's decision will stand.

Receiver's Thoughts on Water System Monetization



- First, the Receiver recognizes that the City does not have any asset, other than the water system, that would come close to generating the level of proceeds that the City needs to address its severely underfunded retiree benefit liabilities. Consequently, the City must monetize the water system
- However, that does not mean that the water system needs to be privatized. The Receiver has no issue with the water system remaining in public hands if the City can receive a fair price for the system.
- In light of the Commonwealth Court's decision, the Receiver has directed his team to do its due diligence to see whether the City could receive a fair price for the water system while at the same time keeping it in public hands. The Receiver has not made a decision yet and will continue to keep all options on the table.



Thank you for your time.