



Philadelphia
Water
Department

2010
Annual
Financial
Report

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Measurement	FY07	FY08	FY09	FY10	FY11 (Goals)
Millions of Gallons of Treated Water	95,374	93,679	91,747	91,560	94,170
Percent of Time Philadelphia's Drinking Water Met or Surpassed State & Federal Standards	100%	100%	100%	100%	100%
Miles of Pipeline Surveyed for Leakage	1,024	1,113	931	1,133	1,110
Water Main Breaks Repaired	824	687	802	646	850
Avg. Time to Repair a Water Main Break (hrs.)	7.6	7.6	7.6	7.8	8.0
Percent of Hydrants Available	99.7%	99.7%	99.7%	99.6%	99.7%
Number of Storm Drains Cleaned	76,478	75,804	77,012	72,802	111,444

Letter From the Commissioner



To our colleagues:

I am pleased to report that our Fiscal Year 2011 budget request was actually lower than our Fiscal Year 2010 appropriation. The Philadelphia Water Department (PWD) is committed to operating efficiently, effectively and sustainably. This means we carefully review and assess our operational functions to find smart, safe economies as well as more efficient ways to meet our State and Federal requirements. One major challenge this year is the management of energy costs, now that electric rate caps were removed. From construction of a solar energy demonstration program at our Southeast Water Pollution Control Plant to a

proposed biogas cogeneration project, we are utilizing new technologies and current assets to minimize these costs.

PWD is a municipal utility. This means 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.

Our commitment to providing utility services consistent with the highest level of customer expectation remains strong. Philadelphia's drinking water is safer than ever, substantially better than what State and Federal regulations require. In Fiscal Years 2009 and 2010, the purity of Philadelphia's drinking water, as measured by the industry standard of turbidity, greatly exceeded even the most stringent industry standards contained in the Partnership for Safe Water, a voluntary program between the EPA and the drinking water industry. In fact, PWD's three water treatment plants remain among an elite group of 31 facilities nationwide that have received the Director's Award from the Partnership for Safe Water for having met the Partnership goals for 10 consecutive years.

PWD is 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. Our three wastewater treatment plants will receive peak awards from the National Association of Clean Water Agencies for meeting permit requirements.

This annual financial report contains some of our accomplishments for Fiscal Year 2010. We continue to improve the credit rating of our revenue bonds, and all three of the major rating agencies (Moody's, Standard and Poor's and Fitch) currently rate the Department's debt in the A range.

Our commitments and accomplishments would not be possible without PWD's dedicated and professional staff, many of whom hold leadership positions 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 PA, Water Environment Federation, Pennsylvania DEP Water Advisory Council and the Pennsylvania section of the American Water Works Association.

Sincerely,

A handwritten signature in black ink, appearing to read "H. Neukrug". The signature is fluid and cursive.

Howard M. Neukrug, P.E.
Water Commissioner



Partnership for Safe Water

The Philadelphia Water Department (PWD) consistently produces high quality drinking water, substantially better than the drinking water quality standards set by State and Federal regulations. As a member of the Partnership for Safe Water since 1996, PWD has adopted, as standard practice, treatment goals far stricter than the regulatory requirements. In 2008, the Baxter, Queen Lane and Belmont Water Treatment Plants were honored with the Partnership for Safe Water 10-Year Director's Award in recognition of PWD's decade-long commitment to achieving and maintaining the highest possible drinking water quality.

Since 1998, the PWD average turbidity level (measure of water clarity) of

drinking water has been at or below 0.06 nephelometric turbidity units (NTU). The turbidity of Philadelphia's water is 80 percent less than the maximum of 0.30 NTU allowed by State and Federal regulations and is 40 percent less than the Partnership for Safe Water turbidity goal of 0.10 NTU.

The Partnership for Safe Water is a voluntary optimization program conceived and initiated by the U.S. Environmental Protection Agency, the American Water Works Association, the Association of Metropolitan Water Agencies and advocated by the Pennsylvania Department of Environmental Protection. Pennsylvania leads the nation in participation in this program and the Philadelphia Water Department is one of Pennsylvania's leaders.

Stormwater Management Service Charge – Transition to Parcel Based Charge

The Philadelphia Water Department (PWD) implemented the first phase of a parcel area based, Stormwater Management Service Charge (stormwater fee), which went into effect on July 1, 2010. This charge is applicable to all parcels that are within the City's limits, and is not a new charge to existing water/sewer customers.

The monthly fee is now assessed based on a parcel's gross area (lot size) and impervious area (compacted hard surface that prevents absorption of water), and is billed as a separate line item in the water/sewer/stormwater utility bill. In addition, properties

that do not have any water/sewer service are now assessed a monthly stormwater fee, as those properties also contribute stormwater runoff during rainstorms.

PWD has also established a credit program for those property owners who've seen an increase in their stormwater fees to mitigate the monthly bill impact due to this transition.

More information on our stormwater parcel based charge and credit program can be found at http://www.phila.gov/water/stormwater_billing.html.

Quality

Green City, Clean Waters: Combined Sewer Overflow Long-Term Control Plan Update

The Philadelphia Water Department (PWD) has committed approximately \$2 billion over the next 25 years to meet its Clean Water Act obligations to significantly reduce the release of stormwater combined with sewage into rivers and streams. Green City, Clean Waters is the Department's infrastructure management plan that will manage stormwater runoff in a way that significantly reduces the reliance on construction of additional underground infrastructure. To ensure this substantial, public investment results in clean and beautiful waterways while also providing tangible, additional benefits to Philadelphia's citizens, PWD is dedicating a large portion of the Green City, Clean Waters plan to a green stormwater infrastructure approach, the first of its kind in the United States.



PWD's green stormwater infrastructure includes a range of soil-water-plant systems that intercept stormwater, infiltrate a portion of it into the ground, evaporate a portion of it into the air, and in some cases, releases a portion of it slowly back into the sewer system. As a result, less stormwater enters the combined sewer system, ultimately reducing combined sewer overflows.

One of the green stormwater infrastructure programs that PWD has initiated is Green Homes. The Green Homes Program envisions a number of small scale solutions that homeowners can carry out themselves. In November, 2010, the Philadelphia Water Department (PWD), Rebuilding Together

Philadelphia (RTP) and State and local officials kicked-off the City's first "Green Homes" blocks on the 6000, 6100 and 6200 blocks of Spruce Street. The residents on these blocks volunteered their homes to pilot this program and



volunteers and residents installed rain barrels, downspout planters and rain gardens on the properties on these blocks. In addition, PWD will work with the residents over the next few years to monitor the effectiveness and enthusiasm for these stormwater-friendly practices.

Projects, such as the use of rain barrels, have already proven popular in pilot programs, and if implemented and maintained properly on a larger scale, can ultimately impact the health of our creeks and rivers. Additionally, more ambitious (and somewhat more costly) measures can also be considered, including the installation of a green roof or capturing stormwater in larger cisterns for reuse. By temporarily holding the stormwater runoff during a rain event, more capacity can be added to the City's sewer system.



As green stormwater infrastructure becomes the standard practice, we will systematically reduce the amount of stormwater runoff from the City's built environment every time we re-create or renew the urban landscape and streetscapes.



Water

Dobson's Run Storm Relief Sewer

On Tuesday, June 8, 2010, Deputy Mayor Rina Cutler, former Water Commissioner Bernard Brunwasser and other City officials, commemorated the completion of the Dobson's Run Storm Relief Sewer at the new scenic overlook on Kelly Drive.



The objective of building the Dobson's Run Storm Relief Sewer was to augment the existing 8' 6"-diameter brick storm sewer by building a new storm relief sewer and outfall. This new sewer was built in a rock tunnel approximately 100 feet below the ground surface to avoid disrupting the community and the numerous utilities located in the bed of the street.

The rock tunnel was constructed using a Tunnel Boring Machine (TBM). The unique tunnel alignment (L-shaped) included a 90-degree tunnel turn, which required that the TBM would have to be installed at each end of the tunnel and then backed out. The total weight of the TBM and trailing gear was close to 400 tons and the combined length was about 240 feet.

The tunnel crosses beneath the CSX railroad tracks and the Laurel Hill Cemetery, a National Historic Landmark and final resting place for General George Gordon Meade, Union Commander at Gettysburg, as well as several other Civil War



generals. The tunnel section ends on the east side of Kelly Drive and changes configuration to a box sewer, emptying out into the Schuylkill River.

The new 12' 6"-diameter concrete sewer is approximately 3500 feet in length and is located primarily underneath Allegheny Avenue. In addition, a scenic overlook with benches was built over top of the new outfall at the river to provide a nice amenity to users of the bike path which runs along the Schuylkill River.

The Dobson's Run Storm Relief Sewer, built upstream of the flood-prone areas, will augment the drainage capacity of the existing sewers in the area by capturing some of the stormwater and carrying it directly to the Schuylkill River, relieving flooding in the valley of the former Dobson's Run.





Environment

Water Pollution Control Plants: Southwest, Southeast and Northeast

In Calendar Year 2010, the Philadelphia Water Department's three Water Pollution Control Plants were selected to receive Peak Awards from the National Association of Clean Water Agencies (NACWA). NACWA's Peak Performance Awards program recognizes member agency facilities for excellence in wastewater treatment as measured by their compliance with their National Pollutant Discharge Elimination System (NPDES) permits.

The Northeast and Southeast Water Pollution Control Plants were recognized with

Platinum Awards. Platinum Awards pay special tribute to member agency facilities that have received Gold Awards for five consecutive years. Gold Awards recognize member agency facilities that achieve perfect compliance for an entire calendar year. The Northeast and Southeast plants have achieved perfect permit compliance for five and 11 years, respectively. Historically high flows in February 2010, contributed to the Southwest Plant receiving a violation for one NPDES parameter, which qualified the plant for a Silver award.

Fairmount Dam Fishway Facility

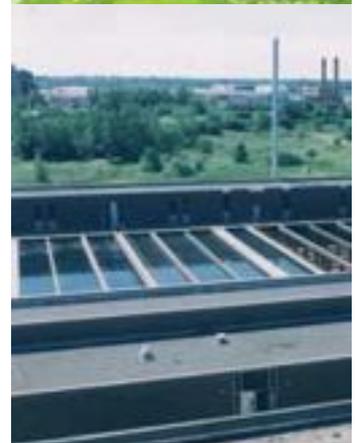
The 2010 fish passage season at the Fairmount Fishway was a record-breaking year, with a total of 22,620 fish representing 26 species that were documented using the Fairmount Fishway.

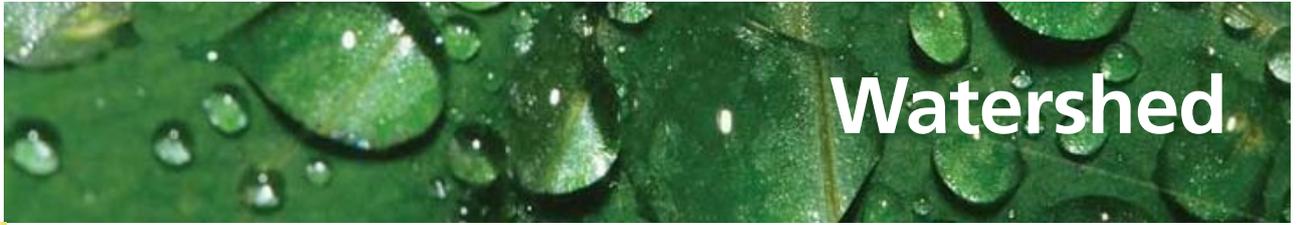
American shad had the highest ever recorded numbers with 2,521 ascending the Fishway. This number was more than seven times greater than passage numbers prior to the renovations in 2008. Hickory shad, listed as a State Endangered Species in Pennsylvania, also showed an increase in passage and exceeded all previous records. In addition to migratory species, fish passage for key resident species, such as Walleye, were the highest ever recorded and more than three times greater than pre-restoration.

From 2002 until the present, the Philadelphia Water Department (PWD) has maintained a robust monitoring program, quantifying the resurgence of key migratory species (e.g., American shad), assessing the relative health

and abundance of both resident and migratory fish, and evaluating the efficacy of restoration activities within the Fairmount Dam Fishway.

As the most downstream passageway, the Fairmount Dam Fishway is especially critical to the overall success of restoring migratory fish runs in the Schuylkill River Watershed. Therefore, all planned upstream fish passage projects will be affected by the success or failure of the Fairmount Dam Fishway at passing migratory species during spawning runs. Moreover, successful colonization of resident species is highly contingent upon minimizing the effects of fish barriers on movement. Post-restoration monitoring below the Fairmount Dam and within the Fishway has shown marked increases in both migratory and resident numbers. While these numbers are promising, it is the intention of PWD to continue its monitoring program until a healthy and sustainable fisheries community has been established.





Watershed Protection

Clean water needs clean land. Clean land means clean watersheds. A watershed encompasses 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, initiated 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.

Schuylkill and Delaware River 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 sources of contamination to Philadelphia's raw water supply and outline several approaches to reducing them. PWD has made exceptional progress accomplishing Plan goals, including prioritizing and promoting land for permanent protection, establishing a regional network of organizations, businesses and governments to work together to protect and enhance the Schuylkill River Watershed, supporting policies that preserve forests and emphasize water resource protection, and collaborating with the State of Pennsylvania to ensure regulations are enforced for wastewater treatment plants that discharge upstream of Philadelphia. Much progress has been made addressing threats to our water supply within Philadelphia's own boundaries, including storm drain markings, improved buffers in Fairmount Park to protect water quality, a goose deterrent program, and education about proper disposal of unused pharmaceuticals.

During the past year, the Source Water Program has conducted research to continue to improve our knowledge of Philadelphia's water supplies and to help further define priorities for watershed protection. This research includes an analysis of flows needed to protect PWD's Baxter Drinking Water Treatment Plant on the Delaware River from saltwater intrusion; a preliminary analysis of water use availability in the Schuylkill River; monitoring and evaluating natural gas development activity to ensure continued protection of our drinking water supply; and, tracking of major sources of human infectious pathogens such as *Cryptosporidium*. Information from the latter study will be used to develop a *Cryptosporidium* Watershed Control Program Plan for the Schuylkill River watershed. The Watershed Control Plan will help ensure PWD compliance with the EPA's Long-Term 2 Enhanced Surface Water Treatment Rule at the Queen Lane Drinking Water Treatment Plant.



Protection

Protecting Drinking Water Supplies

PWD is the owner and operator of the highly renowned Delaware Valley Early Warning System (EWS). The EWS is an integrated monitoring, notification, and communication system designed to provide advanced warning of surface water contamination events in the Schuylkill and lower Delaware River watersheds.

The EWS is comprised of four principal components; the EWS Partnership, the notification system, the monitoring network and the web-based database and portal. The EWS Partnership consists of stakeholders, which include representatives from both public and private drinking water treatment plants in the coverage area, industries who withdraw water from the Schuylkill and Delaware rivers for daily operations, the Federal government, and representatives of State government agencies from both PA and NJ. The notification system contains both automated telephone notification and web-based notification capabilities.

In order to further strengthen the monitoring and notification capabilities of the EWS, PWD recently implemented the following system enhancements:

- Integrating industrial users with intakes into the EWS partnership and



designing an industrial user fee based on withdrawal and position in the watershed;

- Adding the City of Philadelphia Office of Emergency Management (OEM) as an EWS member as part of a pilot expansion of the EWS partnership to include country OEMs;
- Creating the Spill Model Analysis Tool which allows users to test the travel time of a spill without generating an event that notifies other users. This effort incorporated the National Hydrologic Data stream network into all EWS mapping functionality, resulting in more accurate calculations of spill paths and travel times.

In addition to the above changes, PWD is currently in the process of developing a 5-year strategic plan for the EWS. Through the strategic planning process, PWD is evaluating the system's core functions, user base and potential funding sources. As of 2010, the EWS consists of 92 partner organizations with 286 individual members. During the past year, there were a total of 28 water quality events reported. Operation, maintenance and development costs during this period totaled \$351,994 and income from user fees totaled \$73,765.





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, 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 water distribution system consists of over 3,100 miles of water mains, 25,200 fire 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 collects

wastewater from our residential, commercial and industrial customers and carries it through our sewer system to our three water pollution control plants for treatment. The population served is 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

There is annual dedicated funding in place for the renewal of our water and wastewater distribution and collector system. This renewal program has been in place for over 20 years and has resulted in our current level of 230 breaks per 1,000 miles of water main compared to 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 the physical condition of our infrastructure to determine that the capital investment provided is adequate to ensure the integrity of the water supply distribution and collector systems.



Management

Geographic Information Systems

The full-scale conversion of City-wide 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.

Using GIS, we have converted all of our existing plans and specifications for all City-wide 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.

The GIS database will be the key component of our new work order/asset management system, Cityworks Server. This system is currently being piloted and tested by a select number of operational units and is scheduled to go live for the entire Department by the third quarter of 2011. CityWorks Server will replace and consolidate many outdated legacy systems. Work orders and service requests will be linked to a GIS feature in the database that will allow us to spatially track all aspects of our field operations and maintenance.

Sewer Assessment Program

The Philadelphia Water Department (PWD) is responsible for a wastewater and stormwater collection system that includes nearly 3,600 miles of sewers. The system is composed of sanitary, combined and storm sewers ranging in diameters from 8 inches to 22 feet. Most of these sewers are constructed of brick, concrete, terra cotta or vitrified clay pipe and are circular, box or egg-shaped. PWD has developed and pilot-tested the Sewer Assessment Program (SAP) and this program has become an ongoing part of the Department's capital improvement, operations and maintenance efforts.

The SAP is a systematic methodology used to:

- inspect and evaluate the sewers within the PWD wastewater collection system

- capture and analyze the resulting information in computerized databases
- apply a uniform protocol to prioritizing sewers for repair and replacement

As part of the development of the SAP, PWD's collection system staff was trained in inspection and evaluation techniques using industry standard methods and state-of-the-art techniques and equipment. The development of an electronic database and the handling of very substantive quantities of data, has also been an integral part of the SAP. The databases that were generated are currently integrated into PWD's GIS system. In its current form, the SAP serves as an evaluation and project prioritization technique for improvements to be made to the sewer collection system.



Public Education



The Fairmount Water Works Interpretive Center (FWWIC)

The Fairmount Water Works, a National Historic Landmark, once served as the City's second pumping station (1815 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, the FWWIC informs the public about Philadelphia's water resources and its role in protecting them.

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.

From billstuffers and brochures to our Water Quality Report and the Fairmount Water Works Interpretive Center, our Public Education and Outreach staff works to provide educational information to our customers of all ages.

Please visit our website, www.fairmountwaterworks.org, for more information about our exhibits and programs. We also invite you to Friend us on Facebook, and to follow us on Twitter at @FWWIC.

Over the past seven years, the Fairmount Water Works Interpretive Center (FWWIC) has become the region's premier ecotourism center and is recognized by the Pennsylvania Department of Environmental Protection as The Delaware River Basin's Official Watershed Education Center and as a Gateway Center for the Schuylkill River National and State Heritage Area. With more than 245,000 visitors to date, the Fairmount Water Works Interpretive Center has become the destination for innovative water and watershed education programming in the Delaware Valley.

Water in Our World is the overarching theme that unites the exhibits at the Fairmount Water Works Interpretive Center. Through the use of both high-tech interactive exhibits and user-friendly panels, visitors are engaged in learning about the many fascinating aspects of water by:

- Watching an award-winning film that tells the story of the Fairmount Water Works history;
- Flying on a virtual helicopter ride up the Delaware Bay to the headwaters of the Delaware and Schuylkill Rivers and learning how our activities on the land affect water quality;
- Witnessing a simulation of the rise and fall of tides in the Schuylkill River with an actual working model of the Fairmount Water Works;
- Going outside to cast a discerning eye at the river and calculate where the river is in the tidal cycle and collect a sample of river water;
- *Experiencing Seeing is Believing* in the FWWIC's state-of-the-art Water Lab where you can observe the teeming "unseen" life in a water sample at 400 times magnification;

and Outreach

Educating Our Public Protects Our Valuable Water Resources

- Visiting Pollutionopolis, America's dirtiest City;
- Following a flush through the City's sewer system;
- Making rain fall and seeing the affects of rainfall on the watershed; and
- Viewing fish and animals migrating up the Schuylkill River via a television camera installed in the new Fairmount Dam Fishway Facility located on the riverbank opposite the Interpretive Center.

School Programs Include:

- Water In Our World
- Land and Water: A Delicate Balance
- From Street to Stream: Slow the Flow
- Building as Machine: Water for the City
- Seeing is Believing: A Drop in the Bucket
- **New!** Green City, Clean Waters: Following Nature's Lead



Lifelong Learning:

To engage our adult audience, we offer guided group tours of both the historic Fairmount Water Works and the Interpretive Center's exhibits.

On a monthly basis, we offer the Schuylkill Soundings speakers' series, which presents lively and thought-provoking events featuring artists, writers and environmental professionals who share our passion for water.

On an annual basis, we celebrate the United Nations' World Water Day, Earth Day, Drinking Water Week and the Spring Shad Run. In addition, our collaboration with the Mayor's Office of Sustainability is helping Philadelphia reach its goal of being the nation's greenest City.

Visit Us Soon!

The Interpretive Center is located at 640 Water Works Drive, below the Art Museum. Our hours are Tuesday through Saturday, 10:00 am to 5:00 pm, and Sunday from 1:00 pm to 5:00 pm. We are closed on Mondays and City holidays. Admission is free.

The Center is ADA accessible. To schedule classroom tours or to check out the Center's Saturday Family Programs, Sunday Film Series, Schuylkill Soundings offering, visit our website: www.fairmountwaterworks.org.

Management Discussion and Analysis

The Water Department was established by the City pursuant to the City's Home Rule Charter with the power and duty to operate, maintain, repair and improve the Water and Wastewater Systems. The Charter requires the Water Department to fix and regulate rates and charges for supplying water and for wastewater treatment service in accordance with standards established by City Council. Such standards must enable the City to realize, from rates and charges, an amount at least equal to operating expenses and debt service charges on any debt incurred or to be incurred for the Water and Wastewater Systems, and proportionate charges for all services performed for the Water Department by all officers, departments, boards or commissions of the City. The Charter also authorizes the Water Department, with the authorization of City Council, to enter into contracts for supplying water service and sewer and sewage disposal service to users outside the limits of the City.

The operations of the Water Department are accounted for in the Water Fund, which is an enterprise fund of the City. The Water Fund is an accounting convention established pursuant to the Charter for the purpose of accounting for the assets, liabilities, revenues, expenses and Rate Covenant compliance on a legally enacted basis for the Water and Wastewater Systems. The Water and Wastewater Funds are funds required by the 1993 General Water Revenue Bond Ordinance to be established and maintained with the Fiscal Agent for so long as the Revenue Bonds authorized under the ordinance are outstanding. Under the ordinance, Water Fund Bond proceeds and Project Revenues must be segregated from other funds of the City.

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 Water Department, which began water system service in 1801, supplies water to the City and a portion of each of Montgomery, Delaware and Bucks Counties, Pennsylvania, and wastewater service to the City and to ten municipalities and authorities located in Montgomery, Delaware and Bucks Counties, Pennsylvania. The population

served by the water system was approximately 1,728,900 as of the 2000 census, of which 1,518,000 were in the City, 154,000 were in Bucks County and approximately 56,900 were in Montgomery and Delaware Counties. The population served by the wastewater system was approximately 2,218,000 as of the 2000 census, of which 1,518,000 were in the City and 700,000 were in the suburbs.

Administration

The Water Department is managed by a Commissioner appointed by the Managing Director of the City with the approval of the Mayor. The Commissioner appoints deputies with the approval of the City's Managing Director; substantially all other employees of the Water Department are appointed under the provisions of the City's Civil Service Regulations.

The City's Department of Revenue performs all functions relating to meter reading, customer accounts and collections for the Water Department through the Water Revenue Bureau. The Department of Revenue and the Water Revenue Bureau are under the direction of the Director of Finance. The Director of Finance, as the chief financial, accounting and budget officer of the City, has overall responsibility for the fiscal administration of all City departments, including the Water Department. Audits of all City departments, including the Water Department, are performed annually by the Office of the City Controller. The Law Department of the City, headed by the City Solicitor, handles all legal matters affecting the Water Department.

Water and Wastewater Systems

The water and wastewater systems of Philadelphia are owned by the City and operated by the City's Water Department. The water system provides water to the City (130 square mile service area), to Aqua Pennsylvania, Inc., formerly Philadelphia Suburban Water Company, and to the Bucks County Water and Sewer Authority. The City obtains approximately 58 percent of its water from the Delaware River and the balance from the Schuylkill River. The water system serves approximately 472,600 accounts through 3,137 miles of mains, three water treatment plants, 15 pumping stations and provides fire protection through more than 25,200 fire hydrants.

The wastewater system services a total of 360 square miles of which 130 square miles are within the City and 230 square miles are in suburban areas. There are approximately 471,000 accounts. The wastewater and stormwater systems contain three water pollution control plants, 17 pumping stations and approximately 3,652 miles of sewers. Based on its current NPDES discharge permit, the City is required to achieve effluent limitations that are considered more stringent than those required to achieve secondary treatment levels as defined in the Federal Water Pollution Control Act, as amended.

PWD's three water treatment plants deliver approximately 260 million gallons of top quality drinking water each day. The Department performs more than 350,000 tests annually at these plants to ensure consistent, optimal treatment and a healthy water supply. In addition, thousands of samples of tap water are analyzed annually at the Department's state-of-the-art testing laboratory. These samples are collected from City reservoirs and from more than 65 locations throughout the Philadelphia area as well as monitoring water flows and pressures at 40 locations throughout the City.

The Department also treats wastewater at its three water pollution control plants. These plants treat approximately 490 million gallons of wastewater per day that meet or exceed Federal and State standards, protecting and preserving our precious waterways. The Philadelphia Water Department also operates a central laboratory facility, and a range of technical and administrative support services.

Effective November 9, 2009, the Water Department entered into a contract with the Philadelphia Authority for Industrial Development to assume ownership and control of the public water and sewer system located within the former Philadelphia Naval Shipyard. The Philadelphia Navy Yard consists of approximately 1,100 acres of land,

which was the Philadelphia Naval Shipyard and Naval Station from 1875 to 1995. The Navy officially closed the Philadelphia Navy Yard in 1995 and turned the property over to the City of Philadelphia, namely Philadelphia Authority for Industrial Development (PAID). The City at that time tasked the Philadelphia Industrial Development Corporation (PIDC) with the job of redeveloping the Navy Yard.

The Navy Yard contains approximately 38 miles of water mains, 21 miles of sewers and 60 miles of stormwater conduit. The water system contains approximately 1,220 valves, 92 potable water hydrants and a pump station. The wastewater system contains approximately 1,340 manholes, three small lift stations and one large pump station.

In 2007, the City created the New River City program using \$67 million of Water Department Debt Service Reserve funds. These funds were required to be used for water, wastewater, and/or stormwater purposes. Approximately \$60 million were allocated to PIDC for use at the Navy Yard to improve these systems. Several infrastructure improvement contracts are currently underway. Overall, the improvement projects are about 2/3 complete.

The management of the Water Department 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 1.10, and a net operating revenue bond coverage ratio of 1.19 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 \$755.2 million resulting from an excess of its assets over its liabilities; its unrestricted net assets showed a balance of \$168.5 million.

The Water Fund's net assets showed an increase of \$39.3 million during the current fiscal year compared with \$6.7 million for the prior fiscal year.

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 \$755.2 million.

Capital assets, such as land, buildings, meters, water mains and sewer lines, less any outstanding debt issued to acquire these assets, comprise \$225.6 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, \$361.1 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 \$168.5 million.

Bond Issuance

On April 15, 2010, PWD settled on \$396,460,000 in refinancing revenue bonds. The bonds were issued as the City of Philadelphia, Pennsylvania-Water and Wastewater Revenue Bonds, Series 2010A. These bonds were used to refinance the Series 2003 City



of Philadelphia, Pennsylvania-Water and Wastewater Revenue Bonds and to pay costs related to the transaction. The Series 2003 Bonds were insured by AGM with Dexia as the liquidity provider. The liquidity facility expired on April 1, 2010 and was not renewed by Dexia. The City refunded the Series 2003 Bonds with the proceeds of the Series 2010A Bonds and terminated the Series 2003 Swap as further described in the forepart of the Official Statement for this transaction.

The bonds were issued at true interest cost of 3.384965%. The final bond maturity was accelerated to 2019 with a bond yield of 4.11%. The 2010A issue included both insured (AGM) and uninsured bonds. As part of the transaction, the Department received confirmation of its existing bond ratings from each of the three major bond rating agencies. Copies of the bond official statement and the rating agency reports are available on our website.

Bond Restructuring

On July 1, 2009, the Department successfully completed its "remarketing" of the Series 2005b bonds. The remarketing involved the removal of DEPFA as liquidity provider and FSA as bond insurer and the substitution of Bank Of America, NA to provide both liquidity and credit enhancement via a direct pay letter of credit. Details of the transaction are more fully described in the reoffering circular which was issued in connection with this transaction and is available on the Department's internet site.

Termination of Rate Lock (Swap) Agreement

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 extended by the City until August, 2010.

The eleventh supplemental ordinance (#060620) authorized 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 "2009 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. The 2009A new money issue was also authorized under this ordinance.

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 a Confirmation, as amended on February 10, 2009 (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 August 1, 2010, if the City issues new money variable rate bonds, the City will make regularly scheduled payments to the 2007 Swap providers on the notional amount thereof at a fixed rate of 4.52275%, and the 2007 Swap providers will make regularly scheduled payments to the City on such notional amount at a variable rate equal to the Bond Market Association Rate or the

Securities Industry and Financial Markets Association Rate.

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 it may be required to pay upon the occurrence of certain events of default or termination under the applicable Swap agreement.

On June 30th, 2010, one of the two forward-starting Swap "rate lock" agreements with Merrill Lynch & Co. was terminated. A termination fee of \$15,198,000 was paid and is included in debt service expense on the modified cash basis income statement. The City completed the termination of the second Swap in August, 2010, in conjunction with the issuance of the 2010C-D bonds described below.

Authorized and Unissued Bonds:

During FY2007, the Department was authorized to issue additional Water and Wastewater Revenue Bonds in the aggregate principal amount of \$325,000,000 under ordinance 060620. A portion of these bonds have not yet been issued and are planned to be issued in August, 2010, as the Series 2010C-D Water & Wastewater Revenue Bonds at a maximum par amount of \$185,000,000. 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, 2009, the City extended its forward-starting Swap "rate lock" agreement with two counterparties for \$180,000,000 of these bonds. These agreements had an execution date of not later than August 1, 2010, unless further extended by the parties.

The Department is also authorized for the issuance of \$135,000,000 in additional new money bonds under the 12th supplemental ordinance (no. 090321). The current capital spending plan calls for the issuance of these bonds in early FY 2014.

Pennvest Loans

During fiscal years 2009 and 2010, the Water Department settled on several new Pennvest (the Pennsylvania State Infrastructure Financing Authority) Loans.

These loans are more fully described in the "Pennvest Loans" section of the footnotes attached to the financial statements.

Subsequent Events

On August 4, 2010, PWD settled on \$185,000,000 in new money revenue bonds. The bonds were issued as the City of Philadelphia, Pennsylvania Water and Wastewater Revenue Bonds, Series 2010C.

This transaction is more fully described in the "Subsequent Events" section of the footnotes attached to the financial statements.

Water and Wastewater Rates

In terms of rates, the Philadelphia Water Department 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 Department has initiated numerous measures to improve service, reduce costs and enhance revenues over the past decade. The cost of operating the wastewater facilities has been reduced. The refinancing of more than \$2 billion in revenue bonds has resulted in a cumulative net present value savings in excess of \$78 million in debt service expense. A Revenue Protection Unit created in fiscal year 2000 has recovered more than \$20 million in previously unbilled revenue to date. The Department has steadily improved the credit rating of the revenue bonds. All seven of the major plant facilities have been winning national performance awards on an annual basis.

In April of 2008, the Water Department announced a revision of rates for the period covering FY09 through FY12. After conclusion of the rate process, the Commissioner issued his opinion granting rate increases on November 1, 2008, July 1, 2009, July 1, 2010 and July 1, 2011. The new rates enable the Philadelphia Water Department to meet its obligations under the City Charter of having a balanced budget through June 2012 and to meet its bond covenants. The new rates will allow the Water Department to meet rapidly escalating costs of fuel, chemicals, employee benefits, regulatory demands and debt service, and to continue a variety of initiatives that are critical to protecting Philadelphia's drinking water quality, preserving its waterways and improving stormwater management programs. The continuing demographic changes in the City are causing the Department's fixed costs (to maintain water mains, sewer mains, pumping stations, treatment plants, sewer inlets, etc.) to be spread over fewer customers.

Beginning July 1, 2009, a typical residential customer's bill increased by an additional \$3.40 a month, for a total monthly bill of \$56.24. This change was for the period of July 1, 2009 to June 30, 2010. A typical senior citizen's monthly bill increased by an additional \$2.02, or a total monthly bill of \$35.03, for those seniors who qualify for the Department's 25-percent senior citizen discount. The income test to qualify for this discount was increased to \$28,900 on July 1, 2009. In addition, the Department has adopted rate changes to be phased in for fiscal years 2011 and 2012. These changes include:

- \$3.20 increase in the typical monthly bill (total monthly bill \$59.44) from July 1, 2010 to June 30, 2011; and
- \$3.49 increase in the typical monthly bill (total monthly bill \$62.93) from July 1, 2011 to June 30, 2012.

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. As shown on the table at the top of page 15, PWD's water rates are less than half those charged by many neighboring investor-owned utilities.

2010 Regional Residential* Water and Sewer Charges		
	Monthly Water Bill	Monthly Sewer Bill
Aqua Pennsylvania+	\$60.42	N/A
Pennsylvania American Water+	\$54.31	N/A
New Jersey American Water+	\$37.18	N/A
North Penn Water Authority+	\$25.08	N/A
North Wales Water Authority+	\$22.85	N/A
Doylestown Township	\$31.54	\$42.15
Lower Gwynedd Municipal Authority**	N/A	\$33.16
CCMUA (Camden County)**	N/A	\$26.25
Trenton	\$30.25	\$28.93
Philadelphia Water Department	\$26.84	\$19.12

Rates in effect on November 8, 2010. Stormwater charges (\$13.48) are excluded from sewer calculations, 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

Historical Rates

The following table shows monthly water and sewer rates, based, in each case, on a typical customer with a 5/8 inch meter using 700 cubic feet or 5,236 gallons monthly.

Philadelphia Water Department Monthly Water and Sewer Rate Charges				
EFFECTIVE DATE	WATER	SEWER	TOTAL	PERCENTAGE INCREASE
07/01/1993	\$10.61	\$23.52	\$34.13	N/A
07/01/1994	10.86	24.06	34.92	2.3%
07/01/1995	11.20	24.80	36.00	3.1
09/04/2001	12.16	24.77	36.93	2.6
07/01/2002	13.75	24.48	38.23	3.5
07/01/2003	15.06	23.60	38.66	1.1
02/01/2005	17.63	25.94	43.57	12.7
08/01/2005	18.06	26.32	44.38	1.9
07/01/2006	19.41	27.94	47.35	6.7
07/01/2007	20.36	28.99	49.35	4.2
11/01/2008	22.29	30.55	52.84	7.1
07/01/2009	24.56	31.68	56.24	6.4
07/01/2010	26.84	32.60	59.44	5.7
07/01/2011	29.37	33.57	62.94	5.9

Bond Ratings

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

City of Philadelphia's Bond Ratings General Obligation and Revenue Bonds			
	Moody's Investor's Service	Standard & Poor's Corporation	Fitch IBCA
General Obligation Bonds	A1*	BBB	A- **
Water & Sewer Revenue Bonds	A1*	A	A+ **
Aviation Revenue Bonds	A2	A+	A

*Ratings were recalibrated by Moody's on April 23, 2010
 ** Ratings were recalibrated by Fitch April 30, 2010

The following excerpt accompanied the reaffirmed A1 rating of Moody's Investor's Service issued on July 19, 2010:

The management team of this large combined water and wastewater system has produced strong operational and financial performance over the past decade. Operational achievements include continued improvements in environmental compliance, the launch of a proactive water main replacement program that has significantly reduced the number of main breaks, and the installation of automatic meters for a significant proportion of residential customers. In addition to the improved accuracy of billing, the billing cycle was accelerated to a monthly basis, and both of these improvements have led to an increase in 120-day payment patterns. Operating costs have been well-managed, with significant reductions in some areas such as contracted electricity costs and a projected \$197 million in savings over the life of a contract for the management outsourcing of the biosolids recycling center. As discussed in detail below, 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 July 2010:

The underlying 'A+' rating for the combined water and wastewater system (the system) reflects independent rate-setting authority and an affordable rate structure, manageable capital needs relative to the overall size of the system and its customer base, ample water supply coupled with substantial treatment capacity at all facilities and a relatively stable service area.

The following excerpt accompanied the upgrade to the A rating of Standard & Poor's:

The stable outlook reflects Standard & Poor's opinion of the Water Department's improved financial position and operations, which we expect management will continue to maintain due to its conservative budgeting practices.

Fund Balances

During FY 2010, the Department withdrew \$2.7 million from its Rate Stabilization Fund, bringing the cumulative fund balance to approximately \$145.7 million, all of which is available to provide necessary working capital to the Department and to offset future rate increases. In addition, approximately \$18.9 million was transferred to the Residual Fund and \$16.5 million was transferred from the Residual Fund to the Capital 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 \$271.3 million to its capital fund via its annual 1% transfer and \$87.4 million via additional discretionary transfers to capital from its Residual Fund.

Maintaining excellence in water purity standards

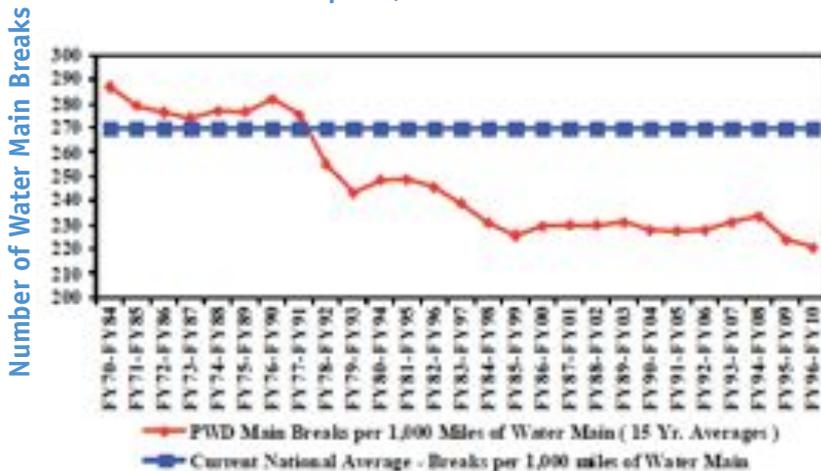
Philadelphia's drinking water meets or surpasses the requirements of State and Federal standards 100 percent of the time. Since voluntarily joining the U.S. Environmental Protection Agency's (EPA) Partnership for Safe Water (PFSW) in 1996 (a joint program of the EPA and the water industry), the PWD has committed itself to reduced "turbidity," an industry standard measure of water purity. In FY10, 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 Philadelphia Water Department's three water treatment plants are among an elite group of 31 facilities that have received the Director's Award from the Partnership for Safe Water for meeting the Partnership goals for 10 consecutive years. To put this in perspective, there are over 400 water treatment plants enrolled in the PFSW and there are over 4,700 water utilities nationwide.

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 FY10, 16 miles of water mains were replaced.

As shown in the chart below, the PWD's FY96-FY10 fifteen-year moving average level of 221 breaks per 1,000 miles is less than the national average of 270 breaks per 1,000 miles, and is the lowest level in more than 20 years.

Main Breaks per 1,000 Miles of Water Main



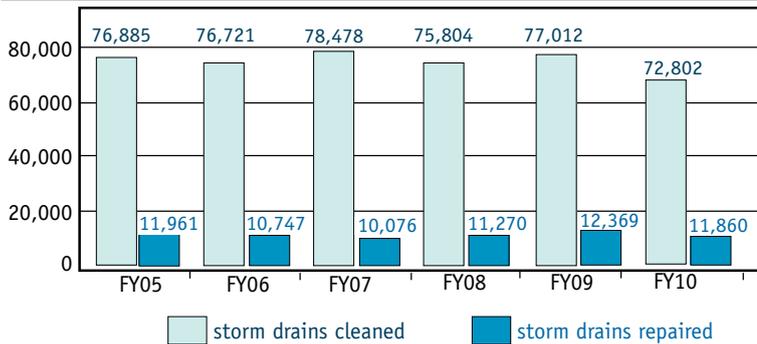
Reducing unbilled or non-revenue water

PWD maintains programs to reduce uncaptured revenue and loss of treated water from the distribution system. Over the past 15 years, PWD has cut non-revenue water by 45 percent, from 133 million gallons per day (mgd) to 73 mgd at the close of FY09. PWD continued a number of successful loss control initiatives in FY09, including a leak detection and repair program that surveyed 953 miles of pipeline for leaks, and abated over 31 mgd of leakage, representing a cost savings of over \$1,700,000. PWD completed the 3-year pilot phase of its first permanent District Metered Area (DMA) which includes pressure control features to reduce the occurrence of leakage and water main breaks. The results of this project have been impressive, saving over one million gallons of water per day for an annual savings of \$55,000 with full payback projected by 2013. PWD is also one of the few water utilities in the United States employing inline leak detection services on its large-diameter transmission pipelines as a strategy to detect leaks before they become catastrophic ruptures. Through October 2010, a total of 63 leaks on almost 30 miles of large pipelines have been identified and most have been repaired. 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 almost \$21 million since its inception in 2000. Going forward, water loss control activities are keying on investigation of customer meter application and accuracy for large commercial and industrial customers, which, while small in number, account for a relatively large portion of the water consumed in the City of Philadelphia.

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 79,500 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 FY10, PWD cleaned 72,802 storm drains. In addition, the Department reconstructed 11,860 storm drains. As shown on the following chart on page 17, the PWD has maintained a high level of performance in these two important areas, and aims to clean each storm drain at least once per year.

Productivity Enhancements Led to More Storm Drains Cleaned & Repaired



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 FY10, PWD received 424 conceptual submittals for zoning permits and 384 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. The program has approved over 1,500 acres of proposed development. Based on this area, approximately 1.5 billion gallons of stormwater runoff is managed annually, reducing excess burden and stress on the City’s stormwater infrastructure and treatment plants.

Sinking Fund Reserve Substitution

In late November, 2007, a partial substitution in the amount of \$67 million was completed. AGM was contracted to provide the surety policy. At that time, the transaction costs were paid and the balance of the funds (\$64,325,000) were deposited into the Residual Fund-Special Water Infrastructure Account as required by the Ordinance. No provision was included in either the fiscal year 2009 or fiscal year 2010 Water Fund budget for additional substitutions.

As part of the New River City program, the Water Department executed a program agreement with PAID to provide program management and oversight. To date, eight asset acquisition agreements totaling \$83,697,833 have been executed (actual disbursements will be limited to the \$64,325,000 in currently available funding and may be supplemented with the “Pennworks” grant/loan discussed herein). Four of the eight projects are substantially completed; final disbursement has been made on two of these, and the other two are in process. The other four projects are underway and are expected to be completed within the next 12 months. As described in a preceding section, the transfer of the water and sewer utilities at PNBC from PAID to the Water Department, including the projects outlined above, occurred in November, 2009.

Approximately \$16.2 million was paid to PIDC during FY 2010 for this project.

Bond Insurance Ratings

On November 21, 2008, Moody’s Investor’s Service Inc. (“Moody’s”) reduced the Aaa insurance financial strength of FSA and its affiliated insurance operating companies to Aa3 with developing outlook. An explanation of the significance of any rating action should be obtained from the rating agency furnishing same.

FSA currently meets the credit rating requirements prescribed by the General Ordinance with respect to eligible providers of supply policies for deposit in the Debt Reserve Account. The City and the Water Department are monitoring the financial condition and ratings of FSA in relation to such credit quality requirement, and are considering all options currently available to ensure continued compliance in this respect.

Protecting Drinking Water Supplies

PWD is the owner and operator of the highly renowned Delaware Valley Early Warning System (EWS). The EWS is an integrated monitoring, notification and communication system designed to provide advanced warning of surface water contamination events in the Schuylkill and lower Delaware River watersheds.

The EWS is comprised of four principal components; the EWS Partnership, the notification system, the monitoring network and the web-based database and portal. The EWS Partnership consists of stakeholders, which include representatives from both public and private drinking water treatment plants in the coverage area, industries who withdraw water from the Schuylkill and Delaware rivers for daily operations, the Federal government, and representatives of State government agencies from both PA and NJ. The notification system contains both automated telephone notification and web-based notification capabilities.

In order to further strengthen the monitoring and notification capabilities of the EWS, PWD recently implemented the following system enhancements:

- Integrated industrial users with intakes into the EWS partnership and designing an industrial user fee based on withdrawal and position in the watershed;
- Added the City of Philadelphia Office of Emergency Management (OEM) as an EWS member as part of a pilot expansion of the EWS partnership to include county OEMs;
- Created the Spill Model Analysis Tool which allows users to test the travel time of a spill without generating an event that notifies other users. This effort incorporated the National Hydrologic Data stream network into all EWS mapping functionality, resulting in more accurate calculations of spill paths and travel times.

In addition to the above changes, PWD is currently in the process of developing a 5-year strategic plan for the EWS. Through the strategic planning process, PWD is evaluating the system's core functions, user base and potential funding sources. As of 2010, the EWS consists of 92 partner organizations with 286 individual members. During the past year, there were a total of 28 water quality events reported. Operation, maintenance and development costs during this period totaled \$351,994 and income from user fees totaled \$73,765.

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. In 1997, PWD submitted its Combined Sewer Overflow Long-Term Control Plan (CSOLTCP) to the PA Department of Environmental Protection. These plans included the incorporation of Nine Minimum Controls (NMCs) – using industry-accepted best practices to efficiently operate and maintain our sewer system, in addition to the identification of \$48 million of capital improvement projects that would ensure localized capture and storage of wet weather flows within the existing sewer collection system. These efforts successfully reduced overflow volume by three percent or six billion gallons a year. Initial efforts were focused on 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.

The final component of the CSOLTCP embraces the development of regional watershed partnerships committed to the development of Integrated Watershed Management Plans (IWMPs). These plans are guided by a 20-year vision to restore our region's waterways to fishable, swimmable and beautiful rivers and streams that are life-sustaining and are an amenity to our communities.

In September 2009, the Philadelphia Water Department released its Green City, Clean Waters plan for meeting its CSOLTCP to meet its regulatory obligations while also looking to ensure that investments in the stormwater system also help to revitalize Philadelphia environmentally. The Department determined that a green stormwater management infrastructure approach would provide maximum return in environmental, economic and social benefits within the most efficient timeframe. Green stormwater infrastructure includes: planters, rain barrels, green roofs, permeable pavements, an enhanced network of street trees and restored creek corridors. Over the next five years, the PWD will lay the foundation for achieving the Green City, Clean Waters vision over the full 20-year implementation period of this plan and beyond.

Waterways Restoration Program

In FY04, the PWD created the Waterways Restoration Team (WRT), which consists of four 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 and streambanks that contain exposed infrastructure. In addition, these teams maintain a number of green infrastructure Best Management Practices (BMPs) that have been installed by PWD and are recognized as a component of the Department's sewer collection system. In FY08, the teams removed 346 tons of debris including 41 cars, 1,969 tires and 83 shopping carts from Philadelphia's streams. In FY09, 658 tons of debris was removed, and in FY10 1,437 tons were removed. A large component of the team's mission is to work in partnership with the Fairmount Park Commission 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.

Awards and Recognition

The Philadelphia Water Department and the Partnership for the Delaware Estuary Inc. presented "Healthy Stream, Healthy City, Healthy World" at the 2010 Philadelphia Flower Show. A rendition of a reclaimed stream was featured in the exhibit to demonstrate the extensive environmental benefits they provide as well as their ability to enrich our City's natural beauty, fish, wild life and water quality.

In fiscal year 2010, the Philadelphia Water Department's three Water Pollution Control Plants were selected to receive Platinum Awards from the National Association of Clean Water Agencies (NACWA). The Southwest Water Pollution Control Plant was recognized for seven years of perfect permit compliance, the Southeast Water Pollution Control Plant was recognized for ten years of perfect permit compliance and the Northeast Water Pollution Control Plant achieved Platinum status for recording the required five years of perfect compliance. NACWA's Peak Performance Awards program recognizes member agency facilities for excellence in wastewater treatment as measured by their compliance with their National Pollutant Discharge Elimination System (NPDES) permits. Platinum Awards pay special tribute to member agency facilities that have received Gold Awards for five consecutive years.

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, 2010 AND 2009

(amounts in thousands)

	2010	2009
ASSETS		
Current Assets:		
Cash on Deposit and on Hand	\$ 30	\$ 30
Equity in Treasurer's Account	69,795	56,445
Due from Other Governments	373	456
Accounts Receivable	225,170	209,454
Allowance for Doubtful Accounts	(90,980)	(89,845)
Inventories	12,913	12,800
Prepaid Insurance – Surety Bond	--	--
Total Current Assets	<u>217,301</u>	<u>189,340</u>
Noncurrent Assets:		
Restricted Assets:		
Equity in Treasurer's Account	290,282	377,704
Sinking Funds and Reserves	117,852	116,075
Grants for Capital Purposes	--	--
Deferred Outflow–Financial Instruments	29,227	--
Receivables	898	1,145
Total Restricted Assets	<u>438,259</u>	<u>494,924</u>
Net Pension Asset	17,371	37,878
Capital Assets:		
Land	5,919	5,919
Infrastructure	1,983,922	1,915,671
Construction in Progress	204,591	151,517
Buildings and Equipment	1,497,507	1,461,682
Accumulated Depreciation	(1,880,592)	(1,808,339)
Total Capital Assets	<u>1,811,347</u>	<u>1,726,450</u>
Total Noncurrent Assets	<u>2,266,977</u>	<u>2,259,252</u>
Total Assets	<u>2,484,278</u>	<u>2,448,592</u>
LIABILITIES		
Current Liabilities:		
Vouchers Payable	25,043	9,172
Accounts Payable	8,388	7,761
Salaries & Wages Payable	3,641	3,320
Construction Contracts Payable	33,113	8,224
Accrued Expenses	19,292	18,416
Deferred Revenue	8,016	7,478
Funds Held in Escrow	--	2,820
Current Portion of Long-Term Obligations	102,862	94,778
Total Current Liabilities	<u>200,355</u>	<u>151,969</u>
Noncurrent Liabilities:		
Long-Term Obligations	1,555,568	1,623,779
Unamortized Discount and Loss	(81,322)	(66,395)
Derivative Instrument Liability	29,227	--
Other Noncurrent Liabilities	25,256	23,343
Total Noncurrent Liabilities	<u>1,528,729</u>	<u>1,580,727</u>
Total Liabilities	<u>1,729,084</u>	<u>1,732,696</u>
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	225,589	190,535
Restricted For:		
Capital Projects	97,580	87,404
Debt Service	117,852	116,075
Rate Stabilization	145,693	147,637
Unrestricted	168,480	174,245
Total Net Assets	<u>\$755,194</u>	<u>\$715,896</u>

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS FOR THE FISCAL YEARS ENDED JUNE 30, 2010 AND 2009

(amounts in thousands)

	2010	2009
Operating Revenues:		
Charges for Goods and Services	\$546,361	\$494,087
Miscellaneous Operating Revenues	<u>5,989</u>	<u>5,566</u>
Total Operating Revenues	<u>552,350</u>	<u>499,653</u>
Operating Expenses:		
Personal Services	106,120	110,324
Purchase of Services	68,613	85,553
Materials and Supplies	35,429	38,795
Employee Benefits	71,634	81,855
Indemnities and Taxes	5,126	5,859
Depreciation and Amortization	<u>86,490</u>	<u>83,996</u>
Total Operating Expenses	<u>373,412</u>	<u>406,382</u>
Operating Income (Loss)	<u>178,938</u>	<u>93,271</u>
Nonoperating Revenues (Expenses):		
Operating Grants	3,048	583
Interest Income	6,015	21,252
Net Pension Obligation	(20,506)	(7,401)
Debt Service - Interest	(103,619)	(100,254)
Other Expenses	<u>(4,967)</u>	<u>(16,741)</u>
Total Nonoperating Revenues (Expenses):	<u>(120,029)</u>	<u>(102,561)</u>
Income (loss) before Transfers	58,909	(9,290)
Transfers Out	(28,315)	(4,185)
Capital Contributions	--	--
Change in Net Assets	<u>30,594</u>	<u>(13,475)</u>
Net Assets - Beginning of Period	715,896	722,606
Adjustment	<u>8,704</u>	<u>6,765</u>
Net Assets - End of Period	<u>\$755,194</u>	<u>\$715,896</u>

STATEMENT OF CASH FLOWS, JUNE 30, 2010

(amounts in thousands)

	2010	2009
Cash Flows from Operating Activities		
Receipts from Customers	\$535,572	\$492,875
Payments to Suppliers	(89,110)	(122,952)
Payments to Employees	(175,309)	(190,137)
Claims Paid	(4,915)	(5,100)
Other Receipts (Payments)	--	--
Net Cash Provided by Operating Activities	<u>266,238</u>	<u>174,686</u>
Cash Flows from Non-Capital Financing Activities		
Operating Grants Received	3,048	583
Operating Subsidies and Transfers to Other Funds	(28,315)	(4,185)
Net Cash Provided by Non-Capital Financing Activities	<u>(25,267)</u>	<u>(3,602)</u>
Cash Flows from Capital & Related Financing Activities		
Proceeds from Capital Debt	13,431	133,039
Capital Contributions Received	--	--
Acquisition and Construction of Capital Assets	(136,316)	(100,009)
Interest Paid on Capital Debt	(96,799)	(92,719)
Principal Paid on Capital Debt	(99,919)	(91,534)
Other Receipts (Payments)	--	--
Net Cash Provided (Used) by Non-Capital Financing Activities	<u>(319,603)</u>	<u>(151,223)</u>
Cash Flows from Investing Activities		
Interest and Dividends	4,560	18,626
Net Cash Provided by Investing Activities	4,560	18,626
Net Increase (Decrease) in Cash & Cash Equivalents	(74,072)	38,487
Balances - Beginning of the Year	434,179	395,692
Balances - End of the Year	<u>360,107</u>	<u>434,179</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:		
Operating Income (Loss)	178,938	93,271
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation Expense	86,490	83,996
Change in Assets and Liabilities:		
Receivables, Net	(16,434)	(6,533)
Inventories	(113)	2,608
Accounts and Other Payables	16,819	1,589
Accrued Expenses	--	--
Deferred Revenue	538	(245)
Net Cash Provided by operating activities	<u>\$266,238</u>	<u>\$174,686</u>

BUDGETARY COMPARISON SCHEDULE

Water Operating Fund For the Fiscal Year Ended June 30, 2010

(amounts in thousands)

	BUDGETED AMOUNTS			FINAL BUDGET TO ACTUAL Positive (Negative)
	Original	Final	Actual	
Revenues				
Locally Generated Non-Tax Revenue	\$ 528,141	\$ 513,029	\$ 516,378	\$ 3,349
Revenue from Other Governments	4,000	3,000	2,631	(369)
Revenue from Other Funds	81,469	58,696	27,734	(30,962)
Total Revenues	\$ 613,610	\$ 574,725	\$ 546,743	\$ (27,982)
Expenditures and Encumbrances				
Personal Services	111,393	111,417	101,754	9,664
Pension Contributions	39,986	38,686	27,494	11,192
Other Employee Benefits	40,420	41,720	39,974	1,746
Sub-Total Employee Compensation	191,799	191,823	169,222	22,602
Purchase of Services	123,152	123,127	106,002	17,125
Materials and Supplies	53,025	53,038	41,991	11,047
Equipment	6,320	6,308	2,435	3,872
Contributions, Indemnities and Taxes	6,513	6,513	4,897	1,616
Debt Service	200,123	200,123	196,917	3,206
Debt Service – Interest	--	--	--	--
Short-Term Interest	--	--	--	--
Payments to Other Funds	49,678	49,678	47,987	1,691
Total Expenditures and Encumbrances	630,610	630,610	569,450	61,160
Operating Surplus (Deficit) for the Year	\$ (17,000)	\$ (55,885)	\$ (22,707)	\$ 33,178
Fund Balance Available, July 1, 2009	--	--	--	--
Operations in Respect to Prior Fiscal Years				
Commitments Cancelled - Net	17,000	17,000	22,707	5,707
Prior Period Adjustments	--	--	--	--
Adjusted Fund Balance, July 1, 2009	17,000	17,000	22,707	5,707
Fund Balance Available, June 30, 2010	--	\$ (38,885)	\$ --	\$ 38,885

BONDED DEBT FOR THE FISCAL YEAR ENDED JUNE 30, 2010

(amounts in thousands)

ORIGINAL AUTHORIZATION			Outstanding June 30, 2010	Maturities	Interest Rates	Service Interest	FISCAL YEAR 2011 DEBT	
Series	Date	Issued					Principal Requirements	Outstanding June 30, 2011
Revenue Bonds:								
Series 1993	08/01/93	1,157,585	73,685	06/2008 to 06/2011	5.50 to 7.00	5,158	73,685	--
Series 1995	04/15/95	221,630	38,240	08/2007 to 08/2012	5.30 to 6.25	2,016	11,960	26,280
Series 1997 (B)	11/25/97	100,000	75,800	08/2007 to 08/2027	Variable	168	2,800	73,000
Series 1998	12/25/98	135,185	135,185	12/2011 to 12/2014	5.25	7,097	--	135,185
Series 2001	11/15/01	285,920	137,875	11/2011 to 11/2028	3.80 to 5.50	7,069	--	137,875
Series 2003*	04/01/03	381,275	--	06/2008 to 06/2023	Variable	--	--	--
Series 2005 (A)	05/04/05	250,000	235,000	07/2007 to 07/2035	3.25 to 5.25	11,682	4,610	230,390
Series 2005 (B)	05/04/05	86,105	83,275	08/2007 to 08/2018	Variable	3,763	405	82,870
Series 2007 (A)	05/04/07	191,440	179,845	08/2007 to 08/2027	4.00 to 5.00	8,553	4,665	175,180
Series 2007 (B)	05/04/07	153,595	153,110	11/2007 to 11/2031	4.00 to 5.00	6,959	210	152,900
Series 2009 (A)	05/21/09	140,000	140,000	01/2017 to 01/2036	5.15 to 5.25	7,294	--	140,000
Series 2010 (A)	04/15/10	396,460	390,045			18,159	3,245	386,800
Pennvest-1999	04/30/00	6,700	711	07/2007 to 04/2019	1.41 to 2.73	19	72	639
Pennvest-2009 (C)	06/16/10	13,431	13,431	07/2013 to 06/2033	1.193 to 2.107	154	--	13,431
Total Revenue Bonds		\$3,519,326	\$1,656,202			78,093	101,652	1,554,550
General Obligation Bonds:								
Pennvest	06/15/93	20,000	2,228	07/2007 to 04/2012	1.00	17	1,210	1,018
Total Bonded Debt			\$ 1,658,430			78,110	102,862	1,555,568

* Refunded in FY 2010

ANNUAL BONDED DEBT SERVICE REQUIREMENT: (amounts in thousands)

Fiscal Year	Interest	Principal	Total
2011	78,110	102,862	180,972
2012	70,620	109,942	180,562
2013	65,362	117,271	182,633
2014	59,541	123,822	183,363
2015	53,430	130,176	183,606

The First Series through the Thirteenth were refunded.

Capitalized Interest added to Construction in Progress in Fiscal 2010 was \$5,286,925. Interest Expense was reduced by the same amount.

SUPPLEMENTAL SCHEDULE OF RATE COVENANT COMPLIANCE FOR FISCAL YEAR ENDED JUNE 30, 2010 (Legally Enacted Basis)

(amounts in thousands)

LINE NO.	2010
1. Total Revenue and Beginning Fund Balance	\$ 566,749
2. Net Operating Expense	(344,045)
3. Transfer (To) From Rate Stabilization Fund	<u>2,702</u>
4. Net Revenues	<u>235,406</u>
5. Revenue Bonds Outstanding	(195,690)
6. General Obligation Bonds Outstanding	0
7. Pennvest Loan	<u>(1,227)</u>
8. Total Debt Service	<u>(196,917)</u>
9. Net Revenue after Debt Service	38,489
10. Transfer to General Fund	(2,304)
11. Transfer to Capital Fund	(17,265)
12. Transfer to Residual Fund	<u>(18,920)</u>
13. Total Transfers	<u>(38,489)</u>
14. Net Operating Balance for Current Year	<u>0</u>

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; (iv) debt service on all General Obligations Bonds issued for the Water and Wastewater Systems payable in such fiscal year; (v) debt service payable on Interim Debt in such fiscal year; and (vi) 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	\$235,406	Line 4	\$235,406	Line 4 - Line 3	\$232,704
/Line 5	\$195,690	/Line 8 + Line 11	\$214,182	/Line 5	\$195,690
= COVERAGE A:	1.20	= COVERAGE B:	1.10	= COVERAGE C:	1.19

1. THE GOVERNMENT OF PHILADELPHIA

The City of Philadelphia was founded in 1682 and was merged with the county in 1854. The City currently occupies an area of 129 square miles along the Delaware River, serves a population in excess of 1.4 million and is the hub of a five-county metropolitan area including Bucks, Chester, Delaware and Montgomery counties in Southeastern Pennsylvania.

The City's Water Department supplies water and provides wastewater treatment services to residents of Philadelphia and portions of Bucks, Montgomery and Delaware Counties (G.O. rated Aa1, Aaa and Aa2, respectively), although over 90% of customers are residents of the City and approximately 9% are from Bucks County. Philadelphia has experienced a long trend of industry and population loss since 1950, with a particularly sharp economic retreat hitting in the late 1980s and early 1990s. The late 1990s saw a resumption of growth, with employment up 5.7% between 1998 and 2001, and then down about 1.6% between 2001 and 2003, reflecting the slowdown in the national economy. The decline flattened in fiscal 2004 and then grew by about 1.0% in 2005, 0.9% in 2006, and 0.7% in 2007. Although employment continued to grow for 2008 (overall annual growth was 0.2%), employment growth halted in October and turned negative in every month from November through March. Manufacturing has continued to decline in importance, and as of 2005, diversified services account for 54% of total employment (or more than 60% including the finance/insurance/real estate sector). Population loss during the 1990s was just over 4%, although this was only about half the loss that had been estimated prior to the 2000 census count. With an estimated 1.45 million residents, the City remains the nation's fifth most populous. The suburban portions of the service area are wealthier and somewhat faster-growing than the City, but are much less significant to the system as they account for less than 10% of total customer revenues.

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.

The City government is responsible for establishing, and the Water Department is responsible for maintaining, internal controls designed to protect the assets of the Water Department from loss, theft or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of Financial Statements in conformity with Generally Accepted Accounting Principles. These internal controls are subject to periodic evaluation by management and the City Controller's Office in order to determine their adequacy.

The Philadelphia Water Department serves the Greater Philadelphia region by providing an integrated water, wastewater and stormwater system. 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. In fulfilling its mission, the utility seeks to be customer-focused, delivering services in a fair, equitable and cost-effective manner, with a commitment to public involvement. Having already served the City and region for nearly two centuries, the utility's commitment for the future includes an active role in the economic development of Greater Philadelphia and a legacy of environmental stewardship.

The Water Revenue Bureau of the Department of Revenue of the City gathers and processes meter readings of the Water Department customers, issues the invoices for the services provided by the Water Department, processes the revenue collected for these services, thus maintaining the Accounts Receivable of the Water Department. 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 requirements for the City, including the Water Department, are 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.

In order to accomplish its mission and 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Philadelphia Water Department have been prepared in accordance with Generally Accepted Accounting Principles (GAAP) as they apply to governmental units. The Governmental Accounting Standards Board (GASB) of the American Institute of Certified Public Accountants 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 twenty 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

Fund Balance-Legal Basis 6/30/10	\$	-	-
Assets omitted from the legal basis:			
(1) Receivables from Other Governments or Funds	\$	49,592	
(2) Fixed Assets-Net of Depreciation		1,811,347	
(3) Restricted Assets		408,881	
(4) Proprietary Portion of Net Pension Obligation		17,372	
	\$	<u>2,287,192</u>	
Liabilities omitted from the legal basis:			
(5) Construction Contracts Payable	\$	(33,113)	
(6) Other Current Liabilities		(130,516)	
(7) Bonds Payable and Other Long-Term Debt		<u>(1,499,502)</u>	
	\$	<u>(1,663,131)</u>	
Fund Balance accounts included in the legal basis:			
(8) Reserve for Collectible Receivables	\$	84,970	
(9) Reserve for Inventories		12,913	
(10) Reserve for Purchase Commitments		<u>33,250</u>	
	\$	<u>131,133</u>	
Equity accounts omitted from the legal basis:			
(11) Invested in Capital Assets, Net of Related Debt		(225,589)	
(12) Restricted for Capital Projects		(97,580)	
(13) Restricted for Debt Service		(117,852)	
(14) Restricted for Rate Stabilization		<u>(145,693)</u>	
	\$	<u>(586,714)</u>	
Unrestricted Net Assets – GAAP Basis – 6/30/2010	\$	<u><u>168,480</u></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

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 2010 was \$5,286,925.

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, 2010 are included in accounts receivable. In addition, an amount for services rendered through June 30, 2010, 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. Rates

Under the Charter, the Water Department is empowered and required to establish rates for water and wastewater service, in accordance with standards ordained by City Council, but without further authorization required by the City Council, at levels which provide sufficient revenue to meet operating expenses of the water and wastewater systems, including interdepartmental charges for services provided to the Water Department, and debt service requirements on all obligations issued for the Water Department, as well as other specific covenants of the General Ordinance.

The City has covenanted in the General Ordinance that it has authorized the imposition of rates and charges by the Water Department sufficient to comply with the Rate Covenant and that it will not repeal or materially adversely dilute or impair such authorization.

The Philadelphia Code requires the Water Department to give written notice to City Council at least 30 days in advance of the filing of notice of any proposed change in water or sewer rates or charges and to submit with such written notice financial, engineering and other data upon which the proposed changes are based. After the filing of the proposed regulations providing for changes in rates or charges with the City's Department of Records, the Department of Records is required to give public notice that the regulations have been filed and that any person affected by the proposed regulations may request a public hearing before the Water Department and the City Solicitor. Revised rates and charges become effective ten days after filing of a decision by the Water Commissioner at the conclusion of hearings or at any time thereafter, at his discretion.

The Water Department filed a notice of request for new rates for the period fiscal year 2009 through fiscal year 2012 with City Council on April 4, 2008. The rate request was filed with the Department of Records on May 5, 2008. In accordance with the regulations, a hearing examiner and public advocate were appointed. Public hearings were held during the period from July 21 to July 31 and technical hearings were held during the week of August 11, 2008. The Department also proposed to change the way it charges customers for stormwater management services; this part of the case was concluded with the Water Commissioner's decision of July 21, 2009, and new stormwater rates and charges were effective on July 1, 2010.

No timely challenges to the City's existing rate determinations have been filed. Several parties have filed for intervention or participation in the recent rate case; however, the Department believes that the time to appeal any decision on the revenue requirements part of the case has passed. A civil action was commenced on December 17, 2009, when a Complaint was filed with the Court of Common Pleas. Plaintiffs' Complaint contains seven counts that purport to state claims seeking declaratory relief under the Declaratory Judgments Act, 42 Pa. C.S. 7531, et seq. challenging the legality of parts of the Philadelphia Water Department Rate Determination, dated October 21, 2008 ("Rate Determination") and related regulations (Sections 300, et seq.) issued by the Water Commissioner, effective November 1, 2009 (the "Regulations"), to the extent that the Regulations establish three successive increases in water and sewer rates implemented or to be implemented during the period fiscal years 2010-2012. Preliminary Objections were filed in response to the above action on January 22, 2010. These objections address all seven counts of Plaintiffs' Complaint and request that the Court reject the complaint on grounds of lack of jurisdiction, legal insufficiency, failure to comport with law or rule of court and/or non-joinder of indispensable parties. Replies to such Preliminary Objections were filed February 12, 2010, and a sur-reply was filed on March 1, 2010. On May 12, 2010, the Court sustained the Preliminary Objections raised by the Water Department and dismissed Plaintiff's case in its entirety. Plaintiff has since filed a Notice of Appeal with the Commonwealth Court of Pennsylvania. The City believes that the lawsuit was without merit and properly dismissed by the Court of Common Pleas; however, there can be no assurance of the outcome of the appeal pending before the Commonwealth Court and the effect of such litigation on future

rates. Bucks County Water and Sewer Authority has filed for arbitration with respect to the current rate notice. The parties have agreed to a 90-day stay to give the parties time to settle the matter and have participated in the exchange of information and partial settlement discussions.

M. Advance Service Charge

The City's Water Fund Regulations provide for the assessment of an "Advance Service Charge" (ASC) at the time a property is initially connected to the system. The initial charge is calculated to be the equivalent of three monthly service charges. This long-standing practice of assessing an initial charge equivalent to the average of three monthly service charges has been consistent whether the billing period was semi-annually (through 1979), quarterly (1979-1994) or monthly (1994-current). The Fund includes these charges in current revenues at the time they are received. Fund regulations also provide for a refund of any advance service charges upon payment of a \$100 fee and permanent disconnection from the system. During FY 2010, 334 disconnection permits were issued, resulting in a refund or final credit of approximately \$329,500, and 960 new connection permits were issued, resulting in additional advance service charges of approximately \$338,200.

N. 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 selfinsured 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.

O. 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.

P. 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.

Q. 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 2010, excess interest earnings of \$2,303,986 were transferred to the General Fund of the City.

3. ACCOUNTS RECEIVABLE

Balances consisted of the following:

FISCAL YEAR ENDED JUNE 30, 2010

Accounts Receivable:

Billed in the Last Twelve Months	\$ 130,889,170
Billed in 15-year Cycle Billing	43,896,918
Penalties on Receivables	28,576,468
Other Receivables	21,807,363

Total	\$ 225,169,919
Bad Debts Written Off	\$13,535,707

ALLOWANCE FOR DOUBTFUL ACCOUNTS:

Billed in the Last Twelve Months	\$ --
Billed in 15-year Cycle Billing	41,994,835
Penalties on Receivables	27,484,229
Other Receivables	21,501,324

TOTAL	\$ 90,980,388
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Balances consisted of the following:

FISCAL YEAR ENDED JUNE 30, 2009

Accounts Receivable:

Billed in the Last Twelve Months	\$ 112,240,726
Billed in 15-year Cycle Billing	46,360,685
Penalties on Receivables	30,630,361
Other Receivables	20,222,623

Total	\$ 209,454,395
Bad Debts Written Off	\$ 9,115,844

ALLOWANCE FOR DOUBTFUL ACCOUNTS:

Billed in the Last Twelve Months	\$ --
Billed in 15-year Cycle Billing	52,808,871
Penalties on Receivables	24,495,304
Other Receivables	12,541,219

TOTAL	\$ 89,845,394
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4. THE TEN LARGEST RETAIL CUSTOMERS OF THE PHILADELPHIA WATER DEPARTMENT DURING FISCAL YEAR 2010

Customer	Billings (millions)	% of total Billings	Consumption (MGD)	% of total Consumption
City of Philadelphia	\$28.143	5.51%	9.49	5.58%
Philadelphia Housing Authority	11.939	2.34	4.23	2.48
Philadelphia School District	6.719	1.31	1.58	0.93
Trigen Corporation	4.907	0.96	2.14	1.26
Sunoco	4.218	0.83	4.34	2.55
University of Penna.	3.752	0.73	1.60	0.94
Temple University	2.769	0.54	1.10	0.65
US Government	2.766	0.54	1.19	0.70
SEPTA	1.945	0.38	0.38	0.22
Paperworks Industries Inc.	1.769	0.35	2.43	1.43
Total Top Ten	\$68.927	13.49%	28.48	16.73%
Total Retail Billings	\$511.040		170.14	

5. WHOLESALE CUSTOMERS OF PWD DURING FISCAL YEAR 2010

The Department is permitted, via ordinance, to provide wholesale water and sewer service to jurisdictions outside of the City's borders. This "wholesale" service is provided via agreement. Service is limited to delivery of water or acceptance of wastewater at the City border.

Wastewater Customer	Revenues
Delcora	\$ 8,789,736
Bucks County Water & Sewer Authority	7,295,679
Upper Darby Township	3,389,507
Cheltenham Township	3,239,440
Lower Merion Township	2,816,586
Lower Southampton Township	2,117,190
Springfield Township - Erdenheim	2,538,979
Bucks (for Bensalem) *	1,554,095
Abington Township	1,339,683
Lower Moreland Township	736,917
Springfield Township - Wyndmoor	251,619
Total	\$ 34,069,431

Water Customer	Revenues
Bucks County Water & Sewer Authority	\$ 5,777,578
Aqua PA	3,200,883
Total	\$ 8,978,461

Total Wholesale Revenues	\$ 43,047,892
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*Revenues do not include FY 2009 monies escrowed for Bucks County Water & Sewer Authority that were deposited into the operating fund account in FY 2010: \$236,655 for Bensalem and \$1,072,146 for Bucks County. These amounts were included in the FY 2009 Revenues.

6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30, 2010 and 2009 consisted of the following:

Fiscal Years Ended	June 30, 2010	June 30, 2009
Land	\$ 5,919,160	\$ 5,919,160
Buildings and related improvements	1,427,513,880	1,393,076,406
Meters and other improvements	96,773,569	85,927,860
Equipment	69,993,066	68,605,739
Transmission and distribution lines	1,887,148,203	1,829,743,103
Construction in progress	204,590,604	151,517,409
Total	\$3,691,938,482	\$ 3,534,789,677
Less: Accumulated Depreciation	(1,880,592,059)	(1,808,339,469)
Total	\$ 1,811,346,423	\$ 1,726,450,208

7. 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 (BRC), which was destroyed by fire in the early 1990s; 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: the portion of our Biosolids Recycling Center which performs composting, but which has become functionally obsolete. 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. 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 obsolete (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.

In the summer of 2003, the Water Department began a process to move to an entirely Class A biosolids process, and one that could operate in Philadelphia without odors. It entered into a contract with the engineering consultant firm Camp, Dresser & McKee to assist with procurement of facilities and services for Philadelphia to operate for 20 years the dewatering station, and to construct new facilities to produce Class A biosolids products. Alternative processes identified for this procurement process included fully-enclosed composting systems and heat drying technologies. The Request for Qualifications was released in August 2003, and, in response, the City received qualification statements from four teams, of which two were found qualified and invited to receive a Request for Proposals. One team, Philadelphia Biosolids Services, LLC ("PBS") submitted a proposal on November 24, 2004. This team offered to build a pair of sludge dryers. The Water Department has negotiated a long-term contract with PBS for improvements to the Biosolids Recycling Center. The contract includes a provision for interim operation of up to five years, during which PBS will take over operation of the existing Biosolids Recycling Center. Within the first three to five years, PBS will finance, design, build, own and operate a thermal drying facility that will handle all of the sludge processed by the Water Department and make a Class A product in the form of pellets that can be used as fertilizer and has potential as a fuel. PBS will be responsible for the disposition of the Class A pellets, thus relieving the Water Department of this burden. The Class A period of operation will last twenty years with a five-year renewal at the option of

the Water Department. The project is estimated to result in a savings of approximately \$200 million over the contract life. On June 19, 2008, City Council passed enabling legislation to allow the proposed contract to proceed. Mayor Nutter approved the contract with PBS in October 2008 and PBS has been operating the facility since October 13, 2008. Total payments for fiscal year 2009 were \$12,609,352. Total payments for fiscal year 2010 were \$22,828,657. The fiscal year 2011 proposed budget includes \$21,480,000 for payments to PBS.

As a result of the transfer of operations and the discontinuance of composting operations, a total of \$40.5 million of equipment and facilities were retired. The balance of the equipment and facilities being utilized by the contractor remains on the balance sheet. No additional asset impairments occurred during FY 2010.

8. 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 2010 was \$9,120,870 and in 2009 was \$9,598,019. The expense for vacation pay is recognized in the year earned.

9. 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.

10. CAPITALIZED LEASES

Leases consist of \$2,675,389 in photocopier and computer equipment in Fiscal 2010. Capital leases are defined by the Financial Accounting Standard Board in Statement 13, Accounting for Leases.

11. 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 2010 the fund had the following activity:

Balance at July 1, 2009	\$ 147,636,618
Transfer to Operating Fund	(2,701,524)
Interest Earnings	757,897
Interest Transferred to Water Operating Fund	--
Balance at June 30, 2010	\$ 145,692,991

12. 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 2010 the fund had the following activity:

Balance at July 1, 2009:	\$ 81,324,002
Interest Income	253,189
Deposit from Operating Fund	21,223,671
Capital Payments for New River City Project	(20,648,789)
Transfer to General Fund	(2,303,986)
Transfer to Capital Projects Fund	(16,468,000)
Balance at June 30, 2010	\$ 63,380,087

Note: Currently \$46,424,217 is reserved for prior year encumbrances. (New River City Project)

13. ACCOUNTING FOR THE NEW RIVER CITY PROJECT FUNDS – WATER SINKING FUND RESERVE SUBSTITUTION

Pursuant to the Water Department's General Bond Ordinance, the Sinking Fund Reserve provides a reserve against default of the payment of principal and interest on Water Revenue Bonds when due.

The New River City Ordinance, dated 1/23/07 (Bill No 060005), authorized the purchase and deposit of a surety bond that meets the requirements of the General Ordinance to replace \$67,000,000 of the Sinking Fund Reserve balance. The \$67,000,000 will be used as follows:

\$ 2,010,000	Cost of the surety bond
290,000	Legal and financial services
375,000	Management fees
64,325,000	Costs of certain water and sewer infrastructure components of the New River City Program

The prepaid surety bond was recorded as an asset in the Sinking Fund Reserve and amortized over the lives of the outstanding bonds.

As of June 30, 2010, \$46,424,217 in unexpended proceeds from the substitution remains. PWD has approved projects that are currently in process that would expend the balance of the remaining funds.

14. 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.

15. 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. There was an arbitrage liability as of June 30, 2008 in the amount of \$571,496. There was an arbitrage liability as of June 30, 2009 in the amount of \$493,111. As of June 20, 2010 there was an arbitrage liability of \$72,158.

16. DEBT PAYABLE

Defeased Debt

In prior years, the Water Fund defeased certain bonds by placing the proceeds of new bonds in irrevocable 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, \$172.5 million of bonds outstanding was considered defeased.

Financings

In July 2009, the outstanding balance of \$83.7 million of Water & Wastewater Revenue Refunding Bonds, Variable Rate Series 2005B was remarketed under an irrevocable direct pay letter of credit (LOC) from Bank of America. The LOC replaces a bond insurance policy from Financial Security Assurance, Inc. ("FSA") and a liquidity facility for the 2005B Bonds provided by DEPFA Bank. The LOC will constitute both a credit facility and liquidity facility and Bank of America, N.A. a credit provider and liquidity provider for the 2005B Bonds. The bonds continue to have a weekly interest rate maturing in 2018.

In April 2010, PWD settled on \$396,460,000 in refinancing revenue bonds. The bonds were issued as the City of Philadelphia, Pennsylvania-Water and Wastewater Revenue Bonds, Series 2010A and authorized under Ordinance #100005. These bonds were used to refinance the series 2003 City of Philadelphia, Pennsylvania-Water and Wastewater Revenue Bonds and to pay costs related to the transaction. The Series 2003 Bonds were insured by AGM with Dexia as the liquidity provider. The liquidity facility expired on April 1, 2010 and was not renewed by Dexia. The City refunded the Series 2003 Bonds with the proceeds of the Series 2010A Bonds and terminated the Series 2003 Swap as further described in the forepart of the Official Statement for this transaction. The bonds were issued at total average interest cost of 3.384965%. The final bond maturity was accelerated to 2019 with a bond yield of 4.11%. The 2010A issue included both insured (AGM) and uninsured bonds. This transaction considerably reduced the Water Department's risk exposure related to interest rate Swaps, variable interest rates and liquidity costs.

On June 30, 2010, one of the two forward-starting Swap "rate lock" agreements with Merrill Lynch & Co. was terminated. A termination fee of \$15,198,000 was paid and is included in debt service expense on the modified cash basis income statement. The City anticipates the termination of the second Swap to occur in conjunction

with the issuance of the 2010C-D bonds described below.

Pennvest Loans

On April 20, 2009, the Water Department received notice that Pennvest (the Pennsylvania State Infrastructure Financing Authority) had approved three of the traditional water and sewer applications, totaling \$184.9 million, were approved for funding through low interest loans of 1.193% during the construction period and for the first five years of amortization (interest-only payments are due during the construction period, up to three years) and 2.107% for the remaining fifteen years. In addition, a \$30,000,000 "green infrastructure" application was also approved for funding through a low interest loan on the same terms. The Department did not originally anticipate the funding of these projects through additional borrowings. Additional debt service for these loans has been included in the Department's fiscal year 2010 budget, the Department's five-year plan projections and the Engineering Report. These loans are being provided on an interest-only basis during the construction period of up to three years, after which they are amortized on a 20-year basis at 1.193% for the first five years and 2.107% for the next fifteen years. The Department has accepted all of the funding. A supplemental ordinance to the Restated General Ordinance authorizing \$350,000,000 in new borrowing (the Twelfth Supplemental Water Bond Ordinance No. 090321) was introduced and approved by City Council in May, 2009. The City and Pennvest finalized loan documents on the three traditional loans described above during FY 2010.

Pennvest loan number 83104 (series 2009B) was settled on October 14, 2009. The maximum loan amount is \$42,886,030. Estimated project costs are currently \$33,195,803. Project draws on the amount of \$3,039,858.72 have been requested through June 30, 2010. No reimbursements have yet been received on this loan.

Pennvest loan number 83105 (series 2009C) was settled on October 14, 2009. The maximum loan amount is \$57,268,193. Estimated project costs are currently \$50,423,484. Project draws on the amount of \$13,430,972.51 have been requested and received through June 30, 2010. Interest-only payments on this loan are scheduled to begin on July 1, 2010.

Pennvest loan number 27771 (series 2009D) was settled on March 31, 2010. The maximum loan amount is \$84,759,263. Estimated project costs are currently \$82,462,284. Project draws on the amount of \$8,455,618.68 have been requested through June 30, 2010. No reimbursements have yet been received on this loan.

Pennvest loan number 75235 (series 2010B) is not currently scheduled for settlement. The maximum loan amount is \$30,000,000. Estimated project costs are currently \$30,000,000. No project draws have been requested or received through June 30, 2010.

Additional debt service for these loans has been included in the Department's fiscal year 2011 budget, the Department's five-year plan projections and the Engineering Report. These loans are being provided on an interest-only basis during the construction period of up to three years, after which they are amortized on a 20-year basis at 1.193% for the first five years and 2.107% for the next 15 years. The Pennvest loans were authorized through a supplemental ordinance to the Restated General Ordinance (the Twelfth Supplemental Water Bond Ordinance No. 090321).

Subsequent Events

On August 4, 2010, PWD settled on \$185,000,000 in new money revenue bonds. The bonds were issued as the City of Philadelphia, Pennsylvania-Water and Wastewater Revenue Bonds, Series 2010C. The net proceeds of \$170.5 million from these bonds will be used to fund a portion of the Water Department's 2011 to 2016 Capital budget and to pay costs

related to the transaction. The City also terminated the two forward-starting 2007 Swap agreements as further described in the forepart of the Official Statement for this transaction.

The bonds were issued at true interest cost of 4.373226%. The final bond maturity was in 2040 and had a yield of 4.884%. The 2010C issue was insured by AGM. The financing included the termination of the Wachovia (now Wells Fargo) forward-starting Swap agreement on July 27, 2010 which resulted in a termination payment of \$15,015,000 which was funded with proceeds of the 2010C bonds and will be amortized over the life of these bonds for GAAP accounting purposes.

Thanks to the efforts and to the assistance of many of PWD managers in compiling and presenting the data in the Department's official statement, the Department was able to access the market to complete this transaction which provided essential funding for infrastructure replacement and reduced the Water Department's risk exposure related to interest rate Swaps, variable interest rates and liquidity costs. The Department recently received confirmation of its existing bond ratings from each of the three major bond rating agencies. (Moody's: A1, S&P: A, Fitch: A+)

Future Financings

Approximately 70% of the costs of the Capital Improvement Program are expected to be funded with the proceeds of debt to be incurred during the six-year period. The City expects most of such debt to be in the form of Water and Wastewater Revenue Bonds issued under the Act and the General Ordinance. A portion of the debt may be evidenced by loans to the City from Pennvest, established by the Commonwealth to provide low interest cost financing for water and wastewater projects within the Commonwealth.

Such loans are expected to be evidenced by Water and Wastewater Revenue Bonds. Any additional loans received by the Water Department from Pennvest will reduce the amount of future Water and Wastewater Revenue Bonds to be issued.

The Department is also authorized for the issuance of \$135,000,000 in additional new money bonds under the 12th supplemental ordinance (no. 090321). The current capital spending plan calls for the issuance of these bonds in early FY 2014.

In addition to the \$215 million of Pennvest Loans described earlier, the Capital Improvement Program provides for the issuance of revenue bonds in the anticipated principal amount (exclusive of original issue discount) of \$135,000,000 near the beginning of fiscal year 2014. The emphasis of the Capital Improvement Program is on the renewal and replacement of the water conveyance and sewage collection systems along with improvements to the water and wastewater treatment plants. Additional revenue bond issues are anticipated during or after fiscal year 2011 as necessary to fund the approved capital program. See APPENDIX II – "ENGINEERING REPORT." Black & Veatch Corporation has made certain assumptions in its Engineering Report with respect to inflation which are not reflected in the formal Capital Improvement Plan of the Water Department.

Another \$350 million issue is planned for Fiscal 2015, but has not yet been authorized.

City of Philadelphia Water & Sewer Swap Interest Rates

City Entity	Water	Water
Related Bond Series	2005 Refunding	2010(2) Forward
Initial Notional Amount	\$86,105,000	\$90,000,000
Current Notional Amount	\$83,275,000	\$90,000,000
Termination Date	8/1/2018	1/1/2037
Product	Fixed Payer Swap (1)	Fixed Payer Swap
Rate Paid by Dealer	Bond Rate/ 68.5% - 1 month LIBOR	SIFMA
Rate Paid by City Entity	4.53%	4.52275%
Dealer	Citigroup Financial Products, Inc.	Wachovia Bank, N.A.
Dealer Rating	A3/A (Citigroup, Inc.)	Aa2/AA
Fair Value (3)	(14,133,142)	(15,093,563)

Notes:

(1) The City received an up-front payment of \$4,000,000 for the related swaption. Citigroup exercised its option to enter into the Swap on 5/4/2005. Under the Swap, the City receives the bond rate or 68.5% of one-month LIBOR in the event of an Alternative Floating Rate Date. An Alternative Floating Rate Date has been triggered and the City is currently receiving the LIBOR-based rate.

(2) On 2/10/2009, the City amended the effective date on the forward-starting Swap from 2/17/2009 to 8/1/2010. This resulted in an upward adjustment in the fixed rate from 4.1184% to 4.52275%. The City terminated the forward-starting Swap with Merrill Lynch on 6/30/2010. The City paid a termination payment of \$15,198,000 to Merrill Lynch.

3) Fair values are shown from the City's perspective and include accrued interest.

City of Philadelphia 2003 Water & Sewer Swap

Objective: In December 2002, the City entered into a Swaption that provided the City's Water and Sewer Department with an up-front payment of \$25.0 million. The original notional amount was \$381,275,000. As a synthetic refunding of all or a portion of its 1993 Bonds, this payment approximated the present value savings, as of December 2002, of a refunding on March 18, 2003, based upon interest rates in effect at the time. 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. On April 8, 2010, the City terminated the Swap and refunded the underlying bonds to fixed rate. The City paid a Swap termination payment of \$48,755,000 to Citigroup.

City of Philadelphia, 2005 Water & Sewer Swap

Objective: In December, 2002, the City entered into a Swaption that provided the City with an up-front payment of \$4.0 million. As a synthetic refunding of all or a portion of its 1995 Bonds, this payment approximated the present value savings, as of December 2002, of a refunding on May 4, 2005. The Swaption gave 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.

Terms: Citigroup exercised its option to enter into a Swap on May 4, 2005, and the Swap

commenced on that date. Under the terms of the Swap, the City pays a fixed rate of 4.53% and receives a variable payment computed as the actual bond rate or alternatively, 68.5% of one-month LIBOR, in the event the average rate on the bonds as a percentage of the average of one-month LIBOR has exceeded 68.5% for a period of more than 180 days. Citigroup exercised its option during this fiscal year to pay 68.5% of one-month LIBOR under the Swap. The payments 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 were expected to approximate the debt service of the refunded bonds at the time the Swaption was entered into.

As of June 30, 2010, the Swap had a notional amount of \$83.3 million and the associated variable-rate bond had an \$83.3 million principal amount. The bonds' variable-rate coupons are not based on an index but on remarketing performance. The bonds mature on August 1, 2018 and the related Swap agreement terminates on August 1, 2018.

Fair value: As of June 30, 2010, the Swap had a negative fair value of (\$14.1 million). This means that the Water Department would have to pay this amount if the Swap terminated.

Risk: As of June 30, 2010, 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. Since the City is now receiving 68.5% of one-month LIBOR, the City is 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 Federal tax system or in marginal tax rates cause the rate paid on the outstanding bonds to be greater than the 68.5% of LIBOR received on the Swap. The Swap includes an additional termination event based on credit ratings. The Swap may be terminated by the City if the ratings of Citigroup or its Credit Support Provider fall below A3 and A-, or by Citigroup if the rating of the City's Water and Wastewater Revenue Bonds falls below A3 or A-. There are 30-day cure periods to these termination events. However, because the City's Swap payments are insured by Assured Guaranty Municipal Corp. (formerly FSA), no termination event based on the City's Water and Wastewater Revenue Bond ratings can occur as long as Assured is rated at least A or A2.

As of June 30, 2010, rates were as follows:

Terms	Rates
Fixed payment to Citigroup under Swap	Fixed 4.53000%
Variable payment from Citigroup under Swap	68.5% of one-month LIBOR (0.23868%)
Net interest rate Swap payments	4.29132%
Variable rate bond coupon payments	Weekly resets 0.21%
Synthetic interest rate on bonds	4.50132%

Swap payments and associated debt: As of June 30, 2010, 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		
2011	405,000	174,878	3,573,597	3,748,475
2012	425,000	174,027	3,556,217	3,730,244
2013	450,000	173,135	3,537,979	3,711,114
2014	14,820,000	172,190	3,518,668	3,690,858
2015	15,535,000	141,068	2,882,694	3,023,762
2016-2019	51,640,000	221,151	4,519,189	4,740,340

City of Philadelphia Forward-Starting Water & Wastewater Swaps

Objective: In February, 2007, the City entered into two forward-starting Swaps to take advantage of the current low-interest rate environment in advance of the issuance of Water and Wastewater Revenue Bonds expected to be issued by the City in 2008. The notional amount was evenly split between two counterparties, Merrill Lynch Capital Services, Inc. and Wachovia Bank, N.A. On June 30, 2010, the Swap with Merrill Lynch was terminated. The City paid a termination payment of \$15,198,000 to Merrill Lynch.

Terms: The Swap confirmation was amended in December, 2007 to move the Swap start date from February, 2008 to February, 2009 as the bond issuance had been delayed. In February, 2009, the Swap confirmation was amended again to move the Swap start date from February, 2009 to August, 2010, as the bond issuance had been delayed. The termination date is January, 2037. The Swap was priced based on an amortizing notional schedule with a \$90 million initial notional amount. Under the Swap, the City would pay a fixed rate of 4.52275% and will receive a variable rate equal to the SIFMA Municipal Swap Index.

Fair value: As of June 30, 2010, the Swap had a negative fair value of (\$15.1 million). This means that the Water and Sewer Department would have to pay this amount to terminate the Swap.

Risk: As of June 30, 2010, 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. The City is subject to traditional basis risk should the relationship between SIFMA and the bonds change, if SIFMA resets at a rate below the variable-rate bond coupon payments, the synthetic interest rate on the bonds will increase. The Swap included additional termination events based on credit ratings. The Swap may be terminated by the City if Wachovia fails to have a rating of at least Baa2 or higher or BBB or higher, or by Wachovia if the City fails to have a rating of at least Baa2 or higher or BBB or higher.

The Wachovia Swap was terminated in connection with the issuance of the 2010C bonds in August, 2010 (see subsequent events).

17. BOND RATINGS, AS OF JUNE, 2010:

In April of 2010, *Moody's Investor's Service* assigned the A3 underlying rating and stable outlook to the City of Philadelphia's \$396,460,000 Water and Wastewater Revenue Refunding Bonds, Series of 2010A. The A3 underlying rating reflects the system's strong management, improved financial operations, significant cash balances in the Rate Stabilization Fund, ongoing improvements addressing environmental concerns and an above-average debt position. Although conservative projections show that management may draw on the Rate Stabilization Fund over the next several years to meet the 1.2x net revenue coverage mandated by the rate covenant, recent improvements to financial operations, as well as anticipated ongoing rate increases, will likely mitigate the dependence on this fund. The closed-loop system is effectively segregated financially from the City's general funds and accounts, with a daily sweep of customer revenues to a third party fiscal agent. In addition, a moderate portion of revenues is related to wholesale services provided under contract to various suburban communities outside of the City.

In April 2010, *Standard & Poor's Ratings Services* assigned its 'A' long-term rating, and stable outlook, to Philadelphia, Pa.'s series 2010A \$396,460,000 and Wastewater Revenue Refunding Bonds affirmed its 'A' long-term rating and underlying rating (SPUR), with a stable outlook, on the City's existing water and wastewater revenue debt.

In their report, *Standard & Poor's Ratings Services* commented as follows:

In our opinion, positive credit factors include the City's:

- Stable financial performance despite its reliance on rate stabilization support – with the Rate Stabilization Funds, senior-lien debt service coverage (DSC) was an adequate 1.2x in Fiscal 2009;
- Competitive rates, which will remain low despite planned increases through Fiscal 2012;

and

- Experienced management team continues to emphasize, and is achieving, improved system maintenance, stronger collections and more-comprehensive fiscal monitoring systems.

In our opinion, despite these positive credit factors, the rating remains restrained by the City's:

- Continued reliance on Rate Stabilization Fund support – projections have officials continuing to draw on the fund over the forecast period of 2010-2016 – to meet covenanted coverage;
 - Overall service area economy, characterized by weak demographic trends, including a long-term population decline, resulting in overcapacity in the water system;
 - Sizable capital improvement program (CIP) for the system, totaling \$1.04 billion for Fiscals 2010-2015;
- and
- Highly leveraged system with a debt-to-plant ratio of 94%, which we consider high.

In May, 2010, Moody's and Fitch Ratings both announced that they were recalibrating their long-term municipal ratings to their respective global rating scales. The current ratings assigned to the bonds by Moody's and Fitch Ratings are on their respective global rating scales. The recalibrations do not reflect a change in credit quality, or a change in Moody's or Fitch Ratings' credit opinions, of an issue or issuer; the recalibrations are simply changes in scale.

More information is currently available from Moody's at <http://www.moody.com/gsr> and from Fitch Ratings at <http://www.fitchratings.com>. As a result of the recalibrations, PWD's underlying ratings were raised by Moody's from A3 to A1 and by Fitch from A- to A+. These ratings were subsequently affirmed in their July, 2010 ratings reports on the City of Philadelphia's \$185 million Water and Wastewater Revenue Bonds, Series of 2010C issued in August, 2010.

CITY OF PHILADELPHIA'S (WATER) BOND RATINGS			
YEAR	MOODY'S INVESTOR'S SERVICE	STANDARD & POOR'S CORP.	FITCH ICBA
2010	A1	A	A+
2009	A3	A	A-
2008	A3	A	A-
2007	A3	A-	A-
2006	A3	A-	A-
2005	A3	A-	A-
2004	A3	A-	A-
2003	A3	A-	A-
2002	A3	A-	A-
2001	A3	A-	A-
2000	Baa1	BBB+	A-
1998	Baa1	BBB+	BBB+
1997	Baa1	BBB	BBB+
1995	Baa	BBB	BBB+
1993	Baa	BBB-	BBB
1991	B	BBB	BBB
1990	Baa	BBB	
1974	A	A	

18. 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 maintain 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. Each 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, 2009 was as follows:

Retirees and beneficiaries currently receiving benefits	35,694
Terminated members entitled to benefits but not yet receiving them	1,336
Active Members	<u>28,632</u>
Total Members	<u>65,662</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 \$566 million or 40.0% of covered payroll of \$1,423 million. The City's actual contribution was \$297.4 million. The City's contribution did not meet the Minimum Municipal Obligation (MMO) as required by the Commonwealth of Pennsylvania's Acts 205 and 189.

In fiscal year 2010, the City made several changes to the pension plan based on Act 44, which provided a new method of determining municipal distress levels and alternative funding relief in response to the 2008/2009 market decline. The City adopted fresh start amortization, alternating to 30 years and lowered the assumed rate of interest from 8.75% to 8.25% assuming a partial deferral of the pension payments in fiscal years 2010 and 2011 of \$150 million and \$90 million respectively, which must be repaid by fiscal year 2014. The change in amortization period and the partial deferral were approved by the Commonwealth of Pennsylvania General Assembly.

The Annual Pension Cost and related percentage contributed for the three most recent fiscal years are as follows:

(Millions of USD)

Fiscal Year Ended June 30	Annual Pension Cost	Percentage Contributed	Net Pension Obligation
2008	561.0	76.10%	(559.5)
2009	559.0	81.47%	(456.0)
2010	597.0	54.89%	(171.6)

The actuarial valuation to compute the current year's required contribution was performed as of July 1, 2009. Methods and assumptions used for that valuation include:

- The individual entry age actuarial cost method
- A ten-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 8.25%
- Projected annual salary increases of 5% (including inflation)
- Annual inflation of 2.75%
- No post-retirement benefit increases

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

(c) Annual Pension Cost and Net Pension Obligation

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

(Thousands of USD)

Annual Required Contribution (ARC)	581,123
Interest on Net Pension Obligation (NPO)	(39,899)
Adjustment to ARC	55,744
Annual Pension Cost	596,968
Contributions Made	(312,556)
Increase in NPO	284,412
NPO at Beginning of Year	(455,988)
NPO at End of Year	(171,576)
Interest Rate	8.75%
15 Year Amortization Factor (EOY)	8.18%

(d) 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.

19. OTHER POST EMPLOYMENT BENEFITS (OPEB)

Primary Government

Plan description: The City of Philadelphia self-administers a single employer, defined benefit plan and provides health care for five years subsequent to separation for eligible retirees. Certain union-represented employees may defer their coverage until a later date but the amount that the City pays for their

health care is limited to the amount that the City would have paid at the date of their retirement. The City also provides lifetime insurance coverage for all eligible retirees. Firefighters are entitled to \$7,500 coverage and all other employees receive \$6,000 in coverage. The plan does not issue stand alone financial statements, and the accounting for the plan is reported within the financial statements of the City of Philadelphia.

Funding Policy: The City funds its retiree benefits on a pay-as-you-go basis. To provide health care coverage, the City pays a negotiated monthly premium for retirees covered by union contracts and is self insured for non-unionized employees. For fiscal year 2010, the City paid \$71.7 million for retiree healthcare.

Annual OPEB Cost and Net OPEB Obligation: The City's annual other post employment benefit (OPEB) expense is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB statement 45. The ARC represents a level of funding, which if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty (30) years. The following table shows the components of the City's annual OPEB cost for the year, the amount actually contributed to the plan and changes in the net OPEB obligation (dollar amount in thousands).

Annual Required Contribution	93,602
Interest on Net OPEB Obligation	1,057
Adjustment to ARC	(815)
Annual OPEB Cost	93,844
Payments Made	(71,693)
Increase/(Decrease) in net OPEB Obligation	22,151
Net OPEB Obligation - Beginning of Year	21,150
Net OPEB Obligation - End of Year	43,301

Funded Status and Funding Progress: The City is funding OPEB on a pay-as-you-go basis and accordingly, the unfunded actuarial accrued liability for benefits was \$1.1 billion, as of July 1, 2009, the most recent actuarial valuation date. The covered annual payroll was \$1.5 billion and the ratio of the UAAL to the covered payroll was 79.0 percent.

Actuarial Methods and Assumptions: Costs were determined according to the individual entry age actuarial cost method with the attribution period ending at each decrement age. This is consistent with the cost method used for the City of Philadelphia Municipal Retirement System. Unfunded liabilities are funded over a 30-year period as a level percentage of payroll, which is assumed to increase at a compound annual rate of 4% per year. The actuarial assumption included a 5% compound annual interest rate on the City's general investments.

20. 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 \$3.3 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 \$4.8 million.

21. ENHANCED SECURITY

In light of the events of September 11, 2001, when terrorists struck the United States, the Water Department took steps to improve the security of the City's water supply and all other major Water Department facilities and assets. These steps were taken in close coordination with the City's Managing Director's Office and all other appropriate City agencies and departments. The Water Department is a representative agency in the City of Philadelphia Emergency Operations Center. The EOC is designed to permit City emergency personnel to respond quickly to any major event through specialized computer and communications equipment, including a backup 911 system.

This center can accommodate around-the-clock staffing by officials from the Police, Fire, Health and Water Departments and additional City agencies. The Water Department remains in contact with Federal, State and local law enforcement and emergency personnel and has performed a vulnerability analysis of its entire potable water system. The work was primarily funded by the EPA and the Water Department delivered its report to the EPA on March 31, 2003. Details of the enhanced security measures already taken, and those presently under consideration, cannot be 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; video surveillance equipment has been installed; and the Water Department continues to draw and conduct nearly one thousand tests on water samples from various locations each day. Municipal guards were assigned to the main entrance at each water plant in 2002 to control access to the facility to only authorized persons and/or deliveries. Online water-quality monitors provide continuous testing of all stages of the treatment process.

To further ensure the safety and quality of the City's drinking water, the Water Department will continue to expand its network to continuously monitor water quality using online instrumentation. The system provides the Department with the ability to track real-time water quality conditions at strategic locations throughout the City's water distribution system and to monitor any variations should they occur. Water quality data is currently transmitted

from more than 20 monitoring sites to the Water Department's central laboratory where engineers and scientists check for early warning signs of water quality deterioration and document any unforeseen changes.

The water treatment plants have online instrument clusters at multiple raw and finished water locations. These monitors will also be connected to the distribution system's monitoring network. The Water Department plans to assess the performance of the monitoring system at the current locations while continuing to investigate alternative technology for further installations at wholesale customer interconnects, pumping stations and other critical points in the distribution system.

Recently, the EPA, under its Water Security Initiative program, awarded a grant to the Water Department to develop and install a Contamination Warning System Demonstration Pilot for detecting and mitigating possible contamination of the City's drinking water distribution system. Philadelphia, New York, San Francisco and Dallas were the cities selected for this research pilot program. The City's project included total costs of \$12,599,846.

On November 21, 2008, the Department was notified that appropriations for the initial phase of the project totaling \$2,677,963 were approved. The initial phase included \$2 million in Federal funds and \$677,963 in local share. As of the close of calendar 2009, PWD has received \$5.75 million of Federal funding. PWD anticipates receiving an additional \$3.75 million in calendar year 2010, which will complete the full \$9.5 million Federal share for the Demonstration Pilot. The City's share will comprise approximately \$3 million when the project is finished. More than 80% of the City's share is comprised of services-in-kind, salaries and benefits for existing City employees assigned to the project.

The City recently received a grant to design and install Emergency Back-up Power generation at key facilities. The Water Department's treatment and finished water pumping stations were included. Installation of back-up power generators was completed at the Belmont High Service Pumping Station in 2007 and at the Samuel S. Baxter Water Treatment Plant in 2009. Capital contract work began in late 2009 on emergency back-up power generation installations at the Torresdale High Service Pump Station and the Roxborough High Service Pump Station. Design work is underway on emergency generation equipment for East Oak Lane Reservoir Pump Station and Fox Chase Booster Pumping Station. The remainder of the Water Department facilities are scheduled for design and construction over the next five fiscal years, with the final facility being in-service in 2015.



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