

# MUNICIPAL FUNDING RESOURCE GUIDE



**SEPTEMBER 2003  
ALLEGHENY COUNTY, PENNSYLVANIA**

This guide was initiated by the Finance Advisory Panel of 3 Rivers Wet Weather Demonstration Program. It is intended as a basic guide for municipalities facing the cost of assessment, evaluation and repair of their sewage collection systems. The objective of the Finance Advisory Panel was to compile information about sources of funding into a single document, thereby simplifying the initial research process.

3 Rivers Wet Weather wishes to acknowledge and thank the members of the Finance Advisory Panel sub-committee, listed on pages 28-29.

3 Rivers Wet Weather Demonstration Program • 3901 Penn Avenue • Building 3 • Pittsburgh, PA 15224 • 412.578.8375

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## *Forward*

Wet weather sewage overflow problems have long plagued the Allegheny County region and have been under the scrutiny of U.S. Environmental Protection Agency (EPA) officials since 1995 when flow monitoring was required of the sanitary sewer communities within the ALCOSAN service area. In February 2002, EPA proposed a non-traditional enforcement approach—municipal consent orders, one designed for combined sewer communities and another for separate sanitary communities, which do not include penalties for past and current violations of the Clean Water Act and the Clean Streams Law.

The municipalities will be able to sign or decline the municipal consent order approach; if signed the orders require a thorough assessment and evaluation of the municipal sewage collection systems and repair of areas discovered to be in danger of collapse or severely restricting flow. Since April 2002, the municipal engineers, solicitors and other representatives have been working with agency representatives to craft agreements that are feasible and cost-effective while meeting the objectives of the regulatory agencies.

The Allegheny County Health Department and the Pennsylvania Department of Environmental Protection (DEP) will enforce and oversee the process locally. The assessment and evaluation activities will include televising, mapping, dye testing, flow monitoring and hydraulic evaluation. Municipalities will be financially responsible for conducting the assessment, evaluation and critical repairs, which for many communities could represent a significant portion of their budget.

The data gathered through the assessments will be the basis for developing long-term capital improvement strategies to bring the region into compliance with federal and state regulations. The nature and scope of the future capital projects is as yet unclear. But it is certain that their collective cost will represent the largest countywide investment in infrastructure improvement since the planning and construction of the Pittsburgh International Airport.

The 3RWWDP Finance Advisory Panel offers this second edition of the “Municipal Funding Resource Guide” as a resource for municipal and authority officials. The individuals who developed this guide are listed on pages 28 and 29; each is a source of additional information and will be glad to answer your questions. We at 3 Rivers thank them for their continued support.

Resolving the wet weather sewage management issues will require cooperative efforts at all levels of government. Together with the staffs of the funding organizations referenced in the guide, the 3RWWDP team looks forward to working with municipalities and authorities to achieve cost-effective, long-term improvements in their communities.

Sincerely,

John Schombert  
Executive Director  
3 Rivers Wet Weather Demonstration Program

William Youngblood  
Chair  
3RWWDP Finance Advisory Panel

## ***About 3 Rivers Wet Weather Demonstration Program***

The 3 Rivers Wet Weather Demonstration Program (3RWWDP) is a non-profit organization created in 1998 to work with the municipalities and authorities within the Allegheny County Sanitary Authority (ALCOSAN) service area to address the region's aging and deteriorating sewer infrastructure. 3RWWDP was created through the efforts of the Allegheny County Health Department (ACHD) and ALCOSAN.

As of 2003, 3RWWDP has provided financial assistance to 33 municipal projects, many of them involving numerous municipalities. These sub-grant projects have ranged from rehabilitation of house laterals using trenchless technologies; parallel replacement of sanitary sewer lines and converting the existing sanitary sewer to a storm sewer; updating inter-municipal maintenance agreements; and, the technical and financial process necessary for a municipality to transfer ownership of its sewage collection infrastructure to an authority. The common objective of the sub-grant projects is to benchmark and develop sustainable, regional solutions to the wet weather sewage overflow problem.

3RWWDP has expanded the scope of its assistance to municipalities to include a GPS/mapping project, program management of the assessment and rehabilitation activities related to the municipal consent orders, and data management of the information gathered through the orders. The assessment activities required by the municipal consent orders from the ACHD and the Pennsylvania Department of Environmental Protection (DEP) will result in a wealth of data being gathered in a consistent useable format by the municipalities that choose to sign the orders. 3RWWDP will assemble this data into a “data warehouse” to ensure it is available to all entities as they collaborate on regional, long-term solutions.

As a stakeholder-based organization, 3RWWDP has convened a Stakeholders’ Committee, four Advisory Panels, three Basin Groups, three Basin Engineer Groups and three Basin Manager Groups. These groups continue to meet regularly to collaborate on the wet weather sewage management issues from many perspectives. The hundreds of individuals that generously give of their time to participate in meetings and workshops are moving the region forward by removing an obstacle—deteriorated, and malfunctioning sewers—to the continued growth and prosperity of the region.

**“Collaboration is the Key to Success.”**

## ***Overview***

Municipalities planning to address sewage and stormwater management projects may choose from a number of funding sources to finance their projects. Applicable to all stages of project activity from diagnosis through actual construction, financial support may be obtained from a variety of public and private sector agencies and organizations - some established specifically to assist with infrastructure improvements. Depending on such applicant distinctions as municipality size, financial condition and economic status of customers served, available funding forms range from grants and loan guarantees to a full menu of more conventional financing practices.

System owners frequently combine multiple sources and fund types to meet their project objectives. Typically, the process involves exhausting government-related options before considering more costly financing arrangements with the private sector, where a hierarchy of choices exists as well.

A comprehensive review of sewage and stormwater project funding sources, public and private, follows this overview. The review contains core information on the sources' service scope and availability as well as application requirements and procedures.

## ***Government-Related Funding Sources***

The sources included in this section share a number of common purposes, although they represent various government levels and observe specifically defined funding guidelines. Consequently, their representatives are in frequent contact and they often cooperate in their support of infrastructure improvement projects.

### ***Allegheny County Authority for Improvements in Municipalities (AIM)***

*Service Scope:* Loans to all Allegheny county municipalities, authorities and Councils of Governments for improvements to sanitary sewer, stormwater and drinking water systems.

*Funding Terms:* Loan amounts typically capped at \$75,000 at below-market rates and term durations not to exceed five years. Eligible costs include engineering, legal and construction services, and may include such annual system maintenance activities such as flow monitoring, dye testing and the like.

*Applications available from and submitted to:*

Allegheny County Department of Economic Development  
425 Sixth Avenue, Suite 800  
Pittsburgh, PA 15219

Phone: (412) 350-1000

Fax: (412) 642-2217

[www.county.allegheny.pa.us](http://www.county.allegheny.pa.us)

## ***Allegheny County Community Development Block Grants (CDBG)***

*Service Scope:* Grants to all Allegheny county municipalities, authorities, Councils of Governments and non-profit organizations for the construction, reconstruction or rehabilitation of sewage, drinking water and stormwater control systems, (excluding Penn Hills, McDonald, Trafford and the cities of Pittsburgh and McKeesport\*).

Diagnostic activity normally lies outside the funding scope of CDBG programs. However, specific to support of the EPA proposed administrative consent orders, CDBG funding will be available to certain eligible Allegheny County municipalities. Eligible costs will be activities required by the orders, such as sewer line cleaning and televising, flow monitoring, dye testing and other measures to evaluate system performance.

*Funding Terms:* Grant funding, typically limited to 65 percent of project construction costs with a 35-percent local match, usually does not exceed \$250,000. Applicants must demonstrate that, of the population principally benefiting from their projects, at least 42.7 percent are persons of low to moderate income. Projects undertaken to benefit an entire community must meet census tract eligibility criteria regarding low and moderate-income population levels. Matching fund requirements may be met from other grant and loan sources.

*Applications available from and submitted to:*

Allegheny County Department of Economic Development  
425 Sixth Avenue, Suite 800  
Pittsburgh, PA 15219

Phone: (412) 350-1000

Fax: (412) 642-2217

[www.county.allegheny.pa.us](http://www.county.allegheny.pa.us)

Pre-applications are accepted during May of each year. Applicants advised that they have met eligibility criteria submit full applications by the August deadline of the same year. Funding becomes available for successful applicants during the following March, and funded projects must begin - and the allocated funds spent - during the designated program year. Applications are also available at Councils of Governments offices. Municipalities located outside of Allegheny County should contact their respective county governments for CDBG application information.

*\* Pittsburgh, McKeesport and Penn Hills each operates its own block grant programs. McDonald and Trafford officials should apply to Washington and Westmoreland counties, respectively.*

## ***Improvement Program of Allegheny County (IMPAC)***

*Service Scope:* Home improvement loans to Allegheny County home owners to repair or prevent a problem, or to increase the dwelling's attractiveness and living quality. Residents of Pittsburgh, McKeesport, Penn Hills, McDonald and Trafford are not eligible for IMPAC funding but may apply to similar programs established to serve those communities.

*Funding Terms:* Providing that certain eligibility requirements are met, the program applies to owners of one- or two-unit residential properties within the county. Maximum loan amounts are \$20,000 for a one-unit household and \$25,000 if a second unit is involved. Currently set at three percent, the interest rate remains fixed throughout the loan term, which cannot exceed five years. Approved loan purposes span a variety of interior and exterior improvements. They include energy-related and general property enhancements, sanitary sewage lateral work, tap-in fees, and stormwater drainage, roof, gutter and downspout improvements.

In addition to residency and loan purpose requirements, IMPAC imposes income restrictions to determine applicant qualification. Based on number of dwelling occupants, the maximum annual income allowances range from \$27,400 for a one-person household to \$45,400 for a six-person household. The income restrictions represent a calculation of 80 percent of median household income, countywide.

*Applications available from and submitted to:*

Allegheny County Department of Economic Development  
425 Sixth Avenue, Suite 800  
Pittsburgh, PA 15219

Phone: (412) 350-1000

Fax: (412) 642-2217

[www.county.allegheny.pa.us](http://www.county.allegheny.pa.us)

### ***United States Department of Agriculture Rural Utilities Service (RUS)***

*Service Scope:* Loans, guaranteed loans and grants for water, sewer, stormwater and solid waste disposal facilities in rural areas and municipalities with populations of up to 10,000 people. Service areas that contain 10,000 or fewer people but are located within more heavily populated municipalities also are eligible for RUS support.

*Funding Terms:* Applicants must be public entities, defined by RUS as ranging from counties and municipalities to non-profit corporations capable of demonstrating that they are unable to obtain funding from commercial sources at reasonable rates and terms. Additionally, they must possess the legal capacity to borrow, repay and pledge security for loans; have the legal authority to operate and maintain the facilities the funding will support; and ensure that the facilities proposed are consistent with any state, county, municipal or multi-jurisdictional development plan that may be in place for the project's location. Further, all facilities to be built or enhanced must comply with federal, state and local laws, most specifically those involving zoning regulations, health and sanitation standards, and water pollution control.

Grants may be provided when necessary to reduce user costs to a reasonable level, and may be awarded in an amount up to 75 percent of eligible facility development costs dependent upon the service area's median household income and project need. Funds supplied by RUS may be used to acquire needed land, water sources and rights, and to pay legal, engineering and other costs necessary to develop the facilities proposed. More commonly, funding is applied to construct, repair, modify, expand or otherwise improve water supply and distribution systems and waste collection and treatment systems, including those addressing stormwater drainage and solid waste disposal. Certain other costs related to facility development also may be eligible under the

agency's funding guidelines. Projects undertaken to assess the effectiveness of existing systems are not immediately eligible for funding. However, the costs of diagnostic activity may be included in subsequent applications covering projects required to remedy the problems determined during the diagnostic phase.

As of 2003, a grant is now available to assist in paying costs associated with development of an application for a proposed water or wastewater project. Documents such as Preliminary Engineering Reports and Environmental Reports are required prior to having funds committed for a project. Predevelopment Planning Grant funds can be used to help pay for these costs. Grants are limited to \$15,000 or 75% of the project cost, whichever is less.

Project selection criteria will include:

- Limited resources;
- Small systems with low incomes; and,
- Funding availability.

Eligible pre-development items funded must be agreed to and accepted by Rural Development prior to disbursement of the Grant. Other eligibility requirements and guidelines for these grants include:

- The Median Household Income (MHI) of the service area must be either below poverty level or below 80% of states' MHI.
- The proposed project must be for eligible loan and grant purposes.
- Applicants must show they do not have resources to pay redevelopment expenses on their own.
- Grants are limited to projects the Agency expects to fund soon after the application is submitted.

Direct loan terms permit a maximum repayment period of 40 years. However, the repayment period cannot exceed either the useful operating life of the improvement financed or any statutory limitation governing the applicant's borrowing authority. Set periodically based on an index of current market yields for municipal obligations, three interest rates are employed to calculate loan repayment. They are the poverty rate, the market rate, and intermediate rate. The poverty rate, currently 4.5 percent, applies when:

- The loan's primary purpose is to build or upgrade facilities necessary to meet applicable health and sanitation standards.
- The median household income (MHI) of the service area is below the poverty line for a family of four as defined in Section 673 (2) of the Community Services Block Grant Act.
- The median household income is below 80 percent of the Statewide Non-metropolitan MHI (SNMHI).

Governing loans for projects in service areas where the MHI exceeds the SNMHI, the market rate is established quarterly based on the average of an 11-bond index over the four-week period immediately prior to the start of the quarter. An intermediate rate is applied to loans that do not meet the criteria for either the poverty or market rates. It is calculated at the poverty rate plus half of the difference between the poverty and market rates. In no case, however, will the intermediate rate exceed seven percent. The most current rates are available on the RUS Water

and Environmental Programs website page at [www.usda.gov/rus/water/](http://www.usda.gov/rus/water/). Borrowers of RUS funds may choose from the interest rate in effect on the date of loan approval or on the closing date of the loan transaction. Loans are secured by bonds or notes pledging taxes, assessments or revenues if they meet statutory requirements.

In addition to the RUS direct loan/grant program described above, guaranteed loans are also available through local conventional lenders. RUS ordinarily protects the lender from losses up to 80 percent of the borrowed amount. A 90-percent guarantee may be issued in unusual circumstances, as determined by RUS. In any event, lenders pay a one-percent fee for the guarantee protection and are permitted to pass along that cost to the loan recipient. Rates and terms vary with guaranteed lender.

*For Allegheny, Cambria, Fayette, Greene, Somerset, Washington and Westmoreland counties, applications for either the direct loan/grant or guaranteed loan programs are available from and should be submitted to:*

Barbara J. McMillen  
Rural Development Specialist  
USDA, Rural Development  
Donohoe Center, Donohoe Road  
Greensburg, PA 15601

Phone: (724) 853-5555, Ext. 123

Fax: (724) 832-9721

[www.usda.gov/rus/water](http://www.usda.gov/rus/water)

*For Armstrong, Beaver, Butler, Clarion, Clearfield, Elk, Indiana, Jefferson and Lawrence Counties:*

Lambert M. Rosenbaum  
Rural Development Specialist  
USDA, Rural Development  
602 Evans City Road, Suite 101  
Butler, PA 16001-8701

Phone: (724) 482-4800, Ext. 116

[www.usda.gov/rus/water/](http://www.usda.gov/rus/water/)

## ***United States Department of Agriculture Rural Housing Service (RHS)***

### ***Section 502 Direct Loans***

One of the authorized loan purposes of Section 502 Direct Rural Housing loans is to provide an adequate and safe water supply and/or sewage disposal facility for dwellings located in designated rural areas of a county. The applicant must be under the low and very-low income limit for the area where the property is located. Income limits vary based on household size and county. Applicants should contact the office serving their county for income limits and

designation of rural areas. To be eligible for a Section 502 loan, the following requirements must be met:

- The applicant's adjusted income at the time of loan approval does not exceed the applicable income limit.
- The applicant (and co-applicant, if applicable) has adequate and dependable available income. Such income must be sufficient to meet the income ratios, including any eligible payment assistance the applicant is qualified to receive.
- The applicant must be able to repay the loan; repayment capacity is determined by established income ratios.
- The applicant must have an acceptable credit history, must be a citizen of the United States or be a legally admitted alien, and must have the legal capacity to incur the debt.
- The applicant must personally occupy the dwelling following the purchase.

### ***Section 504 Repair Loans and Grants***

The purpose is to provide assistance to very low-income owners of modest single-family homes in rural areas for home improvements to remove health and safety hazards or to make a home accessible for household members with disabilities. Eligibility criteria include ensuring adequate and safe water supply and/or sewage disposal for dwellings located in designated rural areas of a county. Applicants should contact the office serving their county for income limits and designation of rural areas.

### ***Section 504 Loan***

Applicants must have household incomes below the very-low income limits listed on the web site and provide evidence of repayment ability for the amount requested. The outstanding loan balance may not exceed \$20,000. The loan interest rate is one percent, with a maximum term of 20 years. The duration of the term is determined by the borrower's ability to repay. Mortgages are required on loans in excess of \$7,500.

### ***Section 504 Grant***

Available to very low-income homeowners 62 and older who are unable to repay a loan. The applicant must be unable to repay a 504 loan financed over 20 years. A combination of loan and grant funds may be used. The maximum lifetime grant amount is \$7,500. Signed at closing, grant agreements stipulate that if the home repaired with grant funds is sold within three years of the grant approval, the full amount of the grant will be repaid.

A number of eligibility requirements must be met for 504 loan and grant consideration:

- The applicant's credit history indicates a reasonable ability and willingness to meet financial obligations. There is no charge for a credit report.
- The applicant's liquid assets are considered and may affect the loan or grant amount available.
- Applicants must show a dependable source of income sufficient to repay the loan.

- The property must be owned and occupied by the applicant, with documentation of ownership applied. The property must be modest in size and design, and cannot contain an in-ground swimming pool.

Applicants with an outstanding federal judgment will not be determined eligible for a loan or a grant.

*For applicants from Allegheny, Armstrong, Beaver, Butler, Crawford, Erie, Fayette, Forest, Greene, Indiana, Lawrence, Mercer, Washington, Westmoreland, Venango counties, applications for either of the 502 or 504 programs are available from and should be submitted to:*

Barry E. Miller  
USDA Rural Development  
602 Evans City Road, Suite 101  
Butler, PA 16001-8701

Phone: (724) 482-4800, Ext. 110  
[www.usda.gov/rus/water/](http://www.usda.gov/rus/water/)

### ***Pennsylvania Infrastructure Investment Authority (PENNVEST)***

*Service Scope:* Low-interest loans and supplemental grants to sewer, water and stormwater system owners and operators for infrastructure improvements. Eligible to apply are those individuals, corporations, partnerships, associations, municipal authorities and governmental units having legal and financial responsibility for the system throughout the funding period. Municipalities not directly owning or operating a system or facility may sponsor an application for assistance by providing guarantees that first, the loan will be repaid and, second, that the project will be completed and operated competently and professionally. For stormwater projects, PENNVEST funding is available for counties or municipalities only.

*Funding Terms:* Applicants will be required to demonstrate that PENNVEST's assistance will enhance the health, safety or economic position of occupants of the project's service area and, also, that their projects will result in an effective or complete long-term solution to the problems they address.

In considering its funding decisions, the PENNVEST board also examines:

- The cost-effectiveness of a proposed project relative to financial and technological alternatives.
- The project's compatibility with other state and regional resource management and economic development plans.
- The applicant's demonstrated capacity to operate and maintain the project properly.
- The availability of other funding sources at reasonable rates and the need for PENNVEST's assistance in securing that support.
- The effect of project funding sources on user rates.

- The socio-economic status of the project's service area.
- Any detrimental impact the project could have on air, land and water quality or on historic or aesthetic values.

Finally, the PENNVEST board will review the adequacy and efficiency of proposed projects by considering the extent that:

- The project advances facility regionalization or system consolidation to improve sewage and stormwater control.
- The project involves the participation of multiple government units.

Most PENNVEST loans have a term of 20 years and carry interest rates from one to four percent, fixed for the term of the loan. Beyond basic project expenditures for publicly owned facilities, eligible costs include payments for feasibility and planning studies (unless eligible for DEP 537 planning funding), project design and engineering, and certain administrative and financial reporting expenses. Funding for property acquisition is limited to drinking water projects only. Mirroring the RUS policy on diagnostic activity, PENNVEST will not fund system maintenance as a stand-alone project. However, like RUS, the agency will consider funding diagnostic work retroactively as part of follow-on rehabilitation projects undertaken by the system owner.

Grants will be considered only when the PENNVEST Board determines that the applicant's financial condition indicates that loan repayment is unlikely. In the event that a grant is awarded, the Board will attempt to combine it with loan funds that must be repaid. Total project funding is capped at \$11 million per project, rising to \$20 million if more than one municipality is served. With Board approval, that amount may be increased if a project involves a regional facility serving four or more municipalities.

*Applications available from and submitted to:*

Pennsylvania Infrastructure Investment Authority  
22 South Third Street  
Harrisburg, PA 17101

Phone: (717) 783-6798

Fax: (717) 787-0804

[www.pennvest.state.pa.us](http://www.pennvest.state.pa.us)

## ***Department of Community and Economic Development (DCED)***

### ***Shared Municipal Services Program***

*Service Scope:* Grants to groups of two or more municipalities acting in concert to defray the cost of any local government function. Newly formed Councils of Governments or similar organizations established to undertake programs of inter-municipal cooperation may also receive grant funds to defray the cost of initial administrative expenses.

*Funding Terms:* Excepting the purchase, construction or renovation of buildings, virtually all municipal operations are eligible for grant consideration. Projects funded range from shared administrative improvements to public works and code enforcement projects undertaken by two

or more municipalities or an umbrella group formed for cooperative progress. Grant funds from an annual statewide pool of approximately \$1 million are used to finance up to 50 percent of the total cost, with the local share provided in cash or by labor or other in-kind contribution. Projects submitted for grant consideration will be evaluated by applying such selection criteria as overall quality; potential for cost savings; level of local commitment; funding adequacy; and the applicant's performance following receipt of previous funding awards. Projects to benefit municipalities identified by DCED as disadvantaged will be considered in that context.

*Applications available from and submitted to:*

Governor's Center for Local Government Services  
413 State Office Building  
300 Liberty Avenue  
Pittsburgh, PA 15222  
Phone: (412) 565-5002  
[www.inventpa.com](http://www.inventpa.com)

## ***Private Funding Sources***

Municipalities seeking funds for infrastructure improvements must apply informed disciplined debt management practices to maintain their financial health. Project limits, for example, are framed by such internal restraints as realistic projections of revenues available for loan repayment and also by the need to protect a sufficiently strong credit rating to preserve the capacity for future borrowing. External limits exist as well. A variety of state and local statutes clearly stipulate the conditions under which loan and bond activity can occur. Those limitations aside, adequate funding remains available.

By combining the governmental sources cited previously with those operating in the private sector, prospective owners, operators and sponsors of new sewage and stormwater management projects should be able to address even their most challenging wet weather sewage overflow problems in a timely fashion.

### ***Bank Loans***

Available typically through the Public Finance or Government Banking departments of commercial banks, bank loans are prevalent at lower borrowing levels - usually involving loan amounts of less than \$2 million with repayment schedules up to 15 years at fixed and variable rates of interest. When the borrower qualifies as tax-exempt, which is normally the case with municipalities and authorities, the transaction is generally assigned a tax-exempt rate. Still, funding of this nature obligates borrowers to higher interest rates than would apply to bond-financed projects. Reduced origination costs, together with the absence of bond-related expenses for underwriting and certain other consultant and administrative services, however, represents a clear cost advantage favoring the loan option for smaller-sized projects. Non-arbitrage compliance and rebate requirements are the responsibility of the borrower. As with all forms of borrowing, the credit rating of the borrower is a determining factor in the level of interest established for the transaction.

## ***Tax-Exempt Bond Financing***

Bond financing is a form of borrowing involving the issuance of interest-bearing certificates for sale to prospective investors and is recommended for most private funding initiatives of \$2 million or more and requiring longer terms, up to 40 years. Issuing options relate closely to the proposed project's size and to the nature and financial position of the borrowing entity. Systems owners with taxing power, for example, are authorized to issue general obligation bonds to fund their projects. Secured by the capacity to raise taxes or user fees to meet payment obligations, this class of bonds is capable of attracting investors at lower costs to the borrower. The appeal of general obligation bonds as a financing instrument is offset, to some degree, by stipulations governing their use. Their issuance may require voter and/or legislative approval and, given the existence of state-established debt limits for most governmental units, the issuance of bonds for other purposes may be substantially reduced.

Many system enhancement projects requiring private sector support, therefore, are funded through the issuance of revenue bonds. This instrument provides that a specific portion of system revenue be assigned to meet principal and interest obligations to bond-buying investors. Because they lack the additional security of pledged taxes, revenue bonds could increase borrowing costs by paying slightly higher interest rates than do general obligation bonds. The issuance costs attendant to the two bond types are roughly equal. Both processes require the assistance of professional consultants, printing and distribution expenses and other general administrative costs.

Bond issuance also requires decisions regarding maturity date, rate type and repayment structure, including prepayment options. Issue length usually ranges from 10 to 30 years. The period can be longer or shorter but in no case should extend beyond the average life of the project being financed. Issuers also may elect from fixed rate or variable rate bonds. Establishing fixed rate yields is recommended for financings of less than \$20 million. For financings above the \$20 million threshold, variable rate bonds are a viable alternative. Most bond financings adopt a fixed-rate mode, either directly or through application of a swap transaction, permitting municipalities to budget their future debt service obligations with certainty. Adding the variable rate option can produce significant reductions in the cost of borrowing, but should be employed only with the assistance of an experienced and qualified underwriter or financial advisor.

Regarding repayment, the most common structure employed is the level-debt service bond. Comparable to a fixed rate home mortgage, level-debt service results in equal annual payments over the life of the issue. Thus, in the early years of the financing when interest payments are at their highest level, principal payments are lowest. As the principal balance decreases over time, interest payments decrease and principal payments rise accordingly to maintain the annual obligation at a fixed level.

When the bond issuer has other, perhaps burdensome issues outstanding, an alternative debt service structure should be considered. Aptly named as wrap-around debt service, the alternative structure essentially "wraps" new debt around existing principal and interest obligations to minimize payments during those years when the impact of new financing on existing debt is highest. In effect, the election of a wrap-around service structure creates a level-debt situation. There is one significant distinction, however. The wrap-around approach requires the deferring of a portion of principal payments to later years, resulting in higher interest costs - and increased debt service payments - over the life of the issue. Before pursuing a wrap-around structure, bond issuers, with the assistance of the underwriter or financial advisor, should consider the impact of additional interest costs versus the benefits of a level payment structure.

All tax-exempt bond issuers - general obligation and revenue, for amounts greater than \$2 million - are encouraged to consider loans from bond pools as a source for all or part of their financing. Bond pools contain funds created from tax-exempt revenue bonds issued for the purpose of subsequent third-party borrowing for capital projects. Pool loans have no application fee, feature standardized documents to lower issuance costs, offer lower interest rates and flexible terms, and can permit projects to progress more rapidly by providing variable rate start-up financing that may be converted to fixed rate permanent financing, without incurring duplicative issuance costs. Pool loans generally require the credit enhancement of bond insurance or a letter of credit from a qualified bank.

A dedicated bond pool or simultaneous issuance providing for the combined funding needs of a number of municipalities or authorities may be considered for the cost saving efficiencies. Each borrower would stand on its own credit worthiness while benefiting from the economies of scale and enhanced flexibility of this type of structure.

All bond activity is likely to require specialized professional assistance to meet issue requirements and maximize funding returns. A qualified and experienced underwriter routinely provides these services as part of the scope of their engagement.

*Potential bond financing participants include:*

*Bond Counsel* - A bond counsel is an attorney who specializes in public borrowing and provides issue-specific legal services, including the rendering of the tax-exempt opinion.

*Financial Advisor* - The financial advisor provides consultant services across a wide range of bond activities, including issue structure, timing, terms, the negotiated-versus-competitive sales decision and interface with the underwriter. Financial advisors may be board members or employees of the bond-issuing organization, or may be recruited from a variety of professional backgrounds, including investment and commercial banking as well as law, accounting and investment counseling firms.

*Trustee or Paying Agent* - The trustee or paying agent is usually a bank or trust company designated by the issuer. Serving as the official representative of bondholders, the trustee's role is defined in the document governing the issue and normally includes the collection of funds and distribution to bondholders.

*Underwriter* - The underwriter is an investment banking firm purchasing bond or note issues for resale to other dealers and investors. In negotiated underwritings, the service scope often includes taking the leadership role in structuring and securing a rating for the issue, assisting with the preparation of all authorizing and offering documents, and distributing the securities. In competitive underwriting, the scope is normally limited to distribution with the other services being performed by the financial advisor, for additional fees.

Municipalities and authorities planning bond financings may obtain a comprehensive listing of locally based consultants by reviewing the Pennsylvania section of the Bond Buyer Red Book, a nationally published directory of bond-related financial and professional firms.

## ***Frequently Asked Questions***

### ***What is debt management?***

Debt management consists of the policies and procedures followed when incurring debt and establishing the funding structure to meet debt service requirements. The process necessarily involves planning, budgeting, accounting, financial reporting and effective community relations. Its objective is to enable municipalities and authorities to address their capital and operating requirements in a timely, cost-effective manner while also preserving their ability to borrow for future needs at reasonable costs.

### ***When should a municipal government borrow?***

Debt for capital projects should be incurred only when those projects will return value to the community throughout the term of the debt. This guideline represents an equitable approach to matching costs incurred with benefits generated. State law limits the life of a debt issue to 40 years or the stated useful life of the project being funded, whichever is shorter.

### ***What about grants?***

In most instances, 100-percent grants are not available. However, capital grants may be obtained at the county, state or federal level, but their accompanying requirements should be examined closely. Local matching provisions and other requirements can be burdensome to the point that grant compliance costs outweigh the benefits received.

### ***Can funding sources be combined?***

Combining funding sources is the most practical route to meeting project needs, depending on eligibility guidelines and funding cycles established by governmental sources. Municipalities planning long-term remedies for facing sewage and stormwater problems, in fact, qualify as applicants for virtually all funding forms and are encouraged to explore all available options to finance their projects.

As noted, the process typically begins with public sector agencies before considering more costly arrangements with private lenders and investors. As an example, a community completed the installation of a 27,000-foot, 8-inch separate sanitary sewer line, three manholes and a pumping station, and funded its \$774,000 project with substantial public sector support:

Local	Tap-in Fees	\$ 55,350
County	CDBG	\$ 250,000
State	DCED	\$ 50,000
Federal	RUS loan	\$ 270,000
Federal	RUS grant	\$ 148,750
	<b><i>Total</i></b>	<b><i>\$ 774,100</i></b>

### ***How much funding will I need to comply with the EPA administrative consent orders?***

Initially, the activity to be financed is largely diagnostic in nature, with any actual system improvement resulting from the spot repair of identified critical problems. While the cost to individual municipalities will vary with system size and problem frequency, an estimate of the range of projected expenses is available. A municipality should expect diagnostic and repair costs to approximate from \$15,000 to \$28,000 for each mile of sewer line in its system. Some communities in Allegheny County operate only a mile or two of sewer lines within their municipal boundaries while larger communities may be responsible for 200 miles or more of sewer lines. These larger communities may face initial-phase costs ranging from \$3 million to \$6 million.

### ***How much should I borrow?***

While financing decisions for capital improvements are largely project-specific, consideration also must be given to outstanding debt obligations already in place. As noted previously, clear limits on municipal debt levels have been established by the state. Maintaining future borrowing flexibility is an objective of any sound debt management strategy. The simplistic answer, then, is that the amount financed should not exceed the borrower's ability to meet debt service payments. For government officials, that calculation must include attention to their community's tolerance for any increase in taxes or user rates that project funding might require.

### ***We've made the decision to borrow. What is the next step?***

Because borrowing costs are a priority in evaluating funding options, begin by exploring public sector opportunities. Some government-based sources, for example, include grants and loan guarantees in their funding programs. And they may offer competitive interest rates and origination charges when authorizing loans. For most municipalities, private sector financing represents an alternative or complementary option to government-sourced funding.

### ***For the private-sector borrowing component, are there any rule-of-thumb guidelines?***

When funding projects requiring third party financing of \$2 million or less, fixed-rate, short-term bank loans are recommended. The process is straightforward. Origination costs are clearly determined and repayment schedules, typically spanning five or fewer years, can be budgeted with certainty. For private sector borrowing in excess of \$2 million, bond financing is recommended.

### ***What is Bond Financing?***

Bond financing is a form of borrowing involving the issuance of securities to be sold in the municipal market. Bond maturity dates may be established for up to 30 years or longer, depending on the operating life of the improvement being financed.

### ***How do I begin the bond financing process?***

The process typically begins with the designation of an underwriter or financial advisor and the subsequent assembly of the remaining members of the issuer's consulting team. That professional will provide guidance throughout the process, i.e., structuring the issue, establishing its terms and duration, selecting the professional participants, and managing the interaction of all parties involved. The financial advisor can be a municipal employee, authority board member or

other qualified representative of the bond-issuing organization. More frequently, however, the role is filled by a qualified underwriter, or assigned to a paid consultant possessing the qualifications and experience to manage a successful, cost-effective issue transaction.

***The discussion of private-sector funding sources suggests combining pool loans with bond financing. What is a pool loan?***

A bond pool is formed with funds generated through the sale of bonds issued by municipalities or authorities specifically for the purpose of third-party borrowing for capital projects. These structures can be variable or fixed rate and generally provide issuers with a highly flexible financial tool. Qualified borrowers, for example, may invest loaned funds at higher rates of return until they are actually required to meet project costs. Professional consultants provide guidance on the timing and extent of bond pool usage as part of an overall funding strategy.

***When grant awards require a local match, must the contribution come from funds on hand?***

Many grant sources prescribe no limitation on funding sources for the local share permitting the match to be sourced from existing reserves or other grants or loans from public or private sector organizations. To ensure compliance with any exceptions to this general guideline, recipients are advised to review provisions for local match funding established by the grant making organization. For example, the local match requirement of 3RWWDP grants must be from other than federal sources.

***Where can I get more information about the funding process?***

The agencies and organizations represented by the members of 3RWWDP Finance Advisory Panel that helped produce this Guide are excellent sources of information and practical support. See page 28-29 for a complete list.

## ***Glossary***

Terms and references contained in this glossary may not appear elsewhere in the guide; they are included because they are likely to be encountered during the project financing process.

***AIM*** - Allegheny County Authority for Improvements in Municipalities

***ACHD*** - Allegheny County Health Department

***ALCOSAN*** - Allegheny County Sanitary Authority

***CDBG*** - Community Development Block Grants

***PENNVEST*** - Pennsylvania Infrastructure Development Authority

***RUS*** - Rural Utilities Service, United States Department of Agriculture

***USDA*** - United States Department of Agriculture

***3RWDP*** - The 3 Rivers Wet Weather Demonstration Program

***Accrued Interest*** - Interest earned on a security but not yet paid, calculated from the later of the last coupon payment date or the dated date.

***Ad Valorem Tax*** - A tax based on the value or assessed value of property.

***Basis Point*** - One basis point is equal to .0001 percent. Yields on tax-exempt securities are usually quoted in increments of basis points.

***Basis Price*** - The price of a security when expressed in yield or percentage of return to a certain date.

***Bond*** - An interest-bearing security that promises to pay a specified sum of money - the principal amount - due on a specific date.

***Bond Anticipation Note*** - Securities issued to obtain interim financing for projects that will eventually be funded through the sale of a long-term bond issue.

***Bond Buyer Indices*** - A series of indices, published by "The Bond Buyer," indicating composite yields for representative issues of a similar nature.

***Bond Funds*** - Registered investment companies whose assets are invested in diversified portfolios of bonds.

***Bond Insurance*** - A type of credit enhancement device that is activated in the event that an issuer is unable to make any debt service payment or payments when due to investors. Bond insurance, usually provided by an insurance company or a syndicate of insurance companies, is obtained at the time of bond issuance and is purchased with a single premium payment.

***Bond/Note Proceeds*** - The amount received by an issuer, net of premium, discount or accrued interest, if any, and less an underwriter's spread/discount.

***Bondholders' Lien*** - A legal right acquired by bondholders, pursuant to a bond resolution or indenture, against certain property, income or both, of an issuer as security for payments of principal or interest as they become due.

**Bond Resolution** - Actions of a governing body of state or local government, or agency thereof, authorizing bonds to be issued.

**Broker** - A firm that functions in the secondary market by buying from and selling to securities firms, but not to the general public or to institutions, without assuming a risk position itself.

**Callable Bonds** - Bonds that are redeemable by the issuer prior to the specified maturity date at a specified price at or above par.

**Capitalizing Interest** - In connection with new project financing issues, the practice of providing funds from bond or note proceeds for all or a portion of the interest payments to be due to investors or lenders on those securities during the construction period.

**Closing** - In connection with new issues, the date on which the provisions of the purchase contract are executed; principally, the issuer delivers the securities to the underwriter or syndicate representative and receives the proceeds there from.

**Competitive Underwriting** - A sale of securities by an issuer in which underwriters or syndicates of underwriters submit sealed bids to purchase these securities at a specified price.

**Confirmation** - A written document confirming an oral transaction in tax-exempt securities that provides pertinent information to the buyer or seller concerning the securities and the terms of the transaction.

**Cost of Issuance** - In connection with a new issue of securities those costs to be paid by the issuer, which are directly related to such borrowing. Such costs typically include solicitor and bond counsel fees, credit enhancement charges, printing costs for the securities and the offering statements, rating agency fees, etc.

**Coupon** - The part of a bond that denotes the rate of interest due; coupons are generally payable semi-annually.

**Credit Enhancement Device** - Any device or mechanism designed to provide a supplementary source for payment of debt service in the event such payments are unable to be made by an issuer from sources legally available for such purpose.

**Current Yield** - The ratio of interest to the actual market price of a bond, stated as a percentage. For example, a \$1,000 bond that pays \$80 per year in interest and whose current market price is \$90 would have a current yield of 8.9 percent.

**Dated Date** - The date of a bond issue from which the bondholder is entitled to receive interest.

**Debt Limit** - The statutory or constitutional maximum debt that a particular issuer can legally incur.

**Debt Service** - The payment required for interest on and/or repayment of the principal amount of debt outstanding.

**Defeasance** - The act or process by which debt is deemed paid or satisfied and is no longer an obligation of the issuer. General obligation debt is considered defeased only when the principal and interest due is actually paid. Revenue bonds issued pursuant to an indenture are deemed defeased when the issuer satisfies the obligation in accordance with the terms of the indenture. Ordinarily, an issuer may defease the indenture obligation by irrevocably depositing (escrow)

with the trustees cash and securities, most often government securities, that will produce a cash flow sufficient to provide for all future interest and principal payments, when due.

**Denomination** - The face amount, or par value, of a security that the issuer is obligated to pay on the maturity date. Most municipal bonds are issued in a minimum denomination of \$5,000, although a few older issues are available in \$1,000 denominations.

**Discount** - The amount by which the market price of a security is less than the face amount or par value.

**Double-Barreled Bond** - A bond secured by the pledge of two or more sources of repayment, such as the unlimited taxing power of the issuer as well as revenues generated by a particular user charge.

**Double Exemption** - Securities that are exempt from state as well as federal income taxes are said to have double exemption.

**Full Faith and Credit** - A pledge of the general taxing power for the payment of debt obligations. Bonds carrying such pledges are usually referred to as general obligation bonds or full faith and credit bonds.

**Good Faith Deposit** - A deposit pursuant to a purchase agreement between an issuer and a purchasing underwriter or syndicate of underwriters, representing a small part of the proceeds due the issuer with the balance due at the closing.

**Interest** - Compensation paid or to be paid for the use of money. Interest is generally expressed as an annual percentage rate.

**Issue** - All of the securities comprising any one specific borrowing of an issuer pursuant to the same bond resolution or indenture and which have the same dated date although maturities and initial yields may vary.

**Issuer** - A state, political subdivision, agency, or authority that borrows money through the sale of tax-exempt bonds or notes.

**Letter of Credit** - A commercial credit instrument used as a type of credit enhancement device which is activated in the event that an issuer of securities is unable to make any debt service payment or payments when due from funds legally available for such purpose, under the provisions of the Bond Resolution or Indenture. Letters of Credit are usually provided by rated lending institutions to issuers for the benefit of investors. They are acquired at the time the bonds are issued, with fees typically billed quarterly over the life of the bonds.

**Limited Tax Bond** - A bond secured by a pledge of a tax or category of taxes limited as to rate or amount.

**Market Window** - A temporary condition in the tax-exempt note or bond market, usually of very limited time duration, during which new issues may be sold at a yield less than that which generally prevailed directly before or directly after such period.

**Marketability** - A measure of the ease with which a security can be sold or resold in either the primary or the secondary market.

**Moral Obligation Bond** - A type of municipal security that is not backed by the full faith and credit of a state, but for which state law provides that the state may replenish the issue's debt

service reserve fund if necessary. This pledge is considered evidence of good intention, but is not legally binding.

***Negotiated Underwriting*** - A sale of tax-exempt securities in which the issuer of municipal securities chooses one underwriter or a group of underwriters to sell its bonds and negotiates the price it will receive for such securities.

***Net Debt*** - Total direct debt of a municipality less all self-supporting debt, any sinking funds, tax anticipation notes and revenue anticipation notes outstanding.

***Net Interest Cost*** - A method of calculating the interest cost to an issuer for new issues of tax-exempt securities which represents the total interest paid to investors over the life of the issue expressed as a percentage against the weighted average of principal outstanding. Net interest cost, however, does not take into account the time value of money.

***Net to the Underwriters*** - That portion of the underwriter's discount or spread which represents compensation to all the members of a syndicate in direct proportion to their participation in the underwriting.

***Nominal Yield*** - The ratio of interest to the par or face amount of a bond, stated as a percentage. For example, a \$1,000 bond that pays \$80 a year in interest would have a nominal yield of eight percent.

***Non-Callable Bond*** - A bond that cannot be called for redemption by or at the option of the issuer before its specified maturity date.

***Note*** - An interest-bearing security, which promises to pay a specified sum of money, the principal amount, due on a specific date. A note differs from a bond in that the term of the loan is shorter, typically five years or less, and the source for repayment of principal is often some source of future revenue or the proceeds of another loan such as bonds.

***Notice of Sale*** - An official document disseminated by an issuer of municipal securities that gives pertinent information regarding an upcoming bond issue and invites bids from prospective underwriters. Such notice must be in full conformity with state law and federal securities requirements.

***Offering Price*** - The price at which members of an underwriting syndicate for a new issue will sell securities to investors or the price at which any owner of a security will sell that security.

***Optional Call Date*** - A provision placed in the structure of a bond issue to provide an opportunity to redeem all or a portion of the outstanding bonds.

***Order Period*** - In connection with the issuance of new securities, a specific time period established by the lead managing underwriter during which prospective purchasers may enter orders to buy varying quantities of the issue at the price set with delivery on a "when issued" basis. Such orders are subject to later possible price changes and are contingent upon execution of a purchase contract between the issuer and the underwriters.

***Overlapping Debt*** - That portion of the debt of other government units for which residents of a particular municipality are responsible, usually, for services or facilities shared by several municipalities.

***Par Value*** - The principal amount of a bond or note to be due at maturity, usually expressed as 100 regardless of face value.

**Participation** - With regards to the issuance of tax-exempt securities purchased by a syndicate of underwriters, the proportion or percentage of the total issue size for which each member of the syndicate assumes liability.

**Premium** - The amount by which the market price of a security exceeds its face amount or par value.

**Pricing** - A process whereby an underwriter or group of underwriters determine the price at which each maturity comprising a new issue of securities shall be offered to the market. Such determination is normally based upon current market conditions and the particular merits of the securities involved.

**Primary Market** - The market in which issues of tax-exempt bonds or notes are sold at the time of their issuance.

**Principal** - The face amount of a bond payable at maturity and exclusive of accrued interest.

**Purchase Agreement** - A contract between an issuer of securities and an underwriter or syndicate of underwriters defining the price and all terms and conditions under which the underwriter(s) purchase the securities from the issuer.

**Put (Option Tender) Bond** - A "put" or "option tender" bond is one in which the bondholder has the right to sell the bond at par to the trustee prior to its stated maturity. How soon after issuance and over what period of time or how often the bondholder may tender the bond is defined by the terms of each issue. Usually, put bonds are backed by either a commercial bank or other rated institutional letters of credit in addition to the issuer's pledged revenues.

**Rating Agencies** - Agencies whose professional standards are generally recognized and accepted by the investment community and which standards measure the relative safety against default or credit quality for any given issue of securities. The best known and most widely accepted of such agencies are Moody's Investors Service and Standard & Poor's Corporation.

**Ratings** - The designations assigned by rating agencies to communicate the agencies' opinion of the relative credit quality and safety against default for given issues of securities.

**Refunding** - A system by which an existing, outstanding bond issue is redeemed with the proceeds of a new bond issue under conditions generally more favorable to the issuer. Such refunding must be accomplished under the terms established in the original contract with the existing bondholders. Also called advance refundings or defeasance.

**Registered Bond** - A bond whose owner is registered with the issuer or its agents, either as to both principal and interest or as to principal only. Transfer of ownership can be accomplished only when the securities are properly endorsed by the registered owner. Effective July 1, 1983, all new issues of tax-exempt bonds must be in registered form.

**Remarketing Agent** - A dealer in securities whose function is to resell securities "put" or tendered to an issuer through its trustee when such puts are legally exercised by the then owners of such securities.

**Revenue Anticipation Notes** - Securities issued in anticipation of other sources of future revenue, typically federal or state aid.

**Secondary Market** - The resale market for municipal securities, which after the end of the primary or new issue stage, is governed by current supply and demand.

**Self-Supporting or Self-Liquidating Debt** - Debt incurred for a project or enterprise requiring no tax support other than the specific tax or revenue source earmarked for that purpose.

**Selling Group** - A group of dealers formed by an underwriter to distribute a given issue of securities whose members incur no liability to accept any portion of such securities in the event they cannot be sold - as opposed to a syndicate in which each member does accept such a liability.

**Serial Bond** - A bond of an issue that has maturities scheduled annually or semi-annually over a period of years.

**Special Tax Bond** - Bonds secured by a special tax, such as a gasoline tax.

**Subordinate Debt** - Debt of an issuer, represented by notes or bonds, the security for which, a lien on property, income or both, is conditional upon all rights accruing to holders of another outstanding class of debt having been first fully satisfied.

**Syndicate** - A group of investment bankers or commercial banks who buys - underwrites - a new issue from the issuer and offers it for resale to investors, taking a market risk in the course of the transaction.

**Takedown** - The discount from the offering price allowed to a member of an underwriting account on any bonds he/she sells.

**Tax Anticipation Note** - Securities issued by states or municipalities to finance current operations in anticipation of future tax receipts.

**Tax Base** - The total property and resources subject to taxation.

**Tax-Exempt Lease** - A lease in which the lessee is a municipality or other political subdivision thereof, as defined by statute, and therefore the interest or financing cost portion of the lease payments are exempt from federal income tax to the lessor or lessors.

**Technical Default** - A failure by an issuer of securities to comply with its obligations as contained in the contract with the owners of the securities other than a failure to pay interest and/or principal when due.

**Term Bond** - A bond of a particular issue whose maturity is usually its largest and longest and which is gradually redeemed through the action of a sinking fund.

**Total Bonded Debt** - Total general obligation debt issued by a municipality, regardless of the purpose.

**Total Debt** - The sum of the total bonded debt and any unfunded debt of a municipality.

**Triple Exemption** - Securities that are exempt from city and state as well as federal income taxes are said to have triple exemption.

**True Interest Cost** - A method of calculating the interest cost to an issuer for new issues of tax-exempt securities as is done in a Net Interest Cost calculation but which also takes into consideration the time value of money.

***Underwriter Counsel*** - An attorney, familiar with securities law, engaged by an underwriter, to advise such underwriter as to its rights and obligations in connection with a specific issuance of securities it purchases or intends to purchase directly from an issuer.

***Unlimited Tax Bond*** - A bond secured by the pledge of taxes that are not limited by rate or amount.

***Yield*** - Generally, the investment return on a security.

***Yield Curve*** - A graphed line representing, at any given point in time, the yields on securities of the same general class or type but with different maturities ranging from the shortest to the longest. A normal yield curve would show lower yields on short-term maturities curving upwards towards long maturities. An inverted yield curve would show the opposite. A flat yield curve would show relatively little difference in yield regardless of maturity.

***Yield to Maturity*** - A yield concept designed to give the investor the average annual return on a security. It is based on the assumption that the security is held to maturity and that all interest received over the life of the security can be reinvested at the same yield. It also takes into account any premium over par or discount from par on the purchase price of the security.

***Municipal Funding Guide  
Finance Advisory Panel Committee***

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