# SUSTAINABLE ENERGY FUND
# OF CENTRAL EASTERN PENNSYLVANIA

***(As Established by the PUC-PP&L Utilities Settlement Agreement)***
***Docket # M-00031715 F0003 (Previously R-00973954)***

## Annual Report

## To The

## Pennsylvania Public Utility Commission

## And To The

## Joint Petitioners

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

**October 26, 2004**

**Sustainable Energy Fund**
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**Michael P. McFadden**
**Interim Executive and Managing Director**

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

## 1.0 OVERVIEW ON MISSION PROGRESS

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

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

Several specific areas are noteworthy:

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

## 2.0 ACCOMPLISHMENTS

### 2.1 Program-Related Investment and Grant Commitments

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

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

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

- ***Grants $123,477***
    - $4,900 to **Community Basics** to expand an in depth analysis of the implementation of co-generation for a supplementary heat project in Lancaster.
    - $15,500 to **Eastern York School District** to purchase a wind turbine to provide hands-on instructional opportunities for high school students to learn about alternative energy systems.
    - $4,635 to **Green Building Conference** to support an annual conference held in Pittsburgh. SEF attended and participated at the conference.
    - $6,250 to **Kaufman Gamber Physical Therapy** to support their grid tied solar PV system.
    - $17,000 to **Hersheypark** for the development of the Sustainable Energy Green Team Theater production that accompanies the Renewable Energy Exhibit, partnered with equal contribution from PA DEP.
    - $20,639 to **Penn Future** to install a 3.8 kw solar pv system, an educational exhibit to explain the system and the importance of renewable energy.
    - $1,810 to **Penn Future** for an energy audit for Harrisburg offices.
    - $3,000 to **PFCA (CESA),** a coalition of state, federal and international stationary fuel cell and hydrogen infrastructure programs, with a mission of accelerating the adoption and commercialization of stationary fuel cell technology and hydrogen infrastructure development**.**
    - $12,500 to **Twin Valley School District,** to pay the certification, registration and review fees to build a Leadership in Energy and Environmental Design (LEED) Silver rated middle school.
    - $11,310 to **Unitarian Universalist Church,** to support their church renovations by providing funding for the installation of sun tubes (skylights).
    - $6,500 to **Alternative Fuels Renewable Energies Council,** to support their annual conference on alternative fuels.

- $10,000 to **Clean Energy Expo** to help showcase clean energy technologies, activities in clean energy development, and clean energy education. Staff and board attended and participated at the Expo.
- $9,433 to **Clean Energy States Alliance** for our membership support to the nationwide alliance of state energy funds.

- **Program-Related Investments: $2,670,000**
  - $250,000 to **Community Energy, Inc**. for an equity commitment for investment in common stock of the company.
  - $30,000 to **Oregon Dairy Farm** to support a dairy farm biodigester methane-to-electric generation project.
  - $140,000 to **Pine Hurst Acres** to support a hog farm biodigester methane-to-electric generation project.
  - $600,000 to **SEDA COG** to support the energy efficient renovations and build a 7,500 sq. ft. LEED certified building to house the Energy Resource Center.
  - $100,000 to **Zimmerman Farms** to support a cattle farm biodigester methane-to-electric generation project.
  - $300,000 to **Zimmerman Farms**, (revolving line of credit) to support the construction of a cattle farm biodigester methane-to-electric generation project.
  - $1,000,000 to **Petersburg Commons** to support affordable "green" energy efficient units using LEED standards for a 14 single family attached townhouse dwelling.
  - $250,000 to **Advantek** to purchase, install, and grid connect two 460 kilowatt wind turbines at Energy Unlimited Mountaintop wind farm across the state of PA.

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

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

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

## 2.2 Operation

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

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

## 2.3 Governance

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

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

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

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

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

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

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

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

## 3.0 FINANCIAL REPORTS

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

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

### 3.1 Income

**PPL Ratepayers**

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

**Royalties and Interest Payments from Program-Related Investments**

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

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

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

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

**Leveraging the Funds of Others**

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

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

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

### 3.2 Asset Management

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

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

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

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

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

### 3.3 Operating Expenses

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

### 3.4 Program-Related Investments

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

### 3.5 Health of Balance Sheet

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

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

Total liabilities were $146,340.

## 4.0 NEXT STEPS

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

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

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

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

Appendix A

## *Board Membership (June 30, 2004)*

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

# THE SUSTAINABLE ENERGY FUND OF
# CENTRAL EASTERN PA
## (A Not-for Profit Corporation)

**Financial Statements and Auditors' Report**

**June 30, 2004**


CAMPBELL, RAPPOLD & YURASITS LLP
**Certified Public Accountants**
**1033 SOUTH CEDAR CREST BOULEVARD**
**ALLENTOWN, PA 18103**

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA**
**(A Not-for Profit Corporation)**

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# INDEPENDENT AUDITORS' REPORT

Board of Directors
The Sustainable Energy Fund Central Eastern PA
Allentown, PA

We have audited the accompanying statement of financial position of The Sustainable Energy Fund of Central Eastern PA (A Not-for-Profit Corporation) as of June 30, 2004 and 2003 and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Sustainable Energy Fund of Central Eastern PA as of June 30, 2004 and 2003, and the results of its operations and changes in net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Campbell, Rappold & Yurasits LLP

Certified Public Accountants

August 20, 2004

THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

## STATEMENTS OF FINANCIAL POSITION

| | June 30 2004 | June 30 2003 |
|---|---|---|
| **ASSETS:** | | |
| Cash and Cash Equivalents | $ 1,867,712 | $ 2,606,347 |
| Ratepayer's Contribution Receivable | 268,266 | 260,171 |
| Grant Receivable | 25,193 | 37,842 |
| Investments (Note 3 and 4) | 12,514,535 | 8,355,053 |
| Program Related Investments, Net (Note 5) | 1,699,734 | 986,853 |
| Office Equipment, Net (Note 6) | 13,785 | 17,760 |
| Prepaid Expense and Deposits | 5,017 | 4,958 |
| Investments - Deferred Compensation Plan (Note 9) | 55,534 | 37,867 |
| Total Assets | $16,449,776 | $12,306,851 |
| **LIABILITIES:** | | |
| Accounts Payable | $ 75,988 | $ 58,321 |
| Accrued Employee Benefits | 14,818 | 7,209 |
| Deferred Compensation Liability (Note 9) | 55,534 | 37,867 |
| Total Liabilities | 146,340 | 103,397 |
| **NET ASSETS:** | | |
| Unrestricted Net Assets | 16,303,436 | 12,203,454 |
| Total Liabilities and Net Assets | $16,449,776 | $12,306,851 |

See accompanying notes to financial statements.

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA**
**(A Not-for Profit Corporation)**

## STATEMENT OF ACTIVITIES

| | Year Ended June 30 | |
|---|---|---|
| | 2004 | 2003 |
| *Revenues and Gains:* | | |
| PP&L Ratepayers' Contribution | $ 3,405,695 | $ 3,416,050 |
| Grant Revenue | 22,882 | 37,842 |
| Interest Income - Operating and Money Market | 28,818 | 23,869 |
| Investment Return (Note 3): | | |
| Interest and Dividend Income | 251,749 | 199,469 |
| Net Realized and Unrealized Gains (Losses) | 1,220,599 | 45,822 |
| Less Investment Advisory and Custodian Fees | (62,867) | (48,410) |
| Interest-Program Loans | 57,884 | 27,026 |
| Royalties and Dividends | 22,500 | 10,714 |
| Other | 2,300 | 2,500 |
| Total Revenue and Gains | 4,949,560 | 3,714,882 |
| *Expenses:* | | |
| Program Services | | |
| Grants Awarded | 117,239 | 157,698 |
| Loss Reserve | 62,500 | 687,368 |
| Operating Expenses | 355,779 | 327,658 |
| | 535,518 | 1,172,724 |
| Management and General | 314,060 | 191,114 |
| Total Expenses | 849,578 | 1,363,838 |
| Increase in Unrestricted Net Assets | 4,099,982 | 2,351,044 |
| Unrestricted Net Assets, Beginning | 12,203,454 | 9,852,410 |
| Unrestricted Net Assets, Ending | $16,303,436 | $12,203,454 |

See accompanying notes to financial statements.

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA**
**(A Not-for Profit Corporation)**

## STATEMENT OF FUNCTIONAL EXPENSES
## For the Year Ended June 30, 2004
## With Comparative Totals for 2003

| | Program Services | Management & General | Total 2004 | Total 2003 |
|---|---|---|---|---|
| Grants Awarded | $117,239 | $ – | $117,239 | $ 157,698 |
| Program Related Investments' Loss Allowance | 62,500 | – | 62,500 | 687,368 |
| Operating Expenses: | | | | |
| Salaries and Wages | 118,607 | 108,196 | 226,803 | 169,004 |
| Fringe Benefits | 23,149 | 21,655 | 44,804 | 37,670 |
| Payroll Taxes | 9,311 | 8,710 | 18,021 | 13,423 |
| Contract Managers | 44,460 | – | 44,460 | 98,878 |
| Training | 154 | 144 | 298 | 410 |
| Recruiting | 14,050 | 6,021 | 20,071 | 217 |
| Subtotal Staff | 209,731 | 144,726 | 354,457 | 319,602 |
| Rent | 19,097 | 12,828 | 31,925 | 27,514 |
| Insurance | 2,102 | 1,410 | 3,512 | 3,658 |
| Depreciation | 3,723 | 2,501 | 6,224 | 4,786 |
| Subtotal Occupancy | 24,922 | 16,739 | 41,661 | 35,958 |
| Board Stipends | 10,710 | 24,990 | 35,700 | 29,700 |
| Board Expenses | 2,141 | 4,996 | 7,137 | 8,636 |
| Dues and Publications | – | 2,284 | 2,284 | 1,538 |
| Marketing | 4,071 | – | 4,071 | 11,227 |
| Office Supplies | 3,220 | 2,136 | 5,356 | 4,545 |
| Education Consulting | 481 | – | 481 | 9,882 |
| Audit | – | 9,500 | 9,500 | 9,000 |
| Legal | 3,082 | 77,322 | 80,404 | 20,607 |
| Due Diligence | 48,337 | – | 48,337 | 17,006 |
| Organization Design | – | 11,415 | 11,415 | 1,602 |
| Financial System Support | 906 | 5,136 | 6,042 | 11,636 |
| DEP Grant Reimursable Expenses | 14,937 | – | 14,937 | – |
| Printing and Postage | 3,260 | 2,163 | 5,423 | 3,215 |
| Telephone | 4,631 | 3,072 | 7,703 | 6,220 |
| Travel | 5,770 | 3,829 | 9,599 | 11,149 |
| MIS Support/Web Hosting | 2,613 | 2,613 | 5,226 | 3,572 |
| Director and Officer Insurance | – | 2,738 | 2,738 | 2,738 |
| Workout Expenses | 16,362 | – | 16,362 | 8,976 |
| Miscellaneous | 605 | 401 | 1,006 | 1,963 |
| Subtotal Other | 121,126 | 152,595 | 273,721 | 163,212 |
| Total Operating Expenses | 355,779 | 314,060 | 669,839 | 518,772 |
| Totals | $535,518 | $314,060 | $849,578 | $1,363,838 |

See accompanying notes to the financial statements.

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA**
**(A Not-for Profit Corporation)**

**STATEMENT CASH FLOWS**

| | Year Ended June 30, 2004 | Year Ended June 30, 2003 |
|---|---|---|
| *Cash Flows from Operating Activities:* | | |
| Increase in Net Assets | $ 4,099,982 | $2,351,044 |
| Adjustments to Reconcile Change in Net Assets to Net Cash Used by Operating Activities: | | |
| Depreciation | 6,224 | 4,786 |
| Loss Reserve | 62,500 | 687,368 |
| Net Realized and Unrealized (Gains) Losses on Investments | (1,220,599) | (45,822) |
| Changes in Assets and Liabilities: | | |
| Decrease (Increase) in Accounts and Grants Receivables | 4,554 | 1,914 |
| (Increase) in Prepaid Expense and Deposits | (59) | (2,483) |
| Increase (Decrease) in Account Payable | 17,668 | 36,630 |
| Increase in Employee Benefit Liabilities | 25,276 | 16,119 |
| Net Cash Provided by Operating Activities | 2,995,546 | 3,049,556 |
| *Cash Flows from Investing Activities:* | | |
| Purchase of Office Equipment and Furniture | (2,249) | (16,456) |
| Net Purchase of Investments | (2,938,883) | (1,148,356) |
| Additions to Deferred Compensation Plan Investments | (17,667) | (37,867) |
| Increase in Program Related Investments | (900,000) | (355,000) |
| Return of Program Related Investments | 124,618 | 47,785 |
| Net Cash Used in Investing Activities | (3,734,181) | (1,509,894) |
| Increase (Decrease) in Cash and Cash Equivalents | (738,635) | 1,539,662 |
| Cash and Cash Equivalents, Beginning of Year | 2,606,347 | 1,066,685 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | $ 1,867,712 | $2,606,347 |

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS
June 30, 2004

## 1. Nature of Organization

PP&L Sustainable Energy Fund, d/b/a Sustainable Energy Fund of Central Eastern PA (the Fund) is a Pennsylvania non-profit corporation formed to promote, research and invest in clean and renewable energy technologies, energy conservation, energy efficiency and sustainable energy enterprises that provide opportunities and benefits for PP&L ratepayers.

The Fund was formed pursuant to a joint settlement agreement arising from the Pennsylvania Utility Commission (PUC) electric utility deregulation proceedings in 1998. The agreement provides, in part, a rate surcharge on electric power consumers (ratepayers) through 2004. The surcharge is collected from the ratepayers by the power distribution entity, PPL Electric Utilities for this local service area, and remitted to the Fund for investment.

The Fund is managed by an executive director who reports to a Board of Directors. The PUC also maintains oversight of the Fund.

## 2. Summary of Significant Accounting Policies

*Basis of Accounting*

The financial statements of the Fund have been prepared on the accrual basis of accounting and accordingly reflect all significant receivables, payables, and other liabilities.

*Basis of Presentation*

Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, the Fund is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. At June 30, 2004 and 2003, all net assets are unrestricted.

*Cash and Cash Equivalents*

For purposes of the Statement of Cash Flows, the Fund considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents.

*Concentration of Revenue*

The Fund receives a substantial amount of its support from the PPL ratepayers contributions, as more fully described in Note 1, which expires December 31, 2004. Management and the Board of Directors believe that at least the current level of funding will be renewed beyond 2004.

*Donated Services*

No amounts have been reflected in the financial statements for donated services. The Organization generally pays for services requiring specific expertise. However, individuals volunteer their time and perform a variety of tasks that assist the Organization with specific investment programs, and various committee assignments.

*Estimates*

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

*Investments in Marketable Securities*

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statement of financial position. Investment income or loss (including gains and losses on investments, interest and dividends) is included in the statement of activities as increases or decreases in unrestricted net assets unless the income or loss is restricted by donor or law.

*Program Related Investments*

(a) Loans

Loans are stated at their outstanding unpaid principal balance. Interest income is recognized as revenue when received.

(b) Allowance for Loan Losses

The allowance for loan losses has been established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance and subsequent recoveries, if any, are credited to the allowance. The allowance is maintained at a level considered adequate to provide for potential loan losses. In making this determination, management takes into consideration the results of internal review procedures, prior loan loss experience, an assessment of the effect of current and anticipated future economic conditions, the financial condition of the borrower and such other factors that, in management's judgement, deserve consideration. The determination of the adequacy of the allowance is inherently subjective, as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change.

(c) Nonmarketable Equity Securities

Nonmarketable equity investments are holdings of less than 20% of the stock of investees and are carried at cost. The shares carry various conditions or restrictions on transfers and redemptions. Cost is reduced for permanent declines in value, as estimated by management, and dividends, if any, are treated as income when received. Investees are typically start-up developmental activities and as such are highly speculative. The determination of write-downs, if any, or ultimate realization of the investment is inherently subjective and as such, it requires material estimates regarding their valuation that are susceptible to significant change. Royalty and dividend income is recognized as revenue when received.

*Concentration of Credit and Market Risk*

Financial instruments that potentially expose the Fund to concentrations of credit and market risk consist primarily of cash equivalents and investments. The Fund places its cash at a high credit quality financial institution. From time to time, deposits at the institution exceed federal depository insurance limits. The Fund has significant investments in stocks and bonds. Though the market value of investments is subject to fluctuations, management believes the investment policy is prudent for the long-term welfare of the Fund. In addition, investments do not represent significant concentrations of market risk in as much as the Fund's investment portfolio is adequately diversified among issuers.

Concentrations of credit risk with respect to program related investments are subject to the individual credit worthiness of the borrowers and investees, who are predominately located in Central Eastern Pennsylvania and associated with early stage sustainable or alternate energy endeavors. Consequently, the ability to realize the amounts may be affected by economic and political fluctuations in the power industry in this geographic region. The Fund performs ongoing credit evaluations and reserves for estimated and known uncollectibles.

*Office Equipment*

Office equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful lives of the assets of three to five years and computed on straight-line and accelerated methods.

Additions and betterments of $500 or more are capitalized, while maintenance and repairs that do not improve or extend the original useful lives of the assets are expensed as incurred.

*Advertising Costs*

Advertising costs are expensed as incurred.

## 3. Investments

Investments are managed by professional investment managers. The investment managers are subject to the Fund's investment policies which contain objectives, guidelines and restrictions designed to complement the Fund's activities and mission. Investments at fair value at June 30, are comprised of the following:

| | 2004 | 2003 |
|---|---|---|
| U.S. Government Obligations | $ 2,985,942 | $2,006,910 |
| Corporate Bonds | 404,133 | 526,694 |
| Equity Securities | 8,915,787 | 5,648,202 |
| Temporary Cash and Money Market | 208,673 | 173,247 |
| | $12,514,535 | $8,355,053 |

Investment return is summarized as follows:

| | 2004 | 2003 |
|---|---|---|
| Interest and Dividend Income | $ 251,749 | $ 199,469 |
| Net Realized and Unrealized Gains (Losses) on Investments | 1,220,599 | 45,822 |
| | 1,472,348 | 245,291 |
| Less Investment Advisory and Custodian Fees | (62,867) | (48,410) |
| Total Investment Return | $ 1,409,481 | $ 196,881 |

## 4. Commitments-Program Related Investments

The Organization has designated $4,450,000 of investments to be used for program related investments (ie-loans, equity, grants) which have been committed to and/or are pending approval as of June 30, 2004, but have not yet been disbursed.

## 5. Program Related Investments

Program related investments consist of loans to and equity investments in entities to assist them in pursuing sustainable energy opportunities.

| Loans | 2004 | 2003 |
|---|---|---|
| Powerweb Technologies, Inc. - due in monthly principal repayments of $1,042 through April 2004, $3,125 through April 2004 and $7,500 thereafter, due April 2008. Royalties payable at 3% of borrower's gross revenue, up to a maximum of $650,000. Secured by assets of the borrower. | $431,250 | $459,376 |

## 5. Program Related Investments (continued)

| Loans (continued) | 2004 | 2003 |
|---|---|---|
| Energy Unlimited, Inc. - interest only due monthly at 10%, due February, 2006. | $ 100,000 | $ 100,000 |
| Energy Unlimited, Inc. - interest accruing at 7.5%, principal and accrued interest due earlier of December 31, 2004 or upon related project's completion | 200,000 | – 0 – |
| Community Energy, Inc. - due in monthly installments of $3,042, including interest at 8%, due December 2006. Paid July, 2004 | 82,451 | 111,095 |
| Community Energy, Inc. - $250,000 line of credit, interest only due monthly at prime plus 1%, due June, 2004. Paid July, 2004. | 250,000 | 50,000 |
| Allentown Technology Center - interest only due monthly at 6% through May, 2004, thereafter, monthly installments of $3,207, including interest at 6%, due November, 2009. | 177,691 | 180,000 |
| Nova Cruz, Products, Inc. - due March 2007, royalties payable at 3% of net factoring sales, up to a maximum of $487,500, secured by assets of the borrower. | | |
| Foreclosed in August 2003, reduced to expected net realizable value. | 50,000 | 104,882 |
| Londonderry School - due in monthly installments of $2,773 including interest at 3% plus $115,522 principal due on each of May, 2006 and November, 2008, due in full May, 2011 | 489,342 | – 0 – |
| | 1,780,734 | 1,005,353 |
| Less Loss Reserve | (331,000) | (268,500) |
| Total Loans, Net | 1,449,734 | 736,853 |

5. **Program Related Investments (continued)**

| | 2004 | 2003 |
|---|---|---|
| Nonmarketable Equity Securities | | |
| 250,000 Shares Community Energy, Inc. Series A Preferred | 250,000 | 250,000 |
| Total Equity Investments | 250,000 | 250,000 |
| Total Program Related Investments | $1,699,734 | $ 986,853 |

In July, 2004, the two Community Energy loans totaling $332,451 were repaid. Subsequently, the Organization acquired 132,591 shares of Community Energy new common stock for $250,000 subject to terms of the original November, 2001 investors agreement.

6. **Office Equipment**

| | 2004 | 2003 |
|---|---|---|
| Furniture | $ 12,482 | $ 12,077 |
| Computer and Phone Equipment | 17,662 | 15,818 |
| | 30,144 | 27,895 |
| Less Accumulated Depreciation | (16,359) | (10,135) |
| | $ 13,785 | $ 17,760 |

7. **Lease**

The Fund leases its office facilities under a non-cancellable operating lease expiring September 30, 2005. The lease provides for monthly base rent of $2,467 through September 30, 2003 and annual adjustments thereafter based on the consumer price index. The former lease required monthly rent of $1,400 through September 2002. Future minimum lease payments are:

| Years ended June 30: | Amount |
|---|---|
| 2005 | $31,604 |
| 2006 | 7,901 |

Total rents charged to expense under the leases were $31,433 and $26,403 for the years ended June 30, 2004 and 2003, respectively.

## 8. Retirement Plan

The Fund has a defined contribution retirement plan (the Plan) covering all full time employees having attained 21 years of age with three months of service. The Fund makes contribution to the Plan each year equal to 10% of all participants' compensation plus 4.3% of compensation in excess of $34,800 and $33,960 for 2004 and 2003, respectively, being 40% of the social security taxable wage base in effect on July 1, the first day of each Plan year. Total expense was $23,302 and $19,858 for the years ended June 30, 2004 and 2003, respectively.

## 9. Deferred Compensation Plan

The Fund provides a key employee a non-qualified deferred compensation retirement plan. The liability is financed with contributions to Fund owned, participant directed, mutual funds. The assets are payable to the participant upon retirement. Total Fund contributions and net investment gain or loss were $55,534 and $37,867 at June 30, 2004 and 2003, respectively.

## 10. Line of Credit

The Fund has a $750,000 Line of Credit with a bank, expiring February 2005. Interest on borrowings is payable at the bank's prime rate minus .75%. There were no borrowings on the line as of or during the periods ended June 30, 2004 and 2003.

## 11. Related Party Transactions

The Organization awarded $42,125 of program grants in 2003 to two organizations, each of which has a director who is a board member of the Fund.