



**SUSTAINABLE  
ENERGY FUND**  
of Central Eastern Pennsylvania

**SUSTAINABLE ENERGY FUND  
OF CENTRAL EASTERN PENNSYLVANIA**  
(Docket # M-00031715 F0003)

**Annual Report  
To The  
Pennsylvania Public Utility Commission  
And To The  
Joint Petitioners**

**For the Period  
July 1, 2004-June 30, 2005**

**October 27, 2005**

**Sustainable Energy Fund  
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**Dr. Rex A. D'Agostino  
President and Executive Director**

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## EXECUTIVE SUMMARY

During its 2004-2005 Fiscal Year, The Sustainable Energy Fund of Central Eastern Pennsylvania (SEF) had been informed of an end to its ratepayer support, a new statewide clean energy commitment through Act 213 developing an Alternative Energy Portfolio Standard (AEPS), and a growing public awareness of Federal energy policy through enacted legislation in Washington. These were a few of the challenges and opportunities that developed for the SEF.

The first challenge to confront the SEF was the ruling by Pennsylvania Public Utility Commission (PUC) for renewal of ratepayer support. Funding by PPL Utilities (PPL) through a ratepayer charge was set to expire at the beginning of 2005. In early 2004, as part of their distribution rate case, PPL proposed that the SEF be renewed and continue to receive PPL ratepayer support. This proposal drew its supporters and critics and eventually was supported by an administrative law judge who recommended to the PUC that ratepayer support for the SEF continue.

In December, 2004, the PUC reviewed the administrative law judge's recommendation and only agreed to a partial renewal of the SEF's ratepayer support. Wendell Holland, Chairman of the PUC, indicated in his remarks concerning the SEF's renewal: *"Given the breakdown of consensus, the strong balance sheet of the SEF and the Legislature's creation of a permanent statutory funding source, now is the appropriate time to begin eliminating the use of distribution revenues to support these funds."*

The SEF was allowed to receive full funding for 2005 and funding at a 50% level for 2006. All ratepayer support for the SEF will end at the beginning of 2007. In order to continue to meet its mission objectives, the SEF has to meet this challenge by seeking business opportunities that provide adequate financial returns to cover operating expenses and future project and program investments.

In late 2004, Governor Rendell signed into law the Alternative Energy Portfolio Standard. This standard established goals for alternative energy generation and conservation using a two-tiered system of deployable technologies. One part of this legislation requires utilities operating in Pennsylvania to meet minimum electrical generation requirements from clean energy sources. Non-compliance penalties for not achieving these objectives will be assessed the power utilities and paid to the regional Sustainable Energy Funds. These penalty payments could provide future funding revenues for clean energy generation projects. The methodologies, processes, and administration of these funds are under review by the PUC as well as the Pennsylvania Sustainable Energy Board (PASEB).

This legislation challenges the SEF to be prepared to accept its responsibilities for participating in the use of non-compliance payments generated by the utilities. It also gives the SEF the opportunity to participate in regulatory discussions to ease electrical generation requirements and to participate in the market and trading of renewable energy credits.

Finally, a building challenge as well as an opportunity for the SEF can be found in a growing public awareness for alternative energy. Escalating fuel prices are driving individuals to seek economies in energy generation and conservation. This eco-economic environment will continue the growth of public awareness and with that, high expectations for action on the part of this fund.

We are confident that we can focus on activities that make the most of these challenges and opportunities, and provide real solutions to the ratepayers in the PPL territory.

## **HIGHLIGHTS AND ACCOMPLISHMENTS**

The SEF continued to expand its financial assistance to organizations to provide for energy generation and conservation projects. These efforts are described below.

A grant and loan program was instituted to encourage municipalities to develop programs for the installation and use of L.E.D. traffic signals. Validated studies verified that L.E.D. signals can save up to 90% of the electricity consumed by traditional incandescent traffic signal lighting. The potential energy and cost savings for the PPL territory is immense. With L.E.D. bulb life approaching 10 years, versus the incandescent bulb at 1 year, it is clear that from an operating and maintenance perspective, this is the way to go. Our efforts generated interest and increased business activity in the application of this conservation technology.

Grant and loan programs were expanded and aimed at schools in order to provide energy efficiency and “green building” design.

Efforts and relationships were developed to expand the capability to use biomass technologies and programs that resulted in the completion of an anaerobic digester and the installation of a waste wood energy recovery unit in a cabinet manufacturing facility.

Exploration of possible low impact hydropower sites in the Lehigh-Delaware River watershed was also encouraged through our grant program.

Financial commitments were expanded to allow for the installation of a 24 megawatt wind farm facility in Luzerne County.

The SEF also provided financial assistance to a number of other projects that provided energy efficiency and conservation and clean energy generation. During the 2004-2005 time period, the SEF made \$3,944,293 in commitments, of which \$194,383 were grants and \$3,749,910 were loans and linked deposits.

#### **Grants:**

- ❖ \$10,000 to Delaware & Lehigh National Heritage Corridor for a feasibility study to determine the technical and economic viability of sites for hydropower, within the PPL territory and through the Lehigh-Delaware River watershed.
- ❖ \$5,000 to E3 for a feasibility study to assess site hydro conditions, site access and ownership issues in the development of in-stream hydro technologies at Lock 40 on the Lehigh Canal in the city of Allentown.
- ❖ \$125,000 for an L.E.D. Traffic Signal program for one-half of the cost of L.E.D. modules for the following municipalities:
  - \$25,000 to City of Bethlehem
  - \$25,000 to City of Harrisburg
  - \$25,000 to Hampden Township
  - \$25,000 to Borough of Danville
  - \$25,000 to Lycoming County Council of Governments in cooperation with Pennsylvania Department of Transportation.
- ❖ \$20,000 to Millersville University for assistance in the certification process for construction of a LEED design education building.
- ❖ \$15,700 to Souderton Charter School to support a 5kw grid connected PV roof mounted array with teaching tools and a teaching module to create school and community awareness of renewable energy. Solar electric modules and demonstration kits are included in the teaching tools.
- ❖ \$5,000 to Clean Air Council for an education project.
- ❖ \$1,000 to Green Building Association for membership costs.
- ❖ \$9,433 to Clean Energy States Alliance (CESA) for annual dues. CESA is a national organization comprised of seventeen public clean energy funds from twelve states.
- ❖ \$2,000 to New Earth Productions for an education program for clean energy that includes a four-day public theater presentation at Lehigh University focusing on renewable energy and energy conservation.
- ❖ \$750 to Alternative Fuels Council for annual dues.
- ❖ \$500 to Ben Franklin Technology Centers to support an annual business conference.

#### **Loans:**

- ❖ \$250,000 to Bear Creek Wind Farm (in addition to a \$1,500,000 commitment) for increased costs associated with an enhanced wind generation project in Luzerne County that was expanded to 26 MW.

- ❖ \$300,000 to Kountry Kraft Kitchens, Inc. for construction and installation of a new state-of-the-art 1.5 million BTU hot water combustion unit that will burn scrap wood and sawdust for generation of clean heat used in the wood cabinet manufacturing process.
- ❖ \$17,816 to Kauffman-Gamber Physical Therapy for installation of a solar hot water facility.
- ❖ \$10,000 to Children’s Wonderland Childcare for installation of a ground source heat pump.
- ❖ \$252,094 to Diocese of Scranton for benefit of Bishop Hafey High School for lighting retrofits and HVAC system controls for energy conservation.
- ❖ \$900,000 to Juniata County School District for installation of energy efficient lighting retrofits for twelve school buildings.
- ❖ \$230,000 to Forest City School District for retrofits of the school’s lighting system to state-of-the-art lighting, adding ventilation and heating controls.
- ❖ \$190,000 to Millville School District for retrofitting of the lighting to state-of-the-art lighting systems.

#### **Linked Deposits:**

- ❖ \$1,000,000 deposit for the benefit of Perry Green Housing Corporation in an agreement with First National Bank of Newport for the purposes of reducing interest charges through a compensating balance agreement related to the construction of fourteen “green” affordable housing units.
- ❖ \$600,000 deposit for the benefit of SEDA COG in an agreement with Citizen’s Bank for purposes of reducing interest charges through a compensating balance agreement related to the construction of a LEED certifiable green office building.

Requests for financial assistance were evaluated against Board approved investment protocols, processes and criteria. The status of all inquiries and requests is reported to the Board on a quarterly basis.

Financial Assistance 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 (PRI) Committee for review and analysis. The requests for financing which are approved by the PRI Committee are recommended to the full Board. The Board makes final decisions on all grants and program related investments.

In some transactions there is a delay between Board commitments and cash disbursements. These delays are customary and reflect continued and on-going negotiations, due diligence activities and project completion. Most current year commitments have not been disbursed and are subject to withdrawal by the grantee and borrower. As an example, the SEF carried forward a \$1,500,000 commitment to the Bear Creek Wind Farm. That commitment was finally funded in August, 2005. In addition,

many of the SEF funded grant and loan projects contain disbursement schedules. These schedules are customary in contracts that require progress payments.

The following projects were finalized and fully funded in FY 2005:

- ❖ City of Harrisburg - \$25,000 Grant for L.E.D. traffic signal modules.
- ❖ Borough of Danville - \$11,150 Grant for L.E.D. traffic signal modules.
- ❖ Lower Windsor Township - \$25,000 Grant for incorporation of green building technologies in a new township municipal building complex.
- ❖ Unitarian Universalist Church - \$6,720 Grant for installation of sun tubes to enhance natural lighting and reduce energy usage on the top floor of the education building.
- ❖ Kaufman-Gamber - \$8,500 Loan for installation of a solar hot water facility.
- ❖ Pine Hurst Acres - \$140,000 Loan for construction of an anaerobic digester for electrical generation on a hog production farm.
- ❖ Perry Green Housing Corporation - \$1,000,000 Linked Deposit for interest benefits for a commercial loan for construction of green housing units.
- ❖ Children's Wonderland Childcare - \$10,000 Loan for installation of a ground source heat pump.

(It should be noted as a subsequent event that loans for Bear Creek Wind Farm (\$1,750,000) and Kountry Kraft Kitchens (\$300,000) were finalized and fully funded in August, 2005.)

## INTERNAL ACTIVITIES

### Board of Directors

The structure of the SEF differs from other fund counterparts in Pennsylvania. The SEF's Board of Directors chose a more direct and active form of involvement, which placed a greater burden on the involvement of its Directors. This organization is unique and unlike the other Pennsylvania regional energy funds that chose to contract their administration to existing institutions already doing similar things as what was required by these funds.

During this year, the SEF Board actively participated in a number of administrative activities that were necessary for the continued operation of the SEF:

- The Board reviewed decisions related to the renewal process and advised its attorney on appropriate actions.
- The Board recommended a Director replacement procedure that closely follows the intentions and the best practices promulgated by the PASEB.

- The Board was actively involved in an Executive Director search by establishing criteria for evaluating candidates and participated in interviews and selections of final candidates.
- The Board reviewed and approved personnel benefits to bring the fund's benefits package in line with comparable non-profit organizations.
- Conflict of Interest policies and Confidentiality Agreements for contractors and employees were developed by the Board.
- A number of business strategy planning meetings were held to investigate business opportunities for the fund which were not only consistent with the fund's mission but also able to contribute to the overall sustainability of the fund.

The Board also was involved in an annual planning process. A two-day meeting in Harrisburg evaluated possible investments and related needs to improve returns to further amplify the fund's mission.

Mr. Gary Lamont completed his term as President in October, 2004 at which time Mr. Arthur Morris succeeded him as President.

### **Staff**

In October, 2004 Mr. Michael McFadden assumed the role of Interim Executive Director in addition to his duties as Managing Director of Operations. A nationwide search was conducted for an Executive Director with the assistance of a personnel recruiting and consulting firm.

The Board determined essential criteria for the position of Executive Director and interviewed and evaluated a short list of prospective candidates. Dr. Rex A. D'Agostino was appointed to the position of President & Executive Director in June, 2005. Dr. D'Agostino has over 25 years of business management experience, primarily in high technology and environmentally focused companies. His experience includes developing and operating organizations in the filtration, waste removal, alternative fuels, and solar industries.

### **FINANCIAL REPORTS**

Highlights of our financial activities and balance sheet for this reporting year are presented below. Details are presented in the Independent Auditor's Report, Appendix B.

Unrestricted Net Assets increased from \$16,303,436 to \$19,375,545 for the fiscal year ending June 30, 2005. For the 2005 Fiscal Year, Total Revenues decreased to \$3,872,349 from the prior fiscal period of \$4,949,560. This decrease can be attributed to a one-time

investment gain of \$1,220,599 for the 2004 Fiscal Year. Without that one-time significant investment gain, 2005 revenues exceeded 2004 revenues. Expenses in 2005 declined to \$800,240 from \$849,578 for the prior fiscal period.

As ordered by the PUC, the SEF receives a monthly transfer of money from PPL, as a system benefit charge, dependent on electric usage during the prior month. During the subject period, the SEF received \$3,429,799. The transfer represents a rate surcharge on electric power consumers (ratepayers) at \$0.01 cents per kWh. The surcharge is collected from the ratepayers by PPL Electric Utilities for this local service area, and remitted to the fund as part of the aforementioned monthly transfer.

The SEF makes investments in program related activities that reflect the charitable mission of assisting in the creation of a sustainable energy environment. Income from these investments is categorized as interest from loan activities and royalties and dividends from investments. For the fiscal period ending June 30, 2005, \$71,841 was reported as interest income from loans and linked deposits and \$15,000 was reported as royalties and dividends from investments. For the fiscal period ending June 30, 2005 total linked deposits and loans net of loan loss reserves were \$1,971,077. For the same fiscal period total equity investments were \$500,000. The SEF reported \$4,760,000 of commitments for program related investments as of June 30, 2005.

The fair market value of investments was reported at \$13,520,779 at June 30, 2005. Cash and cash equivalents, which are held in interest bearing accounts was reported at \$3,088,827 at June 30, 2005.

The SEF derives income from highly liquid interest bearing accounts, in operating demand deposit accounts and money market accounts. The SEF also derives income or investment return from an investment portfolio of debt and equity securities maintained by two professional investment managers. That income, which is net of advisory and custodial fees, includes interest and dividend income as well as net realized and unrealized gains or losses. Interest income from interest bearing accounts is reported at \$38,063 for the subject period. Total investment return was \$306,244 for the 2005 Fiscal Year.

The Finance Committee and staff monitors program related investments and the results of our two investment managers. Program related investments are tracked to insure that payments are prompt and that financial reporting is current. Concerns are immediately addressed through face-to-face discussions with the borrowers. The Board has adopted a comprehensive investment policy that is reviewed annually. The two professional investment managers are monitored to insure that investment selections reflect the SEF policy guidelines. Investment filters are utilized and a restricted list of investments is used to avoid investments that compromise or are counter to the fund's mission.

FY 2005 Operating Expenses were \$800,240. Program service expenses represented \$486,626 of that amount while management and general expenses represented the balance or \$313,614 of that amount.

FY 2005 Operating Expenses were less than the approved budget of \$965,555. The budget is prepared by staff and recommended to the Board. Once the budget is approved and established, expenditures are limited to pre-established budget limits. Expenditures that exceed budget can only be approved by the Board. The Board has also enacted policies and procedures that establish expenditure limitations to individuals and companies.

Management judges that the balance sheet reflects a financially healthy organization. Cash levels were deemed to be adequate to support commitments not yet disbursed, and as of June 30, 2005, commitments for program related investments not disbursed were \$4,760,000.

## **FUTURE PROGRAMS**

The SEF has traditionally provided funds to applicants who not only met mission but were able to demonstrate, with appropriate metrics, a performance profile which validated the uses of these funds. Typical mechanisms for funding have been below market rate loans, equity participation, and grant vehicles. Because the PUC has decided that the SEF is capable of self-sustainability through a combination of a strong balance sheet, as well as receiving potential revenues from Alternative Energy Compliance Payments, the SEF must find other ways to generate revenues in order to continue its mission of supporting renewable energy and energy efficiency projects. In light of this overall environment, the SEF's vision is to evaluate and potentially generate strategic business units (SBU's) compatible with its mission, each of which is chartered to generate renewable energy products and services for defined markets and applications within the PPL Region and the Commonwealth and be able to generate sufficient profits in order to continue to fund the SEF programs. Two examples of this type of approach, being considered but not yet formally approved by the Board of Directors, are the following:

### **L.E.D. Retrofit Program**

Light emitting diode technology has sufficiently advanced from a practical perspective to now replacing incandescent light bulbs in many applications. One typical application is the retrofitting of traffic signals with L.E.D. modules. The advantages to this conversion are: (1) extended life of 7 to 10 years vs. 1 year for incandescents; (2) essentially maintenance free, and (3) reduction of energy usage (cost) of 85-90%. Translating the energy savings to the cost of installation suggests a simple payback of

less than 3 years. The reason that this technology has not been employed as rapidly as the value proposition would suggest is based upon the relatively high cost of the modules. An SEF affiliated business unit will provide significant financial aid to municipalities, boroughs, towns, and cities within the Commonwealth such that they will be able to perform a retrofit program and pay for the project over time with the savings generated. Since the bulbs will have a life expectancy of approximately 10 years and the payback is three years, the township or client will actually have approximately 7 years of savings before a change-out is required. The actual retrofit process is negligible relative to man-hours to perform the operation and the accumulated man-hours for maintenance is obviated by the fact that the bulb has such a long life expectancy. We expect to market this technology throughout the Commonwealth and then follow up with the introduction of a solar retrofit to these L.E.D. modules at critical intersections which require operation regardless of the condition of the grid or power source. Provided that this program is approved by the Board of Directors, it will likely commence operations prior to the end of 2005.

### **Holistic Anaerobic Biodigestion**

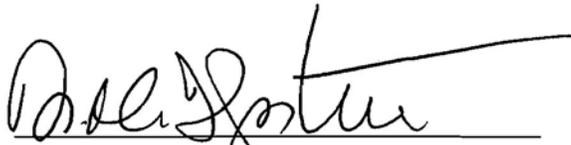
Sixty percent (60%) of Commonwealth land is dedicated to farming. Over 1,110,000 hogs are raised in Pennsylvania on 3,500 facilities. Eight hundred sixty-five thousand (865,000) of these hogs are at one of 310 facilities managing over 1,000 hogs. There are 565,000 dairy cows in Pennsylvania at 9,100 operating facilities. Of those, 50,000 cows are in operations of 500 head or more. With the process of CAFO (Confined Animal Feeding Operations) being employed to maximize the efficiency of growth and production there surfaces the problem of animal waste management. Along with the aesthetic problems generated by high density operations, there is significant pressure placed on the watersheds, rivers, streams, and aquifers, in, on, and around this farmland. The SEF is poised to tackle this problem of waste management by developing an anaerobic biodigestion technology which treats this animal waste while producing commercially significant amounts of biogas (methane) and subsequently electricity through the burning of this methane. This technology is not new but its implementation has been problematic. Of the approximately 50 biodigestors in the Commonwealth both in operation and on the drawing board, only a handful operate effectively. The SEF believes that the classical methodology of plug flow processing in a mesophilic environment is an incorrect approach. The SEF will be building, owning, and operating a thin film or mixed reactor using thermophilic organisms in a two-stage process. From a technical perspective, it is assumed that this model will more effectively ferment the feedstock and produce significantly greater amounts of methane gas; approximately 80-90% vs. 60-65%.

Previous demonstration projects have been less than successful due to the utilization of the farmer's time and resources to make "the system work". The farmer is not a biochemist, microbiologist, or chemical engineer. We would like to be able to provide a modular system on site and operate the facility remotely through SCADA technology. We are seeking funding from State and Federal agencies along with making a financial contribution to this effort. Provided that this program is approved by the Board of Directors, it will likely commence in the 4<sup>th</sup> quarter of 2005 or the first quarter of 2006.

### **Program Related Investments**

The SEF intends to continue to seek out entrepreneurs, businesses, agencies, organizations, as well as other non-profit funds to generate projects which meet the SEF mission. Our intent is to diversify our portfolio of projects to include Solar Technology, Small Hydro Projects, and Ground Source Heat Pump Technology as well as continue to support community wind projects and educational activities which enhance the understanding and acceptance of renewable energy technologies and culture.

Respectfully Submitted By,



**Dr. Rex A. D'Agostino**  
**President and Executive Director**

**Appendix A:**  
**SEF Board Membership (June 30, 2005)**

Arthur Morris, President  
Member, Finance and Audit Committees  
Ex Officio Member of the Human Resource and Investment Committees  
Utilities Solutions, Inc.  
434 W. Chestnut Street  
Lancaster, PA 17603

Brian C. Nagle, Vice President  
Chair, Investment Committee  
Representative to PASEB  
Member, Human Resources Committee  
PPL Services Corporation  
Two North Ninth St. GENTW17  
Allentown, PA 18101-1170

Gary F. Lamont  
Board Secretary and Treasurer  
Chair, Finance and Audit Committees  
Conyngham Pass  
SR 93, P.O. Box 702  
Conyngham, PA 18219-0702

Eric J. Epstein  
Chair, Human Resources Committee  
Finance and Audit Committees  
EFMR Monitoring Group  
4100 Hillsdale Road  
Harrisburg, PA 17712-1419

Craig C. Onori  
Member, Investment Committee  
Lehigh Valley Hospital  
17th and Chew Streets, PO Box 7017  
Allentown, PA 18105-7017

Andrew McElwaine  
Member, Human Resource Committee and Investment Committee  
PA Environmental Council  
130 Locust St., Suite 200  
Harrisburg, PA 17101

# **APPENDIX B**

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

**Financial Statements and Auditors' Report**

**June 30, 2005**

**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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**CAMPBELL, RAPPOLD & YURASITS LLP**

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WARREN R. HENDERSON, CPA  
ROBERT J. TUCKER, CPA

DAWN C. ANDERSON, CPA  
TARA L. BENDER, CPA  
MICHELLE R. BITNER, CPA  
SUSAN S. KOSS, CPA  
FRANK S. RICICKI, CPA  
HEIDI D. WOJCIECHOWSKI, CPA

CONSULTANT  
DALLAS C. HENNINGER, CPA

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, 2005 and 2004 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, 2005 and 2004, 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 11, 2005

MEMBERS: AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
PENNSYLVANIA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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

**STATEMENTS OF FINANCIAL POSITION**

	June 30	
	2005	2004
<b><u>ASSETS:</u></b>		
Cash and Cash Equivalents	\$ 3,088,827	\$ 1,867,712
Ratepayer's Contribution Receivable	279,792	268,266
Grant Receivable	22,737	25,193
Investments (Note 3 and 4)	13,520,779	12,514,535
Program Related Investments, Net (Note 5)	2,471,077	1,699,734
Office Equipment, Net (Note 6)	16,180	13,785
Prepaid Expense and Deposits	4,961	5,017
Investments - Deferred Compensation Plan (Note 9)	-	55,534
	<b>Total Assets</b>	<b>Total Assets</b>
	<b>\$ 19,404,353</b>	<b>\$ 16,449,776</b>
 <b><u>LIABILITIES:</u></b>		
Accounts Payable	\$ 23,408	\$ 75,988
Accrued Employee Benefits	5,400	14,818
Deferred Compensation Liability (Note 9)	-	55,534
	<b>Total Liabilities</b>	<b>Total Liabilities</b>
	<b>28,808</b>	<b>146,340</b>
 <b><u>NET ASSETS:</u></b>		
Unrestricted Net Assets	19,375,545	16,303,436
	<b>Total Liabilities and Net Assets</b>	<b>Total Liabilities and Net Assets</b>
	<b>\$ 19,404,353</b>	<b>\$ 16,449,776</b>

See notes to financial statements.

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

**STATEMENT OF ACTIVITIES**

	June 30	
	2005	2004
<i>Revenues and Gains</i>		
PP&L Ratepayers' Contribution	\$ 3,429,799	\$ 3,405,695
Grant Revenue	11,204	22,882
Interest Income - Operating and Money Market	38,063	28,818
Investment Return (Note 3):		
Interest and Dividend Income	400,573	251,749
Net Realized and Unrealized Gains (Losses)	(16,000)	1,220,599
Less Investment Advisory and Custodian Fees	(78,329)	(62,867)
Interest-Program Loans	71,841	57,884
Royalties and Dividends-Program Related	15,000	22,500
Other	198	2,300
	<u>3,872,349</u>	<u>4,949,560</u>
<i>Expenses</i>		
Program Services		
Grants Awarded	135,355	117,239
Loss Reserve	60,830	62,500
Operating Expenses	290,441	355,779
	<u>486,626</u>	<u>535,518</u>
Management and General	313,614	314,060
	<u>800,240</u>	<u>849,578</u>
Increase in Unrestricted Net Assets	3,072,109	4,099,982
Unrestricted Net Assets, Beginning	<u>16,303,436</u>	<u>12,203,454</u>
Unrestricted Net Assets, Ending	<u>\$ 19,375,545</u>	<u>\$ 16,303,436</u>

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

**STATEMENT OF FUNCTIONAL EXPENSES**  
**For the Year Ended June 30, 2005**  
**With Comparative Totals for 2004**

	Program Services	Management & General	Total	
			2005	2004
Grants Awarded	\$ 135,355	\$ -	\$ 135,355	\$ 117,239
Program Related Investments				
Loss Reserve	60,830	-	60,830	62,500
Operating Expenses:				
Salaries and Wages	126,230	116,532	242,762	226,803
Fringe Benefits	19,245	17,767	37,012	44,804
Payroll Taxes	10,090	9,315	19,405	18,021
Contract Managers	33,495	-	33,495	44,460
Training	205	189	394	298
Recruiting	29,632	15,956	45,588	20,071
Subtotal Staff	218,897	159,759	378,656	354,457
Rent	18,445	13,457	31,902	31,925
Insurance	951	693	1,644	3,512
Depreciation	4,898	3,574	8,472	6,224
Subtotal Occupancy	24,294	17,724	42,018	41,661
Board Stipends	9,090	21,210	30,300	35,700
Board Expense	4,021	9,383	13,404	7,137
Dues and Publications	-	756	756	2,284
Marketing	2,576	-	2,576	4,071
Office Supplies	3,003	2,191	5,194	5,356
Education Consulting	-	-	-	481
Audit	-	9,750	9,750	9,500
Legal	5,830	58,461	64,291	80,404
Due Diligence	8,185	-	8,185	48,337
Organization Design	-	18,299	18,299	11,415
Financial System Support	490	2,776	3,266	6,042
DEP grant Reimbursable Expenses	843	-	843	14,937
Printing and Postage	1,933	1,410	3,343	5,423
Telephone	4,874	3,556	8,430	7,703
Travel	2,161	1,576	3,737	9,599
MIS Support/Web Hosting	3,431	3,431	6,862	5,226
Director and Officer Insurance	-	2,738	2,738	2,738
Workout Expenses	-	-	-	16,362
Miscellaneous	813	594	1,407	1,006
Subtotal Other	47,250	136,131	183,381	273,721
Total Operating Expenses	290,441	313,614	604,055	669,839
Totals	\$ 486,626	\$ 313,614	\$ 800,240	\$ 849,578

See notes to financial statements.

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

**STATEMENT OF CASH FLOWS**

	Years Ended June 30,	
	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Increase in Net Assets	\$ 3,072,109	\$ 4,099,982
Adjustments to Reconcile Increase in Net Assets to Net Cash Provided by Operating Activities:		
Depreciation	8,472	6,224
Loss Reserve	60,830	62,500
Net Realized and Unrealized (Gains) Losses on Investments	16,000	(1,220,599)
Changes in Assets and Liabilities		
Decrease (Increase) in Accounts and Grants Receivables	(9,070)	4,554
Decrease (Increase) in Prepaid Expense and Deposits	56	(59)
Increase (Decrease) in Accounts Payable	(52,580)	17,668
Increase (Decrease) in Employee Benefit Liabilities	(64,952)	25,276
<u>Net Cash Provided by Operating Activities</u>	<u>3,030,865</u>	<u>2,995,546</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of Equipment and Furniture	(10,867)	(2,249)
Net Purchase of Investments	(1,022,245)	(2,938,883)
(Additions to) Distributions from to Deferred Compensation Plan Investments	55,534	(17,667)
Increase in Program Related Investments	(1,566,051)	(900,000)
Return of Program Related Investments	733,879	124,618
<u>Net Cash Used in Investing Activities</u>	<u>(1,809,750)</u>	<u>(3,734,181)</u>
Increase (Decrease) in Cash and Cash Equivalents	1,221,115	(738,635)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>1,867,712</u>	<u>2,606,347</u>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u><u>\$ 3,088,827</u></u>	<u><u>\$ 1,867,712</u></u>

See notes to financial statements.

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

**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**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. In 2005, the rate surcharge was renewed for an additional two years through December 31, 2006. The 2005 surcharge will continue at the existing .01 cents per kwh and decline to .005 cents per kwh in 2006. 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, 2005 and 2004, 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.

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

**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

*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 will expire December 31, 2006.

*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) **Linked Deposits**

A deposit held in an account with a financial institution to induce that institution's support for one or more projects.

(b) **Loans**

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

(c) **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 judgment, 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.

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA**  
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**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

(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.

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA  
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**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**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:

	2005	2004
U.S. Government Obligations	\$ 3,071,502	\$ 2,985,942
Corporate Bonds	594,302	404,133
Equity Securities	9,435,224	8,915,787
Temporary Cash and Money Market	419,751	208,673
	\$ 13,520,779	\$ 12,514,535

Investment return is summarized as follows:

Interest and Dividend Income	\$ 400,573	\$ 251,749
Net Realized and Unrealized Gains (Losses) on Investments	(16,000)	1,220,599
	384,573	1,472,348
Less Investment Advisory and Custodian Fees	(78,329)	(62,867)
Total Investment Return	\$ 306,244	\$ 1,409,481

**4. Commitments-Program Related Investments**

The Organization has designated \$4,760,000 of investments to be used for program related investments (i.e.-loans, equity, grants) which have been committed or are pending approval as of June 30, 2005 but have not yet been disbursed.

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA  
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**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**5. Program Related Investments**

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

	2005	2004
<u>Linked Deposit</u>		
Perry Green Building Housing Corporation - certificate of deposit with bank, 1% interest.	\$ 1,004,986	\$ -
<u>Loans</u>		
Powerweb Technologies, Inc. - interest only accrues at 5% per annum, early payment incentive of \$114,000 by January, 2006 satisfies entire obligation, otherwise due in full January, 2008.	228,000	431,250
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, 2005 or upon related project's completion.	200,000	200,000
Community Energy, Inc. - due in monthly installments of \$3,042, including interest at 8%, due December, 2006. Paid July, 2004.	-	82,451
Community Energy, Inc. - \$250,000 line of credit, interest only due monthly at prime plus 1%, due June, 2004. Paid July, 2004.	-	250,000
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. Paid November, 2004.	-	177,691

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA  
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**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

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

	2005	2004
Nova Cruz, Products, Inc. - due March 3007, 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 realized value.	\$ 50,000	\$ 50,000
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.	470,489	489,342
Pine Hurst Acres - interest only due monthly at 2% until project start-up date, thereafter, \$1,000 a month plus interest at 2%, due December, 2012.	140,000	-
Diocese of Scranton - due in monthly installments of \$1,622, including interest of 2%, due June, 2008.	152,566	-
<b><u>Refundable Grants</u></b>		
Kauffman-Gamber - due in monthly installments of \$142, non interest bearing, due October, 2009.	7,366	-
Children's Wonderland Child Care Center - due in quarterly installments of \$500, non interest bearing, due April, 2010.	9,500	-
	1,357,921	1,780,734
Less Loss Reserve	(391,830)	(331,000)
Total Loans and Refundable Grants, Net	966,091	1,449,734

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA  
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**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

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

Nonmarketable Equity Securities

250,000 Shares Community Energy, Inc., Series A Preferred	\$ 250,000	\$ 250,000
132,591 Shares Community Energy, Inc., Common	250,000	-
Total Equity Investments	500,000	250,000
Total Program Related Investments	\$ 2,471,077	\$ 1,699,734

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.

In January 2005, the Powerweb agreement was modified to the terms described above, pursuant to a \$200,000 accelerated repayment received in 2005. Formerly, repayment was in accelerating monthly principal repayments plus royalties of 3% of borrowers gross revenue through April, 2008.

**6. Office Equipment**

	2005	2004
Furniture	\$ 12,482	\$ 12,482
Computer and Phone Equipment	28,529	17,662
	41,011	30,144
Less: Accumulated Depreciation	(24,831)	(16,359)
	\$ 16,180	\$ 13,785

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA**  
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**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**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 \$2,494 through September 30, 2005. The Fund entered into a non-cancellable operating lease for new office space commencing September 15, 2005 and expiring September 14, 2008. The Organization also leases office equipment under a non-cancellable operating lease. Future minimum lease payments are:

Years ended <u>June 30:</u>	<u>Office</u>	<u>Equipment</u>
2006	35,484	2,388
2007	34,100	2,388
2008	34,700	1,194
2009	5,800	-

Total rents charged to expense under the leases were \$31,164 and \$31,433 for the years ended June 30, 2005 and 2004, 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 \$35,160 and \$34,800 for 2005 and 2004, 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 \$28,320 and \$23,302 for the years ended June 30, 2005 and 2004, respectively.

**9. Deferred Compensation Plan**

The Fund provided 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 termination. In 2005, upon the employee's termination, the accumulated fund balance of \$63,878 was distributed.

**10. Line of Credit**

The Fund has a \$750,000 Line of Credit with a bank, expiring February 2006. 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, 2005 and 2004.

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

**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**11. Litigation**

On December 22, 2004, the Public Utility Commission entered an Opinion and Order in which it concluded that SEF funding within PPL's distribution rates should continue for 2005 and 2006 at rates of .01 cents per kWh and .005 cents per kWh, respectively. On April 29, 2005 the PP & L Industrial Customer Alliance filed an appeal with the Commonwealth Court Challenging, inter alia, the Public Utility Commission's decision to allow continued funding of SEF. SEF intervened in the Commonwealth Court proceeding and filed a brief in support of the Public Utility Commission's decision. In the meantime, funding has continued despite the filing of the appeal. Although it is not possible at this time to know the outcome of the Commonwealth Court proceedings, management has been advised by legal counsel that the continued funding of SEF is consistent with the law and supported by substantial evidence and that a favorable outcome affirming the Commission's decision is reasonably likely.

**APPENDIX C**

**Sustainable Energy Fund**

**Statement of Activity**

**Fiscal year Ended June 30, 2005**

(Provided by management and not a part of the Auditor's Report)

	<b>7/1/2004 6/30/2005</b>	<b>FYE 2005 Budget</b>
<b>INCOME/GAIN</b>		
PPL Ratepayer Contribution	3,429,799	3,473,809
DEP Grant Revenue	11,204	81,629
Endowment - Dividends	238,886	
Endowment - Interest	161,687	
Endowment Investment Gain/Loss	(94,329)	735,000
Processing Fees	0	10,000
Dividends	15,000	15,000
Interest Income - PRI Loans	71,839	71,286
Interest Income - Money Mkt. Accounts	38,064	15,000
Other Income	199	3,000
<b>Total Income</b>	<b>3,872,349</b>	<b>4,404,724</b>
 <b>EXPENSES</b>		
<b>STAFF</b>		
Salaries/Wages	191,748	268,391
Fringe Benefits	36,815	80,699
Payroll Taxes/Expense	19,405	28,239
Recruiting & Relocation	45,587	24,000
Performance Incentives	51,014	57,650
Worker's Comp	197	3,000
Contract Managers	33,495	85,000
Training/Registrations	394	2,000
Total Staff	<b>378,656</b>	<b>548,979</b>
 <b>OCCUPANCY</b>		
Rent	30,894	32,038
Maintenance Fee	1,008	1,008
Insurance	1,644	7,200
Furniture/Office Equipment Purchased		20,000
Office Equipment/Depreciation	8,472	
Total Occupancy	<b>42,018</b>	<b>60,246</b>
 <b>OPERATING</b>		
Directors' Reimbursed Expenses	4,405	5,000
Board Stipends	30,300	32,000
Board Meeting Expenses	8,999	5,000
Dues/Memberships/Publications	756	4,000
Marketing	2,576	24,000
Office Supplies	5,194	10,350

Professional Fees		
Auditing	9,750	10,000
IT Consulting	0	5,000
Legal Fees Renewal	46,983	45,000
Legal - PRI	5,830	12,000
Legal - Governance	11,478	12,000
Due Diligence	8,185	40,000
Organization Consulting	18,299	15,000
Financial/System Control/Business Plan	3,266	21,500
Education Consulting	0	12,480
Printing/Postage	3,343	8,000
Telephone	8,430	9,600
Travel	3,737	21,000
Grant Reimbursed Expenses	843	43,000
Web Hosting/MIS Support	6,862	8,400
D&O Insurance	2,738	8,000
Loan Administration Expense	0	2,000
Miscellaneous	1,406	3,000
Total Operating	183,381	356,330
	<b>Total Expenses</b>	<b>604,055</b>
		<b>965,555</b>
<b>GRANTS</b>	135,355	579,412
<b>LOAN/EQUITY VALUATION ALLOWANCE</b>	60,830	446,513
<b>INCREASE(DECREASE) IN FUND BALANCE</b>	<b>3,072,109</b>	<b>2,413,244</b>