

SADSBURY TOWNSHIP
Management Discussion and Analysis
December 31, 2016

DEBT ADMINISTRATION

As of January 1, 2016, the Township had total outstanding principal on notes of \$2,989,000. During the year, the Township made payments against principal in the amount of \$244,000, resulting in ending outstanding debt, as of December 31, 2016, of \$2,745,000.

Debt Service Schedule
December 31, 2016

	<u>Principal Outstanding Jan. 1, 2016</u>	<u>Additions</u>	<u>Payments</u>	<u>Principal Outstanding Dec. 31, 2016</u>
Guaranteed Sewer Revenue Note Series 1998	\$ 672,000	\$	\$ 49,000	\$ 623,000
Guaranteed Sewer Revenue Note Series 2003	1,773,000		194,000	\$ 1,579,000
Guaranteed Sewer Revenue Note Series 2009	<u>544,000</u>		<u>1,000</u>	<u>543,000</u>
	<u>\$ 2,989,000</u>	<u>\$</u>	<u>\$ 244,000</u>	<u>\$ 2,745,000</u>

More detailed information about our long-term liabilities is included in the Notes to the Financial Statements.

THE TOWNSHIP'S FUTURE

The Township expects to experience growth in the next five years as the economy improves.

FINANCIAL MANAGEMENT

Our financial report is designed to provide our citizens, taxpayers, investors, and creditors with a general overview of the Township's finances and to show the Board's accountability for the money it receives. If you have questions about this report or wish to request additional financial information, please contact Linda Shank, Assistant Secretary/Assistant Treasurer at the Township office.

SADSBURY TOWNSHIP
Notes to Financial Statements
December 31, 2016

Interest Rate Risk

The Township has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The Township has no interest rate risk.

Credit Risk

The Township has no investment policy that would limit its investment choices to certain credit ratings.

Concentration of Credit Risk

The Township places no limit on the amount that the Township may invest in any one issuer.

7. DEBT OBLIGATIONS

Following is a summary of changes in debt obligations for the year ended December 31, 2016:

(See next page)

SADSBURY TOWNSHIP
Notes to Financial Statements
December 31, 2016

Description	Amount Outstanding 1/1/2016	Additions Current Year	Retired Current Year	Amount Outstanding 12/31/2016
<u>1998 Guaranteed Sewer Revenue Note</u> The original issue amount of \$975,000 had a fixed interest rate of 4.584%. Beginning September 2006, the note bears interest at a fixed rate of 4.25%.	\$ 449,000	\$	\$ 33,000	\$ 416,000
<u>1998 Guaranteed Sewer Revenue Note</u> The original issue amount of \$405,000 had a variable weekly interest rate based on the Municipal Swap index as set by the Bond Market Association. This rate cannot exceed 25% per annum. The average rate was 3.35%. Beginning September 2006, the note bears interest at a fixed rate of 4.045%.	223,000		16,000	207,000
<u>2003 Guaranteed Sewer Revenue Notes Series A</u> The original issue amount of \$2,123,000 had a variable weekly interest rate based on the Municipal Swap Index as set by the Bond Market Association. This rate cannot exceed 15% per annum. The average rate was 3.37%. Beginning September 2006, the note bears interest at a fixed rate of 3.979%.	396,000		194,000	202,000
<u>2003 Guaranteed Sewer Revenue Notes Series B</u> The original issue amount of \$1,377,000 had a variable weekly interest rate based on the Municipal Swap Index as set by the Bond Market Association. This rate cannot exceed 15% per annum. The average rate was 3.37%. Beginning September 2006, the note bears interest at a fixed rate of 3.979%.	1,377,000			1,377,000
<u>2009 Guaranteed Sewer Revenue Notes Series A-1</u> The original issue amount of \$8,000 had a variable weekly interest rate based on the Municipal Swap Index as set by the Securities Industry and Financial Market Association. This rate cannot exceed 15% per annum. The average rate was 1.210%.	2,000		1,000	1,000
<u>2009 Guaranteed Sewer Revenue Notes Series A-2</u> The original issue amount of \$542,000 had a variable weekly interest rate based on the Municipal Swap Index as set by the Securities Industry and Financial Market Association. This rate cannot exceed 15% per annum. The average rate was 1.210%.	542,000			542,000
Total Debt Obligations	\$ 2,989,000	\$	\$ 244,000	\$ 2,745,000

SADSBURY TOWNSHIP
Notes to Financial Statements
December 31, 2016

The Township can prepay the Guaranteed Sewer Revenue Notes—the Series of 1998, and both Series A and B of 2003, and both Series A-1 and A-2 of 2009 subject to paying the costs associated with the liquidation of the notes.

The Guaranteed Sewer Revenue Notes—Series of 1998, both Series A and B of 2003, and both Series A-1 and A-2 of 2009—are secured by the revenue base of the sewer system and by the full faith, credit, and taxing powers of the Township.

Interest expense was \$111,581 for the year ended December 31, 2016.

The amounts of future annual principal and interest payments on debt outstanding, assuming a variable rate of 4% for the 2009 notes, as of December 31, 2016, for each of the next five years and in the aggregate are as follows:

Year Ending December 31,	Principal	Interest	Total
2017	\$ 254,000	\$ 107,383	\$ 361,383
2018	263,000	96,899	359,899
2019	273,000	86,029	359,029
2020	284,000	74,798	358,798
2021	296,000	62,980	358,980
2022-2026	1,149,000	150,626	1,299,626
2027-2028	226,000	8,972	234,972
	<u>\$ 2,745,000</u>	<u>\$ 587,687</u>	<u>\$ 3,332,687</u>

Proceeds from tax-exempt bonds issued after September 1, 1986, are subject to the 1986 Tax Reform Act. The Township invests, records, and reports these proceeds in the manner set forth by the U.S. Treasury and Internal Revenue Service to maintain the tax-exempt status of the bonds at December 31, 2016. There are no arbitrage liabilities. The Township is in compliance with provisions of all note agreements.

The Township issued the Guaranteed Sewer Revenue Notes, 1998 A and B Series, the Guaranteed Sewer Revenue Notes, 2003 A and B Series, and the Guaranteed Sewer Revenue Notes, 2009 Series to the Delaware Valley Regional Finance Authority ("DelVal") to evidence its obligations for loans from DelVal. Under the terms of the Loan Agreements, the Township pays interest on the loans sufficient to pay its allocable share of DelVal's bond debt service, interest rate swaps (including termination costs), and administrative costs.

DelVal has entered into interest rate swap transactions to hedge its exposure to changing market conditions, to minimize the costs to provide loans, and to minimize fixed and variable loan rates. All DelVal loans are initially variable rate, and all loans are allocated a notional amount, equal to the outstanding principal of the loans, of DelVal interest rate swaps under which DelVal pays a variable rate to its Counterparty. These are programmatic swap agreements that would only be terminated if the DelVal Loan Program were being collapsed. DelVal provides a fixed rate loan if requested by a borrower by entering into an offsetting swap transaction under which DelVal pays a fixed rate. This offsetting transaction is entirely allocable to the fixed rate borrower. The offsetting transaction would only be terminated if the fixed rate borrower requested the termination (to prepay its loan or to reset the interest rate), the fixed rate borrower defaulted on its payment obligations, or the DelVal Loan Program were collapsed.

SADSBURY TOWNSHIP
Notes to Financial Statements
December 31, 2016

INTEREST RATE SWAP - SERIES OF 1998 GUARANTEED SEWER REVENUE NOTES A

Objective of the interest rate swap - The Township issued the \$975,000 Series of 1998. Guaranteed Sewer Revenue Notes to DelVal to minimize its costs of issuance and to take advantage of the ability to set the Notes at a variable rate or a fixed rate. The Notes were converted to a fixed rate in 2006.

Terms - The Township's obligations for the allocable notional amounts of the DelVal swap agreements are scheduled to terminate on September 25, 2026. The allocable notional amount equals the Notes balance outstanding. Currently, under the Loan Agreement, the Township pays DelVal a fixed rate of 4.25% plus a spread of 40 basis points.

Fair Value - The allocable portion of DelVal's variable rate swap had a positive fair value of \$58,681 at December 31, 2016. The fixed rate swap allocable to the Township had a negative fair value of \$61,200 at December 31, 2016. The fair value was derived from proprietary models based upon well recognized financial principals and reasonable estimates about relevant future market conditions.

Credit risk - As of December 31, 2016, the Township was exposed to credit risk because the swaps had a combined negative fair value. The Township is exposed to credit risk in the amount of the derivatives fair value if the DelVal Loan Program is collapsed, the Township elects to prepay the Notes or to reset the interest rate on the Notes, or the Township defaults on its payment obligations. DelVal was rated A1 by Moody's Investors Service and A+ Standard and Poor's as of December 31, 2016.

Basis risk - The Township does not have any basis risk under the allocable DelVal swap agreements.

INTEREST RATE SWAP SERIES OF 1998 GUARANTEED SEWER REVENUE NOTES B

Objective of the interest rate swap - The Township issued the \$405,000 Series of 1998. Guaranteed Sewer Revenue Notes to DelVal to minimize its costs of issuance and to take advantage of the ability to set the Notes at a variable rate or a fixed rate. The Notes were converted to a fixed rate in 2006.

Terms - The Township's obligations for the allocable notional amounts of the DelVal swap agreements are scheduled to terminate on September 25, 2026. The allocable notional amount equals the Notes balance outstanding. Currently, under the Loan Agreement, the Township pays DelVal a fixed rate of 4.045% plus a spread of 40 basis points.

Fair Value - The allocable portion of DelVal's variable rate swap had a positive fair value of \$29,200 at December 31, 2016. The fixed rate swap allocable to the Township had a negative fair value of \$24,682 at December 31, 2016. The fair value was derived from proprietary models based upon well recognized financial principals and reasonable estimates about relevant future market conditions.

SADSBURY TOWNSHIP
Notes to Financial Statements
December 31, 2016

Credit risk - As of December 31, 2016, the Township was not exposed to credit risk because the swaps had a combined positive fair value. The Township is exposed to credit risk in the amount of the derivatives fair value if the DelVal Loan Program is collapsed, the Township elects to prepay the Notes or to reset the interest rate on the Notes, or the Township defaults on its payment obligations. DelVal was rated A1 by Moody's Investors Service and A+ Standard and Poor's as of December 31, 2016.

Basis risk - The Township does not have any basis risk under the allocable DelVal swap agreements.

INTEREST RATE SWAP - SERIES OF 2003 GUARANTEED SEWER REVENUE NOTES A AND B

Objective of the interest rate swap - The Township issued the \$3,500,000 Series of 2003, Guaranteed Sewer Revenue Notes to DelVal to minimize its costs of issuance and to take advantage of the ability to set the Notes at a variable rate or a fixed rate. The Notes were converted to a fixed rate in 2006.

Terms - The Township's obligations for the allocable notional amounts of the DelVal swap agreements are scheduled to terminate on June 25, 2023. The allocable notional amount equals the Notes balance outstanding. Currently, under the Loan Agreement, the Township pays DelVal a fixed rate of 3.979% plus a spread of 40 basis points.

Fair Value - The allocable portion of DelVal's variable rate swap had a positive fair value of \$222,736 at December 31, 2016. The fixed rate swap allocable to the Township had a negative fair value of \$134,168 at December 31, 2016. The fair value was derived from proprietary models based upon well recognized financial principals and reasonable estimates about relevant future market conditions.

Credit risk - As of December 31, 2016, the Township was not exposed to credit risk because the swaps had a combined positive fair value. The Township is exposed to credit risk in the amount of the derivatives fair value if the DelVal Loan Program is collapsed, the Township elects to prepay the Notes or to reset the interest rate on the Notes, or the Township defaults on its payment obligations. DelVal was rated A1 by Moody's Investors Service and A+ Standard and Poor's as of December 31, 2016.

Basis risk - The Township does not have any basis risk under the allocable DelVal swap agreements.

INTEREST RATE SWAP - SERIES OF 2009 GUARANTEED SEWER REVENUE NOTES

Objective of the interest rate swap - The Township issued the \$550,000 Series of 2009, Guaranteed Sewer Revenue Notes to DelVal to minimize its costs of issuance and to take advantage of the ability to set the Notes at a variable rate or a fixed rate. The Notes were issued at a variable rate.

Terms - The Township's obligations for the allocable notional amounts of the DelVal swap agreements are scheduled to terminate on June 25, 2023. The allocable notional amount equals the Notes balance outstanding. At December 31, 2016, the variable interest rate was 1.253%.

SADSBURY TOWNSHIP
Notes to Financial Statements
December 31, 2016

Fair value - The allocable portion of DelVal's variable rate swap had a positive fair value of \$76,596 at December 31, 2016. The fair value was derived from proprietary models based upon well recognized financial principals and reasonable estimates about relevant future market conditions.

Credit risk - As of December 31, 2016, the Township had no credit risk because the variable rate swap had a positive fair value. DelVal was rated A1 by Moody's Investors Service and A+ Standard and Poor's as of December 31, 2016.

Basis risk - The Township does not have any basis risk under the allocable DelVal swap agreements.

8. JOINT SEWER AGREEMENTS

PENNSYLVANIA-AMERICAN WATER COMPANY (FORMERLY CITY OF COATESVILLE AUTHORITY)

Under an agreement dated July 7, 1997, the Pennsylvania-American Water Company (formerly City of Coatesville Authority) agreed to provide sewage conveyance and treatment capacity of 410,750 gallons per day to Sadsbury Township. The Pennsylvania-American Water Company constructed facilities needed for the additional sewage conveyance and financed this project by issuing bonds. This agreement expires thirty years from the effective date. Either party may terminate this agreement upon giving five years written notice. The Township is responsible for the design, financing, and construction of the sewer lines and pumping stations located within the Township.

For this service, the Township is paying the Pennsylvania-American Water Company's standard, published rates for sewage conveyance on a monthly basis.

In addition, the Township has reimbursed the Pennsylvania-American Water Company its pro rata share of capacity fees and conveyance costs associated with the Township's connection to the system. The Township will also reimburse the Pennsylvania-American Water Company for the pro rata share of the Pennsylvania-American Water Company's bond interest directly attributable to the construction of facilities related to the additional system. These charges are being paid on a per connection basis. At December 31, 2016, prepaid expense was \$40,063 for conveyance costs and \$26,775 for capacity fees.

Under an agreement dated September 16, 2003, two developments located in West Caln Township agreed to connect to the Sadsbury Township system to have their sewage conveyed to the facility owned by the Pennsylvania-American Water Company. Pennsylvania-American Water Company has agreed to construct a force main to carry flows of 110,000 gallons per day from these two developments to the Township's sewage conveyance system. For this service, the two developments agree to pay to the Township connection fees of \$2,319 per equivalent dwelling unit of which the Township will reimburse \$1,178 per equivalent dwelling unit to Sadsbury Sewer Corporation, as discussed below. In addition, the two developments agreed to pay in advance \$26,000 as a sewage conveyance fee for the period beginning September 16, 2003, and ending December 31, 2006. Beginning January 1, 2007, the Township will charge for sewage conveyance on a quarterly basis on a formula contained in the agreement. Sewage fees were \$14,501 for the year ended December 31, 2016. The two developments and Pennsylvania-American Water Company agreed to reimburse the Township for all expenses incurred relating to this agreement.