Financial Statements
For Fiscal Year Ended June 30, 2007

CITY OF PHILADELPHIA WATER DEPARTMENT

2007 FINANCIAL STATEMENTS

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The City of Philadelphia Water Department
Management Discussion and Analysis

The Philadelphia Water Department is a municipal utility serving the citizens of the Philadelphia region by providing integrated water, wastewater, and stormwater services. The utility's primary mission is to plan for, operate, and maintain both the infrastructure and the organization necessary to purvey high-quality drinking water, to provide an adequate and reliable water supply for all household, commercial, and community needs, and to sustain and enhance the region's watersheds and quality of life by managing wastewater and storm water effectively. The PWD operates three water plants treating an average of nearly 300 million gallons of Delaware and Schuylkill river water each day, three wastewater plants cleaning over 450 million gallons per day of sewage, a 73-acre biosolids recycling facility, a sophisticated testing laboratory, and a range of technical and administrative support services. In addition, the Department maintains 3,300 miles of water mains, 3,000 miles of sewers, 75,000 storm water inlets, over 27,500 fire hydrants, and extensive related infrastructure. The Water Revenue Bureau (WRB) of the Department of Revenue manages water and sewer billings and collections for the Water Department.

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

Financial Highlights

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

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

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

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

- A $2.6 million decrease in the Allowance for bad debt

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

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

Net Assets

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

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

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

Bond Issuance

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

The Department also issued $345,035,000 of Water and Wastewater Revenue Refunding Bonds, Series 2007A & 2007B. The proceeds of the 2007A Bonds were used to refund the remaining portions of the City's Water and Wastewater Revenue Bonds, Series 1997A and to pay costs of issuance relating to the Bonds. The proceeds of the 2007B Bonds were used to refund a portion of the

City's Water and Wastewater Revenue Bonds, Series 2001A and to pay costs of issuance relating to the Bonds. The transaction resulted in net present value savings in excess of $14.5 million in future debt service expense. These savings will primarily be recognized in FY09 through FY12, and will help to moderate rate increases during these years. All three of the major bond rating agencies (Moody's, Standard and Poor's and Fitch) affirmed their ratings for the Water Department.

Water and Wastewater Rates

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

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

Unlike many neighboring communities where sewer bills are separate from water bills or assessed through an annual charge, Philadelphians receive a bill that combines water, wastewater, and storm-water 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 following table, PWD's water rates are less than half those charged by many neighboring investor-owned utilities.

2007 Regional Residential Water and Sewer Charges*		
	Monthly Water Bill	**Monthly Sewer Bill**
Aqua Pennsylvania+	$45.60	N/A
Pennsylvania American Water+	$41.53	N/A
New Jersey American Water+	$33.53	N/A
North Penn Water Authority +	$23.68	N/A
North Wales Water Authority +	$22.85	N/A
Doylestown Township	$30.23	$49.76
CCMUA (Camden County) **	N/A	$26.25
Trenton	$21.58	$23.30
Philadelphia Water Department	***$20.36***	***$19.87***
Rates in effect on November 13, 2007. Storm water charges ($9.12) 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		

Bond Ratings

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

City of Philadelphia's Bond Ratings
General Obligation and Revenue Bonds

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

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

The following excerpt accompanied the affirmed A- rating of Fitch issued in March, 2007: Due to the management team's history of conservative budgeting and the system's solid operating performance, Fitch expects the system's trend of actual results outperforming projections to continue and the maintenance of a healthy cushion in the RSF.

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

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

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

Fund Balances

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

Maintaining excellence in water purity standards

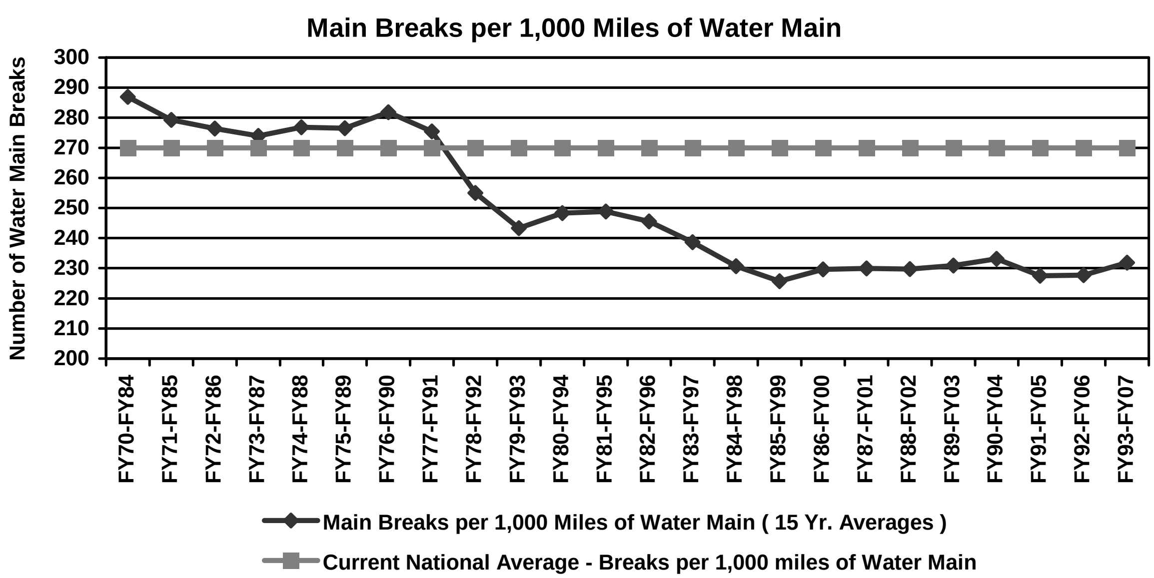
Philadelphia's drinking water meets or surpasses the requirements of state and federal standards 100 percent of the time. Since voluntarily joining the U.S. Environmental Protection Agency's (EPA) Partnership for Safe Water (PfSW) in 1996 (a joint program of the EPA and the water industry), the PWD has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

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

Optimize water and sewer main replacement.

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

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



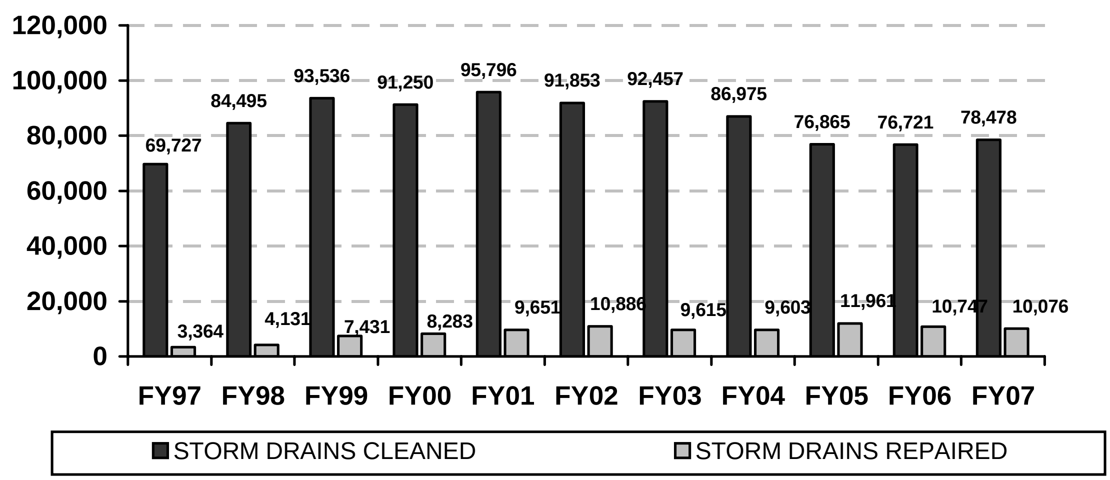
Reducing unbilled or non-revenue water

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

Improved storm-water flood control

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

PRODUCTIVITY ENHANCEMENTS LED TO MORE STORM DRAINS CLEANED & REPAIRED



Source: Philadelphia Water Department

In January 2006, PWD initiated new Storm-water 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 storm water best management practices. During FY 07, PWD received 757 conceptual submittals for zoning permits and 548 full Post Construction Technical submittals for building permits. Storm water regulations include four major components: Water quality protection, channel protection, flood control, and non-structural site design (minimizing impervious land cover). The results of this program since inception have been significant. Seventeen million gallons of storm water runoff has been captured, reducing stress on the storm water infrastructure, and treatment plants. The avoided cost of building more conventional storm water storage tanks for this runoff would have exceeded $34 million.

Protecting drinking water supplies

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

Long-term Control Plan for Combined Sewer Overflows

During heavy rainstorms, the release of some storm water and sewage over flows from combined sewers (sewers that carry storm water and sanitary waste in one pipe) to the City's rivers and streams, causes pollution to these waterways. Nearly eight years ago PWD began a short-term plan, using industry accepted best practices to operate our sewer system. These efforts successfully reduced overflow volume by three percent or six billion gallons a year. Our efforts included detecting and eliminating overflows during dry weather, getting the most storage possible in our sewer system, and stepping up inspections and monitoring at sites where overflows occur. Since then, we have begun a long-term control plan that included $48 million in capital improvements so we can capture even more flow in the sewer system. Our plan features a “watershed-based” approach, which involves other regional stakeholders in planning efforts that are more comprehensive and reach far beyond city boundaries.

Waterways Restoration Program

In FY04, the PWD created the Waterways Restoration Team (WRT), which consists of 2 crews devoted to removing trash and large debris from the streams and tributaries that define our neighborhoods. The teams also perform restoration work around PWD’s storm and combined sewer outfalls. In FY07, the teams removed 441 tons of debris, 41 cars, 1201 tires and 84 shopping carts from Philadelphia's streams. A large component of the team’s mission is to work in partnership with the FPC to restore tributaries and streams that have been significantly damaged over decades by the volume and velocity of flows from sewer outfalls and from the forces of storm water runoff. In FY07, the team tackled two restoration projects, providing interim stabilization to sites challenged by storm-water runoff that resulted in projects that were well received by FPC, regulatory agencies and citizens.

AWARDS AND RECOGNITION

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

Requests for Information

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

STATEMENT OF NET ASSETS, JUNE 30, 2007 AND 2006

(amounts in thousands)

	2007	2006
ASSETS		
Current Assets:		
Cash on Deposit and on Hand	$ 30	$ 30
Equity in Treasurer's Account	52,531	50,253
Due from Other Governments	329	109
Accounts Receivable	174,663	177,360
Allowance for Doubtful Accounts	(75,989)	(78,634)
Inventories	15,184	14,640
Total Current Assets	166,748	163,758
Noncurrent Assets:		
Restricted Assets:		
Equity in Treasurer's Account	350,933	368,675
Sinking Funds and Reserves	174,475	174,332
Grants for Capital Purposes	500	-
Receivables	2,114	2,784
Total Restricted Assets	528,022	545,791
Net Pension Asset	54,069	64,118
Capital Assets:		
Land	5,919	5,919
Infrastructure	1,796,638	1,752,461
Construction in Progress	115,525	146,831
Buildings and Equipment	1,462,116	1,390,699
Accumulated Depreciation	(1,687,615)	(1,597,139)
Total Capital Assets	1,692,583	1,698,771
Total Noncurrent Assets	2,274,674	2,308,680
Total Assets	**2,441,422**	**2,472,438**
LIABILITIES		
Current Liabilities:		
Vouchers Payable	5,077	5,107
Accounts Payable	11,725	7,377
Salaries & Wages Payable	2,406	2,225
Construction Contracts Payable	5,943	7,038
Accrued Expenses	14,985	18,435
Deferred Revenue	7,430	6,923
Funds Held in Escrow	345	-
Current Portion of Long Term Obligations	92,501	84,002
Total Current Liabilities	140,412	131,107
Noncurrent Liabilities:		
Long Term Obligations	1,669,810	1,758,799
Unamortized Discount and Loss	(82,232)	(88,496)
Other Noncurrent Liabilities	20,153	20,485
Total Noncurrent Liabilities	1,607,731	1,690,788
Total Liabilities	**1,748,143**	**1,821,895**
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	86,345	94,958
Restricted For:		
Capital Projects	84,786	51,990
Debt Service	174,475	174,332
Rate Stabilization	185,612	153,910
Unrestricted	162,061	175,353
Total Net Assets	**$ 693,279**	**$ 650,543**

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

(amounts in thousands)

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

STATEMENT OF CASH FLOWS
June 30, 2007

(amounts in thousands)

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

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

(amounts in thousands)

Revenues	Budgeted Amounts			Final Budget to Actual Positive (Negative)
	Original	Final	Actual	
Locally Generated Non-Tax Revenue	$ 465,286	$ 477,078	$ 486,917	$ 9,839
Revenue from Other Governments	1,600	1,500	520	(980)
Revenue from Other Funds	63,328	30,272	32,311	2,039
Total Revenues	**$ 530,214**	**$ 508,850**	**$ 519,747**	**$ 10,897**
Expenditures and Encumbrances				
Personal Services	109,721	103,818	101,056	(2,762)
Pension Contributions	34,100	34,513	34,513	-
Other Employee Benefits	31,019	31,138	31,138	-
Sub-Total Employee Compensation	174,840	169,469	166,707	(2,762)
Purchase of Services	97,059	85,617	83,967	(1,650)
Materials and Supplies	38,994	38,557	38,274	(283)
Equipment	4,820	3,658	3,134	(524)
Contributions, Indemnities and Taxes	6,603	6,038	2,445	(3,593)
Debt Service	178,826	176,415	173,923	(2,492)
Debt Service - Interest	-	-	-	-
Short-Term Interest	-	-	-	-
Payments to Other Funds	42,072	63,460	67,879	4,419
Total Expenditures and Encumbrances	**543,214**	**543,214**	**536,329**	**(6,885)**
Operating Surplus (Deficit) for the Year	**$ (13,000)**	**$ (34,364)**	**$ (16,581)**	**$ 17,783**
Fund Balance Available, July 1, 2006	-	-	-	-
Operations in Respect to Prior Fiscal Years				
Commitments Cancelled - Net	13,000	13,000	16,584	3,584
Prior Period Adjustments	-	-	(3)	(3)
Adjusted Fund Balance, July 1, 2006	13,000	13,000	16,581	3,581
Fund Balance Available, June 30, 2007	**$ -**	**$ (21,364)**	**$ -**	**$ 21,364**

CITY OF PHILADELPHIA WATER DEPARTMENT

BONDED DEBT FOR THE FISCAL YEAR ENDED JUNE 30, 2007
(amounts in thousands)

	ORIGINAL AUTHORIZATION					FISCAL YEAR 2008 DEBT		
Series	**Date**	**Issued**	**Outstanding June 30, 2007**	**Maturities**	**Interest Rates**	**Service Interest**	**Principal Requirements**	**Outstanding June 30, 2008**
Revenue Bonds:								
Fourteenth Series	5/15/89 *	$ 158,265	$47,200	10/2007 to 10/2008	N.A.	$ -	$ 23,600	$ 23,600
Series 1993	8/1/93 *	1,157,585	225,975	6/2008 to 6/2011	5.50 to 7.00	14,671	40,570	185,405
Series 1995	04/15/95	221,630	69,935	8/2007 to 8/2012	5.30 to 6.25	4,061	9,915	60,020
Series 1997 (A)	10/15/97	250,000	5,815	8/2007	5.00 to 5.25	153	5,815	-
Series 1997 (B)	11/25/97	100,000	83,600	8/2007 to 8/2027	Variable	3,033	2,500	81,100
Series 1998	12/25/98	135,185	135,185	12/2011 to 12/2014	5.25	7,097	-	135,185
Series 1999	07/07/99	33,040	-	12/2006	5.00	-	-	-
Series 2001	11/15/01	285,920	137,875	11/2011 to 11/2028	3.800 to 5.500	7,069	-	137,875
Series 2003	04/01/03	381,275	372,270	6/2008 to 6/2023	Variable	16,827	1,095	371,175
Series 2005 (A)	05/04/05	250,000	247,875	7/2007 to 7/2035	3.250 to 5.250	12,167	4,145	243,730
Series 2005 (B)	05/04/05	86,105	84,385	8/2007 to 8/2018	Variable	3,815	350	84,035
Series 2007 (A)	05/04/07	191,440	191,440	8/2007 to 8/2027	4.00 to 5.00	6,577	2,815	188,625
Series 2007 (B)	05/04/07	153,595	153,595	11/2007 to 11/2031	4.00 to 5.00	6,826	90	153,505
Pennvest	04/30/00	6,700	1,373	7/2007 to 4/2019	1.41 to 2.73	32	431	942
Total Revenue Bonds		**3,410,740**	**$1,756,523**			**82,328**	**91,326**	**1,665,197**
General Obligation Bonds:								
Pennvest	06/15/93	20,000	5,787	07/2007 to 04/2012	1.00	52	1,174	4,613
Total Bonded Debt			**$1,762,310**			**82,380**	**92,501**	**1,669,810**

* Partially Refunded

ANNUAL BONDED DEBT SERVICE REQUIREMENT:

Fiscal Year	Interest	Principal	Total
2008	82,380	92,501	174,881
2009	81,456	91,534	172,990
2010	77,829	95,164	172,992
2011	71,718	100,849	172,567
2012	64,128	107,908	172,036

The First Series through the Thirteenth were refunded.

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

SUPPLEMENTAL SCHEDULE OF RATE COVENANT COMPLIANCE FOR FISCAL YEAR ENDED JUNE 30, 2007 (Legally Enacted Basis)

(amounts in millions)

LINE NO.		2007
1.	Total Revenue and Beginning Fund Balance	$536,329
2.	Net Operating Expense	-303,135
3.	Transfer (To) From Rate Stabilization Fund	-25,959
4.	**Net Revenues**	**207,235**
5.	Revenue Bonds Outstanding	-172,696
6.	General Obligation Bonds Outstanding	0
7.	Pennvest Loan	-1,227
8.	**Total Debt Service**	**-173,923**
9.	**Net Revenue after Debt Service**	**33,312**
10.	Transfer to General Fund	-4,994
11.	Transfer to Capital Fund	-16,988
12.	Transfer to Residual Fund	-11,330
13.	**Total Transfers**	**-33,312**
14.	**Net Operating Balance for Current Year**	**0**

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

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

COVERAGE A:	
Line 4	**$207,235**
/ Line 5	**$172,696**
= COVERAGE A:	**1.20**

COVERAGE B:	
Line 4	**$207,235**
/ Line 8 + Line 11	**$190,911**
= COVERAGE B:	**1.08**

COVERAGE C:	
Line 4 - Line 3	**$233,194**
/ Line 5	**$172,696**
= COVERAGE C:	**1.35**

1. THE GOVERNMENT OF PHILADELPHIA

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. Basis of Accounting

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

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

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

B. Legal Compliance

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

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

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

The City Capital Improvement Fund budget is adopted annually by the City Council. The Capital Improvement budget is appropriated by project for each department. Due to the nature of the projects, it is not always possible to complete all bidding, contracts, etc. within a twelve-month period. All transfers between projects exceeding 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 6/30/07	$ ---0----
Assets omitted from the legal basis:	
(1) Receivables from Other Governments or Funds	$ 33,837
(2) Fixed Assets-Net of Depreciation	1,692,583
(3) Restricted Assets	528,022
(4) Proprietary Portion of Net Pension Obligation	54,068
	$ 2,308,510
Liabilities omitted from the legal basis:	
(5) Construction Contracts Payable	$ (5,943)
(6) Other Current Liabilities	(117,355)
(7) Bonds Payable and Other Long-Term Debt	(1,607,731)
	$(1,731,029)
Fund Balance accounts included in the legal basis:	
(8) Reserve for Collectible Receivables	$ 64,814
(9) Reserve for Inventories	15,184
(10) Reserve for Purchase Commitments	35,800
	$ 115,798
Equity accounts omitted from the legal basis:	
(11) Invested in Capital Assets, Net of Related Debt	(86,345)
(12) Restricted for Capital Projects	(84,786)
(13) Restricted for Debt Service	(174,475)
(14) Restricted for Rate Stabilization	(185,612)
	$ (531,218)
Unrestricted Net Assets – GAAP Basis – 6/30/2007	$ 162,061

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 etal. 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 2007 was $4,572,134.

I. Amortization of Bond Discount
Bond discounts and issuance costs are deferred and amortized by the bonds outstanding method.

J. Inventories
The materials and supplies inventory is priced using the “moving average cost” method.

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

L. Insurance
The City, except for the Gas Works, the Airport, and certain other properties, is self-insured for most fire and casualty losses to its structures and equipment and provides statutory worker’s compensation, unemployment benefits, and health and welfare to its employees through a self-insured plan. Construction contractors are required to carry

protective general liability insurance indemnifying the City and the Contractor. A reserve for payment of reported worker's compensation claims and incurred but unreported claims has been recorded in the accompanying financial statements as Other Long-Term Obligations.

M. Investments

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

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

N. Deferred Revenues

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

O. Interfund Charges

In accordance with an agreement between the Finance Director and the Water Department, the Finance Director may transfer to the General Fund up to a limit of $4,994,000 in any fiscal year in "excess interest earnings" as defined by the Rate Covenants under the Ordinance. In fiscal 2007, excess interest earnings of $4,994,000 were transferred to the General Fund of the City.

P. Prior Period Adjustment

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

3. ACCOUNTS RECEIVABLE

Balances consisted of the Following:

FISCAL YEAR ENDED JUNE 30, 2007

Accounts Receivable:	
Billed in the Last Twelve Months	$ 86,119,749
Billed in 15-year Cycle Billing	47,607,358
Penalties on Receivables	24,614,487
Other Receivables	16,321,080
Total	**$174,662,674**
Bad Debts Written Off	$ 8,403,718
ALLOWANCE FOR DOUBTFUL ACCOUNTS:	
Billed in the Last Twelve Months	$ 0
Billed in 15-year Cycle Billing	43,683,227
Penalties on Receivables	20,751,628
Other Receivables	11,554,577
Total	**$75,989,431**

FISCAL YEAR ENDED JUNE 30, 2006

Accounts Receivable:	
Billed in the Last Twelve Months	$ 86,042,036
Billed in 15-year Cycle Billing	49,448,573
Penalties on Receivables	25,744,039
Other Receivables	16,124,893
Total	**$177,359,541**
Bad Debts Written Off	$ 25,976,583
ALLOWANCE FOR DOUBTFUL ACCOUNTS:	
Billed in the Last Twelve Months	$ 0
Billed in 15-year Cycle Billing	45,884,017
Penalties on Receivables	21,960,171
Other Receivables	10,790,077
Total	**$78,634,265**

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

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

5. PROPERTY, PLANT AND EQUIPMENT

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

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

6. IMPAIRED ASSETS

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

In the past, as these assets were removed from service their cost was removed from Utility Plant in service. Assets that were removed from service include the first Mixing & Receiving building at our Biosolids Recycling center which was destroyed by fire in the early 1990's, the grit, scum and screenings incinerators and related handling equipment at our waster water plants which were abandoned due to clean air permit considerations, the chlorine facilities at our water and wastewater plants that were replaced due to safety and clean air act considerations and the high pressure fire system which was removed from service in January 2005 when it was determined to be functionally obsolete.

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

7. VACATION

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

8. SICK LEAVE

Employees are credited with varying amounts of sick leave per year according to type of employee and/or length of service. Employees may accumulate unused sick leave to 200 days and union represented employees may convert up to 20 sick days per year to vacation days at a ratio of 2 for 1. Non-uniformed employees (upon retirement only) are paid 30% of unused sick time, not to exceed predetermined amounts. Employees, who separate for any reason other than indicated above, forfeit their entire sick leave. The City budgets for and charges the cost of sick leave as it is taken.

9. CAPTALIZED LEASES

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

10. RATE STABILIZATION FUND

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

During Fiscal 2007 the fund had the following activity:

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

11. RESIDUAL FUND

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

During Fiscal 2007 the fund had the following activity:

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

12. DEFERRED COMPENSATION PLAN

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

13. ARBITRAGE REBATE

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

14. DEBT PAYABLE

<u>Defeased Debt</u>
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, $364.4 million of bonds outstanding was considered defeased.

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

<u>Interest Rate Swaption</u>
City of Philadelphia 1993 Water and Sewer Swaption/2003 Water and Sewer Swap

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

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

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

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

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

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

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

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

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

City of Philadelphia, 1995 Water & Sewer Swaption

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

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

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

Fair value: As of June30, 2007, the swap had a negative fair value of $4.3 million. Its fair value was estimated using the BDT option pricing model. This model takes into consideration probabilities, volatilities, time and underlying prices.

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

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

Fiscal Year Ending	Variable Rate Bonds		Interest Rate	
June 30	Principal	Interest	Swaps Net	Total Interest
2008	$ 350,000	$ 3,135,593	$ 672,513	$ 3,808,107
2009	370,000	3,121,855	669,567	3,791,421
2010	390,000	3,107,370	666,460	3,773,830
2011	405,000	3,092,310	663,230	3,755,540
2012	425,000	3,076,520	659,843	3,736,363
2013 - 2017	82,280,000	9,747,858	2,090,693	11,838,551
2018 - 2022	165,000	513	110	623
	84,385,000	25,282,018	5,422,417	30,704,434

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

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

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

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

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

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

15. PENSION PLAN

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

(1) City Plan

(a) Plan Description

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

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

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

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

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

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

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

(b) Funding Policy
Employee contributions are required by City Ordinance. For Plan 67 members, employees contribute 3.75% of their total compensation that is subject to Social Security Tax and 6% of compensation not subject to Social Security Tax. Plan 87 contribution rates are defined for the membership as a whole by Council ordinance. Rates for individuals are then determined annually by the actuary so that total individual contributions satisfy the overall rate set by Council.
The City is required to contribute the remaining amounts necessary to fund the Plan, using an acceptable actuarial basis as specified by the Home Rule Charter, City Ordinance and State Statute. Court decisions require that the City's annual employer contributions are sufficient to fund:

- The accrued actuarially determined normal costs;

- Amortization of the unfunded actuarial accrued liability determined as of July 1, 1985. The portion of that liability attributable to a class action lawsuit by pension fund beneficiaries (the Dombrowski suit) is amortized in level installments, including interest, over 40 years through June 30, 2009. The remainder of the liability is amortized over 34 years with increasing payments expected to be level as a percentage of each year's aggregate payroll;

- Amortization in level dollar payments of the changes to the July 1, 1985 liability due to the following causes over the stated period:
  - Non-active member's benefit modifications (10 years)
  - Experience gains and losses (15 years)
  - Changes in actuarial assumptions (20 years)
  - Active members' benefit modifications (20 years)

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

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

Annual Pension Cost and Net Pension Obligation

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

(Amounts in Thousands of USD)

Annual Required Contribution (ARC)	597,925
Interest on Net Pension Obligation (NPO)	(71,541)
Adjustment to ARC	99,953
Annual Pension Cost	556,337
Contributions Made	419,241
Increase in NPO	137,096
NPO at beginning of year	(817,614)
NPO at end of year	(680,518)
Interest Rate	8.75 %
15 Year amortization Factor (EOY)	8.18 %

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

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

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

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

(c) Summary of Significant Accounting Policies

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

16. POST EMPLOYMENT BENEFITS

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

17. CLAIMS, LITIGATION AND CONTINGENCIES

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

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

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

18. ENHANCED SECURITY

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

It should be noted that the Water Department had an extensive water quality protection and security plan in place prior to the events of September 11, 2002. All finished water basins are completely covered; all plants are fenced in and topped by barbed wire; gates are secured; and the Water Department continues to draw and conduct nearly one thousand tests on water samples from various locations each day.

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