

**SUSTAINABLE ENERGY FUND
OF CENTRAL EASTERN PENNSYLVANIA**
(As Established by the PUC-PP&L Utilities Settlement Agreement)
Docket # M-00031715 F0003 (Previously R-00973954)

Annual Report

To The

Pennsylvania Public Utility Commission

And To The

Joint Petitioners

**For the Period
July 1, 2003 – June 30, 2004**

October 26, 2004

**Sustainable Energy Fund
The Sovereign Building
609 Hamilton Street
Allentown, PA 18101
610-740-3182
610-740-9511 Fax**

**Email: TheFund@SustainableEnergyFund.org
www.sustainableenergyfund.org**

**Michael P. McFadden
Interim Executive and Managing Director**

TABLE OF CONTENTS:

	<u>Page</u>
1.0 Overview & Mission Progress	3
2.0 Accomplishments	
2.1 Program-Related Investments and Grants Commitments	3
2.2 Operation	6
2.3 Governance	6
3.0 Financial Reports	7
3.1 Income	8
3.2 Assets Management	9
3.3 Operating Expense	9
3.4 Program-Related Investments	10
3.5 Health of Balance Sheet	10
4.0 Next Steps	10

APPENDICES:

Appendix A: Board Membership	11
Appendix B: Independent Auditor's Report	Attached

Our mission is to promote, research, and invest in clean and renewable energy technologies, energy conservation, energy efficiency, and sustainable energy enterprises that provide opportunities and benefits for PPL ratepayers.

1.0 OVERVIEW ON MISSION PROGRESS

This is The Sustainable Energy Fund of Central Eastern Pennsylvania's (SEF) fourth annual report to the Pennsylvania Public Utility Commission (PUC) and to the Joint Petitioners in the PPL Utilities restructuring proceeding (Docket # M-00031715 F0003 Previously R-00973954). It discusses the progress that SEF has made in the period from July 1, 2003 through June 30, 2004.

Our impact can be measured by what we are doing to promote and invest in clean and renewable energy technologies, energy conservation and energy efficiency that provide opportunities and benefits for PPL ratepayers. As we complete our fourth year of operation, we continue to make significant progress.

Several specific areas are noteworthy:

- The Fund made several commitments to commercial livestock farms for agricultural bio digesters that will produce electricity. These efforts complemented grants awarded through the Department of Environmental Protection and the Department of Agriculture.
- The Fund continued its support of green and high performance energy buildings through financing assistance of construction projects. These green projects include a commercial building for an economic development authority and affordable residential housing for a housing authority.
- The Fund participated with other state funds in revising our commitments to a major wind farm development to include a passive tax equity model.
- The Fund continued to support clean and renewable energy education programs through continued grants to educational institutions and organizations.

2.0 ACCOMPLISHMENTS

2.1 Program-Related Investment and Grant Commitments

We received over 100 inquiries and/or financing requests during the subject period. Each financing request was reviewed by Staff against the Board-approved investment criteria. The investment criteria guidelines are presented on the web site www.SustainableEnergyFund.org. The status of all inquiries and requests is reported to the Board quarterly.

Inquiries are encouraged to submit financing requests. Financing requests that meet our investment criteria, fit the requirements of the Annual Plan, and are supported by available funding are presented to the Program Related Investment Committee for review and analysis. Financing requests approved by the Program Related Investment Committee are recommended to the full Board. The Board, either at quarterly meetings or by special session, makes the final decision on all grants and program-related investments.

During the subject period SEF made \$2,793,477 in commitments, of which \$123,477 were grants and \$2,670,000 were program-related investments.

▪ **Grants \$123,477**

- \$4,900 to **Community Basics** to expand an in depth analysis of the implementation of co-generation for a supplementary heat project in Lancaster.
- \$15,500 to **Eastern York School District** to purchase a wind turbine to provide hands-on instructional opportunities for high school students to learn about alternative energy systems.
- \$4,635 to **Green Building Conference** to support an annual conference held in Pittsburgh. SEF attended and participated at the conference.
- \$6,250 to **Kaufman Gamber Physical Therapy** to support their grid tied solar PV system.
- \$17,000 to **Hersheypark** for the development of the Sustainable Energy Green Team Theater production that accompanies the Renewable Energy Exhibit, partnered with equal contribution from PA DEP.
- \$20,639 to **Penn Future** to install a 3.8 kw solar pv system, an educational exhibit to explain the system and the importance of renewable energy.
- \$1,810 to **Penn Future** for an energy audit for Harrisburg offices.
- \$3,000 to **PFCA (CESA)**, a coalition of state, federal and international stationary fuel cell and hydrogen infrastructure programs, with a mission of accelerating the adoption and commercialization of stationary fuel cell technology and hydrogen infrastructure development.
- \$12,500 to **Twin Valley School District**, to pay the certification, registration and review fees to build a Leadership in Energy and Environmental Design (LEED) Silver rated middle school.
- \$11,310 to **Unitarian Universalist Church**, to support their church renovations by providing funding for the installation of sun tubes (skylights).
- \$6,500 to **Alternative Fuels Renewable Energies Council**, to support their annual conference on alternative fuels.

- \$10,000 to **Clean Energy Expo** to help showcase clean energy technologies, activities in clean energy development, and clean energy education. Staff and board attended and participated at the Expo.
- \$9,433 to **Clean Energy States Alliance** for our membership support to the nationwide alliance of state energy funds.
- **Program-Related Investments: \$2,670,000**
 - \$250,000 to **Community Energy, Inc.** for an equity commitment for investment in common stock of the company.
 - \$30,000 to **Oregon Dairy Farm** to support a dairy farm biodigester methane-to-electric generation project.
 - \$140,000 to **Pine Hurst Acres** to support a hog farm biodigester methane-to-electric generation project.
 - \$600,000 to **SEDA COG** to support the energy efficient renovations and build a 7,500 sq. ft. LEED certified building to house the Energy Resource Center.
 - \$100,000 to **Zimmerman Farms** to support a cattle farm biodigester methane-to-electric generation project.
 - \$300,000 to **Zimmerman Farms**, (revolving line of credit) to support the construction of a cattle farm biodigester methane-to-electric generation project.
 - \$1,000,000 to **Petersburg Commons** to support affordable “green” energy efficient units using LEED standards for a 14 single family attached townhouse dwelling.
 - \$250,000 to **Advantek** to purchase, install, and grid connect two 460 kilowatt wind turbines at Energy Unlimited Mountaintop wind farm across the state of PA.

There is some delay between Board commitments and cash disbursements as the legal documents are drafted, further negotiations are conducted, and project conditions are satisfied. Additionally, a recipient may choose to cancel or delay a project or finance it through other means. Most of our current-year commitments have not yet been disbursed.

From previous years’ commitments, the \$1,500,000 loan commitment to the Bear Creek Wind Farm, part of a \$4.5 million syndicated commitment among the Pennsylvania Funds, has not been yet disbursed. The Bear Creek Wind Farm project developed a financing structure that utilized a passive tax equity model that provided for two classes of ownership. After thorough study and research, our commitment was revised to reflect this change in financing structure. The passive tax investor class required the passage of federal production tax credit to complete the project. The passage of the tax credits occurred after this reporting period.

During the subject period, the Fund disbursed \$117,239 in grants and \$900,000 in program related investments for current and prior year commitments.

2.2 Operation

Several areas of SEF operations were enhanced during the year as follows:

- A Managing Director of Operations was employed. The MDO reviewed and modified financial operating procedures, improved insurance coverage, directed marketing activities, organized staff communications, introduced new employee performance reviews and began an upgrade of computer systems. The MDO also added to our due diligence by reviewing the financial quality of applications and existing loans.
- An Associate for Market and Program Development was employed. This associate developed a marketing plan, enhanced our website, revised brochures, prepared news releases and developed meetings with economic development personnel throughout the PPL territory.
- Gemstone Financial Associates was employed as a contractor to assist in due diligence preparations for program related investments.
- Mission metrics are compiled from each grant and loan recipient. Where applicable, financing recipients can report on dollars leveraged, new energy generated, energy conserved, direct and indirect jobs created, and individuals educated. These figures can be used to further study the impact of our program related investments. We are also compiling this information for projects completed in prior years.
- SEF hosted a meeting of state funds in Carlisle. SEF participated in meetings with the DEP Energy Advisory Board, U.S. Green Building International Conference and Expo, Penn Future, Pennsylvania Environmental Council and the Pennsylvania Energy Development Authority.
- SEF participated in meetings with the Pennsylvania Sustainable Energy Board. Staff assisted in the preparation of best practices for the PASEB.
- SEF has been a regular participant in CESA-Clean Energy States Alliance. Three employees attended the CESA national meeting in New Brunswick, New Jersey.

2.3 Governance

Within Pennsylvania, there are four regional Sustainable Energy Funds, each created by PUC order as a result of deregulation settlements for specific electric utilities, and their respective territories. The Boards of the three other Pennsylvania Funds, representing PECO, GPU (now First Energy), and West Penn Power, chose to contract their administration of their funds to existing institutions.

The SEF Board chose a more direct and active form of involvement by recruiting an Executive Director and building its own staff and organization. Our organization model places a greater burden of involvement on our Directors.

During the year, the Board studied and reviewed operations and structure. These efforts led to a number of recommended changes to operating procedures. As a result of this review, we enhanced programs in the following areas:

- The organization document was updated and improved.
- The program related investment process was standardized.
- The contractor process was modified.
- Investment policies were reviewed and changed.
- An audit committee charter was developed.
- Conflict of interest policies were revised.
- Performance Review and Goals were established.
- Employee performance reviews procedures were established.

The Board of Directors was also involved in an extensive annual planning process. The Board employed an outside facilitator who met with board members, stakeholders and staff to assist in developing goals and objectives for the SEF. The planning process culminated with a two day planning meeting in Grantville, Pa.

The Board of Directors reviewed Director selection procedures and adopted new processes for Director selection. Mr. Marcus Sheffer resigned from the Board effective December 31, 2003 during the program year.

Our Board met ten times during the subject period and conducted an additional 14 Committee meetings. Board members continued to be actively involved in representing the Fund at various related meetings such as the PASEB and Penn Future Conferences.

Our Board clearly takes its responsibilities seriously and is actively involved in direction and oversight of the SEF. We are fortunate to have a diverse, fully involved Board and are grateful for all they do.

3.0 FINANCIAL REPORTS

The SEF completed its fourth full year of operations with over \$16 million in net assets and an additional \$3 million in ratepayer income. Beginning this year, we reported program related investments committed and not disbursed. That figure was \$4,450,000 for the reporting period ending June 30, 2004.

The results of our financial activities and balance sheet for this reporting year are presented below. Further details are presented in the Independent Auditors Report, Appendix B.

3.1 Income

PPL Ratepayers

As ordered by the PUC, we receive a monthly transfer of money from PPL, as a system benefit charge, dependent on electric usage during the prior month. During the subject period we received \$3,405,695.

Royalties and Interest Payments from Program-Related Investments

We are a non-profit foundation organized in accordance with section 501(c)(3) of the Internal Revenue code. As such, our program-related investments are focused on our charitable mission of assisting in the creation of a sustainable energy environment, with financial reward not the prime purpose. Our financial reward expectations and “deal structure” must be more favorable to the recipient than normal commercial terms.

Additionally, we attempt to structure investments so that we may “recycle” funds to other worthy applicants. Our term structures favor short term over long-term transactions. We will consider delaying payments to the end of the term to give the recipient greater internal cash flow in early stages. The terms of each deal are structured to balance the needs of the specific project with that of the greater good, all to accomplish our sustainable energy market development mission.

Early-stage companies that have received the Fund’s investments have experienced cash flow and other operational difficulties. These challenges are not unusual for early-stage entities and often reflect problems associated with unpredictable governmental regulations for energy businesses. We have worked with these companies through such problematic periods.

During the subject year, our royalty and dividend payments received were \$22,500, and our interest payments received from program related investments were \$57,884.

Leveraging the Funds of Others

Our intent is to jump-start the marketplace development of sustainable energy within PPL’s territory and the Commonwealth. Two key objectives include leveraging additional, external funds into projects and reducing project hurdles so that a project with marginal financial returns can be approved. Our stated objective is to push “*but for us*” projects.

In these areas, it is difficult to measure our market impact, but we understand its importance. We continue to invest time and effort in projects in which our involvement and our willingness to finance often provides confidence for other financial organizations to proceed.

Many of our program-related investments leverage other funding. Grant and loan recipients for this reporting period reported receiving outside funds of \$3,641,560 in addition to the funds provided by us.

3.2 Asset Management

For portfolio planning purposes, our “assets” fall into four categories as follows:

- Interest-bearing cash in bank, which we use to meet operating costs and program-related investment commitments, as well as to build reserves.
- PPL ratepayers’ commitment, which we recognize as a positive attribute in our portfolio planning.
- Program-related investments, which are mission-oriented and carry a higher risk profile than would be found in a commercial portfolio.
- An investment portfolio of marketable debt and equity securities, managed by two professional investment managers.

Our Finance Committee continues to monitor the results of our two professional investment managers in relationship to our Investment Policy to insure that investment selections reflect policy guidelines. The Fund utilizes investment filters and has developed a restricted list of corporations to avoid those investments that compromise the Fund’s mission.

The combination of a strong cash position, monthly income from the ratepayers, and an untapped \$750,000 line of credit at Wachovia are deemed adequate to meet our currently planned operating costs and program-related investments. The Fund was approved for a \$2,000,000 line of credit through U.S. Trust arranged by Charles Schwab and Co.

At period end, invested securities are valued at \$12,514,535. Investment return was \$1,409,481. This figure represents investment income and net gains less fees.

3.3 Operating Expenses

At the October 2003 Annual Meeting, the SEF Board approved an annual budget of \$867,101 for the year ended June 30, 2004. This included both program costs and management and general expenses. Actual operating expenses for the period were \$669,839 and under budget. Of this amount, \$314,060 was for management and general expenses.

3.4 Program-Related Investments

As reported in section in Section 2.1, during the year SEF made program-related investment commitments of \$2,793,477.

3.5 Health of Balance Sheet

The SEF completed the year with net assets of \$16,303,436.

At the end of the year, cash and equivalents and accrued PPL income totaled \$2,135,978. We judged this level of cash necessary and adequate to support our commitments, not yet disbursed. As of June 30, 2004 commitments for program related investments not yet disbursed were \$4,450,000.

Total liabilities were \$146,340.

4.0 NEXT STEPS

The SEF is at its critical development stage. Our funding has been ordered by the PUC through December 2004.

In March 2004, PPL submitted a proposed rate filing to the Public Utility Commission, which included a proposal for continued funding for the Sustainable Energy Fund. SEF participated in the rate proceeding in support of continued funding and retained legal counsel, Thomas, Thomas, Armstrong, and Niesen to represent it in the renewal case. The Board also discussed any potential conflict of interest among Staff and Board Members. Three Board Members recognized a potential conflict of interest and recused themselves from renewal deliberations.

Success in renewal ensures our continuance and mission fulfillment. Without renewal, the board will have to reexamine its plan objectives.

SEF has enjoyed support from many parties and we are optimistic that funding will be renewed. Our efforts to build internal operations will permit SEF to meet opportunities and demands in the future. We believe that we will make a significant contribution to the sustainable energy marketplace in the future.

Appendix A

Board Membership (June 30, 2004)

<p>Eric J. Epstein Board Secretary and Treasurer Chair, Finance and Audit Committee (Board President through April 29, 2004) EFMR Monitoring Group 4100 Hillsdale Road Harrisburg, PA 17712-1419</p>	<p>Andrew McElwaine Member, Human Resource Committee PA Environmental Council 130 Locust St., Suite 200 Harrisburg, PA 17101</p>
<p>Vacancy (Marcus Sheffer resigned December 2003)</p>	<p>Arthur Morris Chair, Human Resource Committee Member, Finance and Investment and Audit Committees Utilities Solutions 222 West Orange Street Lancaster, PA 17603</p>
<p>Gary F. Lamont Board President (Board Secretary & Treasurer through April 29, 2004) Member Finance and Audit Committees, Ex officio member of Investment and Human Resource Committees Conyngham Pass SR93, P.O. Box 702 Conyngham, PA 18219-1170</p>	<p>Brian C. Nagle Chair, Investment Committee Representative to PASEB Member, Human Resource Committee PPL, Services Corporation Two North Ninth St. GENTW17 Allentown, PA 18101-1170</p>
<p>Craig C. Onori Board Vice President Member, Investment and Finance Committees AGERE Systems Room 12B 155 1110 American Parkway NE Allentown, PA 18109</p>	

