pfm

March 31, 2020

Memorandum

To: Tamarra Foulkes
New Castle County

From: PFM Financial Advisors LLC
Geoffrey Stewart
Matt Magarity

RE: New Castle County Airport (ILG)

At the request of New Castle County (“County”), PFM Financial Advisors LLC (“PFM”), as independent financial advisor to the County, has reviewed the County’s Acquisition Agreement and Ground Lease (the “Agreements”) with the Delaware River and Bay Authority (“DRBA”). Our review focused specifically on the termination provisions of the Agreements and the proposed termination value presented by the DRBA to the County. We reviewed the calculations prepared by the DRBA to confirm the assumptions used in calculation of the termination value. We reviewed (i) the list of acquired assets, (ii) the cost of the acquired assets, (iii) the loan term assumed for each acquired asset, and (iv) the interest rate assumed for each loan.

COSTS

We were provided with a list of the assets placed in service by the DRBA beginning in 1995 through 2018. The total cost of the assets placed in service from 1995-2018 presented in the DRBA documentation is $73,094,571. We compared the total costs of the assets placed in service to the costs assumed in the loan amortization schedules. We observed one small discrepancy of $35,775 in the list of assets acquired in 2007. A credit of ($35,775) is listed for improvements made to a building that was sold; however, this credit was not included in the total cost assumed in the corresponding loan amortization schedule. If the credit is applied to the amount of the loan, it results in a modest reduction of ($21,336) to the estimated termination value.

LOAN TERM

In the list of assets provided by DRBA, each asset has been assigned a loan term of either 30 or 45 years for purposes of computing the hypothetical loan amortization schedule used in the calculation of the termination value. We compared the loan terms assigned in the list of assets to the loan terms used in the amortization schedules. We do not find any discrepancies between the loan terms assigned in the list of assets and the loan terms used in the amortization schedules. However, we do have fundamental concerns regarding the loan terms assigned by the DRBA to certain acquired assets that are used in the loan amortization schedules and subsequent calculation of the termination value. We detail our concerns below in Calculation of the Termination Payment.

INTEREST RATES

In the loan amortization schedules provided by the DRBA, the DRBA assumes an interest rate that would have been paid on a hypothetical 30 or 45 year loan each year from 1995 to 2018. To validate the DRBA interest rate assumptions, PFM researched tax-exempt interest rates dating back to 1995. As a proxy for the tax-exempt interest rate the DRBA would have paid each year on the hypothetical loans, we computed the average of the Bond Buyer's Revenue Bond Index ("RBI") each year dating back to 1995. The RBI consists of 25 revenue bonds that mature in 30 years. The average rating on bonds in the RBI is equivalent to Moody's "A1" and Standard & Poor's "A+". These ratings are similar to the DRBA's credit ratings. The 25 revenue bonds in this index cover a broad range of types of issues (transportation, housing, hospital, water and sewer) and is a suitable proxy for the cost of capital the DRBA would have paid had it debt-financed the assets. Below is a table that compares the DRBA assumptions to the annual average of the RBI. While there are differences in the interest rates assumed by DRBA and the annual average of the RBI, we have found that the interest rate assumption does not have a material impact on the rate of principal amortization in the hypothetical loans. The term of the loan has a far more significant impact on principal amortization and, therefore, the calculation of the termination value.

Year	DRBA Assumed Rates	RBI Rates
1995	7.100%	6.219%
1996	7.794%	6.008%
1997	7.075%	5.783%
1998	6.247%	5.322%
1999	7.630%	5.638%
2000	6.609%	5.972%
2001	6.618%	5.440%
2002	5.931%	5.372%
2003	6.226%	5.149%
2004	5.979%	5.094%
2005	5.688%	4.961%
2006	5.963%	4.997%
2007	5.605%	4.635%
2008	3.812%	5.319%
2009	6.340%	5.461%
2010	6.450%	4.879%
2011	4.890%	5.312%
2012	4.440%	4.568%
2013	5.320%	4.767%
2014	4.120%	4.923%
2015	4.500%	4.188%
2016	4.250%	3.518%
2017	3.890%	3.895%
2018	4.340%	4.445%

CALCULATION OF TERMINATION PAYMENT

We developed a model to compute the loan amortization of assets placed in service by the DRBA. First, we used the assumptions provided by DRBA to validate DRBA's proposed termination payment. Assuming the same asset costs net of grant funding, the same loan term (either 30 or 45 years) and the same interest rates provided by the DRBA, we are able to replicate DRBA's loan amortization calculations and computation of the proposed termination payment of $50,184,470.

Second, we used the same asset costs net of grant funding and same loan term (either 30 or 45 years), but we changed the loan interest rate assumption to the annual average of the Revenue Bond Index. We estimate the value of the 2025 termination payment at $48,522,151 - a decrease of $1,662,319 or 3.3% compared to the figures provided by DRBA. [Appendix 2]

Third, while reviewing the list of assets provided by DRBA, we noticed $1,846,322 of assets itemized as “retired” and $2,498,170 of “maintenance” costs related to existing assets. We removed the “retired” and “maintenance” costs (total of $4,344,492) from the loan amortization calculations. If we remove the “retired” and “maintenance” costs from the loan amortization calculations, we estimate the 2025 termination payment at $48,359,431 - a decrease of $1,825,039 or 3.6%. We also excluded assets marked as “sold” from the loan amortization calculations. The DRBA did not include “sold” assets in their calculations so there is no effect on the termination payment.

Fourth, after consultation with the County’s airport advisor Airport Business Solutions (“ABS”), ABS and PFM identified a number of assets with much shorter useful lives (computers, radios, vehicles) compared to the assigned loan terms of 30 or 45 years. This resulted in significant unamortized loan balances on assets that have fully depreciated and are well beyond their useful lives. ABS reviewed the list of assets and provided PFM with revised loan term assumptions for each asset to better match the useful lives of the assets consistent with generally accepted accounting guidelines and FAA guidelines. The following changes were made to the loan term:

DRBA Loan Term	Revised Loan Term	Asset Cost
45	30	24,787,093
30	20	32,344,854
30	10	11,384,331
30	5	198,026
	Total	68,714,304

Using the revised loan terms, we computed new loan amortization schedules and estimate the 2025 termination payment at $18,047,653 - a decrease of $28,628,123 or 57%.

Fifth, we modeled the same scenario as the previous paragraph, except we kept the 45 year assets on a 45 year loan amortization schedule.

DRBA Loan Term	Revised Loan Term	Asset Cost
45	45 (no change)	24,787,093
30	20	32,344,854
30	10	11,384,331
30	5	198,026
	Total	68,714,304

Using the revised loan terms in the table above, we computed new loan amortization schedules and estimate the 2025 termination payment at $31,400,000 - a decrease of $18,784,470 or 37%.

<u>SUMMARY</u>

The table below summarizes the impact of each of the discrepancies or changes discussed above. The cumulative impact of all the changes reduces the estimated termination payment to $18,047,653. It should be noted that the DRBA is unlikely to agree to any of the adjustments below (except, perhaps, the 2007 asset discrepancy) and achieving any reduction in the termination value may require litigation.

DRBA 2025 Termination Value	$50,184,470
Less Discrepancy on Credit (2007 Assets)	($21,336)
Less Change in Interest Rate Assumption	($1,662,319)
Less Retired, Sold & Maintenance Assets	($1,825,039)

Less Change in Loan Terms	($28,628,123)
Revised Termination Value	$18,047,653