BEFORE THE PHILADELPHIA WATER, SEWER AND STORMWATER RATE BOARD

Re Application of the Philadelphia Water Department for Increased Rates and Charges	Fiscal Years 2017-2018

DIRECT TESTIMONY OF MELISSA LABUDA

Q. PLEASE STATE YOUR NAME AND WORK ADDRESS FOR THE RECORD.

A. My name is Melissa LaBuda. My business address is 1101 Market Street, Fifth Floor, Philadelphia, Pennsylvania.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the City of Philadelphia and serve as the Water Department's ("Department" or "PWD") Deputy Commissioner in charge of finance.

Q. WHAT ARE YOUR JOB RESPONSIBILITIES?

A. I have overall responsibility for the Department's financial management, including accounting operations and financial reporting, budget formulation and execution, and financial planning.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I received a Bachelor of Science Degree in Business Administration from Bloomsburg University of Pennsylvania in 1995.

Q. PLEASE DESCRIBE YOUR RELEVANT WORK EXPERIENCE.

A. I joined the Department as an Assistant Deputy Commissioner in October 2013. I was elevated to my current position in August 2014. Before joining the Department I worked for a global financial institution where I served as an investment banker to public power and combined utility systems. Prior to that position, I worked for Public Financial Management, Inc. A more detailed description of my relevant work experience is set forth in my resume which accompanies my testimony as Exhibit ML-1.

Q. PLEASE DESCRIBE THE PURPOSE OF YOUR DIRECT TESTIMONY.

A. My direct testimony is divided into two parts. The purpose Part I is to: (i) provide an overview of the rate filing, including the reasons why the Department is seeking rate relief, (ii) summarize the Department's efforts to control its operating costs and minimize the need for rate relief since the last rate case, (iii) describe the requirements of the Philadelphia Home Rule Charter ("Charter"), the Philadelphia Code and the bond covenants related to rates, (iv) summarize the Department's financial challenges and risk factors, and (v) explain the reasons for the proposed rate period. The purpose of Part II is to: (i) describe the budgeting process, accounting practices and financial policies of the City and the Department, and (ii) discuss the Department's budget, accounting, and financial exhibits.

Q. PLEASE IDENTIFY THE EXHIBITS THAT ACCOMPANY YOUR DIRECT TESTIMONY.

A. The following exhibits accompany my testimony. Exhibits ML-2 through ML-7 are described in greater detail in subsequent sections of my testimony.

Exhibit ML-1	Resume
Exhibit ML-2	Rating Agency Reports
Exhibit ML-3	Table 1 – Water Operating Fund, Fund Balance Summary
Exhibit ML-4	Budget Charts for FY13-16
Exhibit ML-5	Table 2 – Water and Wastewater Revenue Bonds Debt Service
Exhibit ML-6	Black & Veatch Table 12, 2012 Rate Proceeding Financial Plan
Exhibit ML-7	PWD FY14 Financial Statements

Part I

Overview of Rate Filing and Supporting Reasons

Q. PLEASE SUMMARIZE THE RELIEF THAT THE DEPARTMENT IS REQUESTING THROUGH THIS FILING?

A. The proposed rate increase is designed to meet a projected revenue shortfall of approximately $105 million during the Rate Period (Fiscal Years 2017 and 2018). It is important to note that the revenue increase does not fully cover the revenue shortfall as the projected withdrawals from the rate stabilization fund for the same time-frame total approximately $58 million.

Q, PLEASE BRIEFLY DESCRIBE THE PROPOSED RATE INCREASE.

A. The Department is proposing rates to achieve average annual increases of 5.42% to its revenue base during Fiscal Year 2017 (FY 2017), which begins on July 1, 2016 and ends on June 30, 2017, and 5.42% during Fiscal Year 2018 (FY 2018), which begins on July 1, 2017 and ends on June 30, 2018.

In the City of Philadelphia, the average residential customer has a 5/8 inch meter and uses approximately 600 cubic feet of water monthly (i.e. typical customer). Under the proposed schedules of water and wastewater rates, the total monthly bill for the typical customer using 600 cubic feet of water per month would increase from $67.43 to $71.59, an increase of $4.16 or about 6.2 percent in Fiscal Year 2017, and to $75.51, an increase of $3.91 or about 5.5 percent in Fiscal Year 2018.

Q. WHY IS THE DEPARTMENT REQUESTING A RATE INCREASE AT THIS TIME?

A. The Department's last rate proceeding was in 2012. Over the last four years, the Department has made significant efforts to control spending where it is possible to do so. However, unavoidable increases have occurred in several areas, including labor and workforce costs, employee health care and pension benefits, purchase of services necessary for regulatory compliance, infrastructure maintenance costs, and cost of debt service. These costs are, generally, costs that do not vary with output and will increase over time.

- The Department is facing substantial capital costs that are required to replace and/or renew aging infrastructure. The Departments Capital Budget for FY16 to FY21 totals $1.78 billion. The City of Philadelphia Water Department entered into a Consent Order & Agreement (CO&A) with the Pennsylvania Department of Environmental Protection (PaDEP) on June 1st, 2011 which obligates the City to meet state and federal environmental mandates. These mandates impact both the operating and capital budgets.

- The City of Philadelphia completed labor negotiations and has established contracts with AFSCME District Council 33 and District Council 47 resulting in increased salary costs. In addition, the Water Fund's contribution to the City's pension fund is growing over the next several years. The potential impact of the labor settlements was not an allowable expense in the prior rate proceeding.

- Bucks County Water and Sewer Authority terminated its wholesale water contract on June 30th, 2014 totaling a revenue loss of approximately $7 to $ 8 million annually.

- Without the requested rate relief, the Department's financial results would deteriorate in Fiscal Years 2017 and 2018. This would jeopardize the Department's ability to maintain its aging infrastructure and improve services. It also could have a negative effect on the Department's bond rating, which would increase costs.

Q. WHAT ACTIONS HAS THE DEPARTMENT TAKEN SINCE THE LAST RATE PROCEEDING TO LOWER ITS COSTS OF BORROWING AND ITS FINANCIAL AND OPERATING EXPENSES?

A. Like all water and wastewater utilities, the Department is challenged by rising costs in a number of areas. Some of the measures taken by the Department to lower or manage its costs include: (1) refinancing debt, (2) negotiating new wastewater agreements with wholesale customers at the expiration of contract terms, (3) effecting long-term operational savings at major plants and facilities, (4) mitigating financial risk through implementation of the Long Term Control Plan (LTCP) for controlling combined sewer overflows and improving water quality as required by the Consent Order and Agreement entered into by the City and PaDEP in 2011, and (5) ongoing investigation and recovery of unpaid revenues. Amore detailed description of each of these matters follows below

<u>Debt Issuance</u>
On January 14th, 2014, the Department sold $123,170,000 of City of Philadelphia, Water & Wastewater revenue Bonds, Series 2014 A. The bonds were used for the following purposes: (i) refund a portion of the Water & Sewer Revenue Bonds, Series 2005A, (ii) finance a portion of the capital improvement program, and (iii) to pay costs related to the transaction. The refunding portion of the transaction generated approximately $6.8 million in net present value savings, or 6.98% of refunded par. The savings were structured uniformly across all maturities, and the resultant cash flow savings are approximately $500,000 to $635,000 per year.

On March 31st, 2015, the Department sold $417,560,000 million of City of Philadelphia, Water & Wastewater Revenue Bonds, Series 2015A and Series 2015B. The Series 2015A bonds were issued to fund the following: (i) fund the Department's capital improvement program, (ii) fund the debt service reserve account and (iii) pay the costs of issuance. In order to better align the Department's useful life of its assets with the debt issued to fund those assets, the debt was issued with long-dated maturities whereby the first principal maturity occurs in 2036 and the final maturity occurs in 2045.

This strategy not only better aligns the useful life of assets with the average life of debt, it also served as a cost savings to current rate payers as current rate payers are not bearing the full financial burden of an asset that will benefit future rate payers over the next 40 to 50 years.

The Series 2015B bonds were issued for the following purposes: (i) refund a portion of the Water & Sewer Revenue Bonds, Series 2005A and Series 2007A, (ii) finance a portion of the capital improvement program, and (iii) to pay costs related to the transaction.

The 2015B Bonds resulted in net present value savings of approximately $19,815,464.44, or 12.93% of refunded par. The savings were structured uniformly across all maturities, and the resultant cash flow savings are approximately $2.8 million in Fiscal Year 2016, $852,900 in Fiscal Year 2017, and $781,000 in Fiscal Year 2018. Thereafter savings range from $480,000 to $1.2 million in years 2019 to 2036.

<u>Rate Stabilization Fund</u>
The Rate Stabilization Fund (RSF) was established in conjunction with the Series 1993 Revenue Bonds to provide funds to cover annual expenditures when the revenues are less than projected and to prevent the need for large swings in the water rates year to year. As such the Department completed the following withdrawals and deposits to/from the RSF:

> In Fiscal Year 2013, the Department had a required withdrawal of $4,666,000 from the Rate Stabilization Fund to cover fiscal year expenditures.
>
> In Fiscal Year 2014, the Department made a deposit to the Rate Stabilization Fund of $22,925,000.
>
> In Fiscal Year 2015, the Department made deposit to the Rate Stabilization Fund of $21,456,000.
>
> In Fiscal Year 2016, Fiscal Year 2017 and Fiscal 2018, as detailed in B&V table 1, the Department is projecting additional withdrawals of $36.9 million, $19.3 million and $39 million respectively to mitigate large shifts in rate increases year over year.

<u>Consent Order and Agreement Cost Included in Wholesale Contracts</u>
The Department has negotiated new wastewater treatment agreements with four of the City's wholesale customers. The Department targets adding CO&A expenses at the time of each current contract's expiration date. The new contracts require the wholesale customers to pay for their proportional share of the City's CO&A obligations.

<u>Revenue Protection Unit</u>
The Department's Revenue Protection Program, which investigates and recovers unpaid revenues, identified additional billings of approximately $14 million from FY2013 to FY2015.

Q. WHAT IS THE ANTICIPATED FUTURE BORROWING BY THE DEPARTMENT DURING THE RATE PERIOD?

A. The Department expects to finance its Capital Improvement Program using revenue bonds, pay-as-you-go financing, and possibly alternate sources of funding, including loans or grants. A significant portion of the costs of the Capital Improvement Program are expected to be funded with the proceeds of debt to be incurred during FY 2016 through 2021. The City expects most of such debt to be in the form of new money revenue bonds issued in several transactions, as necessary.

Anticipated Future Borrowings for Capital Improvement Program during the Rate Period are identified below:

Fiscal Year	Estimate Principal Amount
2017	$270,000,000
2018	$275,000,000

Q. WHAT ARE THE REQUIREMENTS AND STANDARDS OF THE HOME RULE CHARTER AND PHILADELPHIA CODE WITH RESPECT TO RATES AND CHARGES?

A. Section 5-800 of the Home Rule Charter ("Charter") authorizes to the Department to operate its water and wastewater facilities, including fire and drinking hydrants, water meters, sewage system and sewage disposal plants. Section 5-801 historically authorized the Department to establish rates and charges for its services consistent with ratemaking standards ordained by City Council. In November 2012, Philadelphia voters approved an amendment to the Charter to allow City Council to establish, by ordinance, an independent ratemaking body responsible for fixing and regulating rates and charges for water and wastewater services (the Water, Sewer and Stormwater Rate Board, hereinafter the "Board"), provided that City Council, by ordinance, establish open and transparent processes and procedures for fixing and regulating those rates and charges, including ratemaking standards (hereinafter, the "Rate Ordinance"). The Rate Ordinance was enacted and became effective on January 20, 2014, and its substantive provisions are set forth as part of Section 13-101 of the Philadelphia Code.

Section 13-101(4) of the Philadelphia Code, entitled "*Standards for Rates and Charges,*" contains the ratemaking standards. This section, among other things, requires the Board to establish rates and charges sufficient to fund budgeted operating expense and annual debt service obligations from current revenues and to comply with rate covenants and the sinking fund reserve requirement. In addition, this section requires the Board to: (i) fully consider the Water Department's Financial Stability Plan, (ii) consider all relevant information with respect to funding of capital expenditures and minimum levels of reserves, (iii) develop rates and charges in accordance with sound utility rate making practices and consistent with industry standards for water, wastewater and stormwater utilities (including standards published by the American Water Works Association and the Water Environmental Federation), and (iv) establish special rates and charges for certain categories of customers. The proposed rates are designed to meet these standards.

Q. ARE THERE OTHER REQUIREMENTS IN THE PHILADELPHIA CODE THAT APPLY TO RATE PROCEEDINGS?

A. Yes. The Rate Ordinance also requires the Department to develop a comprehensive plan ("Financial Stability Plan" or "Financial Plan") in which the Department forecasts capital and operating costs and expenses and corresponding revenue requirements. The Financial Stability Plan must identify the strengths and challenges to the Department's overall financial status including the Water Fund's credit ratings, planned and actual debt service coverage, capital and operating reserves and utility service benchmarks. In the plan the Department also must compare itself to similar agencies in peer cities in the United States. The Department must submit an updated Financial Stability Plan to City Council every four years and update the plan prior to proposing revisions in rates and charges. These requirements are set forth in the Philadelphia Code at Section 13-101(2), entitled "*Water Department Financial Stability Plan.*"

Q. HAS THE DEPARTMENT PREPARED AND SUBMITTED A FINANCIAL STABILITY PLAN AS REQUIRED BY THE RATE ORDINANCE AND THE PHILADELPHIA CODE?

A. Yes, the Department has always prepared a Financial Plan as part of every prior rate proceeding. Please see Exhibit ML-6 for the Summary of the 2012 rate proceeding Financial Plan. In this table, the Department detailed debt service coverage levels, new debt issuance impacts, targeted use and resulting balances in the Rate Stabilization Fund and Residual Fund.

In addition, the prior filings also detailed the additional assumptions which further drive the overall financial condition of the Department. To that end, the Department has once again prepared a Financial Plan as part of its filing and has mirrored the Black & Veatch assumptions and results in its separate document titled the "Financial Stability Plan". This document is included in the rate filing as Exhibit PW-2. It is critical to stress that the Department can never have two separate financial plans.

Q. PLEASE DESCRIBE THE DEPARTMENT'S FINANCIAL PLAN.

A. The Water Department will maintain financial practices and policies that result in high quality investment grade bond ratings so as to ensure the lowest practical cost of debt necessary to finance the Water Department's long-term capital program.

The Water Department will maintain strong levels of operating cash reserves, which will reside in the Rate Stabilization and Residual Funds, for the management of unforeseen expenses. The Department must maintain at least $110 million in the Rate Stabilization Fund (RSF) and $15 million in the Residual Fund, adjusted for inflation.

- RATE STABILIZATION FUND – Established in conjunction with the Series 1993 Revenue Bonds to provide funds to cover annual expenditures when the revenues are less than projected and to prevent the need for large swings in rates year to year.

- RESIDUAL FUND – Established to maintain the remaining revenues after payment of all operating expenses, all debt service obligations (including those under a Swap agreement), scheduled transfers to the RSF and required deposits to the Capital Account of the Construction Fund.

  Residual Fund may be used to fund the following and among other things: operating expenses, transfers to any other Water Fund accounts (other than the Revenue Fund or the RSF), and transfers to the City's General Fund in an amount not to exceed the lower of (a) net revenue earnings (as defined in the Ordinance) and (b) $4.994 million.

- The Department does not set rates to cover 100% budget as such these funds are required to allow for any unforeseen expenses and to also balance the original budget.

- The reserves will, at a minimum, include any requirements contained in the Water Department's General Bond Ordinance.

The Water Department will maintain a minimum senior debt service coverage of 124 percent in FY2016, 125 percent in FY2017, 126 percent in FY2018, and 135 percent by FY2019, maintaining this level of coverage thereafter, which are in excess of the 1989 General Bond Ordinance (hereinafter defined) requirement of 120 percent. Senior debt service coverage will be calculated in accordance with the General Bond Ordinance. Excess operating revenue above stated projections will be used to increase debt service coverage and result in additional pay-as-you-go capital funding.

The Water Department will whenever possible use the least costly type of financing for capital projects, based on a careful evaluation of the Water Department's capital and operating requirements and financial position for each year.

PWD will target to fund at least 20% of the capital program with cash, thereby reducing a portion of long-term borrowing requirements or needs.

The Water Department will attempt to match the period of debt repayment, in total, with the lives of the assets financed by any such debt.

The Department follows the City of Philadelphia's cash management and investment policy set by the City Treasurer's Office. More information on this policy can be found on the Treasurer's website: http://www.phila.gov/treasurer/Pages/default.aspx.

Q. PLEASE DESCRIBE THE CITY'S OBLIGATIONS TO BONDHOLDERS RELATED TO RATES AND CHARGES.

A. In the 1989 General Ordinance[1] the City covenanted with the bondholders that it will impose, charge and collect rates and charge in each Fiscal Year sufficient to produce annual net revenues which are at least 1.20 times the debt service requirements, excluding the amounts required for subordinated bonds (as defined in the 1989 General Ordinance). In addition, the City's covenants to its bondholders require that net revenues in each fiscal year must be equal to 1.00 times (A) annual debt service requirements for such fiscal year, including the amounts required for subordinated bonds, (B) annual amounts required to be deposited in the debt reserve account, (C) the annual principal or redemption price of and interest on General Obligation Bonds payable, (D) the annual debt service requirements on interim debt, and (E) the annual amount of the deposit to the Capital Account (less amounts transferred from the Residual Fund to the Capital Account) – the Rate Covenants.

Further, the City's bond insurance policies contain an insurance covenant which requires the City to establish rates sufficient to produce net revenues (excluding amounts transferred from the Rate Stabilization Fund into the Revenue Fund for a given year) equal to at least 90% of debt service requirements (as defined by the 1989 General Ordinance) – the Insurance Covenant. In this testimony, the Rate Covenants and the Insurance Covenant are collectively referred to as the "Bond Covenants."

Q. WHY IS IT IMPORTANT THAT THE DEPARTMENT FULFILL ITS OBLIGATIONS TO INVESTORS UNDER THE BOND COVENANTS?

A. A failure by the Department (City) to comply with any provision of its revenue bonds or with any Bond Covenant (a "Covenant Default") constitutes an event of default as defined under the 1989 General Ordinance. In the event of a Covenant Default, a bondholder of any of the Department's revenue bonds will be entitled to all of the remedies provided under the First Class City Revenue Bond Act (the "Act"). More specifically, upon such event, the holders of 25% in aggregate principal amount of the affected series of the Department's revenue bonds may appoint a trustee to

1. The Restated General Water and Wastewater Revenue Bond Ordinance of 1989, as amended, is generally referred to in this testimony as the 1989 General Ordinance.

represent such bondholders to exercise remedies. Such trustee may, and upon the written request of the holders of 25% in aggregate principal amount of such revenue bonds must, sue the City at law or in equity to enforce the rights of the aforesaid bondholders.

Q. ARE THERE OTHER CONSEQUENCES OF FAILING TO ESTABLISH RATES THAT SATISFY THE REQUIREMENT OF THE BOND COVENANTS?

A. Yes. The Department's current bond ratings could be lowered and its cost of raising capital increased, if it fails to establish rates that meet all applicable Bond Covenants and certain legal requirements specified in the Charter and City Code, as referenced above.

Q. WHY IS IT IMPORTANT FOR THE DEPARTMENT TO MAINTAIN ITS CURRENT BOND RATINGS?

A. These ratings are important because the Department, like most utilities, is required to make significant capital investments each year for new and replacement infrastructure. The Department will need continued access to the capital markets as a source of financing these system improvements. Bond ratings are a critical component in determining the cost of debt that is necessary to compensate bondholders for the risk of lending money. A downgrade of the ratings for Water Department bonds would result in higher operating costs for the Department and higher rates for our customers.

Q. HOW HAVE THE BOND RATING AGENCIES RATED THE DEPARTMENT'S BONDS?

A. In March of 2015, Fitch Ratings, Moody's and S&P assigned to municipal bond ratings of "A+" with a stable outlook, "A1" with a stable outlook and "A" with a positive outlook, respectively to the City of Philadelphia, Philadelphia Water Department Series 2015A and Series 2015B Bonds.

Q. WHAT EVENTS, OTHER THAN DEFAULTING ON THE BOND COVENANTS, COULD RESULT IN A DOWNGRADING OF THESE BOND RATINGS?

A. The rating agencies have identified several factors that could result in negative rating actions. Moody's Investor Service stated that failure to increase rates commensurate with incremental increases in debt service or significant narrowing of debt service coverage from current levels could result in a ratings downgrading. Moody's also noted that the new Rate Board's willingness to increase rates and maintain adequate coverage levels will be a key factor in the Water Department's ratings going forward. Furthermore, Moody's noted that the City's demographic profile is below average with an unemployment rate exceeding the national average. Fitch Ratings stated that difficulty in achieving rate relief from the Rate Board could result in negative rating action. Fitch also noted that weak income levels in the service area persist. Standard & Poor's Rating Service stated that the Department has a high system ratio of debt-to-capital, is highly leveraged and is likely to require significant additional debt funding and higher rates. It added that it could lower the Department's ratings if financial metrics deteriorate or a significant amount of capital spending is added to the Department's capital improvement plan. Copies of these rating reports are attached to my testimony as Exhibit ML-2.

Financial Challenges and Risk Factors

Q. WHAT IS THE MOST SIGNIFICANT FINANCIAL CHALLENGE FACING THE DEPARTMENT DURING THE RATE PERIOD?

A. In addition to the challenges mentioned by the bond rating agencies, the ongoing implementation of the Department's Long Term Control Plan for controlling combined sewer overflows and other capital programs will be a significant financial challenge for the Department during the Rate Period. The Department has revised its financial plan and strategies to address the increasing capital and operating requirements associated with its capital planning initiatives and liquidity reserves. Among the financial challenges the Department faces in connection with its revised financial plan are the following: (i) managing cash reserves with the dual intent of covering expenditures when revenues are not sufficient and to prevent the need for large swings in rate increases, (ii) targeting higher coverage levels above the minimum required by the 1989 General Ordinance, and (iii) increasing internally generated funds for the Department's capital improvement program to more closely mirror other municipal water and wastewater utilities.

Q. WHAT OTHER MAJOR FINANCIAL RISK FACTORS ARE PRESENTED DURING THE RATE PERIOD?

A. A few areas where the Department has risk exposure include the following: (i) environmental regulation, (ii) general economic conditions, and (iii) security of the utility system.

Environmental Regulation **–** The Department is subject to state and federal environmental laws and regulations applicable to its facilities. These laws and regulations are subject to change, and the City may be required to expend substantial funds to meet the requirements of such changing laws and regulations in the future. Failure to comply with these laws and regulations may result in the imposition of administrative, civil and criminal penalties, or the imposition of an injunction requiring the City to take or refrain from taking certain actions. In addition, the City may be required to remediate contamination on properties owned or operated by the City or on properties owned by others, but contaminated as a result of City operations. These remedial costs are charged to the Water Fund if they result from prior operations of the Water Department.

Water and wastewater services are governed by various federal and state environmental protection and health and safety laws and regulations, including the federal Safe Drinking Water Act, the Clean Water Act and similar state laws, and federal and state regulations issued under these laws by the U.S. Environmental Protection Agency (EPA) and PaDEP. These laws and regulations establish, among other things, criteria and standards for drinking water and for discharges into the waters of the United States and nearby states. Pursuant to these laws, the Water Department is required to obtain various environmental permits for operations. Environmental laws and regulations are complex and change frequently. These laws, and the enforcement thereof, have tended to become more stringent over time. While the Water Department has budgeted for future capital and operating expenditures to comply with these laws and permitting requirements, it is possible that new or stricter standards could be imposed that will require additional capital expenditures or raise operating costs.

General Economic Conditions – The Department's financial condition and results of operations may also be affected by general economic conditions. A general economic downturn may lead to a reduction in discretionary and recreational water use. General economic turmoil also may lead to an investment market downturn, which may result in asset market values (including pension plan assets) suffering a decline and significant volatility. For instance, a decline in the City's pension plans' asset market values could increase required cash contributions to these plans from the Water Fund and increased pension expenses in subsequent years.

Security of the System – Damage to our infrastructure resulting from vandalism, sabotage, or terrorist activities may also adversely affect the operations and finances of the utility system. There can be no assurance that the City's security, emergency preparedness and response plans will be adequate to prevent or mitigate such damage, or that the costs of maintaining such security measures will not be greater than currently anticipated.

The Department is increasingly dependent on the continuous and reliable operation of information technology systems, and a disruption of these systems, resulting from cyber security attacks or other events, could adversely affect its business. PWD relies on information technology systems with respect to customer service and billing, accounting and, in some cases, the monitoring and operation of treatment, storage and pumping facilities. In addition, the Department relies on these systems to track utility assets and to manage maintenance and construction projects, materials and supplies. A loss of these systems, or major problems with the operation of these systems, could adversely affect operations and have a material adverse effect on the financial condition and results of operations of the Department.

Q. DO YOU HAVE ANY ADDITIONAL RECOMMENDATIONS FOR ACTIONS THAT THE DEPARTMENT OR BOARD MAY TAKE TO CONTROL THE COST OF BORROWING AND IMPROVE THE DEPARTMENT'S FINANCIAL CONDITION?

A. Yes. If the Department's revenues exceed projections, the Department should use the excess revenues to grow coverage beyond the stated minimums so as to improve the cash funding or pay-as-you-go portion of capital, and the Board's decision should enable the Department to grow coverage if this occurs.

Q. PLEASE DESCRIBE WHY THE DEPARTMENT IS PROPOSING A TWO-YEAR RATE PERIOD?

A. As stated previously, the Department must establish rates that meet the requirements of the Bond Covenants and the Rate Ordinance. The last rate proceeding began with the Department giving notice to City Council on February 3, 2012 and extended until the final rate determination on December 20, 2012, approximately 11 months later. The cost of the process was exorbitant. The Rate Ordinance establishes a new process under which the Board is required to make a final decision on proposed new rates and charges within 150 days (approximately 5 months) from the filing of the advance notice with the Board and City Council, and within 120 days (approximately 4 months) of filing the formal notice with the Department of Records. If the Board is able to successfully complete rate proceeding within the required time period, both the length and cost of the rate setting process will be reduced. This would allow the Department to file more frequent rate proceedings with shorter rate periods. Given that this is the first rate proceeding under the new rate setting process, the Department has chosen to a two-year rate period as optimal for determining whether shorter rate periods and rate filing on a more frequent basis are preferable to the prior practice of proposing 4-year rate periods.

PART II

Overview of the City's Budgeting Process, Accounting Practices and Financial Policies

Q. PLEASE DESCRIBE THE VARIOUS CITY DEPARTMENTS AND OFFICES THAT WORK WITH THE WATER DEPARTMENT TO PREPARE THE WATER DEPARTMENT'S OPERATING BUDGET, CAPITAL BUDGET AND CAPITAL PROGRAM.

A. The Director of Finance is the chief financial and budget officer of the City and is responsible for the financial functions of the City, including the development of the annual operating budget, the capital budget, and capital program. The Office of Budget and Program Evaluation (OBPE) within the Office of the Director of Finance oversees the preparation of the operating and capital budgets.

Q. PLEASE BRIEFLY DESCRIBE THE CITY'S PROCESS FOR PREPARING THE ANNUAL OPERATING BUDGET.

A. The Charter requires City Council, at least thirty days before the end of the fiscal year, to adopt the City's annual operating budget for the next fiscal year. The City's fiscal year begins July 1st and ends on June 30th of the following calendar year. City Council's consideration of the operating budget ordinance begins with the receipt of the Mayor's annual operating budget message and proposed annual operating budget ordinance.

The City's annual operating budget is comprised of a consolidated budget of all the operating obligations and expected revenues of the City. The operating funds of the City consist of the General Fund, nine Special Revenue Funds, and two Enterprise Funds (Water and Aviation). Each of these funds is subject to annual operating budgets adopted by City Council. Included with the Water Fund is the Water Residual Fund. 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 (Class 100), purchase of services (Class 200), materials, supplies and equipment (Class 300 and 400), contributions, indemnities and taxes (Class 500), debt service (Class 700), payments to other funds (Class 800), and advances and other miscellaneous payments (Class 900). Expenditures for the repair of any property, the repaving, resurfacing or repairing of streets, and the acquisition of any property, or for any work or project which does not have a probable useful life to the City of at least five years are deemed to be ordinary expenses provided for in the annual operating budget ordinance.

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 City Council approval. Appropriations that are not expended or encumbered at fiscal year-end are lapsed.

The annual review process for the operating budget has several stages. The process begins with the gathering of information on exogenous variables which is followed by the Budget Call, where departments are required to submit their budget requests, including the following information: previous fiscal year actual expenditures, current estimates, the proposed current budget, the five year plan estimates, and information on personnel projections. The information is also sorted by major class and fund as legally required. Departments submit their budget requests which are compiled and used by OBPE to discuss departmental requests with the departments (including potential areas of expenditure reductions or revenue measures) and make budgetary recommendations to the Mayor.

At least 90 days before the end of the Fiscal Year the operating budget for the next Fiscal Year is prepared by the Mayor and must be submitted to City Council for adoption. Once the budget review process is over, OBPE assembles the proposed budget which is submitted to Council in the form of a budget bill. Once the budget bill is introduced in City Council, the Operating Budget Detail is prepared and distributed in time for the annual City Council budget hearing process.

Q. PLEASE BRIEFLY DESCRIBE THE CITY'S PROCESS FOR PREPARING THE ANNUAL CAPITAL BUDGET AND CAPITAL PROGRAM.

A. The City's capital budget and program is comprised of a consolidated budget of all the expected capital expenditures of the City, and a six-year forward looking plan for capital expenditures. The Charter requires the Capital Budget and Program to be adopted by City Council on an annual basis at least thirty days before the end of the fiscal year.

The capital funds of the City consist of General Obligations bonds, self-sustaining revenue bonds, funding from other sources including federal and state government, and private sources. These funds are appropriated for each City department with capital improvements by project through the major class real property (Class 600). The Capital Budget serves as the one year guide for capital expenditures. Any appropriations that are not spent or encumbered at fiscal year-end are either carried forward to the next fiscal year for upcoming use or lapsed. The capital budget ordinance, authorizing in detail the capital expenditures to be made or incurred in the ensuing fiscal year, is adopted by City Council concurrently with the capital program. The capital budget must be in full conformity with that part of the capital program applicable to the fiscal year that it covers.

The capital program serves as a blueprint for capital expenditures and facilitates long range planning for capital improvements in the City's infrastructure, community facilities, and public buildings. The capital program is prepared annually by the City Planning Commission and OBPE to present the capital expenditures planned for each of the six ensuing fiscal years, including the estimated total cost of each project and the sources of funding (local, state, federal, and private) estimated to be required to finance each project.

The annual review process for capital spending requests and recommendations has several stages. All departments requesting capital funding must submit a formal annual request to the City Planning Commission. In addition to their annual capital requests, the agencies are required to present their capital needs over a six year period. After the submission period is over, the City Planning Commission and OBPE meet with each agency, analyze the capital requests, and recommend projects for the Six Year Capital Program. The capital program is reviewed by the Mayor and transmitted to City Council for deliberation and adoption.

Q. PLEASE DESCRIBE THE CITY'S COST CLASSIFICATION SYSTEM.

A. Major classes of expenditures within each City department are defined as: personal services (Class 100), purchase of services (Class 200), materials, supplies and equipment (Class 300 and 400), contributions, indemnities and taxes (Class 500), real property (Class 600), debt service (Class 700), payments to other funds (Class 800), and advances and other miscellaneous payments (Class 900). The cost items included in these classes is described in greater detail below.

Class 100 – Personal Services – This category includes employee compensation and related expenses. Included items are the cost of both regular and overtime salaries, compensation for holidays, vacation, jury duty, funeral leave, military time, the cost of employer paid fringe benefits such as health, welfare, and insurance the cost of employer paid taxes such a social security, Medicare, and unemployment, and the cost of pension contributions made on behalf of past and present employees.

Class 200 – Purchase of Services – This category includes the costs of outside services supplied on behalf of the Water Fund. It includes costs for electricity, telephone, natural gas, biosolids transportation, disposal, and application, repairs made by outside vendors, outside consultants and professionals, rented space, and advertising.

Class 300 – Equipment – This category include the costs of chemicals, pump parts, supplies, fuel, heating oil, vehicle parts, lubricants, and other related items.

Class 400 – Equipment – This category includes the cost of heavy equipment, tucks, vehicles, boats, trailers, cranes, sewer cleaning machines, and other related items.

Class 500 – Contributions, Indemnities, Taxes, and Awards – This category includes payments made by the Law Department on behalf of the Water Department for liabilities, claims, and property damage. It also includes certain taxes and employee awards.

Class 700 – Debt Service – This includes the cost of principal and interest payments due on revenue bonds and other debts of the Department.

Class 800 – Interfunds – This category includes payments to other City departments for services rendered to the Water Department.

Class 900 **-** Advances and other miscellaneous payments.

Q. PLEASE BRIEFLY DESCRIBE THE CITY'S ACCOUNTING PRACTICES AND FINANCIAL POLICIES

A. The Charter requires the City to balance its budget each fiscal year. All revenue and appropriation estimates are on a modified accrual basis in accordance with generally accepted standards. Revenues are recognized as soon as they are both measurable and available. Expenditures are generally recorded when a liability is incurred, as in the case of full accrual accounting. Debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due; however, those expenditures may be accrued if they are to be liquidated with available resources. Budget schedules prepared on the legally enacted basis differ from the General Accepted Accounting Principles (GAAP) basis in that both expenditures and encumbrances are applied against the current budget, adjustments affecting activity budgeted in prior years are accounted for through fund balance or as reduction of expenditures, and certain inter-fund transfers and reimbursements are budgeted as revenues and expenditures.

Q. HOW DOES THE CITY REPORT AND AUDIT ITS FINANCES?

A. The City reports its financial performance on a consolidated basis in its audited Comprehensive Annual Financial Report ("CAFR"). The CAFR is audited by the City Controller. In addition, the City is required, under the Charter, to issue within one hundred and twenty (120) days after the close of each fiscal year, a statement as of the end of the fiscal year showing the balances in all funds of the City, including the Water Fund, the amounts of the City's known liabilities, and such other information as is necessary to furnish a true picture of the financial condition of the City and its component units, including the Water Department (the "Annual Financial Report"). The Annual Financial Report is intended to meet these requirements and is not audited. It also contains budgetary comparison schedules for funds, including the Water Fund, that are subject to an annual budget. Historically, financial results have not changed between the Annual Financial Report and the CAFR. The Annual Financial Report for the Fiscal Year ending June 30, 2015 and the CAFR for the Fiscal Year ending June 30, 2014 are available on the City's Investor Website at: http://www.phila.gov/investor.

Q. WHAT IS THE WATER FUND?

A. 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 for the City's water and wastewater system. The operations of the Water Department are accounted for in the Water Fund, which is an enterprise fund of the City.

Q. PLEASE BRIEFLY DESCRIBE THE CITY'S RELATIONSHIP AND REPORTING TO THE PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY.

A. The Pennsylvania Intergovernmental Cooperation Authority ("PICA") was created on June 5, 1991 by the PICA Act for Cities of the First Class (the "PICA Act"). The City of Philadelphia is the only city of the first class in Pennsylvania.

The PICA Act provides that, upon request by the City to PICA for financial assistance and for so long as any bonds issued by PICA remain outstanding, PICA shall have certain financial and oversight functions. The PICA Act requires the City to annually develop a five-year financial plan and obtain PICA's approval of it. PICA has the power, in its oversight capacity, to exercise certain advisory and review procedures with respect to the City's financial affairs, including the power to review and approve five-year financial plans prepared at least annually by the City, and to certify non-compliance by the City with the then-existing five-year plan adopted by the City pursuant to the PICA Act. PICA is also required to certify non-compliance if, among other things, no approved five-year plan is in place or the City has failed to file mandatory revisions to an approved five-year plan. The PICA Act requires the City to prepare and submit quarterly reports to PICA so that PICA may determine whether the City is in compliance with the then-current five-year plan.

Q. WHAT IS THE MOST RECENT FIVE-YEAR PLAN SUBMITTED BY THE CITY?

A. The most recent Five Year Financial and Strategic Plan submitted by the City pursuant to the PICA Act is the plan presented to City Council on March 5, 2015, for Fiscal Years 2016-2020. It is available online at: http://www.phila.gov/Newsletters/FY16FY20FiveYearPlanFINAL.pdf.

Overview of the Department's Budgeting Process, Accounting Practices, and Financial Policies

Q. HOW DOES THE WATER DEPARTMENT DETERMINE ITS ANNUAL OPERATING BUDGET?

A. The Water Department, like all other City departments, submits a proposed budget to the City's Budget Bureau and the City's Managing Director's Office for consideration and inclusion in the

Mayor's proposed annual operating budget. The Water Department began preparation of its operating budget for Fiscal Year 2016 in September 2014. In November 2014, each of the Department's divisions and the Water Revenue Bureau submitted their budget proposals setting forth their estimated obligations for Fiscal Year 2016. Revenue estimates were prepared by the Water Revenue Bureau under the direction of the City's Office of the Director of Finance and Water Department. The Water Commissioner, with the assistance of the Department's Finance Division, reviewed all of the budget proposals of the various Water Department divisions and the Water Revenue Bureau. In January 2015, the Water Commissioner submitted the Department's Fiscal Year 2016 budget proposal to the City's Budget Bureau and the City's Managing Director's Office. The Mayor reviewed the Department's budget proposal and included it in the City's proposed operating budget for Fiscal Year 2016, which were submitted to City Council on March 5, 2015. The City's Fiscal Year 2016 annual operating budget was approved by City Council and signed by the Mayor on June 18, 2015.

Q. HOW DOES THE WATER DEPARTMENT DEVELOP ITS CAPITAL IMPROVEMENT PROGRAM AND CAPITAL BUDGET?

A. The Water Department updates its capital improvement program and capital budget annually as part of its annual budget process, based on a detailed project review by engineering staff, external engineering consultants, and senior management. Each division of the Department uses its budgeting system to prepare capital budget requests based on historical and current experience. The Department began preparing its capital budget request for Fiscal Year 2016 in October 2014. The budget was approved by the City Planning Commission and the Mayor's office and included in the City's capital budget for Fiscal Year 2016, Five-Year Financial and Strategic Plan for Fiscal Years 2016-2020, and Capital Program for Fiscal Years 2016-2020, all of which were submitted to City Council on March 5, 2015. The City's capital budget for FY 2016 and its capital program for Fiscal Years 2016 through 20202 were approved by City Council and signed by the Mayor on June 18, 2015.

Q. HOW ARE THE CITY'S ACCOUNTING AND FINANCIAL POLICIES APPLIED TO THE WATER FUND ACCOUNTS?

A. For purposes of rate setting, calculating compliance with the Rate Covenant and 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 recorded on a receipts basis, except revenues from other governments and interest, which are accrued as earned. A 100% reserve is provided for all doubtful non-governmental receivables. With respect to governmental receivables, a 100% reserve is provided when the City has reason to believe that no appropriation has been made by other governments to finance these receivables. The Water Department does not account for payments for water and sewer service from its governmental contract customers as "revenues from other governments." Expenditures are recognized and recorded as expenses at the time they are paid or encumbered, except expenditures for debt service and lease payments which are recorded when paid. A reserve is maintained for encumbrances at the close of the fiscal year intended to be sufficient to liquidate estimated obligations incurred in such fiscal year.

Q. PLEASE EXPLAIN THE MEANING OF "ENCUMBRANCE" AND "LIQUIDATED ENCUMBRANCE" AS THOSE TERMS ARE USED IN THE DEPARTMENT'S ACCOUNTING DOCUMENTS AND FINANCIAL STATEMENTS.

A. An encumbrance is an expense that is anticipated to be charged to the Water Fund. Liquidated encumbrances represent cancelled commitments. The Department's budgetary l statements treat liquidated encumbrances as contra-expense.

Overview of the Department's Budget, Accounting, and Financial Exhibits

Q. PLEASE PROVIDE AN OVERVIEW OF THE DEPARTMENT'S PRINCIPAL BUDGET, ACCOUNTING AND FINANCIAL EXHIBITS.

A. The Department's principal accounting and financial exhibits are Exhibits ML-3 (Table 1 – Water Operating Fund, Fund Balance Summary), Exhibit ML-4 (Budget Charts for FY13-16), Exhibit ML-5 (Table 2 – Water and Wastewater Revenue Bond Debt Service), and ML-7 – (Water Department FY2014 Financial Statements).

Q. PLEASE EXPLAIN EXHIBIT ML-3?

A. This exhibit depicts the Water Operating Fund and Fund Balance Summary. The columns labeled "FY'13 Year-End Actual" and "FY'14 Year-End Actual" summarize the Department's actual revenues, obligations/appropriations, adjustments and balances for Fiscal Years 2013 and 2014, respectively, as audited. The column labeled "FY'15 Year-End Unaudited" contains the same unaudited information for Fiscal Year 2015. The column labeled "FY'16 Black &Veatch Projected Budget" summarizes the same information as budgeted for the Department in the City's Fiscal Year 2016 annual operating budget, as adopted by City Council on June 18, 2015, and updated as part of the cost of service study reflecting various spend factors and other adjustments. As explained by the testimony of Black & Veatch, for purposes of developing projections for Fiscal Years 2017 and 2018, further adjustments were made to the budgeted data, where necessary, to ensure that the projections are representative of the levels that the Department expects to experience during the Rate Period.

Q. PLEASE IDENTIFY THE MAJOR OPERATING COST PROJECTIONS THAT UNDERPIN THIS REQUEST FOR RATE RELIEF AS SHOWN ON EXHIBIT ML-3?

A. The major cost projections that underpin this request for a rate increase are in the following expense areas:

- Personal Services (Class 100), which are summarized on the rows labeled "Personal Services," "Personal Services – Employee Benefits," and "Sub-Total Employee Compensation",
- Purchase of Services (Class 200), which is summarized on the rows labeled "Purchase of Services",
- Debt Service (Class 700), which is summarized on the row labeled "Debt Service", and
- Inter-fund Payments (Class 800), which is summarized on the row labeled "Payment to Other Funds – Net Payment to Rate Stabilization Fund."

Q. WHY ARE THE DEPARTMENT'S COSTS FOR PERSONAL SERVICES INCREASING?

A. Personal service costs are increasing because of new collective bargaining agreements with the City's unions and rising costs of the City's employee benefit programs. As noted in the City's Five Year Financial and Strategic Plan for Fiscal Years 2016-2020, employee health care and pension benefits are the largest and fastest growing expenditures of the City's budget. In addition the Department's improved focus on Human Resources is reducing vacancies in Department in a meaningful manner. Both of these trends are leading to higher Class 100 costs for personal services.

Please see the following documents for annual reporting of Water Department employees: (i) City of Philadelphia, Mayor's Fiscal Year 2014 Budget Book II, (ii) City of Philadelphia Mayors Fiscal Year 2015 Budget Book II, (iii) City of Philadelphia Fiscal Year 2016 Budget Book II, and (iv) City of Philadelphia, Quarterly City Manager Report – For the Period Ending September 30, 2015. As a point of reference, the fiscal year end and first quarter 2015 full-time Water Department employee counts are as follows:

As of June 30, 2012 1,636
As of June 30, 2013 1,712
As of June 30, 2014 1,761
As of June 30, 2015 1,758
As of September 30, 2015 1,799

Q. WHY ARE THE DEPARTMENT'S COSTS FOR PROFESSIONAL SERVICES INCREASING?

A. Professional service costs are increasing primarily because of Department's need to contract with vendors, suppliers, and consultants and expand the stormwater management incentive programs to meet the requirement for controlling combined sewer overflows under federal and state laws and the CO&A entered into by the City and PaDEP in 2011.

Q. PLEASE DESCRIBE THE CHANGE IN COSTS FOR MATERIALS, SUPPLIES AND EQUIPMENT IN RECENT YEARS.

A. As shown on Exhibit ML-3, costs for materials, supplies and equipment (Classes 300 and 400) projected in Fiscal Year 2016 have increased but have not increased substantially as compared to actual costs in Fiscal Year 2013.

Q. PLEASE DESCRIBE THE CHANGE IN COSTS FOR CONTRIBUTIONS, INDEMNITIES AND TAXES AS SHOWN ON EXHIBIT ML-3 AND ANY PROJECTIONS FOR THIS CATEGORY OF COSTS DURING FISCAL YEAR 2016.

A. Costs for contributions, indemnities and taxes (Class 500) increased from $5,090,380 in FY 2013 to a budgeted amount of $6,605,000 in Fiscal Year 2016. Claims payable by the Department are expected to meet or exceed the budgeted amount during Fiscal Year 2016 due to an increase in exposure due to claims from recent water main breaks. The available balance in the indemnity account for claims payable by the Water Fund has declined from the initial appropriation of $6,605,000 on July 1, 2015, to approximately $2,509,025 on December 7, 2015. Based on the number of claims and the value of claim funds set aside to pay expenditures or claims during the first four months of Fiscal Year 2016, less than 50% of the total appropriated amount remains available to pay claims during the final seven months of Fiscal Year 2016.

Q. PLEASE DESCRIBE THE CHANGE IN COSTS FOR DEBT SERVICE AS SHOWN ON EXHIBIT ML-5.

A. Costs for debt service (Class 700) increased from $201,015,411 in Fiscal Year 2013 to a projected amount of $220,713,000 in Fiscal Year 2016, as shown on Exhibit ML-3 on the row labeled "Debt Service."

Debt service for Fiscal Year 2017 and Fiscal Year 2018, as projected by Black & Veatch, is $207,714,000 and $223,661,000 respectively.

Q. PLEASE EXPLAIN ANY FACTORS THAT SHOULD BE CONSIDERED WHEN PROJECTING DEBT SERVICE COTS FOR FISCAL YEARS 2017 AND 2018.

A. As part of the City's budgeting process, the Department works with the City of Philadelphia Treasurer's Office to establish the Department's debt service budget for the following five fiscal years. To formulate the debt service budget, the Department reviews historical and projected capital spending levels to ascertain the timing of future debt needs. Once the timing and amount of capital spending is formulated, the Department and its Financial Advisor, Public Financial Management, prepare a series of projected debt schedules reflecting the timing of future issuance needs.

Q. PLEASE DESCRIBE OTHER PAYMENT OBLIGATIONS OF THE WATER FUND.

A. The City of Philadelphia provides the Department with a number of services which support the Department's ongoing operations. The costs of those services are reflected as either direct appropriations for the Water Revenue Bureau, Law Department, Office of the Director of Finance, and other City departments and offices, as reflected in the Mayor's Budget, or as inter-fund transfers from the Water Department to other City departments and offices. Direct appropriations for these departments and offices are shown in the rows included in Obligations/Appropriations on Exhibit ML-3. Inter-fund transfers are included in the row labeled "Payment to Other Funds – Net Payment to Rate Stabilization Fund" on Exhibit ML-3.

Q. PLEASE EXPLAIN EXHIBIT ML-4?

A. Exhibit ML-4 graphically depicts the Water Fund's total obligations both on an actual cost and percent basis for Fiscal Year End 2013, Fiscal Year End 2014, Fiscal Year End 2015 and Projected Fiscal Year 2016.

As detailed in exhibit ML-4, the Water Fund's largest expenses are for personal services and debt service payments which total approximately 60% in each fiscal year presented.

Q. PLEASE EXPLAIN EXHIBIT ML-5?

A. Exhibit ML-5 details the Water Fund's existing debt service payments as of June 30th, 2015 for currently outstanding debt. It does not detail projected future debt issuance.

Q. **PLEASE SUMMARIZE THE RESULTS OF THE 2012 RATE CASE PROJECTIONS AS COMPARED TO YEAR-END RESULTS.**

A. The financial projections in the 2012 rate case show that we out-performed our projections in Fiscal Years 2013, 2014 and 2015. The reasons for this over performance are summarized in the Financial Plan that is being filed as part of this rate proceeding. See Exhibit PWD-2, page 17.

Q. **DOES THIS CONCLUDE YOUR TESTIMONY?**

A. Yes, it does.

Exhibit ML-1

Melissa LaBuda

[redacted]

EXPERIENCE

City of Philadelphia, Philadelphia Water Department, Philadelphia, Pennsylvania
Deputy Water Commissioner, *2015 to Present*
Assistant Deputy Water Commissioner *2013 to 2014*

- Responsible for the Water Department's financial management including: accounting operations and financial reporting; budget formulation and execution; and financial planning.

Representative Accomplishments

- Lead the development of a long-range financial planning model for the Water Department.
- Project leader on the update of the Water Department's Cost Allocation Plan for FY2013 and FY2014
- Established protocols to monitor the Water Department's operating and capital budget spending.
- Encouraged and facilitated training for the Water Departments finance team members.

Morgan Stanley, Inc., New York, New York
Fixed Income Division, Public Finance Department – Vice President *2005 to 2013*

- Lead client relationship manager to Public Power and Combined Utility System's nationally.
- Structure and market various financing and refinancing options to municipal debt issuers. Work independently and as a team member on all aspects of business development, development of product marketing materials, responses to request for proposals, rating agency and investor materials.
- Relationship development expertise that resulted in expansion of the Firm's municipal client base, increasing revenues.

Representative Transaction

- Led marketing, structuring and execution of the South Carolina Public Service Authority's ("Santee Cooper") Series 2012ABC Transaction. Transaction included forward delivery and current delivery refinancing. Worked extensively with Santee Cooper on a presentation to investors and rating agencies that (i) effectively articulated current status of the Summer Nuclear Station expansion, (ii) detailed Santee Cooper's financial condition, and (iii) reviewed potential impact of pending EPA regulations on existing coal plants.

Public Financial Management, Inc., New York, New York
Financial Advisory - Senior Managing Consultant *2001 to 2005*

- Analyzed, structured and executed municipal debt transactions for Utility and Transportation issuers. Worked independently and as a team member on all aspects of transactions including complex modeling, marketing, structuring, pricing, execution and documentation.
- Performed pre and post-pricing analysis including analysis of comparable transactions, market conditions and overall plan of finance objectives. Created rating agency presentations, and written marketing materials for existing clients.

Representative Transactions

- Provided structuring and analytical advice to MEAG Power, JEA, Energy Northwest, BATA, MBTA, and ACTA on debt restructuring and new money issuance totaling in excess of $6 billion of debt.
- Analyzed and structured the State of Wisconsin $1.7 billion Pension Obligation Bonds, which generated in excess of $335 million of present value savings.

Morgan Stanley Investment Management, West Conshohocken, Pennsylvania
Marketing Services - Associate *1999 to 2001*

- Created product proposal responses for Morgan Stanley Investment Management's investment services, specifically for high yield, emerging market debt and investment grade fixed income products.

Public Financial Management, Inc., Harrisburg, Pennsylvania
Asset Management Group - Trader *1996 to 1999*

- Primary responsibility was daily trading of $1 billion dollar short-term investment grade, pooled fixed income portfolio. Also, Assisted in management of individual portfolios for California and Pennsylvania local governments.

Dauphin Deposit Bank & Trust Co., Harrisburg, Pennsylvania
Private Asset Management - Analyst *1995 to 1996*

- Gained familiarity with handling of stock and bond trading from retail and institutional perspective.

EDUCATION

Bloomsburg University of Pennsylvania, Bloomsburg, Pennsylvania
Bachelor of Science in Business Administration May *1995*

FitchRatings

Fitch Rates Philadelphia, PA's Water & Sewer Rfdg Revs 'A+'; Outlook Stable

Ratings Endorsement Policy
20 Mar 2015 12:42 PM (EDT)

Fitch Ratings-New York-20 March 2015: Fitch Ratings has assigned an 'A+' rating to the following Philadelphia, PA (the city) revenue bonds:

--Approximately $300 million water and wastewater revenue bonds, series 2015A;
--Approximately $100 million water and wastewater refunding revenue bonds, series 2015B.

The city expects to sell the bonds in a negotiated sale on March 31. Proceeds of the series 2015A bonds will fund a portion of the city's water and wastewater system's ongoing capital program. Proceeds of the series 2015B bonds will refund portions of the city's water and wastewater system outstanding parity debt (series 2005A and a portion of the 2007A bonds, depending on market conditions)) for cost savings with no extension of bond maturity dates.

In addition, Fitch affirms the following rating:

--$1.78 billion in outstanding water and wastewater revenue bonds at 'A+'.

The Rating Outlook is Stable.

SECURITY
The bonds and outstanding parity bonds are secured by a senior lien on combined net revenues of the Philadelphia Water Department (PWD or the system) water and sewer system. Both the series 2015A and 2015B bonds will also be secured by a debt service reserve fund equal to.

KEY RATING DRIVERS

SOUND MANAGEMENT GUIDES STABLE OPERATIONS: Financial performance of the PWD is satisfactory for the rating category. Operations typically generate narrow, but consistent debt service coverage levels that are somewhat mitigated by a sound level of liquidity and affordable rates.

ELEVATED DEBT LEVELS TO INCREASE: Debt levels are moderately high and sizeable additional borrowing plans are expected over the medium term. Leverage concerns are heightened by the imposition of a new ratemaking board, which will determine PWD's future ability to fund capital needs from a healthy mix of equity and long-term debt.

LARGE CAPITAL PLAN: The capital program remains sizeable and will continue to be elevated for some time as a result of required consent order projects and sizeable maintenance costs associated with the city's aging infrastructure.

ECONOMIC CHARACTERISTICS REMAIN MIXED: The service area is highly diverse and well anchored by a broad economy. However, weak income levels persist, contributing to chronically below-average collection rates and high water loss.

AMPLE CAPACITY: Water supply and overall system treatment capacity are sufficient for the foreseeable future.

RATING SENSITIVITIES

ACCELERATING CAPITAL AND DEBT PLANS: Continued escalation of debt levels to meet rising capital costs beyond what is currently included in the six-year capital improvement plan (CIP) could ultimately pressure the rating.

POLITICIZATION OF RATE RELIEF: Difficulty in achieving rate relief under a new ratemaking board could lead to negative rating action.

CREDIT PROFILE

LARGE, DIVERSE CUSTOMER BASE
The water system serves all of the 1.55 million residents of the city as well as an additional 57,000 people in neighboring Montgomery and Delaware Counties. The system's customer base is highly diverse, comprised predominantly of residential users with the 10 largest customers accounting for just 11% of fiscal 2014 total billings. The wastewater service area, which serves greater portions of the surrounding counties, includes a larger population estimated at nearly 2.3 million.

PWD maintains 10 wholesale agreements for wastewater service and one wholesale contract for water service to customers outside of the city. In total, wholesale revenues accounted for a nominal 5.5% of total system revenues in fiscal 2014. All wholesale agreements except for one are long-term, extending through at least fiscal 2023. Only PWD's smallest wholesale customer has a contract that expires prior to 2023 (in 2017).

SUFFICIENT CAPACITY
Average daily water demand is comfortably below permitted water supply and treatment capacity at all facilities, and daily wastewater flows are well within treatment plant permit limits. Available water supplies from the Delaware and Schuylkill rivers are sufficient for the foreseeable future, although significant water loss through the city's delivery system persists. Unauthorized consumption was reduced significantly during the 1990s, but progress has since stalled as non-revenue water has averaged about 32% annually over the last five years.

The system continues to struggle with below average collection rates with an estimated 90% of budgeted revenues collected on a current basis. The inclusion of delinquent collections brings total collections to a more acceptable 96% (estimated) of budgeted revenues each year. Nevertheless, the amount of operating revenues in accounts receivable is consistently high at about 90 days.

SOUND FINANCIAL MANAGEMENT LEADS TO CONSISTENT OPERATING RESULTS
Fitch believes the system's financial operations are well managed, despite historically narrow debt service coverage levels. Management budgets to meet a satisfactory 1.3x debt service coverage (DSC) target, which in some years requires transfers from PWD's rate stabilization fund (RSF) to balance lower projected cash flow amounts.

Depending on yearly consumption, collections and containment of operating expenditures, the RSF is utilized to augment operating revenues. However, rate revenues have historically covered debt service obligations by a satisfactory margin without the use of the RSF. Financial projections have historically shown sizeable annual drawdowns of the RSF, although actual results have either reduced or eliminated the need for the planned transfers.

Operating results for fiscal 2014 were positive relative to prior projections. DSC improved to 1.4x, and a sizeable deposit was made from excess cash flow to the RSF, increasing the year-end balance to $184.6 million. Prior projections included a nearly $8 million withdrawal from the RSF to supplement projected cash flow needs. Total available liquidity, which includes the RSF, PWD's residual fund and unrestricted cash and investments also improved, increasing to a more robust 290 days of cash on hand.

Affordable user charges provide the system with sufficient capacity to raise revenues if needed. Yearly rate increases have been modest, averaging about 5% since 2002. Consequently, the average combined water and sewer bill for residential users approximates just 1.7% of median household income (MHI). Including the city's stormwater fee levied according to the amount of impervious area a rate-payer owns, monthly charges rise to what Fitch believes is still a reasonable level at 2.2% of MHI.

Projected results through fiscal 2021 appear achievable with DSC and liquidity continuing at acceptable levels. DSC is forecast to remain at 1.3x, although Fitch notes the targeted DSC level relies on RSF transfers in certain years. Consequently, the projected RSF balance declines modestly from its current level to a still healthy balance of $167 million by fiscal 2021. The forecast shows a slight increase in total liquidity, which should keep the number of days cash on hand intact.

Assumptions built into the forecast appear reasonable, although planned rate increases will depend on board approval. Modest declines in consumption are incorporated into the projections, and no additional growth in customer accounts is assumed.

NEW RATE SETTING BODY

With voter authorization in 2012, the city recently established the Philadelphia Water, Sewer, and Storm Water Rate Board (the board), an independent rate-making body responsible for fixing and regulating water, sewer and stormwater rates. The ordinance requires the five-member board to consider the PWD's financial stability plan and to evaluate the impact of rates and charges on PWD's overall financial performance and the system's bond ratings when setting rates. However, the only absolute requirement of the board is to establish rates and charges sufficient to fund budgeted operating expenses and annual debt service obligations from current revenues.

The establishment of the board raises some concern for Fitch given the system's escalating capital program and growing debt levels. It remains uncertain as to what extent the new regulatory body will be committed to reducing its reliance on debt issuance to fund capital needs and instead support a higher level of capital investment from rates revenue. With the 2012 adoption of a series of rate increases lasting through the current fiscal year, and no plans to raise rates in fiscal 2016, PWD's first rate case filing is not expected to occur until the latter part of 2015, with any rate adjustment taking effect at the outset of fiscal 2017.

ENVIRONMENTAL REGULATIONS DRIVE LARGE CAPITAL PROGRAM
After several years of negotiations, the Pennsylvania Department of Environmental Protection (PA DEP) and the city signed a consent order and agreement (the COA) in June 2011 requiring the city to substantially eliminate combined sewer overflows (CSOs) over the following 25 years. To comply with the COA, the city is employing its Green City, Clean Waters Program (the program), which will utilize largely green technologies to capture rainwater runoff that would otherwise infiltrate and overwhelm the sewer system. The system also offers a credit to customers willing to reduce the amount of impervious area on their property in favor of more green space.

Compliance with the COA will require the city to spend approximately $2.4 billion over the 25-year period. The program also includes wastewater treatment facility enhancements and pipe renewal and replacement. Fitch views the program favorably considering that alternative strategies to mitigate CSOs, including the construction of tunnels and storage tanks, would have cost substantially more.

Projected capital spending through fiscal 2020 totals $1.78 billion. The current CIP represents a slight increase of about 1% over the prior six-year plan, but annual growth over the last several years has been more pronounced at closer to 8%. Management believes the capital program is at a peak level and that a gradual reduction in spending will begin within the next few years. Nevertheless, the cumulative projected capital spending has the potential to place downward pressure on the rating over the medium term, particularly if the system continues to pursue nearly 100% debt financing for the CIP.

LEVERAGED SYSTEM
Debt to net plant (93%) and all-in debt service as a percentage of gross revenues (30%) remained consistent with prior years, but will likely escalate in future years based on planned borrowings to support the CIP. Through fiscal 2019, Fitch expects that total debt outstanding will rise by approximately 18%, and debt issuances through fiscal 2021 will roughly double scheduled principal amortization occurring over the same period, based on the current capital plan. Somewhat offsetting this concern is the slightly above average pay-out of existing debt relative to similarly rated systems as well as a sizeable drop-off in debt service that begins in 2019 that will allow future bond issuances to be structured around existing obligations.

ECONOMIC IMPORTANCE OFFSETS WEAK SOCIOECONOMIC INDICATORS
Philadelphia's large population, sound economic underpinnings and distinct role as the economic driver for the broader metropolitan statistical area ensure the continued stability of PWD's service area. Unemployment continues to trend downward after remaining persistently high during and after the recent economic recession. The city's December 2014 unemployment rate fell to a 6.2% compared to 8.2% at the same point in 2013. Weak income levels persist as median household income approximates just 70% of the state and national averages.

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Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria and Related Research:
--'Revenue-Supported Rating Criteria' (June 2014);
--'U.S. Water and Sewer Revenue Bond Rating Criteria' (July 2013);
--'2015 Water and Sewer Medians' (December 2014);
--'2015 Outlook: Water and Sewer Sector' (December 2014).

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
U.S. Water and Sewer Revenue Bond Rating Criteria
2015 Water and Sewer Medians
2015 Outlook: Water and Sewer Sector

Additional Disclosure
Solicitation Status

MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns A1 to Philadelphia, PA's $400M 2015 Water and Sewer Revenue Bonds; outlook stable

Global Credit Research - 19 Mar 2015

Affirms A1 on outstanding debt; A1 applies to $1.85B of debt, post-sale

PHILADELPHIA (CITY OF) PA WATER AND SEWER ENTERPRISE
Combined Water & Sewer Enterprise
PA

Moody's Rating

ISSUE		RATING
Water and Wastewater Revenue Bonds, Series 2015A		A1
Sale Amount	$300,000,000	
Expected Sale Date	03/19/15	
Rating Description	Revenue: Government Enterprise	
Water and Wastewater Revenue Refunding Bonds, Series 2015B		A1
Sale Amount	$100,000,000	
Expected Sale Date	03/19/15	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook STA

NEW YORK, March 19, 2015 --Moody's Investors Service assigns a rating of A1 to the Philadelphia Water and Sewer Enterprise, PA's $300 million Series 2015A and $100 million Refunding Series 2015B Water and Wastewater Revenue Bonds. The outlook is stable. Concurrently, Moody's affirms the A1 rating on the utility's outstanding water and sewer revenue bonds. Post-sale, the utility will have $1.85 billion of senior lien revenue bonds (excluding state revolving fund loans) outstanding.

SUMMARY RATING RATIONALE

The A1 rating incorporates the water department's large and diverse service area, stable operating profile, narrow but consistent debt service coverage, and manageable debt burden. The rating also recognizes the utility's heavy capital needs including those associated with a Commonwealth DEP consent order and agreement, implying a likelihood of increasing debt and potential pressure on coverage levels unless the city continues its solid history of consistent annual rate increases.

OUTLOOK

The stable outlook reflects the city's willingness to continue investing in its system, increasing user rates annually, and maintaining ample operating liquidity. The city's ability to maintain adequate coverage levels will be a key factor in its rating going forward.

WHAT COULD MAKE THE RATING GO UP

Improvement in debt service coverage to levels more consistent with peers

Ongoing improvements in service base

WHAT COULD MAKE THE RATING GO DOWN

Failure to increase rates commensurate with incremental increases in debt service

Significant narrowing of debt service coverage from current levels

STRENGTHS

Large and diverse service area

Solid liquidity

Demonstrated willingness to increase user rates

CHALLENGES

Commonwealth DEP consent order and agreement implying likely increase in capital needs

Heavy capital investment requirements

Debt service coverage somewhat narrower than peers

RECENT DEVELOPMENTS

The utility reported a solid year in 2014, with Moody's-adjusted debt service coverage of approximately 1.4 times, and maintenance of ample operating liquidity with 289 days cash on hand.

The newly formed independent rate-setting board is yet to propose its first rate schedule. The existing rate schedule runs through 2015 and remains in effect.

DETAILED RATING RATIONALE

SERVICE AREA AND SYSTEM CHARACTERISTICS: LARGE AND DIVERSE SERVICE AREA

The Philadelphia Water and Sewer Enterprise (the "water department") serves a large and diverse urban and suburban base consisting mainly of the City of Philadelphia (A2 stable).

The water department operates a water system with about 470,000 accounts. The system's three treatment plants treat water from the Delaware and Schuylkill Rivers, and distribute it to a population of about 1.76 million (the city plus around 211,000 people in the suburbs).

The wastewater system serves a larger area: the system's 530,000 accounts encompass a population of more than 2.3 million people, including 10 mostly suburban wholesale customers. The wastewater system's three treatment plants all discharge into the Delaware River.

Philadelphia's demographic profile is below-average: the median family income in the city is equal to 72% of the US median, and the poverty rate is high at 26.5%. As of the end of 2014, the city unemployment rate was 6.2%, relative to the US rate of 5.6%.

We use Philadelphia's demographic statistics as a proxy for the water department's socioeconomic profile; however, the overall profile is stronger than these numbers, as it includes wealthier suburbs in Montgomery (Aa1 stable), Bucks (Aaa stable), and Delaware (Aa1) Counties.

Further, the city has a substantial institutional presence that provides stability to the local economy and to consumption. Among the water department's 10 largest customers, aside from the city itself and the city's school district and public housing authority, are the University of Pennsylvania (Aa2 positive), the federal government of the United States (Aaa stable), Honeywell Inc. (A2 stable), Temple University (Aa3 negative), and the University of Pennsylvania Health System (Aa3 stable).

The city has been growing, and the outlook for the water department's user base is favorable overall.

DEBT SERVICE COVERAGE AND LIQUIDITY: NARROW BUT CONSISTENT DEBT SERVICE COVERAGE; AMPLE LIQUIDITY

The city's commitment over the past decade to increasing rates consistently has led to debt service coverage that is stable, although narrower than most peers.

In 2014, the city's Moody's-adjusted net revenues covered debt service by approximately 1.4 times; coverage has been between 1.3 times and 1.6 times in each of the past five years. In this report, we evaluate coverage based on Generally Accepted Accounting Principles, with a few adjustments; the water department also reports figures on a "legally enacted" basis that is more cash-focused. These two bases often differ year-to-year. According to the city's calculation, senior-lien coverage on the legally enacted basis in 2014 was 1.22 times.

A key challenge facing the water department going forward is the prospect of higher debt because of capital needs, including those under a state consent order (see debt section below).

The water department's financial forecasts show coverage of around 1.3 times most years.

Liquidity

The water department's liquidity is ample, and a key strength for its credit quality. Operating cash balances at the end of fiscal 2014 totaled roughly 289 days cash on hand, which is above-average. These cash balances include unrestricted cash (73 days) plus cash in two accounts: the residual fund and the rate stabilization fund. As the city can transfer cash from either of these two funds back into operations, we consider it to be usable liquidity and include it in days cash on hand.

The city's long-term projections show cash remaining above 225 days through 2021.

DEBT AND LEGAL COVENANTS: DEBT BURDEN LIKELY TO GROW; WEAK LEGAL COVENANTS

The water department's roughly $2 billion of debt is manageable, but likely to grow due to heavy capital needs. The existing debt structure is front-loaded, which can mitigate future increases in expected debt service.

The current debt portfolio is equal to 2.8 times revenues, and net funded debt is equal to 69% of net fixed assets, which is moderate.

The department entered into a consent order with the Pennsylvania Department of Environmental Protection in June 2011 to address stormwater overflows. The 25-year agreement is expected to cost $2.4 billion (in nominal dollars), and will focus primarily on converting impervious surfaces into green space to better absorb stormwater and reduce overflows.

The department's six-year capital improvement program, which reflects the consent order as well as other capital needs, totals $1.8 billion, and is 80% debt-funded. Estimated borrowing of more than $250 million a year implies a likely increase to the water department's debt burden.

The water department's existing debt service faces a small cliff in 2018, as debt service decreases from more than $200 million in 2018 to $160 million in 2019. This gap is likely to be filled with new debt service from the department's debt funding.

Debt Structure

The debt portfolio consists mostly (86%) of fixed-rate bonds, but also includes Pennsylvania Infrastructure Investment Authority (PennVest) loans (8%) that are on parity with the senior lien bonds, and two series of variable rate bonds (6%). Of the $112 million of variable rate debt, $60.4 million is unhedged. The remainder is backed by a liquidity facility and a swap.

Debt-Related Derivatives

The department is party to a fixed-payer swap to hedge $51.6 million of its variable rate debt

Legal covenants

The legal covenants governing the department's senior lien bonds are moderately weak. The senior lien rate covenant is 1.2 times, and the total debt service covenant is 1 times (although the department currently has no subordinate debt). However, the indenture permits the inclusion of transfers from the rate stabilization fund in net revenues, meaning the department could use prior-year surpluses to meet its covenant.

The additional bonds test is to comply with the rate covenant.

The debt service reserve fund requirement is maximum annual debt service; additionally, the department by ordinance requires that any surety in a debt service reserve fund be rated Aa or higher.

A $67 million surety policy with Assured Guaranty Municipal Corp. (A2 stable) is not eligible to be included in the reserve requirement. Thus, the department has a debt service reserve fund cash-funded at MADS, plus the surety policy. Effectively, the debt service reserve fund is funded at 1.3 times MADS.

MANAGEMENT AND GOVERNANCE: STRONG MANAGEMENT; NEW RATE-SETTING BOARD

The department's management has increased rates consistently, and the department keeps a healthy amount of operating cash on hand. The department's financial projections run through 2021.

Until last year, the water department commissioner had the authority to set rates, and raised rates consistently: user rates increased at least 5% each year since 2009. The commissioner also established rates according to a four-year schedule, with the latest rates scheduled through 2015. Last year, the city council established an independent rate board with authority over rates; the new board's willingness to increase rates sufficient to maintain adequate coverage levels will be a key factor in the water department's rating going forward.

KEY STATISTICS

- Type of System: Water and Sewer

- Asset Condition (remaining useful life): 23 years

- System Size (O&M): $354.7million

- Service Area Wealth, Median Family Income (City of Philadelphia): 72.4%

- Total Debt Service Coverage (2014): 1.4x

- Days Cash on Hand: 289 days

- Debt to Operating Revenues: 2.89x

- Rate Covenant: 1.2x senior lien

- Debt Service Reserve Requirement: MADS

OBLIGOR PROFILE

The Philadelphia Water Department provides water and sewer treatment service to the City of Philadelphia and some of its surrounding suburbs.

LEGAL SECURITY

The department's bonds are secured by a senior lien on the net revenues of its water and sewer systems. The bonds are on parity with PennVest state revolving fund loans. The department currently has no subordinate debt.

USE OF PROCEEDS

Proceeds from the 2015A bonds will be used to fund capital investments. Proceeds from the 2015B bonds will be used to currently refund a portion of the department's 2005A bonds and advance refund a portion of its Series 2007A bonds.

PRINICPAL METHODOLOGY

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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RATINGS SERVICES
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Summary:

Philadelphia; Joint Criteria; Water/Sewer

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Summary:
Philadelphia; Joint Criteria; Water/Sewer

Credit Profile		
US$300.0 mil wtr and wastewtr rev bnds ser 2015A due 06/30/2044		
Long Term Rating	A/Positive	New
US$100.0 mil wtr and wastewtr rev rfdg bnds ser 2015B due 06/30/2044		
Long Term Rating	A/Positive	New
Philadelphia wtr & swr		
Long Term Rating	A/Positive	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'A' long-term rating to Philadelphia's series 2015A and B water and wastewater revenue refunding bonds and affirmed the following ratings:

- The 'A' long-term rating and underlying rating (SPUR) on the city's existing water and wastewater revenue debt; and
- The 'AAA/A-1+' rating on the city's series 1997B bonds, which are jointly secured by the city and the letter of credit (LOC) provider TD Bank N.A.

Except for when applying joint criteria, in which case the outlook is not meaningful, we have revised the outlook on the ratings to positive from stable. The positive outlook reflects our opinion that there is at least a one-in-three chance that the rating could improve from its current level within the next two years if the following trends continue:

- The water department's financial performance meets or exceeds the current projections, both on a GAAP basis and on the essentially modified-accrual basis that the city tracks its financial performance to meet rate and additional bonds covenants;
- There are no significant cost escalations or unanticipated projects that arise in conjunction with the city's large capital improvement plan (CIP); and
- Economic trends in the city and surrounding service base continue to steadily improve, as per the recent trends regarding population and unemployment rates.

Since all of these factors can influence the others, at least in some respects, an upgrade would most likely take into account an amalgam of these credit trends and not necessarily focus on one single factor that would generate upward rating movement. For instance, if the water department's actual financial performance is consistently better than projections, but large, back-dated projects are added to the department's CIP without immediate financial implications, then we would not necessarily raise the rating because of the near-term stronger financial performance.

The city will use the series 2015A bond proceeds for capital projects, and the 2015B proceeds to refund a portion of its outstanding bonds.

The 'A' long-term rating and SPUR are based on the following characteristics:

- A broad service area that covers the city of Philadelphia and several suburbs, but with a weaker economic profile when considering just the city itself;
- A diverse revenue base that includes among its largest users the city of Philadelphia, the city's school district, the University of Pennsylvania, and Temple University;
- Rates that we consider competitive, especially when benchmarked against the stronger demographic profile across the entire service base, along with management's historical willingness to raise rates annually;
- Stable financial performance, albeit with some reliance on its rate stabilization fund to support operations; and
- A sizable CIP, combined with an already-high system ratio of debt to capital, in our opinion.

Securing debt service are net revenues of the water and sewer fund, which includes (net of operating expenses) rates and charges of the system, transfers from the rate stabilization fund, and interest earnings. Rates must be set to provide rates and charges plus transfers from the rate stabilization fund that represent at least 1.2x annual debt service on senior revenue bonds and 1.0x coverage when including all subordinate debt and certain other transfers. The city can issue additional debt as long as it is complying with the rate covenant at the time of issuance and net revenue projections are sufficient to provide for rate covenant compliance for the two fiscal years following the debt issuance. As long as Assured Guaranty Municipal Corp. (AGM; formerly FSA) insures any of the city's 2005A, 2005B, and a portion of the 2010A bonds, AGM requires that the city maintain net system revenues, excluding transfers from the rate stabilization fund, totaling at least 90% of operating requirements (90% test). This provides additional bondholder protection, in our view, since this effectively limits how much the system can rely on draws from the rate stabilization fund. This provision also applies to the additional bonds test.

Philadelphia's water and wastewater systems provide service to roughly 1.7 million and 2.3 million customers, respectively, in the city and suburbs. The systems predominantly serve retail residential customers, but also serve 12 surrounding townships and utility authorities on a wholesale basis. The number of retail accounts has remained relatively stable since 2001; water accounts total about 475,000 and wastewater accounts about 530,000. The water department customer base, in which the city is the leading user, remains stable and diverse: The 10 leading retail customers accounted for 11% of total billings in fiscal 2014. Water and wastewater treatment capacities are 683 million gallons per day (mgd) and 522 mgd, respectively. We consider water capacity adequate, given average use of less than half that; sewer average use is about 90% of capacity, and about 20% of the city's capital budget is dedicated to combined sewer overflow mitigation and flood relief.

Because the service base spans both Philadelphia and suburban areas, the demographic profile takes into account a wide range of socioeconomic scales. Although the city's unemployment rate has historically been high, the 6.2% average for 2014 was equal to the national average. In our opinion, income indicators for the city are just adequate, with median household effective buying income (MHHEBI) at 73% of national levels; meanwhile, we consider combined metropolitan area median household incomes good at 114% of the national average. MHHEBI of Bucks, Delaware, and Montgomery Counties, which are part of the service base, are even stronger at 142%, 118%, and 148% of the national average, respectively.

We view rates as affordable when considering the more broad service territory that the water department serves. We also view as a credit strength the department's commitment to raise rates consistently. Since 2006, they have been generally rising by about 4%-7%, including the last 5% increase effective July 1, 2014. Management estimates that the average monthly combined bill currently totals $67.43 (including stormwater charges, and 600 cubic feet of use). Even when considering higher monthly usage of 1,000 cubic feet, which is what Standard & Poor's uses as its benchmark consumption rate for peer comparison purposes, monthly bills are $94.29. We still consider this affordable.

Despite generally stable financial performance, the city does rely on periodic draws on its rate stabilization fund (RSF) to support operations. During the prior three fiscal years, the city drew $4.7 million from its RSF in 2013, but deposited an aggregate of $31.5 million during fiscal years 2012 and 2014. Management's latest available financial projections show the water department continuing to rely periodically on rate stabilization fund draws to meet its minimum coverage requirements, but the projections do not indicate the balance dropping below $150.2 million.

As reported on an unaudited basis, the system has been able to meet its targeted coverage of debt service by 1.2x. Management can reach this target by making a transfer into or out of its rate stabilization fund, but the city also remains in compliance with the 90% test, as indicated above. On an audited basis, debt service coverage (DSC) has fluctuated more, but remains at least adequate, in our view. Back in 2009, when the system experienced a larger-than-average transfer in from the RSF, audited net revenues available for debt service represented 1.0x annual debt service. But since then, DSC has stabilized at about 1.3x, the level it has been at for both 2013 and 2014. Our calculations of audited DSC are based on the city's audited financial statements, taking the operating income; adding back depreciation, interest income and any miscellaneous nonoperating revenues/expenses; and subtracting transfers out.

Unrestricted cash levels, including the RSF balance, at the end of each fiscal year also demonstrate stable financial performance, in our view. The combined unrestricted and RSF balances have typically represented 225-275 days' operations (about $200 million to $250 million), which we characterize as strong. The bond ordinance also stipulates that amounts on deposit in the water department's RSF, capital fund ($261 million balance at 2014 fiscal year-end), and residual fund ($25 million at 2014 fiscal year-end) can all can be loaned to the revenue fund to pay operating expenses or even debt service because the revenue fund is included as pledged security for the revenue bonds.

Philadelphia's combined water and sewer system is highly leveraged and the $1.78 billion 2016-2021 CIP is likely to require significant additional debt funding. However, now that the city entered into a $1.2 billion (net present value; nominal value is over $2 billion), 25-year consent order with the Pennsylvania Department of Environmental Protection in 2011, a good portion of the CIP projects are now definable. As debt is layered in with PENNVEST loans and proposed revenue debt, we would expect that annual debt service costs would also steadily increase as additional debt is issued. We expect that management will continue to raise rates, as it has in the past, to fund these additional costs as well as cash-funded capital costs for general operating expenses. Total debt has consistently represented about 90% of net property, plant and equipment, which we consider high. Given the large CIP, we do not expect this to change materially over time.

Only about 7% of the city's water and sewer revenue debt outstanding at the end of the 2014 fiscal year is variable rate, and just 3% remains unhedged after taking into account a floating-to-fixed interest rate swap related to the city's 2005B bonds (notional amount of $67.2 million); these bonds have been purchased by Bank of America pursuant to a variable-rate securities agreement that expires at bond maturity in 2018 and payable at 68.5% of LIBOR. The swap counterparty is Citigroup Inc. Under the swap, the city receives the 2005B bond rate or 68.5% of LIBOR and pays a fixed rate of 4.53%. The additional termination event for the counterparty and city are the same: The ratings fall below 'A-'. As long as AGM insures the city's swap payments, no termination event based on the city's water and wastewater rating can occur as long as we rate AGM at least 'A'. Counterparty risk is somewhat elevated since we rate Citigroup 'A-/Negative'. The city, however, maintains the option of terminating the swap if Citigroup's ratings fall below the rating trigger; according to management, there are no current plans to change counterparties or terminate the swap.

Outlook

The positive outlook reflects our opinion that there is at least a one-in-three chance that the rating could improve from its current level within the next two years if the following trends continue:

- The water department's financial performance meets or exceeds the current projections, both on a GAAP basis and on the essentially modified-accrual basis that the city tracks its financial performance to meet rate and additional bonds covenants;
- There are no significant cost escalations or unanticipated projects that arise in conjunction with the city's large CIP; and
- Economic trends in the city and surrounding service base continue to steadily improve, as per the recent trends regarding population and unemployment rates.

If financial metrics deteriorate, or a significant amount of additional capital spending is added to the city's CIP, we could lower the rating or revise the outlook back to stable.

Related Criteria And Research

Related Criteria

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Commercial Paper, VRDO, And Self-Liquidity, July 3, 2007
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012
- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- USPF Criteria: Bank Liquidity Facilities, June 22, 2007
- Criteria: Joint Support Criteria Update, April 22, 2009
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011

Ratings Detail (As Of March 20, 2015)		
Philadelphia wtr & wastewtr (BAM)		
Unenhanced Rating	A(SPUR)/Positive	Affirmed
Philadelphia wtr & swr		
Unenhanced Rating	A(SPUR)/Positive	Affirmed
Philadelphia wtr & wastewtr		

Ratings Detail (As Of March 20, 2015) (cont.)		
Unenhanced Rating	A(SPUR)/Positive	Affirmed
Philadelphia wtr & wastewtr VRDB - 1997B		
Unenhanced Rating	A(SPUR)/Positive	Affirmed
Long Term Rating	AAA/A-1+	Affirmed
Many issues are enhanced by bond insurance.		

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Exhibit ML-3

Table 1
City of Philadelphia
Water Operating Fund
Fund Balance Summary

Category	FY'13 Year-End Actual	FY'14 Year-End Actual	FY'15 Year-End Unaudited	B&V Projected 2016	B&V Projected 2017	B&V Projected 2018
REVENUES						
Locally Generated Non - Tax Revenues	572,016,324	607,107,148	640,221,611	631,142,000	661,313,000	675,357,000
Other Governments	2,727,484	1,945,531	1,083,287	1,000,000	1,000,000	1,000,000
Revenues from Other Funds of City - Net of Rate Stabilization Fund	32,546,139	33,966,224	35,541,085	35,789,000	36,240,000	37,995,000
Revenue from Other Funds of City - Rate Stabilization Fund	4,666,000	-	-	36,900,000	19,300,000	39,000,000
Total Revenues and Other Sources	**611,955,947**	**643,018,903**	**676,845,983**	**704,831,000**	**717,853,000**	**753,352,000**
Category	FY'13 Year-End Actual	FY'14 Year-End Actual	FY'15 Year-End Unaudited	B&V Projected 2016	B&V Projected 2017	B&V Projected 2018
OBLIGATIONS / APPROPRIATIONS						
Personal Services	104,392,354	108,957,000	118,718,436	123,198,999	129,550,969	133,938,818
Personal Services - Employee Benefits	96,328,789	101,799,717	100,569,916	107,987,102	113,643,647	117,301,978
Sub-Total Employee Compensation	200,721,143	210,756,717	219,288,352	231,186,101	243,194,616	251,240,796
Purchase of Services	106,582,639	109,433,118	125,367,444	131,523,059	144,232,546	145,594,375
Purchases of Services - Electricity & Gas	27,833,674	24,508,542	24,618,522	27,503,594	27,679,597	28,423,633
Sub-Total Purchase of Services	134,416,313	133,941,660	149,985,966	159,026,653	171,912,143	174,018,008
Materials, Supplies and Equipment	25,648,300	24,904,835	25,022,262	26,745,156	27,860,929	28,642,581
Materials - Chemicals	22,646,348	24,508,542	22,384,428	22,170,391	22,902,014	23,657,780
Sub Total -Materials, Supplies and Equipment	48,294,648	49,413,377	47,406,690	48,915,547	50,762,943	52,300,361
Contributions, Indemnities and Taxes	5,090,380	6,036,578	3,842,040	6,505,000	6,505,000	6,505,000
Debt Service	201,015,411	204,645,672	200,799,234	220,713,000	207,714,501	223,661,499
Advances and Miscellaneous Payments	-	-	-	-	-	-
Payment to Other Funds - Net of Payment to Rate Stabilization Fund	53,566,306	52,736,467	53,456,628	59,588,699	60,509,797	68,677,336
Payments to Other Funds - Rate Stabilization Fund	-	22,924,772	21,456,199	-	-	-
Total Obligations / Appropriations	**643,104,201**	**680,455,243**	**696,235,109**	**725,935,000**	**740,599,000**	**776,403,000**
Operating Surplus / (Deficit)	**(31,148,254)**	**(37,436,340)**	**(19,389,126)**	**(21,104,000)**	**(22,746,000)**	**(23,051,000)**
OPERATIONS IN RESPECT TO PRIOR FISCAL YEARS						
Net Adjustments - Prior Year (Liquidated Encumbrance)	31,148,254	37,436,340	19,389,126	21,104,000	22,746,000	23,051,000
Total Net Adjustments	**31,148,254**	**37,436,340**	**19,389,126**	**21,104,000**	**22,746,000**	**23,051,000**
Year End Balance	**0**	**0**	**0**	**0**	**0**	**0**

1: Sources used for completion of data for FY13, FY14 and FY15, (i) City of Philadelphia Certified Annual Financial Report as of June 30th for each fiscal year detailed above, and (ii) City of Philadelphia Accounting System - FAMIS.

2: Source for Projected FY16, FY17, and FY18 is Black and Veatch financial plan.

3: Total Revenues and Other Sources as projected for FY 2016, FY2017 and FY 2018 align with Exhibit BV- E1, Table C-1, line number 16 + line number 20.

4. Total Obligations / Appropriations as projected for FY 2016, FY2017 and FY 2018 minus liquidated encumbrances align with Exhibit BV-E1, Table C-1, line number 19 + line number 25+ line 29 + line 33.

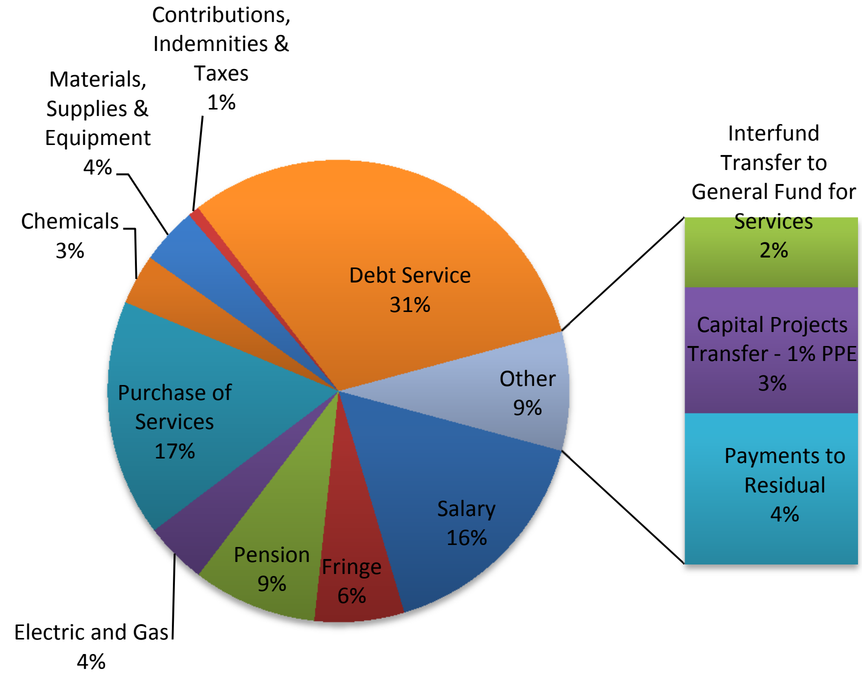
Exhibit ML-4

FY’13 Year End Results

Table 1

FY'13 Year End Total Obligations		% of Total
Total Obligations	*643,104*	
Personal Services	*200,721*	*31.21%*
Salary	*104,392*	*16.23%*
Fringe	*40,369*	*6.28%*
Pension	*55,959*	*8.70%*
Purchase of Services	*134,416*	*20.90%*
Electric and Gas	*27,834*	*4.33%*
Purchase of Services	*106,583*	*16.57%*
Materials, Supplies & Equipment	*48,295*	*7.51%*
Chemicals	*22,646*	*3.52%*
Materials, Supplies & Equipment	*25,648*	*3.99%*
Contributions, Indemnities & Taxes	*5,090*	*0.79%*
Payments to Other Funds	*53,566*	*8.33%*
Interfund Transfer to General Fund for Services	*10,793*	*1.68%*
Capital Projects Fund Transfer - 1% PPE	*19,380*	*3.01%*
Payments to Residual	*23,393*	*3.64%*
Debt Service	*201,015*	*31.26%*

Chart 1



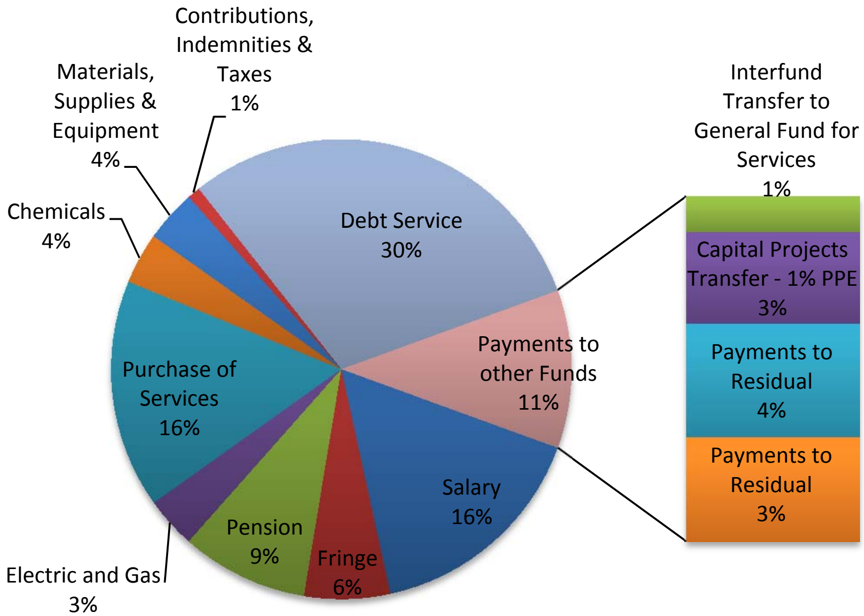
1: Sources used for completion of data for FY13, FY14 and FY15, (i) City of Philadelphia Certified Annual Financial Report as of June 30th for each fiscal year detailed and (ii) City of Philadelphia Accounting System - FAMIS.

FY’14 Year End Results

Table 2

FY'14 Year End Total Obligations		% of Total
Total Obligations	*680,455*	
Personal Services	*210,757*	*30.97%*
Salary	*108,957*	*16.01%*
Fringe	*41,044*	*6.03%*
Pension	*60,755*	*8.93%*
Purchase of Services	*133,942*	*19.68%*
Electric and Gas	*24,509*	*3.60%*
Purchase of Services	*109,433*	*16.08%*
Materials, Supplies & Equipment	*49,413*	*7.26%*
Chemicals	*24,509*	*3.60%*
Materials, Supplies & Equipment	*24,905*	*3.66%*
Contributions, Indemnities & Taxes	*6,037*	*0.89%*
Payments to Other Funds	*75,661*	*11.12%*
Interfund Transfer to General Fund for Services	*7,714*	*1.13%*
Capital Projects Fund Transfer - 1% PPE	*20,194*	*2.97%*
Payments to Residual	*24,829*	*3.65%*
Payment to RSF	*22,925*	*3.37%*
Debt Service	*204,646*	*30.07%*

Chart 2



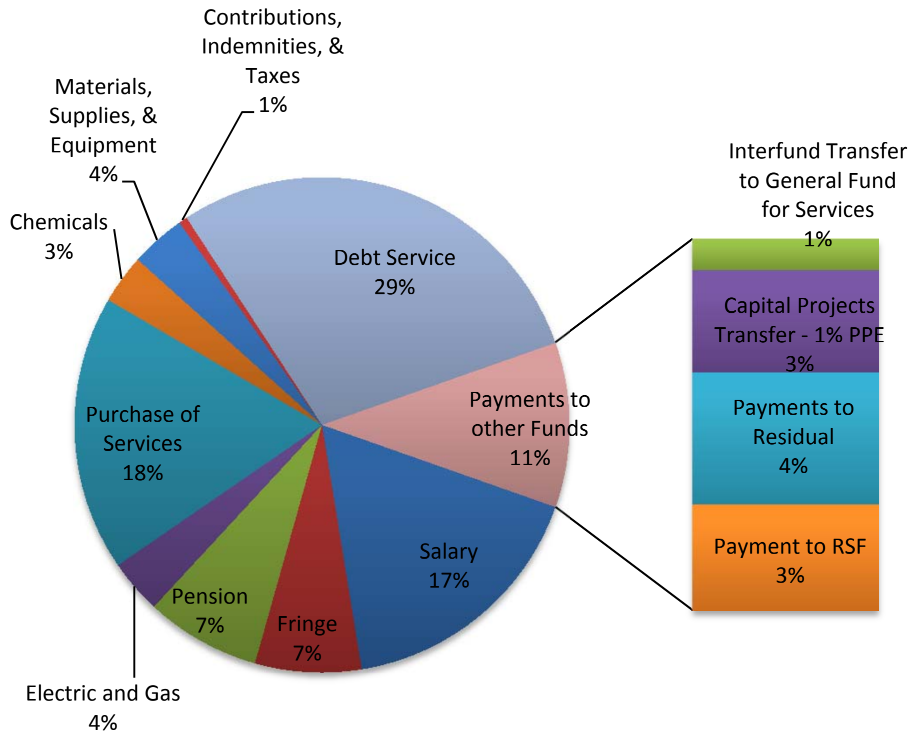
1: Sources used for completion of data for FY13, FY14 and FY15, (i) City of Philadelphia Certified Annual Financial Report as of June 30th for each fiscal year detailed and (ii) City of Philadelphia Accounting System - FAMIS.

FY'15 Year End Results

Table 3

FY'15 Year End Total Obligations		% of Total
Total Obligations	*696,235*	
Personal Services	*219,288*	*31.50%*
Salary	*118,718*	*17.05%*
Fringe	*48,293*	*6.94%*
Pension	*52,277*	*7.51%*
Purchase of Services	*149,986*	*21.54%*
Electric and Gas	*24,619*	*3.54%*
Purchase of Services	*125,367*	*18.01%*
Materials, Supplies & Equipment	*47,407*	*6.81%*
Chemicals	*22,384*	*3.22%*
Materials, Supplies & Equipment	*25,022*	*3.59%*
Contributions, Indemnities & Taxes	*3,842*	*0.55%*
Payments to Other Funds	*74,913*	*10.76%*
Interfund Transfer to General Fund for Services	*6,245*	*0.90%*
Capital Projects Fund Transfer - 1% PPE	*20,705*	*2.97%*
Payments to Residual	*26,507*	*3.81%*
Payment to RSF	*21,456*	*3.08%*
Debt Service	*200,799*	*28.84%*

Chart 3



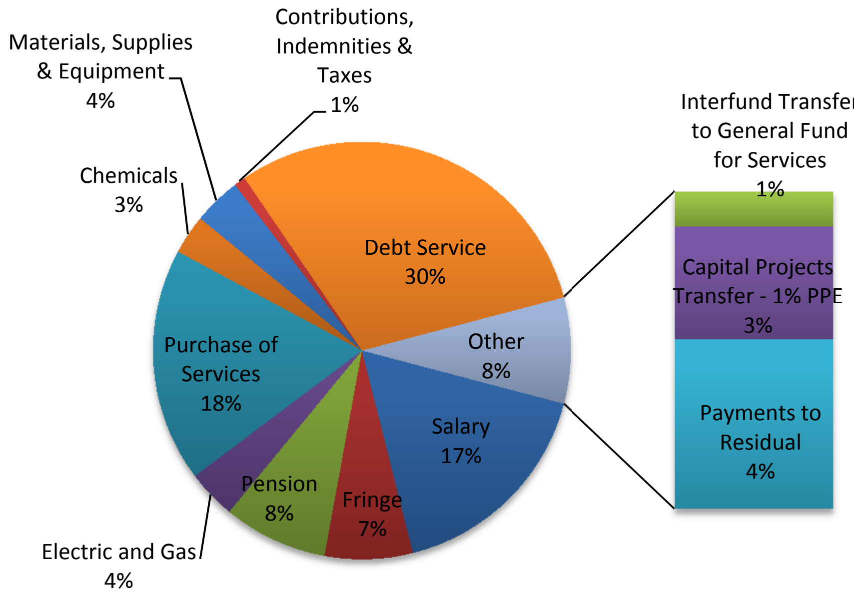
1: Sources used for completion of data for FY13, FY14 and FY15, (i) City of Philadelphia Certified Annual Financial Report as of June 30th for each fiscal year detailed and (ii) City of Philadelphia Accounting System - FAMIS.

FY'16 Projected Obligations

Table 4

FY'16 Projected Obligations		% of Total
Total Projected Obligations	*725,935*	
Personal Services	*231,186*	*32.00%*
Salary	*123,199*	*17.00%*
Fringe	*49,358*	*7.00%*
Pension	*58,629*	*8.00%*
Purchase of Services	*159,027*	*22.00%*
Electric and Gas	*27,504*	*4.00%*
Purchase of Services	*131,523*	*18.00%*
Materials, Supplies & Equipment	*48,916*	*7.00%*
Chemicals	*22,170*	*3.00%*
Materials, Supplies & Equipment	*26,745*	*4.00%*
Contributions, Indemnities & Taxes	*6,505*	*1.00%*
Payments to Other Funds	*59,589*	*8.00%*
Interfund Transfer to General Fund for Services	*6,545*	*1.00%*
Capital Projects Fund Transfer - 1% PPE	*21,215*	*3.00%*
Payments to Residual	*31,829*	*4.00%*
Debt Service	*220,713*	*30.00%*

Chart 4



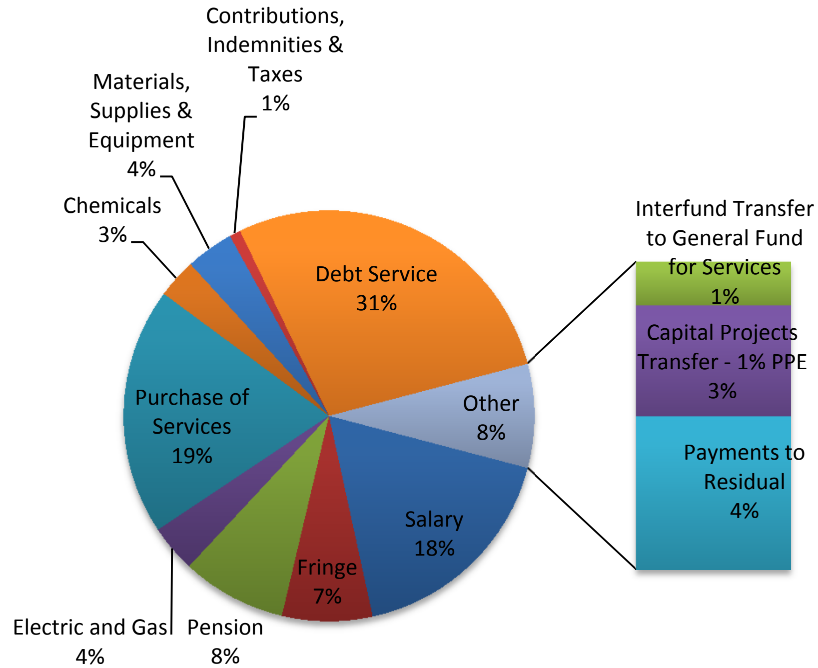
SOURCE: BLACK & VEATCH FINANCIAL PLAN PROJECTION

FY'17 Total Obligations

Table 5

FY'17 Projected Appropriations		% of Total
Total Projected Obligations	*740,599*	
Personal Services	*243,195*	*32.84%*
Salary	*129,551*	*17.49%*
Fringe	*52,636*	*7.11%*
Pension	*61,008*	*8.24%*
Purchase of Services	*171,912*	*23.21%*
Electric and Gas	*27,680*	*3.74%*
Purchase of Services	*144,233*	*19.48%*
Materials, Supplies & Equipment	*50,763*	*6.85%*
Chemicals	*22,902*	*3.09%*
Materials, Supplies & Equipment	*27,861*	*3.76%*
Contributions, Indemnities & Taxes	*6,505*	*0.88%*
Payments to Other Funds	*60,510*	*8.17%*
Interfund Transfer to General Fund for Services	*8,541*	*1.15%*
Capital Projects Fund Transfer - 1% PPE	*21,745*	*2.94%*
Payments to Residual	*30,223*	*4.08%*
Debt Service	*207,715*	*28.05%*

Chart 5



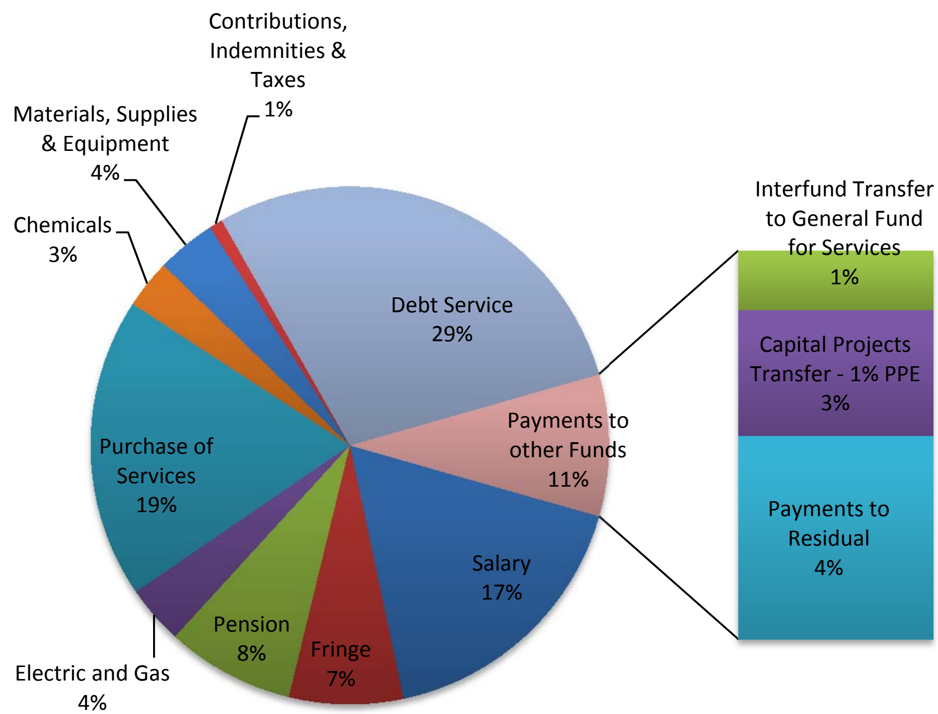
SOURCE: BLACK & VEATCH FINANCIAL PLAN PROJECTION

FY'18 Total Obligations

Table 6

FY'18 Projected Obligations		% of Total
Total Projected Obligations	*776,403*	
Personal Services	*251,241*	*32.36%*
Salary	*133,939*	*17.25%*
Fringe	*55,256*	*7.12%*
Pension	*62,046*	*7.99%*
Purchase of Services	*174,018*	*22.41%*
Electric and Gas	*28,424*	*3.66%*
Purchase of Services	*145,594*	*18.75%*
Materials, Supplies & Equipment	*52,301*	*6.74%*
Chemicals	*23,658*	*3.05%*
Materials, Supplies & Equipment	*28,643*	*3.69%*
Contributions, Indemnities & Taxes	*6,505*	*0.84%*
Payments to Other Funds	*68,677*	*8.85%*
Interfund Transfer to General Fund for Services	*10,444*	*1.35%*
Capital Projects Fund Transfer - 1% PPE	*22,289*	*2.87%*
Payments to Residual	*35,945*	*4.63%*
Payment to RSF		
Debt Service	*223,661*	*28.81%*

Chart 6



SOURCE: BLACK & VEATCH FINANCIAL PLAN PROJECTION

Exhibit ML-5

Table 2

City of Philadelphia, Pennsylvania

Water and Wastewater Revenue Bonds

Debt Service Reserve Fund (DSRF) Requirement Calculation

As of June 30, 2015

(Includes Pennvest Loans)

	Total		
Fiscal Year Ending	Principal	Interest	Debt Service
6/30/2014			
6/30/2016	136,724,006.33	82,290,441.35	**219,014,447.68**
6/30/2017	124,798,459.08	81,325,944.79	206,124,403.87
6/30/2018	131,548,468.95	76,459,307.04	208,007,775.99
6/30/2019	86,812,005.88	72,012,330.28	158,824,336.16
6/30/2020	79,671,608.23	68,312,591.90	147,984,200.13
6/30/2021	83,487,045.63	64,813,353.24	148,300,398.87
6/30/2022	76,117,492.94	61,221,806.47	137,339,299.41
6/30/2023	80,243,055.67	57,954,509.52	138,197,565.19
6/30/2024	59,318,842.66	54,538,628.04	113,857,470.70
6/30/2025	61,456,544.96	52,252,718.34	113,709,263.30
6/30/2026	61,235,928.35	49,874,283.35	111,110,211.70
6/30/2027	61,009,607.74	47,443,528.96	108,453,136.70
6/30/2028	47,976,607.82	45,274,383.26	93,250,991.08
6/30/2029	59,439,511.06	42,888,240.54	102,327,751.60
6/30/2030	61,728,789.07	40,021,582.19	101,750,371.26
6/30/2031	64,645,568.49	37,099,221.52	101,744,790.01
6/30/2032	67,703,130.38	34,034,197.13	101,737,327.51
6/30/2033	39,767,094.01	31,770,706.94	71,537,800.95
6/30/2034	41,635,000.00	29,748,537.50	71,383,537.50
6/30/2035	43,680,000.00	27,693,706.25	71,373,706.25
6/30/2036	45,745,000.00	25,607,043.75	71,352,043.75
6/30/2037	43,615,000.00	23,167,375.00	66,782,375.00
6/30/2038	45,830,000.00	20,949,750.00	66,779,750.00
6/30/2039	48,160,000.00	18,619,625.00	66,779,625.00
6/30/2040	50,615,000.00	16,170,750.00	66,785,750.00
6/30/2041	69,025,000.00	13,597,250.00	82,622,250.00
6/30/2042	54,150,000.00	10,066,325.00	64,216,325.00
6/30/2043	56,920,000.00	7,290,006.25	64,210,006.25
6/30/2044	41,440,000.00	4,371,500.00	45,811,500.00
6/30/2045	32,520,000.00	2,522,500.00	35,042,500.00
6/30/2046	34,190,000.00	854,750.00	35,044,750.00
	2,116,503,683.63	**1,279,885,349.63**	**3,396,389,033.25**

NOTES:

• Interest on the Series 1997B bonds assumes a rate of 0.0447%, the average interest rate of the bonds during the period 24 consecutive calendar months preceding the date of calculation per the Ordinance. (As of June 30, 2015)

• Interest on Series 2005B assumes rate of 4.53%

• DSRF Requirement definition (from Ordinance):

"an amount equal to the lesser of (i) the greatest amount of Debt Service Requirements payable in any one Fiscal Year, determined as of any particular date or (ii) the maximum amount to be financed with proceeds of Bonds permitted by Section 148(d)(1) of Code"

• For Pennvest, individual DSRF calculation is based on currently outstanding amount rather than original amount at time the loan closed.

• DSRF fund calculation on individual series uses the original par and debt service at issuance.

Exhibit ML-6

ATTACHMENT B

TABLE 11
PROJECTED REVENUE AND REVENUE REQUIREMENTS
(in thousands of dollars)

Line No.	Description	Percent Increase	Months Effective	2012	2013	2014	2015	2016	2017	2018
				Fiscal Year Ending June 30,						
	OPERATING REVENUE									
1	Water Service - Existing Rates			233,546	233,780	232,370	230,658	228,939	227,219	225,496
2	Wastewater Service - Existing Rates			331,850	332,913	331,597	330,215	328,823	327,435	326,042
3	Total Service Revenue - Existing Rates			565,396	566,693	563,967	560,873	557,762	554,654	551,538
	Additional Service Revenue Required									
	Year	Percent Increase	Months Effective							
4	FY 2013	4.48%	6		9,546	25,266	25,127	24,988	24,848	24,709
5	FY 2014	4.48%	12			26,398	26,253	26,107	25,962	25,816
6	FY 2015	4.48%	12				27,429	27,277	27,125	26,972
7	FY 2016	5.30%	12					33,715	33,527	33,339
8	FY 2017	5.30%	12						35,304	35,106
9	FY 2018	5.30%	12							36,966
10	Total Additional Service Revenue Required			0	9,546	51,664	78,809	112,087	146,766	182,908
11	Total Water & Wastewater Service Revenue			565,396	576,239	615,631	639,682	669,849	701,420	734,446
12	Transfer From/(To) Rate Stabilization Fund			14,435	43,615	20,325	3,675	575	(17,960)	(9,310)
	Other Income (a)									
13	Other Operating Revenue			16,663	19,622	19,676	19,631	19,485	19,440	19,395
14	Construction Fund Interest Income			1,156	1,215	831	911	3,066	2,019	2,543
15	Debt Reserve Fund Interest Income			0	0	0	0	0	0	0
16	Operating Fund Interest Income			356	550	748	948	1,155	1,368	1,635
17	Rate Stabilization Interest Income			749	906	888	960	1,122	1,464	1,951
18	Total Revenues			598,755	642,147	658,099	665,807	695,252	707,751	750,660
	OPERATING EXPENSES									
19	Water & Wastewater Operations			320,010	344,788	354,719	357,559	369,134	378,802	388,901
20	Direct Interdepartmental Charges			48,523	51,331	51,511	50,878	52,014	52,551	53,097
21	Total Operating Expenses			368,533	396,119	406,230	408,437	421,148	431,353	441,998
22	**NET REVENUES AFTER OPERATIONS**			230,222	246,028	251,869	257,370	274,104	276,398	308,662
	DEBT SERVICE									
	Senior Debt Service									
	Revenue Bonds									
23	Outstanding Bonds			178,515	181,629	182,001	173,843	174,149	115,363	115,444
24	Pennvest Parity Bonds			3,180	10,211	11,839	12,175	12,175	12,310	12,844
25	Projected Future Bonds			10,150	11,483	12,606	23,220	34,720	93,440	116,677
26	Total Senior Debt Service			191,845	203,323	206,446	209,238	221,044	221,113	244,965
27	**TOTAL SENIOR DEBT SERVICE COVERAGE (L22/L2**			1.200 x	1.210 x	1.220 x	1.230 x	1.240 x	1.250 x	1.260 x
	Subordinate Debt Service									
28	Outstanding General Obligation Bonds			0	0	0	0	0	0	0
29	Pennvest Subordinate Bonds			1,022	0	0	0	0	0	0
30	Total Subordinate Debt Service			1,022	0	0	0	0	0	0
31	Total Debt Service on Bonds			192,867	203,323	206,446	209,238	221,044	221,113	244,965
32	**CAPITAL ACCOUNT DEPOSIT**			18,476	19,000	19,380	19,767	20,163	20,566	20,977
33	**TOTAL COVERAGE (L22/(L31+L32))**			1.08 x	1.10 x	1.11 x	1.12 x	1.13 x	1.14 x	1.16 x
	RESIDUAL FUND									
34	Beginning of Year Balance			34,909	51,669	7,726	9,429	11,794	14,691	14,909
35	Interest Income (b)			237	398	0	0	0	0	0
	Plus:									
36	End of Year Revenue Fund Balance			18,879	23,705	26,043	28,365	32,897	34,719	42,720
37	Deposit for Transfer to City General Fund (c)			1,351	2,060	2,095	2,708	3,324	3,890	4,452
	Less:									
38	Transfer to Construction Fund			(1,500)	(2,500)	23,500	26,000	30,000	34,500	42,300
39	Transfer to City General Fund			1,351	2,060	2,095	2,708	3,324	3,890	4,452
40	Transfer to Debt Service Reserve Fund			3,856	70,545	840	0	0	0	0
41	End of Year Balance			51,669	7,726	9,429	11,794	14,691	14,909	15,330
	RATE STABILIZATION FUND									
42	Beginning of Year Balance			156,563	142,128	98,513	78,188	74,513	73,938	91,898
43	Deposit From/(To) Revenue Fund			(14,435)	(43,615)	(20,325)	(3,675)	(575)	17,960	9,310
44	End of Year Balance			142,128	98,513	78,188	74,513	73,938	91,898	101,208

(a) Includes other operating and nonoperating income, including interest income on funds and accounts transferable to the Revenue Fund.
(b) Includes interest earnings on Debt Service Reserve substitution funds deposited in the Special Water Infrastructure Account.
(c) Transfer of interest earnings from the Bond Reserve Account to the Residual Fund as shown in Line 37 to satisfy the requirements for the Transfer to the City General Fund

Philadelphia Water Department
Financial Statements
Fiscal Year Ended June 30, 2014

CITY OF PHILADELPHIA WATER DEPARTMENT

2014 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 stormwater effectively.

The Water Department was established by the City pursuant to the Charter with the power and duty to operate, maintain, repair, and improve the Water and Wastewater Systems. The Charter requires that the Water Rate Board must set rates and charges such as shall yield to the City at least an amount equal to operating expenses and debt service, on all obligation of the City in respect of the water, sewer, storm water systems and, in respect of water, sewer, and storm water revenue obligations of the City, such additional amounts as shall be required to comply with any rate covenant and sinking fund reserve requirements approved by ordinance of Council in connection with the authorization or issuance of water, sewer, and storm water revenue bonds, 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 approval 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.

2014 Financial Highlights

The Water Department met its bond coverage ratios for the year with a revenue bond coverage ratio of 1.22, a total debt service coverage ratio of 1.11, and a net operating revenue bond coverage ratio of 1.34 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 position totaled $970.5 million resulting from an excess of its assets over its liabilities; its unrestricted net position showed a balance of $126.8 million.

The Water Fund's net position showed an increase of $72.4 million during the current Fiscal Year compared with an increase of $32.8 million for the prior fiscal year.

Overview of the Financial Statements

This section serves as an introduction to the Basic Financial Statements. It represents management's examination and analysis of the Water Department's financial condition and performance. Summary financial data, key financial and operational indicators used in Water Department's budget, bond resolutions, and other management tools were used for the analysis.

The Financial Statements report information about the Water Department on the Full Accrual Accounting method as used by similar business activities in the private sector.

The Water Department's basic financial statements include the statement of net position, statement of revenues, expenses, and changes in net position, statement of cash flows, and notes to the financial statements.

The Water Department's financial statements are prepared in accordance with accounting principles promulgated by the Governmental Accounting Standards Board (GASB).

Statement of Net Position: The statement of net position presents the financial position of the Water Department. It presents information on the Water Department's assets, deferred outflows of resources, and liabilities with the difference between the three reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Water Department is improving or deteriorating.

Statement of Revenues, Expenses, and Changes in Net Position: The statement of revenues, expenses, and changes in net position presents information showing how the Water Department's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Revenues are recognized when earned, not when they are received. Expenses are recognized when incurred, not when they are paid. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g. salary and wages payable).

Statement of Cash Flows: The statement of cash flows presents information on the effects changes in assets, liabilities, and operations have on cash during the course of the fiscal year.

The Water Fund financial statements can be found following the Management Discussion and Analysis. The Notes provide additional information that is essential to a full understanding of the data provided in the Water Fund financial statements. In addition to the basic financial statements and accompanying notes, government accounting standards require presentation of required supplementary information ("RSI"). Following the RSI, the Water Department has presented other supplementary information ("OSI").

Please see the Comprehensive Annual Financial Report of the City of Philadelphia for complete financial information for the City and its component units, which can be found at http://www.phila.gov/investor/CAFR.html.

Financial Analysis

Net Position

A three year condensed summary of the Water Department's net position as of June 30 of each year is presented as follows:

Condensed Statement of Net Position
(Thousands of Dollars)
June 30

	2014	2013	2012*
Assets:			
Current Assets	$ 230,330	$ 243,123	$ 233,512
Capital Assets	2,070,492	2,019,350	1,938,001
Restricted Assets	690,596	526,249	631,960
Total Assets	2,991,418	2,788,722	2,803,473
Deferred Outflows of Resources	66,586	73,865	12,018
Total Assets and Deferred Outflows	3,058,004	2,862,587	2,815,491
Liabilities:			
Current Liabilities	214,671	211,872	200,381
Bonds Payable	1,809,952	1,702,895	1,698,122
Other Non-Current Liabilities	62,898	49,732	51,668
Total Liabilities	2,087,521	1,964,499	1,950,171
Net Position:			
Net Investment in Capital Assets	336,980	351,160	243,997
Restricted	506,669	472,310	439,084
Unrestricted	126,834	74,618	182,239
Total Net Position, as Restated	$ 970,483	$ 898,088	$ 865,320

*Fiscal Year 2012 was not restated for GASB Statement No. 65.

The Water Department's net position at June 30, 2014 was approximately $970.5 million, a $72.4 million or 8.1% increase from June 30, 2013. Total assets and deferred outflows of resources increased by $195.4 million, or 6.8%, to $3.1 billion, and total liabilities increased $123.0 million, or 6.3%, to $2.1 billion.

The following is a discussion of the more significant changes in assets and deferred outflows of resources, liabilities, and net position in fiscal year 2014:

- Capital assets, net of depreciation and amortization, increased by $51.1 million to $2.1 billion, or 2.5% as a result of capital additions of $314.6 million, offset by depreciation of $90.5 million and retirements of $173.0 million.

- Current assets decreased by $12.8 million to $230.3 million, or 5.3%, due to decreases in cash, investments, and net accounts receivables.

- Restricted assets increased by $164.3 million to $690.6 million, or 31.2%, due to increases in the Water Capital Fund primarily due to the bond issuance in August 2013 and January 2014.

- Deferred outflows of resources decreased by $7.3 million to $66.6 million, or 9.9%, due to decreases in the fair market value of the Water Funds hedging instrument and amortization of the unamortized loss on refunded debt.

- Current liabilities increased by $2.8 million to $214.7 million, or 1.3%, primarily due to an increase in accrued expenses and other components offset by reductions in construction contracts payable.

- Bonds payable increased by $107.1 million to $1.8 billion, or 6.3%, primarily due to the bond issuances in August of 2013 and January of 2014 offset by the maturing principal of $225.1 million during the year.

- Other non-current liabilities increased by $13.2 million to $62.9 million, or 26.5%, primarily due to an increase in the net pension obligation of $17.7 million offset by decreases in the other non-current liabilities and derivative instrument liability.

- The Water Department's net position increased by $72.4 million to $970.5 million, or 8.1%, as a result of fiscal year 2014 operations and capital contributions.

- Net investment in capital assets decreased by $14.2 million, or 4.0%, to $337.0 million.

- Unrestricted net position increased by $52.2 million, or 70.0%, to $126.8 million. The unrestricted component of net position represents the net amount of total assets, deferred outflows of resources, and total liabilities that are not included in the determination of net investment in capital assets or restricted components of net position.

Changes in Net Position

A condensed summary of the Water Department's Statement of Revenues, Expenses, and Changes in Net Position for the years ended June 30 is presented as follows:

Condensed Statement of Revenues, Expenses, and Changes in Net Position
(Thousands of Dollars)
Year Ended June 30

	2014	2013	2012*
Operating Revenues:			
Charges for Goods and Services	$ 630,429	$ 600,156	$ 591,571
Miscellaneous Operating Revenues	8,146	8,547	6,749
Operating Grants	1,399	2,285	3,481
Total Operating Revenues	639,974	610,988	601,801
Operating Expenses:			
Operating Expenses excluding Depreciation and Amortization	354,686	345,409	300,829
Depreciation and Amortization	90,523	89,045	92,113
Total Operating Expenses	445,209	434,454	392,942
Operating Income (Loss)	194,765	176,534	208,859
Nonoperating Revenues (Expenses):			
Federal, State, & Local Grants	-	880	479
Interest Income	4,207	12,079	3,334
Net Pension Obligation	(17,712)	2,839	(11,259)
Debt Service – Interest	(77,561)	(80,146)	(85,374)
Other Expenses	(2,971)	(1,665)	(1,243)
Total Nonoperating Revenues (Expenses)	(94,037)	(66,013)	(94,063)
Increase in Net Position before Transfers	100,728	110,521	114,796
Transfers Out	(28,333)	(21,380)	(27,460)
Change in Net Position	72,395	89,141	87,336
Net Position – Beginning of Period	898,088	808,947	777,984
Net Position – Ending of Period	$ 970,483	$ 898,088	$ 865,320

*Fiscal Year 2012 was not restated for GASB Statement No. 65.

Operating revenues increased by $29.0 million to $640.0 million due to increased revenue from a typical bill increase of 5.8% in fiscal year 2014.

Operating expenses increased by $10.8 million to $445.2 million due to increased costs for personnel services, purchase of services, materials and supplies, partially offset by lower expenses for employee benefits.

Non-operating expenses increased by $28.0 million to $94.0 million. The increase in non-operating expenses is due to the net pension obligation expense increase of $20.6 million and the interest income decrease of $7.9 million.

Capital Assets and Debt Administration

Capital Assets

The Water Department's investment in capital assets, net of accumulated depreciation, amounted to $2.07 billion as of June 30, 2014. This represented an increase of $51.1 million, or 2.5% over the previous year's total of $2.02 billion. Capital assets consist primarily of land, infrastructure, construction in progress, buildings, and equipment. Infrastructure consists of water and wastewater transmission and distribution lines. The following is a summary of capital assets as of June 30:

Capital Asset Activity
(Thousands of Dollars)
June 30

	2014	2013	2012
Land	$ 5,919	$ 5,919	$ 5,919
Construction in Progress	361,592	373,844	314,162
Infrastructure	2,269,015	2,167,639	2,087,956
Buildings and Equipment	1,623,520	1,591,073	1,572,818
Accumulated Depreciation	(2,189,554)	(2,119,125)	(2,042,854)
Total Capital Assets, net	$ 2,070,492	$ 2,019,350	$ 1,938,001

Long-Term Debt

As of June 30, 2014, the Water Department had $1.87 billion of non-current liabilities outstanding. This was an increase of $120.2 million or 6.9% from the previous year. The following is a summary of the non-current liability outstanding as of June 30:

Non-Current Liability Activity
(Thousands of Dollars)
June 30

	2014	2013	2012
Revenue Bonds – Net	$ 1,809,952	$ 1,702,895	$ 1,698,122
Derivative Instrument	5,711	8,565	12,018
Other Non-Current Liabilities	30,514	32,205	27,849
Net Pension Obligation	26,673	8,962	11,801
Total Non-Current Liabilities	$ 1,872,850	$ 1,752,627	$ 1,749,790

The following details activity to debt during 2014:

	(Thousands of Dollars)
Beginning balance at July 1, 2013	$ 1,830,387
Debt issued	345,096
Less principal payments and amortization	(240,231)
Ending balance at June 30, 2014	$ 1,935,252

More detailed information concerning long-term debt activity and capital asset activity is disclosed in Note 14 and Note 5, respectively, of the financial statements.

Budgetary Highlights

Please see the supplementary Budgetary Comparison Schedule located in the Required Supplementary Information section.

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, Pennsylvania 19107.

STATEMENTS OF NET POSITION
JUNE 30, 2014 AND 2013 (Thousands of Dollars)

	June 30 2014	June 30 2013
ASSETS:		
Current Assets:		
Cash on Deposit and on Hand	$ 30	$ 30
Equity in Treasurer's Account	71,136	82,494
Due from Other Governments	176	76
Accounts Receivable	164,042	160,060
Allowance for Doubtful Accounts	(18,629)	(13,661)
Inventories	13,423	13,799
Receivables	152	325
Total Current Assets	230,330	243,123
Noncurrent Assets:		
Restricted Assets:		
Equity in Treasurer's Account	470,740	313,927
Sinking Funds and Reserves	219,013	210,990
Grants for Capital Purposes	-	252
Receivables	843	1,080
Total Restricted Assets	690,596	526,249
Capital Assets:		
Land	5,919	5,919
Infrastructure	2,269,015	2,167,639
Construction in Progress	361,592	373,844
Buildings and Equipment	1,623,520	1,591,073
Accumulated Depreciation	(2,189,554)	(2,119,125)
Total Capital Assets	2,070,492	2,019,350
Total Noncurrent Assets	2,761,088	2,545,599
Total Assets	**2,991,418**	**2,788,722**
DEFERRED OUTFLOWS OF RESOURCES:		
Deferred Outflow - Fin. Instruments	5,711	8,565
Unamortized Loss - Refunded Debt	60,875	65,300
Total Deferred Outflows of Resources	**66,586**	**73,865**
LIABILITIES:		
Current Liabilities:		
Vouchers Payable	8,230	6,763
Accounts Payable	11,664	12,655
Salaries & Wages Payable	4,819	4,187
Construction Contracts Payable	22,783	27,530
Accrued Expenses	27,477	23,812
Due to Other Components	3,607	-
Unearned Revenue	8,923	7,531
Funds Held in Escrow	1,868	1,902
Current Portion of Long Term Obligations	125,300	127,492
Total Current Liabilities	214,671	211,872
Noncurrent Liabilities:		
Bond Payable - Net	1,809,952	1,702,895
Derivative Instrument Liability	5,711	8,565
Other Noncurrent Liabilities	30,514	32,205
Net Pension Liability	26,673	8,962
Total Noncurrent Liabilities	1,872,850	1,752,627
Total Liabilities	**2,087,521**	**1,964,499**
NET POSITION:		
Net Investment in Capital Assets	336,980	351,160
Restricted For:		
Capital Projects	102,860	99,856
Debt Service	219,013	210,990
Rate Stabilization	184,796	161,464
Unrestricted	126,834	74,618
Total Net Position	**$ 970,483**	**$ 898,088**

The accompanying notes are an integral part of the financial statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR FISCAL YEAR ENDED JUNE 30, 2014 AND 2013

(Thousands of Dollars)

	Year Ended June 30	
	2014	**2013**
Operating Revenues:		
Charges for Goods and Services	$ 630,429	$ 600,156
Miscellaneous Operating Revenues	8,146	8,547
Operating Grants	1,399	2,285
Total Operating Revenues	639,974	610,988
Operating Expenses:		
Personal Services	112,820	110,784
Purchase of Services	90,611	88,395
Materials and Supplies	43,453	38,409
Employee Benefits	102,623	104,713
Indemnities and Taxes	5,179	3,108
Depreciation and Amortization	90,523	89,045
Total Operating Expenses	445,209	434,454
Operating Income	194,765	176,534
Nonoperating Expenses:		
Federal, State, & Local Grants	-	880
Interest Income	4,207	12,079
Net Pension Obligation	(17,712)	2,839
Debt Service - Interest	(77,561)	(80,146)
Other Expenses	(2,971)	(1,665)
Total Nonoperating Expenses	(94,037)	(66,013)
Increase in Net Position before Transfers	100,728	110,521
Transfers Out	(28,333)	(21,380)
Change in Net Assets	72,395	89,141
Net Position - Beginning of Year	898,088	865,320
Adjustment (Note 23)	-	(56,373)
Net Position - End of Year	**$ 970,483**	**$ 898,088**

STATEMENTS OF CASH FLOWS
FOR FISCAL YEAR ENDED JUNE 30, 2014 AND 2013

(Thousands of Dollars)

	Year Ended June 30 2014	2013
Cash Flows from Operating Activities:		
Receipts from Customers	$ 640,819	$ 602,342
Payments to Suppliers	(130,852)	(129,513)
Payments to Employees	(216,574)	(208,891)
Claims Paid	(5,179)	(5,090)
Net Cash Provided by Operating Activities	**288,214**	**258,848**
Cash Flows from Non-Capital Financing Activities:		
Operating Grants Received	1,649	2,285
Operating Subsidies and Transfers to Other Funds	(31,322)	(21,380)
Net Cash Used by Non-Capital Financing Activities	**(29,673)**	**(19,095)**
Cash Flows from Capital & Related Financing Activities:		
Proceeds from Capital Debt	229,204	97,860
Capital Contributions Received	-	628
Acquisition and Construction of Capital Assets	(142,039)	(153,388)
Interest Paid on Capital Debt	(74,701)	(76,180)
Principal Paid on Capital Debt	(127,009)	(207,220)
Net Cash Used by Non-Capital Financing Activities	**(114,545)**	**(338,300)**
Cash Flows from Investing Activities:		
Interest and Dividends	1,459	(63,653)
Net Cash Provided by (Used in) Investing Activities	1,459	(63,653)
Net Increase (Decrease) in Cash & Cash Equivalents	145,455	(162,200)
Balances - Beginning of the Year	396,451	558,651
Balances - End of the Year	**$ 541,906**	**$ 396,451**
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating Income	194,765	176,534
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation Expense	90,523	89,045
Change in Assets and Liabilities:		
Receivables, Net	(547)	(9,551)
Inventories	376	(343)
Accounts and Other Payables	3,396	(4,134)
Accrued Expenses	(1,691)	6,392
Unearned Revenue	1,392	905
Net Cash Provided by Operating Activities	**$ 288,214**	**$ 258,848**
Reconciliation of Cash and Cash Equivalents to Statement of Net Position		
Cash on Deposit and on Hand	30	30
Equity in Treasurer's Account - Current Portion	71,136	82,494
Equity in Treasurer's Account - Noncurrent Portion	470,740	313,927
Total Cash and Cash Equivalents	**$ 541,906**	**$ 396,451**

PHILADELPHIA WATER DEPARTMENT
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2014

NOTE 1: REPORTING ENTITY

The City of Philadelphia was founded in 1682 and was merged with the county in 1854. The City of Philadelphia, Pennsylvania (the "City" or "Philadelphia"), was incorporated in 1789 by an Act of the General Assembly of the Commonwealth of Pennsylvania (the "Commonwealth") (predecessors of the City under charters granted by William Penn in his capacity as proprietor of the colony of Pennsylvania may date to as early as 1684). In 1854, the General Assembly of the Commonwealth, by an act commonly referred to as the Consolidation Act, made the City's boundaries coterminous with the boundaries of Philadelphia County (the same boundaries that exist today) (the "County"), abolished all governments within these boundaries other than the City and the County and consolidated the legislative functions of the City and the County. Article 9, Section 13 of the Pennsylvania Constitution abolished all county offices in the City and provides that the City performs all functions of county government and that laws applicable to counties apply to the City.

Since 1952, the City has been governed under a Home Rule Charter authorized by the General Assembly of the Commonwealth (First Class City Home Rule Act, Act of April 21, 1949, P.L. 665, Section 17) and adopted by the voters of the City. The Home Rule Charter, as amended and supplemented to this date, provides, among other things, for the election, organization, powers and duties of the legislative branch (the "City Council"); the election, organization, powers and duties of the executive and administrative branch; and the basic rules governing the City's fiscal and budgetary matters, contracts, procurement, property and records. The Home Rule Charter, as amended, also provides for the governance of the School District of Philadelphia (the "School District") as a home rule school district. Certain other constitutional provisions and Commonwealth statutes continue to govern various aspects of the City's affairs, notwithstanding the broad grant of powers of local self-government in relation to municipal functions set forth in the First Class City Home Rule Act.

The City's Water Department supplies water and provides wastewater treatment services to residents of Philadelphia and portions of Bucks, Montgomery, and Delaware Counties, although over 90% of those served are residents of the City.

NOTE 1: REPORTING ENTITY (CONTINUED)

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 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 Department ("Water Department") that is a Department of the City and is included in the financial statements of the City.

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.

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 operations of the activity of the Water Department are accounted for with a separate set of balancing accounts that comprise its assets, liabilities, and net position, revenues and expenses. The activity of the Water Department is grouped in the financial statements into the broad category referred to as an enterprise fund. Such activities are used to account for operations (1) that are financed and operated in a manner similar to private business enterprises – where the intent of the Government Body is that costs (expenses, including depreciation) of providing goods and services to the general public on a continuous basis be recovered primarily through user charges or (2) where the Government Body has decided that periodic determination of revenues earned, expenses occurred, and/or net income is appropriate for capital maintenance, public policy, management's control of accountability, and other purposes.

The activities of the Water Department are segregated as follows:

- The Operating Fund is used to account for the operations of the water and waste water systems.

- The Revenue Bond Sinking Fund is used to account for the payment of interest of the outstanding debt.

NOTE 1: REPORTING ENTITY (CONTINUED)

- The Debt Reserve Fund shall be funded from the proceeds of each series of Water and Wastewater Revenue Bonds; provided, however, that if the Supplemental Ordinance authorizing a series of Water and Wastewater Revenue Bonds shall so authorize, the deposit to the Debt Reserve Account in respect of such Water and Wastewater Revenue Bonds may be accumulated from project revenues over a period of not more than three fiscal years after the issuance and delivery of such Water and Wastewater Revenue Bonds. The moneys and investments in the Debt Reserve Account shall be held and maintained in an amount equal at all times to the Debt Reserve Requirement. If at any time the moneys in the Debt Service Account of the Sinking Fund shall be insufficient to pay as and when due the principal of (and premium, if any) or interest on any Water and Wastewater Revenue Bonds or other obligations payable from the Debt Service Account (including obligations arising in connection with Qualified Swap Agreements and Credit Facilities), the fiscal agent is required to pay over from the Debt Reserve Account the amount of such deficiency for deposit in the Debt Service Account. With respect to any issue of Water and Wastewater Revenue Bonds, in lieu of the required deposit into the Debt Reserve Account, the City may cause to be deposited into the Debt Reserve Account a surety bond, an insurance policy or an irrevocable letter of credit meeting the requirements of the General Ordinance and the Bond Committee Determination relating to such issue.

  The Debt Reserve Account Amendment authorizes (i) the Director of Finance to apply moneys currently on deposit in the Debt Reserve Account to purchase a surety bond or insurance policy complying with the terms of the General Ordinance (described below), (ii) the transfer of the resulting excess moneys in the Debt Reserve Fund to the Revenue Fund and from there, upon compliance with the provisions of the General Ordinance to a new account in the Residual Fund called the Special Water Infrastructure Account and (iii) the application of the moneys deposited in the Special Water Infrastructure Account to the cost of renewals, replacements and improvements to the water and wastewater systems.

- 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 2014 the fund had the following activity:

Balance at July 1, 2013	$161,463,768
Deposit from Operating Fund	22,924,772
Interest Earnings	407,041
Deposit to Operating Fund	-
Balance at June 30, 2014	$184,795,581

NOTE 1: REPORTING ENTITY (CONTINUED)

During Fiscal 2013 the fund had the following activity:

Balance at July 1, 2012	$165,906,600
Deposit from Operating Fund	-
Interest Earnings	223,120
Deposit to Operating Fund	(4,665,952)
Balance at June 30, 2013	$161,463,768

- 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.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements include all funds which are controlled by the Philadelphia Water Department. The financial statements have been prepared in accordance with Generally Accepted Accounting Principles 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 following is a summary of the significant accounting policies.

A. Basis of Accounting

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and deferred outflows of resources, liabilities, and net position and disclosures at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of timing of related cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Basis of Accounting (Continued)

Operating revenues and expenses are distinguished from non-operating items in the statement of revenues, expenses and changes in net position. Operating revenues and expenses result from providing services in connection with the Water Department's principle ongoing operations. Principal operating revenues of the Water Department are charges to customers for water use and watershed collection, transmission and treatment. When calculating user fees charged to customers, the Water Department includes a component for the repayment of principal on the Water Department's outstanding debt. Operating expenses include the cost of providing water and watershed services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. The principal non-operating revenues of the Water Department are interest and grants. The principal non-operating expenses of the Water Department include interest expense and pension expense.

B. Capital Assets

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. The expenses are reported at cost including any liability for contract retainage and construction costs payable.

Contributed assets are carried at estimated market value at the time of contribution. Depreciation is determined using 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

Normal maintenance and repairs are charged to operations as incurred. Renewals and betterments are capitalized and depreciated based upon the expected life of such improvements.

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 2014 was $3,926,863 and for fiscal year 2013 was $12,951,027.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Bond Discount

Bond discounts are deferred and amortized by the bonds outstanding method, which appropriates the interest method. For financial reporting purposes, bond discounts and premiums are offset against bonds payable.

D. Inventories

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

E. Deferred Refunding Loss

The accounting loss incurred by the Water Department related to the refunding of certain bonds is deferred and amortized over the life of the original bond or the refunded bonds whichever is shorter.

F. Accounts Receivables

Accounts receivable consist of billed retail and wholesale water and sewer charges that have not been collected as of June 30. The Water Department evaluates the collection of individual account balances and if necessary, records an allowance for doubtful accounts. The Water Department’s policy is to file a lien against the respective property for delinquent water, sewer, and storm water customers. The Water Department’s policy regarding its water customers is to discontinue services for those that refuse to pay, but only as a last resort. As of June 30, 2014 and 2013 the allowance for doubtful accounts was $18,629,063 and $13,660,860 respectively.

G. Unbilled Revenue

The Water Department bills residential water and sewer customers on a monthly basis and wholesale water and sewer customers on a monthly basis. Revenue earned for services provided through June 30 but unbilled is included in accounts receivable on the accompanying financial statements.

H. Insurance

The City, except for the Airport and certain other properties, is self-insured for most fire and casualty losses to its structures and equipment and provides statutory workers’ 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.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

I. Cash and Investments

The Water Department's cash and investments are held in segregated operating and capital accounts. Sinking funds and reserves are maintained in segregated investment accounts to comply with reserve and other requirements of the bond covenants.

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.

Statutes authorize the City to invest in obligations of the Treasury, agencies, and instruments of the United States, repurchase agreements, collateralized certificates of deposit, bank acceptance or mortgage obligations, certain corporate bonds, and money market funds.

J. Restricted Assets

Restricted assets represent revenues set-aside for liquidation of specific obligations, as detailed in Note 8.

K. Unearned Revenues

Unearned revenues represent funds received in advance of being earned. In the Water Department, unearned revenues relate principally to over paid water and sewer bills.

L. Payment to City

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 year 2014 and 2013, excess interest earnings of $400,364 and $560,156, respectively, were transferred to the General Fund of the City.

M. Transfers for Long Term Contracts

In addition to the transfer of funds to the General Fund of the City, the Water Department had operating transfers of $27,932,268 and $20,819,479 in fiscal year 2014 and 2013, respectively, to the Philadelphia Municipal Authority ("PMA") for the long-term contracts described in Note 19 A, B, and C.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

N. Net Position

The basic financial statements utilize the net position presentation, net position is categorized as net investment in capital assets, restricted, and unrestricted.

- *Net Investment in Capital Assets* – This category is intended to reflect the portion of net position that is allocated with non-liquid capital assets, less outstanding capital asset related debt.
- *Restricted Net Position* – This category represents external restrictions imposed by creditors, grantors, contributors, laws and regulations of other governments, and restrictions imposed by law through constitutional provisions or enabling legislation.
- *Unrestricted Net Position* – This category represents net position of the Water Department, not restricted for any project or other purpose.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

O. Deferred Outflows / Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to future period(s) and so will not be recognized as an outflow of resources (expense) until then. The Water Department has two items that qualify for reporting in this category. The statement of net position reports a deferred loss on refunded debt and the change in fair value of a hedging derivative instrument.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Water Department does not have an item that qualified for reporting in this category.

P. Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

Q. Reclassifications

For comparative purposes, certain prior year financial statement amounts have been reclassified to conform to current year presentation. The reclassification had no effect on net position.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

R. Adoption of Governmental Accounting Standards Board Statements

The Water Department adopted the requirements of GASB Statement No. 66, *"Technical Corrections – 2012 – an amendment of GASB Statements No. and No. 62."* The adoption of this statement had no effect on previously reported amounts.

The Water Department adopted the requirements of GASB Statement No. 67 "*Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25"*. The adoption of this statement has no effect on the previously reported amounts.

The Water Department adopted the requirements of GASB Statement No. 70, "*Accounting and Financial Reporting for Nonexchange Financial Guarantees"*. The adoption of this statement had no effect on previously reported amounts.

S. Pending Changes in Accounting Principles

In June 2012, the GASB issued a Statement No. 68, *"Accounting and Financial Reporting for Pensions– an amendment of GASB Statement No. 27"*. The Water Department is required to adopt statement No. 68 for its fiscal year 2015 financial statements.

In January 2013, the GASB issued a Statement No. 69, "*Government Combinations and Disposals of Government Operations"*. The Water Department is required to adopt statement No. 69 for its fiscal year 2015 financial statements.

In November 2013, the GASB issued a Statement No. 71, "*Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*". The Water Department is required to adopt statement No. 71 for its fiscal year 2015 financial statements.

The Water Department has not yet completed the various analyses required to estimate the financial statement impact of these new pronouncements.

NOTE 3: DEPOSITS AND INVESTMENTS

A. Deposits

State statutes require banks to collateralize City deposits at amounts equal to or in excess of the City's balance. Such collateral is to be held by the Federal Reserve Bank or the trust department of a commercial bank other than the pledging bank. At June 30, 2014 and June 30, 2013, all of the collateralized securities were held in the City's name except for $106 million and $121 million, respectively, which was collateralized but held in the pledging institution's name.

NOTE 3: DEPOSITS AND INVESTMENTS (CONTINUED)

B. Investments

The City has established a comprehensive investment policy. To minimize custodial credit risk for investments, the City's policy is to select custodian banks that are members of the Federal Reserve System to hold its investments. Delivery of the applicable investment documents to the City's custodian is required for all investments.

As of June 30, 2014 the fair values of the Water Department's investments consist of the following:

(Thousands of Dollars)

Classifications	Fair Value	Percent of Total
U.S. Government Securities	$ 370,176	74.91%
U.S. Government Agency Securities	98,400	19.91%
Corporate Bonds	11,313	2.29%
Other Bonds and Investments	14,300	2.89%
Grand Total	$ 494,189	100.00%

As of June 30, 2013, the fair values of the Water Department's investments consist of the following:

(Thousands of Dollars)

Classifications	Fair Value	Percent of Total
U.S. Government Securities	$ 336,277	80.84%
U.S. Government Agency Securities	43,542	10.46%
Corporate Bonds	30,025	7.22%
Other Bonds and Investments	6,149	1.48%
Grand Total	$ 415,993	100.00%

Interest Rate Risk: The City's investment portfolio is managed to accomplish preservation of principal, maintenance of liquidity, and to maximize the return on investments. To limit its exposure to fair value losses from rising interest rates, the City's investment policy limits investments to maturities of no longer than 2 years.

NOTE 3: DEPOSITS AND INVESTMENTS (CONTINUED)

B. Investments (Continued)

As of June 30, 2014 the maturities of the Water Department's investments were as follows:

(Thousands of Dollars)

Classifications	Less Than 1 Year	1 - 2 Years
U.S. Government Securities	$ 260,368	$ 109,808
U.S. Government Agency Securities	49,071	49,329
Corporate Bonds	11,313	-
Other Bonds and Investments	6,266	8,034
Grand Total	$ 327,018	$ 167,171

As of June 30, 2013 the maturities of the Water Department's investments were as follows:

(Thousands of Dollars)

Classifications	Less Than 1 Year	1 - 2 Years
U.S. Government Securities	$ 187,315	$ 148,962
U.S. Government Agency Securities	5,953	37,589
Corporate Bonds	26,089	3,936
Other Bonds and Investments	6,149	-
Grand Total	$ 225,506	$ 190,487

Credit Risk: The City's policy to limit credit risks is to invest in US Government securities (12.86%) or US Government Agency obligations (4.80%). The US Government Agency obligations must be rated AAA by Standard & Poor's Corp. ("S&P") or Aaa by Moody's Investor Services ("Moody's"). All US Government Securities meet the criteria. The City's investment in Commercial Paper (4.21%) must be rated A1 by S&P and/or M1G1 by Moody's and the senior long-term debt of the issuer must not be rated lower than A by S&P and/or Moody's. Commercial Paper is also limited to 25% of the portfolio. All commercial paper investments meet the criteria. Of the corporate bonds held by the City, 9.94% had a S&P rating of AAA to AA. Cash accounts are swept nightly and idle cash invested in money market funds (short term investment pools). Short Term Investment Pools are rated AAA by S&P and Aaa by Moody's. The Short Term Investment Pools' fair value is the same as the value of the pool shares. The City limits its foreign currency risk by investing in certificates of deposits and banker's acceptances issued or endorsed by non-domestic banks that are denominated in US dollars, providing that the banking institution has assets of not less than $100 million and has a Thompson's Bank Watch Service "Peer Group Rating" not lower than II. At the end of the fiscal year, the City did not have any investments of that nature.

NOTE 4: ACCOUNTS RECEIVABLE

Balances of accounts receivable and allowance for doubtful accounts consisted of the following:

FISCAL YEAR ENDED JUNE 30, 2014		
Accounts Receivable:		
Billed in the Last Twelve Months	$	138,553,005
Billed in 15-year Cycle Billing		-
Penalties on Receivables		13,992,499
Other Receivables		11,496,268
Total	$	164,041,772
Bad Debts Written Off	$	36,402,784
Allowance for Doubtful Accounts	$	18,629,063

FISCAL YEAR ENDED JUNE 30, 2013		
Accounts Receivable:		
Billed in the Last Twelve Months	$	112,392,541
Billed in 15-year Cycle Billing		-
Penalties on Receivables		33,165,628
Other Receivables		14,502,308
Total	$	160,060,477
Bad Debts Written Off**	$	125,750,066
Allowance for Doubtful Accounts:		
Billed in the Last Twelve Months	$	2,470,849
Billed in 15-year Cycle Billing		6,436,465
Penalties on Receivables		4,753,546
Other Receivables		-
Total	$	13,660,860

**During FY 2013, a proposal was presented and accepted by the City's Accounts Review Panel to write off aged receivables over one year old.

NOTE 5: PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30, 2014 and 2013 consisted of the following:

	Beginning Balance	Additions	Dispositions	Ending Balance
Fiscal Year Ended June 30, 2014				
Capital Assets Not Being Depreciated				
Land	$ 5,919,160	$ -	$ -	$ 5,919,160
Construction in Progress	373,844,154	140,968,008	(153,220,212)	361,591,950
Total Capital Assets Not Being Depreciated	$ 379,763,314	$ 140,968,008	$ (153,220,212)	$ 367,511,110
Capital Asssets Being Depreciated				
Buildings and related improvements	1,517,587,479	44,662,033	(10,269,725)	1,551,979,787
Intangible Assets	12,234,866	738,640	-	12,973,506
Equipment	73,485,553	20,255,147	(22,200,434)	71,540,266
Infrastructure	2,155,403,733	107,998,169	(7,360,430)	2,256,041,472
Total Capital Assets Being Depreciated	$ 3,758,711,631	$ 173,653,989	$ (39,830,589)	$ 3,892,535,031
Less Accumulated Depreciation For:				
Buildings and related improvements	(888,398,708)	(41,711,939)	7,267,028	(922,843,619)
Intangible Assets	(6,129,171)	(1,260,419)	-	(7,389,590)
Equipment	(65,974,792)	(2,723,579)	5,466,741	(63,231,630)
Infrastructure	(1,158,622,726)	(44,826,982)	7,360,430	(1,196,089,278)
Total Accumulated Depreciation	(2,119,125,397)	(90,522,919)	20,094,199	(2,189,554,117)
Total Capital Assets, Being Depreciated, Net	1,639,586,234	83,131,070	(19,736,390)	1,702,980,914
Total Capital Assets	$ 2,019,349,548	$ 224,099,078	$ (172,956,602)	$ 2,070,492,024

	Beginning Balance	Additions	Dispositions	Ending Balance
Fiscal Year Ended June 30, 2013				
Capital Assets Not Being Depreciated				
Land	$ 5,919,160	$ -	$ -	$ 5,919,160
Construction in Progress	314,162,257	63,795,220	(4,113,323)	373,844,154
Total Capital Assets Not Being Depreciated	$ 320,081,417	$ 63,795,220	$ (4,113,323)	$ 379,763,314
Capital Asssets Being Depreciated				
Buildings and related improvements	1,502,631,913	19,703,244	(4,747,678)	1,517,587,479
Intangible Assets	11,414,581	820,285	-	12,234,866
Equipment	70,186,353	20,219,282	(16,920,082)	73,485,553
Infrastructure	2,076,541,650	86,819,904	(7,957,821)	2,155,403,733
Total Capital Assets Being Depreciated	$ 3,660,774,497	$ 127,562,715	$ (29,625,581)	$ 3,758,711,631
Less Accumulated Depreciation For:				
Buildings and related improvements	(852,672,838)	(40,473,548)	4,747,678	(888,398,708)
Intangible Assets	(4,946,699)	(1,182,472)	-	(6,129,171)
Equipment	(64,047,323)	(2,670,465)	742,996	(65,974,792)
Infrastructure	(1,121,187,009)	(44,718,881)	7,283,164	(1,158,622,726)
Total Accumulated Depreciation	(2,042,853,869)	(89,045,366)	12,773,838	(2,119,125,397)
Total Capital Assets, Being Depreciated, Net	1,617,920,628	38,517,349	(16,851,743)	1,639,586,234
Total Capital Assets	$ 1,938,002,045	$ 102,312,569	$ (20,965,066)	$ 2,019,349,548

NOTE 6: LEASES

The Water Department enters into various operating leases to finance the purchase of photocopier and computer equipment. Leases are defined by the Financial Accounting Standard Board in Statement 13, Accounting for Leases. Lease payments consisted of $1,848,062 in fiscal year 2014, and $1,514,466 in fiscal year 2013. The assets acquired through the leases are shown as equipment within the Capital Asset Note (See Note 5).

NOTE 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 the Water Department's assets that were either damaged or destroyed, were abandoned or became functionally obsolete.

One 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. A permanent solution for sludge processing that does not involve composting is being utilized by the Water Department through the biosolids treatment and utilization plant operated by Philadelphia Biosolids Services, LLC (see Note 19). The Water Department'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.

No asset impairments occurred during fiscal year 2014 and 2013.

NOTE 8: RESTRICTED ASSETS

Assets whose use is limited to a specific purpose have been classified as "restricted" in the Statement of Fund Net Position. Restricted assets as of June 30, 2014, are comprised of the following:

(Thousands of Dollars)

	Cash and Investments	Accrued Interest
Amounts Reserved for:		
Capital Projects	$ 260,834	$ 505
Rate Stabilization	184,631	165
Residual	25,275	-
Debt Service	219,013	173
Total	$ 689,753	$ 843

NOTE 8: RESTRICTED ASSETS (CONTINUED)

Restricted assets as of June 30, 2013, are comprised of the following:

	(Thousands of Dollars)		
	Cash and Investments	**Accrued Interest**	**Grants Receivable**
Amounts Reserved for:			
Capital Projects	$ 150,603	$ 286	$ 252
Rate Stabilization	161,239	225	-
Residual	2,085	2	-
Debt Service	210,990	567	-
Total	$ 524,917	$ 1,080	$ 252

NOTE 9: VACATION LEAVE

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 under Other Noncurrent Liabilities on the Statement of Net Position in Fiscal Year 2014 was $10,170,963 and in Fiscal Year 2013 was $9,972,902. The expense for vacation pay is recognized in the year earned.

NOTE 10: 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.

NOTE 11: 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.

NOTE 11: ACCOUNTING FOR THE NEW RIVER CITY PROJECT FUNDS – WATER SINKING FUND RESERVE SUBSTITUTION (CONTINUED)

The New River City Ordinance dated January 23, 2007 (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:

Cost of the surety bond	$2,010,000
Legal and financial services	290,000
Management fees	375,000
Costs of certain water and sewer infrastructure components of the New River City Program	64,325,000
Total	$67,000,000

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

In connection with the New River City Program, the Water Department executed a program agreement with Philadelphia Authority for Industrial Development ("PAID") to provide program management and oversight for the program. To date, twelve projects totaling $83,697,833 have been executed (disbursements were limited to the $64,325,000). As of June 30, 2014, all projects were completed and $1,963 of the project funds remains undisbursed. The transfer of the water and sewer utilities at Philadelphia Naval Business Center from PAID to the Water Department, including the projects outlined above, and occurred in November, 2009.

NOTE 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, 2014, 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.

NOTE 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. The arbitrage liability was zero as of June 30, 2014 and 2013.

NOTE 14: DEBT PAYABLE

A summary of changes in long-term debt obligations as of June 30, 2014 follows:

(In Thousands)

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Water and Sewer Revenue Bonds	$ 1,620,275	$ 293,170	$ (215,385)	$ 1,698,060	$ 114,735
Pennvest Loans	139,504	23,577	(9,696)	153,385	10,565
Unamortized Bond Premium	70,608	28,349	(15,150)	83,807	-
Derivative Instrument Liability	8,565	-	(2,854)	5,711	-
Net Pension Liability	8,962	17,711	-	26,673	-
Other Non-Current Liabilities:					
Accrued Worker's Compensation	17,846	2,277	(3,309)	16,814	-
Accrued Legal Claims	4,387	5,642	(6,500)	3,529	-
Compensated Absences	9,972	1,957	(1,758)	10,171	-
Total Non-Current Liabilities	$ 1,880,119	$ 372,683	$ (254,652)	$ 1,998,150	$ 125,300

An analysis of debt service requirements to maturity on the long-term obligations follows:

(In Millions of USD)

Years Ended June 30:	Principal Requirements	Interest Requirements	Total Debt Service Requirements
2015	$ 125.3	$ 79.6	$ 204.9
2016	136.7	75.4	212.1
2017	124.8	68.4	193.2
2018	131.6	63.5	195.1
2019	86.8	59.1	145.9
2020-2024	381.5	241.7	623.2
2025-2029	292.1	172.3	464.4
2030-2034	279.7	106.4	386.1
2035-2039	161.0	52.5	213.5
2040-2044	131.9	16.6	148.5
Total	$ 1,851.4	$ 935.5	$ 2,786.9

NOTE 14: DEBT PAYABLE (CONTINUED)

Pertinent information regarding long-term debt obligations outstanding is presented below:

Date of Issue	Amount of Original Issue	Purpose	Balance Outstanding at June 30, 2014
1997	$78,500,000	Water and Wastewater Revenue Bonds, Variable Rate Series of 1997B, issued for various capital projects, to fund the Debt Reserve Account, and to pay the costs of issuance related to the bond issue at a variable rate.	$63,800,000
1998	135,185,000	Water and Wastewater Revenue Refunding Bonds, Series of 1998, issued for defeasing a portion of the Series of 1993 Bonds, for defeasing a portion of the Fifteenth Series Bonds, and to pay the costs of issuance related to the bond issue at a rate of 5.25%.	38,025,000
1999	6,700,000	Pennsylvania Infrastructure Investment Authority Loan of 1999, issued for various capital projects at a rate of 1.41% - 2.73%.	410,107
2005	250,000,000	Water and Wastewater Revenue Bonds, Series of 2005A, issued for various capital projects, to fund the Debt Reserve Account of the Sinking Fund, and to pay the costs of issuance related to the bond issue at a rate of 3% - 5.25%.	117,250,000
2005	83,665,000	Water and Wastewater Revenue Refunding Bonds, Variable Rate Series of 2005B, issued for defeasing a portion of the Series of 1995 Bonds, and to pay the costs of issuance related to the bond issue at a variable rate.	67,175,000
2007	345,035,000	Water and Wastewater Revenue Refunding Bonds, Series of 2007A and 2007B, issued for defeasing the Series of 1997A and Series of 2001A Bonds, and to pay the costs of issuance related to the bond issue at a rate of 4% - 5%.	289,230,000

NOTE 14: DEBT PAYABLE (CONTINUED)

Date of Issue	Amount of Original Issue	Purpose	Balance Outstanding at June 30, 2014
2009	140,000,000	Water and Wastewater Revenue Bonds, Series of 2009A, issued for various capital projects, issued for funding the Debt Reserve Account of the Sinking Fund, and to pay the costs of issuance related to the bond issue at a rate of 4% - 5.75%.	140,000,000
2009	22,828,000	Pennsylvania Infrastructure Investment Authority Loan of 2009 (B), issued for various capital projects at a rate of 1.193% - 2.107%.	25,090,064
2009	35,667,000	Pennsylvania Infrastructure Investment Authority Loan of 2009 (C), issued for various capital projects at a rate of 1.193% - 2.107%.	36,230,899
2009	64,380,000	Pennsylvania Infrastructure Investment Authority Loan of 2009 (D), issued for various capital projects at a rate of 1.193% - 2.107%.	64,520,996
2010	8,111,000	Pennsylvania Infrastructure Investment Authority Loan of 2010 (B), issued for various capital projects at a rate of 1.193% - 2.107%.	27,133,256
2010	396,460.000	Water and Wastewater Revenue Refunding Bonds, Series of 2010A, issued for defeasing the Series of 2003 Bonds, issued for funding a payment to terminate the Series of 2003 Swap Agreement, for funding the required deposit into the Debt Reserve Account of the Sinking Fund, and to pay the costs of issuance related to the bond issue at a rate of 2% - 5%.	251,830,000
2010	185,000,000	Water and Wastewater Revenue Bonds, Series of 2010C, issued for funding a payment to terminate the Series of 2007 Swap Agreement, fund the required deposit into the Debt Reserve Account of the Sinking Fund, and to pay the costs of issuance related to the bond issue at a rate of 3% - 5%.	185,000,000

NOTE 14: DEBT PAYABLE (CONTINUED)

Date of Issue	Amount of Original Issue	Purpose	Balance Outstanding at June 30, 2014
2011	184,855,000	Water and Wastewater Revenue Bonds, Series of 2011A, and Water and Wastewater Revenue Refunding Bonds, Series of 2011B, issued for partially defeasing the Series of 2001A and Series of 2007A Bonds, for various capital projects, for funding of capitalized interest, for financing any required deposit into the Debt Reserve Account of the Sinking Fund, and to pay the cost of issuance related to the bond issue at a rate of 4% - 5%.	184,855,000
2012	70,370,000	Water and Wastewater Revenue Refunding Bonds, Series of 2012, issued for defeasing the Series of 2001A and 2001B Bonds and to pay the cost of issuance related to the bond issue at a rate of 1% - 5%.	67,725,000
2013	170,000,000	Water and Wastewater Revenue Bonds, Series of 2013A, issued to finance capital improvements, financing a deposit to the Debt Reserve Account, and to pay the cost of issuance related to the bond issue at a rate of 3% to 5.125%.	170,000,000
2014	123,170,000	Water and Wastewater Revenue Bonds, Series of 2014A, issued advance refund a portion of the Series of 2005A Bonds, to finance capital improvements, financing a deposit to the Debt Reserve Account, and to pay the cost of issuance related to the bond issue at a rate of 3% to 5%.	123,170,000
			$ 1,851,445,322

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. As of June 30, 2014, $138.5 million of bonds outstanding were considered defeased. As of June 30, 2013 $40.5 million of bonds outstanding were considered defeased.

NOTE 14: DEBT PAYABLE (CONTINUED)

Bond Issues

In August 2013, the city issued Water and Wastewater Revenue Bonds Series 2013 A in the amount of $170 million. Serial Bonds were issued in the amount of $120 million with interest rates ranging from 3% to 5% and have a maturity date of 2023. Term Bonds were issued in the amount of $50 million with an interest rate of 5.125% and mature in 2043. The proceeds of the bonds together with other available funds of the City's Water Department will be used to finance capital improvements to the City's Water and Wastewater systems, a deposit to the Debt Reserve account of the Sinking Fund and the cost of issuance relating to the Bonds.

In January 2014, the City issued Water and Wastewater Revenue Bonds Series 2014A in the amount of $123.2 million. Serial Bonds were issued for $93.2 million with interest rates ranging from 3.0% to 5.0% maturing July 1, 2027. Term bonds were issued in the amount of $30 million with a 5.0% interest rate maturing July 1, 2043. The purpose of the bonds is to provide funds that will be used for the advance refunding of a portion of the City's outstanding Water and Wastewater Revenue Bonds, Series 2005A, capital improvements to the City's Water and Wastewater System, a deposit to the Debt Reserve Sinking Fund and the cost of issuance relating to the bonds. The aggregate difference in debt service between the refunding debt and the refunded debt is $8.8 million. This refunding transaction resulted in a net economic gain of $6.8 million.

Pennvest Loans

In July 2010, the City of Philadelphia Water Department received approval from the Pennsylvania Infrastructure Investment Authority ("PENNVEST") for the Green Infrastructure Project (Series 2010B), bringing the total financing from PENNVEST to $214.9 million. During fiscal year 2014 and 2013, PENNVEST drawdowns totaled $23.6 million and $15.4 million, respectively, which represents an increase in bond issuances. The funding is through low interest loans of 1.193% during the construction period and for the first five years of amortization (interest only payment are due during the construction period up to three years) and 2.107% for the remaining fifteen years. Individual loan information as of June 30, 2014 is as follows:

Date	Series	Maximum Loan Amount	Approved Project Costs	Amount Requested through 6/30/14	Amount Received Yes/No
October 2009	2009B	$42,886,030	$42,339,199	$28,790,697	Yes
October 2009	2009C	57,268,193	56,264,382	41,771,895	Yes
March 2010	2009D	84,759,263	84,404,754	71,703,769	Yes
July 2010	2010B	30,000,000	31,376,846	27,741,841	Yes
	Totals	$214,913,486	$214,385,181	$170,008,202	

NOTE 14: DEBT PAYABLE (CONTINUED)

Pennvest Loans (Continued)

Individual loan information as of June 30, 2013 is as follows:

Date	Series	Maximum Loan Amount	Approved Project Costs	Amount Requested through 6/30/13	Amount Received Yes/No
October 2009	2009B	$42,886,030	$42,339,199	$25,908,165	Yes
October 2009	2009C	57,268,193	56,264,382	40,338,440	Yes
March 2010	2009D	84,759,263	84,404,754	70,930,405	Yes
July 2010	2010B	30,000,000	31,376,846	9,254,100	Yes
	Totals	$214,913,486	$214,385,181	$146,431,110	

NOTE 15: DERIVATIVE INSTRUMENT

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 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 is currently paying 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.

In May 2013, the City and Water Department converted the original variable rate bonds associated with the swap to an index-based rate, terminating the existing letter of credit in the process.

As of June 30, 2014, the swap had a notional amount of $67.175 million and the associated variable rate bond had $67.175 million principal amount. The bonds' variable rate coupons are based on the same index as the receipt on the swap. The bonds mature on August 1, 2018 and the related swap agreement terminates on August 1, 2018.

NOTE 15: DERIVATIVE INSTRUMENT (CONTINUED)

Fair value: As of June 30, 2014, the swap had a negative fair value of ($5.71 million). This means that the Water Department would have to pay this amount if the swap terminated.

Risk: As of June 30, 2014, 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, and paying 68.5% of one month LIBOR plus a fixed spread, the City is no longer exposed to basis risk, or tax risk. 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 or 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 Corporation (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, 2014, rates were as follows:

Terms	Rates	
Interest Rate Swap		
Fixed payment to Citi under swap	Fixed	4.53000 %
Variable rate payment from Citi under swap	68.5% of 1-month Libor	(0.10631) %
Net interest rate swap payments		4.42369 %
Variable rate note coupon payments	68.5% of 1-month Libor + fixed spread	0.10631 %*
Synthetic interest rate on bonds		4.53000 %

**Excludes fixed spread, which is similar to the City's expected Letter of Credit costs on a comparable variable rate bond*

As of June 30, 2013, rates were as follows:

Terms	Rates	
Interest Rate Swap		
Fixed payment to Citi under swap	Fixed	4.53000 %
Variable rate payment from Citi under swap	68.5% of 1-month Libor	(0.13334)%
Net interest rate swap payments		4.39666 %
Variable rate note coupon payments	68.5% of 1-month Libor + fixed spread	0.13334 %*
Synthetic interest rate on bonds		4.53000 %

**Excludes fixed spread, which is similar to the City's expected Letter of Credit costs on a comparable variable rate bond*

NOTE 15: DERIVATIVE INSTRUMENTS (CONTINUED)

Swap payments and associated debt: As of June 30, 2014, 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
2015	$ 15,535,000	$ 71,415	$ 2,971,612	$ 3,043,027
2016	16,315,000	54,900	2,284,392	2,339,292
2017	17,145,000	37,555	1,562,668	1,600,223
2018	18,015,000	19,328	804,226	823,554
2019	165,000	175	7,299	7,474
Total	$ 67,175,000	$ 183,373	$7,630,197	$7,813,570

NOTE 16: PENSION PLAN

Effective with fiscal year 2014, the City implemented GASB Statement No. 67, *Financial Reporting for Pension Plans.* The new GASB required the City to re-evaluate its status as a single, multi, or employer defined benefit pension plan. The new statement defines a single employer as the primary government and its component units. However, the City's pension plan includes an entity, the Philadelphia Housing Development Corporation (PHDC), that is not a component unit. Therefore, beginning with fiscal year 2014, the City's pension plan meets the definition of a multi-employer plan. The City also maintains one single-employer defined pension plan for the Philadelphia Gas Works.

In June 2012, the GASB issued Statement No. 67, *Financial Reporting for Pension Plans*. This Statement replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and Statement No. 50, *Pension Disclosures*. The statement establishes standards of financial reporting for separately issued financial reports and specifies the required approach for measuring a participating employer's pension liability. In most respects, the requirements for pension plan financial statements remain unchanged from the prior standards; however, the statements do require additional note disclosures including new schedules of required supplementary information.

Required Supplementary Information calculated in accordance with GASB Statement No. 25 is presented in audited financial statements of the respective pension plans. Copies of these financial statements may be obtained by contacting the Director of Finance of the City of Philadelphia.

The Pension Plans' financial statements are prepared using the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds of contributions are recognized when due and payable in accordance with the terms of the Fund.

NOTE 16: PENSION PLAN (CONTINUED)

A. Plan Administration

The Philadelphia Board of Pensions and Retirement (the "Board") administers the City of Philadelphia Public Employees Retirement System, a multiple employer defined benefit pension plan with a small but increasing defined contribution component, which provides pensions for all officers and employees of the City, as well as those of three quasi-governmental agencies (per applicable enabling legislation and contractual agreements). The Board was established by section 2-308 of the 1952 Philadelphia Home Rule Charter. Its actions in administering the Retirement System are governed by Title 22 of the Philadelphia Code.

B. Plan Membership

At July 1, 2013, the date of the most recent actuarial valuation, pension plan membership consisted of the following:

Actives	26,788
Terminated Vested	1,281
Disabled	4,152
Retirees	21,696
Beneficiaries	8,614
DROP	2,427
Total City Members	64,958
Annual Salaries	$1,429,723,436
Average Salary per Active Member	$53,372
Annual Retirement Allowances	$676,634,789
Average Retirement Allowance	$19,634

C. Contributions

Per Title 22 of the Philadelphia Code, members contribute to the System at various rates based on bargaining unit, uniform status, and entry date into the System. As of July 1, 2013 uniform employees will be contributing either 5.00%, 5.50%, or 6.00% of pensionable earnings; non-uniform employees will be contributing either 1.93%, 2.03%, 2.55%, or 6.00% of pensionable earnings; and elected employees will be contributing either 8.16% or 9.60% of pensionable earnings.

Employer contributions are made by the City throughout each fiscal year (which ends June 30) and by three (3) quasi-governmental agencies on a quarterly basis. These contributions, determined by an annual actuarial valuation report ("AVR"), when combined with plan member contributions, are expected to finance the cost of benefits earned by plan members during the year, with an additional amount to finance any unfunded accrued liability.

NOTE 16: PENSION PLAN (CONTINUED)

C. Contributions (Continued)

Within the AVR, two contribution amounts are determined based upon two different sets of rules for determining the way the unfunded actuarial liability is funded.

The first method is defined in accordance with Act 205 and defines the Minimum Municipal Obligation (“MMO”), which is the City’s minimum required contribution under Pennsylvania state law.

The second method is in accordance with the City’s Funding Policy which predates the Act 205 rules and calls for contributions that are greater than the MMO until the initial unfunded liability determined in 1984 is fully funded.

Under both funding methods there are two components: the normal cost and the amortized unfunded actuarial liability. The actuarial unfunded liability is the amount of the unfunded actuarial liability that is paid each year based upon the given or defined amortization periods. The amortization periods are different under the MMO and City’s Funding Policy.

D. Funding Policy

The initial July 1, 1985 unfunded actuarial liability (“UAL”) is amortized over 34 year ending June 30, 2019 with payments increasing at 3.3% per year, the assumed payroll growth. Other charges in the actuarial liability are amortized in level-dollar payments follows:

- Actuarial gains and losses – 20 years beginning July 1, 2009. Prior gains and losses were amortized over 15 years.
- Assumptions changes – 15 years beginning July 1, 2010. Prior changes were amortized over 20 years.
- Plan changes for active members – 10 years.
- Plan changes for inactive members – 1 year.
- Plan changes mandated by the State – 20 years.

In fiscal year 2014, the City and other employers’ contributions of $533.2 million was less than the actuarially determined employer contribution (ADEC) of $823.9 million. In the event that the City contributes less than the funding policy, an experience loss will be created that will be amortized in accordance with funding policy over 20 years.

The Schedule of Employer Contributions (based on the City’s Funding Policy) is included as Required Supplemental Information and provides a 6-year presentation of employer contributions.

NOTE 16: PENSION PLAN (CONTINUED)

E. Minimum Municipal Obligation

For the purposes of the MMO under Act 205 reflecting the fresh start amortization schedule, the July 1, 2009 UAL was "fresh started" to be amortized over 30 years ending June 30, 2039. This is a level dollar amortization of the UAL. All future amortization periods will follow the City's Funding Policies as outlined above. In fiscal year 2014, the City and other employers' contributions of $553.2 million exceeded the Minimum Municipal Obligation of $523.4 million.

F. Benefits

The Public Employees Retirement System provides retirement, disability, and death benefits according to the provisions of Title 22 of the Philadelphia Code. These provisions prescribe retirement benefit calculations, vesting thresholds, and minimum retirement ages, that vary based on bargaining unit, uniform/non-uniform status, and entry date into the System.

Non-uniform employees may retire at either age 55 with up to 80% of average final compensation ("AFC") or may retire at either age 60 with up to 100% or 25% of AFC, depending on entry date into the System. Uniform employees may retire at either age 45 with up to 100% of AFC or age 50 with up to either 100% or 35% of AFC, depending on entry date into the System. Survivorship selections may result in an actuarial reduction to the calculated benefit.

Members may qualify for service-connected disability benefits regardless of length of service. Service-connected disability benefits are equal to 70% of a member's final rate of pay, and are payable immediately without an actuarial reduction. These applications require approval by the Board.

Eligibility to apply for non-service-connected disability benefits varies by bargaining unit and uniform/non-uniform status. Non-service connected disability benefits are determined in the same manner as retirement benefits, and are payable immediately.

Service connected death benefits are payable to:

1) surviving spouse/life partner at 60% of final rate of pay plus up to 2 children under age 18 at 10% each of final rate of pay (maximum payout: 80%);

2) if no surviving spouse/life partner, up to 3 children under age 18 at 25% each of final rate of pay (maximum payout 75%); or

3) if no surviving spouse/life partner or children under age 18, up to 2 surviving parents at 15% each of final rate of pay (maximum payout 30%).

NOTE 16: PENSION PLAN (CONTINUED)

F. Benefits (Continued)

Non-service connected deaths are payable as a lump sum payment, unless the deceased was either vested or had reached minimum retirement age for their plan, in which case the beneficiary(s) may instead select a lifetime monthly benefit, payable immediately with an actuarial reduction.

A Pension Adjustment Fund ("PAF") is funded with 50% of the excess earnings that are between 1% and 6% above the actuarial assumed earnings rate. Each year within sixty days of the end of the fiscal year, by majority vote of its members, the Board of Directors of the Fund (the "Board") shall consider whether sufficient funds have accumulated in the PAF to support an enhanced benefit distribution (which may include, but is not limited to, a lump sum bonus payment, monthly pension payment increases, ad-hoc cost-of-living adjustments, continuous cost-of-living adjustments, or some other form of increase in benefits as determined by the Board) to retirees, their beneficiaries and their survivors. As of July 1, 2013, the date of the most recent actuarial valuation, there was $1,096,608 in the PAF and the Board voted to make distributions of $0 during the fiscal year ended June 30, 2014.

The Fund includes a Deferred Retirement Option Plan (DROP Plan). The DROP Plan allows a participant to declare that they will retire within 4 years. During the 4-year period, the City will make no further contributions for the participant. The participant would continue to work and to receive their salary; however, any increases would not be counted towards their pension benefit. During the 4-year period the individual participates in the DROP Plan, their pension benefits will be paid into an escrow account in the participant's name. After the 4-year period, the participant would begin to receive their pension benefits and the amount that has been accumulated in the escrow account in a lump sum payment. The balance in the DROP Plan as of June 30, 2014 is $216.9 million.

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

(Millions of Dollars)

Fiscal Year Ended June 30	Annual Pension Cost	Percentage Contributed	Net Pension Obligation
2012	$ 719.6	77.22%	$ 243.9
2013	729.1	105.43%	204.3
2014	816.3	69.35%	454.5

NOTE 16: PENSION PLAN (CONTINUED)

F. Benefits (Continued)

The actuarial valuation used to compute the current year's required contribution was performed as of July 1, 2013. 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
- an annual investment rate of return of 7.85%
- projected annual salary increases based on new age based scale
- payroll growth rate is 3.3%
- no post-retirement benefit increases

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

G. Funding Status

The following schedule shows the funding status based on the latest actuary report. The schedule of funding progress, which presents multiyear trend information about whether the actuarial value of plan assets is decreasing over time relative to the actuarial accrued liability for benefits, can be found in the Required Supplementary Information section immediately following the Notes to the Financial Statements.

(Millions of Dollars)

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percent of Covered Payroll
	(a)	(b)	(b - a)	(a / b)	(c)	(b - a) / c
7/1/2011	$ 4,489.1	$ 9,487.5	$ 4,998.4	47.32%	$ 1,371.3	364.50%
7/1/2012	4,486.8	9,799.9	5,313.1	45.78%	1,372.2	387.20%
7/1/2013	4,799.3	10,126.2	5,326.9	47.39%	1,429.7	372.59%

NOTE 16: PENSION PLAN (CONTINUED)

G. Funding Status (Continued)

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 Dollars)
Annual Required Contribution (ARC)	$ 823,885
Interest on Net Pension Obligation (NPO)	16,242
Adjustment to ARC	(23,784)
Annual Pension Cost	816,343
Contributions Made	(566,179)
Increase in NPO	250,164
NPO at beginning of year	204,302
NPO at end of year	454,466
Interest Rate	7.95%
15 Year Amortization Factor (EOY)	8.59%

The amount of increase in NPO related to the Water Department was $17.7 million for fiscal year 2014.

H. Derivative Instrument

In 2010, the City of Philadelphia adopted GASB Statement No. 53 which addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. Derivative instruments such as swaps, options, futures and forwards are often complex financial arrangements used by governments to manage specific risks or to make investments. By entering into these arrangements, governments receive and make payments based on market prices without actually entering into the related financial or commodity transactions. Derivative instruments associated with changing financial and commodity prices result in changing cash flows and fair values that can be used as effective risk management or investment tools. Derivative instruments, however, also can expose governments to significant risks and liabilities.

NOTE 16: PENSION PLAN (CONTINUED)

H. Derivative Instrument (Continued)

The City of Philadelphia Municipal Pension Fund (Pension Fund) enters into a variety of financial contracts which include options, futures, forwards and swap agreements to gain exposure to certain sectors of the equity and fixed income markets; collateralized mortgage obligations (CMO's); other forward contracts, and U.S. Treasury strips. The contracts are used primarily to enhance performance and reduce volatility of the portfolio. The Pension Fund is exposed to credit risk in the event of non performance by counterparties to financial instruments. The Pension Fund generally enters into transactions only with high quality institutions. Legal risk is mitigated through selection of executing brokers and review of all documentation. The Pension Fund is exposed to market risk, the risk that future changes in market conditions may make an instrument less valuable. Exposure to market risk is managed in accordance with risk limits set by Board approved guidelines, through buying or selling instruments or entering into offsetting positions. The notional or contractual amounts of derivatives indicate the extent of the Pension Fund's involvement in the various types and uses of derivative financial instruments and do not measure the Pension Fund's exposure to credit or market risks and do not necessarily represent amounts exchanged by the parties. The amounts exchanged are determined by reference to the notional amounts and the other terms of the derivatives.

The following table summarizes the aggregate notional or contractual amounts for the Pension Fund's derivative financial instruments at June 30, 2014:

List of Derivatives Aggregated by Investment Type

	Changes in Fair Value		Fair Value at June 30, 2014		
	Classification	Amount	Classification	Amount	Notional
Investment Derivatives					
Forward Currency Contracts	Net appreciation/(depreciation) in investments	$ (1,981,432)	Accrued interest and other receivables	$ (238,578)	$ 150,909,330
Futures	Net appreciation/(depreciation) in investments	24,249	Accrued interest and other receivables	(3,524)	101
Grand Totals		$ (1,957,183)		$ (242,102)	$ 150,909,431

NOTE 16: PENSION PLAN (CONTINUED)

H. Derivative Instrument (Continued)

A Derivatives Policy Statement identifies and allows common derivative instruments and strategies, which are consistent with the Investment Policy Statement of the City of Philadelphia Municipal Pension Fund. The guidelines identify transaction-level and portfolio-level risk control procedures and documentation requirements. Managers are required to measure and monitor exposure to counterparty credit risk. All counterparties must have credit ratings available from nationally recognized rating institutions such as Moody, Fitch, and S&P. The details of other risks and financial instruments in which the Fund involves are described below:

1) ***Credit Risk*****:** The Pension Fund is exposed to credit risk on hedging derivative instruments that are in asset positions. To minimize its exposure to loss related to credit risk, it is the Pension Fund's policy to require counterparty collateral posting provisions in its non-exchange traded hedging derivative instruments. These terms require full collateralization of the fair value of hedging derivative instruments in asset positions (net of the effect of applicable netting arrangements) should the counterparty's credit rating fall below AA as issued by Fitch Ratings and Standard & Poor's or Aa as issued by Moody's Investors Service. Collateral posted is to be in the form of U.S. Treasury securities held by a third-party custodian. The City has never failed to access collateral when required.

   It is the Pension Fund's policy to enter into netting arrangements whenever it has entered into more than one derivative instrument transaction with counterparty. Under the terms of these arrangements, should one party become insolvent or otherwise default on its obligations, close-out netting provisions permit the non-defaulting party to accelerate and terminate all outstanding transactions and net the transactions' fair values so that a single sum will be owed by, or owed to, the non-defaulting party.

2) ***Swap Agreements*****:** Swap agreements provide for periodic payments at predetermined future dates between parties based on the change in value of underlying securities, indexes or interest rates. During the year ended June 30, 2012 the Fund entered into interest rate swaps. Under the receive fixed interest rate type swap arrangements, the Fund receives the fixed interest rate on certain equity or debt securities or indexes in exchange for a fixed charge. There were not any total receive fixed interest Swaps this year. On its pay-variable, received-fixed interest rate swap, as LIBOR increases, the Fund's net payment on the swap increases. Alternatively, on its pay-fixed, receive-variable interest rate swap, as LIBOR or the SIFMA swap index decreases, the Fund's net payment on the swap increases.

NOTE 16: PENSION PLAN (CONTINUED)

H. Derivative Instrument (Continued)

3) ***Future Contracts*****:** Future contracts are types of contracts in which the buyer agrees to purchase and the seller agrees to make delivery of a specific financial instrument at a predetermined date and price. Gains and losses on futures contracts are settled daily based on a notional (underlying) principal value and do not involve an actual transfer of the specific instrument. Futures contracts are standardized and are traded on exchanges. The exchange assumes the risk that counterparty will not pay and generally requires margin payments to minimize such risk. In addition, the Fund enters into short sales, sales of securities it does not presently own, to neutralize the market risk of certain equity positions. Initial margin requirements on futures contracts and collateral for short sales are provided by investment securities pledged as collateral and by cash held by various brokers. Although the Fund has the right to access individual pledged securities, it must maintain the amount pledged by substituting other securities for those accessed. The realized gain from Future contracts was $749,289.

4) ***Forward contracts*****:** The Fund is exposed to basis risk on its forward contract because the expected funds purchase being hedged will price based on a pricing point different than the pricing point at which the for-ward contract is expected to settle. The realized loss from Forward contracts was $(1,913,361).

5) ***Termination risk***: The Fund or its counterparties may terminate a derivative instrument if the other party fails to perform under the terms of the contract. In addition, the Fund is exposed to termination risk on its receive-fixed interest rate swap. The Fund is exposed to termination risk on its rate cap because the counter-party has the option to terminate the contract if the SIFMA swap index exceeds 12 percent. If at the time of termination, a hedging derivative instrument is in a liability position, the city would be liable to the counter-party for a payment equal to the liability, subject to netting arrangements.

6) ***Rollover Risk***: The Fund is exposed to rollover risk on hedging derivative instruments that are hedges of debt that mature or may be terminated prior to the maturity of the hedged debt. When these hedging derivative instruments terminate, or in the case of a termination option, if the counterparty exercises its option, the Fund will be re-exposed to the risks being hedged by the hedging derivative instrument.

I. Summary of Significant Accounting Policies

Financial statements of the Fund are prepared using the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds of contributions are recognized when due and payable in accordance with the terms of the Fund. Investments are valued as described in Note 2I.

NOTE 17: OTHER POST EMPLOYMENT BENEFITS

A. 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.

B. 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-union employees. For fiscal year 2014, the City paid $67.1 million for retiree healthcare.

C. 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 No. 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:

	(Thousands of Dollars)
Annual Required Contribution	$ 128,619
Interest on Net OPEB Liability	7,068
Adjustment to Annual Required Contribution	(6,369)
Annual OPEB Cost	129,318
Payments Made	(67,100)
Increase in Net OPEB Obligation	62,218
Net OPEB Obligation at beginning of year	166,315
Net OPEB Obligation at end of year	$ 228,533

NOTE 17: OTHER POST EMPLOYMENT BENEFITS (CONTINUED)

C. Annual OPEB Cost and Net OPEB Obligation (Continued)

The City of Philadelphia's annual OPEB cost, the percentage of annual OPEB cost contributed to the Plan, and the net OPEB obligation for the fiscal year ended June 30, 2014 was as follows:

(Thousands of Dollars)

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Contributed	Net OPEB Obligation
6/30/2014	$ 129,318	52%	$ 228,533
6/30/2013	114,392	50%	166,314
6/30/2012	105,369	72%	109,019

D. Funded Status and Funding Progress

As of July 1, 2013, the most recent actuarial valuation date, the City is funding OPEB on a pay as you go basis and accordingly, the unfunded actuarial accrued liability for benefits was $1.7 billion. The covered annual payroll was $1.417 billion and the ratio of the UAAL to the covered payroll was 120.2%.

The required schedule of funding progress immediately following the notes to the financial statements presents multi-year trend information about whether the actuarial value of the plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

The projections of future benefit payments for an ongoing plan obligation involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Amounts determined regarding the funded status of the obligation and the contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

E. Actuarial Methods and Assumptions

Projections of costs for financial reporting purposes are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing costs between the employer and plan members to that point.

NOTE 17: OTHER POST EMPLOYMENT BENEFITS (CONTINUED)

E. Actuarial Methods and Assumptions (Continued)

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. The City uses a level percent open approach as its method of amortization. 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 4.25% per year. The actuarial assumption included a 7.95% compound annual interest rate on the City's general investments. The current plan incorporates the following assumptions: no post-retirement benefit increases since last year; a 7.85% Investment Rate of Return, a 3.30% Rate of Salary increases; and, a 4% Ultimate Rate of Medical Inflation.

NOTE 18: 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, transaction, 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. As of June 30, 2014 and 2013, the aggregate estimate of loss deemed to be probable is $20.3 million and $22.2 million, respectively. This amount has been included on the Statement of Net Position under Other Long-Term Liabilities.

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 $9.2 million and $9.4 million as of June 30, 2014 and 2013, respectively.

NOTE 19: LONG TERM AGREEMENTS

The Water Department has entered into several long term agreements with third parties through the Philadelphia Municipal Authority as follows:

A. Automatic Meter Reading

In September 1997, the Water Department and the Water Revenue Bureau began the implementation of the Automatic Meter Reading Program (the "AMR Program") involving the replacement of all residential water meters with new meters equipped with radio transmitter meter reading devices ("ERT"). Installation commenced on schedule on September 11, 1997. By June 30, 2012, more than 482,841 new meters had been installed. The AMR Program significantly reduced the costs of meter reading and related support. As of June 30, 2014, more than 99.5% of the Water Department's customers have AMR meters, drastically improving the Water Department's ability to initiate and enforce collection of delinquent accounts. From 2011 through 2013, as required in the long-term meter reading contract, the service provider (ITRON) conducted battery replacement of the vast majority of customer reading endpoint devices (ERTs), thus enabling the battery capability of the existing population through 2025. The Water Department is also working on the purchase and installation of upgraded AMR devices for all commercial customers that have ERTs. The AMR Program agreement term ends in 2017. The Department has two one-year renewal options.

Under the agreement ITRON is paid a fixed amount for each monthly meter reading actually obtained. The Water Department paid ITRON, through the Philadelphia Municipal Authority ("PMA"), $1,984,362 and $1,964,275 in Fiscal Year 2014 and Fiscal Year 2013, respectively for meter reads. Additionally, the Water Department paid ITRON, through PMA, $1,809,838 and $1,732,516 in Fiscal Year 2014 and Fiscal Year 2013, respectively, for the purchase of meters.

B. Biosolids Treatment and Utilization

The City is required by Federal and Commonwealth law, administered by the U.S. Environmental Protection Agency ("EPA") and the Pennsylvania Department of Environmental Protection ("PADEP"), respectively, to treat and dispose of biosolids captured during wastewater treatment at the City's Water Pollution Control Plants ("WPCP's"). Biosolids from the three WPCP is treated at the Biosolids Recycling Center ("BRC"). The BRC had historically produced two grades of biosolids, as defined by state and federal regulations. These were Class A biosolids compost and Class B dewatered biosolids cake. Class B biosolids were used on farmlands and at mine reclamation sites and co-disposed with trash at municipal solid waste landfills. Class A compost, which was produced at the BRC until October 2007, was put to a variety of local and regional uses, including garden and horticultural applications and recreation sites.

NOTE 19: LONG TERM AGREEMENTS (CONTINUED)

B. Biosolids Treatment and Utilization (Continued)

Biosolids processing and distribution is governed at the national level by EPA regulations published at 40 CFR Part 503 regulations in February 1993 (the "Part 503 Regulations"). The Part 503 Regulations require, among other things, certain record keeping and monitoring procedures and compliance with technical standards for pathogen reduction, vector attraction reduction and pollutant limits. These regulations are self-implementing and directly enforceable, in that the EPA can initiate enforcement actions for non-compliance even in the absence of the EPA's issuance of permits under the National Pollutant Discharge Elimination System ("NPDES") permitting program. The Water Department is in full compliance with the technical standards in the Part 503 Regulations.

While the Water Department has administered a successful Class A and B biosolids program over the last 25 years, the nation has witnessed continuing health and environmental concerns raised by the public with Class B biosolids recycling. As such, in the summer of 2003, the Water Department began a process to move to an entirely Class A biosolids process, which could operate in Philadelphia without odors. It entered into a contract with the engineering consultant firm Camp, Dresser & McKee to assist with the procurement of facilities and services for Philadelphia to operate the dewatering station for 20 years and to construct new facilities to produce Class A biosolids products.

Philadelphia Biosolids Services, LLC ("PBS") submitted a proposal on November 24, 2004. PBS offered to build a pair of sludge dryers to produce Class A pellets. On June 19, 2008, City Council passed enabling legislation to allow the proposed contract with PBS to proceed. Mayor Nutter approved the contract with PBS in October 2008 and PBS has been operating the facility since October 13, 2008. The Water Department entered into a contract and lease with the Philadelphia Municipal Authority ("PMA") to operate the Water Department's existing BRC, including a dewatering station, and to construct new thermal drying facilities to produce Class A biosolids pellets. The contract term is up to 25 years, including a five-year renewal option. PMA has contracted with PBS for these services.

The contract included a provision for an interim period of up to five years, during which PBS took over operation of the existing Biosolids Recycling Center. Within the first four years, PBS financed $68,275,000 through the Pennsylvania Economic Development Finance Authority, designed, built and now owns and operates a thermal drying facility that handles all of the sludge processed by the Water Department and makes a Class A product in the form of pellets that is used as fertilizer and has potential as a fuel. PBS is 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 20 years with a five-year renewal at the option of the Water Department.

NOTE 19: LONG TERM AGREEMENTS (CONTINUED)

B. Biosolids Treatment and Utilization (Continued)

When the contract was executed, the Water Department transferred the remaining 60 employees at this facility to other assignments. Subsequently, the Water Department has also transferred to other units, certain vehicles and equipment that had been part of the existing BRC operation but were no longer needed by the contractor. At this time, most of the fixed assets associated with the facility, except for those related to the discontinued composting operations, remain in service (see Note 7).

Payments for the facility are made to PBS through PMA. Fiscal year 2012 payments totaled $21,835,872, which included partial year operation of the new Class A pellet facility. Fiscal year 2013 was the first full year of operation of the Class A facility with payments totaling $21,275,441. Fiscal year 2014 payments for the facility totaled $20,364,249.

C. Northeast Water Pollution Control Plant Digester Gas Cogeneration Facility

On December 23, 2011, the Department entered into a contract for the construction and leaseback of a 5.6 Megawatt digester gas (biomethane, which is a renewable energy source) cogeneration facility at the Water Department's Northeast WPCP. This project is expected to produce over 40 million kWh per year. The facility was placed into operation on December 12, 2013.

The parties to this agreement, which will bring green power to the Northeast WPCP, are the Philadelphia Water Department ("City"), Ameresco Energy ("Developer"), and Bank of America. The Developer will build the biogas combined heat and power system that runs on methane gas produced on site and incorporates a small amount of natural gas to optimize engine performance. Bank of America, the facility owner and lessor, has formed a special purpose entity "BAL Biogas 1" and the City pays a monthly fee through PMA, the lessee. The Philadelphia Water Department operates the facility. Under a separate but related agreement Ameresco Energy will maintain the equipment. The structure of the deal allows for Bank of America to apply for the IRS code section 1603 grant in lieu of tax credit under the ARRA and ITC rules that amount to 30% of the qualified cost.

In fiscal year 2014, the Water Department paid Bank of America, through PMA, lease payments of $2,427,767, maintenance fees of $1,291,352, and legal, administrative, and other miscellaneous fees of $54,700. Maintenance fees vary per year based on the amount of work required and is paid separately.

NOTE 19: LONG TERM AGREEMENTS (CONTINUED)

D. Laurel Street Combined Sewer Overflow

On June 7, 2011 the City of Philadelphia entered into an Amended and Restated Development and Tax and Claim Settlement Agreement (the "agreement") with Sugarhouse HSP Gaming, L.P. (HSP). In accordance with the agreement, HSP is required to fund development and expansion of the Laurel Street combined sewer overflow. In compensation for this construction, HSP is allotted a five year credit against its real estate taxes and settlement payments otherwise due to the City of Philadelphia. This credit is equal to 28 percent of the amount expended on the Laurel Street Combined Sewer Overflow project. If the credit exceeds the amount of real estate taxes and settlement payments due to the City, the credit carries over to the following year.

As the Laurel Street Combined Sewer Overflow is a capital asset of the Water Department, the Water Department is required to transfer to the General Fund of the City the amount of this credit. This credit is approximately $3.5 million per year during fiscal year 2014 through 2018.

NOTE 20: COMBINED SEWER OVERFLOW PROGRAM

The present NPDES permits require the Water Department to implement a combined sewer overflow program. In older sections of the City, both wastewater and stormwater are conveyed in one pipe to the sewage treatment plant. This is known as a combined system. During certain rain events, the additional stormwater exceeds the capacity of the collection system and/or wastewater treatment plant and causes an overflow. The excess stormwater/wastewater mix known as combined sewer overflow ("CSO") discharges directly to local waterways. The Water Department has 164 CSO points in its collection system.

Since 1997, the Water Department has been committed to restoring the region's waterways to fishable, swimmable, and beautiful rivers and streams that are life sustaining and are an amenity to nearby communities. The PADEP and the Water Department signed a consent order and agreement dated as of June 1, 2011 ("COA") that allowed the Water Department to officially embark on the implementation of its landmark strategy known as the *Green City, Clean Waters Program*. Pursuant to the *Green City, Clean Waters Program*, the Water Department will spend approximately $2.4 billion over the next 25 years ($1.2 billion in 2009 dollars) to use green technologies to substantially mitigate CSOs and enhance the quality of local waterways. The plan also includes wastewater treatment facility enhancements and pipe renewal and replacement.

NOTE 20: COMBINED SEWER OVERFLOW PROGRAM (CONTINUED)

The COA complies with Clean Water Act requirements by adopting the presumption approach to CSO control. The goal under the presumption approach is to eliminate or remove the mass of pollutants that otherwise would be removed by the capture of 85% by volume of the combined sewage otherwise collected in the City's combined sewer system during precipitation events. To ensure this ultimate goal is met, the COA requires that interim water quality milestones at years 5, 10, 15, and 20 of the COA. The interim milestones require the City to achieve specific targets in four categories: (1) Total Greened Acres; (2) Overflow Reduction Volume; (3) Miles of Interceptor Lined; (4) WPCP Upgrades: Design and Construction.

The COA includes financial protections in the event that the costs of complying with the COA exceed the Water Department's projections. Should COA costs increase to extent that the wastewater component of a customer's bill exceed 2.27% of the median household income the City may petition the PADEP for an extension of time to satisfy the COA so that the financial burden does not become excessive on ratepayers.

The COA also includes significant penalties for noncompliance with the 5 year milestone targets. Penalties start at $25,000 per month for each violation (for the first six months) and increase up to $100,000 per month for uncured violations of 13 months or more.

NOTE 21: PLEDGE OF REVENUES

Section 4.02 and 4.04 of the Water bond ordinance of 1989, as amended in 1993, which authorized the issuance of Water and Sewer Revenue Bonds, 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. The amount of this pledge is the equal to the remaining principal and interest outstanding on the Water and Sewer Revenue Bonds. The purpose for the debt secured by the pledge can be found in Note 14 to the financial statements.

NOTE 21: PLEDGE OF REVENUES (CONTINUED)

The following chart displays information related to the pledge as of June 30, 2014:

	Water and Sewer Revenue Bonds
Pledged Revenue Required for Principal and Interest Payments	$2,786.9 million
Term of Pledge	2044
Percentage of Revenue Pledged	100%
Current Year Pledged Revenue	$644.2 million
Current Year Principal and Interest Paid	$302.6 million

The following chart displays information related to the pledge as of June 30, 2013:

	Water and Sewer Revenue Bonds
Pledged Revenue Required for Principal and Interest Payments	$2,613.2 million
Term of Pledge	2041
Percentage of Revenue Pledged	100%
Current Year Pledged Revenue	$626.8 million
Current Year Principal and Interest Paid	$287.2 million

NOTE 22: RISK MANAGEMENT

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City (except for Aviation Fund operations, the Municipal Authority and PICA) is self-insured for fire damage, casualty losses, public liability, Workers' Compensation and Unemployment Compensation. The Aviation Fund is self-insured for Workers' Compensation and Unemployment Compensation and insured through insurance carriers for other coverage.

The City covers all claim settlements and judgments, except for those discussed above, out of the resources of the fund associated with the claim. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include: an estimate of claims that have been incurred but not reported; the effects of specific, incremental claims adjustment expenditures, salvage, and subrogation; and unallocated claims adjustment expenditures.

NOTE 22: RISK MANAGEMENT (CONTINUED)

At June 30, the amount of these liabilities was $349.3 million for the City. This liability is the City's best estimate based on available information. Changes in the reported liability since June 30, 2012 resulted from the following:

Amounts in Millions of USD

Fiscal Years Ending June 30	Beginning Liability	Current Year Claims and Changes in Estimates	Claim Payments	Ending Liability
2012	$353.5	$102.1	$(99.8)	$355.8
2013	355.8	101.6	(101.3)	356.1
2014	356.1	274.2	(281.0)	349.3

The City's Unemployment Compensation and Workers' Compensation coverages are provided through its General Fund. Unemployment Compensation and Workers' Compensation coverages are funded by a pro rata charge to the various funds. Payments for the year were $3.2 million for Unemployment Compensation claims and $62.2 million for Workers' Compensation claims.

The City's estimated outstanding workers' compensation liabilities are $280.2 million discounted at 3.5%. On an undiscounted basis, these liabilities total $367.5 million. These liabilities include provisions for indemnity, medical and allocated loss adjustment expense (ALAE). Excluding the ALAE, the respective liabilities for indemnity and medical payments relating to workers' compensation total $251.7 million (discounted) and $330.9 million (undiscounted). The Water Department's accrued liability for workers compensation was $20.3 million and $22.2 million at June 30, 2014 and 2013, respectively.

During the last five (5) fiscal years, no claim settlements have exceeded the level of insurance coverage for operations using third party carriers. None of the City's insured losses have been settled with the purchase of annuity contracts.

NOTE 23: RESTATEMENT OF NET POSITION / CHANGE IN ACCOUNTING PRINCIPLE

The following restatement of net position was necessary to properly reflect the adoption of GASB Statement No. 65, *"Items Previously Reported as Assets and Liabilities"*:

		(Amounts in Thousands)
Net Position, Beginning Balance of Fiscal Year 2013, as Previously Stated	$	865,320
Expense of Bond Issuance Costs due to the adoption of GASB Statement No. 65		(56,373)
Net Position, Beginning Balance of Fiscal Year 2013, as Restated	$	808,947

NOTE 24: SUBSEQUENT EVENTS

The Water Department self-insures up to $6.5 million for claims and damages under litigation. As of January 31, 2015, the amount of self-insurance available was $0.

Through January 2015, drawdowns totaling $0.4 million represent new loans from the Pennsylvania Infrastructure Investment Authority ("PENNVEST").

Required Supplementary Information

BUDGETARY COMPARISON SCHEDULE
Water Operating Fund
For the Fiscal Year Ended June 30, 2014
(Legally Enacted Basis) (Thousands of Dollars)

Revenues	Budgeted Amounts			Final Budget to Actual
	Original	Final	Actual	Positive (Negative)
Locally Generated Non-Tax Revenue	$ 606,789	$ 603,747	$ 607,107	$ 3,360
Revenue from Other Governments	1,350	850	1,946	1,096
Revenue from Other Funds	79,941	52,752	33,966	(18,786)
Total Revenues	**$ 688,080**	**$ 657,349**	**$ 643,019**	**$ (14,330)**
Expenditures and Encumbrances				
Personal Services	116,125	116,065	108,957	7,108
Pension Contributions	59,200	61,486	60,755	731
Other Employee Benefits	43,330	41,044	41,044	-
Sub-Total Employee Compensation	218,655	218,595	210,756	7,839
Purchase of Services	157,164	157,224	133,942	23,282
Materials and Supplies	49,002	48,881	45,946	2,935
Equipment	4,964	5,085	3,468	1,617
Contributions, Indemnities and Taxes	6,602	6,602	6,037	565
Debt Service	205,355	205,355	204,646	709
Payments to Other Funds	58,456	58,456	75,660	(17,204)
Advances and Other Miscellaneous Payments	9,882	9,882	-	9,882
Total Expenditures and Encumbrances	710,080	710,080	680,455	29,625
Operating Surplus (Deficit) for the Year	**$ (22,000)**	**$ (52,731)**	**$ (37,436)**	**$ 15,295**
Fund Balance Available, July 1, 2013	-	-	-	-
Operations in Respect to Prior Fiscal Years				
Commitments Cancelled - Net	22,000	22,000	37,436	15,436
Prior Period Adjustments	-	-	-	-
Adjusted Fund Balance, July 1, 2013	22,000	22,000	37,436	15,436
Fund Balance Available, June 30, 2014	**$ -**	**$ (30,731)**	**$ -**	**$ 30,731**

CITY OF PHILADELPHIA
PENSION PLANS AND OTHER POST EMPLOYMENT BENEFITS
SCHEDULE OF FUNDING PROGRESS
FISCAL YEAR ENDED JUNE 30, 2014

(Amounts in Millions of USD)

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
	(a)	(b)	(b - a)	(a / b)	(c)	(b - a) / c
City of Philadelphia Municipal Pension Plan						
07/01/2008	$4,623.6	$8,402.2	$3,778.6	55.03%	$1,456.5	259.43%
07/01/2009	4,042.1	8,975.0	4,932.9	45.04%	1,463.3	337.11%
07/01/2010	4,230.9	9,317.0	5,086.1	45.41%	1,421.2	357.87%
07/01/2011	4,489.1	9,487.5	4,998.4	47.32%	1,371.3	364.50%
07/01/2012	4,486.8	9,799.9	5,313.1	45.78%	1,372.2	387.20%
07/01/2013	4,799.3	10,126.2	5,326.9	47.39%	1,429.7	372.59%
City of Philadelphia Other Post Employment Benefits						
07/01/2008	$-	$1,156.0	$1,156.0	0.00%	$1,456.5	79.37%
07/01/2009	-	1,119.6	1,119.6	0.00%	1,461.7	76.60%
07/01/2010	-	1,169.5	1,169.5	0.00%	1,419.5	82.39%
07/01/2011	-	1,212.5	1,212.5	0.00%	1,469.2	82.53%
07/01/2012	-	1,511.9	1,511.9	0.00%	1,371.6	110.23%
07/01/2013	-	1,703.6	1,703.6	0.00%	1,416.9	120.23%

Other Supplementary Information

BONDED DEBT FOR THE FISCAL YEAR ENDED JUNE 30, 2014

(Thousands of Dollars)

	ORIGINAL AUTHORIZATION					FISCAL YEAR 2015 DEBT		
Series	Date	Issued	Outstanding June 30, 2014	Maturities	Interest Rates	Service Interest	Principal Requirements	Outstanding June 30, 2015
Revenue Bonds:								
Series 1997 (B)	11/25/97	100,000	63,800	8/2007 to 8/2027	Variable	53	3,400	60,400
Series 1998	12/25/98	135,185	38,025	12/2011 to 12/2014	5.25	998	38,025	-
Series 2005 (A)	05/04/05	250,000	117,250	7/2007 to 7/2035	3.250 to 5.250	5,724	5,535	111,715
Series 2005 (B)	05/04/05	86,105	67,175	8/2007 to 8/2018	Variable	2,691	15,535	51,640
Series 2007 (A)	05/04/07	191,440	137,010	8/2007 to 8/2027	4.00 to 5.00	6,551	-	137,010
Series 2007 (B)	05/04/07	153,595	152,220	11/2007 to 11/2031	4.00 to 5.00	6,923	245	151,975
Series 2009 (A)	05/21/09	140,000	140,000	1/2017 to 1/2036	5.15 to 5.25	7,294	-	140,000
Series 2010 (A)	04/15/10	396,460	251,830	6/2010 to 6/2019	0.500 to 4.110	12,023	49,275	202,555
Series 2010 (C)	08/05/10	185,000	185,000	8/2016 to 8/2030	2.530 to 4.560	9,022	-	185,000
Series 2011 (A)	11/16/11	135,000	135,000	1/2036 to 1/2041	4.50 to 5.00	6,737	-	135,000
Series 2011 (B)	11/16/11	49,855	49,855	11/2016 to 11/2026	4.00 to 5.00	2,461	-	49,855
Series 2012	11/01/12	70,370	67,725	11/2013 to 11/2028	1.00 to 5.00	3,305	2,720	65,005
Series 2013 (A)	08/22/13	170,000	170,000	1/2017 to 1/2043	3.00 to 5.125	8,472	-	170,000
Series 2014 (A)	01/23/14	30,000	30,000	7/2041 to 7/2043	5.00	1,408	-	30,000
Series 2014 (R)	01/23/14	93,170	93,170	7/2016 to 7/2027	3.00 to 5.00	4,219	-	93,170
Pennvest - 1999	04/30/00	6,700	410	7/2007 to 4/2019	1.41 to 2.73	10	80	330
Pennvest - 2009 (B)	10/14/09	28,791	25,090	7/2013 to 6/2033	1.193 to 2.107	288	2,124	22,966
Pennvest - 2009 (C)	10/14/09	41,772	36,231	7/2013 to 6/2033	1.193 to 2.107	417	2,803	33,428
Pennvest - 2009 (D)	03/31/10	71,704	64,521	7/2013 to 6/2033	1.193 to 2.107	747	4,164	60,357
Pennvest - 2010 (B)		27,742	27,133			316	1,394	25,739
Total Revenue Bonds		**2,362,889**	**$ 1,851,445**			**79,659**	**125,300**	**$ 1,726,145**
Total Bonded Debt			**$ 1,851,445**			**$ 79,659**	**$ 125,300**	**$ 1,726,145**

ANNUAL BONDED DEBT SERVICE REQUIREMENT:

Fiscal Year	Interest	Principal	Total
2015	79,659	125,300	204,959
2016	75,377	136,733	212,110
2017	68,402	124,808	193,210
2018	63,533	131,558	195,091
2019	59,079	86,827	145,906

The First Series through the Thirteenth were refunded.

Capitalized Interest added to Construction in Progress in Fiscal 2014 was $3,926,863.
Interest Expense was reduced by the same amount.

SUPPLEMENTAL SCHEDULE OF RATE COVENANT COMPLIANCE FOR FISCAL YEAR ENDED JUNE 30, 2014 (Legally Enacted Basis)

(Thousands of Dollars)

LINE NO.		2014
1.	Total Revenue and Beginning Fund Balance	$ 680,455
2.	Net Operating Expense	(410,797)
3.	Transfer (To) From Rate Stabilization Fund	(22,925)
4.	**Net Revenues**	**246,733**
5.	Revenue Bonds Outstanding	(201,710)
6.	General Obligation Bonds Outstanding	-
7.	Pennvest Loan	-
8.	**Total Debt Service**	**(201,710)**
9.	**Net Revenue after Debt Service**	45,023
10.	Transfer to General Fund	-
11.	Transfer to Capital Fund	(20,194)
12.	Transfer to Residual Fund	(24,829)
13.	**Total Transfers**	**(45,023)**
14.	**Net Operating Balance for Current Year**	**-**

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	$246,733
/ Line 5	$201,710
= COVERAGE A:	1.22

COVERAGE B:	
Line 4	$246,733
/ Line 8 + Line 11	$221,904
= COVERAGE B:	1.11

COVERAGE C:	
Line 4 - Line 3	$269,658
/ Line 5	$201,710
= COVERAGE C:	1.34