



2007 annual Financial Report



Blue is the New Green!

Being green has long been part of our way of doing business. And being efficient and reducing waste reduces our costs, and helps us to enhance our positive impact on our environment.

We are continuously evaluating our treatment processes to both meet and exceed state and federal regulations – while maintaining efficient, safe standards for our employees, customers, and environment.

In Fiscal Year 2007, our leak detection and repair program has surveyed over 1,024 miles of pipeline and we reduced leakage by 27.6 million gallons per day, representing a savings of over \$879,000.

Our award-winning exhibit at the Philadelphia Flower Show focuses on green gardening methods that conserve water.

At the Philadelphia Water Department, we're proud that the treated water we return to the Delaware River is cleaner than the water we took from it originally.



photo: R. Nowitz for GPTMC

At PWD we

- operate three water treatment plants and three wastewater treatment plants, serving approximately 2.3 million customers
- provide an average of nearly 300,000,000 gallons of drinking water per day
- treat over 450,000,000 gallons of wastewater per day – and the water we return to the river is cleaner than the untreated river water.
- maintain 3,300 miles of water mains, 3,000 miles of sewers, 75,000 stormwater inlets, and over 27,500 fire hydrants
- have consistently won major awards for our treatment plants, including Gold awards for our wastewater treatment plants for achieving perfect compliance with their National Pollution Discharge Elimination System permits in calendar year 2006.

Table of Contents



A Letter from the Water Commissioner. 3

Water Quality. 4

Water Environment. 6

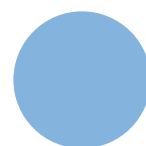
Watershed Protection. 8

Asset Management. 10

Public Education and Outreach. 12

Management Discussion. 14

Financial Statements. 18





Measurement	FY04 Actual	FY05 Actual	FY06 Actual	FY07 Target	FY07 Current Projection	FY08 Projected
Millions of Gallons of Treated Water	97,993	96,799	94,139	98,550	93,261	93,261
Percent of Time Philadelphia's Drinking Water Met or Surpassed State & Federal Standards	100%	100%	100%	100%	100%	100%
Miles of Pipeline Surveyed for Leakage	1,168	1,279	1,104	1,260	1,260	1,260
Water Main Breaks Repaired	794	706	659	745	770	760
Avg. Time to Repair a Water Main Break (hrs.)	7.3	7.8	7.8	8.0	8.0	8.0
Percent of Hydrants Available	97.5%	96.2%	98.9%	99.0%	99.3%	99.1%
Number of Storm Drains Cleaned	86,975	76,965	76,721	97,271	79,928	99,506
Citizen Satisfaction Survey Results						
Percent Satisfied with Overall PWD Services	78.9%	79.8%	%	81.0%	%	%
Percent Satisfied with Water Overall Quality	80.0%	80.2%	%	82.0%	%	%



Letter From the

Commissioner



To our colleagues:

The Philadelphia Water Department represents an effective blend of experience and technology. We are the nation's oldest water utility (1799), and at the same time we are committed to developing and utilizing advances in treatment processes and practices.

We serve the citizens of the Philadelphia region by providing integrated water, wastewater, and stormwater services. Our primary mission is to operate and maintain the infrastructure necessary to provide high quality, affordable drinking water to protect the public health, to provide an adequate and reliable water supply for all residential, business, and public needs, and to sustain and enhance the region's watersheds and quality of life by managing wastewater and stormwater effectively.

Philadelphia's drinking water is consistently safer than ever, and is substantially better than State and federal regulations for water quality requirements. We maintain an ongoing capital program to invest in additional improvements to our treatment processes, to continue to minimize any risk to public health, and to operate at top efficiency. We continually meet new issues and challenges; today, nationally, there are increased concerns about the presence of pharmaceuticals in source water and drinking water. Since 2004, the Philadelphia Water Department has participated in national research and monitoring of pharmaceuticals in drinking water. The technology to detect pharmaceuticals in water is very recent – only a few laboratories in the nation have this capability, and the Philadelphia Water Department has been working with them, conducting research.

We are also treating wastewater to award-winning levels, overseeing the cleanest water environment in 150 years, and making progress in protecting our watersheds to keep our streams and rivers clean.

The Philadelphia Water Department continues to have some of the lowest rates in the region for water, wastewater, and stormwater services. Our success in containing costs, increasing employee productivity, and improving services has permitted us to keep services high, and rates low. From FY97 through FY07 the Department increased rates in six of ten years, adding up to a total increase for residential customers of 33.0 percent during the entire ten-year period. This rate of increase was below the Philadelphia Consumer Price Index that measured 34.91 percent during the same period. However, the costs of providing services including personnel, debt-service, environmental mandates, and increased security have continued to rise, and as a result, the PWD has needed to increase rates.

In this report are some of our accomplishments for Fiscal Year 2007.

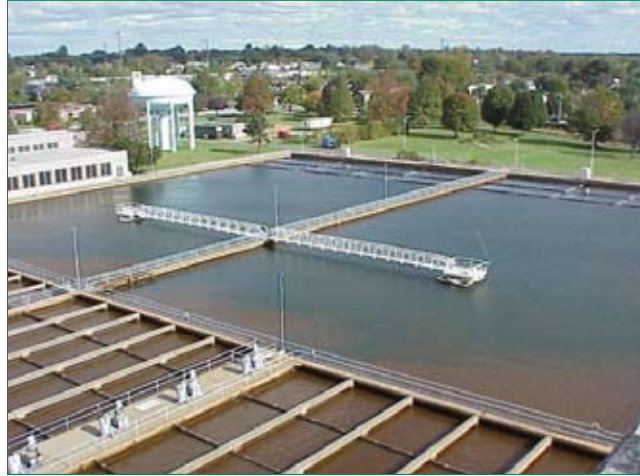
We are one of the largest publicly-owned water, wastewater, and stormwater utilities in the nation, and we are proud of our record of providing safe drinking water, protecting our environment, and maintaining fiscal responsibility. We employ a dedicated and talented group of laborers, skilled trades workers, engineers, scientists, technicians, managers, and other support employees who provide high-quality services to the public. None of the above financial or service improvements would have been possible without the hard work and professional achievements of the employees of the Philadelphia Water Department, and we are proud of their accomplishments.

Sincerely,

A handwritten signature in black ink that reads "Bernard Brunwasser". The signature is written in a cursive, flowing style.

Bernard Brunwasser
Water Commissioner

Water Quality



Our pilot plant allows us to perform comprehensive, preliminary testing on a range of new treatment processes and systems. We can then determine what will work best and most effectively – at far lower costs than testing these changes at any of our treatment plants.

Partnership for Safe Drinking Water

Philadelphia's drinking water is safer than ever! The quality of our water is substantially better than the drinking water quality standards sets by State and federal regulations. Our water meets, and in many cases surpasses, these standards 100 percent of the time. Ensuring that our water continues to be of the highest quality is essential for us to minimize any potential risk to public health. That's an important challenge for us to meet and we are firmly committed to doing so by investing in treatment process improvements at all three of our water plants.

One initiative we have undertaken towards this end was to voluntarily join the Partnership for Safe Water, a joint program formed by the United States Environmental Protection Agency and the national water industry. Since joining the Partnership in 1998, our water treatment professionals have significantly reduced "turbidity," an industry standard measure of the water's clarity.

Today, the turbidity of Philadelphia's water is 80 percent less than the maximum amount allowed by State and federal regulations. Our water's turbidity level is .06 nephelometric turbidity units (ntu), meaning it is 40 percent less than the Partnership's maximum turbidity goal of 0.1 ntu.

During the next five years, we have set a new challenge – to receive the Partnership's highest honor, the "Excellence in Water Treatment" award. Very few water treatment plants in the country have earned this prestigious award for overcoming all obstacles in achieving excellence in water treatment. They have done so by maintaining a high level of treatment performance resulting in water quality that is consistent with the Partnership's highest goals.

To meet this goal, our three water treatment plants must control turbidity so that levels do not exceed 0.1 ntu for more than 15 minutes at any time. This past year, the Queen Lane Plant was evaluated on its ability to maintain plant performance levels consistent with goals for this award. During the next two years, the Baxter and Belmont plants are undergoing capital modifications to their respective filtration systems. The design phase of this project is expected to begin in the first year, with construction taking place the following year.



Pilot Plant Research

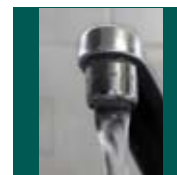
We continue to stay at least one step ahead of drinking water regulations through the operation of our pilot plant research program, which we initiated approximately ten years ago.

The pilot plants function as miniature water treatment plants. This allows us to study and test the impacts of modifications to our water treatment processes on a controlled scale before we move forward with expensive, extensive system-wide changes.

Our pilot plant studies have been focusing on the effectiveness of different types of coagulants other than ferric chloride, which we use currently during the water treatment process. Coagulants bind to organic particles in the source water, causing these particles to fall out of the water treatment process by virtue of the coagulant's weight. Due to changes in the coagulant marketplace, it is important for us to evaluate alternative coagulants and determine their suitability in comparison to ferric chloride on the basis of performance and cost.

In addition, we have performed extensive studies on an emerging technology, magnetic ion exchange (MIEX). The MIEX treatment process removes a substantial portion of organic material from the source water. MIEX targets organic material that is typically not able to be removed through the coagulation process. This can provide significant benefits, such as greatly reducing disinfection by-product formation, decreasing treatment chemical dosages and lowering the amount of water treatment residuals produced.

Our research also includes an international multi-utility study designed to gain a better understanding of the occurrence of manganese in drinking water. Although it is currently undetectable in Philadelphia's drinking water, proposed changes in the treatment process may produce a level of manganese that could be of aesthetic concern. The pilot plant study will help us avoid manganese problems that may result from treatment modifications that we are currently considering.



Water Environment

Combined Sewer Overflow Long Term Control Plan Update

In 2007, PWD began to reevaluate its combined sewer overflow program and capital improvements program. Our goal was to integrate additional projects that reduce Combined Sewer Overflow (CSO) frequency and volume. As a result, the CSO Long Term Control Plan Update (LTCPU) was created. We are developing new methods and systems to capture and treat sanitary sewer systems flows and reduce the number of CSOs.

What is a Combined Sewer Overflow (CSO)?

A combined sewer system transports sewage (from homes, businesses and industry) and stormwater through a single underground pipe to a Water Pollution Control Plant (treatment plant).

Under heavier rainfall conditions, the flow of the sewage and stormwater in combined sewers may exceed the capacity of the pipe or treatment facility. Some of the sewage and stormwater may be sent directly to a nearby stream or river to prevent the flooding of homes and streets. This is a Combined Sewer Overflow.

We are committed to a balanced “Land-Water-Infrastructure” approach to achieve our watershed management and CSO control goals. The “Land-Water-Infrastructure” approach is made up of three programs:

LAND: Wet Weather Source Control

This program promotes the use of Low Impact Development (LID). This includes innovative approaches such as an extensive street tree program, green roofs and rain gardens. We work with developers to make sure new construction includes stormwater runoff management in the building site plans.

WATER: Ecosystem Restoration and Aesthetics Program

This program focuses on projects that contribute to improving the quality of our water sources. Such water-based approaches include stream bed and bank stabilization and reconstruction, aquatic habitat creation, plunge pool removal, improvement of fish passage, and floodplain reconnection.

INFRASTRUCTURE: Capital Improvement Projects

This program is a continuation of our previous CSO capital improvement projects, as well as new projects to increase the capture and treatment of combined sewage. These projects include the work of the Waterways Restoration Team, Stream Habitat Restoration, Wetland Enhancement and Construction, Fish Passage Projects and Riparian Buffer Creation and Enhancement.



Southwest Water Pollution Control Plant

The Southwest Plant again received the National Association of Clean Water Agencies' Gold Award for excellence in wastewater treatment for calendar year 2006. This marks the eleventh time in 12 years that the plant has earned this award by maintaining perfect compliance under its National Pollutant Discharge Elimination System (NPDES) permit.

Some of the major plant accomplishments during fiscal year 2007 included: beginning the Final Sedimentation Tank Rehabilitation; restarting the digester cleaning program; rehabilitation of Effluent Pump #5; and upgrading the plant water system. The planning, training and investigative efforts of many PWD employees managed these endeavors through to completion.



Southeast Water Pollution Control Plant

The Southeast Plant was awarded the NACWA Gold Award in July 2007 for perfect effluent permit compliance in calendar year 2006. This is the seventh consecutive annual NACWA Gold Award achieved by this facility.

Our Water Pollution Control Plants continue to win major national awards for excellence in treatment practices and performance. We are committed to continuing this success.

Northeast Water Pollution Control Plant

The Northeast Plant completed the overhaul of the aeration system at our Northeast Water Pollution Control Plant in Fiscal Year 2006. The project included the removal of the existing fine bubble diffuser system in the seven aeration tanks; the installation of over 50,000 fine bubble diffuser domes and piping; the installation of a new above-ground main air header; and the automation of the aeration system.

The cost of the project was \$9,800,158. Improvements in the effluent quality can be partly attributed to the new system. The suspended solids and the five-day carbonaceous biochemical oxygen demand concentrations being discharged to the river have been decreased by 4 mg/l and 3 mg/l, respectively.



Watershed Protection

Clean water needs clean land. Clean land means clean watersheds. A watershed is all of the waterways – such as creeks, streams, and rivers – and the surrounding land. Our watersheds are where we live, play, and get the water we drink. Clean watersheds mean our drinking water is cleaner even before we treat it at one of our water treatment plants.

Our watersheds were not always in good environmental health. The federal Clean Water Act, passed over 30 years ago, along with advances in wastewater treatment, began our involvement and commitment to cleaning up our watersheds. These watersheds are cleaner and healthier than they have been in well over a century.

Watersheds don't stop at political and geographical boundaries. This means we must partner with other key stakeholders in the region to continue this critical progress. Our Office of Watersheds has received over \$4.4 million in grant funds to work in Philadelphia and with our surrounding neighbors to improve the quality of our watersheds.



photo: B. Krist, for GPTMC

Schuylkill and Delaware Rivers Source Water Protection Plans

The Schuylkill and Delaware River Source Water Protection Plans provide a comprehensive framework for implementing a watershed-wide effort to improve source water quality. The Plans prioritize real and potential sources of contamination to Philadelphia's raw water supply, and outlines several approaches to reducing them.

One major component of the Schuylkill Plan, completed in 2005, is a build-out scenario of the Schuylkill River Watershed that looks at the possible impacts of significant development in the watershed on source water quality. Under current zoning, low-density housing could increase drastically as agricultural and forested lands are developed. This scenario helped us to see the importance of land preservation for source water protection, and has led to the development of a tool which prioritized land for protection based on its importance for preserving or improving water quality.

The Delaware River Plan, completed in 2007, brought to the forefront the need for the ongoing protection of our Baxter drinking water intake from salt intrusion from the Delaware Bay. To date, we have had ample protection from salt intrusion due to the large quantity of fresh water coming down the Delaware River. Now with the new Flexible Flow Management Plan, which was enacted for the Delaware River in October of 2007, we need to conduct extensive modeling of this plan. Along with projecting changes in flow characteristics from global warming, climate change, sea level rise, and population changes, this plan will make sure we continue to provide adequate protection of Baxter's intake from salt intrusion well into the future.



Our annual exhibit at the Philadelphia Flower Show provides an opportunity to blend beauty with good conservation techniques. From green roofs to rainwater barrels, our exhibit demonstrates attractive solutions to managing stormwater runoff. We are proud that our exhibits have been award-winners, proving that Best Management Practices can be Beautiful as well.

Providing Early Warning Protection

Since 2004 we have led the development and implementation of the Early Warning System for the Schuylkill and lower Delaware rivers. This system is an integrated communication and water-quality monitoring network that supports the identification, notification and analysis of source water quality events such as chemical spills and other potential hazards.

The system's goal is to provide advance warning of potential source water contamination to water suppliers. Funded in part by a \$775,000 grant from the Pennsylvania Department of Environmental Protection, the system provides water suppliers on both rivers with essential information to make critical treatment and pumping decisions in response to spills and accidents that can have a detrimental impact on the rivers. The Schuylkill and Delaware system is comprised of a partnership of water suppliers, industries with water intakes, and government agencies. The system also includes a web-based centralized database for water quality and event information, a telephone notification system, and a network of real-time water quality monitors located throughout the two watersheds.

Delaware Valley Early Warning System serves

- Over 3 million people
- Philadelphia, Camden and Trenton Metro areas
- 12 water utilities, 23 water treatment plants in Pennsylvania
- 5 water utilities, 5 water treatment plants in New Jersey

Since the system was fully deployed in January of 2005, 100 events have been entered into the system, ranging from a 100-million-gallon fly-ash spill on the Delaware and a cyanide discharge in the Wissahickon Creek, to flood warnings and sewage discharges. In each of these cases, the improved awareness, communication, and coordination provided by the system was valuable to our response.



Asset Management

Maintaining Today's Assets for Tomorrow's Customers

Managing complex systems and operations is our daily job. Our responsibilities extend to six large water and wastewater treatment facilities and a biosolids recycling center, as well as numerous water and wastewater pumping stations. These facilities require a large portion of our operating and capital resources to maintain and operate.

Another part of our story lies underground. Our system consists of nearly 3,300 miles of water mains, 26,080 hydrants, and 75,000 valves that deliver water to a population of over 1.7 million in Philadelphia and Lower Bucks County.

Our extensive sewer system takes used water from our residential, commercial and industrial customers. The sewer system carries wastewater to our three water pollution control plants for treatment from a population of more than 2.2 million customers – from Philadelphia as well as suburban counties, through our wholesale water and wastewater contracts.

Investing in the maintenance of the city's infrastructure is a major priority for us. Investments in infrastructure not only maintain these assets for future generations; they also help to cut down on costly emergency repairs.

Water Main Replacement

Our accelerated water main replacement program, in place now for over ten years, continues. Our current level of 227.5 breaks per 1,000 miles is significantly better than the national average of 270 breaks per 1,000 miles. By reducing the emergency repairs required, we are better able to manage our crews and other resources, and continually provide better service to our customers. We also closely monitor water main conditions to determine that adequate capital investment is made to ensure the integrity of the water supply system.





Sewer Assessment

Maintaining our sewer system infrastructure is equally important to us. With 3,000 miles of sewer mains collecting nearly 500 million gallons of sewage per day, assessing the condition of the sewer system is a major part of our operations and maintenance program. We recently completed a \$6 million pilot sewer assessment program that evaluated the condition of the sewer system. This information has been used to develop a database as well as a ranking system to assist us in prioritizing sewer improvements.

Our specially trained personnel are continuing to collect information through the sewer assessment surveys. This project has already helped to identify sewers that were in immediate need of repair and it is anticipated that, over time, this project will result in a reduction of costly and disruptive emergency sewer repairs, such as those that occur when a sewer collapses.

Geographical Information System

The full-scale conversion of citywide water and sewer assets into a Geographic Information System (GIS) database has been completed, and we will continue to maintain and operate this system. The database spatially displays our infrastructure and links it to operations, maintenance, engineering, and construction data, providing us with a fully integrated, asset management system.

Using GIS, we have converted all of our existing plans and specification for all citywide water and sewer assets into a much more manageable electronic information management system.

Quick access to utility infrastructure data through GIS will allow us to make timely management decisions, increasing productivity and reducing risk.



As millions of gallons of raw, treated, and used water move through our systems on a daily basis, we use technology to track and monitor many of our assets, from our 26,080 fire hydrants to the 75,000 valves, to the 3,000 miles of sewer mains.

Public Education and Outreach



The Fairmount Water Works Interpretive Center (FWWIC)

Learning about protecting our water resources, the history of technology, public health over the past 250 years – and having fun at the same time!

The Fairmount Water Works, a National Historic Landmark, once served as the city's second pumping station (1812 to 1909), providing water to the citizens of Philadelphia. The Philadelphia Water Department has transformed these magnificent buildings into an exciting watershed education center. Through a variety of educational programs, interactive exhibits and authentic experiences, FWWIC informs the public about Philadelphia's water resources and its role in protecting them.

Interpretive Center visitors gain a clearly visible understanding of their relationship to the river they drink.

The historic Fairmount Water Works is part of the Interpretive Center experience –the original buildings surround today's modern exhibits. Visitors can experience the flowing Schuylkill River from this unique vantage point – right at river's edge.

The Center is about more than fun. The Center's mission is to promote stewardship of water resources by helping people make responsible decisions about their use of land and water, by educating citizens about the urban watershed environment and its future; and by promoting an appreciation for the connections between daily life and the natural environment.

Educating Our Public Protects Our Valuable Water Resources

Science, history, medicine, law, architecture, city planning, mathematics, ecology: each of these disciplines is just one gateway into learning about Water in Our World. Through our Fairmount Water Works Interpretive Center, we are able to offer educational programs for children and adults, bringing the story of water to our many audiences in an easily accessible and historic environment. More than 140,000 visitors have brought their questions and enthusiasm, and left with knowledge and insights.

Hands-on Exhibits and Lectures

From Nobel Prize lecturers to authors to performers, the Interpretive Center serves as a central source of experience and information. This past year we continued several very successful programs, including the Urban Shad Watch, Earth Day events, the Calendar Art Contest and the well-attended *Schuylkill Soundings* series which attracts adult audiences to hear authors, scholars and environmentalists discuss important water issues.

Among our new programs was *World Water Week*, which included George F. Hoguet, a volunteer presenter from The Climate Project, who gave an in-depth slide presentation of former Vice-President Al Gore's "An Inconvenient Truth" and invited the audience to participate with comments and questions.

Lifting the Burden was another event to mark World Water Week and featured volunteers carrying water in five-gallon buckets around the Philadelphia Museum of Art to gain an understanding of the difficulties faced by people without access to clean drinking water on a daily basis.

Another program that focused on the world water crisis was a United Nations live videoconference where representatives of the United Nations' Food and Agricultural Organization in Rome, along with students in schools from Philadelphia, Vancouver, BC, White Plains, NY, Lindenwold, NJ and Karachi, Pakistan, participated in a discussion of the world's water shortages.

In addition, the Interpretive Center welcomed 14 Udall Foundation Scholars on their first stop of a cross-country, biodiesel bus tour to promote environmental awareness of lower fuel emissions.

Other programs and exhibits focused on the achievements of women and minorities in the fields of engineering, technology and the sciences by presenting some of PWD's employees as role models and mentors. Visiting high school students had the opportunity to ask questions and talk one-on-one with many of the employees.

Educational Programs Bring Science Alive

Our educational programs for students include a number of topics linked to academic standards established by Pennsylvania and New Jersey. The programs range from two-hour classes to two-day workshops, and take students through the Interpretive Center, the Water Works, and along the banks of the Schuylkill River. Topics include a general overview of water and wastewater issues; a look at the relationship between land and water; storm-water runoff and pollution; and technology over the past two hundred years.



Our public education programs are for all ages. From school groups who come to learn about science and history while having fun, to adults who come to hear Nobel Prize lecturers, we provide science-based programs that educate while they engage.



Management Discussion and Analysis

The Philadelphia Water Department is a municipal utility serving the citizens of the Philadelphia region by providing integrated water, wastewater, and stormwater services. The utility's primary mission is to plan for, operate, and maintain both the infrastructure and the organization necessary to purvey high-quality drinking water, to provide an adequate and reliable water supply for all household, commercial, and community needs, and to sustain and enhance the region's watersheds and quality of life by managing wastewater and stormwater effectively.

The PWD operates three water plants treating an average of nearly 300 million gallons of Delaware and Schuylkill river water each day, three wastewater plants cleaning over 450 million gallons per day of sewage, a 73-acre biosolids recycling facility, a sophisticated testing laboratory, and a range of technical and administrative support services. In addition, the Department maintains 3,300 miles of water mains, 3,000 miles of sewers, 75,000 stormwater inlets, over 27,500 fire hydrants, and extensive related infrastructure. The Water Revenue Bureau (WRB) of the Department of Revenue manages water and sewer billings and collections for the Water Department.

The Water Department management has prepared this narrative overview and analysis of the financial statements of the City of Philadelphia, Pennsylvania Water Fund for the fiscal year. The information presented here should be read in conjunction with the financial statements immediately following the discussion and analysis.

Financial Highlights

The Water Department met its bond coverage ratios for the year with a revenue bond coverage ratio of 1.20, a total debt service coverage ratio of 1.08, and a net operating revenue bond coverage ratio of 1.35 prior to the deduction of the transfer to the rate stabilization fund.

At the end of the current fiscal year, the Water Fund's *Net Assets* totaled \$693.3 million resulting from an excess of its assets over its liabilities; its *unrestricted net assets* showed a balance of \$162.1 million.

The Water Fund's net assets showed an increase of \$42.7 million during the current Fiscal Year compared with \$34.2 million for the prior fiscal year. This increase was primarily due to the following:

- A 4.2% water and sewer rate increase effective on July 1, 2007, which resulted in a \$22.4 million increase in revenue collections.
- An \$8.7 million increase in interest earnings on the Sinking Fund and other investments.
- A \$7.6 million decrease in interest expense.
- A \$2.6 million decrease in the Allowance for bad debt.

These increases in the Water Fund's net assets were offset by the following:

- A \$3.8 million increase in employee benefits expense.
- A \$3.4 million increase in the purchase of materials and supplies.
- A \$7.3 million increase in personal services.
- A \$9.3 million increase in the purchase of services.
- A \$3.7 million increase in depreciation expense.

Net Assets

As noted earlier, net assets are useful indicators of a government's financial position. At the close of the current fiscal year, the Water Department's assets exceeded its liabilities by \$693.3 million.

Capital assets, such as land, buildings, meters, water mains, and sewer lines, less any outstanding debt issued to acquire these assets, comprise \$86.3 million of the Water Department's net assets. Although these capital assets assist in providing services to our customers, they are generally not available to fund the operations of future periods.

In addition, a portion of the Department's net assets, \$531.2 million, is subject to external restrictions as to use. The remaining component of net assets is the unrestricted net assets, which ended the fiscal year with \$162.1 million.

Bond Issuance

During FY2007, the Department was authorized to issue additional Water and Wastewater Revenue Bond in the aggregate principal amount of \$325,000,000. These bonds have not yet been issued. The proceeds of the bonds will be applied to (i) fund capital improvements to the City's Water and Wastewater Systems (as hereinafter defined), (ii) fund a Debt Reserve Account of the Sinking Fund (as hereinafter defined) relating to the bonds, and (iii) pay costs of issuance relating to the new bonds. In February 2007 the City entered into a "rate lock" agreement with two counterparties for a \$180,000,000 portion of these bonds which has an execution date of not later than February 21, 2008, unless extended by the parties. These agreements were recently extended by the City until February 2009.

The Department also issued \$345,035,000 of Water and Wastewater Revenue Refunding Bonds, Series 2007A & 2007B. The proceeds of the 2007A Bonds were used to refund the remaining portions of the City's Water and Wastewater Revenue Bonds, Series 1997A and to pay costs of issuance relating to the Bonds. The proceeds of the 2007B Bonds were used to refund a portion of the City's Water and Wastewater Revenue Bonds, Series 2001A and to pay costs of issuance relating to the Bonds. The transaction resulted in net present value savings in excess of \$14.5 million in future debt service expense. These savings will primarily be recognized in FY09 through FY12, and will help to moderate rate increases during these years. All three of the major bond rating agencies (Moody's, Standard and Poor's and Fitch) affirmed their ratings for the Water Department.

Water and Wastewater Rates

In terms of rates, the PWD continues to have some of the lowest rates in the region for water, wastewater, and stormwater services. The PWD has had great success in containing costs, increasing employee productivity, and improving services. The impact of these cost-saving measures has been to keep services high, and rates low. From FY97 through FY07 the Department increased rates in six of ten years, adding up to a total increase for residential customers of 33.0 percent during the entire ten-year period. This rate of increase is well below the Philadelphia Consumer Price Index that measured 34.91 percent during the same period.

In July of 2005, the Water Department announced a revision of rates for the period covering FY06 through FY08. These rates were needed to offset increased costs and additional debt service required to support PWD's extensive capital program. For the typical PWD residential customer, the rate revision translated into an increase of 1.9 percent or a \$0.88 monthly increase that began on August 1, 2005; a 6.7 percent or a \$3.20 monthly increase starting July 1, 2006; and a 4.2 percent or a \$2.14 monthly increase starting July 1, 2007. These rates and charges will enable the Philadelphia Water Department to meet its obligations under the Charter of having a balanced budget through FY08. The Department anticipates that further rate revisions will be required in FY09. The Department is currently in the process of conducting a comprehensive cost of service rate study, and the amount of the rate revision will not be known until completion of the study and the mandated rate process.

Unlike many neighboring communities where sewer bills are separate from water bills or assessed through an annual charge, Philadelphians receive a bill that combines water, wastewater, and stormwater charges. Unfortunately, this combined billing sometimes leads to the impression that our water rates are high. In fact, even with the most recent revisions to rates, Philadelphia's water and sewer charges continue to be among the lowest in the region.

The following excerpt accompanied the affirmed A3 rating of Moody's Investors service issued in March, 2007: "The management team of this large combined water and wastewater system has produced a strong record of operational and financial achievements over the past decade. Operational achievements include continued improvements in environmental compliance, launch of a proactive water main replacement program that has significantly reduced the number of main breaks, and installation of automatic meters for a significant proportion (to date 99.3%) of residential customers. In addition to the resulting improvements in billing accuracy, the billing cycle was accelerated to a monthly basis. On the financial side, operating costs have been well controlled, with significant reductions in some areas such as contracted electricity costs and costs of operating the biosolids recycling center... management has been able to maintain significant cash balances that support the system's working capital needs, help with rate stabilization, and provide for contingencies."

The following excerpt accompanied the affirmed A- rating of Fitch issued in March, 2007: Due to the management team's history of conservative budgeting and the system's

As shown on the following table, PWD's water rates are less than half those charged by most neighboring investor-owned utilities.

2007 Regional Residential* Water/Sewer Charges		
	Monthly Water Bill	Monthly Sewer Bill
Aqua Pennsylvania+	\$45.60	N/A
Pennsylvania American Water+	\$41.53	N/A
New Jersey American Water+	\$33.53	N/A
North Penn Water Authority+	\$23.68	N/A
North Wales Water Authority+	\$22.85	N/A
Doylestown Township	\$30.23	\$49.76
CCMUA (Camden County)**	N/A	\$26.25
Trenton	\$21.58	\$23.30
Philadelphia Water Department	\$20.36	\$19.87

Rates in effect on November 13, 2007. Stormwater charges (\$9.12) are excluded from sewer calculation because many jurisdictions fund such services from the general tax base or a separate utility assessment.

* Calculations based on 5,236 gallons/month (700.cu.ft.)
 ** Sewer-only utility.
 + Water-only utilities

Source: Philadelphia Water Department.

As of the close of the current fiscal year, Moody's, Standard and Poor's, and Fitch rate the City's bonds as follows:

City of Philadelphia's Bond Ratings

General Obligation and Revenue Bonds

	Moody's Investors Service	Standard & Poors Corporation	Fitch IBCA
General obligation bonds	Baa1	BBB	BBB+
Water & sewer revenue bonds	A3	A-	A-
Aviation revenue bonds	A3	A	A

solid operating performance, Fitch expects the system's trend of actual results outperforming projections to continue and the maintenance of a healthy cushion in the RSF.

The system's proposed capital improvement plan (CIP) for fiscal 2008-2013 totals \$952 million, up almost \$200 million over the fiscal 2007-2012 CIP due to the inclusion of several flood and combined sewer overflow mitigation projects. Despite the increase, Fitch believes the spending levels in the CIP are manageable.

The following excerpt accompanied the affirmation of the A- rating of Standard and Poors: "The water department is headed by an experienced and long-standing management team that has implemented a number of operational improvements in recent years. The water department is in full regulatory compliance with safe water regulations. In addition, the system's plants are now regularly cited for the high quality of their operation."

"The seasoned management team emphasizes, and is achieving, improved system maintenance, stronger collections, and more comprehensive fiscal monitoring systems."

Fund Balances

During FY2007 the department was again able to add almost \$26 million to its Rate Stabilization fund, bringing the cumulative fund balance to approximately \$185.6 million all of which is available to provide necessary working capital to the department and to offset future rate increases. In addition, approximately \$12 million was transferred to the Residual fund. Virtually all of these funds will be used to provide capital funding to reduce the amount of additional bond issues to fund the capital program. To date, the department has transferred in excess of \$220 million to its capital fund via its annual 1% transfer and \$58 million via additional discretionary transfers to capital from its Residual fund.

Maintaining excellence in water purity standards

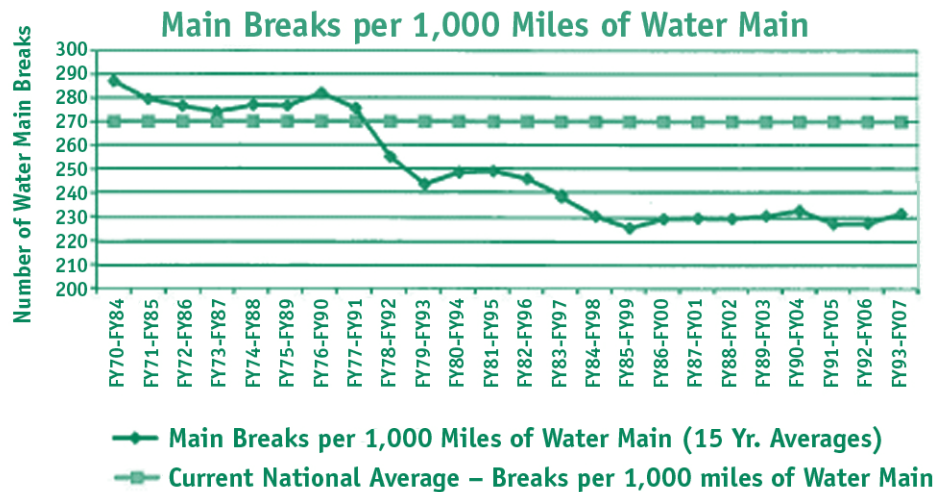
Philadelphia's drinking water meets or surpasses the requirements of state and federal standards 100 percent of the time. Since voluntarily joining the U.S. Environmental Protection Agency's (EPA) Partnership for Safe Water (PFSW) in 1996 (a joint program of the EPA and the water industry), the PWD has committed itself to reduced "turbidity," an industry standard measure of water purity. In FY07, the turbidity of Philadelphia's water (.05 ntu) was 83 percent lower than the amount required by state and federal regulations and 50 percent lower than the Partnership's turbidity goal of 0.1 ntu. Nationally, the PWD is among an elite group of 56 water utilities that have received a Directors Award from the PFSW for meeting the partnership's goals for five consecutive years.

In FY07, PWD also had to comply with the newest EPA water quality requirements, the Long-Term 2 Enhanced Surface Water Treatment Rule (LT2ESWTR) that was published in the Federal Register in January 2006. The PWD water quality program, instituted to achieve the PFSW goals, was well positioned to achieve compliance with the requirements of the new rule.

Optimize water and sewer main replacement

PWD closely monitors water main conditions to ensure that adequate capital investment is made, the integrity of the water supply system is sustained, and the occurrence of disruptive and costly water main breaks is reduced. In FY07, 20 miles of main were replaced.

As shown in the chart in the next column, the FY93-FY07 fifteen-year moving average level of 232 breaks per 1,000 miles is less than the national average of 270 breaks per 1,000 miles, and is near the lowest level in more than 20 years.

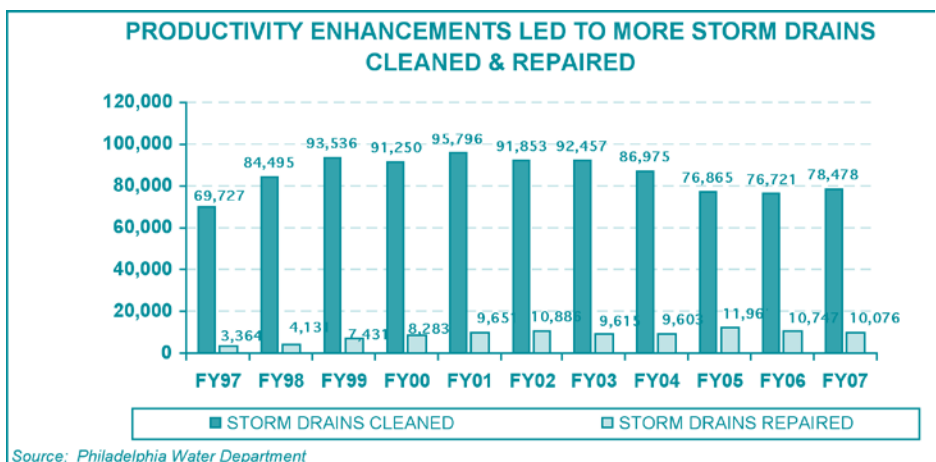


Reducing unbilled or non-revenue water

PWD maintains programs to reduce uncaptured revenue and loss of treated water from the distribution system. Over the past 13 years, PWD has cut non-revenue water by 35 percent, from 133 million gallons per day (mgd) to 86 mgd at the close of FY07. PWD continued a number of successful loss control initiatives in FY07, including a leak detection and repair program that surveyed over 1,024 miles of pipeline for leaks, and abated 27.6 mgd of leakage, representing a cost savings of over \$879,000. PWD successfully constructed field equipment to establish its first permanent District Metered Area (DMA) which includes pressure control features to reduce the occurrence of leakage and water main breaks. The DMA was installed in the Germantown section of Philadelphia at a cost of \$335,000. The results of this project have been impressive, saving one million gallons of water loss per day for an annual savings of \$55,000 and a payback of 5.5 years. In addition, the PWD's Revenue Protection Program continued to recover uncaptured revenue from billing errors, lost customer accounts, and unauthorized consumption. This program has recovered over \$18 million since its inception in 2000.

Improved stormwater flood control

PWD's management of the stormwater system is an important multi-faceted service for both flood control and environmental protection. With approximately 90,000 storm drains to maintain, the Department focuses on keeping them in good condition to prevent blockage of stormwater flow and creation of hazardous conditions for pedestrians. In FY07, PWD cleaned 78,478 storm drains, a 12.5 percent increase over the FY97 level. In addition, the Department reconstructed 10,076 storm drains, tripling the FY97 level.



Source: Philadelphia Water Department

In January 2006, PWD initiated new Stormwater Regulations. The new regulations are an important tool in the City's efforts to reduce flooding and to protect our rivers and streams. Accordingly, all development projects that disturb more than 15,000 square feet of earth must comply with water quality and non-structural site design requirements that are consistent with State and federal stormwater best management practices. During FY07, PWD received 757 conceptual submittals for zoning permits and 548 full Post Construction Technical submittals for building permits. Stormwater regulations include four major components: Water quality protection, channel protection, flood control, and non-structural site design (minimizing impervious land cover). The results of this program since inception have been significant. Seventeen million gallons of stormwater runoff has been captured, reducing stress on the stormwater infrastructure, and treatment plants. The avoided cost of building more conventional stormwater storage tanks for this runoff would have exceeded \$34 million.

Protecting drinking water supplies

PWD operates the Delaware Valley Early Warning System (EWS) to protect our drinking water supplies from chemical spills and other potential hazards in the Delaware and Schuylkill rivers. The system enables communication among water suppliers and emergency agencies to aid decision-making during source water contamination events. Through the EWS, PWD and other utilities have been provided with advanced warning of significant water quality events, such as the discharge of 100 million gallons of an arsenic-laden fly ash slurry to the Delaware from PP&L in August 2005; a 10,000 gallon leachate discharge into the Delaware from the Tullytown Landfill in March 2006; a cyanide spill into the Wissahickon in June 2006; and numerous other oil, chemical, and sewage spills in PWD's source waters. In FY07 a major redesign of the EWS website and system functionality was accomplished to improve system usability and performance. A user manual was created to provide assistance in using the redesigned EWS, and training was provided to the participants of the EWS Steering Committee as well as to emergency responders and water quality supervisors in Pennsylvania Department of Environmental Protection's (PA DEP's) Northeast, Southeast, and Southcentral regional offices. Outreach to industrial intakes within the EWS coverage area was also initiated during this time. In FY07 steps were also taken to acquire the City's first aquatic biomonitoring system to further protect Philadelphia's drinking water supply from contaminant events.

Long-term Control Plan for Combined Sewer Overflows

During heavy rainstorms, the release of some stormwater and sewage overflows from combined sewers (sewers that carry stormwater and sanitary waste in one pipe) to the City's rivers and streams, causes pollution to these waterways. Nearly eight years ago PWD began a short-term plan, using industry accepted best practices to operate our sewer system. These efforts successfully reduced overflow volume by three percent or six

billion gallons a year. Our efforts included detecting and eliminating overflows during dry weather, getting the most storage possible in our sewer system, and stepping up inspections and monitoring at sites where overflows occur. Since then, we have begun a long-term control plan that included \$48 million in capital improvements so we can capture even more flow in the sewer system. Our plan features a "watershed-based" approach, which involves other regional stakeholders in planning efforts that are more comprehensive and reach far beyond city boundaries.

Waterways Restoration Program

In FY04, the PWD created the Waterways Restoration Team (WRT), which consists of two crews devoted to removing trash and large debris from the streams and tributaries that define our neighborhoods. The teams also perform restoration work around PWD's storm and combined sewer outfalls. In FY07, the teams removed 441 tons of debris, 41 cars, 1,201 tires and 84 shopping carts from Philadelphia's streams. A large component of the team's mission is to work in partnership with the FPC to restore tributaries and streams that have been significantly damaged over decades by the volume and velocity of flows from sewer outfalls and from the forces of stormwater runoff. In FY07, the team tackled two restoration projects, providing interim stabilization to sites challenged by stormwater runoff that resulted in projects that were well received by FPC, regulatory agencies and citizens.

Awards and Recognition

In May, 2007 the National Association of Clean Water Agencies (NACWA) issued Gold awards for perfect National Pollutant Discharge Elimination System Permit compliance of the Southwest and Northeast Water Pollution Control Plants in 2006. The Southeast Water Pollution Control Plant achieved the highest Platinum Award for seven continuous years of perfect permit compliance.

Requests for Information

This financial report is designed to provide a general overview of the City of Philadelphia Water Department's finances for all interested parties. Questions concerning any of the information provided in this report, or requests for additional information, should be addressed to the Philadelphia Water Department, Finance Division, Aramark Tower, 5th Floor, 1101 Market Street, Philadelphia, Pa. 19107.

STATEMENT OF NET ASSETS, JUNE 30, 2007 AND 2006

(amounts in thousands)

	2007	2006
ASSETS		
Current Assets:		
Cash on Deposit and on Hand	\$ 30	\$ 30
Equity in Treasurer's Account	52,531	50,253
Due from Other Governments	329	109
Accounts Receivable	174,663	177,360
Allowance for Doubtful Accounts	(75,989)	(78,634)
Inventories	15,184	14,640
Total Current Assets	<u>166,748</u>	<u>163,758</u>
Noncurrent Assets:		
Restricted Assets:		
Equity in Treasurer's Account	350,933	368,675
Sinking Funds and Reserves	174,475	174,332
Grants for Capital Purposes	500	0
Receivables	2,114	2,784
Total Restricted Assets	<u>528,022</u>	<u>545,791</u>
Net Pension Asset	<u>54,069</u>	<u>64,118</u>
Capital Assets:		
Land	5,919	5,919
Infrastructure	1,796,638	1,752,461
Construction in Progress	115,525	146,831
Buildings and Equipment	1,462,116	1,390,699
Accumulated Depreciation	<u>(1,687,615)</u>	<u>(1,597,139)</u>
Total Capital Assets	<u>1,692,583</u>	<u>1,698,771</u>
Total Noncurrent Assets	<u>2,274,674</u>	<u>2,308,680</u>
TOTAL ASSETS	<u>2,441,422</u>	<u>2,4723,438</u>
LIABILITIES		
Current Liabilities:		
Vouchers Payable	5,077	5,107
Accounts Payable	11,725	7,377
Salaries & Wages Payable	2,406	2,225
Construction Contracts Payable	5,943	7,038
Accrued Expenses	14,985	18,435
Deferred Revenue	7,430	6,923
Funds Held in Escrow	345	-
Current Portion of Long Term Obligations	<u>92,501</u>	<u>84,002</u>
Total Current Liabilities	<u>140,412</u>	<u>131,107</u>
Noncurrent Liabilities:		
Long Term Obligations	1,669,810	1,758,799
Unamortized Discount and Loss	(82,232)	(88,496)
Other Noncurrent Liabilities	<u>20,153</u>	<u>20,485</u>
Total Noncurrent Liabilities	<u>1,607,731</u>	<u>1,690,788</u>
Total Liabilities	<u>1,748,143</u>	<u>1,821,895</u>
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	86,345	94,958
Restricted For:		
Capital Projects	84,786	51,990
Debt Service	174,475	174,332
Rate Stabilization	185,612	153,910
Unrestricted	<u>162,061</u>	<u>175,353</u>
Total Net Assets	<u>\$693,279</u>	<u>\$650,543</u>

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS FOR THE FISCAL YEARS ENDED JUNE 30, 2007 AND 2006

(amounts in thousands)

	2007	2006
Operating Revenues:		
Charges for Goods and Services	\$487,928	\$465,519
Miscellaneous Operating Revenues	5,641	5,325
	<u>493,569</u>	<u>470,844</u>
Operating Expenses:		
Personal Services	106,023	98,773
Purchase of Services	77,779	68,469
Materials and Supplies	30,993	27,526
Employee Benefits	66,643	62,852
Indemnities and Taxes	2,889	3,758
Depreciation and Amortization	82,554	78,855
	<u>366,881</u>	<u>340,233</u>
Operating Income (Loss)	<u>126,688</u>	<u>130,611</u>
Nonoperating Revenues (Expenses):		
Operating Grants	1,278	569
Interest Income	31,804	23,141
Net Pension Obligation	(10,049)	(7,182)
Debt Service - Interest	(93,069)	(100,682)
Other Expenses	(6,156)	(7,266)
	<u>(76,192)</u>	<u>(91,420)</u>
Total Nonoperating Revenues (Expenses):	<u>(76,192)</u>	<u>(91,420)</u>
Income (loss) before Transfers	50,496	39,191
Transfers Out	(4,994)	(4,994)
Change in Net Assets	45,502	34,197
Net Assets - Beginning of Period	650,543	616,346
Adjustment	(2,766)	-
	<u>693,279</u>	<u>616,346</u>
Net Assets - End of Period	<u>\$693,279</u>	<u>\$616,346</u>

STATEMENT OF CASH FLOWS, JUNE 30, 2007

(amounts in thousands)

	2007	2006
Cash Flows from Operating Activities		
Receipts from Customers	\$494,254	\$474,387
Payments to Suppliers	(106,080)	(96,672)
Payments to Employees	(173,323)	(163,124)
Claims Paid	(2,417)	(4,176)
Other Receipts (Payments)	-	-
Net Cash Provided by Operating Activities	<u>212,434</u>	<u>210,415</u>
Cash Flows from Non-Capital Financing Activities		
Operating Grants Received	744	569
Operating Subsidies and Transfers to Other Funds	(4,994)	(4,994)
Net Cash Provided by Non-Capital Financing Activities	<u>(4,250)</u>	<u>(4,425)</u>
Cash Flows from Capital & Related Financing Activities		
Proceeds from Capital Debt	-	-
Capital Contributions Received	-	-
Acquisition and Construction of Capital Assets	(80,661)	(85,213)
Interest Paid on Capital Debt	(89,920)	(87,866)
Principal Paid on Capital Debt	(84,003)	(78,550)
Other Receipts (Payments)	-	-
Net Cash Provided (Used) by Non-Capital Financing Activities	<u>(254,584)</u>	<u>(251,629)</u>
Cash Flows from Investing Activities		
Interest and Dividends	30,936	19,861
Net Cash Provided by Investing Activities	<u>30,936</u>	<u>19,861</u>
Net Increase (Decrease) in Cash & Cash Equivalents	<u>(15,464)</u>	<u>(25,778)</u>
Balances - Beginning of the Year	418,958	444,736
Balances - End of the Year	<u><u>403,494</u></u>	<u><u>418,958</u></u>
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:		
Operating Income (Loss)	126,688	130,611
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation Expense	82,554	78,855
Change in Assets and Liabilities:		
Receivables, Net	177	3,360
Inventories	(544)	(563)
Accounts and Other Payables	6,502	(2,031)
Accrued Expenses	(3,450)	-
Deferred Revenue	507	183
Net Cash Provided by operating activities	<u><u>\$212,434</u></u>	<u><u>\$210,415</u></u>

BUDGETARY COMPARISON SCHEDULE

Water Operating Fund For the Fiscal Year Ended June 30, 2007

(amounts in thousands)

<u>REVENUES</u>	<u>BUDGETED AMOUNTS</u>			<u>FINAL BUDGET TO ACTUAL</u>
	<u>Original</u>	<u>Final</u>	<u>Actual</u>	<u>Positive (Negative)</u>
Locally Generated Non-Tax Revenue	\$ 465,286	\$ 477,078	\$ 486,917	\$ 9,839
Revenue from Other Governments	1,600	1,500	520	(980)
Revenue from Other Funds	63,328	30,272	32,311	2,039
Total Revenues	530,214	508,850	519,748	10,898
Expenditures and Encumbrances				
Personal Services	109,721	103,813	101,056	2,762
Pension Contributions	32,600	34,513	34,513	0
Other Employee Benefits	32,519	31,138	31,138	0
Sub-Total Employee Compensation	174,840	169,469	166,707	2,762
Purchase of Services	97,059	85,617	83,967	1,650
Materials and Supplies	38,994	38,557	38,274	283
Equipment	4,820	3,658	3,134	524
Contributions, Indemnities and Taxes	6,603	6,038	2,445	3,593
Debt Service	178,826	176,415	173,923	2,492
Debt Service – Interest				
Short-Term Interest				
Payments to Other Funds	42,072	63,460	67,879	(4,419)
Total Expenditures and Encumbrances	543,214	543,214	536,329	6,885
Operating Surplus (Deficit) for the Year	(13,000)	(34,364)	(16,581)	17,783
Fund Balance Available, July 1, 2006	-	-	-	-
Operations in Respect to Prior Fiscal Years				
Commitments Cancelled - Net	13,000	13,000	16,584	3,584
Prior Period Adjustments	-	-	(3)	(3)
Adjusted Fund Balance, July 1, 2006	13,000	13,000	16,581	3,581
Fund Balance Available, June 30, 2007	-	(21,364)	-	\$ 21,364

BONDED DEBT FOR THE FISCAL YEAR ENDED JUNE 30, 2007

(amounts in thousands)

ORIGINAL AUTHORIZATION			FISCAL YEAR 2008					
Series	Date	Issued	Outstanding June 30, 2007	Maturities	Interest Rates	Debt Service Interest	Principal Requirements	Outstanding June 30, 2008
Revenue Bonds:								
Fourteenth Series	05/15/89 *	\$ 158,265	\$ 47,200	10/2007 to 10/2008	N.A.	\$ -	\$ 23,600	\$ 23,600
Series 1993	08/01/93 *	1,157,585	225,975	6/2008 to 6/2011	5.50 to 7.00	14,671	40,570	185,405
Series 1995	04/15/95	221,630	69,935	8/2007 to 8/2012	5.30 to 6.25	4,061	9,915	60,020
Series 1997 (A)	10/15/97	250,000	5,815	8/2027	5.00 to 5.25	153	5,815	-
Series 1997 (B)	11/25/97	100,000	83,600	8/2007 to 8/2027	Variable	3,033	2,500	81,100
Series 1998	12/25/98	135,185	135,185	12/2011 to 12/2014	5.25	7,097	-	135,185
Series 1999	07/07/99	33,040	-	12/2006	5.00	-	-	-
Series 2001	11/15/01	285,920	137,875	11/2011 to 11/2028	3.800 to 5.500	7,069	-	137,875
Series 2003	04/01/03	381,275	372,270	6/2008 to 6/2023	Variable	16,827	1,095	372,175
Series 2005 (A)	05/04/05	250,000	247,875	7/2007 to 7/2035	3.250 to 5.250	12,167	4,145	243,730
Series 2005 (B)	05/04/05	86,105	84,385	8/2007 to 8/2018	Variable	3,815	350	84,035
Series 2007 (A)	05/04/07	191,440	191,440	8/2007 to 8/2027	4.00 to 5.00	6,577	2,815	188,625
Series 2007 (B)	05/04/07	153,595	153,595	11/2007 to 11/2031	4.00 to 5.00	6,826	90	153,505
Penn Vest	04/30/00	6,700	1,373	7/2007 to 4/2019	1.41 to 2.73	32	431	942
Total Revenue Bonds		\$3,410,740	\$1,756,523			82,328	91,326	1,655,197
General Obligation Bonds:								
Penn Vest	06/15/93	20,000	5,787	07/2007 to 04/2012	1.00	52	1,174	4,613
Total Bonded Debt			\$1,762,310			82,380	92,501	1,669,810

*Partially Refunded

ANNUAL BONDED DEBT SERVICE REQUIREMENT: (amounts in thousands)

Fiscal Year	Interest	Principal	Total	
2008	82,380	92,501	174,881	The First Series through the Thirteenth, Fifteenth, and the Sixteenth were refunded.
2009	81,456	91,534	172,990	
2010	77,829	95,164	172,992	
2011	71,718	100,849	172,567	
2012	64,128	107,908	107,908	

Capitalized Interest added to Construction in Progress in Fiscal 2007 was \$4,572,134. Interest Expense was reduced by the same amount.

SUPPLEMENTAL SCHEDULE OF RATE COVENANT COMPLIANCE FOR FISCAL YEAR ENDED JUNE 30, 2007

(amounts in thousands)

LINE NO.	2007
1. Total Revenue and Beginning Fund Balance	\$ 536,328
2. Net Operating Expense	(303,135)
3. Transfer (To) From Rate Stabilization Fund	(25,959)
4. Net Revenues	207,235
5. Revenue Bonds Outstanding	(172,696)
6. General Obligation Bonds Outstanding	0
7. Pennvest Loan	(1,227)
8. Total Debt Service	(173,923)
9. Net Revenue after Debt Service	33,312
10. Transfer to General Fund	(4,994)
11. Transfer to Capital Fund	(16,988)
12. Transfer to Residual Fund	(11,330)
13. Total Transfers	(33,312)
14. Net Operating Balance for Current Year	0

The rate covenant contained in the General Ordinance requires the City to establish rates and charges for the use of the Water and Wastewater Systems sufficient to yield Net Revenues, as defined therein, in each fiscal year at least equal to 120% (coverage A) of the Debt Service Requirements for such fiscal year (excluding debt service due on any Subordinated Bonds). In addition, Net Revenues, in each fiscal year, must equal at least 100% (coverage B) of : (i) the Debt Service Requirements (including Debt Service Requirements in respect of Subordinated Bonds) payable in such fiscal year; (ii) amounts required to be deposited of Subordinated Bonds payable in such fiscal year; (iii) amounts required to be deposited into the Debt Reserve Account during such fiscal year; (iii) debt service on all General Obligations Bonds issued for the Water and Wastewater Systems payable in such fiscal year; (iv) debt service payable on Interim Debt in such fiscal year; and (v) the Capital Account Deposit Amount for such fiscal year, less amounts transferred from the Residual Fund to the Capital Account during such fiscal year. To insure compliance with the rate covenant, the General Ordinance requires that the City review its rates, rents, fees, and charges at least annually.

Additional Rate Covenant. As long as the Insured Bonds are outstanding, the City covenants to establish rates and charges for the use of the System sufficient to yield Net Revenues (excluding amounts transferred from the Rate Stabilization Fund into the Revenue Fund during, or as of the end of, such fiscal year) at least equal to 90% (coverage C) of the Debt Service Requirements (excluding debt service on any Subordinated Bonds) in such fiscal year.

COVERAGE A:	COVERAGE B:	COVERAGE C:			
Line 4	\$207,235	Line 4	\$233,194	Line 4 - Line 3	\$233,194
/ Line 5	\$172,696	/ (Line 8 + Line 11)	\$172,696	/Line 5	\$172,696
= COVERAGE A:	<u>1.20</u>	= COVERAGE B:	<u>1.35</u>	= COVERAGE C:	<u>1.35</u>

1. THE GOVERNMENT OF PHILADELPHIA

The City of Philadelphia was founded in 1682 and was merged with the county in 1854. There are two principal governmental entities in Philadelphia: (1) the City of Philadelphia, which performs both the ordinary municipal functions and the traditional county functions; and (2) the School District of Philadelphia, which is part of the public education system of the Commonwealth of Pennsylvania. In addition to the School District of Philadelphia, there are a number of other governmental and quasi-governmental entities operating within the City. The financial statements as set forth herein present only the operations of the City of Philadelphia Water Fund.

The City is governed largely under the 1951 Philadelphia Home Rule Charter. In some matters, including the issuance of short- and long-term debt, the City is governed by the laws of the Commonwealth of Pennsylvania.

Pursuant to the Philadelphia Home Rule Charter, the Water Department has the power and duty to operate, maintain, repair and improve the City's Water and Wastewater Systems. The Water Department is managed by a Commissioner who is appointed by the City's Managing Director with the approval of the Mayor. The Commissioner appoints his deputies with the approval of the City's Managing Director and substantially all other employees are appointed under the provisions of the City's Civil Service Regulations. The executive offices of the Water Department are located at ARAMark Tower, 1101 Market Street, Philadelphia, Pennsylvania 19107-2994.

The Department of Revenue of the City has performed for the Water Department all functions relating to meter reading, billing and collections. The Director of Finance performs general fiscal accounting and has overall responsibility for the fiscal administration of all City departments, including the Water Department. The audit function for the City, including the Water Department, is the responsibility of the Office of the City Controller. Legal matters affecting the Water Department are the responsibility of the Office of the City Solicitor.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Philadelphia Water Department have been prepared in conformity with Generally Accepted Accounting Principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of the City's accounting policies are described below.

A. Basis of Accounting

For purposes of rate setting, calculating rate covenant compliance, debt service coverage and budgeting, the Water Fund accounts are maintained on the modified accrual basis of accounting also referred to as the "Legally Enacted Basis." Under this basis, revenues are recognized in the accounting period in which they are received. Investment earnings are recorded when earned, as they are measurable and available. Expenditures are recorded in the accounting period in which the fund liability is incurred, if measurable, except expenditures for debt service, prepaid expenditures, and other long-term obligations, which are recognized when paid. Expenditures for claims and

judgments, compensated absences and other long-term obligations are accrued if expected to be liquidated with available resources.

At fiscal year-end the Water Fund accounts are adjusted to the full accrual basis of accounting required by GAAP. The Water Fund is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation are included on the Statement of Net Assets. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. In accrual basis accounting, revenues are recognized in the accounting period in which they are earned and expenses are recognized at the time the liabilities are incurred. Under GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Activities, the Water Fund will continue to follow Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements and will follow FASB standards issued after that date which do not conflict with GASB standards.

Water revenues, net of uncollected accounts, are recognized as billed on the basis of scheduled meter readings. Revenues are accrued for unpaid bills at June 30 and for services provided but not yet billed at June 30.

B. Legal Compliance

The City's budgetary process accounts for certain transactions on a basis other than GAAP.

In accordance with the Philadelphia Home Rule Charter, the City has formally established budgetary accounting control for its operating and capital improvement funds.

The operating funds of the City – consisting of the General Fund, five Special Revenue Funds (County Liquid Fuels Tax, Special Gasoline Tax, Hotel Room Rental Tax, Grants Revenue and Community Development Funds) and two Enterprise Funds (Water and Aviation Funds) – are subject to annual operating budgets adopted by City Council. These budgets appropriate funds for all City departments, boards and commissions by major class of expenditure within each department. Major classes are defined as: personal services; purchase of services; materials and supplies; equipment; contributions; indemnities and taxes; debt service; payments to other funds; and miscellaneous. The appropriation amounts for each fund are supported by revenue estimates and take into account the elimination of accumulated deficits and the re-appropriation of accumulated surpluses to the extent necessary. All transfers between major classes (except for materials and supplies and equipment, which are appropriated together) must have Council approval. Appropriations not expended or encumbered at year-end are lapsed. Departmental comparisons of budget to actual activity are located in the City's Supplemental Report of Revenues and Obligations.

The City Capital Improvement Fund budget is adopted annually by the City Council. The Capital Improvement budget is appropriated by project for each department. Due to the nature of the projects, it is not always possible to complete all bidding, contracts, etc. within a twelve-month period. All transfers between projects exceeding 20 percent for each project's original appropriation must be approved by City Council.

As part of the amendment process, budget estimates of City related revenues are adjusted and submitted to City Council for review. Changes in revenue estimates do not need City Council approval, but are submitted in support of testimony with regard to the appropriation adjustments.

The following schedule reconciles the differences between the Legally Enacted Basis and GAAP Basis:

Water Fund (amounts in thousands)

Fund Balance-Legal Basis 6/30/07	\$	0
Assets omitted from the legal basis:		
(1) Receivables from Other Governments or Funds		33,837
(2) Fixed Assets-Net of Depreciation		1,692,583
(3) Restricted Assets		528,022
(4) Proprietary Portion of Net Pension Obligation		<u>54,068</u>
	\$	<u>2,308,510</u>
Liabilities omitted from the legal basis:		
(5) Construction Contracts Payable		(5,943)
(6) Other Current Liabilities		(117,355)
(7) Bonds Payable and Other Long-Term Debt		<u>(1,607,731)</u>
		<u>(1,731,029)</u>
Fund Balance accounts included in the legal basis:		
(8) Reserve for Collectible Receivables		64,814
(9) Reserve for Inventories		15,184
(10) Reserve for Purchase Commitments		<u>35,800</u>
		<u>115,798</u>
Equity accounts omitted from the legal basis:		
(11) Invested in Capital Assets, Net of Related Debt		(86,345)
(12) Restricted for Capital Projects		(84,786)
(13) Restricted for Debt Service		(174,475)
(14) Restricted for Rate Stabilization		<u>(185,612)</u>
		<u>(531,218)</u>
Unrestricted Net Assets – GAAP Basis – 6/30/2007		<u>\$162,061</u>

C. Water Account

The City has established a City of Philadelphia Water Account to be held exclusively for Water Department purposes, separate and apart from all other funds and accounts of the City, and not to be commingled with the City's Consolidated Cash Account or any other fund or account of the City not held exclusively for Water Department purposes.

The City has covenanted that it will not make temporary loans or advances of Bond proceeds or Project Revenues (even while temporarily held in the City's Consolidated Cash Account) from the Water Account, the Water Sinking Fund, the Water Sinking Fund Reserve or the Water Rate Stabilization Fund to any City account not held exclusively for Water Department purposes. The City has established subaccounts within the Water Account into which deposits and from which disbursements shall be made for operating and capital purposes.

D. Pledge of Revenues

Section 4.02 and 4.04 of The ordinance of 1989, amended 1993, which authorized the issuance of Water and Sewer Revenue Bonds, hereby pledges and assigns to the Fiscal Agent for the security and payment of all Bonds, a lien on and security interest in all Project Revenues and amounts on deposit in or standing to the credit of the: 1) Revenue Fund; 2) Sinking Fund et al; 3) Subordinated Bond Fund; 4) Rate Stabilization Fund; 5) Residual Fund; and 6) Construction Fund et al. The Fiscal Agent shall hold and apply the security interest granted in trust for the Holders of Bonds listed above without preference, priority, or distinction; provided however, that the pledge of this ordinance may also be for the benefit of a Credit Facility and Qualified Swap, or any other person who undertakes to provide moneys for the account of the City for the payment of principal or redemption price and interest on any Series of Bonds (other than Subordinated Bonds), on an equal and ratable basis with Bonds, to the extent provided by any Supplemental Ordinance or Determination.

E. Grants from Other Governments for Capital Purposes

Grants from Federal, State, and other governments are recognized as revenue when grant expenditures have been recorded. Grants are recorded as non-operating revenues.

F. Property, Plant and Equipment

Property, plant and equipment are stated at cost. Where cost could not be developed from the records available, estimated historical cost was used to record the value of the assets. Upon sale or retirement, the cost of the assets and the related accumulated depreciation are removed from the accounts. Maintenance and repair costs are charged to operations. Capital assets are defined by the City as assets with an initial

individual cost of more than \$5,000 and an estimated useful life in excess of three years.

G. Depreciation

Depreciation on fixed assets is provided on the straight-line method over their estimated useful lives as follows:

Computer equipment	3 years
Automotive	5 years
Leasehold Improvements	8 years
General and monitoring equipment	10-20 years
Buildings	40 years
Reconstructed transmission and distribution lines	40 years
New transmission and distribution lines	50 years

H. Construction in Progress

Cost of construction includes all direct contract costs plus overhead charges. Overhead costs include direct and indirect engineering costs and interest incurred during the construction period on projects financed with Revenue Bond proceeds. Interest is capitalized by applying the average financing rate during the year to construction costs incurred. Interest earnings on bond proceeds reduce the amount capitalized. Capitalization of interest during construction for Fiscal Year 2007 was \$4,572,134.

I. Amortization of Bond Discount

Bond discounts and issuance costs are deferred and amortized by the bonds outstanding method.

J. Inventories

The materials and supplies inventory is priced using the "moving average cost" method.

K. Revenues

All billings rendered to general customers through June 30, 2007 are included in accounts receivable. In addition an amount for services rendered through June 30, 2007, but not billed, has been accrued. Historically, billings and collections for general customers remain relatively constant except for periods when there has been a rate change.

L. Insurance

The City, except for the Gas Works, the Airport, and certain other properties, is self-insured for most fire and casualty losses to its structures and equipment and provides statutory worker's compensation, unemployment benefits, and health and welfare to its employees through a self-insured plan. Construction contractors are required to carry protective general liability insurance indemnifying the City and the Contractor. A reserve for payment of reported worker's compensation claims and incurred but unreported claims has been recorded in the accompanying financial statements as Other Long-Term Obligations.

M. Investments

All highly liquid investments (except for Repurchase Agreements) with a maturity of three months or less when purchased are considered to be cash equivalents.

The investments of the City are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on national or international exchanges are valued at the last reported sales price. The fair value of real estate investments is based on independent appraisals. Investments, which do not have an established market, are reported at estimated fair value.

N. Deferred Revenues

Deferred revenues represent funds received in advance of being earned. In the Water Fund, deferred revenues relate principally to overpaid Water and Sewer bills.

O. Interfund Charges

In accordance with an agreement between the Finance Director and the Water Department, the Finance Director may transfer to

the General Fund up to a limit of \$4,994,000 in any fiscal year in "excess interest earnings" as defined by the Rate Covenants under the Ordinance. In fiscal 2007, excess interest earnings of \$4,994,000 were transferred to the General Fund of the City.

P. Prior Period Adjustment

Business-Type net assets beginning balance was decreased by \$2.8 million, which represents the net effect of corrections made to Buildings & Equipment and Depreciation in the Water and Sewer Fund.

4. THE TEN LARGEST RETAIL CUSTOMERS OF THE PHILADELPHIA WATER DEPARTMENT DURING FISCAL YEAR 2007

Customer	Billings (millions)	% of total Billings	Consumption (MGD)	% of total Consumption
City of Philadelphia	\$19.78	4.47%	12.59	8.36%
Philadelphia Housing Authority	10.07	2.27	4.19	2.78
Philadelphia School District	5.97	1.35	1.55	1.03
University of Penna.	5.19	1.17	2.77	1.84
Trigen Corporation	3.15	0.71	2.02	1.34
Temple University	2.46	0.55	1.29	0.86
Sunoco	2.34	0.53	2.22	1.48
SEPTA	1.56	0.35	0.99	0.66
Altivity Packaging LLC	1.41	0.32	1.52	1.01
US Government	1.32	0.30	1.54	1.02
Total top ten	\$53.23	12.02%	30.68	20.37%
Total retail billings	\$442.85		150.6	

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30, 2007 and 2006 consisted of the following:

Fiscal Years Ended	June 30, 2007	June 30, 2006
Land	\$ 5,919,160	\$ 5,919,160
Buildings and related improvements	1,403,157,790	1,342,281,174
Meters and other improvements	80,461,201	79,574,255
Equipment	58,958,365	48,418,422
Transmission and distribution lines	1,716,176,413	1,672,887,106
Construction in progress	115,524,780	146,831,322
Total	\$3,380,197,709	\$3,295,911,439
Less: Accumulated Depreciation	(1,687,615,071)	(1,597,138,725)
Total	\$1,692,582,637	\$1,698,772,714

6. IMPAIRED ASSETS

Government Accounting Standards Board (GASB) Statement 42 requires the disclosure of the impairment of any major capital assets. Over the years there have been a number of PWD assets that were either damaged or destroyed, were abandoned or became functionally obsolete.

In the past, as these assets were removed from service their cost was removed from Utility Plant in service. Assets that were removed from service include the first Mixing & Receiving building at our Biosolids Recycling center which was destroyed by fire in the

3. ACCOUNTS RECEIVABLE

Balances consisted of the Following:

FISCAL YEAR ENDED JUNE 30, 2007	
Accounts Receivable:	
Billed in the Last Twelve Months	\$ 86,119,749
Billed in 15-year Cycle Billing	47,607,358
Penalties on Receivables	24,614,487
Other Receivables	16,321,080
Total	<u>\$174,662,674</u>
Bad Debts Written Off	<u>\$ 8,403,718</u>

ALLOWANCE FOR DOUBTFUL ACCOUNTS:

Billed in the Last Twelve Months	\$ 0
Billed in 15-year Cycle Billing	43,683,227
Penalties on Receivables	20,751,628
Other Receivables	11,554,577
Total	<u>\$75,989,431</u>

FISCAL YEAR ENDED JUNE 30, 2006

Accounts Receivable:	
Billed in the Last Twelve Months	\$ 86,042,036
Billed in 15-year Cycle Billing	49,448,573
Penalties on Receivables	25,744,039
Other Receivables	16,124,893
Total	<u>\$177,359,541</u>
Bad Debts Written Off	<u>\$ 25,976,583</u>

ALLOWANCE FOR DOUBTFUL ACCOUNTS:

Billed in the Last Twelve Months	\$ 0
Billed in 15-year Cycle Billing	45,884,017
Penalties on Receivables	21,960,171
Other Receivables	10,790,077
TOTAL	\$78,634,265

early 1990's, the grit, scum and screenings incinerators and related handling equipment at our wastewater plants which were abandoned due to clean air permit considerations, the chlorine facilities at our water and wastewater plants that were replaced due to safety and clean air act considerations and the high-pressure fire system which was removed from service in January 2005 when it was determined to be functionally obsolete.

One additional facility remains in service, which has become "functionally obsolescent" - the portion of our Biosolids Recycling Center which performs composting. Composting of our sludge products was stopped in approximately March of 2007 as an interim solution to the air management problems that have occurred at this site. Processing of the remaining compost material on the site will actually continue until approximately October of this year. A permanent solution for sludge processing that does not involve composting is still in development. PWD's engineering division estimates the value of the compost facilities that are "functionally obsolescent" (which were built in conjunction with the remaining BRC facilities which will remain in service such as the mixing/receiving building, administrative offices and the dewatering facility) to be in the area of \$20 million, including the value of any land acquisition and site preparation costs.

7. VACATION

Employees are credited with vacation at rates which vary according to length of service. Vacation may be taken or accumulated up to certain limits until paid upon retirement or termination. Employees' vacation time accrued in Fiscal Year 2007 was \$9,487,527 and in 2006 was \$9,339,210. The expense for vacation pay is recognized in the year earned.

8. SICK LEAVE

Employees are credited with varying amounts of sick leave per year according to type of employee and/or length of service. Employees may accumulate unused sick leave to 200 days and union-represented employees may convert up to 20 sick days per year to vacation days at a ratio of 2 for 1. Non-

uniformed employees (upon retirement only) are paid 30% of unused sick time, not to exceed predetermined amounts. Employees, who separate for any reason other than indicated above, forfeit their entire sick leave. The City budgets for and charges the cost of sick leave as it is taken.

9. CAPITALIZED LEASES

Leases consist of \$2,300,662 in photocopier and computer equipment in Fiscal 2007. Capital leases are defined by the Financial Accounting Standard Board in Statement 13, Accounting for Leases.

10. RATE STABILIZATION FUND

The Rate Stabilization Fund was created with the sale of the Series 1993 Revenue Bonds on August 20, 1993. The purpose of the Fund is to maintain assets to be drawn down to offset future deficits (and corresponding rate increase requirements) in the Water Department Operating Fund.

During Fiscal 2007 the fund had the following activity:

Balance at July 1, 2006	\$153,909,810
Deposit from Operating Fund	25,958,616
Transfer to Operating Fund	0
Interest Earnings	<u>5,743,282</u>
Balance at June 30, 2007	<u>\$185,611,708</u>

11. RESIDUAL FUND

The Residual Fund was created with the sale of the Series 1993 Revenue Bonds on August 20, 1993. The purpose of the Fund is to maintain the remaining assets after payment of all operating expenses, payment of all debt service obligations including payments under a swap agreement, scheduled transfers to the Rate Stabilization fund, and required deposits to the Capital Account of the Construction Fund.

During Fiscal 2007 the fund had the following activity:

Balance at July 1, 2006	\$ 6,866,582
Interest income	323
Deposit from Operating Fund	16,324,405
Transfer to General Fund	(4,994,000)
Transfer to Capital Projects Fund	(16,500,000)
Balance at June 30, 2007	<u>\$ 1,697,310</u>

12. DEFERRED COMPENSATION PLAN

The City offers its employees a deferred compensation plan in accordance with Internal Revenue Code section 457. As required by the Internal Revenue Code and Pennsylvania laws in effect at June 30, 2007, the assets of the plan are held in trust for the exclusive benefit of the participants and their beneficiaries. In accordance with GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, the City does not include the assets or activity of the plan in its financial statements.

13. ARBITRAGE REBATE

The City has issued Water Revenue Bonds subject to federal arbitrage requirements. Federal tax legislation requires the accumulated net excess of interest income on the proceeds of these issues over interest expense paid on the bonds be paid to the federal government at the end of a five-year period. In Fiscal 2005, \$30,077 was paid. As of June 30, 2005 there was no arbitrage liability. There was no Arbitrage liability incurred during FY 2006. There was no Arbitrage liability incurred during FY 2007.

14. DEBT PAYABLE

Defeased Debt: In prior years, the Water Fund defeased certain bonds by placing the proceeds of new bonds in ir-

revocable trusts to provide for all future debt service payments on old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Water Fund's financial statements. At year end, \$364.4 million of bonds outstanding was considered defeased.

In May 2007, the City issued \$191.4 million of Water & Wastewater Revenue refunding Series 2007A and \$153.6 million Water & Wastewater Revenue refunding Series 2007B bonds. The proceeds of the bonds were used to refund a portion of the 1997A Series Water and Wastewater Revenue Bonds maturing from 2008 through 2031 in the amount of \$341.5 million. The refunding structure of the bonds generated approximately \$14.5 million in net present value savings or 4.22% of the principal amount of the refunded bonds. This early extinguishing of debt resulted in an accounting loss of approximately \$17.1 million representing the difference between the reacquisition price of \$353.7 million and the amount of debt extinguished of \$341.5 million (less \$4.9 million unamortized discount). The resulting loss attributed to the Series 1997A and Series 2001A bonds, \$17.1 million, will be amortized over the life of the refunded bonds at a rate of \$66,238.95 monthly through November 2031.

Interest Rate Swaption: City of Philadelphia 1993 Water and Sewer Swaption/2003 Water and Sewer Swap

Objective of swaption: In December 2002, the City entered into a swaption that provided the City with an up-front payment of \$24,989,926. As a synthetic refunding of its 1993 Bonds, this payment represents the present value savings, as of December 2002 of a refunding on March 18, 2003, without issuing refunding bonds as of December 2002. The swaption gave Citigroup (formerly Salomon Brothers Holding Company, Inc.) the option to enter into an interest rate swap to receive fixed amounts and pay variable amounts. The option was exercised on March 18, 2003 and the City issued variable-rate refunding bonds and started making payments under the terms of the swap.

Terms: Citigroup exercised its option to enter into a swap on March 18, 2003 – the City's 1993 water and sewer bonds' first call date. The swap also commenced on the exercise date of March 18, 2003. Under the swap, the City pays a fixed payment of 4.52% and receives a variable payment computed as the actual bond rate through March 1, 2005 and thereafter computed as the actual bond rate or alternately, 68.5% of the USD- London Interbank Offered Rate (LIBOR)-BBA with a designated maturity of one month ("one month LIBOR"), in the event the average rate on the Bonds as a percentage of the one month as a percentage LIBOR has exceeded 68.5% for a period of more than 180 days. The rates are based on an amortizing notional schedule (with an initial notional amount of \$381.2 million) and when added to an assumption for remarketing, liquidity costs and cost of issuance will approximate the debt service of the "refunded bonds."

As of June 30, 2007, the swap had a notional amount of \$372.2 million and the associated variable-rate bond has a \$372.2 million principal amount. The bonds' variable-rate coupons are not based on an index but on market conditions. The bonds and the related swap agreement mature on June 15, 2023. As of June 30, 2007 rates were as follows:

	Terms	Rates
Interest Rate Swap		
Fixed payment to Citigroup	Fixed	4.52%
Variable payment from Citigroup	Actual Bond Rate	(3.73%)
Net Interest Rate Swap payments		0.79%
Variable Rate bond coupon payments	Market Driven	3.73%
Synthetic interest rate on bonds		4.52%

Fair Value: As of June 30, 2007, the swap had a negative fair value of \$18.0 million. Since the coupons on the City's variable rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. The payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap.

Risk: As of June 30, 2007 the City is not exposed to credit risk because the swap had a negative fair value. Should interest rates change and the fair value of the swap become positive, the City would be exposed to credit risk in the amount of the swap's fair value. Should the variable-rate received on the swap change from the actual bond rate to the alternative floating rate of 68.5% of one month

LIBOR, the City would be exposed to (i) basis risk, as reflected by the relationship between the variable rate bond coupon payments and 68.5% of one month LIBOR received on the swap, and (ii) tax risk, where the City is exposed to a potential interest cost in the event that changes in the structure of the federal tax system or in the marginal rates causes the rate paid on the outstanding bonds to be greater than the 68.5% of LIBOR received on the swap. The Schedule to the Master Agreement includes an "additional termination event." That is, the swap may be terminated if Citigroup's or its Credit Support Provider, or the City has one or more outstanding issues of rated unsecured, unenhanced senior debt and none of such issues has a rating of at least (i) Baa3 or higher as determined by Moody's Investors Service, Inc., or (ii) BBB- or higher as determined by Standard & Poor's Ratings Service, A Division of the McGraw-Hill Companies, Inc., or (iii) an equivalent investment grade rating determined by a nationally-recognized rating service acceptable to both parties.

Swap payments and associated debt: As of June 30, 2007, debt service requirements of the variable-rate debt and net swap payments for their term, assuming current interest rates remain the same, were as follows.

Fiscal Year Ending June 30	Variable Rate Bonds		Interest Rate Swaps Net	Total Interest
	Principal	Interest		
2008	1,095,000	13,883,969	2,940,573	16,824,542
2009	1,145,000	13,843,048	2,931,906	16,774,954
2010	1,205,000	13,800,246	2,922,840	16,723,087
2011	1,260,000	13,755,214	2,913,303	16,668,517
2012	41,195,000	13,646,151	2,890,203	16,536,354
2013 - 2017	245,585,000	41,760,046	8,844,621	50,604,668
2018 - 2022	65,620,000	10,316,465	2,184,989	12,501,454
2023 - 2027	<u>15,165,000</u>	<u>542,086</u>	<u>114,812</u>	<u>656,897</u>
	\$372,270,000	\$121,547,225	\$25,743,246	\$147,290,471

As rates vary, variable rate bond interest payment and net swap payments will vary.

City of Philadelphia, 2005 Water & Sewer Swaption

Objective of Swaption: In December 2002, the City entered into a swaption that provided the City with an up-front payment of \$4,000,000. As a synthetic refunding of its 1995 Bonds, this payment represents the present value savings, as of December 2002, of a refunding on May 4, 2005, without issuing refunding bonds as of December, 2002. The swaption gives Citigroup (formerly of Salomon Brothers Holding Company, Inc.), the option to enter into an interest rate swap to receive fixed amounts and pay variable amounts. If the option is exercised, the City would then expect to issue variable-rate refunding bonds.

Terms: Citigroup has the option to exercise the agreement on May 4, 2005 – the City's 1995 water and sewer bonds' first call date. The swap also commence on the exercise date of May 4, 2005. Under the swap, the City pays a fixed payment of 4.53% and receives a variable payment computed as the actual bond rate or alternately, 68.5% of the USD-London Interbank Offered Rate (LIBOR)-BBA with a designated maturity of one month ("one month LIBOR"), in the event the average rate on the Bonds as a percentage of the one month as a percentage LIBOR has exceeded 68.5% for a period of more than 180 days. The rates are based on an amortizing notional schedule (with an initial notional amount of \$86.1 million), and when added to an assumption for remarketing, liquidity costs and cost of issuance will approximate the debt service of the "refunded bonds." As of June 30, 2007 the swap had a notional amount of \$84.4 million and the associated variable-rate bond has an \$84.4 principal amount. The bonds variable-rate coupons are not based on an index but on market conditions. The bonds, and the related swap agreement mature on August 1, 2018. As of June 30, 2007, the rates were as follows:

	Terms	Rates
Interest Rate Swap		
Fixed payment to Citigroup	Fixed	4.53%
Variable payment from Citigroup	Actual Bond Rate	(3.73%)
Net Interest Rate Swap payments		0.80%
Variable Rate bond coupon payments	Market Driven	3.73%
Synthetic interest rate on bonds		4.53%

Fair value: As of June 30, 2007, the swap had a negative fair value of \$4.3 million. Its fair value was estimated using the BDT option pricing model. This model takes into consideration probabilities, volatilities, time and underlying prices.

Market access risk and interest rate risk: As of June 30, 2007 the City is not exposed to credit risk because the swap had a negative fair value. Should interest rates change and the fair value of the swap become positive, the City would be exposed to credit risk in the amount of the swap's fair value. Should the variable rate received on the swap change from the actual bond rate to the alternative floating rate 68.5% of one month LIBOR, the City would be exposed to (i) basis risk, as reflected by the relationship between the variable-rate bond coupon payments and 68.5% of one month LIBOR received on the swap, and (ii) tax risk, a form of basis risk, where the City is exposed to a potential additional interest cost in the event that changes in the structure of the federal tax system or in the marginal tax rates causes the rate paid on the outstanding bonds to be greater than the 68.5% of LIBOR received on the swap. The swap uses the International Swap Dealers Association Master Agreement, which includes standard termination events. The Schedule to the Master Agreement includes an "additional termination event." That is, the swap may be terminated if Citigroup's or its Credit Support Provider, or the City has one or more outstanding issues of rated unsecured, unenhanced senior debt and none of such issues has a rating of at least (i) Baa3 or higher as determined by Moody's Investors Service, Inc., or (ii) BBB- or higher as determined by Standard & Poor's Ratings Service, A Division of the McGraw-Hill Companies, Inc., or (iii) an equivalent investment grade rating determined by a nationally-recognized rating service acceptable to both parties.

Swap payments and associated debt: As of June 30, 2007, debt service requirements of the variable-rate debt and net swap payments for their term, assuming current interest rates remain the same, were as follows. As rates vary, variable rate bond interest payments and net swap payments will vary.

Fiscal Year Ending June 30	Variable Rate Bonds		Interest Rate Swaps Net	Total Interest
	Principal	Interest		
2008	350,000	3,135,593	672,513	3,808,107
2009	370,000	3,121,855	669,567	3,791,421
2010	390,000	3,107,370	666,460	3,773,829
2011	405,000	3,092,310	663,230	3,755,540
2012	425,000	3,076,520	659,843	3,736,363
2013 - 2017	82,280,000	9,747,858	2,090,693	11,838,551
2018 - 2022	<u>165,000</u>	<u>513</u>	<u>110</u>	<u>623</u>
	<u>84,385,000</u>	<u>25,282,018</u>	<u>5,422,417</u>	<u>30,704,434</u>

Rate Lock (Swap) Agreement: The eleventh supplemental ordinance authorizes the City to issue up to \$325,000,000 in aggregate principal amount (exclusive of original issue discount) of additional Water and Wastewater Revenue Bonds (the "2008 New money bonds") under the general ordinance to finance certain capital projects of the Water department. The City originally anticipated issuing such bonds during Fiscal year 2008 and has entered into the 2007 Swap agreements (as described below) relating to \$180,000,000 aggregate principal amount of such bonds.

In connection with the anticipated issuance of the 2008 New money bonds, on February 21, 2007, the City entered into two separate forward starting interest rate swap transactions, each evidenced by an ISDA Master agreement, schedule and confirmation (collectively the "2007 Swap agreements," and together with the 2002 Swap agreement, the "Swap agreements" between the City and each of Merrill Lynch Capital Services, Inc. and Wachovia Bank, National Association (the "2007 Swap providers"). The 2007 Swap agreements are intended to hedge the interest rate risk on \$180,000,000 aggregate principal amount of the 2008 New money bonds, split equally between the 2007 Swap providers. Under the 2007 Swap agreements, commencing on February 1, 2008, the City will pay interest to the 2007 Swap providers on the notional amount thereof at a fixed rate of 3.999% and the 2007 Swap providers will pay interest to the City

on such notional amount at a variable interest rate equal to the Bond Market Association Rate (BMA) or the Securities Industry and Financial Markets Association Rate, each as defined therein.

The City's regularly scheduled payments under the Swap agreements are secured on a parity basis by a lien and a security interest in all Project Revenues for the benefit of each of the Swap Providers, as the Swap provider, and with respect to the 2002 Swap agreement, Financial Security Assurance Inc., as the bond insurer. All other obligations of the City under each of the Swap agreements, including payments due upon early termination of a Swap agreement, are secured by a lien on and security interest on all Project Revenues subordinate to the lien prescribed in the previous sentence.

Under certain conditions, each of the Swap agreements may be terminated prior to its stated termination date in which case the City may be obligated to make a substantial payment to, or may be entitled to receive a substantial payment from the applicable Swap provider. There can be no assurance that a Swap provider will pay or perform its obligations under the applicable Swap agreement in accordance with the terms thereof, or that Swap provider will be able to pay any termination payment which may be required to pay upon the occurrence of certain events of default or termination under the applicable Swap agreement.

The City recently extended the 2007 Rate Lock agreement until February 17, 2009. Plans to issue all or part of the planned 2008 New Money issue in February 2008 as originally planned have been delayed until sometime during the second half of FY 2009.

Subsequent events: In November, 2007 the Water Department purchased a surety bond to replace cash reserves in accordance with the water general ordinance. This transaction allowed the Water Department to transfer \$64 million from the Sinking Fund Reserve to be used for Water/Sewer projects.

15. PENSION PLAN

The City, via the Municipal Pension Plan, maintains the following employee retirement system:

- (1) City Plan
 - (a) Plan Description

The Philadelphia Home Rule charter (the Charter) mandates that the City maintains an Actuarially sound pension and retirement system. To satisfy that mandate, the City's Board of Pensions and Retirement maintains the single-employer Municipal Pension Plan (the Plan). The Plan covers all officers and employees of the City and officers and employees of five other governmental and quasi-governmental organizations. By authority of two Ordinances and related amendments passed by City Council, the Plan provides retirement benefits as well as death and disability benefits. Benefits vary by the class of employee. The Plan has two major classes of members – those covered under the 1967 Plan and those covered under the 1987 Plan. Both of these two plans have multiple divisions.

Retirement Benefits: An employee who meets the age and service requirements of the particular division in which he participates is entitled to an annual benefit, payable monthly for life, equal to the employee's average final compensation multiplied by a percentage that is determined by the employee's years of credited service. The formula for determining the percentage is different for each division. If fund earnings exceed the actuarial assumed rate by a sufficient amount, an enhanced benefit distribution to retirees, their beneficiaries, and their survivors shall be considered. A deferred vested benefit is available to an employee who has 10 years of credited service, has not withdrawn contributions to the system and has attained the appropriate service retirement age. Members of both plans may opt for early retirement with a reduced benefit. The Deferred Retirement Option Plan (DROP) was initiated on October 1, 1999. Under this plan, employees that reach retirement age may accumulate their monthly service retirement benefit in an interest bearing account at the Board of Pensions for up to four (4) years and continue to be employed by the City of Philadelphia.

Death Benefits: If an employee dies from the performance of duties, his/her spouse, children or dependent parents may be eligible for an annual benefit ranging from 15% to 80% of the employee's final average compensation. Depending on age and years of service, the beneficiary of an employee who dies other than from the performance of duties will be eligible for either a lump sum benefit only or a choice between a lump sum or an annual pension.

Disability Benefits: Employees disabled during the performance of duties are eligible for an immediate benefit equal to contributions plus a yearly benefit. If the employee subsequently becomes employed, the benefit is reduced by a percentage of the amount earned. Certain employees who are disabled other than during the performance of duties are eligible for an ordinary disability payment if they apply for the benefit within one year of termination. If the employee subsequently becomes employed, the benefit is reduced by a percentage of the amount earned.

Membership: Membership in the plan as of July 1, 2006 was as follows:

Employee Group	Number
Retirees and beneficiaries	
Currently receiving benefits	35,554
Terminated members entitled to	
Benefits but not yet receiving them	809
Active members	<u>28,017</u>
Total Members	<u>64,380</u>

The Municipal Pension fund issues a separate annual financial report. To obtain a copy, contact the Director of Finance of the City of Philadelphia.

(b) Funding Policy: Employee contributions are required by City Ordinance. For Plan 67 members, employees contribute 3.75% of their total compensation that is subject to Social Security Tax and 6% of compensation not subject to Social Security Tax. Plan 87 contribution rates are defined for the membership as a whole by Council ordinance. Rates for individuals are then determined annually by the actuary so that total individual contributions satisfy the overall rate set by Council.

The City is required to contribute the remaining amounts necessary to fund the Plan, using an acceptable actuarial basis as specified by the Home Rule Charter, City Ordinance and State Statute. Court decisions require that the City's annual employer contributions are sufficient to fund:

- The accrued actuarially determined normal costs;
- Amortization of the unfunded actuarial accrued liability determined as of July 1, 1985. The portion of that liability attributable to a class action lawsuit by pension fund beneficiaries (the Dombrowski suit) is amortized in level installments, including interest, over 40 years through June 30, 2009. The remainder of the liability is amortized over 34 years with increasing payments expected to be level as a percentage of each year's aggregate payroll;
- Amortization in level dollar payments of the changes to the July 1, 1985 liability due to the following causes over the stated period:
 - Non-active member's benefit modifications (10 years)
 - Experience gains and losses (15 years)
 - Changes in actuarial assumptions (20 years)
 - Active members' benefit modifications (20 years)

Under the City's current funding policy, the total required employer contribution for the current year amounted to \$477.5 million or 34.9 % of covered payroll of \$1,367.4 million.

Administrative costs of the Plan are paid out of the Plan's assets.

Annual Pension Cost and Net Pension Obligation

The City and other employers' annual pension cost and net pension obligation for the Municipal Pension Plan for the current year were as follows:

Annual Required Contribution (ARC)	527,925
Interest on Net Pension Obligation (NPO)	(71,541)
Adjustment to ARC	<u>99,953</u>
Annual Pension Cost	556,337
Contributions Made	<u>419,241</u>
Increase in NPO	137,096
NPO at beginning of year	(817,614)
NPO at end of year	(680,518)
Interest Rate	8.75 %
15-Year amortization Factor (EOY)	8.18 %

The actuarial valuation that was used to compute the current year's required contribution was performed as of July 1, 2006. Methods and assumptions used for that valuation include:

- The individual entry age actuarial cost method
- A five-year smoothed market value method for valuing investments
- A level percentage closed method for amortizing the unfunded liability
- An annual investment rate of return of 8.75%
- Projected annual salary increases of 5% (including inflation)
- Annual inflation of 2.75%
- No post-retirement benefit increases

Under the City's funding policy, the recommended contribution for the City for the current year amounted to \$477.5 million. The City's actual contribution was \$419.2 million. The City's contribution did meet the Minimum Municipal Obligation (MMO) as required by the Commonwealth of Pennsylvania's Acts 205 and 189. The Annual Pension Cost and related percentage contributed for the three most recent fiscal years are as follows:

Fiscal Year Ended	Annual Pension Cost	Percentage Contributed	Net Pension Obligation
June 30	(In Millions)		(In Millions)
2005	392.3	76.27%	(911.9)
2006	426.0	77.88%	(817.6)
2007	556.3	75.36%	(680.5)

(c) Summary of Significant Accounting Policies

Financial statements of the Plan are prepared using the accrual basis of accounting. Contributions are recognized as revenues when due, pursuant to formal commitments, as well as statutory or contractual requirements. Benefits and refunds paid are recognized when due and payable in accordance with the terms of the plan. Investments are valued as described in Footnote M.

16. POST EMPLOYMENT BENEFITS

In addition to providing pension benefits, the City provides certain post employment health care and life insurance benefits for retired employees, dependents and/or beneficiaries through provisions of City ordinances, civil service regulations and agreements with its various employee bargaining units. The City provides these benefits from one to five years after retirement depending upon the classification of the employee at his or her retirement. Substantially all of the City's employees may become eligible for those benefits if they reach normal retirement age while working for the City. These and similar benefits for active employees are provided through a combination of a self-insurance program and insurance companies whose premiums are based on the benefits paid during the year. The cost of providing these health benefits and life insurance for approximately 5,225 eligible retirees amounted to \$49.0 million and \$4.2 million respectively.

17. CLAIMS, LITIGATION AND CONTINGENCIES

Generally, claims against the City are payable out of the General Fund, except claims against the City Water Department, City Aviation Division, or Component Units which are paid out of their respective funds and only secondarily out of the General Fund which is then reimbursed for the expenditure. Unless specifically noted otherwise, all claims hereinafter discussed are payable out of the Water Fund. The Act of October 5, 1980, P.L. 693, No. 142, known as the "Political Subdivision Tort Claims Act," established a \$500,000 aggregate limitation on damages arising from the same cause of action or transaction or occurrence or series of causes of action, transactions or occurrences with respect to governmental units in the Commonwealth such as the City. The constitutionality of that aggregate limitation has been upheld by the United States Supreme Court. There is no such limitation under federal law.

Various claims have been asserted against the Water Department and in some cases lawsuits have been instituted. Many of these claims are reduced to judgment or otherwise settled in a manner requiring payment by the Water Department. At year-end, the aggregate estimate of loss deemed to be probable is \$1.5 million.

In addition to the above, there are other lawsuits against the Water Department in which some amount of loss is reasonably possible. The aggregate estimate of the loss, which could result if unfavorable legal determinations were rendered against the Water Department with respect to these lawsuits, is \$3.2 million.

18. ENHANCED SECURITY

In light of the events of September 11, 2001, when terrorists struck the United States, the Water Department has taken steps to improve the security of the City's water supply and all other major Water Department facilities and assets. These steps have been taken in close coordination with the City's Managing Director's Office and all other appropriate city agencies and departments. On October 11, 2002, the City of Philadelphia reopened the Emergency Operations Center, designed to permit city emergency personnel to respond quickly to any major event through specialized computer and communications equipment. This center is staffed around the clock by officials from the Police, Fire, and Health Departments, as well as the Water Department and additional city agencies. The Center has a backup 911 system, in addition to computer terminals that are able to communicate with all City enforcement and emergency personnel. Details of the enhanced security measures already taken and those presently under consideration cannot be presently disclosed.

It should be noted that the Water Department had an extensive water quality protection and security plan in place prior to the events of September 11, 2001. All finished water basins are completely covered; all plants are fenced in and topped by barbed wire; gates are secured; and the Water Department continues to draw and conduct nearly 1,000 tests on water samples from various locations each day.

Over the last several years the Department has completed the initiative to convert its disinfection facilities from liquid chlorine to sodium hypochlorite. This conversion was done for safety and security reasons and to eliminate certain costs and complications associated with the operation of these facilities.

Our staff hold leadership positions and participate in the American Water Works Association, National Association of Clean Water Agencies, Delaware River Basin Commission, Eastern Meter Management Association, Partnership for the Delaware Estuary, Coastal Zone Management Steering Committee for Pennsylvania, Water Environment Federation, Pennsylvania Department of Environmental Protection Water Advisory Council, and the Pennsylvania section of the American Water Works Association.



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