

REQUEST FOR PROPOSALS
FOR
WHOLESALE ELECTRIC SUPPLY
FOR THE
BOROUGH OF MIDDLETOWN, MIDDLETOWN, PENNSYLVANIA

ISSUE DATE: May 3, 2019

INITIAL SUBMISSION DUE DATE: May 30, 2019

ISSUED BY:
BOROUGH OF MIDDLETOWN PUBLIC WORKS

60 West Emaus Street
Middletown, PA 17057

1. INTRODUCTION

The Borough of Middletown ("Borough"), requests proposals to provide wholesale energy, capacity, transmission, ancillary services, and scheduling services for Middletown. The Borough is issuing this Request for Proposals ("RFP") to solicit proposals from potential respondents ("Respondents") to meet the Borough's electric generation supply requirements.

The Borough is a municipal electric utility, serving approximately 3,888 residential, commercial, and industrial electric customers located in Middletown, Pennsylvania. The Borough seeks an arrangement by which its supplier provides fixed-price and firm energy, capacity, transmission and ancillary services to meet the portion of the Borough's load that is not met by other resources to which the Borough is contractually entitled during the applicable term ("Partial Requirements Service").

Through this RFP, the Borough looks to secure a contract for Partial Requirements Service, as described above, for a 36-month or 72-month term commencing January 1, 2022. The Respondent should treat Network Integrated Transmission Service ("NITS") and capacity as "pass-throughs" of actual costs.

1. POINTS OF DELIVERY

The Delivery Points are the PNode ID numbers set forth as follows:

- Supplier settlement will occur at the Metropolitan Edison ("Met-Ed") Residual Aggregate Zonal PNode 116472947;
- Settlement volumes will be based on meter readings at the Delivery Points set forth above, as adjusted by the NYPA production further described in Section 4(a), below.

2. SYSTEM PEAKS AND ENERGY USAGE

The Borough had a 2017 system peak of approximately 14.8 MW, a 2018 system peak of 16.8 MW and a 2019 system peak (through March 2019) of 16.9 MW. The following table provides the Borough's annual system peaks and annual energy usage for the years 2017-2019.

Year	Annual Peak Demand (MW)	Annual Energy Usage (MWh)
2017	14.8	65,508
2018	16.8	69,329
2019 ¹	16.9	20,367

¹ Through March 31, 2019.

Hourly load data for the January 2017-March 2019 time period will be provided upon request. The hourly meter data represents the PJM wholesale load responsibility of the supplier and reflects the meter reads at the physical point of interconnection between the Borough and the Met-Ed transmission system as adjusted by PJM.

3. THE BOROUGH'S CUSTOMER BASE AND RETAIL ACCESS STATUS

Set forth below is information on the Borough's customer base.

Customer Class	Dec 2017	Dec 2018
Residential	3,543	3,547
Commercial	210	238
Large Com. & Industrial	89	103
Total	3,842	3,888

All eligible customers receive service through the Borough. The Borough does not have a customer choice program.

4. OTHER BOROUGH RESOURCES

Other resources to which the Borough is contractually entitled include:

(a) "Preference power" from the New York Power Authority ("NYPA") that will be available through the contract period. As set forth in Exhibit C to the RFP, the Borough received from 274 MWh to 392 MWh per month pursuant to this allocation in 2018. The total production available to Middletown in 2018 was 3994 MWh. This resource would be used to meet the requirements of the Borough's load and should be netted with the Borough's load. The energy associated with the NYPA entitlement shall be applied to the PJM load subaccount for the Borough and subtracted from the Borough's load. The PJM import pricing point for the NYPA energy is the MetEd Residual Aggregate Zone (PNode ID 116472947). Please note that the load data provided by Middletown is not net of the NYPA production.

5. TRANSACTION STRUCTURE

The Borough seeks a partial-requirements contract to provide energy, capacity, transmission, ancillary services, and scheduling services to meet the portion of the Borough's load that is not met by other resources to which the Borough is contractually entitled. The Borough desires a fixed priced product that includes energy, ancillary

services, transmission losses and congestion management costs. The Borough requests that proposals include the provision of all required transmission and capacity on a pass-through basis, so the Borough's total electricity requirements are met on a firm basis. The Borough is interested in proposals for a 36-month and 72-month term, beginning January 1, 2022. Respondents may bid on either or both of the terms.

The Borough's preferred structure is for its supplier to create a subaccount at PJM to break out charges related to the Borough's load for the various services that PJM provides. The Borough will pay for NITS based on its Network Service Peak Load ("NSPL") in the Met-Ed transmission zone and capacity based on its Peak Load Contribution ("PLC") value in the Met-Ed transmission zone, priced at the Reliability Pricing Model ("RPM") capacity charge to load for the applicable delivery year. Because the Borough is neither a PJM Member nor a PJM Load-Serving Entity ("LSE"), the successful Respondent will function as the Borough's LSE in PJM, including developing daily load forecasts based on accurate forecast models that minimize pass-through costs associated with deviations between schedules and real-time transactions. As the LSE, any winning Respondent would receive the Auction Revenue Rights ("ARRs") and Marginal Loss Credits attributable to the Borough's load.

A form EEI Master Agreement is provided in Exhibit A. Respondent shall review the form contract and provide any proposed edits or comments in the form of a mark-up and consistent with the schedule set forth in Section 6 of this RFP. The Borough of Middletown shall be the counterparty executing the contract. Please note that financial information for the Borough of Middletown may be found in the 2017 Audited Financial Statement attached as Exhibit D.³

The Borough will negotiate a Transaction Confirmation in the form attached to form EEI Master Agreement with a short-list of selected suppliers based on initial proposals received. As more fully set out in the negotiated confirmation, the Supplier will be responsible for:

1. The supply of firm energy to the Borough at specified Delivery Point;
2. The supply of capacity sufficient to satisfy the PJM Capacity obligations, the cost of which shall be collected from the Borough on a pass-through basis;
3. All necessary PJM ancillary services;
4. Arranging transmission service, the cost of which shall be collected from the Borough on a pass-through basis; and,
5. Scheduling the Borough's other resources (*i.e.*, NYPA).

³ The Borough's 2018 Audited Financial Statement is not yet available.

The energy pricing proposal must be inclusive of all costs, with the exception of PJM services that the Respondent identifies in its proposal that will be treated as pass-throughs.

The supplier will be responsible for providing the power necessary to meet all load growth at the price specified in the power purchase agreement ("PPA") that is ultimately negotiated.

Regarding the NYPA resource, the Respondent must agree to schedule the NYPA power on the Borough's behalf to meet its load at no cost to the Borough. In so doing, the amount of MWs, based on the amount of water that flowed, would simply be scheduled into the selected supplier's account for the Borough's load.

6. SCHEDULE

The following schedule addresses the submission of proposals and subsequent contract award:

<u>Action</u>	<u>Date To Be Completed</u>
Issue RFP	Friday, May 3, 2019
Deadline To Submit Questions	Friday, May 17, 2019
Deadline to Provide Notice of Intent To Participate	Friday, May 17, 2019
All Questions To Be Answered	Thursday, May 23, 2019
Proposals Due, including:	
1. Proposed Edits to the form EEI Master Agreement; and	Thursday, May 30, 2019
2. Proposed Transaction Confirmation	
Confirmation of any Accepted Edits to the form EEI Master Agreement and Finalization of Transaction Confirmation	Wednesday, June 5, 2019
Request for Final Bids	After Monday, June 10, 2019

7. BID PROCESS

Proposals must be received no later than 5:00 p.m. on Thursday, May 30, 2019, and delivered as follows:

Four hard copies (an original and three copies) plus one electronic .pdf copy are to be enclosed in a sealed envelope, bearing on the outside the name and address of the Respondent making the proposal and marked "PROPOSAL FOR SUPPLY OF WHOLESALE ELECTRICITY" and addressed to:

Karen O. Moury
Carl R. Shultz
Eckert Seamans
213 Market St, 8th Floor
Harrisburg, PA 17101

Notwithstanding the required hard copies, service via email by 5:00 p.m.⁴, on Thursday, May 30, 2019, shall be considered timely, with the hard copies following by overnight mail for delivery by Friday, May 31, 2019. It is the Respondent's responsibility to ensure proposals are timely received.

Due to the volatility of the electric power markets, indicative pricing and firm pricing structures may be provided in response to this RFP, subject to the ability to refresh bids at future times as requested by the Borough. Actual pricing will be updated at the time of contract execution. The Borough will not be responsible for any additional costs not specifically identified in the proposal.

Proprietary data and information that a Respondent does not want disclosed to the public shall be clearly indicated. The Borough shall regard as public record all proposals and information submitted except to the extent that proposal information is clearly indicated as proprietary and segregated from the rest of the proposal. The Respondent must identify proprietary information on each page of the proposal. If a third party under Pennsylvania's Public Records Law requests any document that includes information designated as "proprietary" by Respondent, then the Borough will notify Respondent of the request and will release the document with the information designated as proprietary redacted. It will be the responsibility of the Respondent, not the Borough, to defend the designation of information as proprietary, including initiation of any court proceedings necessary to prevent disclosure as a public record.

8. COMMUNICATIONS

No Respondent is to contact the Borough with questions. Any questions with respect to this RFP must be submitted in writing by Friday, May 17, 2019, via email to Eckert Seamans Cherin & Mellott, LLC (Karen O. Moury (kmoury@eckertseamans.com) and Carl R. Shultz (cshultz@eckertseamans.com)). Answers thereto will be issued via email by Thursday, May 23, 2019.

9. EVALUATION CRITERIA

Proposals will be judged based on their ability to meet the Borough's need for economical and reliable power supply. Respondents to this solicitation should provide all relevant information necessary to allow the Borough to conduct a thorough analysis of the proposal.

⁴ See Section 8 for email addresses for the Borough's representatives.

The principal criteria to be used by the Borough in evaluating proposals include:

- Quality and feasibility of the technical proposal and ability to perform the required service, including reliability of proposed power supply;
- Total delivered cost of power;
- Availability of delivery to the PNodes specified above;
- Financial viability of the Respondent, including its parent or any other guarantor of services under the Respondent's proposal (please include copies of the most recent Moody's/Fitch/S&P ratings reports for the performance guarantor);
- Competence of the Respondent to perform the required service;
- Experience as indicated by past performance providing comparable service to similarly situated customers;
- Compliance with all applicable state and federal laws, rules and orders;
- Minimization of the risks of future energy price changes; and,
- Term of contract.

The Borough reserves the right to consider other relevant factors that the Borough deems to be appropriate in evaluating the proposal that will best meet its power supply needs.

9.1 Total Delivered Cost of Power

The total cost of power delivered to the Borough will be considered, taking into account any additional costs required for the Borough to utilize the proposed power supply, including losses, imbalance charges, capacity charges, transmission charges, and the costs of any other services provided by the Respondent.

The Respondent should clearly explain the pricing under the proposal so that the Borough can evaluate the total price of power under the terms of the proposal. Respondents should separately identify and specify any costs included for transmission charges necessary to deliver energy to the Borough.

9.2 Viability of Respondent

The Respondent must provide sufficient evidence of financial and operational capability to provide the services outlined in the proposal during the contract term. The financial and operational viability of any third parties relied upon by the Respondent for providing service to the Borough must also be demonstrated. The Respondent, its parent, and any

other guarantor of services under the Respondent's proposal, must provide an Annual Report and audited financial statements from the previous two years in order to demonstrate financial viability. If the Respondent's guarantor has a credit rating, the most recent ratings' reports must be provided also. The Respondent should disclose any defaults in the PJM energy market over the past five years and identify any pending or resolved investigations by Respondent's applicable federal or state energy regulatory authorities. Information submitted to demonstrate operational capability must include description of its experience providing wholesale supply services generally and to municipal and cooperative wholesale customers specifically, including references of current and/or recent power supply agreements with municipal and cooperative wholesale customers.

9.3 Reliability of Delivered Power

The power supply provided pursuant to the PPA must be firm and be deliverable under the PJM Open Access Transmission Tariff ("OATT") to be acceptable to the Borough. In general, the energy proposed to be offered should be available at all times to the Borough, even during adverse conditions, subject only to interruption due to forces beyond the reasonable control of the Borough or the Respondent (*i.e.*, "Force Majeure").

Preference will be given to those proposals providing assurances of reliability including corporate or other such guarantees that ensure delivery should the proposed power supply resource be unavailable to serve the Borough's loads.

10. RFP CONDITIONS

Respondents are responsible for their costs to participate in this process, including (but not limited to) proposal preparation costs, the cost of investigation and other due diligence activities, and the costs of participation in any discussions or meetings.

This RFP does not constitute an offer by the Borough. The Borough expressly reserves the right to cancel this process at any time, modify the RFP, adjust the schedule, exclude any Respondent from the process and/or to reject any or all bids and offers submitted in response to this RFP, in each case without liability. Please note further that the consummation of this transaction is subject to the Borough's execution and delivery of a definitive agreement.

The information contained herein has been prepared to assist interested parties in making their own proposals and does not purport to be all-inclusive or to contain all of the information that a prospective supplier may desire. The Borough makes no representation or warranty (express or implied) as to the accuracy or completeness of the information contained in this RFP and expressly disclaims any and all liability based on or relating to any representations or warranties (express or implied) contained in, or errors or omissions from, this RFP or based on or relating to the recipient's use or the use by any of its affiliates or representatives of this RFP or any other written or oral

communications transmitted to the recipient or any of its affiliates or representatives in the course of making its proposal.

Please be further advised that:

- The Borough, at its sole discretion, shall evaluate responsive proposals and select proposals, if any, which provide the most value to the Borough and its customers;
- Proposals may be combined with other proposals, at the Borough's sole discretion;
- The Borough shall evaluate any proposal in terms of price and non-price attributes;
- The Borough shall perform an initial screening evaluation to identify and eliminate any proposals that are not responsive to the RFP, do not meet the minimum requirements set forth in the RFP, are clearly not economically competitive with other proposals, or are submitted by Respondents that lack appropriate creditworthiness, sufficient financial resources, or qualifications to provide dependable and reliable services;
- The Borough reserves the right, without qualification and in its sole discretion, to accept or reject any or all proposals for any reason without explanation to the Respondent, or to make the award to that Respondent, who, in the opinion of the Borough, will provide the most value to the Borough and its customers. The Borough also reserves the right to make an award to a Respondent other than the one with the lowest price offer or the proposal evidencing the greatest technical ability if the Borough determines that to do so would result in the greatest value to the Borough and its customers;
- The Borough reserves the right to reject any, all, or portions of the proposals received for failure to meet any criteria set forth in this RFP. The Borough also may decline to enter into a power purchase arrangement with any Respondent, terminate negotiations with any Respondent, or to abandon the RFP process in its entirety; and
- Those Respondents who submit proposals agree to do so without legal recourse against the Borough, its members, and their directors, officers, employees and agents for rejection of their proposal(s) or for failure to execute a power purchase agreement for any reason. The Borough shall not be liable to any Respondent or party in law or equity for any reason whatsoever for any acts or omissions arising out of or in connection with this RFP.

11. DEFINITIVE AGREEMENT PROVISIONS

Consistent with Section 8.1 of the form EEL Master Agreement, any agreement executed with a successful Respondent must contain a contract performance bond or a letter of credit or equivalent, which will address Supplier nonperformance respecting the delivery

of reliable wholesale energy and capacity. This performance surety will be designed to protect the Borough from financial risk related to the Supplier's failure to perform based on the price and delivery terms specified in the Agreement. The Borough reserves the right to impose additional contractual requirements as part of the negotiation process.

EXHIBITS

- Exhibit A Form EEI Master Agreement
- Exhibit B Monthly Load Data for the Period January 2017- March 2019
- Exhibit C New York Power Authority Load Data for the Period January 2017-
March 2019
- Exhibit D Borough of Middletown 2017 Audited Financial Statements

Exhibit A

FORM EEI MASTER AGREEMENT

Master Power Purchase & Sale Agreement



Version 2.1 (modified 4/25/00)
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MASTER POWER PURCHASE AND SALES AGREEMENT

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MASTER POWER PURCHASE AND SALE AGREEMENT

COVER SHEET

This *Master Power Purchase and Sale Agreement* ("Master Agreement") is made as of the following date: _____ ("Effective Date"). The *Master Agreement*, together with the exhibits, schedules and any written supplements hereto, the Party A Tariff, if any, the Party B Tariff, if any, any designated collateral, credit support or margin agreement or similar arrangement between the Parties and all Transactions (including any confirmations accepted in accordance with Section 2.3 hereto) shall be referred to as the "Agreement." The Parties to this *Master Agreement* are the following:

Name ("_____ " or "Party A")

All Notices:

Street: _____

City: _____ Zip: _____

Attn: Contract Administration

Phone: _____

Facsimile: _____

Duns: _____

Federal Tax ID Number: _____

Invoices:

Attn: _____

Phone: _____

Facsimile: _____

Scheduling:

Attn: _____

Phone: _____

Facsimile: _____

Payments:

Attn: _____

Phone: _____

Facsimile: _____

Wire Transfer:

BNK: _____

ABA: _____

ACCT: _____

Credit and Collections:

Attn: _____

Phone: _____

Facsimile: _____

With additional Notices of an Event of Default or Potential Event of Default to:

Attn: _____

Phone: _____

Facsimile: _____

Name ("Counterparty" or "Party B")

All Notices:

Street: _____

City: _____ Zip: _____

Attn: Contract Administration

Phone: _____

Facsimile: _____

Duns: _____

Federal Tax ID Number: _____

Invoices:

Attn: _____

Phone: _____

Facsimile: _____

Scheduling:

Attn: _____

Phone: _____

Facsimile: _____

Payments:

Attn: _____

Phone: _____

Facsimile: _____

Wire Transfer:

BNK: _____

ABA: _____

ACCT: _____

Credit and Collections:

Attn: _____

Phone: _____

Facsimile: _____

With additional Notices of an Event of Default or Potential Event of Default to:

Attn: _____

Phone: _____

Facsimile: _____

The Parties hereby agree that the General Terms and Conditions are incorporated herein, and to the following provisions as provided for in the General Terms and Conditions:

Party A Tariff Tariff _____ Dated _____ Docket Number _____

Party B Tariff Tariff _____ Dated _____ Docket Number _____

Article Two

Transaction Terms and Conditions ☐ Optional provision in Section 2.4. If not checked, inapplicable.

Article Four

Remedies for Failure to Deliver or Receive ☐ Accelerated Payment of Damages. If not checked, inapplicable.

Article Five

Events of Default; Remedies ☐ Cross Default for Party A:
☐ Party A: _____ Cross Default Amount \$ _____
☐ Other Entity: _____ Cross Default Amount \$ _____
☐ Cross Default for Party B:
☐ Party B: _____ Cross Default Amount \$ _____
☐ Other Entity: _____ Cross Default Amount \$ _____

5.6 Closeout Setoff

- ☐ Option A (Applicable if no other selection is made.)
☐ Option B - Affiliates shall have the meaning set forth in the Agreement unless otherwise specified as follows: _____

☐ Option C (No Setoff)

Article 8

Credit and Collateral Requirements

8.1 Party A Credit Protection:

(a) Financial Information:

- ☐ Option A
☐ Option B Specify: _____
☐ Option C Specify: _____

(b) Credit Assurances:

- ☐ Not Applicable
☐ Applicable

(c) Collateral Threshold:

- ☐ Not Applicable
☐ Applicable

If applicable, complete the following:

Party B Collateral Threshold: \$ _____; provided, however, that Party B's Collateral Threshold shall be zero if an Event of Default or Potential Event of Default with respect to Party B has occurred and is continuing.

Party B Independent Amount: \$ _____

Party B Rounding Amount: \$ _____

(d) Downgrade Event:

- ☐ Not Applicable
- ☐ Applicable

If applicable, complete the following:

- ☐ It shall be a Downgrade Event for Party B if Party B's Credit Rating falls below _____ from S&P or _____ from Moody's or if Party B is not rated by either S&P or Moody's
- ☐ Other:
Specify: _____

(e) Guarantor for Party B: _____

Guarantee Amount: _____

8.2 Party B Credit Protection:

(a) Financial Information:

- ☐ Option A
- ☐ Option B Specify: _____
- ☐ Option C Specify: _____

(b) Credit Assurances:

- ☐ Not Applicable
- ☐ Applicable

(c) Collateral Threshold:

- ☐ Not Applicable
- ☐ Applicable

If applicable, complete the following:

Party A Collateral Threshold: \$ _____; provided, however, that Party A's Collateral Threshold shall be zero if an Event of Default or Potential Event of Default with respect to Party A has occurred and is continuing.

Party A Independent Amount: \$ _____

Party A Rounding Amount: \$ _____

(d) Downgrade Event:

- ☐ Not Applicable
- ☐ Applicable

If applicable, complete the following:

- ☐ It shall be a Downgrade Event for Party A if Party A's Credit Rating falls below _____ from S&P or _____ from Moody's or if Party A is not rated by either S&P or Moody's

- ☐ Other:
Specify: _____

(e) Guarantor for Party A: _____

Guarantee Amount: _____

Article 10

Confidentiality

☐ Confidentiality Applicable If not checked, inapplicable.

Schedule M

- ☐ Party A is a Governmental Entity or Public Power System
- ☐ Party B is a Governmental Entity or Public Power System
- ☐ Add Section 3.6. If not checked, inapplicable
- ☐ Add Section 8.6. If not checked, inapplicable

Other Changes

Specify, if any: _____

IN WITNESS WHEREOF, the Parties have caused this Master Agreement to be duly executed as of the date first above written.

Party A Name

By: _____

Name: _____

Title: _____

Party B Name

By: _____

Name: _____

Title: _____

DISCLAIMER: This Master Power Purchase and Sale Agreement was prepared by a committee of representatives of Edison Electric Institute (“EEI”) and National Energy Marketers Association (“NEM”) member companies to facilitate orderly trading in and development of wholesale power markets. Neither EEI nor NEM nor any member company nor any of their agents, representatives or attorneys shall be responsible for its use, or any damages resulting therefrom. By providing this Agreement EEI and NEM do not offer legal advice and all users are urged to consult their own legal counsel to ensure that their commercial objectives will be achieved and their legal interests are adequately protected.

GENERAL TERMS AND CONDITIONS

ARTICLE ONE: GENERAL DEFINITIONS

1.1 “Affiliate” means, with respect to any person, any other person (other than an individual) that, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, such person. For this purpose, “control” means the direct or indirect ownership of fifty percent (50%) or more of the outstanding capital stock or other equity interests having ordinary voting power.

1.2 “Agreement” has the meaning set forth in the Cover Sheet.

1.3 “Bankrupt” means with respect to any entity, such entity (i) files a petition or otherwise commences, authorizes or acquiesces in the commencement of a proceeding or cause of action under any bankruptcy, insolvency, reorganization or similar law, or has any such petition filed or commenced against it, (ii) makes an assignment or any general arrangement for the benefit of creditors, (iii) otherwise becomes bankrupt or insolvent (however evidenced), (iv) has a liquidator, administrator, receiver, trustee, conservator or similar official appointed with respect to it or any substantial portion of its property or assets, or (v) is generally unable to pay its debts as they fall due.

1.4 “Business Day” means any day except a Saturday, Sunday, or a Federal Reserve Bank holiday. A Business Day shall open at 8:00 a.m. and close at 5:00 p.m. local time for the relevant Party’s principal place of business. The relevant Party, in each instance unless otherwise specified, shall be the Party from whom the notice, payment or delivery is being sent and by whom the notice or payment or delivery is to be received.

1.5 “Buyer” means the Party to a Transaction that is obligated to purchase and receive, or cause to be received, the Product, as specified in the Transaction.

1.6 “Call Option” means an Option entitling, but not obligating, the Option Buyer to purchase and receive the Product from the Option Seller at a price equal to the Strike Price for the Delivery Period for which the Option may be exercised, all as specified in the Transaction. Upon proper exercise of the Option by the Option Buyer, the Option Seller will be obligated to sell and deliver the Product for the Delivery Period for which the Option has been exercised.

1.7 “Claiming Party” has the meaning set forth in Section 3.3.

1.8 “Claims” means all third party claims or actions, threatened or filed and, whether groundless, false, fraudulent or otherwise, that directly or indirectly relate to the subject matter of an indemnity, and the resulting losses, damages, expenses, attorneys’ fees and court costs, whether incurred by settlement or otherwise, and whether such claims or actions are threatened or filed prior to or after the termination of this Agreement.

1.9 “Confirmation” has the meaning set forth in Section 2.3.

1.10 “Contract Price” means the price in \$U.S. (unless otherwise provided for) to be paid by Buyer to Seller for the purchase of the Product, as specified in the Transaction.

1.11 “Costs” means, with respect to the Non-Defaulting Party, brokerage fees, commissions and other similar third party transaction costs and expenses reasonably incurred by such Party either in terminating any arrangement pursuant to which it has hedged its obligations or entering into new arrangements which replace a Terminated Transaction; and all reasonable attorneys’ fees and expenses incurred by the Non-Defaulting Party in connection with the termination of a Transaction.

1.12 “Credit Rating” means, with respect to any entity, the rating then assigned to such entity’s unsecured, senior long-term debt obligations (not supported by third party credit enhancements) or if such entity does not have a rating for its senior unsecured long-term debt, then the rating then assigned to such entity as an issues rating by S&P, Moody’s or any other rating agency agreed by the Parties as set forth in the Cover Sheet.

1.13 “Cross Default Amount” means the cross default amount, if any, set forth in the Cover Sheet for a Party.

1.14 “Defaulting Party” has the meaning set forth in Section 5.1.

1.15 “Delivery Period” means the period of delivery for a Transaction, as specified in the Transaction.

1.16 “Delivery Point” means the point at which the Product will be delivered and received, as specified in the Transaction.

1.17 “Downgrade Event” has the meaning set forth on the Cover Sheet.

1.18 “Early Termination Date” has the meaning set forth in Section 5.2.

1.19 “Effective Date” has the meaning set forth on the Cover Sheet.

1.20 “Equitable Defenses” means any bankruptcy, insolvency, reorganization and other laws affecting creditors’ rights generally, and with regard to equitable remedies, the discretion of the court before which proceedings to obtain same may be pending.

1.21 “Event of Default” has the meaning set forth in Section 5.1.

1.22 “FERC” means the Federal Energy Regulatory Commission or any successor government agency.

1.23 “Force Majeure” means an event or circumstance which prevents one Party from performing its obligations under one or more Transactions, which event or circumstance was not anticipated as of the date the Transaction was agreed to, which is not within the reasonable control of, or the result of the negligence of, the Claiming Party, and which, by the exercise of due diligence, the Claiming Party is unable to overcome or avoid or cause to be avoided. Force Majeure shall not be based on (i) the loss of Buyer’s markets; (ii) Buyer’s inability economically

to use or resell the Product purchased hereunder; (iii) the loss or failure of Seller's supply; or (iv) Seller's ability to sell the Product at a price greater than the Contract Price. Neither Party may raise a claim of Force Majeure based in whole or in part on curtailment by a Transmission Provider unless (i) such Party has contracted for firm transmission with a Transmission Provider for the Product to be delivered to or received at the Delivery Point and (ii) such curtailment is due to "force majeure" or "uncontrollable force" or a similar term as defined under the Transmission Provider's tariff; provided, however, that existence of the foregoing factors shall not be sufficient to conclusively or presumptively prove the existence of a Force Majeure absent a showing of other facts and circumstances which in the aggregate with such factors establish that a Force Majeure as defined in the first sentence hereof has occurred. The applicability of Force Majeure to the Transaction is governed by the terms of the Products and Related Definitions contained in Schedule P.

1.24 "Gains" means, with respect to any Party, an amount equal to the present value of the economic benefit to it, if any (exclusive of Costs), resulting from the termination of a Terminated Transaction, determined in a commercially reasonable manner.

1.25 "Guarantor" means, with respect to a Party, the guarantor, if any, specified for such Party on the Cover Sheet.

1.26 "Interest Rate" means, for any date, the lesser of (a) the per annum rate of interest equal to the prime lending rate as may from time to time be published in *The Wall Street Journal* under "Money Rates" on such day (or if not published on such day on the most recent preceding day on which published), plus two percent (2%) and (b) the maximum rate permitted by applicable law.

1.27 "Letter(s) of Credit" means one or more irrevocable, transferable standby letters of credit issued by a U.S. commercial bank or a foreign bank with a U.S. branch with such bank having a credit rating of at least A- from S&P or A3 from Moody's, in a form acceptable to the Party in whose favor the letter of credit is issued. Costs of a Letter of Credit shall be borne by the applicant for such Letter of Credit.

1.28 "Losses" means, with respect to any Party, an amount equal to the present value of the economic loss to it, if any (exclusive of Costs), resulting from termination of a Terminated Transaction, determined in a commercially reasonable manner.

1.29 "Master Agreement" has the meaning set forth on the Cover Sheet.

1.30 "Moody's" means Moody's Investor Services, Inc. or its successor.

1.31 "NERC Business Day" means any day except a Saturday, Sunday or a holiday as defined by the North American Electric Reliability Council or any successor organization thereto. A NERC Business Day shall open at 8:00 a.m. and close at 5:00 p.m. local time for the relevant Party's principal place of business. The relevant Party, in each instance unless otherwise specified, shall be the Party from whom the notice, payment or delivery is being sent and by whom the notice or payment or delivery is to be received.

1.32 “Non-Defaulting Party” has the meaning set forth in Section 5.2.

1.33 “Offsetting Transactions” mean any two or more outstanding Transactions, having the same or overlapping Delivery Period(s), Delivery Point and payment date, where under one or more of such Transactions, one Party is the Seller, and under the other such Transaction(s), the same Party is the Buyer.

1.34 “Option” means the right but not the obligation to purchase or sell a Product as specified in a Transaction.

1.35 “Option Buyer” means the Party specified in a Transaction as the purchaser of an option, as defined in Schedule P.

1.36 “Option Seller” means the Party specified in a Transaction as the seller of an option, as defined in Schedule P.

1.37 “Party A Collateral Threshold” means the collateral threshold, if any, set forth in the Cover Sheet for Party A.

1.38 “Party B Collateral Threshold” means the collateral threshold, if any, set forth in the Cover Sheet for Party B.

1.39 “Party A Independent Amount” means the amount, if any, set forth in the Cover Sheet for Party A.

1.40 “Party B Independent Amount” means the amount, if any, set forth in the Cover Sheet for Party B.

1.41 “Party A Rounding Amount” means the amount, if any, set forth in the Cover Sheet for Party A.

1.42 “Party B Rounding Amount” means the amount, if any, set forth in the Cover Sheet for Party B.

1.43 “Party A Tariff” means the tariff, if any, specified in the Cover Sheet for Party A.

1.44 “Party B Tariff” means the tariff, if any, specified in the Cover Sheet for Party B.

1.45 “Performance Assurance” means collateral in the form of either cash, Letter(s) of Credit, or other security acceptable to the Requesting Party.

1.46 “Potential Event of Default” means an event which, with notice or passage of time or both, would constitute an Event of Default.

1.47 “Product” means electric capacity, energy or other product(s) related thereto as specified in a Transaction by reference to a Product listed in Schedule P hereto or as otherwise specified by the Parties in the Transaction.

1.48 “Put Option” means an Option entitling, but not obligating, the Option Buyer to sell and deliver the Product to the Option Seller at a price equal to the Strike Price for the Delivery Period for which the option may be exercised, all as specified in a Transaction. Upon proper exercise of the Option by the Option Buyer, the Option Seller will be obligated to purchase and receive the Product.

1.49 “Quantity” means that quantity of the Product that Seller agrees to make available or sell and deliver, or cause to be delivered, to Buyer, and that Buyer agrees to purchase and receive, or cause to be received, from Seller as specified in the Transaction.

1.50 “Recording” has the meaning set forth in Section 2.4.

1.51 “Replacement Price” means the price at which Buyer, acting in a commercially reasonable manner, purchases at the Delivery Point a replacement for any Product specified in a Transaction but not delivered by Seller, plus (i) costs reasonably incurred by Buyer in purchasing such substitute Product and (ii) additional transmission charges, if any, reasonably incurred by Buyer to the Delivery Point, or at Buyer’s option, the market price at the Delivery Point for such Product not delivered as determined by Buyer in a commercially reasonable manner; provided, however, in no event shall such price include any penalties, ratcheted demand or similar charges, nor shall Buyer be required to utilize or change its utilization of its owned or controlled assets or market positions to minimize Seller’s liability. For the purposes of this definition, Buyer shall be considered to have purchased replacement Product to the extent Buyer shall have entered into one or more arrangements in a commercially reasonable manner whereby Buyer repurchases its obligation to sell and deliver the Product to another party at the Delivery Point.

1.52 “S&P” means the Standard & Poor’s Rating Group (a division of McGraw-Hill, Inc.) or its successor.

1.53 “Sales Price” means the price at which Seller, acting in a commercially reasonable manner, resells at the Delivery Point any Product not received by Buyer, deducting from such proceeds any (i) costs reasonably incurred by Seller in reselling such Product and (ii) additional transmission charges, if any, reasonably incurred by Seller in delivering such Product to the third party purchasers, or at Seller’s option, the market price at the Delivery Point for such Product not received as determined by Seller in a commercially reasonable manner; provided, however, in no event shall such price include any penalties, ratcheted demand or similar charges, nor shall Seller be required to utilize or change its utilization of its owned or controlled assets, including contractual assets, or market positions to minimize Buyer’s liability. For purposes of this definition, Seller shall be considered to have resold such Product to the extent Seller shall have entered into one or more arrangements in a commercially reasonable manner whereby Seller repurchases its obligation to purchase and receive the Product from another party at the Delivery Point.

1.54 “Schedule” or “Scheduling” means the actions of Seller, Buyer and/or their designated representatives, including each Party’s Transmission Providers, if applicable, of notifying, requesting and confirming to each other the quantity and type of Product to be delivered on any given day or days during the Delivery Period at a specified Delivery Point.

1.55 “Seller” means the Party to a Transaction that is obligated to sell and deliver, or cause to be delivered, the Product, as specified in the Transaction.

1.56 “Settlement Amount” means, with respect to a Transaction and the Non-Defaulting Party, the Losses or Gains, and Costs, expressed in U.S. Dollars, which such party incurs as a result of the liquidation of a Terminated Transaction pursuant to Section 5.2.

1.57 “Strike Price” means the price to be paid for the purchase of the Product pursuant to an Option.

1.58 “Terminated Transaction” has the meaning set forth in Section 5.2.

1.59 “Termination Payment” has the meaning set forth in Section 5.3.

1.60 “Transaction” means a particular transaction agreed to by the Parties relating to the sale and purchase of a Product pursuant to this Master Agreement.

1.61 “Transmission Provider” means any entity or entities transmitting or transporting the Product on behalf of Seller or Buyer to or from the Delivery Point in a particular Transaction.

ARTICLE TWO: TRANSACTION TERMS AND CONDITIONS

2.1 Transactions. A Transaction shall be entered into upon agreement of the Parties orally or, if expressly required by either Party with respect to a particular Transaction, in writing, including an electronic means of communication. Each Party agrees not to contest, or assert any defense to, the validity or enforceability of the Transaction entered into in accordance with this Master Agreement (i) based on any law requiring agreements to be in writing or to be signed by the parties, or (ii) based on any lack of authority of the Party or any lack of authority of any employee of the Party to enter into a Transaction.

2.2 Governing Terms. Unless otherwise specifically agreed, each Transaction between the Parties shall be governed by this Master Agreement. This Master Agreement (including all exhibits, schedules and any written supplements hereto), , the Party A Tariff, if any, and the Party B Tariff, if any, any designated collateral, credit support or margin agreement or similar arrangement between the Parties and all Transactions (including any Confirmations accepted in accordance with Section 2.3) shall form a single integrated agreement between the Parties. Any inconsistency between any terms of this Master Agreement and any terms of the Transaction shall be resolved in favor of the terms of such Transaction.

2.3 Confirmation. Seller may confirm a Transaction by forwarding to Buyer by facsimile within three (3) Business Days after the Transaction is entered into a confirmation (“Confirmation”) substantially in the form of Exhibit A. If Buyer objects to any term(s) of such Confirmation, Buyer shall notify Seller in writing of such objections within two (2) Business Days of Buyer’s receipt thereof, failing which Buyer shall be deemed to have accepted the terms as sent. If Seller fails to send a Confirmation within three (3) Business Days after the Transaction is entered into, a Confirmation substantially in the form of Exhibit A, may be forwarded by Buyer to Seller. If Seller objects to any term(s) of such Confirmation, Seller shall notify Buyer of such objections within two (2) Business Days of Seller’s receipt thereof, failing

which Seller shall be deemed to have accepted the terms as sent. If Seller and Buyer each send a Confirmation and neither Party objects to the other Party's Confirmation within two (2) Business Days of receipt, Seller's Confirmation shall be deemed to be accepted and shall be the controlling Confirmation, unless (i) Seller's Confirmation was sent more than three (3) Business Days after the Transaction was entered into and (ii) Buyer's Confirmation was sent prior to Seller's Confirmation, in which case Buyer's Confirmation shall be deemed to be accepted and shall be the controlling Confirmation. Failure by either Party to send or either Party to return an executed Confirmation or any objection by either Party shall not invalidate the Transaction agreed to by the Parties.

2.4 Additional Confirmation Terms. If the Parties have elected on the Cover Sheet to make this Section 2.4 applicable to this Master Agreement, when a Confirmation contains provisions, other than those provisions relating to the commercial terms of the Transaction (e.g., price or special transmission conditions), which modify or supplement the general terms and conditions of this Master Agreement (e.g., arbitration provisions or additional representations and warranties), such provisions shall not be deemed to be accepted pursuant to Section 2.3 unless agreed to either orally or in writing by the Parties; provided that the foregoing shall not invalidate any Transaction agreed to by the Parties.

2.5 Recording. Unless a Party expressly objects to a Recording (defined below) at the beginning of a telephone conversation, each Party consents to the creation of a tape or electronic recording ("Recording") of all telephone conversations between the Parties to this Master Agreement, and that any such Recordings will be retained in confidence, secured from improper access, and may be submitted in evidence in any proceeding or action relating to this Agreement. Each Party waives any further notice of such monitoring or recording, and agrees to notify its officers and employees of such monitoring or recording and to obtain any necessary consent of such officers and employees. The Recording, and the terms and conditions described therein, if admissible, shall be the controlling evidence for the Parties' agreement with respect to a particular Transaction in the event a Confirmation is not fully executed (or deemed accepted) by both Parties. Upon full execution (or deemed acceptance) of a Confirmation, such Confirmation shall control in the event of any conflict with the terms of a Recording, or in the event of any conflict with the terms of this Master Agreement.

ARTICLE THREE: OBLIGATIONS AND DELIVERIES

3.1 Seller's and Buyer's Obligations. With respect to each Transaction, Seller shall sell and deliver, or cause to be delivered, and Buyer shall purchase and receive, or cause to be received, the Quantity of the Product at the Delivery Point, and Buyer shall pay Seller the Contract Price; provided, however, with respect to Options, the obligations set forth in the preceding sentence shall only arise if the Option Buyer exercises its Option in accordance with its terms. Seller shall be responsible for any costs or charges imposed on or associated with the Product or its delivery of the Product up to the Delivery Point. Buyer shall be responsible for any costs or charges imposed on or associated with the Product or its receipt at and from the Delivery Point.

3.2 Transmission and Scheduling. Seller shall arrange and be responsible for transmission service to the Delivery Point and shall Schedule or arrange for Scheduling services

with its Transmission Providers, as specified by the Parties in the Transaction, or in the absence thereof, in accordance with the practice of the Transmission Providers, to deliver the Product to the Delivery Point. Buyer shall arrange and be responsible for transmission service at and from the Delivery Point and shall Schedule or arrange for Scheduling services with its Transmission Providers to receive the Product at the Delivery Point.

3.3 Force Majeure. To the extent either Party is prevented by Force Majeure from carrying out, in whole or part, its obligations under the Transaction and such Party (the “Claiming Party”) gives notice and details of the Force Majeure to the other Party as soon as practicable, then, unless the terms of the Product specify otherwise, the Claiming Party shall be excused from the performance of its obligations with respect to such Transaction (other than the obligation to make payments then due or becoming due with respect to performance prior to the Force Majeure). The Claiming Party shall remedy the Force Majeure with all reasonable dispatch. The non-Claiming Party shall not be required to perform or resume performance of its obligations to the Claiming Party corresponding to the obligations of the Claiming Party excused by Force Majeure.

ARTICLE FOUR: REMEDIES FOR FAILURE TO DELIVER/RECEIVE

4.1 Seller Failure. If Seller fails to schedule and/or deliver all or part of the Product pursuant to a Transaction, and such failure is not excused under the terms of the Product or by Buyer’s failure to perform, then Seller shall pay Buyer, on the date payment would otherwise be due in respect of the month in which the failure occurred or, if “Accelerated Payment of Damages” is specified on the Cover Sheet, within five (5) Business Days of invoice receipt, an amount for such deficiency equal to the positive difference, if any, obtained by subtracting the Contract Price from the Replacement Price. The invoice for such amount shall include a written statement explaining in reasonable detail the calculation of such amount.

4.2 Buyer Failure. If Buyer fails to schedule and/or receive all or part of the Product pursuant to a Transaction and such failure is not excused under the terms of the Product or by Seller’s failure to perform, then Buyer shall pay Seller, on the date payment would otherwise be due in respect of the month in which the failure occurred or, if “Accelerated Payment of Damages” is specified on the Cover Sheet, within five (5) Business Days of invoice receipt, an amount for such deficiency equal to the positive difference, if any, obtained by subtracting the Sales Price from the Contract Price. The invoice for such amount shall include a written statement explaining in reasonable detail the calculation of such amount.

ARTICLE FIVE: EVENTS OF DEFAULT; REMEDIES

5.1 Events of Default. An “Event of Default” shall mean, with respect to a Party (a “Defaulting Party”), the occurrence of any of the following:

- (a) the failure to make, when due, any payment required pursuant to this Agreement if such failure is not remedied within three (3) Business Days after written notice;

- (b) any representation or warranty made by such Party herein is false or misleading in any material respect when made or when deemed made or repeated;
- (c) the failure to perform any material covenant or obligation set forth in this Agreement (except to the extent constituting a separate Event of Default, and except for such Party's obligations to deliver or receive the Product, the exclusive remedy for which is provided in Article Four) if such failure is not remedied within three (3) Business Days after written notice;
- (d) such Party becomes Bankrupt;
- (e) the failure of such Party to satisfy the creditworthiness/collateral requirements agreed to pursuant to Article Eight hereof;
- (f) such Party consolidates or amalgamates with, or merges with or into, or transfers all or substantially all of its assets to, another entity and, at the time of such consolidation, amalgamation, merger or transfer, the resulting, surviving or transferee entity fails to assume all the obligations of such Party under this Agreement to which it or its predecessor was a party by operation of law or pursuant to an agreement reasonably satisfactory to the other Party;
- (g) if the applicable cross default section in the Cover Sheet is indicated for such Party, the occurrence and continuation of (i) a default, event of default or other similar condition or event in respect of such Party or any other party specified in the Cover Sheet for such Party under one or more agreements or instruments, individually or collectively, relating to indebtedness for borrowed money in an aggregate amount of not less than the applicable Cross Default Amount (as specified in the Cover Sheet), which results in such indebtedness becoming, or becoming capable at such time of being declared, immediately due and payable or (ii) a default by such Party or any other party specified in the Cover Sheet for such Party in making on the due date therefor one or more payments, individually or collectively, in an aggregate amount of not less than the applicable Cross Default Amount (as specified in the Cover Sheet);
- (h) with respect to such Party's Guarantor, if any:
 - (i) if any representation or warranty made by a Guarantor in connection with this Agreement is false or misleading in any material respect when made or when deemed made or repeated;
 - (ii) the failure of a Guarantor to make any payment required or to perform any other material covenant or obligation in any guaranty made in connection with this Agreement and such failure shall not be remedied within three (3) Business Days after written notice;

- (iii) a Guarantor becomes Bankrupt;
- (iv) the failure of a Guarantor's guaranty to be in full force and effect for purposes of this Agreement (other than in accordance with its terms) prior to the satisfaction of all obligations of such Party under each Transaction to which such guaranty shall relate without the written consent of the other Party; or
- (v) a Guarantor shall repudiate, disaffirm, disclaim, or reject, in whole or in part, or challenge the validity of any guaranty.

5.2 Declaration of an Early Termination Date and Calculation of Settlement Amounts. If an Event of Default with respect to a Defaulting Party shall have occurred and be continuing, the other Party (the "Non-Defaulting Party") shall have the right (i) to designate a day, no earlier than the day such notice is effective and no later than 20 days after such notice is effective, as an early termination date ("Early Termination Date") to accelerate all amounts owing between the Parties and to liquidate and terminate all, but not less than all, Transactions (each referred to as a "Terminated Transaction") between the Parties, (ii) withhold any payments due to the Defaulting Party under this Agreement and (iii) suspend performance. The Non-Defaulting Party shall calculate, in a commercially reasonable manner, a Settlement Amount for each such Terminated Transaction as of the Early Termination Date (or, to the extent that in the reasonable opinion of the Non-Defaulting Party certain of such Terminated Transactions are commercially impracticable to liquidate and terminate or may not be liquidated and terminated under applicable law on the Early Termination Date, as soon thereafter as is reasonably practicable).

5.3 Net Out of Settlement Amounts. The Non-Defaulting Party shall aggregate all Settlement Amounts into a single amount by: netting out (a) all Settlement Amounts that are due to the Defaulting Party, plus, at the option of the Non-Defaulting Party, any cash or other form of security then available to the Non-Defaulting Party pursuant to Article Eight, plus any or all other amounts due to the Defaulting Party under this Agreement against (b) all Settlement Amounts that are due to the Non-Defaulting Party, plus any or all other amounts due to the Non-Defaulting Party under this Agreement, so that all such amounts shall be netted out to a single liquidated amount (the "Termination Payment") payable by one Party to the other. The Termination Payment shall be due to or due from the Non-Defaulting Party as appropriate.

5.4 Notice of Payment of Termination Payment. As soon as practicable after a liquidation, notice shall be given by the Non-Defaulting Party to the Defaulting Party of the amount of the Termination Payment and whether the Termination Payment is due to or due from the Non-Defaulting Party. The notice shall include a written statement explaining in reasonable detail the calculation of such amount. The Termination Payment shall be made by the Party that owes it within two (2) Business Days after such notice is effective.

5.5 Disputes With Respect to Termination Payment. If the Defaulting Party disputes the Non-Defaulting Party's calculation of the Termination Payment, in whole or in part, the Defaulting Party shall, within two (2) Business Days of receipt of Non-Defaulting Party's calculation of the Termination Payment, provide to the Non-Defaulting Party a detailed written

explanation of the basis for such dispute; provided, however, that if the Termination Payment is due from the Defaulting Party, the Defaulting Party shall first transfer Performance Assurance to the Non-Defaulting Party in an amount equal to the Termination Payment.

5.6 Closeout Setoffs.

Option A: After calculation of a Termination Payment in accordance with Section 5.3, if the Defaulting Party would be owed the Termination Payment, the Non-Defaulting Party shall be entitled, at its option and in its discretion, to (i) set off against such Termination Payment any amounts due and owing by the Defaulting Party to the Non-Defaulting Party under any other agreements, instruments or undertakings between the Defaulting Party and the Non-Defaulting Party and/or (ii) to the extent the Transactions are not yet liquidated in accordance with Section 5.2, withhold payment of the Termination Payment to the Defaulting Party. The remedy provided for in this Section shall be without prejudice and in addition to any right of setoff, combination of accounts, lien or other right to which any Party is at any time otherwise entitled (whether by operation of law, contract or otherwise).

Option B: After calculation of a Termination Payment in accordance with Section 5.3, if the Defaulting Party would be owed the Termination Payment, the Non-Defaulting Party shall be entitled, at its option and in its discretion, to (i) set off against such Termination Payment any amounts due and owing by the Defaulting Party or any of its Affiliates to the Non-Defaulting Party or any of its Affiliates under any other agreements, instruments or undertakings between the Defaulting Party or any of its Affiliates and the Non-Defaulting Party or any of its Affiliates and/or (ii) to the extent the Transactions are not yet liquidated in accordance with Section 5.2, withhold payment of the Termination Payment to the Defaulting Party. The remedy provided for in this Section shall be without prejudice and in addition to any right of setoff, combination of accounts, lien or other right to which any Party is at any time otherwise entitled (whether by operation of law, contract or otherwise).

Option C: Neither Option A nor B shall apply.

5.7 Suspension of Performance. Notwithstanding any other provision of this Master Agreement, if (a) an Event of Default or (b) a Potential Event of Default shall have occurred and be continuing, the Non-Defaulting Party, upon written notice to the Defaulting Party, shall have the right (i) to suspend performance under any or all Transactions; provided, however, in no event shall any such suspension continue for longer than ten (10) NERC Business Days with respect to any single Transaction unless an early Termination Date shall have been declared and notice thereof pursuant to Section 5.2 given, and (ii) to the extent an Event of Default shall have occurred and be continuing to exercise any remedy available at law or in equity.

ARTICLE SIX: PAYMENT AND NETTING

6.1 Billing Period. Unless otherwise specifically agreed upon by the Parties in a Transaction, the calendar month shall be the standard period for all payments under this Agreement (other than Termination Payments and, if “Accelerated Payment of Damages” is specified by the Parties in the Cover Sheet, payments pursuant to Section 4.1 or 4.2 and Option premium payments pursuant to Section 6.7). As soon as practicable after the end of each month,

each Party will render to the other Party an invoice for the payment obligations, if any, incurred hereunder during the preceding month.

6.2 Timeliness of Payment. Unless otherwise agreed by the Parties in a Transaction, all invoices under this Master Agreement shall be due and payable in accordance with each Party's invoice instructions on or before the later of the twentieth (20th) day of each month, or tenth (10th) day after receipt of the invoice or, if such day is not a Business Day, then on the next Business Day. Each Party will make payments by electronic funds transfer, or by other mutually agreeable method(s), to the account designated by the other Party. Any amounts not paid by the due date will be deemed delinquent and will accrue interest at the Interest Rate, such interest to be calculated from and including the due date to but excluding the date the delinquent amount is paid in full.

6.3 Disputes and Adjustments of Invoices. A Party may, in good faith, dispute the correctness of any invoice or any adjustment to an invoice, rendered under this Agreement or adjust any invoice for any arithmetic or computational error within twelve (12) months of the date the invoice, or adjustment to an invoice, was rendered. In the event an invoice or portion thereof, or any other claim or adjustment arising hereunder, is disputed, payment of the undisputed portion of the invoice shall be required to be made when due, with notice of the objection given to the other Party. Any invoice dispute or invoice adjustment shall be in writing and shall state the basis for the dispute or adjustment. Payment of the disputed amount shall not be required until the dispute is resolved. Upon resolution of the dispute, any required payment shall be made within two (2) Business Days of such resolution along with interest accrued at the Interest Rate from and including the due date to but excluding the date paid. Inadvertent overpayments shall be returned upon request or deducted by the Party receiving such overpayment from subsequent payments, with interest accrued at the Interest Rate from and including the date of such overpayment to but excluding the date repaid or deducted by the Party receiving such overpayment. Any dispute with respect to an invoice is waived unless the other Party is notified in accordance with this Section 6.3 within twelve (12) months after the invoice is rendered or any specific adjustment to the invoice is made. If an invoice is not rendered within twelve (12) months after the close of the month during which performance of a Transaction occurred, the right to payment for such performance is waived.

6.4 Netting of Payments. The Parties hereby agree that they shall discharge mutual debts and payment obligations due and owing to each other on the same date pursuant to all Transactions through netting, in which case all amounts owed by each Party to the other Party for the purchase and sale of Products during the monthly billing period under this Master Agreement, including any related damages calculated pursuant to Article Four (unless one of the Parties elects to accelerate payment of such amounts as permitted by Article Four), interest, and payments or credits, shall be netted so that only the excess amount remaining due shall be paid by the Party who owes it.

6.5 Payment Obligation Absent Netting. If no mutual debts or payment obligations exist and only one Party owes a debt or obligation to the other during the monthly billing period, including, but not limited to, any related damage amounts calculated pursuant to Article Four, interest, and payments or credits, that Party shall pay such sum in full when due.

6.6 Security. Unless the Party benefiting from Performance Assurance or a guaranty notifies the other Party in writing, and except in connection with a liquidation and termination in accordance with Article Five, all amounts netted pursuant to this Article Six shall not take into account or include any Performance Assurance or guaranty which may be in effect to secure a Party's performance under this Agreement.

6.7 Payment for Options. The premium amount for the purchase of an Option shall be paid within two (2) Business Days of receipt of an invoice from the Option Seller. Upon exercise of an Option, payment for the Product underlying such Option shall be due in accordance with Section 6.1.

6.8 Transaction Netting. If the Parties enter into one or more Transactions, which in conjunction with one or more other outstanding Transactions, constitute Offsetting Transactions, then all such Offsetting Transactions may by agreement of the Parties, be netted into a single Transaction under which:

- (a) the Party obligated to deliver the greater amount of Energy will deliver the difference between the total amount it is obligated to deliver and the total amount to be delivered to it under the Offsetting Transactions, and
- (b) the Party owing the greater aggregate payment will pay the net difference owed between the Parties.

Each single Transaction resulting under this Section shall be deemed part of the single, indivisible contractual arrangement between the parties, and once such resulting Transaction occurs, outstanding obligations under the Offsetting Transactions which are satisfied by such offset shall terminate.

ARTICLE SEVEN: LIMITATIONS

7.1 Limitation of Remedies, Liability and Damages. EXCEPT AS SET FORTH HEREIN, THERE IS NO WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, AND ANY AND ALL IMPLIED WARRANTIES ARE DISCLAIMED. THE PARTIES CONFIRM THAT THE EXPRESS REMEDIES AND MEASURES OF DAMAGES PROVIDED IN THIS AGREEMENT SATISFY THE ESSENTIAL PURPOSES HEREOF. FOR BREACH OF ANY PROVISION FOR WHICH AN EXPRESS REMEDY OR MEASURE OF DAMAGES IS PROVIDED, SUCH EXPRESS REMEDY OR MEASURE OF DAMAGES SHALL BE THE SOLE AND EXCLUSIVE REMEDY, THE OBLIGOR'S LIABILITY SHALL BE LIMITED AS SET FORTH IN SUCH PROVISION AND ALL OTHER REMEDIES OR DAMAGES AT LAW OR IN EQUITY ARE WAIVED. IF NO REMEDY OR MEASURE OF DAMAGES IS EXPRESSLY PROVIDED HEREIN OR IN A TRANSACTION, THE OBLIGOR'S LIABILITY SHALL BE LIMITED TO DIRECT ACTUAL DAMAGES ONLY, SUCH DIRECT ACTUAL DAMAGES SHALL BE THE SOLE AND EXCLUSIVE REMEDY AND ALL OTHER REMEDIES OR DAMAGES AT LAW OR IN EQUITY ARE WAIVED. UNLESS EXPRESSLY HEREIN PROVIDED, NEITHER PARTY SHALL BE LIABLE FOR CONSEQUENTIAL, INCIDENTAL, PUNITIVE, EXEMPLARY OR INDIRECT DAMAGES, LOST PROFITS OR

OTHER BUSINESS INTERRUPTION DAMAGES, BY STATUTE, IN TORT OR CONTRACT, UNDER ANY INDEMNITY PROVISION OR OTHERWISE. IT IS THE INTENT OF THE PARTIES THAT THE LIMITATIONS HEREIN IMPOSED ON REMEDIES AND THE MEASURE OF DAMAGES BE WITHOUT REGARD TO THE CAUSE OR CAUSES RELATED THERETO, INCLUDING THE NEGLIGENCE OF ANY PARTY, WHETHER SUCH NEGLIGENCE BE SOLE, JOINT OR CONCURRENT, OR ACTIVE OR PASSIVE. TO THE EXTENT ANY DAMAGES REQUIRED TO BE PAID HEREUNDER ARE LIQUIDATED, THE PARTIES ACKNOWLEDGE THAT THE DAMAGES ARE DIFFICULT OR IMPOSSIBLE TO DETERMINE, OR OTHERWISE OBTAINING AN ADEQUATE REMEDY IS INCONVENIENT AND THE DAMAGES CALCULATED HEREUNDER CONSTITUTE A REASONABLE APPROXIMATION OF THE HARM OR LOSS.

ARTICLE EIGHT: CREDIT AND COLLATERAL REQUIREMENTS

8.1 Party A Credit Protection. The applicable credit and collateral requirements shall be as specified on the Cover Sheet. If no option in Section 8.1(a) is specified on the Cover Sheet, Section 8.1(a) Option C shall apply exclusively. If none of Sections 8.1(b), 8.1(c) or 8.1(d) are specified on the Cover Sheet, Section 8.1(b) shall apply exclusively.

(a) Financial Information. Option A: If requested by Party A, Party B shall deliver (i) within 120 days following the end of each fiscal year, a copy of Party B's annual report containing audited consolidated financial statements for such fiscal year and (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of Party B's quarterly report containing unaudited consolidated financial statements for such fiscal quarter. In all cases the statements shall be for the most recent accounting period and prepared in accordance with generally accepted accounting principles; provided, however, that should any such statements not be available on a timely basis due to a delay in preparation or certification, such delay shall not be an Event of Default so long as Party B diligently pursues the preparation, certification and delivery of the statements.

Option B: If requested by Party A, Party B shall deliver (i) within 120 days following the end of each fiscal year, a copy of the annual report containing audited consolidated financial statements for such fiscal year for the party(s) specified on the Cover Sheet and (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of quarterly report containing unaudited consolidated financial statements for such fiscal quarter for the party(s) specified on the Cover Sheet. In all cases the statements shall be for the most recent accounting period and shall be prepared in accordance with generally accepted accounting principles; provided, however, that should any such statements not be available on a timely basis due to a delay in preparation or certification, such delay shall not be an Event of Default so long as the relevant entity diligently pursues the preparation, certification and delivery of the statements.

Option C: Party A may request from Party B the information specified in the Cover Sheet.

(b) Credit Assurances. If Party A has reasonable grounds to believe that Party B's creditworthiness or performance under this Agreement has become unsatisfactory, Party A will provide Party B with written notice requesting Performance Assurance in an amount determined by Party A in a commercially reasonable manner. Upon receipt of such notice Party B shall have three (3) Business Days to remedy the situation by providing such Performance Assurance to Party A. In the event that Party B fails to provide such Performance Assurance, or a guaranty or other credit assurance acceptable to Party A within three (3) Business Days of receipt of notice, then an Event of Default under Article Five will be deemed to have occurred and Party A will be entitled to the remedies set forth in Article Five of this Master Agreement.

(c) Collateral Threshold. If at any time and from time to time during the term of this Agreement (and notwithstanding whether an Event of Default has occurred), the Termination Payment that would be owed to Party A plus Party B's Independent Amount, if any, exceeds the Party B Collateral Threshold, then Party A, on any Business Day, may request that Party B provide Performance Assurance in an amount equal to the amount by which the Termination Payment plus Party B's Independent Amount, if any, exceeds the Party B Collateral Threshold (rounding upwards for any fractional amount to the next Party B Rounding Amount) ("Party B Performance Assurance"), less any Party B Performance Assurance already posted with Party A. Such Party B Performance Assurance shall be delivered to Party A within three (3) Business Days of the date of such request. On any Business Day (but no more frequently than weekly with respect to Letters of Credit and daily with respect to cash), Party B, at its sole cost, may request that such Party B Performance Assurance be reduced correspondingly to the amount of such excess Termination Payment plus Party B's Independent Amount, if any, (rounding upwards for any fractional amount to the next Party B Rounding Amount). In the event that Party B fails to provide Party B Performance Assurance pursuant to the terms of this Article Eight within three (3) Business Days, then an Event of Default under Article Five shall be deemed to have occurred and Party A will be entitled to the remedies set forth in Article Five of this Master Agreement.

For purposes of this Section 8.1(c), the calculation of the Termination Payment shall be calculated pursuant to Section 5.3 by Party A as if all outstanding Transactions had been liquidated, and in addition thereto, shall include all amounts owed but not yet paid by Party B to Party A, whether or not such amounts are due, for performance already provided pursuant to any and all Transactions.

(d) Downgrade Event. If at any time there shall occur a Downgrade Event in respect of Party B, then Party A may require Party B to provide Performance Assurance in an amount determined by Party A in a commercially reasonable manner. In the event Party B shall fail to provide such Performance Assurance or a guaranty or other credit assurance acceptable to Party A within three (3) Business Days of receipt of notice, then an Event of Default shall be deemed to have occurred and Party A will be entitled to the remedies set forth in Article Five of this Master Agreement.

(e) If specified on the Cover Sheet, Party B shall deliver to Party A, prior to or concurrently with the execution and delivery of this Master Agreement a guarantee in an amount not less than the Guarantee Amount specified on the Cover Sheet and in a form reasonably acceptable to Party A.

8.2 Party B Credit Protection. The applicable credit and collateral requirements shall be as specified on the Cover Sheet. If no option in Section 8.2(a) is specified on the Cover Sheet, Section 8.2(a) Option C shall apply exclusively. If none of Sections 8.2(b), 8.2(c) or 8.2(d) are specified on the Cover Sheet, Section 8.2(b) shall apply exclusively.

(a) Financial Information. Option A: If requested by Party B, Party A shall deliver (i) within 120 days following the end of each fiscal year, a copy of Party A's annual report containing audited consolidated financial statements for such fiscal year and (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of such Party's quarterly report containing unaudited consolidated financial statements for such fiscal quarter. In all cases the statements shall be for the most recent accounting period and prepared in accordance with generally accepted accounting principles; provided, however, that should any such statements not be available on a timely basis due to a delay in preparation or certification, such delay shall not be an Event of Default so long as such Party diligently pursues the preparation, certification and delivery of the statements.

Option B: If requested by Party B, Party A shall deliver (i) within 120 days following the end of each fiscal year, a copy of the annual report containing audited consolidated financial statements for such fiscal year for the party(s) specified on the Cover Sheet and (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of quarterly report containing unaudited consolidated financial statements for such fiscal quarter for the party(s) specified on the Cover Sheet. In all cases the statements shall be for the most recent accounting period and shall be prepared in accordance with generally accepted accounting principles; provided, however, that should any such statements not be available on a timely basis due to a delay in preparation or certification, such delay shall not be an Event of Default so long as the relevant entity diligently pursues the preparation, certification and delivery of the statements.

Option C: Party B may request from Party A the information specified in the Cover Sheet.

(b) Credit Assurances. If Party B has reasonable grounds to believe that Party A's creditworthiness or performance under this Agreement has become unsatisfactory, Party B will provide Party A with written notice requesting Performance Assurance in an amount determined by Party B in a commercially reasonable manner. Upon receipt of such notice Party A shall have three (3) Business Days to remedy the situation by providing such Performance Assurance to Party B. In the event that Party A fails to provide such Performance Assurance, or a guaranty or other credit assurance acceptable to Party B within three (3) Business Days of receipt of notice, then an Event of Default under Article Five will be deemed to have occurred and Party B will be entitled to the remedies set forth in Article Five of this Master Agreement.

(c) Collateral Threshold. If at any time and from time to time during the term of this Agreement (and notwithstanding whether an Event of Default has occurred), the Termination Payment that would be owed to Party B plus Party A's Independent Amount, if any, exceeds the Party A Collateral Threshold, then Party B, on any Business Day, may request that Party A provide Performance Assurance in an amount equal to the amount by which the Termination Payment plus Party A's Independent Amount, if any, exceeds the Party A Collateral

Threshold (rounding upwards for any fractional amount to the next Party A Rounding Amount) (“Party A Performance Assurance”), less any Party A Performance Assurance already posted with Party B. Such Party A Performance Assurance shall be delivered to Party B within three (3) Business Days of the date of such request. On any Business Day (but no more frequently than weekly with respect to Letters of Credit and daily with respect to cash), Party A, at its sole cost, may request that such Party A Performance Assurance be reduced correspondingly to the amount of such excess Termination Payment plus Party A’s Independent Amount, if any, (rounding upwards for any fractional amount to the next Party A Rounding Amount). In the event that Party A fails to provide Party A Performance Assurance pursuant to the terms of this Article Eight within three (3) Business Days, then an Event of Default under Article Five shall be deemed to have occurred and Party B will be entitled to the remedies set forth in Article Five of this Master Agreement.

For purposes of this Section 8.2(c), the calculation of the Termination Payment shall be calculated pursuant to Section 5.3 by Party B as if all outstanding Transactions had been liquidated, and in addition thereto, shall include all amounts owed but not yet paid by Party A to Party B, whether or not such amounts are due, for performance already provided pursuant to any and all Transactions.

(d) Downgrade Event. If at any time there shall occur a Downgrade Event in respect of Party A, then Party B may require Party A to provide Performance Assurance in an amount determined by Party B in a commercially reasonable manner. In the event Party A shall fail to provide such Performance Assurance or a guaranty or other credit assurance acceptable to Party B within three (3) Business Days of receipt of notice, then an Event of Default shall be deemed to have occurred and Party B will be entitled to the remedies set forth in Article Five of this Master Agreement.

(e) If specified on the Cover Sheet, Party A shall deliver to Party B, prior to or concurrently with the execution and delivery of this Master Agreement a guarantee in an amount not less than the Guarantee Amount specified on the Cover Sheet and in a form reasonably acceptable to Party B.

8.3 Grant of Security Interest/Remedies. To secure its obligations under this Agreement and to the extent either or both Parties deliver Performance Assurance hereunder, each Party (a “Pledgor”) hereby grants to the other Party (the “Secured Party”) a present and continuing security interest in, and lien on (and right of setoff against), and assignment of, all cash collateral and cash equivalent collateral and any and all proceeds resulting therefrom or the liquidation thereof, whether now or hereafter held by, on behalf of, or for the benefit of, such Secured Party, and each Party agrees to take such action as the other Party reasonably requires in order to perfect the Secured Party’s first-priority security interest in, and lien on (and right of setoff against), such collateral and any and all proceeds resulting therefrom or from the liquidation thereof. Upon or any time after the occurrence or deemed occurrence and during the continuation of an Event of Default or an Early Termination Date, the Non-Defaulting Party may do any one or more of the following: (i) exercise any of the rights and remedies of a Secured Party with respect to all Performance Assurance, including any such rights and remedies under law then in effect; (ii) exercise its rights of setoff against any and all property of the Defaulting Party in the possession of the Non-Defaulting Party or its agent; (iii) draw on any outstanding

Letter of Credit issued for its benefit; and (iv) liquidate all Performance Assurance then held by or for the benefit of the Secured Party free from any claim or right of any nature whatsoever of the Defaulting Party, including any equity or right of purchase or redemption by the Defaulting Party. The Secured Party shall apply the proceeds of the collateral realized upon the exercise of any such rights or remedies to reduce the Pledgor's obligations under the Agreement (the Pledgor remaining liable for any amounts owing to the Secured Party after such application), subject to the Secured Party's obligation to return any surplus proceeds remaining after such obligations are satisfied in full.

ARTICLE NINE: GOVERNMENTAL CHARGES

9.1 Cooperation. Each Party shall use reasonable efforts to implement the provisions of and to administer this Master Agreement in accordance with the intent of the parties to minimize all taxes, so long as neither Party is materially adversely affected by such efforts.

9.2 Governmental Charges. Seller shall pay or cause to be paid all taxes imposed by any government authority ("Governmental Charges") on or with respect to the Product or a Transaction arising prior to the Delivery Point. Buyer shall pay or cause to be paid all Governmental Charges on or with respect to the Product or a Transaction at and from the Delivery Point (other than ad valorem, franchise or income taxes which are related to the sale of the Product and are, therefore, the responsibility of the Seller). In the event Seller is required by law or regulation to remit or pay Governmental Charges which are Buyer's responsibility hereunder, Buyer shall promptly reimburse Seller for such Governmental Charges. If Buyer is required by law or regulation to remit or pay Governmental Charges which are Seller's responsibility hereunder, Buyer may deduct the amount of any such Governmental Charges from the sums due to Seller under Article 6 of this Agreement. Nothing shall obligate or cause a Party to pay or be liable to pay any Governmental Charges for which it is exempt under the law.

ARTICLE TEN: MISCELLANEOUS

10.1 Term of Master Agreement. The term of this Master Agreement shall commence on the Effective Date and shall remain in effect until terminated by either Party upon (thirty) 30 days' prior written notice; provided, however, that such termination shall not affect or excuse the performance of either Party under any provision of this Master Agreement that by its terms survives any such termination and, provided further, that this Master Agreement and any other documents executed and delivered hereunder shall remain in effect with respect to the Transaction(s) entered into prior to the effective date of such termination until both Parties have fulfilled all of their obligations with respect to such Transaction(s), or such Transaction(s) that have been terminated under Section 5.2 of this Agreement.

10.2 Representations and Warranties. On the Effective Date and the date of entering into each Transaction, each Party represents and warrants to the other Party that:

- (i) it is duly organized, validly existing and in good standing under the laws of the jurisdiction of its formation;

- (ii) it has all regulatory authorizations necessary for it to legally perform its obligations under this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3);
- (iii) the execution, delivery and performance of this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3) are within its powers, have been duly authorized by all necessary action and do not violate any of the terms and conditions in its governing documents, any contracts to which it is a party or any law, rule, regulation, order or the like applicable to it;
- (iv) this Master Agreement, each Transaction (including any Confirmation accepted in accordance with Section 2.3), and each other document executed and delivered in accordance with this Master Agreement constitutes its legally valid and binding obligation enforceable against it in accordance with its terms; subject to any Equitable Defenses.
- (v) it is not Bankrupt and there are no proceedings pending or being contemplated by it or, to its knowledge, threatened against it which would result in it being or becoming Bankrupt;
- (vi) there is not pending or, to its knowledge, threatened against it or any of its Affiliates any legal proceedings that could materially adversely affect its ability to perform its obligations under this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3);
- (vii) no Event of Default or Potential Event of Default with respect to it has occurred and is continuing and no such event or circumstance would occur as a result of its entering into or performing its obligations under this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3);
- (viii) it is acting for its own account, has made its own independent decision to enter into this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3) and as to whether this Master Agreement and each such Transaction (including any Confirmation accepted in accordance with Section 2.3) is appropriate or proper for it based upon its own judgment, is not relying upon the advice or recommendations of the other Party in so doing, and is capable of assessing the merits of and understanding, and understands and accepts, the terms, conditions and risks of this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3);
- (ix) it is a “forward contract merchant” within the meaning of the United States Bankruptcy Code;

- (x) it has entered into this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3) in connection with the conduct of its business and it has the capacity or ability to make or take delivery of all Products referred to in the Transaction to which it is a Party;
- (xi) with respect to each Transaction (including any Confirmation accepted in accordance with Section 2.3) involving the purchase or sale of a Product or an Option, it is a producer, processor, commercial user or merchant handling the Product, and it is entering into such Transaction for purposes related to its business as such; and
- (xii) the material economic terms of each Transaction are subject to individual negotiation by the Parties.

10.3 Title and Risk of Loss. Title to and risk of loss related to the Product shall transfer from Seller to Buyer at the Delivery Point. Seller warrants that it will deliver to Buyer the Quantity of the Product free and clear of all liens, security interests, claims and encumbrances or any interest therein or thereto by any person arising prior to the Delivery Point.

10.4 Indemnity. Each Party shall indemnify, defend and hold harmless the other Party from and against any Claims arising from or out of any event, circumstance, act or incident first occurring or existing during the period when control and title to Product is vested in such Party as provided in Section 10.3. Each Party shall indemnify, defend and hold harmless the other Party against any Governmental Charges for which such Party is responsible under Article Nine.

10.5 Assignment. Neither Party shall assign this Agreement or its rights hereunder without the prior written consent of the other Party, which consent may be withheld in the exercise of its sole discretion; provided, however, either Party may, without the consent of the other Party (and without relieving itself from liability hereunder), (i) transfer, sell, pledge, encumber or assign this Agreement or the accounts, revenues or proceeds hereof in connection with any financing or other financial arrangements, (ii) transfer or assign this Agreement to an affiliate of such Party which affiliate's creditworthiness is equal to or higher than that of such Party, or (iii) transfer or assign this Agreement to any person or entity succeeding to all or substantially all of the assets whose creditworthiness is equal to or higher than that of such Party; provided, however, that in each such case, any such assignee shall agree in writing to be bound by the terms and conditions hereof and so long as the transferring Party delivers such tax and enforceability assurance as the non-transferring Party may reasonably request.

10.6 Governing Law. THIS AGREEMENT AND THE RIGHTS AND DUTIES OF THE PARTIES HEREUNDER SHALL BE GOVERNED BY AND CONSTRUED, ENFORCED AND PERFORMED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK, WITHOUT REGARD TO PRINCIPLES OF CONFLICTS OF LAW. EACH PARTY WAIVES ITS RESPECTIVE RIGHT TO ANY JURY TRIAL WITH RESPECT TO ANY LITIGATION ARISING UNDER OR IN CONNECTION WITH THIS AGREEMENT.

10.7 Notices. All notices, requests, statements or payments shall be made as specified in the Cover Sheet. Notices (other than scheduling requests) shall, unless otherwise specified herein, be in writing and may be delivered by hand delivery, United States mail, overnight courier service or facsimile. Notice by facsimile or hand delivery shall be effective at the close of business on the day actually received, if received during business hours on a Business Day, and otherwise shall be effective at the close of business on the next Business Day. Notice by overnight United States mail or courier shall be effective on the next Business Day after it was sent. A Party may change its addresses by providing notice of same in accordance herewith.

10.8 General. This Master Agreement (including the exhibits, schedules and any written supplements hereto), the Party A Tariff, if any, the Party B Tariff, if any, any designated collateral, credit support or margin agreement or similar arrangement between the Parties and all Transactions (including any Confirmation accepted in accordance with Section 2.3) constitute the entire agreement between the Parties relating to the subject matter. Notwithstanding the foregoing, any collateral, credit support or margin agreement or similar arrangement between the Parties shall, upon designation by the Parties, be deemed part of this Agreement and shall be incorporated herein by reference. This Agreement shall be considered for all purposes as prepared through the joint efforts of the parties and shall not be construed against one party or the other as a result of the preparation, substitution, submission or other event of negotiation, drafting or execution hereof. Except to the extent herein provided for, no amendment or modification to this Master Agreement shall be enforceable unless reduced to writing and executed by both Parties. Each Party agrees if it seeks to amend any applicable wholesale power sales tariff during the term of this Agreement, such amendment will not in any way affect outstanding Transactions under this Agreement without the prior written consent of the other Party. Each Party further agrees that it will not assert, or defend itself, on the basis that any applicable tariff is inconsistent with this Agreement. This Agreement shall not impart any rights enforceable by any third party (other than a permitted successor or assignee bound to this Agreement). Waiver by a Party of any default by the other Party shall not be construed as a waiver of any other default. Any provision declared or rendered unlawful by any applicable court of law or regulatory agency or deemed unlawful because of a statutory change (individually or collectively, such events referred to as "Regulatory Event") will not otherwise affect the remaining lawful obligations that arise under this Agreement; and provided, further, that if a Regulatory Event occurs, the Parties shall use their best efforts to reform this Agreement in order to give effect to the original intention of the Parties. The term "including" when used in this Agreement shall be by way of example only and shall not be considered in any way to be in limitation. The headings used herein are for convenience and reference purposes only. All indemnity and audit rights shall survive the termination of this Agreement for twelve (12) months. This Agreement shall be binding on each Party's successors and permitted assigns.

10.9 Audit. Each Party has the right, at its sole expense and during normal working hours, to examine the records of the other Party to the extent reasonably necessary to verify the accuracy of any statement, charge or computation made pursuant to this Master Agreement. If requested, a Party shall provide to the other Party statements evidencing the Quantity delivered at the Delivery Point. If any such examination reveals any inaccuracy in any statement, the necessary adjustments in such statement and the payments thereof will be made promptly and shall bear interest calculated at the Interest Rate from the date the overpayment or underpayment was made until paid; provided, however, that no adjustment for any statement or payment will be

made unless objection to the accuracy thereof was made prior to the lapse of twelve (12) months from the rendition thereof, and thereafter any objection shall be deemed waived.

10.10 Forward Contract. The Parties acknowledge and agree that all Transactions constitute “forward contracts” within the meaning of the United States Bankruptcy Code.

10.11 Confidentiality. If the Parties have elected on the Cover Sheet to make this Section 10.11 applicable to this Master Agreement, neither Party shall disclose the terms or conditions of a Transaction under this Master Agreement to a third party (other than the Party’s employees, lenders, counsel, accountants or advisors who have a need to know such information and have agreed to keep such terms confidential) except in order to comply with any applicable law, regulation, or any exchange, control area or independent system operator rule or in connection with any court or regulatory proceeding; provided, however, each Party shall, to the extent practicable, use reasonable efforts to prevent or limit the disclosure. The Parties shall be entitled to all remedies available at law or in equity to enforce, or seek relief in connection with, this confidentiality obligation.

SCHEDULE M

(THIS SCHEDULE IS INCLUDED IF THE APPROPRIATE BOX ON THE COVER SHEET IS MARKED INDICATING A PARTY IS A GOVERNMENTAL ENTITY OR PUBLIC POWER SYSTEM)

A. The Parties agree to add the following definitions in Article One.

“Act” means _____.¹

“Governmental Entity or Public Power System” means a municipality, county, governmental board, public power authority, public utility district, joint action agency, or other similar political subdivision or public entity of the United States, one or more States or territories or any combination thereof.

“Special Fund” means a fund or account of the Governmental Entity or Public Power System set aside and or pledged to satisfy the Public Power System’s obligations hereunder out of which amounts shall be paid to satisfy all of the Public Power System’s obligations under this Master Agreement for the entire Delivery Period.

B. The following sentence shall be added to the end of the definition of “Force Majeure” in Article One.

If the Claiming Party is a Governmental Entity or Public Power System, Force Majeure does not include any action taken by the Governmental Entity or Public Power System in its governmental capacity.

C. The Parties agree to add the following representations and warranties to Section 10.2:

Further and with respect to a Party that is a Governmental Entity or Public Power System, such Governmental Entity or Public Power System represents and warrants to the other Party continuing throughout the term of this Master Agreement, with respect to this Master Agreement and each Transaction, as follows: (i) all acts necessary to the valid execution, delivery and performance of this Master Agreement, including without limitation, competitive bidding, public notice, election, referendum, prior appropriation or other required procedures has or will be taken and performed as required under the Act and the Public Power System’s ordinances, bylaws or other regulations, (ii) all persons making up the governing body of Governmental Entity or Public Power System are the duly elected or appointed incumbents in their positions and hold such

¹ Cite the state enabling and other relevant statutes applicable to Governmental Entity or Public Power System.

positions in good standing in accordance with the Act and other applicable law, (iii) entry into and performance of this Master Agreement by Governmental Entity or Public Power System are for a proper public purpose within the meaning of the Act and all other relevant constitutional, organic or other governing documents and applicable law, (iv) the term of this Master Agreement does not extend beyond any applicable limitation imposed by the Act or other relevant constitutional, organic or other governing documents and applicable law, (v) the Public Power System's obligations to make payments hereunder are unsubordinated obligations and such payments are (a) operating and maintenance costs (or similar designation) which enjoy first priority of payment at all times under any and all bond ordinances or indentures to which it is a party, the Act and all other relevant constitutional, organic or other governing documents and applicable law or (b) otherwise not subject to any prior claim under any and all bond ordinances or indentures to which it is a party, the Act and all other relevant constitutional, organic or other governing documents and applicable law and are available without limitation or deduction to satisfy all Governmental Entity or Public Power System' obligations hereunder and under each Transaction or (c) are to be made solely from a Special Fund, (vi) entry into and performance of this Master Agreement and each Transaction by the Governmental Entity or Public Power System will not adversely affect the exclusion from gross income for federal income tax purposes of interest on any obligation of Governmental Entity or Public Power System otherwise entitled to such exclusion, and (vii) obligations to make payments hereunder do not constitute any kind of indebtedness of Governmental Entity or Public Power System or create any kind of lien on, or security interest in, any property or revenues of Governmental Entity or Public Power System which, in either case, is proscribed by any provision of the Act or any other relevant constitutional, organic or other governing documents and applicable law, any order or judgment of any court or other agency of government applicable to it or its assets, or any contractual restriction binding on or affecting it or any of its assets.

D. The Parties agree to add the following sections to Article Three:

Section 3.4 Public Power System's Deliveries. On the Effective Date and as a condition to the obligations of the other Party under this Agreement, Governmental Entity or Public Power System shall provide the other Party hereto (i) certified copies of all ordinances, resolutions, public notices and other documents evidencing the necessary authorizations with respect to the execution, delivery and performance by Governmental Entity or Public Power System of this Master Agreement and (ii) an opinion of counsel for Governmental Entity or Public Power System, in form and substance reasonably satisfactory to the Other Party, regarding the validity, binding effect and enforceability of this Master Agreement against Governmental Entity or Public Power System in

respect of the Act and all other relevant constitutional organic or other governing documents and applicable law.

Section 3.5 No Immunity Claim. Governmental Entity or Public Power System warrants and covenants that with respect to its contractual obligations hereunder and performance thereof, it will not claim immunity on the grounds of sovereignty or similar grounds with respect to itself or its revenues or assets from (a) suit, (b) jurisdiction of court (including a court located outside the jurisdiction of its organization), (c) relief by way of injunction, order for specific performance or recovery of property, (d) attachment of assets, or (e) execution or enforcement of any judgment.

E. If the appropriate box is checked on the Cover Sheet, as an alternative to selecting one of the options under Section 8.3, the Parties agree to add the following section to Article Three:

Section 3.6 Governmental Entity or Public Power System Security. With respect to each Transaction, Governmental Entity or Public Power System shall either (i) have created and set aside a Special Fund or (ii) upon execution of this Master Agreement and prior to the commencement of each subsequent fiscal year of Governmental Entity or Public Power System during any Delivery Period, have obtained all necessary budgetary approvals and certifications for payment of all of its obligations under this Master Agreement for such fiscal year; any breach of this provision shall be deemed to have arisen during a fiscal period of Governmental Entity or Public Power System for which budgetary approval or certification of its obligations under this Master Agreement is in effect and, notwithstanding anything to the contrary in Article Four, an Early Termination Date shall automatically and without further notice occur hereunder as of such date wherein Governmental Entity or Public Power System shall be treated as the Defaulting Party. Governmental Entity or Public Power System shall have allocated to the Special Fund or its general funds a revenue base that is adequate to cover Public Power System's payment obligations hereunder throughout the entire Delivery Period.

F. If the appropriate box is checked on the Cover Sheet, the Parties agree to add the following section to Article Eight:

Section 8.4 Governmental Security. As security for payment and performance of Public Power System's obligations hereunder, Public Power System hereby pledges, sets over, assigns and grants to the other Party a security interest in all of Public Power System's right, title and interest in and to [specify collateral].

G. The Parties agree to add the following sentence at the end of Section 10.6 - Governing Law:

NOTWITHSTANDING THE FOREGOING, IN RESPECT OF THE
APPLICABILITY OF THE ACT AS HEREIN PROVIDED, THE LAWS
OF THE STATE OF _____² SHALL APPLY.

² Insert relevant state for Governmental Entity or Public Power System.

SCHEDULE P: PRODUCTS AND RELATED DEFINITIONS

“Ancillary Services” means any of the services identified by a Transmission Provider in its transmission tariff as “ancillary services” including, but not limited to, regulation and frequency response, energy imbalance, operating reserve-spinning and operating reserve-supplemental, as may be specified in the Transaction.

“Capacity” has the meaning specified in the Transaction.

“Energy” means three-phase, 60-cycle alternating current electric energy, expressed in megawatt hours.

“Firm (LD)” means, with respect to a Transaction, that either Party shall be relieved of its obligations to sell and deliver or purchase and receive without liability only to the extent that, and for the period during which, such performance is prevented by Force Majeure. In the absence of Force Majeure, the Party to which performance is owed shall be entitled to receive from the Party which failed to deliver/receive an amount determined pursuant to Article Four.

“Firm Transmission Contingent - Contract Path” means, with respect to a Transaction, that the performance of either Seller or Buyer (as specified in the Transaction) shall be excused, and no damages shall be payable including any amounts determined pursuant to Article Four, if the transmission for such Transaction is interrupted or curtailed and (i) such Party has provided for firm transmission with the transmission provider(s) for the Product in the case of the Seller from the generation source to the Delivery Point or in the case of the Buyer from the Delivery Point to the ultimate sink, and (ii) such interruption or curtailment is due to “force majeure” or “uncontrollable force” or a similar term as defined under the applicable transmission provider’s tariff. This contingency shall excuse performance for the duration of the interruption or curtailment notwithstanding the provisions of the definition of “Force Majeure” in Section 1.23 to the contrary.

“Firm Transmission Contingent - Delivery Point” means, with respect to a Transaction, that the performance of either Seller or Buyer (as specified in the Transaction) shall be excused, and no damages shall be payable including any amounts determined pursuant to Article Four, if the transmission to the Delivery Point (in the case of Seller) or from the Delivery Point (in the case of Buyer) for such Transaction is interrupted or curtailed and (i) such Party has provided for firm transmission with the transmission provider(s) for the Product, in the case of the Seller, to be delivered to the Delivery Point or, in the case of Buyer, to be received at the Delivery Point and (ii) such interruption or curtailment is due to “force majeure” or “uncontrollable force” or a similar term as defined under the applicable transmission provider’s tariff. This transmission contingency excuses performance for the duration of the interruption or curtailment, notwithstanding the provisions of the definition of “Force Majeure” in Section 1.23 to the contrary. Interruptions or curtailments of transmission other than the transmission either immediately to or from the Delivery Point shall not excuse performance

“Firm (No Force Majeure)” means, with respect to a Transaction, that if either Party fails to perform its obligation to sell and deliver or purchase and receive the Product, the Party to which performance is owed shall be entitled to receive from the Party which failed to perform an

amount determined pursuant to Article Four. Force Majeure shall not excuse performance of a Firm (No Force Majeure) Transaction.

“Into _____ (the “Receiving Transmission Provider”), Seller’s Daily Choice” means that, in accordance with the provisions set forth below, (1) the Product shall be scheduled and delivered to an interconnection or interface (“Interface”) either (a) on the Receiving Transmission Provider’s transmission system border or (b) within the control area of the Receiving Transmission Provider if the Product is from a source of generation in that control area, which Interface, in either case, the Receiving Transmission Provider identifies as available for delivery of the Product in or into its control area; and (2) Seller has the right on a daily prescheduled basis to designate the Interface where the Product shall be delivered. An “Into” Product shall be subject to the following provisions:

1. Prescheduling and Notification. Subject to the provisions of Section 6, not later than the prescheduling deadline of 11:00 a.m. CPT on the Business Day before the next delivery day or as otherwise agreed to by Buyer and Seller, Seller shall notify Buyer (“Seller’s Notification”) of Seller’s immediate upstream counterparty and the Interface (the “Designated Interface”) where Seller shall deliver the Product for the next delivery day, and Buyer shall notify Seller of Buyer’s immediate downstream counterparty.

2. Availability of “Firm Transmission” to Buyer at Designated Interface; “Timely Request for Transmission,” “ADI” and “Available Transmission.” In determining availability to Buyer of next-day firm transmission (“Firm Transmission”) from the Designated Interface, a “Timely Request for Transmission” shall mean a properly completed request for Firm Transmission made by Buyer in accordance with the controlling tariff procedures, which request shall be submitted to the Receiving Transmission Provider no later than 30 minutes after delivery of Seller’s Notification, provided, however, if the Receiving Transmission Provider is not accepting requests for Firm Transmission at the time of Seller’s Notification, then such request by Buyer shall be made within 30 minutes of the time when the Receiving Transmission Provider first opens thereafter for purposes of accepting requests for Firm Transmission.

Pursuant to the terms hereof, delivery of the Product may under certain circumstances be redesignated to occur at an Interface other than the Designated Interface (any such alternate designated interface, an “ADI”) either (a) on the Receiving Transmission Provider’s transmission system border or (b) within the control area of the Receiving Transmission Provider if the Product is from a source of generation in that control area, which ADI, in either case, the Receiving Transmission Provider identifies as available for delivery of the Product in or into its control area using either firm or non-firm transmission, as available on a day-ahead or hourly basis (individually or collectively referred to as “Available Transmission”) within the Receiving Transmission Provider’s transmission system.

3. Rights of Buyer and Seller Depending Upon Availability of/Timely Request for Firm Transmission.

A. Timely Request for Firm Transmission made by Buyer, Accepted by the Receiving Transmission Provider and Purchased by Buyer. If a Timely Request for Firm Transmission is made by Buyer and is accepted by the Receiving Transmission Provider

and Buyer purchases such Firm Transmission, then Seller shall deliver and Buyer shall receive the Product at the Designated Interface.

i. If the Firm Transmission purchased by Buyer within the Receiving Transmission Provider's transmission system from the Designated Interface ceases to be available to Buyer for any reason, or if Seller is unable to deliver the Product at the Designated Interface for any reason except Buyer's non-performance, then at Seller's choice from among the following, Seller shall: (a) to the extent Firm Transmission is available to Buyer from an ADI on a day-ahead basis, require Buyer to purchase such Firm Transmission from such ADI, and schedule and deliver the affected portion of the Product to such ADI on the basis of Buyer's purchase of Firm Transmission, or (b) require Buyer to purchase non-firm transmission, and schedule and deliver the affected portion of the Product on the basis of Buyer's purchase of non-firm transmission from the Designated Interface or an ADI designated by Seller, or (c) to the extent firm transmission is available on an hourly basis, require Buyer to purchase firm transmission, and schedule and deliver the affected portion of the Product on the basis of Buyer's purchase of such hourly firm transmission from the Designated Interface or an ADI designated by Seller.

ii. If the Available Transmission utilized by Buyer as required by Seller pursuant to Section 3A(i) ceases to be available to Buyer for any reason, then Seller shall again have those alternatives stated in Section 3A(i) in order to satisfy its obligations.

iii. Seller's obligation to schedule and deliver the Product at an ADI is subject to Buyer's obligation referenced in Section 4B to cooperate reasonably therewith. If Buyer and Seller cannot complete the scheduling and/or delivery at an ADI, then Buyer shall be deemed to have satisfied its receipt obligations to Seller and Seller shall be deemed to have failed its delivery obligations to Buyer, and Seller shall be liable to Buyer for amounts determined pursuant to Article Four.

iv. In each instance in which Buyer and Seller must make alternative scheduling arrangements for delivery at the Designated Interface or an ADI pursuant to Sections 3A(i) or (ii), and Firm Transmission had been purchased by both Seller and Buyer into and within the Receiving Transmission Provider's transmission system as to the scheduled delivery which could not be completed as a result of the interruption or curtailment of such Firm Transmission, Buyer and Seller shall bear their respective transmission expenses and/or associated congestion charges incurred in connection with efforts to complete delivery by such alternative scheduling and delivery arrangements. In any instance except as set forth in the immediately preceding sentence, Buyer and Seller must make alternative scheduling arrangements for delivery at the Designated Interface or an ADI under Sections 3A(i) or (ii), Seller shall be responsible for any additional transmission purchases and/or associated congestion charges incurred by Buyer in connection with such alternative scheduling arrangements.

B. Timely Request for Firm Transmission Made by Buyer but Rejected by the Receiving Transmission Provider. If Buyer's Timely Request for Firm Transmission is rejected by the Receiving Transmission Provider because of unavailability of Firm Transmission from the Designated Interface, then Buyer shall notify Seller within 15 minutes after receipt of the Receiving Transmission Provider's notice of rejection ("Buyer's Rejection Notice"). If Buyer timely notifies Seller of such unavailability of Firm Transmission from the Designated Interface, then Seller shall be obligated either (1) to the extent Firm Transmission is available to Buyer from an ADI on a day-ahead basis, to require Buyer to purchase (at Buyer's own expense) such Firm Transmission from such ADI and schedule and deliver the Product to such ADI on the basis of Buyer's purchase of Firm Transmission, and thereafter the provisions in Section 3A shall apply, or (2) to require Buyer to purchase (at Buyer's own expense) non-firm transmission, and schedule and deliver the Product on the basis of Buyer's purchase of non-firm transmission from the Designated Interface or an ADI designated by the Seller, in which case Seller shall bear the risk of interruption or curtailment of the non-firm transmission; provided, however, that if the non-firm transmission is interrupted or curtailed or if Seller is unable to deliver the Product for any reason, Seller shall have the right to schedule and deliver the Product to another ADI in order to satisfy its delivery obligations, in which case Seller shall be responsible for any additional transmission purchases and/or associated congestion charges incurred by Buyer in connection with Seller's inability to deliver the Product as originally prescheduled. If Buyer fails to timely notify Seller of the unavailability of Firm Transmission, then Buyer shall bear the risk of interruption or curtailment of transmission from the Designated Interface, and the provisions of Section 3D shall apply.

C. Timely Request for Firm Transmission Made by Buyer, Accepted by the Receiving Transmission Provider and not Purchased by Buyer. If Buyer's Timely Request for Firm Transmission is accepted by the Receiving Transmission Provider but Buyer elects to purchase non-firm transmission rather than Firm Transmission to take delivery of the Product, then Buyer shall bear the risk of interruption or curtailment of transmission from the Designated Interface. In such circumstances, if Seller's delivery is interrupted as a result of transmission relied upon by Buyer from the Designated Interface, then Seller shall be deemed to have satisfied its delivery obligations to Buyer, Buyer shall be deemed to have failed to receive the Product and Buyer shall be liable to Seller for amounts determined pursuant to Article Four.

D. No Timely Request for Firm Transmission Made by Buyer, or Buyer Fails to Timely Send Buyer's Rejection Notice. If Buyer fails to make a Timely Request for Firm Transmission or Buyer fails to timely deliver Buyer's Rejection Notice, then Buyer shall bear the risk of interruption or curtailment of transmission from the Designated Interface. In such circumstances, if Seller's delivery is interrupted as a result of transmission relied upon by Buyer from the Designated Interface, then Seller shall be deemed to have satisfied its delivery obligations to Buyer, Buyer shall be deemed to have failed to receive the Product and Buyer shall be liable to Seller for amounts determined pursuant to Article Four.

4. Transmission.

A. Seller's Responsibilities. Seller shall be responsible for transmission required to deliver the Product to the Designated Interface or ADI, as the case may be. It is expressly agreed that Seller is not required to utilize Firm Transmission for its delivery obligations hereunder, and Seller shall bear the risk of utilizing non-firm transmission. If Seller's scheduled delivery to Buyer is interrupted as a result of Buyer's attempted transmission of the Product beyond the Receiving Transmission Provider's system border, then Seller will be deemed to have satisfied its delivery obligations to Buyer, Buyer shall be deemed to have failed to receive the Product and Buyer shall be liable to Seller for damages pursuant to Article Four.

B. Buyer's Responsibilities. Buyer shall be responsible for transmission required to receive and transmit the Product at and from the Designated Interface or ADI, as the case may be, and except as specifically provided in Section 3A and 3B, shall be responsible for any costs associated with transmission therefrom. If Seller is attempting to complete the designation of an ADI as a result of Seller's rights and obligations hereunder, Buyer shall co-operate reasonably with Seller in order to effect such alternate designation.

5. Force Majeure. An "Into" Product shall be subject to the "Force Majeure" provisions in Section 1.23.

6. Multiple Parties in Delivery Chain Involving a Designated Interface. Seller and Buyer recognize that there may be multiple parties involved in the delivery and receipt of the Product at the Designated Interface or ADI to the extent that (1) Seller may be purchasing the Product from a succession of other sellers ("Other Sellers"), the first of which Other Sellers shall be causing the Product to be generated from a source ("Source Seller") and/or (2) Buyer may be selling the Product to a succession of other buyers ("Other Buyers"), the last of which Other Buyers shall be using the Product to serve its energy needs ("Sink Buyer"). Seller and Buyer further recognize that in certain Transactions neither Seller nor Buyer may originate the decision as to either (a) the original identification of the Designated Interface or ADI (which designation may be made by the Source Seller) or (b) the Timely Request for Firm Transmission or the purchase of other Available Transmission (which request may be made by the Sink Buyer). Accordingly, Seller and Buyer agree as follows:

A. If Seller is not the Source Seller, then Seller shall notify Buyer of the Designated Interface promptly after Seller is notified thereof by the Other Seller with whom Seller has a contractual relationship, but in no event may such designation of the Designated Interface be later than the prescheduling deadline pertaining to the Transaction between Buyer and Seller pursuant to Section 1.

B. If Buyer is not the Sink Buyer, then Buyer shall notify the Other Buyer with whom Buyer has a contractual relationship of the Designated Interface promptly after Seller notifies Buyer thereof, with the intent being that the party bearing actual responsibility to secure transmission shall have up to 30 minutes after receipt of the Designated Interface to submit its Timely Request for Firm Transmission.

C. Seller and Buyer each agree that any other communications or actions required to be given or made in connection with this “Into Product” (including without limitation, information relating to an ADI) shall be made or taken promptly after receipt of the relevant information from the Other Sellers and Other Buyers, as the case may be.

D. Seller and Buyer each agree that in certain Transactions time is of the essence and it may be desirable to provide necessary information to Other Sellers and Other Buyers in order to complete the scheduling and delivery of the Product. Accordingly, Seller and Buyer agree that each has the right, but not the obligation, to provide information at its own risk to Other Sellers and Other Buyers, as the case may be, in order to effect the prescheduling, scheduling and delivery of the Product

“Native Load” means the demand imposed on an electric utility or an entity by the requirements of retail customers located within a franchised service territory that the electric utility or entity has statutory obligation to serve.

“Non-Firm” means, with respect to a Transaction, that delivery or receipt of the Product may be interrupted for any reason or for no reason, without liability on the part of either Party.

“System Firm” means that the Product will be supplied from the owned or controlled generation or pre-existing purchased power assets of the system specified in the Transaction (the “System”) with non-firm transmission to and from the Delivery Point, unless a different Transmission Contingency is specified in a Transaction. Seller’s failure to deliver shall be excused: (i) by an event or circumstance which prevents Seller from performing its obligations, which event or circumstance was not anticipated as of the date the Transaction was agreed to, which is not within the reasonable control of, or the result of the negligence of, the Seller; (ii) by Buyer’s failure to perform; (iii) to the extent necessary to preserve the integrity of, or prevent or limit any instability on, the System; (iv) to the extent the System or the control area or reliability council within which the System operates declares an emergency condition, as determined in the system’s, or the control area’s, or reliability council’s reasonable judgment; or (v) by the interruption or curtailment of transmission to the Delivery Point or by the occurrence of any Transmission Contingency specified in a Transaction as excusing Seller’s performance. Buyer’s failure to receive shall be excused (i) by Force Majeure; (ii) by Seller’s failure to perform, or (iii) by the interruption or curtailment of transmission from the Delivery Point or by the occurrence of any Transmission Contingency specified in a Transaction as excusing Buyer’s performance. In any of such events, neither party shall be liable to the other for any damages, including any amounts determined pursuant to Article Four.

“Transmission Contingent” means, with respect to a Transaction, that the performance of either Seller or Buyer (as specified in the Transaction) shall be excused, and no damages shall be payable including any amounts determined pursuant to Article Four, if the transmission for such Transaction is unavailable or interrupted or curtailed for any reason, at any time, anywhere from the Seller’s proposed generating source to the Buyer’s proposed ultimate sink, regardless of whether transmission, if any, that such Party is attempting to secure and/or has purchased for the Product is firm or non-firm. If the transmission (whether firm or non-firm) that Seller or Buyer is attempting to secure is from source to sink is unavailable, this contingency excuses performance for the entire Transaction. If the transmission (whether firm or non-firm) that Seller

or Buyer has secured from source to sink is interrupted or curtailed for any reason, this contingency excuses performance for the duration of the interruption or curtailment notwithstanding the provisions of the definition of “Force Majeure” in Article 1.23 to the contrary.

“Unit Firm” means, with respect to a Transaction, that the Product subject to the Transaction is intended to be supplied from a generation asset or assets specified in the Transaction. Seller’s failure to deliver under a “Unit Firm” Transaction shall be excused: (i) if the specified generation asset(s) are unavailable as a result of a Forced Outage (as defined in the NERC Generating Unit Availability Data System (GADS) Forced Outage reporting guidelines) or (ii) by an event or circumstance that affects the specified generation asset(s) so as to prevent Seller from performing its obligations, which event or circumstance was not anticipated as of the date the Transaction was agreed to, and which is not within the reasonable control of, or the result of the negligence of, the Seller or (iii) by Buyer’s failure to perform. In any of such events, Seller shall not be liable to Buyer for any damages, including any amounts determined pursuant to Article Four.

EXHIBIT A

**MASTER POWER PURCHASE AND SALE AGREEMENT
CONFIRMATION LETTER**

This confirmation letter shall confirm the Transaction agreed to on _____, _____
between _____ (“Party A”) and _____ (“Party B”)
regarding the sale/purchase of the Product under the terms and conditions as follows:

Seller: _____

Buyer: _____

Product:

☐ Into _____, Seller’s Daily Choice

☐ Firm (LD)

☐ Firm (No Force Majeure)

☐ System Firm

(Specify System: _____)

☐ Unit Firm

(Specify Unit(s): _____)

☐ Other _____

☐ Transmission Contingency (If not marked, no transmission contingency)

☐ FT-Contract Path Contingency ☐ Seller ☐ Buyer

☐ FT-Delivery Point Contingency ☐ Seller ☐ Buyer

☐ Transmission Contingent ☐ Seller ☐ Buyer

☐ Other transmission contingency

(Specify: _____)

Contract Quantity: _____

Delivery Point: _____

Contract Price: _____

Energy Price: _____

Other Charges: _____

Confirmation Letter
Page 2

Delivery Period: _____
Special Conditions: _____
Scheduling: _____
Option Buyer: _____
Option Seller: _____
Type of Option: _____
Strike Price: _____
Premium: _____
Exercise Period: _____

This confirmation letter is being provided pursuant to and in accordance with the Master Power Purchase and Sale Agreement dated _____ (the "Master Agreement") between Party A and Party B, and constitutes part of and is subject to the terms and provisions of such Master Agreement. Terms used but not defined herein shall have the meanings ascribed to them in the Master Agreement.

[Party A]

[Party B]

Name: _____
Title: _____
Phone No: _____
Fax: _____

Name: _____
Title: _____
Phone No: _____
Fax: _____

Exhibit B

HISTORICAL MONTHLY PEAK DEMAND AND
ENERGY REQUIREMENTS JANUARY 2017 –
MARCH 2019

Peak Demand (MW)

[illegible]**Energy (MWh)**[illegible]

Exhibit C

NEW YORK POWER AUTHORITY LOAD DATA FOR THE PERIOD
JANUARY 2017-MARCH 2019

NYPA Preference Power (kWh)

[illegible]

Exhibit D

BOROUGH OF MIDDLETOWN 2017 AUDITED FINANCIAL STATEMENT

**BOROUGH OF MIDDLETOWN
MIDDLETOWN, PENNSYLVANIA**

FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2017

BOROUGH OF MIDDLETOWN

YEAR ENDED DECEMBER 31, 2017

BOROUGH OF MIDDLETOWN
YEAR ENDED DECEMBER 31, 2017

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YEAR ENDED DECEMBER 31, 2017

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YEAR ENDED DECEMBER 31, 2017

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Independent Auditors' Report

Borough Council
Borough of Middletown
Middletown, Pennsylvania

Report on the Financial Statements

We have audited the financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Borough of Middletown (the Borough) as of and for the year ended December 31, 2017 and the related notes to the financial statements, which collectively comprise the Borough's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the Borough's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Borough's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Borough of Middletown as of December 31, 2017, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the schedules of changes in the net pension liability and related percentages - last four years, schedule of employer contributions in the pension plans - last ten years, schedule of investment returns in the pension plans - last four years, schedule of funding progress for post-employment benefits other than pensions, schedules of changes in the net OPEB liability and related percentages, schedule of employer contributions in the post-employment benefits other than pensions, schedule of investment returns in the post-employment benefits other than pensions and budgetary comparison information on pages 83 through 95 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Borough's basic financial statements. The combining and individual nonmajor fund financial statements on pages 96 through 99 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Omission of Management's Discussion and Analysis

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standard Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinions on the basic financial statements are not affected by this missing information.

Brown Schultz Steindler & Fritz

Camp Hill, Pennsylvania
September 11, 2018

BOROUGH OF MIDDLETOWN

STATEMENT OF NET POSITION

DECEMBER 31, 2017

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	Primary government		
	Governmental activities	Business-type activities	Total
Current assets:			
Unrestricted, cash and cash equivalents	\$ 6,868,992	\$ 8,762,705	\$ 15,631,697
Receivables:			
Accounts	230,594	728,538	959,132
Taxes	436,325		436,325
Notes receivable	68,868		68,868
Internal balances	439,103	(439,103)	-
Prepaid assets	41,167	12,623	53,790
Service concession arrangement receivable, net of present value discount of \$79,753		608,724	608,724
Total current assets	8,085,049	9,673,487	17,758,536
Noncurrent assets:			
Restricted cash and cash equivalents	15,620	10,755,867	10,771,487
Investment in joint venture	6,339		6,339
Service concession arrangement receivable, net of present value discount of \$19,702,165		8,024,111	8,024,111
Notes receivable	1,454,446		1,454,446
Net pension asset	96,071	439,980	536,051
Net other post-employment benefits asset	3,104,085	1,510,183	4,614,268
Capital assets:			
Not being depreciated	88,514	870,468	958,982
Net of accumulated depreciation	8,379,959	31,229,375	39,609,334
Total noncurrent assets	13,145,034	52,829,984	65,975,018
Total assets	21,230,083	62,503,471	83,733,554
Deferred outflows of resources, pensions	1,058,643	207,704	1,266,347
Total assets and deferred outflows of resources	\$ 22,288,726	\$ 62,711,175	\$ 84,999,901

(continued)

BOROUGH OF MIDDLETOWN

STATEMENT OF NET POSITION (CONTINUED)

DECEMBER 31, 2017

LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION

	Primary government		
	Governmental activities	Business-type activities	Total
Liabilities:			
Current liabilities:			
Accounts payable	\$ 171,687	\$ 453,635	\$ 625,322
Accrued:			
Salaries	125,366	23,637	149,003
Interest	14,102		14,102
Developer escrows	15,620	8,813	24,433
Unearned revenue	67,748	46,966	114,714
Current portion of notes payable	172,322	362,500	534,822
Total current liabilities	566,845	895,551	1,462,396
Long-term liabilities:			
Security deposits		129,916	129,916
Notes payable, net of current portion	1,097,881	371,717	1,469,598
Compensated absences	276,767	51,174	327,941
Total noncurrent liabilities	1,374,648	552,807	1,927,455
Total liabilities	1,941,493	1,448,358	3,389,851
Deferred inflows of resources:			
Pensions	896,382	430,821	1,327,203
Deferred inflows of resources, service concession arrangement, net of present value discount of \$19,781,918		49,249,921	49,249,921
Total deferred inflows of resources	896,382	49,680,742	50,577,124
Net position:			
Net investment in capital assets	7,198,270	31,365,626	38,563,896
Restricted for:			
Electric trust		9,438,289	9,438,289
Economic development		436,300	436,300
Program purposes	850,521		850,521
Capital projects		451,871	451,871
Unrestricted (deficit)	11,402,060	(30,110,011)	(18,707,951)
Total net position	19,450,851	11,582,075	31,032,926
Total liabilities, deferred inflows of resources and net position	\$ 22,288,726	\$ 62,711,175	\$ 84,999,901

See notes to financial statements.

BOROUGH OF MIDDLETOWN

STATEMENT OF ACTIVITIES

YEAR ENDED DECEMBER 31, 2017

Functions/programs	Expenses	Program revenues		Capital grants and contributions	Net (expenses) revenue and changes in net position		
		Charges for services	Operating grants and contributions		Governmental activities	Primary government Business-type activities	Total
Primary government:							
Governmental activities:							
General government	\$ 636,186	\$ 158,816	\$ 70,276	\$ 13,811	\$ (393,283)	\$	\$ (393,283)
Public safety	3,098,788	112,735	71,878	13,811	(2,900,566)		(2,900,566)
Public works	2,499,063	893,544	266,472	25,364	(1,313,683)		(1,313,683)
Parks and recreation	247,139				(247,139)		(247,139)
Community development	108,596				(108,596)		(108,596)
Interest expense and debt issuance costs	40,889				(40,889)		(40,889)
Total governmental activities	6,630,661	1,165,095	408,424	52,986	(5,004,156)		(5,004,156)
Business-type activities:							
Water-sewer operations	1,318,025					\$ (1,318,025)	(1,318,025)
Electric operations	5,341,912	8,426,660				3,084,748	3,084,748
Economic development	53,286	17,110				(36,176)	(36,176)
Total business-type activities	6,713,223	8,443,770				1,730,547	1,730,547
Total primary government	\$ 13,343,884	\$ 9,608,865	\$ 408,424	\$ 52,986	(5,004,156)	1,730,547	(3,273,609)
General revenues:							
Taxes:							
Property					1,455,791		1,455,791
Transfer					70,860		70,860
Earned income tax					818,020		818,020
Business and mercantile					84,766		84,766
Other					101,086		101,086
Loss disposal of capital assets					(1,845)	2,476	631
Investment earnings and rents					129,991	125,577	255,568
Homestead program interest					2,832		2,832
Service concession arrangement:							
Interest income						87,994	87,994
Amortized income						1,509,441	1,509,441
Contributions from private sector					82,443		82,443
Miscellaneous					13,003	12,968	25,971
Total general revenues					2,756,957	1,738,456	4,495,413
Transfers					2,208,854	(2,208,854)	-
Change in net position					(38,345)	1,260,149	1,221,804
Net position:							
January 1					19,489,196	10,321,926	29,811,122
December 31					\$ 19,450,851	\$ 11,582,075	\$ 31,032,926

See notes to financial statements.

BOROUGH OF MIDDLETOWN

BALANCE SHEET – GOVERNMENTAL FUNDS

DECEMBER 31, 2017

	General	Nonmajor governmental funds	Total governmental funds
ASSETS			
Cash and cash equivalents:			
Operating	\$ 4,950,576	\$ 1,918,416	\$ 6,868,992
Restricted	15,620		15,620
Accounts receivable	230,594		230,594
Taxes receivable	435,613	712	436,325
Notes receivable	1,490,493	32,821	1,523,314
Prepaid assets	41,167		41,167
Due from other funds	565,018	312,905	877,923
	<u>\$ 7,729,081</u>	<u>\$ 2,264,854</u>	<u>\$ 9,993,935</u>
Total assets			
	<u>\$ 7,729,081</u>	<u>\$ 2,264,854</u>	<u>\$ 9,993,935</u>
LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 171,687		\$ 171,687
Accrued salaries	125,366		125,366
Developer escrows	15,620		15,620
Due to other funds		\$ 438,820	438,820
Unearned revenue	34,927	32,821	67,748
	<u>347,600</u>	<u>471,641</u>	<u>819,241</u>
Total liabilities			
	<u>347,600</u>	<u>471,641</u>	<u>819,241</u>
Deferred inflows of resources, unavailable revenues, property taxes	<u>231,010</u>	<u>712</u>	<u>231,722</u>
Fund balances:			
Nonspendable	1,531,660	32,821	1,564,481
Restricted for:			
Highway aid		639,188	639,188
Rehabilitation program		54,723	54,723
Fire sinking		154,514	154,514
Community fund		2,096	2,096
Committed for:			
Capital projects		319,206	319,206
Economic stabilization fund	1,252,217		1,252,217
Assigned to:			
Charity	45,861		45,861
Flood relief		245,795	245,795
Fire operations		2,304	2,304
Debt service		341,854	341,854
Police sinking	7,832		7,832
Unassigned	4,312,901		4,312,901
	<u>7,150,471</u>	<u>1,792,501</u>	<u>8,942,972</u>
Total fund balances			
	<u>7,150,471</u>	<u>1,792,501</u>	<u>8,942,972</u>
Total liabilities, deferred inflows of resources and fund balances	<u>\$ 7,729,081</u>	<u>\$ 2,264,854</u>	<u>\$ 9,993,935</u>

See notes to financial statements.

BOROUGH OF MIDDLETOWN

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO
THE STATEMENT OF NET POSITION

DECEMBER 31, 2017

Total fund balances, governmental funds		\$ 8,942,972
Total net position reported for governmental activities in the statement of net position is different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. Those assets consist of:		
Capital assets not being depreciated	\$ 88,514	
Capital assets net of \$13,970,974 accumulated depreciation	<u>8,379,959</u>	
Total capital assets		8,468,473
Some of the Borough's taxes will be collected after year-end, but are not available soon enough to pay for the current period's expenditures and, therefore, are reported as unavailable revenue, property taxes in the funds.		231,722
Other assets and deferred outflows of resources are not available to pay for current-period expenditures:		
Net pension asset	96,071	
Deferred outflows of resources, pensions	1,058,643	
Net other post-employment benefits asset	3,104,085	
Investment in joint venture	<u>6,339</u>	
		4,265,138
Liabilities and deferred inflows of resources applicable to the Borough's governmental activities are not due and payable in the current period, and accordingly, are not reported as fund liabilities. All liabilities, both current and long-term, are reported in the statement of net position.		
Balances at December 31, 2017 are:		
Compensated absences	(276,767)	
Deferred inflows of resources, pensions	(896,382)	
Notes payable	(1,270,203)	
Accrued interest	<u>(14,102)</u>	
		<u>(2,457,454)</u>
Total net position, governmental activities		<u>\$ 19,450,851</u>

See notes to financial statements.

BOROUGH OF MIDDLETOWN

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES –
GOVERNMENTAL FUNDS**

YEAR ENDED DECEMBER 31, 2017

	General	Nonmajor governmental funds	Total governmental funds
Revenues:			
Taxes	\$ 2,588,031	\$ 386	\$ 2,588,417
Licenses and permits	33,565		33,565
Fines and forfeitures	59,932		59,932
Interest and rents	108,390	21,600	129,990
Intergovernmental	216,377	245,032	461,409
Charges for services	1,072,740	6,769	1,079,509
Homestead program interest		2,832	2,832
Contributions from private sector	82,443		82,443
Miscellaneous income	12,580	423	13,003
Total revenues	<u>4,174,058</u>	<u>277,042</u>	<u>4,451,100</u>
Expenditures:			
General government	535,225	19,047	554,272
Public safety	2,738,271	46,437	2,784,708
Public works	2,198,019	113,768	2,311,787
Parks and recreation	191,025	9,576	200,601
Community development	108,596		108,596
Debt service:			
Principal	52,258	148,579	200,837
Interest and issuance costs	10,418	16,369	26,787
Total expenditures	<u>5,833,812</u>	<u>353,776</u>	<u>6,187,588</u>
Deficiency of revenues over (under) expenditures	<u>(1,659,754)</u>	<u>(76,734)</u>	<u>(1,736,488)</u>
Other financing sources (uses):			
Proceeds of long-term debt		387,000	387,000
Gain on sale of fixed assets	13,555		13,555
Transfers in	2,265,814		2,265,814
Transfers out		(56,960)	(56,960)
Total other financing sources (uses)	<u>2,279,369</u>	<u>330,040</u>	<u>2,609,409</u>
Net change in fund balances	619,615	253,306	872,921
Fund balances:			
Beginning of year	<u>6,530,856</u>	<u>1,539,195</u>	<u>8,070,051</u>
End of year	<u>\$ 7,150,471</u>	<u>\$ 1,792,501</u>	<u>\$ 8,942,972</u>

See notes to financial statements.

BOROUGH OF MIDDLETOWN

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

YEAR ENDED DECEMBER 31, 2017

Net change in fund balance, total governmental funds \$ 872,921

The change in net position reported for governmental activities in the statement of activities is different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation and disposals exceeded capital outlays in the current period.

The details of the differences are as follows:

Capital outlays	\$ 432,295	
Depreciation	(527,514)	
Disposal of capital assets	<u>(15,400)</u>	
Net adjustment		(110,619)

Debt proceeds are reported as financing sources in governmental funds, and thus, contribute to the change in fund balance. In the statement of net position, however, issuing debt increases long-term liabilities and does not affect the statement of activities. Similarly, repayment is an expenditure in the governmental funds, but reduces the liability in the statement of net position.

The details of the differences are as follows:

Issuance of notes payable	(387,000)	
Repayments:		
Notes payable	172,579	
Capital leases	<u>28,258</u>	
Net adjustment		(186,163)

Under the modified accrual basis of accounting used in governmental funds, revenues are not reported until they become available. In the statement of activities, however, revenues are recorded regardless of when financial resources are available.

The details of the differences are as follows:

Unavailable revenue, property taxes	(57,885)	
Decrease in investment in joint venture	<u>(7,909)</u>	
		(65,794)

Under the modified accrual basis of accounting used in the governmental funds, expenditures are not recognized for transactions that are not normally paid with expendable available financial resources. In the statement of activities, however, which is presented on the accrual basis, expenses and liabilities are reported regardless of when financial resources are available. In addition, interest on long-term debt is not recognized under the modified accrual basis of accounting until due, rather than as it accrues.

The details of the difference are as follows:

Compensated absences	49,677	
Accrued interest	(14,102)	
Net pension asset	468	
Deferred outflows of resources, pensions	263,130	
Deferred inflows of resources, pensions	(580,642)	
Net other post-employment benefits asset	<u>(267,221)</u>	
		(548,690)

Change in net position of governmental activities	\$ (38,345)	
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See notes to financial statements.

BOROUGH OF MIDDLETOWN

STATEMENT OF NET POSITION – ENTERPRISE FUNDS

DECEMBER 31, 2017

	Business-type activities, enterprise funds			
	Water-Sewer Fund	Electric Fund	Middletown Borough Industrial and Commercial Development Fund	Total
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES				
Assets:				
Current assets:				
Unrestricted, cash and cash equivalents	\$ 2,254,622	\$ 6,355,924	\$ 152,159	\$ 8,762,705
Accounts receivable	12,372	716,166		728,538
Due from other funds	206	256,103		256,309
Prepaid expenses		12,623		12,623
Service concession arrangement receivable, net of present value discount of \$116,276	608,724			608,724
Total current assets	2,875,924	7,340,816	152,159	10,368,899
Noncurrent assets:				
Restricted cash and cash equivalents	8,733	10,310,834	436,300	10,755,867
Service concession arrangement receivable, net of present value discount of \$19,565,889	8,024,111			8,024,111
Net pension asset		439,980		439,980
Other post-employment benefits asset		1,510,183		1,510,183
Capital assets:				
Not being depreciated	202,556	634,102	33,810	870,468
Net of accumulated depreciation	28,284,708	2,476,436	468,231	31,229,375
Total noncurrent assets	36,520,108	15,371,535	938,341	52,829,984
Total assets	39,396,032	22,712,351	1,090,500	63,198,883
Deferred outflows of resources, pensions		207,704		207,704
Total assets and deferred outflows of resources	\$ 39,396,032	\$ 22,920,055	\$ 1,090,500	\$ 63,406,587
LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION (DEFICIT)				
Liabilities:				
Current liabilities:				
Accounts payable	\$ 29,524	\$ 419,994	\$ 4,117	\$ 453,635
Accrued salaries		23,637		23,637
Developer escrows	8,813			8,813
Due to other funds	279,328	415,878	206	695,412
Unearned revenue		46,966		46,966
Current portion of note payable	362,500			362,500
Total current liabilities	680,165	906,475	4,323	1,590,963
Long-term liabilities:				
Security deposits		128,469	1,447	129,916
Note payable, net of current portion	371,717			371,717
Compensated absences		51,174		51,174
Total noncurrent liabilities	371,717	179,643	1,447	552,807
Total liabilities	1,051,882	1,086,118	5,770	2,143,770
Deferred inflows of resources:				
Pensions		430,821		430,821
Deferred inflows of resources, service concession arrangement, net of present value discount of \$19,702,165	49,249,921			49,249,921
Total deferred inflows of resources	49,249,921	430,821		49,680,742
Net position (deficit):				
Net investment in capital assets	27,753,047	3,110,538	502,041	31,365,626
Restricted:				
Capital projects		451,871		451,871
Electric trust		9,438,289		9,438,289
Economic development			436,300	436,300
Unrestricted	(38,658,818)	8,402,418	146,389	(30,110,011)
Total net position (deficit)	(10,905,771)	21,403,116	1,084,730	11,582,075
Total liabilities, deferred inflows of resources and net position (deficit)	\$ 39,396,032	\$ 22,920,055	\$ 1,090,500	\$ 63,406,587

See notes to financial statements.

BOROUGH OF MIDDLETOWN

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION –
ENTERPRISE FUNDS

YEAR ENDED DECEMBER 31, 2017

	Business-type activities, enterprise funds			
	Water-Sewer Fund	Electric fund	Middletown Borough Industrial and Commercial Development Fund	Total
Operating revenue, service billings		\$ 8,426,660	\$ 17,110	\$ 8,443,770
Operating expenses:				
Electric transmission and distribution		4,515,230		4,515,230
General and administrative	\$ 162,653	651,012	26,412	840,077
Other operating expenses			9,836	9,836
Depreciation expense	1,155,372	175,670	17,038	1,348,080
Total operating expenses	1,318,025	5,341,912	53,286	6,713,223
Operating income (loss)	(1,318,025)	3,084,748	(36,176)	1,730,547
Nonoperating revenue (expense):				
Investment income		125,577		125,577
Miscellaneous income	7,863	5,105		12,968
Service concession arrangement:				
Interest income	87,994			87,994
Amortized income	1,509,441			1,509,441
Gain (loss) on disposal of capital assets	11,000		(8,524)	2,476
Total nonoperating revenue (expense)	1,616,298	130,682	(8,524)	1,738,456
Income (loss) before transfers	298,273	3,215,430	(44,700)	3,469,003
Transfers, out	(725,000)	(1,401,966)	(81,888)	(2,208,854)
Change in net position (deficit)	(426,727)	1,813,464	(126,588)	1,260,149
Net position (deficit):				
January 1	(10,479,044)	19,589,652	1,211,318	10,321,926
December 31	<u>\$ (10,905,771)</u>	<u>\$ 21,403,116</u>	<u>\$ 1,084,730</u>	<u>\$ 11,582,075</u>

See notes to financial statements.

BOROUGH OF MIDDLETOWN
STATEMENT OF CASH FLOWS – ENTERPRISE FUNDS
YEAR ENDED DECEMBER 31, 2017

	Business-type activities, enterprise funds			
	Water-Sewer Fund	Electric Fund	Middletown Borough Industrial and Commercial Development Fund	Total
Cash flows from operating activities:				
Receipts from customers and users	\$ 196	\$ 8,590,190	\$ 17,110	\$ 8,607,496
Payments to:				
Suppliers	(144,835)	(4,246,063)	(51,570)	(4,442,468)
Employees		(890,445)		(890,445)
Internal activity, payments (to) from other funds	255,897	(256,103)		(206)
Net cash provided by (used in) operating activities	111,258	3,197,579	(34,460)	3,274,377
Cash flows from noncapital financing activities:				
Miscellaneous income	7,863	5,105		12,968
Transfers out	(725,000)	(1,401,966)	(81,888)	(2,208,854)
Net cash used in noncapital financing activities	(717,137)	(1,396,861)	(81,888)	(2,195,886)
Cash flows from capital and related financing activities:				
Purchase of capital assets	(147,813)	(54,966)		(202,779)
Proceeds on sale of capital assets	11,000		81,888	92,888
Principal paid on debt, net of premium	(362,500)			(362,500)
Net cash provided by (used in) capital and related financing activities	(499,313)	(54,966)	81,888	(472,391)
Cash flows from investing activities:				
Investment income	8,241	125,577		133,818
Service concession arrangement payment	725,000			725,000
Net cash provided by investing activities	733,241	125,577		858,818
Net increase (decrease) in cash and cash equivalents	(371,951)	1,871,329	(34,460)	1,464,918
Cash and cash equivalents (including restricted):				
Beginning of year	2,635,306	14,795,429	622,919	18,053,654
End of year	\$ 2,263,355	\$ 16,666,758	\$ 588,459	\$ 19,518,572
Reconciliation with financial statements:				
Unrestricted cash	\$ 2,254,622	\$ 6,355,924	\$ 152,159	\$ 8,762,705
Restricted cash	8,733	10,310,834	436,300	10,755,867
Total cash and cash equivalents	\$ 2,263,355	\$ 16,666,758	\$ 588,459	\$ 19,518,572
Supplemental disclosures of noncash transactions:				
Service concession arrangement:				
Interest income	\$ 79,753			\$ 79,753
Amortized income	1,509,441			1,509,441
Transfer of proceeds from sale of asset to the primary government			\$ 81,888	81,888
Total noncash transactions	\$ 1,589,194		\$ 81,888	\$ 1,671,082

(continued)

BOROUGH OF MIDDLETOWN

STATEMENT OF CASH FLOWS – ENTERPRISE FUNDS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

	Business-type activities, enterprise funds			
	Water-Sewer Fund	Electric Fund	Middletown Borough Industrial and Commercial Development Fund	Total
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:				
Operating income (loss)	\$ (1,318,025)	\$ 3,084,748	\$ (36,176)	\$ 1,730,547
Adjustments:				
Depreciation expense	1,155,372	175,670	17,038	1,348,080
Changes in assets and liabilities:				
Accounts receivable	196	116,564		116,760
Prepaid expenses		15,363		15,363
Net pension asset		(358,860)		(358,860)
Other post-employment benefits		(69,886)		(69,886)
Deferred outflows of resources, pensions		160,018		160,018
Accounts payable	17,818	(116,307)	(15,004)	(113,493)
Accrued salaries		2,589		2,589
Due to/from other funds	255,897	(256,103)	(318)	(524)
Unearned revenue		46,966		46,966
Deferred inflows of resources, pensions		373,328		373,328
Compensated absences		18,339		18,339
Security deposits		5,150		5,150
Net cash provided by (used in) operating activities	<u>\$ 111,258</u>	<u>\$ 3,197,579</u>	<u>\$ (34,460)</u>	<u>\$ 3,274,377</u>

See notes to financial statements.

BOROUGH OF MIDDLETOWN

**STATEMENT OF FIDUCIARY NET POSITION –
PENSION AND OTHER POST-EMPLOYMENT BENEFIT TRUST FUNDS**

DECEMBER 31, 2017

	Non-uniform pension	Police pension	OPEB	Total fiduciary funds
Assets:				
Cash and cash equivalents	\$ 161,341	\$ 142,666	\$ 1,636,637	\$ 1,940,644
Investments:				
Domestic fixed income	4,305,758	2,025,054	2,958,369	9,289,181
Domestic equities	6,294,174	3,730,577	4,060,415	14,085,166
International equities	1,902,764	1,139,856	1,246,911	4,289,531
Cash surrender value of life insurance		99,514		99,514
Contributions receivable			4,962	4,962
Total assets	<u>\$ 12,664,037</u>	<u>\$ 7,137,667</u>	<u>\$ 9,907,294</u>	<u>\$ 29,708,998</u>
Liabilities, accounts payable and cash overdraft	\$ 100,188	\$ 4,631	\$ 1,651,930	\$ 1,756,749
Net position held in trust for employees' pension benefits and other post-employment benefits	<u>12,563,849</u>	<u>7,133,036</u>	<u>8,255,364</u>	<u>27,952,249</u>
Total liabilities and net position	<u>\$ 12,664,037</u>	<u>\$ 7,137,667</u>	<u>\$ 9,907,294</u>	<u>\$ 29,708,998</u>

See notes to financial statements.

BOROUGH OF MIDDLETOWN

**STATEMENT OF CHANGES IN FIDUCIARY NET POSITION –
PENSION AND OTHER POST-EMPLOYMENT BENEFIT TRUST FUNDS**

YEAR ENDED DECEMBER 31, 2017

	<u>Non-uniform pension</u>	<u>Police pension</u>	<u>OPEB</u>	<u>Total fiduciary funds</u>
Additions:				
Contributions:				
Employer		\$ 112,266	\$ 235,473	\$ 347,739
Member	\$ 28,242	23,177	35,384	86,803
Total contributions	<u>28,242</u>	<u>135,443</u>	<u>270,857</u>	<u>434,542</u>
Investment income:				
Net appreciation in fair value of investments	1,412,912	827,977	799,404	3,040,293
Dividends	321,087	138,282	174,938	634,307
Interest	<u>1,661</u>	<u>850</u>	<u>23,066</u>	<u>25,577</u>
Total investment income	<u>1,735,660</u>	<u>967,109</u>	<u>997,408</u>	<u>3,700,177</u>
Total additions	<u>1,763,902</u>	<u>1,102,552</u>	<u>1,268,265</u>	<u>4,134,719</u>
Deductions:				
Administrative expense	47,166	27,450	62,744	137,360
Benefit payments	<u>695,407</u>	<u>413,116</u>	<u>666,467</u>	<u>1,774,990</u>
Total deductions	<u>742,573</u>	<u>440,566</u>	<u>729,211</u>	<u>1,912,350</u>
Change in net position	1,021,329	661,986	539,054	2,222,369
Net position held in trust for employees' pension benefits and other post-employment benefits:				
Beginning of year	<u>11,542,520</u>	<u>6,471,050</u>	<u>7,716,310</u>	<u>25,729,880</u>
End of year	<u>\$ 12,563,849</u>	<u>\$ 7,133,036</u>	<u>\$ 8,255,364</u>	<u>\$ 27,952,249</u>

See notes to financial statements.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies:

The Borough of Middletown (Borough) is located in Dauphin County, Pennsylvania. It operates under an elected mayor and seven-member Council. The Borough provides various services to its residents, including police protection, building codes enforcement, maintenance of roads and parks, contracted refuse collection and other community enrichment programs. The Borough also operates, maintains and upgrades, as needed, the electric systems. The accompanying financial statements of the Borough were prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) applicable to government units as prescribed by the Governmental Accounting Standards Board (GASB), except for the omission of the Management Discussion and Analysis.

Reporting entity:

Consistent with the guidance provided by GASB, the criteria used by the Borough to evaluate the possible inclusion of related entities (authorities, boards, etc.) within its reporting entity is the financial accountability concept. The concept considers the fiscal dependency of the component unit on the Borough and the nature and significance of the financial benefit or burden relationship between the related entities. In determining the financial accountability concept in a given case, the Borough reviews the applicability of the following criteria:

The Borough is financially accountable for:

- Legally separate organizations if the Borough's officials appoint a voting majority of the organization's governing body and the Borough is able to impose its will on the organization or if there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Borough as defined below:

Impose its will – If the Borough can significantly influence the programs, projects or activities of or the level of services performed or provided by the organization.

Financial benefit or burden – Exists if the Borough (1) is entitled to the organization's resources or (2) is legally obligated or has otherwise assumed the obligation to finance the deficits of, or provide support to, the organization or (3) is obligated in some manner for the debt of the organization.

- Legally separate organizations that are fiscally dependent on the Borough. Fiscal dependency is established if the organization is unable to adopt its own budget, levy taxes or set rates or charges or issue bond debt without approval of the Borough.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Reporting entity (continued):

Based on the foregoing criteria, the reporting entity has been defined to include all funds for which the Borough is financially accountable and entities with which there is a significant financial benefit or burden relationship. Specific information on the nature of the Borough's component units and a description of how the aforementioned criteria have been considered in determining whether to include a unit in the Borough's financial statements are provided in the following paragraphs.

Blended component units:

The Middletown Borough Industrial and Commercial Development Authority (the MBICDA) is governed by a five-member board appointed by Borough Council. Although it is legally separate from the Borough, the MBICDA is reported as if it were part of the primary government because the Borough has the ability to impose its will on the MBICDA. It is blended as the Middletown Borough Industrial and Commercial Development Fund, which is presented as a major enterprise fund in these financial statements. On June 7, 2015, the Borough Council passed a motion to dissolve the MBICDA. As of September 11, 2018, the MBICDA has not been officially dissolved.

Separate audited financial statements of the MBICDA are available at the MBICDA office located in the Borough's Community Building. The MBICDA operates on a fiscal year ending December 31.

Joint venture:

The Olmsted Regional Recreation Board (ORRB) was formed by the Boroughs of Middletown and Royaltown, Lower Swatara Township and Middletown Area School District to manage the recreational sites within their boundaries. Each of the four governmental participants has a 25% equity interest in the net position of the ORRB. At December 31, 2017, the net position of the ORRB was approximately \$25,354; therefore, the Borough's investment in the joint venture equals \$6,339. This equity interest has been included in the government-wide financial statements. The ORRB does not generate sufficient income to cover its own expenses on an annual basis and relies on the contributions from its four participants. A copy of the ORRB's annual treasurer's report is available at their office located at 55 West Water Street, Middletown, Pennsylvania.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Reporting entity (continued):

Related organization:

The Borough Council is also responsible for appointing members to the Middletown Public Library Board (the Library), but the Borough's accountability for this organization does not extend beyond making appointments. The Borough does not designate management, nor does it have the ability to significantly influence the operations of the Library. The Borough does supply funding to the Library, but this funding is not required of the Borough (see Note 18). In addition, the Borough is not responsible for fiscal matters of the Library (i.e., not responsible for deficits or entitled to surpluses, no guarantees of debt, etc.).

Government-wide and fund financial statements:

The government-wide financial statements (i.e., statement of net position and the statement of activities) report information on all the non-fiduciary activities of the government as a whole. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely, to a significant extent, on fees and charges for support.

The statement of activities demonstrates the degree to which direct expenses of a given function or segment is affected by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include (1) charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds, the proprietary funds and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Measurement focus, basis of accounting and financial statement presentation:

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary funds and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when the liability is incurred regardless of the timing of the related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grant and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Amounts paid to acquire capital assets are capitalized as assets in the government-wide financial statements rather than reported as an expenditure. Proceeds of long-term debt are recorded as liabilities in the government-wide financial statements rather than as another financing source. Amounts paid to reduce long-term indebtedness of the reporting government are reported as a reduction of the related liability rather than an expenditure.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Borough considers revenues to be available if they are collected within 60 days of year end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Licenses, operating grants, capital grants and interest associated with the current fiscal period are all considered to be susceptible to accrual, and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable only when the Borough receives cash.

Under the current financial resources measurement focus, only current assets, long-term notes receivable and current liabilities are generally included on the balance sheet. The reported fund balance is considered to be a measure of "available spendable resources". Governmental funds operating statements present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in current assets. Accordingly, they present a summary of sources and uses of "available spendable resources" during the period.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Measurement focus, basis of accounting and financial statement presentation (continued):

Because of their spending measurement focus, expenditure recognition for governmental fund types excludes amounts represented by noncurrent liabilities. Since they do not affect net current assets, such long-term amounts are not recognized as governmental fund type expenditures of fund liabilities.

Amounts expended to acquire capital assets are recorded as expenditures in the year that resources were expended rather than as fund assets. The proceeds of long-term debt are recorded as another financing source rather than a fund liability. However, debt service expenditures, as well as expenditures related to compensated absences and claims for judgments, are recorded only when payment is due.

Fund financial statements of the reporting entity are organized into funds, each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, deferred inflows of resources, fund balance, revenues and expenditures/expenses. Funds are organized into three major categories: governmental, proprietary and fiduciary. An emphasis is placed on major funds within the governmental category. A fund is considered major if it is the primary operating fund of the Borough or meets the following criteria:

- Total assets and deferred outflows of resources, liabilities and deferred inflows of resources, revenues or expenditures/expenses of that individual fund are at least 10% of the corresponding element total for all funds of that category or type and;
- Same element that met 10% criteria above is at least 5% of the corresponding element total for all funds combined.

The Borough reports the following major governmental fund:

- The General Fund is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Measurement focus, basis of accounting and financial statement presentation (continued):

The Borough also has the following nonmajor funds:

- Nonmajor Special Revenue Funds: The Highway Aid Fund, Flood Relief Fund, Rehabilitation Program Fund, Lease Proceeds Fund, Fire Operations Fund, Community Fund and Fire Sinking Fund are used to account for and report the proceeds of specific revenue sources that are restricted or assigned to expenditures for specified purposes other than debt service or capital projects.
- Nonmajor Capital Projects Funds: The Capital Projects Fund is used to account for and report financial resources that have been committed by the Borough Council for the payment of future capital projects.
- Nonmajor Debt Service Fund: The General Debt Service Fund is used to account for and report financial resources that are restricted to expenditures for principal and interest.

The Borough's enterprise funds are proprietary funds. In the fund financial statements, the proprietary funds are presented using the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recognized when the related goods or services are delivered. In the fund financial statements, the proprietary funds are presented using the economic resources measurement focus. This means that all assets and all liabilities (whether current or noncurrent) associated with their activity are included on their balance sheet. The proprietary fund types operating statement presents increases (revenues) and decreases (expenses) in total net position.

Proprietary funds operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the funds. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Measurement focus, basis of accounting and financial statement presentation (continued):

The Borough reports the following major proprietary funds:

- The Water-Sewer Fund is used to account for the fiscal activities for the water-sewer system of the Borough.
- The Electric Fund is used to account for the fiscal activities for the electric system.
- The Middletown Borough Industrial and Commercial Development Fund is used to account for the fiscal activities of the economic development within the Borough.

Fiduciary funds are used to account for assets held by the Borough in a trustee capacity or as an agent for individuals, private organizations, other governments and/or other funds. These include the Pension Trust Funds and Other Post-Employment Benefit Trust Fund. The fiduciary funds are accounted for in essentially the same manner as the proprietary funds since capital maintenance is critical. The fiduciary fund's financial statements are prepared using the accrual basis of accounting.

Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The Borough reports the following fiduciary fund types:

- The Non-Uniform Pension Trust Fund accounts for the revenue (i.e., member contributions, Borough contributions and net investment income) and the expenses (i.e., contributions refunded, retirement benefits and death benefits paid) of the Non-Uniform Municipal Employees Pension Trust Fund.
- The Police Pension Trust Fund accounts for the revenue (i.e., member contributions, Borough contributions and net investment income) and the expenses (i.e., contributions refunded, retirement benefits and death benefits paid) of the Police Employees Pension Trust Fund.
- The Other Post-Employment Benefit (OPEB) Trust Fund accounts for revenue (i.e., employer contributions, net investment income) and expenses (i.e., direct payments) of qualified retirees.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Assets, liabilities and net position or fund balances:

Cash and cash equivalents:

For purposes of the accompanying statement of cash flows, the Borough considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Receivables and payables:

Interfund receivables and payables - Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the year are referred to as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

Utilities receivable - Receivables are stated at the amount management expects to collect from outstanding balances. Unbilled utilities receivable relate to services performed at December 31 and not billed until the following January. All receivables are shown net of an allowance for doubtful accounts.

Investments:

Investments are reported at fair value. Fair values for fixed income and equity securities are determined by quoted market prices based on national exchanges when available. External investment pools are reported at amortized cost, which approximates fair value. The amortized cost method involves valuing a security at its cost on the date of purchase and recording a constant amortization or accretion to maturity of any discount or premium. Cash deposits and cash equivalents are reported at carrying amount, which reasonably estimates fair value.

Capital assets:

Capital assets, which include property, plant and equipment and infrastructure assets, are reported in the applicable governmental or business-type activity columns in the government-wide financial statements. Property, plant and equipment and infrastructure assets, with initial, individual costs that equal or exceed \$5,000 and estimated useful lives of over one year, are recorded at cost or acquisition value at the date of donation. Acquisition value is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the acquisition date.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Assets, liabilities and net position or fund balances (continued):

Capital assets (continued):

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend its useful life are not capitalized.

Major outlay of capital assets and improvements are capitalized as projects are completed. Interest incurred during the construction phase of the capital asset of business-type activities is included as part of the capitalized value of the assets constructed.

Capital assets are depreciated using the straight-line method over the following useful lives:

<u>Assets</u>	<u>Years</u>
Infrastructure	25-50
Buildings and building improvements	40
Vehicles	5-7
Machinery and equipment	10

Allowance for doubtful accounts:

The Borough has recorded an allowance of doubtful accounts of \$3,435 and \$10,143 in the General Fund and Electric Fund, respectively, at December 31, 2017.

Prepaid items:

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

Pension plans:

The government-wide financial statements report pension obligations as earned using actuarial calculations which allocate expected costs over employees' service periods. Fund financial statements report employer contributions to the pension plans as expenditures as they are made.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Assets, liabilities and net position or fund balances (continued):

Compensated absences:

Borough policy permits employees to accumulate a limited amount of earned but unused vacation, sick and compensatory time. These benefits are payable to employees upon separation of services. All leave pay is accrued when incurred in the government-wide financial statements and the proprietary fund statements. A liability for these amounts is reported.

Long-term obligations:

In the government-wide and proprietary funds financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable statement of net position. Bond premiums and discounts are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuance are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Unearned revenues:

Revenues that are received but not earned are unearned in the Borough's financial statements. In the Borough's governmental funds, unearned revenues arise when potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period. Unearned revenues also arise when resources are received by the government before it has a legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the Borough has a legal claim to the resources, the liability for unearned revenue is removed from the governmental funds' balance sheet and revenue is recognized.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Assets, liabilities and net position or fund balances (continued):

Net position, fund balances:

The governmental fund financial statements present fund balances based on classifications that comprise a hierarchy that is based primarily on the extent to which the Borough is bound to honor constraints on the specific purposes for which amounts in the respective governmental funds can be spent. The classifications used in the governmental fund financial statements are as follows:

- *Nonspendable fund balance* – Resources that are not in a spendable form (such as prepaids and inventory) or are required to be maintained intact.
- *Restricted fund balance* – Resources constrained by external parties (such as grantors, creditors and other governments) or imposed by law through enabling legislation.
- *Committed fund balance* – Resources constrained to specific purposes by the Borough itself, using its highest level of decision-making authority (i.e., Borough Council). To be reported as committed, amounts cannot be used for any other purpose unless the Borough takes the same level action to remove or change the constraint. This formal action is a Borough Council approved resolution.
- *Assigned fund balance* – Resources the Borough intends to be used for a specific purpose, but are neither restricted nor committed. Assignments of fund balance are created by the Borough Manager pursuant to authorization established by the Borough Council.
- *Unassigned fund balance* – Resources that are available for any purpose. Positive amounts are reported only in the general fund.

When an expenditure is incurred for purposes for which both restricted and unrestricted resources are available, it is the Borough's policy to use restricted resources first. When expenditures are incurred for purposes for which unrestricted resources are available, it is the Borough's policy to spend committed resources first, followed by assigned amounts and then unassigned amounts.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Assets, liabilities and net position or fund balances (continued):

Net position, fund balances (continued):

The government-wide and proprietary fund financial statements utilize a net position presentation. Net position is categorized as net investment in capital assets, restricted and unrestricted.

- *Net investment in capital assets* – Consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets.
- *Restricted net position* – Consists of net position with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors or laws or regulators of other governments or (2) law through constitutional provisions or enabling legislation.
- *Unrestricted net position* – All other net position that does not meet the definition of “restricted” or “net investment in capital assets.”

Interfund transactions:

Transactions that constitute reimbursements to a fund for expenditures/expenses initially made from it that are properly applicable to another fund are recorded as expenditures/expenses in the reimbursing fund and as reductions of expenditures/expenses in the fund that is reimbursed. All other interfund transactions and reimbursements are reported as transfers.

Use of estimates:

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows of resources, liabilities and deferred inflows of resources and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting periods. Actual results could differ from those estimates.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Assets, liabilities and net position or fund balances (continued):

Deferred outflows/inflows of resources:

In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. The government has one item that qualifies for reporting in this category, deferred outflows related to pensions. Deferred outflows related to pensions are further described in Note 11. The components of deferred outflows of resources related to pensions are the difference between expected and actual pension experience, which is amortized into pension expense over the weighted average remaining service life of all members of the plan beginning the year in which the deferred amount occurs (current year). The annual difference between the projected and actual earnings on plan investments is amortized over a five-year closed period beginning in the year in which the difference occurs (current year).

In addition to liabilities, the statement of net position and balance sheet will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The government has three items that qualify for reporting in this category. The first item, service concession arrangement, net of discount, represents future revenue related to the service concession arrangement reported in the government-wide statement of net position (see Note 19). This amount is amortized over the term of the agreement. The second item, which arises under a modified accrual basis of accounting, relates to unavailable revenue from property tax reported in the governmental funds balance sheet. This amount is deferred and recognized as an inflow of resources in the period that the amount becomes available. The third item, deferred inflows related to pensions is further described in Note 11. The component of deferred inflows related to pensions is the annual difference between the projected and actual earnings on plan investments amortized over a five-year closed period beginning in the year in which the difference occurs (current year).

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Nature of operations and summary of significant accounting policies (continued):

Adoption of GASB Statements:

During 2017, the Borough adopted GASB issued Statement No. 74, *Financial Reporting for Post-Employment Benefit Plans Other Than Pension Plans*, Statement No. 80, *Blending Requirements for Certain Component Units – an Amendment of GASB Statement No. 14* and Statement No. 81, *Irrevocable Split-Interest Agreements*.

Pending GASB statements:

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Post-Employment Benefits Other Than Pensions*. This Statement addresses reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions of GASB Statement No. 75 are effective for the Borough's December 31, 2018 financial statements.

In March 2016, the GASB issued Statement No. 82, *Pension Issues - an Amendment of GASB Statements No. 67, No. 68 and No. 73*. This Statement addresses certain issues that have been raised with respect to the previous pension standards. The provisions of GASB Statement No. 82 are effective for the Borough's December 31, 2018 financial statements.

In November 2016, the GASB issued Statement No. 83, *Certain Asset Retirement Obligations*. This Statement addresses accounting and financial reporting for certain asset retirement obligations. The provisions of GASB Statement No. 83 are effective for the Borough's December 31, 2019 financial statements.

In January 2017, the GASB issued Statement No. 84, *Fiduciary Activities*. This Statement improves guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The provisions of GASB Statement No. 84 are effective for the Borough's December 31, 2019 financial statements.

In March 2017, the GASB issued Statement No. 85, *Omnibus 2017*. This Statement addresses practice issues that have been identified during implementation and application of certain GASB Statements. The provisions of GASB Statement No. 85 are effective for the Borough's December 31, 2018 financial statements.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

1. Summary of significant accounting policies (continued):

Pending GASB statements (continued):

In May 2017, the GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*. This Statement improves guidance regarding in-substance defeasance of debt for accounting and financial reporting purposes and how those activities should be reported. The provisions of GASB Statement No. 86 are effective for the Borough's December 31, 2018 financial statements.

In June 2017, the GASB issued Statement No. 87, *Leases*. This Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. The provisions of GASB Statement No. 87 are effective for the Borough's December 31, 2020 financial statements.

In April 2018, the GASB issued Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*. This Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The provisions of GASB Statement No. 88 are effective for the Borough's December 31, 2019 financial statements.

In June 2018, the GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. This Statement is to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and to simplify accounting for interest cost incurred before the end of a construction period. The provisions of GASB Statement No. 89 are effective for the Borough's December 31, 2020 financial statements.

The effect of implementation of these statements has not yet been determined.

2. Deposits and investments:

Deposits:

Custodial credit risk:

For deposits, custodial credit risk is the risk that, in the event of bank failure, the Borough's deposits may not be returned to it. For investments, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Borough will not be able to recover the value of its investment or collateral security that is in the possession of the outside party. The Borough does not have an investment policy for custodial credit risk.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

2. Deposits and investments (continued):

Deposits (continued):

Custodial credit risk (continued):

As of December 31, 2017, \$26,167,164 of the Borough's bank balance of \$26,917,164 was not covered by the Federal Deposit Insurance Corporation, but was collateralized in accordance with Act 72. This Act requires the institution to pool collateral for all its government deposits and to have the collateral held by an approved custodian in the institution's name.

Deposits:

Collateral held by the pledging bank under Act 72 but not in the Borough's name	\$ 4,059,637
Insured by Federal Deposit Insurance Corporation	750,000
Outstanding checks	<u>(87,060)</u>

Total deposits	<u>4,722,577</u>
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Cash equivalents:

Pennsylvania Local Government Investment Trust (PLGIT) AAAM	431,682
Pennsylvania Treasurer's INVEST Program for Local Government and Nonprofits (INVEST) AAAM	180,205
Pennsylvania School District Liquid Asset Fund (PSDLAF) AAAM	21,495,640
Outstanding checks	(275,587)
Deposits in transit	<u>97,361</u>

Total cash equivalents	<u>21,929,301</u>
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Total cash and cash equivalents	<u>\$ 26,651,878</u>
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Cash and cash equivalents:

Cash and cash equivalents, unrestricted:	
Governmental activities	\$ 6,868,992
Business-type activities	8,762,705
Cash and cash equivalents, restricted:	
Governmental activities	15,620
Business-type activities	10,755,867
Fiduciary funds	1,940,644
Pooled cash account overdrafts included in liabilities, fiduciary funds	<u>(1,691,950)</u>

Total cash and cash equivalents	<u>\$ 26,651,878</u>
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BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

2. Deposits and investments (continued):

Deposits (continued):

Custodial credit risk (continued):

The Borough uses external investment pools to ensure safety and maximize efficiency, liquidity and yield for Borough funds. The external investment pools are valued at amortized cost, which approximates fair value. The amortized cost method involves valuing a security at its cost on the date of purchase and recording a constant amortization or accretion to maturity of any discount or premium. The fair value of the securities, held by the external investment pool, are evaluated on at least a weekly basis using prices supplied from an independent pricing service. These values are compared to the amortized cost of the securities.

The Borough has funds totaling \$431,682 and \$180,205 invested in the Pennsylvania Local Government Investment Trust (PLGIT) and Pennsylvania Treasurer's INVEST Program for Local Government and Nonprofits (INVEST), respectively. Each of these entities separately issue audited financial statements that are available to the public via their respective websites. The Commonwealth of Pennsylvania provides external regulatory oversight for the external investment pools. At December 31, 2017, PLGIT and INVEST carry AAAm ratings and have average maturities of less than one year.

The Borough has funds totaling \$21,495,640 invested in an external investment pool with the Pennsylvania School District Liquid Asset Fund (PSDLAF) investing in bank repurchase agreements, certificates of deposit, U.S. treasuries and U.S. government obligations. PSDLAF issues audited financial statements that are available to the public via their website.

The following represents the unrestricted cash and cash equivalents:

Cash and cash equivalents, unrestricted:	
Governmental activities	\$ 6,868,992
Business-type activities	<u>8,762,705</u>
Total cash and cash equivalents, unrestricted	<u>\$ 15,631,697</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

2. Deposits and investments (continued):

Deposits (continued):

Custodial credit risk (continued):

The Borough maintains cash accounts that are restricted in the following funds:

Cash and cash equivalents, restricted:	
Governmental activities, general fund	\$ 15,620
Business-type activities:	
Electric capital investments	451,871
Electric trust	9,858,963
Water-Sewer Fund	8,733
Economic development	436,300
Total business-type activities	10,755,867
Fiduciary funds:	
Non-uniform pension funds	161,341
Police pension funds	142,666
OPEB funds	1,636,637
Total fiduciary funds	1,940,644
Total cash and cash equivalents, restricted	12,712,131
Pooled cash account overdrafts included in liabilities:	
Fiduciary funds:	
OPEB funds	(1,651,572)
Non-uniform pension funds	(40,378)
Total pooled cash account overdrafts included in liabilities	(1,691,950)
Total restricted accounts	\$ 11,020,181

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

2. Deposits and investments (continued):

Investments:

The Borough's investments are under the custody of the Finance Director. The Borough can deposit or invest funds as authorized for local government units by the Local Government Unit Debt Act. Borough funds may be invested in:

- United States treasury bills
- Obligations of the United States government and federal agencies
- Insured savings and checking accounts and certificates of deposit in banks, savings and loan associations and credit unions
- General obligation bonds of the federal government, the Commonwealth of Pennsylvania or any state agency or of any Pennsylvania political subdivision
- Shares of mutual funds whose investments are restricted to the above categories
- Repurchase agreements collateralized by United States treasury bills or federal agency securities
- Commercial paper issued by corporations or other business entities organized in accordance with federal and state law, with a maturity not to exceed 270 days and the issuing corporation or business entity is rated in the top short-term category by at least two nationally recognized statistical ratings organizations
- Bankers' acceptances that do not exceed 180 days' maturity and the accepting bank is rated in the top short-term category by at least two nationally recognized statistical ratings organizations
- Negotiable certificates of deposit with a remaining maturity of three years or less, issued by a nationally or state-chartered bank, a federal or state savings and loan association or a state-licensed branch of a foreign bank

The Act does not prescribe regulations related to demand deposits; however, it does allow the pooling of governmental funds for investment purposes.

In addition to the investments authorized for governmental funds, fiduciary fund investments may also be made in corporate stocks and bonds, repurchase agreements and other investments consistent with sound business practice.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

2. Deposits and investments (continued):

Investments (continued):

The Borough categorizes the fair value of its investments based on the hierarchy established by generally accepted accounting principles. The fair value hierarchy, which has three levels, is based on the valuation inputs used to measure an asset's fair value: Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs and Level 3 inputs are significant unobservable inputs. The Borough does not have any investments that are measured using Level 3 inputs. Certificates of deposit are not included in any of the fair value hierarchy levels.

Investments consisted of the following at December 31, 2017:

<u>Investment type</u>	<u>Fair value</u>
Fiduciary fund investments:	
Level 1:	
Domestic fixed income	\$ 9,289,181
Domestic equities	14,085,166
International equities	<u>4,289,531</u>
Total fiduciary fund investments	<u>\$ 27,663,878</u>
Reconciliation with the financial statements:	
Fiduciary funds:	
Non-uniform pension funds	\$ 12,502,696
Police pension funds	6,895,487
OPEB funds	<u>8,265,695</u>
	<u>\$ 27,663,878</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

2. Deposits and investments (continued):

Investments (continued):

The Borough has the following recurring amortized cost measurements as of December 31, 2017, including unfunded commitments and redemption terms as follows:

	<u>Amortized cost</u>	<u>Unfunded commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
Investments measured at amortized cost, external investment pool ¹ :				
PLGIT	\$ 431,682	\$ -	Weekly	5 days
INVEST	180,205	-	Weekly	5 days
PSDLAF	<u>21,317,414</u>	-	Weekly	5 days
Total investments measured at amortized cost	<u>\$ 21,929,301</u>			

¹ External investment pool: This type includes pooled investments in bank repurchase agreements, certificates of deposit, U.S. treasuries and U.S. government obligations. The fair value of the investments in this type have been determined using amortized cost. Distributions from the fund will be received as the underlying investments of the funds are liquidated, which is expected to occur weekly.

Concentration of credit risk:

Concentration of credit risk is the risk of a loss attributed to the magnitude of a government's investments in a single issuer. The Borough places no limits on the amount the Borough may invest in any one issuer.

Credit risk:

As indicated above, investing is performed in accordance with investment policies complying with state statutes and the Borough Code. The Borough does not have an investment policy that would further limit its investment choices with regard to credit risk.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

2. Deposits and investments (continued):

Investments (continued):

Interest rate risk:

The Borough does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The following is a summary of the Borough's fixed income investments and their related average maturities.

Investment	Fair value	Rating	Concentration	Investment maturities (in years)		
				Less than one	One to five	Six to ten
Level 1:						
Baird Core Plus Bond Inst	\$ 3,071,426	BBB	33%			\$ 3,071,426
DoubleLine Core Fixed Income I	1,379,284	Not rated	15%	\$ 1,379,284		
Prudential Total Return Bond Q	926,701	BBB	10%			926,701
Vanguard High-Yield Corporate Adm	850,494	B	9%		\$ 850,494	
Vanguard Inter-Term Investment-Grde Adm	3,061,276	A	33%			3,061,276
Total	<u>\$ 9,289,181</u>			<u>\$ 1,379,284</u>	<u>\$ 850,494</u>	<u>\$ 7,059,403</u>

Foreign currency risk:

The Borough invested in international equities and international fixed income, which contains foreign currency risk. The Borough's balance at December 31, 2017 in international equities was \$4,289,531.

3. Interfund receivables and payables:

During the course of operations, numerous transactions occur between individual funds for goods provided or services rendered. These receivables and payables are classified as "Due from other funds" or "Due to other funds" on the balance sheet.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

3. Interfund receivables and payables (continued):

Interfund receivable and payable balances consist of the following at December 31, 2017:

	<u>Due from other funds</u>	<u>Due to other funds</u>
General fund	\$ 565,018	
Nonmajor governmental funds:		
Highway	127,347	
Rehabilitation program		\$ 25,309
Flood relief		286,164
Capital projects	185,558	127,347
Water-Sewer Fund	206	279,328
Electric Fund, operations	256,103	415,878
Middletown Borough Industrial and Commercial Development Authority		206
	<u>\$ 1,134,232</u>	<u>\$ 1,134,232</u>

4. Interfund operating transfers:

Interfund transfers are executed as a result of the requirements for the general fund to maintain a balance based on budgeted expenditures of the funds. Interfund operating transfers are as follows:

	<u>Transfers in</u>	<u>Transfers out</u>
General fund	\$ 2,265,814	
Nonmajor governmental funds:		
Capital projects		\$ 21,946
Debt service		35,014
Water-Sewer Fund		725,000
Electric Fund, operations		1,401,966
Middletown Borough Industrial and Commercial Development Authority		81,888
	<u>\$ 2,265,814</u>	<u>\$ 2,265,814</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

5. Real estate taxes:

Real estate taxes attach as an enforceable lien on property on January 1. Taxes are billed by Dauphin County on February 1, payable under the following terms: 2% discount, February 1 based on the assessed value listed as of the prior December 31 for the real property located in the Borough through March 31; face amount, April 1 through May 31 and 10% penalty after May 31. Dauphin County bills these taxes which are collected by the tax collector and remitted to the Borough. Real estate taxes levied for 2017 are recorded as receivables, net of estimated uncollectibles. The net receivables collected during 2017 and within the first 60 days of 2018 are recognized as revenue in 2017. Net receivables estimated to be collectible subsequent to March 1 are reflected in unavailable revenue – property taxes. Prior years' levies are recorded using these same principles, and remaining receivables are annually reevaluated as to collectability.

The rate of real estate taxation in 2017 was 5.631 mills for general purposes on a total Borough assessed valuation of \$264,546,600.

6. Notes receivable:

Under the Borough's Homestead Loan Program, the Borough has entered into low interest loans or grants to owners of property within the Borough to rehabilitate and/or acquire homes. The outstanding notes receivable balance for the Rehabilitation Program Fund at December 31, 2017 was \$32,821.

The MBICDA granted a developer a \$1,100,000 note receivable (Note Receivable 1) on December 30, 2015 in order to fund renovation of a property. During 2016, this note receivable was transferred to the Borough. The note receivable carries interest at a rate of 4%. Interest on the note receivable is due monthly, with the first payment starting on January 1, 2017. Principal on the note receivable is due monthly, with the first payment starting on January 1, 2018, with final maturity on January 1, 2027. During 2015 and 2016, the developer drew down \$17,587 and \$1,482,413 on the note receivable, respectively. The developer has given the Borough security interests in the property, the developer's assets, licenses, contracts, leases and rents, and personal guarantees from the developer's company's members as collateral for the note receivable.

On December 30, 2015, the MBICDA sold a portion of property to a developer in exchange for a \$400,000 note receivable (Note Receivable 2). During 2016, this note receivable was transferred to the Borough. The note receivable carries interest at a rate of 4%, and principal and interest are due monthly starting on January 1, 2017, with final maturity on January 1, 2027.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

6. Notes receivable (continued):

The following is a schedule of future principal and interest payments for the notes receivable:

Year	Note Receivable 1			Note Receivable 2			Total		
	Principal	Interest	Total	Principal	Interest	Total	Principal	Interest	Total
2018	\$ 26,150	\$ 43,525	\$ 69,675	\$ 9,897	\$ 15,439	\$ 25,336	\$ 36,047	\$ 58,964	\$ 95,011
2019	27,216	42,459	69,675	10,300	15,036	25,336	37,516	57,495	95,011
2020	28,325	41,350	69,675	10,719	14,617	25,336	39,044	55,967	95,011
2021	29,479	40,196	69,675	11,157	14,179	25,336	40,636	54,375	95,011
2022	30,680	38,995	69,675	11,610	13,726	25,336	42,290	52,721	95,011
2023	31,929	37,746	69,675	12,084	13,252	25,336	44,013	50,998	95,011
2024	33,231	36,444	69,675	12,576	12,760	25,336	45,807	49,204	95,011
2025	34,584	35,090	69,674	13,089	12,248	25,337	47,673	47,338	95,011
2026	35,994	33,680	69,674	13,622	11,715	25,337	49,616	45,395	95,011
2027	822,412	2,740	825,152	285,439	952	286,391	1,107,851	3,692	1,111,543
	<u>\$ 1,100,000</u>	<u>\$ 352,225</u>	<u>\$ 1,452,225</u>	<u>\$ 390,493</u>	<u>\$ 123,924</u>	<u>\$ 514,417</u>	<u>\$ 1,490,493</u>	<u>\$ 476,149</u>	<u>\$ 1,966,642</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

7. Capital assets:

A summary of the changes in capital assets activity is as follows:

Governmental activities	January 1, 2017	Increases	Deletions	December 31, 2017
Capital assets, not being depreciated:				
Land	\$ 48,238		\$ (15,400)	\$ 32,838
Construction in progress		\$ 55,676		55,676
Total capital assets, not being depreciated	48,238	55,676	(15,400)	88,514
Capital assets, being depreciated:				
Buildings and pool	2,267,903			2,267,903
General equipment and vehicles	1,632,084	5,944		1,638,028
Highway equipment and vehicles	1,746,956	106,716		1,853,672
Parks and recreation building and equipment	1,231,064			1,231,064
Library equipment and furniture	87,391	10,489		97,880
Infrastructure	15,008,916	253,470		15,262,386
Total capital assets, being depreciated	21,974,314	376,619		22,350,933
Less accumulated depreciation for:				
Buildings and pool	1,046,220	65,051		1,111,271
General equipment and vehicles	1,467,432	96,005		1,563,437
Highway equipment and vehicles	1,492,385	59,556		1,551,941
Parks and recreation building and equipment	356,922	29,542		386,464
Library equipment and furniture	87,391	262		87,653
Infrastructure	8,993,110	277,098		9,270,208
Total accumulated depreciation	13,443,460	527,514		13,970,974
Total capital assets, being depreciated, net	8,530,854	(150,895)		8,379,959
Total governmental activities capital assets, net	\$ 8,579,092	\$ (95,219)	\$ (15,400)	\$ 8,468,473

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

7. Capital assets (continued):

Depreciation expense has been allocated to the various departments as follows:

General government administration	\$ 66,974
Public safety	72,270
Public works	349,970
Parks and recreation	34,542
Community development, library	<u>3,758</u>
Total depreciation	<u>\$ 527,514</u>

Business-type activities	January 1, 2017	Increases	Deletions	December 31, 2017
Capital assets, not being depreciated:				
Land	\$ 691,145		\$ (17,793)	\$ 673,352
Construction in progress	<u>197,116</u>			<u>197,116</u>
Total capital assets, not being depreciated	<u>888,261</u>		<u>(17,793)</u>	<u>870,468</u>
Capital assets, being depreciated:				
Electric distribution system and equipment	6,093,867	\$ 54,966		6,148,833
Water-sewer systems and equipment	50,261,596	147,813		50,409,409
Other buildings and building improvements	<u>595,840</u>		<u>(87,207)</u>	<u>508,633</u>
Total capital assets, being depreciated	<u>56,951,303</u>	<u>202,779</u>	<u>(87,207)</u>	<u>57,066,875</u>
Less accumulated depreciation for:				
Electric distribution system and equipment	3,496,727	175,670		3,672,397
Water-sewer systems and equipment	20,969,329	1,155,372		22,124,701
Other buildings and building improvements	<u>37,950</u>	<u>17,038</u>	<u>(14,586)</u>	<u>40,402</u>
Total accumulated depreciation	<u>24,504,006</u>	<u>1,348,080</u>	<u>(14,586)</u>	<u>25,837,500</u>
Total capital assets, being depreciated, net	<u>32,447,297</u>	<u>(1,145,301)</u>	<u>(72,621)</u>	<u>31,229,375</u>
Total business-type activities capital assets, net	<u>\$ 33,335,558</u>	<u>\$ (1,145,301)</u>	<u>\$ (90,414)</u>	<u>\$ 32,099,843</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

7. Capital assets (continued):

Depreciation expense has been allocated to the various funds as follows:

Water-Sewer Fund	\$ 1,155,372
Electric Fund:	
Operations	175,583
Electric capital improvements	87
Middletown Borough Industrial and Commercial Development Authority	<u>17,038</u>
Total depreciation	<u>\$ 1,348,080</u>

8. Long-term liabilities:

Governmental activities:

General Revenue Note, Series of 2014 was issued in the face amount of \$1,500,000 to fund the cost of a streetscape improvement and utility replacement project, and to pay for the cost of issuance of the note. The note bears interest at a rate of 0.50%, and annual payments of principal and interest are \$153,858. Final maturity on the note is on January 1, 2023.

\$ 907,203

General Revenue Note, Series of 2017 was issued in the face amount of \$387,000 to fund the cost of street lighting upgrades. Semi-annual payments are due in November and May of each year ranging from \$3,328 to \$33,469 starting in May 2017. The note bears a 2.84% interest rate and matures on November 1, 2030.

363,000

Total long-term debt at December 31, 2017

1,270,203

Less current portion

172,322

Total net position, governmental activities

\$ 1,097,881

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

8. Long-term liabilities (continued):

Governmental activities (continued):

The following is a summary of changes in governmental activities long-term liabilities for the year ended December 31, 2017:

	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Governmental activities:					
2014 General Revenue Note	\$ 1,055,782		\$ (148,579)	\$ 907,203	\$ 149,322
2017 General Revenue Note		\$ 387,000	(24,000)	363,000	23,000
Total bonds, notes and loans payable	1,055,782	387,000	(172,579)	1,270,203	172,322
Compensated absences	326,444	196,788	(246,465)	276,767	
Total governmental activities long-term liabilities	<u>\$ 1,382,226</u>	<u>\$ 583,788</u>	<u>\$ (419,044)</u>	<u>\$ 1,546,970</u>	<u>\$ 172,322</u>

For governmental funds, compensated absences are generally liquidated by the general fund.

Debt service maturities for the General Revenue Note, Series of 2014 is as follows:

	Principal	Interest	Total
2018	\$ 149,322	\$ 4,536	\$ 153,858
2019	150,068	3,790	153,858
2020	150,819	3,039	153,858
2021	151,573	2,285	153,858
2022	152,331	1,527	153,858
2023	153,090	766	153,856
	<u>\$ 907,203</u>	<u>\$ 15,943</u>	<u>\$ 923,146</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

8. Long-term liabilities (continued):

Governmental activities (continued):

Debt service maturities for the General Revenue Note, Series of 2017 is as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 23,000	\$ 10,309	\$ 33,309
2019	24,000	9,656	33,656
2020	25,000	8,974	33,974
2021	26,000	8,264	34,264
2022	26,000	7,526	33,526
2023-2027	143,000	26,015	169,015
2028-2030	96,000	5,511	101,511
	<u>\$ 363,000</u>	<u>\$ 76,255</u>	<u>\$ 439,255</u>

Interest expense of \$5,279 and \$10,546, on the General Revenue Note, Series of 2014 and General Revenue Note, Series of 2017, respectively, has been included as a direct expense in the activities of the governmental funds on the government-wide statement of activities.

Business-type activities:

Information regarding outstanding long-term debt of business-type activities at December 31, 2017 is presented below:

In 2016, a note payable was issued in the amount of \$1,096,717. The note was issued for future expenditures associated with the Borough's water and wastewater system. Payments range from \$31,181 to \$362,500 and are due annually in April. The note bears a 0% interest rate and matures on April 3, 2026.	\$ 734,217
Less current portion	<u>362,500</u>
Long-term debt, net of current portion, business-type activities	<u>\$ 371,717</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

8. Long-term liabilities (continued):

Business-type activities (continued):

The following is a summary of changes in business-type activities long-term liabilities for the year ended December 31, 2017:

	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Business-type activities:					
Note payable	\$ 1,096,717		\$ (362,500)	\$ 734,217	\$ 362,500
Compensated absences	32,835	\$ 88,670	(70,331)	51,174	
Business-type activities long-term liabilities	<u>\$ 1,129,552</u>	<u>\$ 88,670</u>	<u>\$ (432,831)</u>	<u>\$ 785,391</u>	<u>\$ 362,500</u>

Following is a schedule of the annual debt requirements on outstanding long-term debt of the Borough's business-type activities as of December 31, 2017:

Year ending December 31,	Note payable		
	Principal	Interest	Total
2018	\$ 362,500		\$ 362,500
2019	48,648		48,648
2020	48,648		48,648
2021	48,648		48,648
2022	48,648		48,648
2023-2026	177,125		177,125
	<u>\$ 734,217</u>		<u>\$ 734,217</u>

In prior years, the Borough's business-type activities defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased debt are not included in these financial statements. The Borough's business-type activities have \$5,507,489 in outstanding bonds which are considered defeased.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

9. Fund balances (deficit) and net position, classifications and restrictions:

The governmental fund financial statements present fund balances (deficit) based on classifications that comprise a hierarchy that is based primarily on the extent to which the Borough is bound to honor constraints on the specific purposes for which amounts in the respective governmental funds can be spent.

The classifications used in the governmental funds' financial statements are as follows:

Governmental funds:

General fund:

Nonspendable:

Notes receivable \$ 1,490,493

Prepaid items 41,167

Committed, economic stabilization fund 1,252,217

Assigned:

Charity 45,861

Police sinking 7,832

Unassigned, amounts available for any purpose 4,312,901

Nonmajor governmental funds:

Nonspendable, rehabilitation program loans 32,821

Restricted:

Highway aid 639,188

Rehabilitation program 54,723

Fire sinking 154,514

Community fund 2,096

Committed, capital projects 319,206

Assigned:

Fire operations 2,304

Flood relief 245,795

Debt service 341,854

Total governmental funds, fund balance \$ 8,942,972

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

9. Fund balances (deficit) and net position, classifications and restrictions (continued):

The classifications used in the fiduciary and enterprise funds' financial statements are as follows:

Fiduciary funds:

Non-uniform pension trust fund, amounts restricted for payment of non-uniform pension benefits	\$ 12,563,849
Police pension trust fund, amounts restricted for payment of police pension benefits	7,133,036
OPEB trust fund, amounts restricted for payment of other post-employee benefit costs	<u>8,255,364</u>

Total fiduciary funds, net position	<u><u>\$ 27,952,249</u></u>
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Enterprise funds:

Water-Sewer Fund:	
Net investment in capital assets	\$ 27,753,047
Unrestricted (deficit)	(38,658,818)
Electric Fund:	
Net investment in capital assets	3,110,538
Restricted:	
Amounts set aside to comply with the provisions of the Middletown Electric Rate Stabilization Irrevocable Trust	9,438,289
Amounts restricted for electric capital projects	451,871
Unrestricted	8,402,418
Middletown Borough Industrial Commercial Development Fund:	
Net investment in capital assets	502,041
Restricted, for economic development	436,300
Unrestricted	<u>146,389</u>

Total enterprise funds, net position	<u><u>\$ 11,582,075</u></u>
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BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

9. Fund balances (deficit) and net position, classifications and restrictions (continued):

Committed economic stabilization funds:

During 2016, the Borough's Council adopted a resolution to establish a fund balance policy, which is designed to provide the availability of funds in the event of emergencies, economic down turns, long-term unfunded liabilities and specific upcoming projects. The policy will apply to the General and Electric Operations Funds. The policy commits the appropriate level of reserves, which the Borough will strive to maintain in its General and Electric Operations Funds' fund balances. The Borough will strive to hold fund balances in both the General and Electric Operations Funds equal to 30% of the annual operating revenues, with recognition that fund balance levels can fluctuate from year to year due to the normal course of Borough operations. The fund balances shall not be used for normal or recurring annual operating expenditures and under no circumstances shall the total General and Electric Operations Funds committed fund balances fall below 30% of its annual operating revenues. As of December 31, 2017, the General and Electric Operations Funds' committed economic stabilization fund balances were \$1,252,217 and \$2,527,998, respectively.

10. Defined benefit pension plans:

Administration:

The Borough has two defined benefit pension plans covering substantially all of its employees. The plans' benefit provisions and all other requirements are established by Borough ordinances and the Unions' collective bargaining agreements. The Police Pension Plan, a single-employer plan, was administered by SEI Investments until April of 2017 and is now administered by PFM Asset Management LLC. The Non-Uniform Pension Plan, a single-employer plan, was administered by The Standard, StanCorp Financial Group until April of 2017 and is now administered by PFM Asset Management LLC. Both plans are reported as pension trust funds in the statement of fiduciary net position and changes therein. The plans are administered by the Borough Council, which is made up of seven elected councilors. The plans do not have separately issued financial reports.

The respective plan assets may be used only for the payment of benefits to members and expenses of the plans, in accordance with the terms of the plans. The plans provide retirement, disability and death benefits to plan members and their beneficiaries.

Administrative costs, including the investment manager, custodial trustee and actuarial services, are charged to the plan and funded through investment earnings.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Police Pension Plan description:

Police Pension Plan membership:

Active plan members	11
Inactive plan members or beneficiaries currently receiving benefits	16
Inactive plan members entitled to but not yet receiving benefits	<u>0</u>
Total	<u><u>27</u></u>

Police Pension Plan benefits:

All full-time, non-probationary police officers are eligible to participate in the plan. After 12 years of service, participants are fully vested. To be eligible for full retirement benefits, an officer must serve not less than an aggregate of 25 years and must attain the age of 50. Upon normal retirement, the monthly benefit is calculated at 50% of the average monthly compensation during the last 36 months of the participant's employment, plus a service increment equal to 1.25% of average monthly compensation for each year of service in excess of 25 years, up to a maximum service increment of \$100 per month. Upon the death of the officer, these monthly benefits will be made to the surviving spouse until death, or to an eligible child at a rate of 50% of the amount payable to the member at the time of the member's death.

Police Pension Plan contributions:

Plan members are required to contribute 2.0% of gross wages to the Police Pension Plan. This member requirement is reviewed and approved annually by the Borough. The members of the Police Pension Plan contributed \$23,177 during 2017.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Police Pension Plan description (continued):

Police Pension Plan contributions (continued):

The Borough is required to fund the plan based upon actuarially determined minimum funding standards. The minimum funding standards were mandated by Act 205, enacted by the Pennsylvania legislature on December 18, 1984. The minimum funding requirement includes normal costs, administrative expenses and amortization of the unfunded actuarial accrued liability. The Act also provides state aid to assist municipalities in meeting their minimum funding requirements. The Commonwealth's contributions are reported as Commonwealth contributions in the Borough's Police Pension Fund. Any remaining minimum funding obligations are paid from the General Fund of the Borough. Including the Commonwealth aid, the Borough contributed \$112,266 to the plan during 2017.

Police Pension Plan reporting:

The components of the net pension liability of the Borough's Police Pension Plan at December 31, 2017 were as follows:

Total pension liability	\$ 7,411,586
Plan fiduciary net position	<u>7,114,855</u>
Net pension liability	<u>\$ 296,731</u>
Plan fiduciary net position as a percentage of the total pension liability	96.00%

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Police Pension Plan reporting (continued):

Changes in the Borough's net pension liability for the Police Pension Plan for the year ended December 31, 2017 were as follows:

	Increase (decrease)		
	Total pension liability	Plan fiduciary net position	Net pension liability (asset)
	(a)	(b)	(a) - (b)
Balances at January 1, 2017	\$ 6,456,414	\$ 6,471,052	\$ (14,638)
Changes for the year:			
Service cost	141,360		141,360
Interest	498,383		498,383
Changes for experience	53,473		53,473
Changes of assumptions	675,072		675,072
Contributions:			
Employer		112,266	(112,266)
Member		23,177	(23,177)
Net investment income		921,476	(921,476)
Benefit payments, including refunds of member contributions	(413,116)	(413,116)	-
Net changes	955,172	643,803	311,369
Balances at December 31, 2017	\$ 7,411,586	\$ 7,114,855	\$ 296,731

BOROUGH OF MIDDLETOWN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Police Pension Plan reporting (continued):

The total pension expense recognized in the governmental activities in 2017 for the Police Pension Plan is as follows:

Service cost	\$ 141,360
Interest on total pension liability	498,383
Differences between expected and actual experience ¹	(118,483)
Changes of assumptions ¹	135,014
Members' contributions	(23,177)
Projected earnings on pension plan investments	(443,255)
Difference between projected and actual earnings on investments ²	<u>42,476</u>
	<u><u>\$ 232,318</u></u>

¹ Each year's gain or loss is recognized over a closed period, using the average of the expected remaining service lives of all active and inactive employees that are provided pensions through this pension plan.

² Each year's gain or loss is recognized over a five-year period.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Police Pension Plan reporting (continued):

At December 31, 2017, the Borough reported deferred outflows of resources and deferred inflows of resources related to the Police Pension Plan from the following sources:

	Deferred outflows of resources	Deferred inflows of resources	Total
Difference between expected and actual experience	\$ 42,778	\$ 129,178	\$ (86,400)
Change of assumptions	540,058		540,058
Difference between projected and actual earnings	290,374	382,577	(92,203)
Total	<u>\$ 873,210</u>	<u>\$ 511,755</u>	<u>\$ 361,455</u>

The deferred outflows of resources and deferred inflows of resources will be recognized in pension expense as follows:

Year ended December 31,	Deferred outflows of resources	Deferred inflows of resources	Total
2017	\$ 283,829	\$ 224,823	\$ 59,006
2018	283,829	95,644	188,185
2019	159,842	95,644	64,198
2020	145,710	95,644	50,066
Total	<u>\$ 873,210</u>	<u>\$ 511,755</u>	<u>\$ 361,455</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Police Pension Plan reporting (continued):

Police Pension Plan actuarial methods and assumptions:

The net pension asset was measured as of December 31, 2017, and the total pension liability was determined by rolling forward the liabilities from an actuarial valuation as of January 1, 2017. No significant events or changes in assumptions occurred between the valuation date and the fiscal year end.

The total pension liability in the January 1, 2017 actuarial valuation was determined using the following economic assumptions, applied to all periods included in the measurement:

Inflation	3.00%
Salary increases	4.00% (average, including inflation)
Investment rate of return	7.00% (including inflation)
Post-retirement cost of living increase	0.00%

Mortality rates were based on the IRS 2017 Static Combined Table for Small Plans. Incorporated into the table are rates for annuitants projected seven years and rates for non-annuitants projected 15 years using Scale AA to reflected mortality improvement.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Police Pension Plan reporting (continued):

Police Pension Plan investments:

Investments of the plan are reported at fair value (see Note 2).

The plan is authorized to invest in legal investments under the Pennsylvania Fiduciaries Investment Act. It is the policy of the plan to invest in the following:

<u>Asset class</u>	<u>Target allocation</u>
Domestic equity	55.00 %
International equity	15.00
Fixed income	<u>30.00</u>
	<u>100.00 %</u>

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset class</u>	<u>Long-term expected real rate of return</u>
Domestic equity	5.50% - 7.50%
International equity	4.50% - 6.50%
Fixed income	1.00% - 3.00%

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Police Pension Plan reporting (continued):

Discount rate:

The discount rate used to measure the total pension liability for the Police Pension Plan was 7.00%. The Police Pension Plan's fiduciary net position is projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability. The employer has always made the funding requirements of Pennsylvania Act 205 of 1984. Act 205 requires full funding of the entry age normal cost plus plan expenses, as well as amortization of the unfunded liability.

Sensitivity of the net pension liability (asset) to changes in the discount rate:

The following presents the net pension liability (asset) of the Police Pension Plan, calculated using the discount rate of 7.00%, as well as what the Police Pension Plan's net pension liability (asset) would be if it were calculated using a discount rate that is one percentage point lower (6.00%) or one percentage point higher (8.00%) than the current rate:

	1% Decrease (6.00%)	Current discount rate (7.00%)	1% Increase (8.00%)
Police plan net pension liability (asset)	\$ 1,138,613	\$ 296,731	\$ (415,008)

Rate of return:

Based on the January 1, 2017 actuarial valuation, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 7.2% for the Police Pension Plan. The money weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Non-Uniform Pension Plan description:

Non-Uniform Pension Plan membership:

Active plan members	10
Inactive plan members or beneficiaries currently receiving benefits	42
Inactive plan members entitled to but not yet receiving benefits	<u>25</u>
Total	<u>77</u>

Non-Uniform Pension Plan benefits:

The remainder of the Borough's personnel is covered by a separate defined benefit plan or a defined contribution plan (See Note 11). All full-time, non-uniform employees hired prior to January 1, 2016 are eligible to participate in the plan and are required to contribute to the plan through payroll deductions of 5.0% of their gross salary. After five years of service, participants are fully vested. Normal retirement age is 60; however, there are provisions in the plan for early retirement. Upon normal retirement, an employees' monthly benefit is calculated by multiplying the years of service by the average compensation of the final five years of service times 2%. If a vested participant dies prior to his retirement, his surviving spouse, or eligible beneficiary is eligible for a monthly income equal to 50% of the benefit the participant would have received if he had retired on his date of death.

Non-Uniform Pension Plan contributions:

Plan members are required to contribute 5.0% of gross wages to the Non-Uniform Pension Plan. This member requirement is reviewed and approved annually by the Borough. The Borough is required to fund the plan based upon actuarially determined minimum funding standards. The members of the Non-Uniform Pension Plan contributed \$28,242 during 2017.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Non-Uniform Pension Plan description (continued):

Non-Uniform Pension Plan contributions (continued):

The minimum funding standards were mandated by Act 205, enacted by the Pennsylvania legislature on December 18, 1984. The minimum funding requirement includes normal cost, administrative expenses and amortization of the unfunded actuarial accrued liability. The Act also provides state aid to assist municipalities in meeting their minimum funding requirements. The Commonwealth's contributions are reported as Commonwealth contributions in the Borough's Non-Uniform Pension Fund. Any remaining minimum funding obligations are paid from the General and Electric Funds of the Borough. Including the Commonwealth aid, the Borough contributed \$0 to the plan during 2017.

Non-Uniform Pension Plan reporting:

The components of the net pension asset of the Borough's Non-Uniform Pension Plan at December 31, 2017 were as follows:

Total pension liability	\$ 11,738,813
Plan fiduciary net position	<u>12,571,595</u>
Net pension asset	<u>\$ (832,782)</u>
Plan fiduciary net position as a percentage of the total pension liability	107.09%

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Non-Uniform Pension Plan reporting (continued):

Changes in the Borough's net pension asset for the Non-Uniform Pension Plan for the year ended December 31, 2017 were as follows:

	Increase (decrease)		
	Total pension liability (a)	Plan fiduciary net position (b)	Net pension asset (a) - (b)
Balances at January 1, 2017	<u>\$ 11,380,436</u>	<u>\$ 11,542,521</u>	<u>\$ (162,085)</u>
Changes for the year:			
Service cost	58,911		58,911
Interest	790,707		790,707
Changes for experience	27,869		27,869
Changes of assumptions	176,297		176,297
Contributions, member		28,242	(28,242)
Net investment income		1,696,239	(1,696,239)
Benefit payments, including refunds of member contributions	<u>(695,407)</u>	<u>(695,407)</u>	<u>-</u>
Net changes	<u>358,377</u>	<u>1,029,074</u>	<u>(670,697)</u>
Balances at December 31, 2017	<u><u>\$ 11,738,813</u></u>	<u><u>\$ 12,571,595</u></u>	<u><u>\$ (832,782)</u></u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Non-Uniform Pension Plan reporting (continued):

The total pension expense recognized in the governmental and business-type activities in 2017 for the Non-Uniform Pension Plan is as follows:

Service cost	\$ 58,911
Interest on total pension liability	790,707
Differences between expected and actual experience ¹	172,905
Changes of assumptions ¹	176,297
Members' contributions	(28,242)
Projected earnings on pension plan investments	(784,626)
Difference between projected and actual earnings on investments ²	<u>(14,474)</u>
	<u>\$ 371,478</u>

¹ Each year's gain or loss is recognized over a closed period, using the average of the expected remaining service lives of all active and inactive employees that are provided pensions through this pension plan.

² Each year's gain or loss is recognized over a five-year period.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Non-Uniform Pension Plan reporting (continued):

At December 31, 2017, the Borough reported deferred outflows of resources and deferred inflows of resources related to the Non-Uniform Pension Plan from the following sources:

	Deferred outflows of resources	Deferred inflows of resources	Total
Difference between projected and actual earnings	<u>\$ 393,137</u>	<u>\$ 815,448</u>	<u>\$(422,311)</u>

The deferred outflows of resources and deferred inflows of resources will be recognized in pension expense as follows:

Year ended December 31,	Deferred outflows of resources	Deferred inflows of resources	Total
2018	\$ 196,568	\$ 211,042	\$ (14,474)
2019	196,569	211,042	(14,473)
2020		211,042	(211,042)
2021		182,322	(182,322)
Total	<u>\$ 393,137</u>	<u>\$ 815,448</u>	<u>\$(422,311)</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Non-Uniform Pension Plan reporting (continued):

Non-Uniform Pension Plan actuarial methods and assumptions:

The net pension asset was measured as of December 31, 2017, and the total pension liability was determined by rolling forward the liabilities from an actuarial valuation as of January 1, 2017. No significant events or changes in assumptions occurred between the valuation date and the fiscal year end.

The total pension liability in the January 1, 2017 actuarial valuation was determined using the following economic assumptions, applied to all periods included in the measurement:

Inflation	3.00%	
Salary increases	4.00%	(average, including inflation)
Investment rate of return	7.00%	(including inflation)
Post-retirement cost of living increase	3.00%	

Mortality rates were based on the IRS 2017 Static Combined Table for Small Plans. Incorporated into the table are rates for annuitants projected seven years and rates for non-annuitants projected 15 years using Scale AA to reflected mortality improvement.

Non-Uniform Pension Plan investments:

Investments of the Non-Uniform Pension Plan are reported at fair value (see Note 2).

The plan is authorized to invest in legal investments under the Pennsylvania Fiduciaries Investment Act. It is the policy of the plan to invest in the following:

<u>Asset class</u>	<u>Target allocation</u>
Domestic equity	55.00 %
International equity	15.00
Fixed income	30.00
	<u>100.00 %</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Non-Uniform Pension Plan reporting (continued):

Non-Uniform Pension Plan investments (continued):

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The best estimates of the arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset class</u>	<u>Long-term expected real rate of return</u>
Domestic equity	5.5% - 7.5%
International equity	4.5% - 6.5%
Fixed income	1.0% - 3.0%

Discount rate:

The discount rate used to measure the total pension liability was 7.00%. The projection of cash flows used to determine the discount rate assumed that contributions to the plan will be made at actuarially determined contribution rates. Based on those assumptions, the pension plan's fiduciary net position is projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

10. Defined benefit pension plans (continued):

Non-Uniform Pension Plan reporting (continued):

Sensitivity of the net pension liability (asset) to changes in the discount rate:

The following presents the net pension liability (asset) of the plan, calculated using the discount rate of 7.00%, as well as what the Non-Uniform Pension Plan's net pension liability (asset) would be if it were calculated using a discount rate that is one percentage point lower (6.00%) or one percentage point higher (8.00%) than the current rate:

	1% Decrease (6.00%)	Current discount rate (7.00%)	1% Increase (8.00%)
Nonuniform net pension (asset) liability	\$ 429,139	\$ (832,782)	\$ (1,893,501)

Rate of return:

Based on the January 1, 2017 actuarial valuation, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 8.4%. The money weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

11. Defined contribution pension plan:

Non-Uniform Pension Plan reporting:

On July 5, 2016, the Middletown Borough Council adopted Ordinance 1325, which amended the Non-Uniform Pension Plan for non-uniform union participants hired after May 17, 2016 and non-union participants hired after January 1, 2016. The Ordinance changes the pension plan from a defined benefit plan to a defined contribution plan. The defined contribution plan calls for Borough contributions to the plan of 1% of the participants' salary annually. The Borough made \$4,293 in employer contributions during the year ended December 31, 2017.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

12. Post-employment healthcare and life insurance benefits:

Plan descriptions:

In addition to the pension benefits described in Notes 10 and 11, the Borough has two single-employer, defined benefit other post-employment benefit (OPEB) plans covering substantially all of its employees. The plans do not have separately issued financial reports. The plans are administered by PFM Asset Management LLC. The plans' benefit provisions and all other requirements are established by collective bargaining agreements and Council approval. Collective bargaining agreements, which require Council approval, are the authority under which benefit provisions are established or may be amended.

Police OPEB Plan

Benefits are payable for members who retired from the Borough prior to January 1, 2018 and after completion of 20 years of service. Eligible retirees and spouses may participate in the Borough's PPO medical plan. Additionally, the Borough reimburses retirees and spouses for Medicare Part B premiums for those who have reached Medicare age. Dental and vision insurance is also available. The spouses may continue in the plan after the death of a retiree.

The Borough provides a \$50,000 life insurance benefit for certain police officers whose date of retirement is on or after January 1, 2006. The officer may elect to have the actuarial equivalence of this benefit paid in cash to an Internal Revenue Code 457 savings plan.

Non-Uniform OPEB Plan

Benefits are payable for management employees hired prior to January 1, 2016 and Teamsters hired prior to May 1, 2017, who retire from the Borough after they have completed a combined 78 years of age and service. Eligible retirees may participate in the Borough's PPO medical plan. Additionally, the Borough reimburses retirees and spouses for Medicare Part B premiums for those who have reached Medicare age. Dental and vision insurance is also available. Full-time employees must have completed at least 12 years of service to qualify for coverage. The spouses may continue in the plan after the death of a retiree.

The Borough provides an \$8,000 life insurance benefit for certain management and Teamsters employees whose date of retirement is on or after January 1, 2006. The retiring employee may elect to have the actuarial equivalence of this benefit paid in cash to an Internal Revenue Code 457 savings plan.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

12. Post-employment healthcare and life insurance benefits (continued):

Plan membership:

At December 31, 2017, the Police and Non-Uniform OPEB plan membership consisted of the following (actual number of plan members):

	Police OPEB Plan	Non-Uniform OPEB Plan
Active plan members	11	14
Terminated plan members entitled to benefits but not yet receiving benefits	0	0
Retirees and beneficiaries receiving benefits	14	36
Total	25	50

Contributions and benefits:

The Borough's contribution is based on actuarially determined amounts. For the year ended December 31, 2017, the Borough contributed \$63,627 and \$171,846 to the Police OPEB Plan and the Non-Uniform OPEB Plan, respectively. Police and Non-Uniform OPEB Plan members receiving benefits contributed \$16,984 and \$18,400, respectively, through their contributions as required by the cost-sharing provisions of the plans.

Collective bargaining agreements, which require Council approval for establishment or amendments, are the authority which obligates the Borough and others to contribute to the plans.

Police OPEB Plan:

The Borough pays the entire cost of medical coverage, prescription drug, dental and vision coverage for the retiree. Pre-Medicare age spouses must pay \$75 per month towards medical coverage. Some existing retirees pay a fixed percentage of medical, dental and vision premiums as determined at their retirement date.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

12. Post-employment healthcare and life insurance benefits (continued):

Contributions and benefits (continued):

Police OPEB Plan (continued):

Upon disability, police officers and spouses may continue medical and prescription drug coverage at no cost to the employee until each becomes eligible for Medicare/Medicaid or Social Security disability coverage. Spouses must contribute \$75 per month.

The Borough pays the entire cost of the life insurance benefit.

Non-Uniform OPEB Plan:

The Borough pays the entire cost of medical, prescription drug, dental and vision coverage for the retiree plus spouse for management employees hired prior to January 1, 2016. The Borough pays the entire cost of medical, prescription drug and vision coverage for the retiree plus spouse for Teamster employees hired prior to May 1, 2017. Dental premiums must be paid by Teamster retirees. Some current Teamster retirees pay a fixed percentage of medical, dental and vision premiums as determined at their retirement date.

The Borough pays the entire cost of the life insurance benefit.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

12. Post-employment healthcare and life insurance benefits (continued):

GASB 45 employer reporting:

Annual OPEB cost and net OPEB obligation (asset):

The Borough's annual OPEB costs and net OPEB obligations (assets) to the plans for the year ended December 31, 2017 were as follows:

	Police OPEB Plan	Non-Uniform OPEB Plan
Annual required contribution	\$ 200,896	\$ 130,727
Interest on net OPEB obligation	(145,032)	(215,838)
Adjustment to annual required contribution	185,698	276,357
Annual OPEB cost	241,562	191,246
Contributions made	63,627	171,846
Changes in net OPEB obligation (asset)	177,935	19,400
Net OPEB obligation (asset):		
Beginning of year	(1,933,764)	(2,877,839)
End of year	<u>\$ (1,755,829)</u>	<u>\$ (2,858,439)</u>

The Borough's annual OPEB cost (expense) for each plan is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

12. Post-employment healthcare and life insurance benefits (continued):

GASB 45 employer reporting (continued):

Annual OPEB cost and net OPEB obligation (asset) (continued):

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the ARC are subject to continual revisions as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

The Borough's annual OPEB costs, the percentage of annual OPEB costs contributed to the plans, and the net OPEB obligation (asset) for 2017 and the previous two years were as follows:

	<u>Year</u>	<u>Annual OPEB cost (AOC)</u>	<u>Percentage of AOC contributed</u>	<u>Net OPEB obligation (asset)</u>
Police OPEB Plan:	2017	\$ 241,562	26.3 %	\$(1,755,829)
	2016	88,103	65.5	(1,933,764)
	2015	85,845	332.9	(1,964,144)
Non-Uniform OPEB Plan:	2017	\$ 191,246	89.9 %	\$(2,858,439)
	2016	137,165	65.6	(2,877,839)
	2015	133,652	180.5	(2,925,027)

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

12. Post-employment healthcare and life insurance benefits (continued):

GASB 45 employer reporting (continued):

Funded status and schedule of funding progress:

The schedules of funding progress, presented as required supplementary information, follows the notes to the financial statements and present multi-year trend information about whether the actuarial value of plan assets are increasing or decreasing over time relevant to the actuarial accrued liability for benefits.

	Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) (b)	Unfunded (AAL) (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll ((b-a)/c)
Police	January 1, 2017	\$ 3,168,555	\$ 4,196,620	\$ 1,028,065	75.5 %	\$ 915,214	112.3 %
Non-Uniform	January 1, 2017	4,547,756	5,107,738	559,982	89.0	692,431	80.9

Schedules of funding progress and employer contributions for the Borough's OPEB plans are included in the required supplementary information, immediately following the notes to the financial statements, and include three fiscal years of information about whether the actuarial value of plan assets is increasing or decreasing in relation to the actuarial accrued liability for benefits.

GASB 74 plan reporting:

Actuarial methods and assumptions:

Projections of benefits for financial reporting purposes are based on the substantive plan and include the types of benefits provided at the time of the valuation, and on the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities consistent with the long-term perspective of the calculation. The projections of benefit for financial reporting purposes do not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

12. Post-employment healthcare and life insurance benefits (continued):

GASB 74 plan reporting (continued):

Actuarial methods and assumptions (continued):

Information as of the latest actuarial valuation follows:

	Police OPEB Plan	Non-Uniform OPEB Plan
Valuation date	1/1/2017	1/1/2017
Actuarial cost method	Entry age normal	Entry age normal
Actuarial assumptions:		
Interest rate	7.5%	7.5%
Inflation	2.5%	2.5%
Salary increases	5.0%	5.0%
Medical inflation	5.6% in 2017	5.6% in 2017
	5.4% in 2018 - 2019	5.4% in 2018 - 2019
	5.3% in 2020 - 2044	5.3% in 2020 - 2044
	5.1% in 2045 - 2046	5.1% in 2045 - 2046
	5.0% in 2047 - 2049	5.0% in 2047 - 2049
	4.9% in 2050 - 2053	4.9% in 2050 - 2053
	4.8% in 2054 - 2059	4.8% in 2054 - 2059
	4.7% in 2060 - 2065	4.7% in 2060 - 2065
	4.6% in 2066	4.6% in 2066
	4.5% in 2067	4.5% in 2067
	4.4% in 2068 - 2069	4.4% in 2068 - 2069
	4.3% in 2070	4.3% in 2070
	4.2% in 2071	4.2% in 2071
	4.1% in 2072 - 2073	4.1% in 2072 - 2073
	4.0% in 2074	4.0% in 2074
	3.9% in 2075+	3.9% in 2075+
Amortization period	21 years	21 years
Amortization method	Level dollar, closed period	Level dollar, closed period
Mortality	RP2000 Table	RP2000 Table

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

12. Post-employment healthcare and life insurance benefits (continued):

GASB 74 plan reporting (continued):

Investments:

The Borough's investments are under the custody of the Finance Director. The plan is authorized to invest in legal investments under the Pennsylvania Fiduciaries Investment Act.

Investments of the plan are reported at fair value (see Note 2).

The long-term expected rate of return on OPEB plan investments was determined using a building-block method in which the best-estimate ranges of expected future real rates of return (expected returns, net of inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The plan is authorized to invest in legal investments under the Pennsylvania Fiduciaries Investment Act. It is the policy of the plan to invest in the following:

Asset class	Police and Non-Uniform OPEB Plans	
	Target allocation	Long-Term Expected Rate of Return
U.S. equity	39 %	5.2 %
International equity	15	5.2
Emerging equity	6	5.2
Core fixed income	20	3
Interim IG corp	10	3.8
High yield debt	5	4.3
Emerging debt	5	4.8
Cash		0.8
Total	<u>100 %</u>	

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

12. Post-employment healthcare and life insurance benefits (continued):

GASB 74 plan reporting (continued):

Rate of return:

For the year ended December 31, 2017, the annual money-weighted rate of return on investments, net of investment expense was 10.90% for both the Police and Non-Uniform OPEB plan investments.

Net OPEB liability:

The components of the net OPEB liability for the Borough at December 31, 2017 were as follows:

	Police OPEB Plan	Non-Uniform OPEB Plan
Total OPEB liability	\$ 4,356,513	\$ 5,133,337
Plan fiduciary net position	<u>(3,379,172)</u>	<u>(4,866,626)</u>
Plan net OPEB liability	<u>\$ 977,341</u>	<u>\$ 266,711</u>
Plan fiduciary net position as a percentage of total OPEB liability	77.57%	94.80%

Discount rate:

The discount rate used to measure the total OPEB liability was 7.50%, based upon the expected rate of return, net of expected investment expenses. The OPEB plan's fiduciary net position is projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability. The employer's funding policy is to fund actuarially determined employer contribution each year.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

12. Post-employment healthcare and life insurance benefits (continued):

GASB 74 plan reporting (continued):

Sensitivity of the net OPEB liability to changes in the discount rate:

The following presents the net OPEB liability of the Borough, as well as what the Borough's net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower (6.5%) or one percentage point higher (8.5%) than the current discount rate:

	1% Decrease 6.50%	Current discount rate 7.5%	1% Increase 8.50%
Police net OPEB liability	\$ 1,448,323	\$ 977,341	\$ 577,185
Non-uniform net OPEB liability (asset)	\$ 703,253	\$ 266,711	\$ (110,591)

Sensitivity of the net OPEB liability to changes in the healthcare cost trend rates:

The following presents the net OPEB liability of the Borough, as well as what the Borough's net OPEB liability would be if it were calculated using healthcare cost trend rates that are one percentage point lower (4.6% decreasing to 2.9%) or one percentage point higher (6.6% decreasing to 4.9%) than the current healthcare cost trend rates:

	Health cost trend rates		
	1% Decrease 4.6% decreasing to 2.9%	Current healthcare cost trend 5.6% decreasing to 3.9%	1% Increase 6.6% decreasing to 4.9%
Police net OPEB liability	\$ 509,864	\$ 977,341	\$ 1,534,121
Non-uniform net OPEB liability (asset)	\$ (157,445)	\$ 266,711	\$ 758,822

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

13. Internal service billings, proprietary funds:

For the year ended December 31, 2017, the Electric Fund recorded \$441,352 of service billings revenue billed to the Borough. Included in the billings is \$345,843 related to Borough owned property for the leased water/sewer system. These billings are recorded in these financial statements as expenditures/expenses in the applicable Borough fund.

14. Rental income:

During 2014, the Borough and the MBICDA were assigned the right to collect lease payments on a lease formerly held by the MBICDA. The lease is a 20-year lease through December 31, 2034, separated into four five-year terms. The lease can be cancelled at the end of each five-year term, with 12 months prior notification by either party. The lease payments increase 10% each five-year term. Total lease payments received by the Borough in 2017 under this assignment were \$31,699.

The future minimum non-cancellable lease payments due to the Borough under this lease are:

Year ending December 31,	
2018	\$ 29,261
2019	<u>29,261</u>
Total	<u>\$ 58,522</u>

15. Contingencies and commitments:

The Borough provides unemployment compensation to eligible claimants through the General Fund. The Borough would be liable for unemployment compensation claims out of its general revenues.

The Borough currently employs a labor force of which approximately 75% is covered by one of two collective bargaining agreements. The non-management, non-uniform employees are covered by the Borough's agreement with Teamsters Local Union 776, which expires on December 31, 2018. The Borough's agreement with the Middletown Borough Police Officers Association expired December 31, 2016 and is currently in negotiations.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

15. Contingencies and commitments (continued):

The Borough is involved in various employment-related lawsuits and charges asserted by and against its employees and its bargaining units. The outcome of these matters cannot be determined at this time. Management believes that any potential losses from these matters will not have a material adverse effect on the Borough's financial position.

The Borough is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees and natural disasters. The Borough maintains commercial insurance covering each of these risks of loss. Management believes such coverage is sufficient to preclude any significant uninsured losses. Settled claims have not significantly exceeded this commercial coverage in any of these past three years.

During the year ended December 31, 2017, the Borough became a member of a modified self-funded trust to provide medical benefits to employees and retirees. Under the trust plan, the Township pays reasonable and customary healthcare expenses. For the year ended December 31, 2017, the Borough did not have any outstanding claims or refunds.

On September 8, 1998, the Borough entered into a settlement agreement with Metropolitan Edison Company (Met-Ed) thereby ending the complaint Met-Ed filed against the Borough in October 1994 seeking termination of the supply contract and damages for certain past sales, calculated on the basis of the difference between the Borough's contracted rate of one cent per kilowatt hour (KWH) and the tariff rate applicable to Met-Ed's other wholesale customers.

The terms of the agreement stated that in exchange for a termination of the Electricity Supply Contract between Met-Ed and the Borough, on January 1, 1999, Met-Ed agreed to pay the Borough \$18,000,000, payable over ten years, through 2008. These payments were backed by an irrevocable letter of credit provided to the Borough by Met-Ed, which was updated each year until it expired on February 22, 2008.

The Borough has set up the "Middletown Electric Rate Stabilization Irrevocable Trust" (Trust) in which these payments were being deposited. The purpose of the Trust is to ensure that the settlement payments be used solely to subsidize the cost incurred by the Borough to purchase electricity transmission capacity and wholesale electricity, in order to reduce the rate increase in prices that customers of the Borough's electric distribution system must pay for electricity. The funds placed in the Trust must be invested in accordance with Article XIII, Section 1316 of the Borough Code as amended. As of December 31, 2017, the balance of invested funds in the Trust is \$9,858,963.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

15. Contingencies and commitments (continued):

On March 20, 2018, Middletown Water Joint Venture LLC (MWJV) filed a demand for arbitration with the American Arbitration Association against the Borough of Middletown as a result of a dispute over certain terms in the parties' Municipal Water and Wastewater Utility System Concession and Lease Agreement dated September 30, 2014 (Agreement). MWJV claims the Borough is in breach of the agreement. Specifically the claim states that the Borough has deprived MWJV from capital cost recovery for major improvements to the Borough's water and sewer systems. The arbitration hearing is expected to be scheduled for some time in November 2018. As of the date of issuance of these financial statements, there can be no determination made of a potential favorable or unfavorable outcome from the pending arbitration hearing.

16. Capital leases:

Governmental activities:

In 2015, the Borough entered into two capital leases to finance the purchase of two cars. The terms of the leases include three years with annual payments beginning in 2015 and going through 2017.

The assets (recorded as general equipment and vehicles) subject to the capital leases are as follows:

Assets:	
Vehicles	\$ 84,858
Less: accumulated depreciation	<u>39,641</u>
Total	<u><u>\$ 45,217</u></u>

The following is a summary of the changes in capital lease obligations for the year ended December 31, 2017:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Governmental activities, capital lease obligations	<u>\$ 28,258</u>		<u>\$ (28,258)</u>	<u>\$ -</u>	

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

17. Net position deficit:

For the year ended December 31, 2017, the following fund had a deficit in unrestricted net position:

Business-type funds, Water-Sewer Fund	\$ 38,658,818
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The primary cause for the deficit in the Water-Sewer Fund unrestricted net position is the \$49,249,921 deferred inflow of resources from the service concession arrangement as of December 31, 2017 (see Note 19).

18. Related party transactions:

The Borough has paid for expenses on behalf of and contributed funds to the Middletown Public Library (the Library), a related organization, with these expenses to be partially reimbursed by the Library. During the year ended December 31, 2017, the Borough contributed \$49,981 worth of expenses for the Library.

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

19. Service concession arrangement:

On December 30, 2014, the MBICDA completed a service concession arrangement to allow Middletown Water Joint Venture LLC to manage, operate and collect water and sewer charges from the Borough's water and sewer system for 50 years. The Middletown Water Joint Venture LLC assumed all obligations under the service concession arrangement. The MBICDA received an upfront payment of \$43,209,666, which was recorded as a deferred inflow that will be amortized on the straight-line method and recognized as revenue over the term of the agreement. On May 19, 2016, the MBICDA transferred \$9,962,045 (net of present value discount of \$19,822,955) of the service concession arrangement receivable to the Borough. During 2017, the Borough and MBICDA recognized amortized income of \$864,193 from the upfront payments received from the service concession arrangement. The Borough will also receive annual installment payments, which were recorded as a deferred inflow and discounted at 6%. The annual installment payments will be recognized as revenue over the term of the agreement as follows:

Year	Payment	Present value discount	Net present value
2018	\$ 725,000	\$ 116,276	\$ 608,724
2019	725,000	150,732	574,268
2020	725,000	183,238	541,762
2021	630,000	185,875	444,125
2022	630,000	211,014	418,986
2023-2027	3,070,000	1,346,028	1,723,972
2028-2032	2,950,000	1,714,885	1,235,115
2033-2037	2,950,000	2,027,049	922,951
2038-2042	2,950,000	2,260,319	689,681
2043-2047	2,950,000	2,434,630	515,370
2048-2052	2,950,000	2,564,885	385,115
2053-2057	2,950,000	2,662,219	287,781
2058-2062	2,950,000	2,734,955	215,045
2063-2064	1,180,000	1,110,060	69,940
	28,335,000	19,702,165	8,632,835
Less current portion	725,000	116,276	608,724
Long-term portion	<u>\$ 27,610,000</u>	<u>\$ 19,585,889</u>	<u>\$ 8,024,111</u>

BOROUGH OF MIDDLETOWN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 2017

19. Service concession arrangement (continued):

The service concession arrangement was completed for the primary purpose of leveraging Borough assets and generating cash resources. The water and sewer system assets are reported on the Borough's statement of net position and will be depreciated over their useful lives. The following is a summary of changes in the deferred inflows of resources, service concession arrangement, net of discount for the year ended December 31, 2017:

	<u>Beginning balance</u>	<u>Amortization</u>	<u>Ending balance</u>
Deferred inflows of resources, service concession arrangement, net of discount:			
Upfront payment	\$ 41,481,280	\$ (864,193)	\$ 40,617,087
Installment payments	<u>9,278,082</u>	<u>(645,248)</u>	<u>8,632,834</u>
	<u>\$ 50,759,362</u>	<u>\$ (1,509,441)</u>	<u>\$ 49,249,921</u>

20. Subsequent events:

On February 15, 2018, the Borough entered into a lease for three vehicles at a total cost of principal plus interest of \$300,751. The principal and interest is payable annually in January of each year with the first payment being due in January 2019. The lease bears interest at a rate of 4.28% and matures on January 15, 2022.

The Borough has evaluated subsequent events through September 11, 2018, which is the date the financial statements were available to be issued.

BOROUGH OF MIDDLETOWN

**SCHEDULE OF CHANGES IN THE NET PENSION LIABILITY (ASSET) AND RELATED
PERCENTAGES – LAST FOUR YEARS FOR POLICE PENSION PLAN**
(Required supplementary information – unaudited)

YEAR ENDED DECEMBER 31, 2017

	2017	2016	2015	2014
Total pension liability:				
Service cost	\$ 141,360	\$ 124,146	\$ 118,234	\$ 155,966
Interest	498,383	478,833	464,366	489,721
Change in experience	53,473		(516,712)	
Change of assumptions	675,072			
Benefit payments, including refunds of member contributions	(413,116)	(401,826)	(401,850)	(434,811)
Net change in total pension liability	955,172	201,153	(335,962)	210,876
Total pension liability:				
Beginning of year	6,456,414	6,255,261	6,591,223	6,380,347
End of year (a)	<u>\$ 7,411,586</u>	<u>\$ 6,456,414</u>	<u>\$ 6,255,261</u>	<u>\$ 6,591,223</u>
Plan fiduciary net position:				
Contributions:				
Employer	\$ 112,266	\$ 126,544	\$ 353,287	\$ 1,895,605
Employee	23,177	21,585	16,681	18,088
Net investment income (loss)	921,476	409,213	(118,885)	174,442
Benefit payments, including refunds of member contributions	(413,116)	(401,826)	(401,850)	(434,811)
Administrative expense		(6,565)	(16,503)	(11,811)
Net change in plan fiduciary net position	643,803	148,951	(167,270)	1,641,513
Total fiduciary net position:				
Beginning of year	6,471,052	6,322,101	6,489,371	4,847,858
End of year (b)	<u>\$ 7,114,855</u>	<u>\$ 6,471,052</u>	<u>\$ 6,322,101</u>	<u>\$ 6,489,371</u>
Net pension liability (asset), end of year (a) - (b)	<u>\$ 296,731</u>	<u>\$ (14,638)</u>	<u>\$ (66,840)</u>	<u>\$ 101,852</u>
Plan fiduciary net position as a percentage of the total pension liability	96.00%	100.23%	101.07%	98.45%
Covered employee payroll	\$ 1,117,365	\$ 869,026	\$ 898,542	\$ 812,815
Net pension liability (asset) as a percentage of the covered employee payroll	26.56%	(1.68)%	(7.44)%	12.53%

The schedule of changes in net pension liability (asset) and related percentages results for the required 10-year timeframe will be added as available.

BOROUGH OF MIDDLETOWN

**SCHEDULE OF CHANGES IN THE NET PENSION ASSET AND RELATED PERCENTAGES –
LAST FOUR YEARS FOR NON-UNIFORM PENSION PLAN
(Required supplementary information – unaudited)**

YEAR ENDED DECEMBER 31, 2017

	2017	2016	2015	2014
Total pension liability:				
Service cost	\$ 58,911	\$ 110,737	\$ 93,055	\$ 133,234
Interest	790,707	775,385	749,532	801,569
Change in experience	27,869	406,282	(821,832)	
Change of assumptions	176,297			
Benefit payments, including refunds of member contributions	(695,407)	(943,740)	(850,715)	(782,861)
Net change in total pension liability	358,377	348,664	(829,960)	151,942
Total pension liability:				
Beginning of year	11,380,436	11,031,772	11,861,732	11,709,790
End of year (a)	<u>\$ 11,738,813</u>	<u>\$ 11,380,436</u>	<u>\$ 11,031,772</u>	<u>\$ 11,861,732</u>
Plan fiduciary net position:				
Contributions:				
Employer		\$ 120,323	\$ 466,593	\$ 2,740,716
Employee	\$ 28,242	29,242	46,809	63,544
Net investment income (loss)	1,696,239	915,579	(159,130)	454,439
Benefit payments, including refunds of member contributions	(695,407)	(943,740)	(850,715)	(782,861)
Administrative expense		(8,584)	(19,621)	(1,976)
Net change in plan fiduciary net position	1,029,074	112,820	(516,064)	2,473,862
Total fiduciary net position:				
Beginning of year	11,542,521	11,429,701	11,945,765	9,471,903
End of year (b)	<u>\$ 12,571,595</u>	<u>\$ 11,542,521</u>	<u>\$ 11,429,701</u>	<u>\$ 11,945,765</u>
Net pension asset, end of year (a) - (b)	<u>\$ (832,782)</u>	<u>\$ (162,085)</u>	<u>\$ (397,929)</u>	<u>\$ (84,033)</u>
Plan fiduciary net position as a percentage of the total pension liability	107.09%	101.42%	103.61%	100.71%
Covered employee payroll	\$ 564,846	\$ 847,479	\$ 704,523	\$ 1,025,163
Net pension asset as a percentage of the covered employee payroll	(147.44)%	(19.13)%	(56.48)%	(8.20)%

The schedule of changes in net pension asset and related percentages results for the required 10-year timeframe will be added as available.

BOROUGH OF MIDDLETOWN

SCHEDULE OF EMPLOYER CONTRIBUTIONS IN THE PENSION PLANS – LAST TEN YEARS
(Required supplementary information – unaudited)

YEAR ENDED DECEMBER 31, 2017

Police Pension Plan	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Actuarially determined contribution	\$ 111,414	\$ 73,575	\$ 352,096	\$ 312,337	\$ 336,045	\$ 309,995	\$ 300,172	\$ 237,608	\$ 241,587	\$ 213,820
Contributions from employer	112,266	126,544	353,287	1,895,605	340,067	313,718	301,962	237,608	241,587	213,820
Contribution deficiency (excess)	\$ (852)	\$ (52,969)	\$ (1,191)	\$ (1,583,268)	\$ (4,022)	\$ (3,723)	\$ (1,790)	\$ -	\$ -	\$ -
Covered-employee payroll	\$ 1,117,365	\$ 869,026	\$ 898,542	\$ 812,815	\$ 979,508	\$ 1,186,189	\$ 1,169,840	\$ 1,169,842	\$ 1,048,293	\$ 1,172,713
Contributions as a percentage of covered-employee payroll	10.05%	14.56%	39.32%	233.21%	34.72%	26.45%	25.81%	20.31%	23.05%	18.23%
Non-Uniform Pension Plan	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Actuarially determined contribution	\$ -	\$ 95,764	\$ 450,848	\$ 398,710	\$ 417,962	\$ 476,417	\$ 381,750	\$ 84,559	\$ 74,370	\$ 42,249
Contributions from employer	-	120,323	466,593	2,740,716	420,612	476,417	381,750	84,560	74,370	42,250
Contribution deficiency (excess)	\$ -	\$ (24,559)	\$ (15,745)	\$ (2,342,006)	\$ (2,650)	\$ -	\$ -	\$ (1)	\$ -	\$ (1)
Covered-employee payroll	\$ 564,846	\$ 847,479	\$ 704,523	\$ 1,025,163	\$ 1,557,088	\$ 2,520,120	\$ 2,354,008	\$ 2,364,663	\$ 2,356,782	\$ 2,249,761
Contributions as a percentage of covered-employee payroll	0.00%	14.20%	66.23%	267.34%	27.01%	18.90%	16.22%	3.58%	3.16%	1.88%

BOROUGH OF MIDDLETOWN

NOTES TO SCHEDULE OF EMPLOYER CONTRIBUTIONS IN THE PENSION PLANS (Required supplementary information – unaudited)

YEAR ENDED DECEMBER 31, 2017

	Police Pension Plan	Non-Uniformed Employees Pension Plan
Methods and assumptions used to determine contribution rates:		
Valuation date*	January 1, 2015	January 1, 2015
Actuarial cost method	Entry age normal	Entry age normal
Amortization method	Level dollar closed	Level percent
Remaining amortization period	N/A years	N/A years
Asset valuation method	Smoothed value with a corridor of 80% to 120% of market value	Smoothed value with a corridor of 80% to 120% of market value
Inflation	3.00%	3.00%
Salary increases	5.00%	4.00%
Investment rate of return	7.75%	7.00%
Retirement age	Age 53 and 25 years of service	Normal retirement age
Mortality	RP2000 Table	2008+ IRS Combined Static Table
Changes in benefit terms	None since 1/1/2015	None since 1/1/2015

* Actuarially determined contributions are calculated as of January 1, two to four years prior to the end of the fiscal year in which contributions are reported.

BOROUGH OF MIDDLETOWN

SCHEDULE OF INVESTMENT RETURNS IN THE PENSION PLANS – LAST FOUR YEARS
(Required supplementary information – unaudited)

YEAR ENDED DECEMBER 31, 2017

	<u>2016</u>	<u>2015</u>
Police Pension Plan, annual money-weighted rate of return, net of investment expense	7.2%	(1.4)%
Non-Uniform Pension Plan, annual money-weighted rate of return, net of investment expense	8.4%	(1.8)%

Note to the schedule:

The schedule of investment returns results for the required 10-year timeframe with be added as available.
The 2017 annual money-weighted rate of return was not available.

BOROUGH OF MIDDLETOWN

**SCHEDULE OF FUNDING PROGRESS FOR POST-EMPLOYMENT BENEFITS
OTHER THAN PENSIONS**

(Required supplementary information – unaudited)

YEAR ENDED DECEMBER 31, 2017

SCHEDULE OF FUNDING PROGRESS - POLICE OPEB PLAN

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) - entry age (b)	Unfunded (AAL) (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll ((b-a)/c)
1/1/2012	\$ 918,419	\$ 3,205,261	\$ 2,286,842	28.7 %	\$ 1,216,096	188.0 %
1/1/2015	3,297,768	3,299,408	1,640	100.0	849,266	0.2
1/1/2017	3,168,555	4,196,620	1,028,065	75.5	915,214	112.3

SCHEDULE OF FUNDING PROGRESS - NON-UNIFORM OPEB PLAN

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) - entry age (b)	Unfunded (AAL) (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll ((b-a)/c)
1/1/2012	\$ 1,473,356	\$ 5,141,974	\$ 3,668,618	28.7 %	\$ 2,469,825	148.5 %
1/1/2015	4,942,043	4,944,500	2,457	100.0	822,462	0.3
1/1/2017	4,547,756	5,107,738	559,982	89.0	692,431	80.9

BOROUGH OF MIDDLETOWN

**SCHEDULE OF CHANGES IN THE NET OPEB LIABILITY AND RELATED PERCENTAGES – FOR
POLICE POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS**
(Required supplementary information – unaudited)

YEAR ENDED DECEMBER 31, 2017

Total OPEB liability:	
Service cost	\$ 95,044
Interest	312,585
Benefit payments, including refunds of member contributions	<u>(247,736)</u>
Net change in total OPEB liability	159,893
Total OPEB liability:	
Beginning of year	<u>4,196,620</u>
End of year (a)	<u><u>\$ 4,356,513</u></u>
Plan fiduciary net position:	
Contributions, employer	\$ 63,627
Net investment income	394,726
Benefit payments, including refunds of member contributions	<u>(247,736)</u>
Net change in plan fiduciary net position	210,617
Total fiduciary net position:	
Beginning of year	<u>3,168,555</u>
End of year (b)	<u><u>\$ 3,379,172</u></u>
Net OPEB liability, end of year (a) - (b)	<u><u>\$ 977,341</u></u>
Plan fiduciary net position as a percentage of the total OPEB liability	77.57%
Covered employee payroll	\$ 1,115,423
Net OPEB liability as a percentage of the covered employee payroll	87.62%

Note to the schedule:

The Borough adopted GASB 74 on a prospective basis for the fiscal year ended December 31, 2017; therefore, only one year is presented in the above schedule.

BOROUGH OF MIDDLETOWN

**SCHEDULE OF CHANGES IN THE NET OPEB LIABILITY AND RELATED PERCENTAGES – FOR
NON-UNIFORM POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS**
(Required supplementary information – unaudited)

YEAR ENDED DECEMBER 31, 2017

Total OPEB liability:	
Service cost	\$ 71,583
Interest	372,747
Benefit payments, including refunds of member contributions	<u>(418,731)</u>
Net change in total OPEB liability	25,599
Total OPEB liability:	
Beginning of year	<u>5,107,738</u>
End of year (a)	<u><u>\$ 5,133,337</u></u>
Plan fiduciary net position:	
Contributions, employer	\$ 171,846
Net investment income	565,755
Benefit payments, including refunds of member contributions	<u>(418,731)</u>
Net change in plan fiduciary net position	318,870
Total fiduciary net position:	
Beginning of year	<u>4,547,756</u>
End of year (b)	<u><u>\$ 4,866,626</u></u>
Net OPEB liability, end of year (a) - (b)	<u><u>\$ 266,711</u></u>
Plan fiduciary net position as a percentage of the total OPEB liability	94.80%
Covered employee payroll	\$ 833,575
Net OPEB liability as a percentage of the covered employee payroll	32.00%

Note to the schedule:

The Borough adopted GASB 74 on a prospective basis for the fiscal year ended December 31, 2017; therefore, only one year is presented in the above schedule.

BOROUGH OF MIDDLETOWN

**SCHEDULE OF EMPLOYER CONTRIBUTIONS IN POST-EMPLOYMENT BENEFITS
OTHER THAN PENSIONS**

(Required supplementary information – unaudited)

YEAR ENDED DECEMBER 31, 2017

<u>Police OPEB Plan</u>	<u>2017</u>
Actuarially determined contribution	\$ 200,896
Contributions from employer	<u>63,627</u>
Contribution deficiency	<u>\$ 137,269</u>
Percentage contributed	31.67%
Covered-employee payroll	\$ 915,214
Contributions as a percentage of covered-employee payroll	6.95%
<u>Non-Uniform OPEB Plan</u>	<u>2017</u>
Actuarially determined contribution	\$ 130,727
Contributions from employer	<u>171,846</u>
Contribution excess	<u>\$ (41,119)</u>
Percentage contributed	131.45%
Covered-employee payroll	\$ 692,431
Contributions as a percentage of covered-employee payroll	24.82%

Note to the schedule:

The Borough adopted GASB 74 on a prospective basis for the fiscal year ended December 31, 2017; therefore, only one year is presented in the above schedule.

BOROUGH OF MIDDLETOWN

NOTES TO SCHEDULE OF EMPLOYER CONTRIBUTIONS IN POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS (Required supplementary information – unaudited)

YEAR ENDED DECEMBER 31, 2017

	Police OPEB Plan	Non-Uniform OPEB Plan
Methods and assumptions used to determine contribution rates:		
Valuation date	January 1, 2017	January 1, 2017
Actuarial cost method	Entry age normal	Entry age normal
Amortization method	Level dollar closed	Level percent
Remaining amortization period	21 years	21 years
Asset valuation method	Fair market value	Fair market value
Medical inflation	Not Applicable	Not Applicable
Inflation	2.50%	2.50%
Salary increases	5.00%	4.00%
Investment rate of return	7.50%	7.50%
Retirement age	Latest of age 53, age at completion of 25 years of service, or the valuation date	Latest of age 60, age when the sum of their age plus service is at least 78, or the valuation date
	RP2000 Table	2008+ IRS Combined Static Table
	None since 1/1/2015	None since 1/1/2015
Mortality		
Changes in benefit terms		

BOROUGH OF MIDDLETOWN

**SCHEDULE OF INVESTMENT RETURNS IN POST-EMPLOYMENT BENEFITS
OTHER THAN PENSIONS**

(Required supplementary information – unaudited)

YEAR ENDED DECEMBER 31, 2017

Police OPEB Plan, annual money-weighted rate of return, net of investment expense	10.90%
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Non-Uniform OPEB Plan, annual money-weighted rate of return, net of investment expense	10.90%
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Note to the schedule:

The schedule of investment returns results for the required 10-year
timeframe with be added as available.

BOROUGH OF MIDDLETOWN

**SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE –
BUDGET AND ACTUAL - GENERAL FUND
(Required supplementary information – unaudited)**

YEAR ENDED DECEMBER 31, 2017

	Original budget	Final budget	Actual	Variance with final budget positive (negative)
Revenues:				
Taxes	\$ 2,393,700	\$ 2,393,700	\$ 2,588,031	\$ 194,331
Licenses and permits	151,300	151,300	33,565	(117,735)
Fines and forfeitures	32,000	32,000	59,932	27,932
Interest and rents	6,000	6,000	108,390	102,390
Intergovernmental	157,900	157,900	216,377	58,477
Charges for services	891,325	891,325	1,072,740	181,415
Contributions from private sector			82,443	82,443
Miscellaneous income	30,600	30,600	12,580	(18,020)
Total revenues	3,662,825	3,662,825	4,174,058	511,233
Expenditures:				
General government	671,050	671,050	535,225	(135,825)
Public safety	2,952,475	2,952,475	2,738,271	(214,204)
Public works	2,051,925	2,051,925	2,198,019	146,094
Parks and recreation	51,500	51,500	191,025	139,525
Community development	68,200	68,200	108,596	40,396
Debt service			62,676	62,676
Total expenditures	5,795,150	5,795,150	5,833,812	38,662
Deficiency of revenues under expenditures	(2,132,325)	(2,132,325)	(1,659,754)	472,571
Other financing sources (uses):				
Gain on sale of fixed assets	15,000	15,000	13,555	(1,445)
Transfers in	2,149,325	2,149,325	2,265,814	116,489
Transfers out	(32,000)	(32,000)		32,000
Total other financing sources	2,132,325	2,132,325	2,279,369	147,044
Net change in fund balance	\$ -	\$ -	\$ 619,615	\$ 619,615

(continued)

BOROUGH OF MIDDLETOWN

**SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE –
BUDGET AND ACTUAL - GENERAL FUND (CONTINUED)
(Required supplementary information – unaudited)**

YEAR ENDED DECEMBER 31, 2017

Budgets:

Formal budgetary accounting is employed as a management control in certain governmental fund types of the Borough. Annual operating budgets are adopted each year through the passage of an annual budget ordinance, and the modified basis of accounting is used to complete the budget for governmental fund types. Budgetary control is exercised at the department level in the General Fund and at the fund level for all other funds. The Borough approves budgets for the General Fund, Fire Operations Fund and Capital Projects Fund. The Borough does not prepare a budget for the Highway Aid Fund, which is a major special revenue fund.

Actual expenditures exceeded budget appropriations in 2017 for the following General Fund functions:

Public works	\$ 146,094
Parks and recreation	139,525
Community development	40,396
Debt service	62,676

BOROUGH OF MIDDLETOWN **COMBINING BALANCE SHEET – NONMAJOR GOVERNMENTAL FUNDS**

DECEMBER 31, 2017

	Special revenue funds							Debt service fund			Total nonmajor governmental funds
	Highway Aid	Rehabilitation program	Fire operations deposit	Fire sinking fund	Flood relief	Lease proceeds	Community fund	Total special revenue funds	Capital projects	General debt service	
ASSETS											
Cash and cash equivalents	\$ 511,841	\$ 112,853	\$ 2,304	\$ 154,514	\$ 531,959	\$ 934	\$ 2,096	\$ 1,316,501	\$ 260,995	\$ 340,920	\$ 1,918,416
Taxes receivable			509	203				712			712
Notes receivable		32,821						32,821			32,821
Due from other funds	127,347							127,347	185,558		312,905
Total assets	\$ 639,188	\$ 145,674	\$ 2,813	\$ 154,717	\$ 531,959	\$ 934	\$ 2,096	\$ 1,477,381	\$ 446,553	\$ 340,920	\$ 2,264,854
LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND FUND BALANCES											
Due to other funds	\$ 25,309				\$ 286,164			\$ 311,473	\$ 127,347		\$ 438,820
Unearned revenue	32,821							32,821			32,821
Total liabilities	58,130				286,164			344,294	127,347		471,641
Deferred inflows of resources, unavailable revenue, property taxes			\$ 509	\$ 203				712			712
Fund balances:											
Nonspendable		32,821						32,821			32,821
Restricted for:											
Highway aid	\$ 639,188							639,188			639,188
Rehabilitation program		54,723						54,723			54,723
Fire sinking				154,514				154,514			154,514
Community fund							\$ 2,096	2,096	319,206		319,206
Committed for capital projects											
Assigned to:											
Fire operations			2,304					2,304			2,304
Flood relief					245,795			245,795			245,795
Debt service						\$ 934		934		\$ 340,920	341,854
Total fund balances	639,188	87,544	2,304	154,514	245,795	934	2,096	1,132,375	319,206	340,920	1,792,501
Total liabilities, deferred inflows of resources and fund balances	\$ 639,188	\$ 145,674	\$ 2,813	\$ 154,717	\$ 531,959	\$ 934	\$ 2,096	\$ 1,477,381	\$ 446,553	\$ 340,920	\$ 2,264,854

	Special revenue funds					Total special revenue funds	Debt service fund		Total nonmajor governmental funds
	Highway Aid	Rehabilitation program	Fire operations deposit	Fire sinking fund	Flood relief		Lease proceeds	Community fund	
Revenues:									
Taxes			\$ 276	\$ 110			\$	386	\$ 386
Interest and rents	\$ 4,406				\$ 3,150	\$ 2		\$ 14,018	\$ 24
Intergovernmental	233,897				1,400			9,735	
Homestead Program interest		\$ 2,832						2,832	
Charges for services				6,769				6,769	
Miscellaneous income						423		423	
Total revenues	238,303	2,832	276	6,879	4,550	425		23,753	24
Expenditures:									
General government		4,558						14,489	
Public safety			46,437					46,437	
Public works								113,768	
Parks and recreation								9,576	
Debt service:									
Principal	148,579							148,579	
Interest and issuance costs	5,279							11,090	
Total expenditures	153,858	4,558	46,437					137,833	11,090
Excess (deficiency) of revenues over (under) expenditures	84,445	(1,726)	(46,161)	6,879	4,550	425		(114,080)	(11,066)
Other financing sources (uses):									
Proceeds from issuance of long-term debt									387,000
Transfers out								(21,946)	(35,014)
Total other financing sources (uses)								(21,946)	330,040
Net change in fund balances	84,445	(1,726)	(46,161)	6,879	4,550	425		(136,026)	340,920
Fund balances (deficit):									
Beginning of year	554,743	89,270	48,465	147,835	241,245	509	\$ 2,096	455,232	1,539,195
End of year	\$ 639,188	\$ 87,544	\$ 2,304	\$ 154,514	\$ 245,795	\$ 934	\$ 2,096	\$ 319,206	\$ 1,792,501

BOROUGH OF MIDDLETOWN

**COMBINING STATEMENT OF NET POSITION –
ENTERPRISE FUND – ELECTRIC FUND**

DECEMBER 31, 2017

	Business-type activities - Enterprise Fund						
	Operations	Electric deposit	Electric capital improvements	Electric trust	Electric debt service	Elimination entries	Totals
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES							
Assets:							
Current assets:							
Unrestricted, cash and cash equivalents	\$ 5,575,755	\$ 162,533	\$ 314,170	\$ 1,243	\$ 302,223		\$ 6,355,924
Accounts receivable	716,166						716,166
Prepaid expenses	12,623						12,623
Due from other funds	678,020					\$ (421,917)	256,103
Total current assets	6,982,564	162,533	314,170	1,243	302,223	(421,917)	7,340,816
Noncurrent assets:							
Restricted, cash and investments			451,871	9,858,963			10,310,834
Net pension asset	439,980						439,980
Net other post-retirement benefit asset	1,510,183						1,510,183
Capital assets:							
Not being depreciated	634,102						634,102
Net of accumulated depreciation	2,466,097		10,339				2,476,436
Total noncurrent assets	5,050,362		462,210	9,858,963			15,371,535
Total assets	12,032,926	162,533	776,380	9,860,206	302,223	(421,917)	22,712,351
Deferred outflows of resources, pensions	207,704						207,704
Total assets and deferred outflows of resources	\$ 12,240,630	\$ 162,533	\$ 776,380	\$ 9,860,206	\$ 302,223	\$ (421,917)	\$ 22,920,055
LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION							
Liabilities:							
Current liabilities:							
Accounts payable and accrued expenses	\$ 409,568		\$ 10,426				\$ 419,994
Accrued salaries	23,637						23,637
Due to other funds	415,878			\$ 421,917		\$ (421,917)	415,878
Unearned revenue	46,966						46,966
Total current liabilities	896,049		10,426	421,917		(421,917)	906,475
Long-term liabilities:							
Compensated absences	51,174						51,174
Electric deposits		\$ 128,469					128,469
Total long-term liabilities	51,174	128,469					179,643
Total liabilities	947,223	128,469	10,426	421,917		(421,917)	1,086,118
Deferred inflows of resources, pensions	430,821						430,821
Net position:							
Net investment in capital assets	3,100,199		10,339				3,110,538
Restricted net position			451,871	9,438,289			9,890,160
Unrestricted net position	7,762,387	34,064	303,744		\$ 302,223		8,402,418
Total net position	10,862,586	34,064	765,954	9,438,289	302,223		21,403,116
Total liabilities, deferred inflows of resources and net position	\$ 12,240,630	\$ 162,533	\$ 776,380	\$ 9,860,206	\$ 302,223	\$ (421,917)	\$ 22,920,055

BOROUGH OF MIDDLETOWN

**COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION –
ENTERPRISE FUND – ELECTRIC FUND**

YEAR ENDED DECEMBER 31, 2017

	Business-type activities - Enterprise Fund					Totals
	Operations	Electric deposit	Electric capital improvements	Electric trust	Electric debt service	
Operating revenues, service billings	\$ 8,426,660					\$ 8,426,660
Operating expenses:						
Electric transmission and distribution	4,515,230					4,515,230
General and administrative	649,500	\$ 1,036		\$ 476		651,012
Depreciation expense	175,583		\$ 87			175,670
Total operating expenses	5,340,313	1,036	87	476		5,341,912
Operating income (loss)	3,086,347	(1,036)	(87)	(476)		3,084,748
Nonoperating revenues (expenses):						
Investment income	42,579		3,127	77,606	\$ 2,265	125,577
Miscellaneous income	5,105					5,105
Total nonoperating revenues (expenses)	47,684		3,127	77,606	2,265	130,682
Income (loss) before transfers	3,134,031	(1,036)	3,040	77,130	2,265	3,215,430
Transfers, out	(1,401,966)					(1,401,966)
Changes in net position	1,732,065	(1,036)	3,040	77,130	2,265	1,813,464
Total net position (deficit):						
Beginning of year	9,130,521	35,100	762,914	9,361,159	299,958	19,589,652
End of year	\$ 10,862,586	\$ 34,064	\$ 765,954	\$ 9,438,289	\$ 302,223	\$ 21,403,116