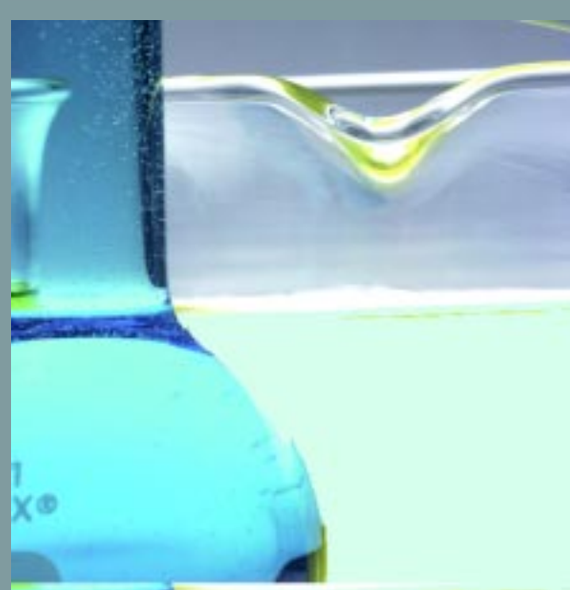
Philadelphia PWD Water Department

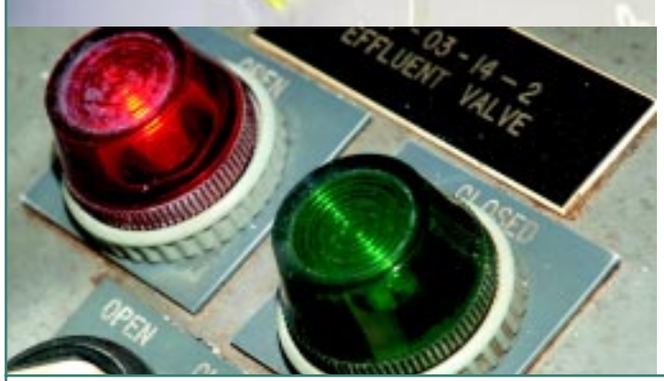
annual

Financial Report



2006

Philadelphia Water Department



Making our Drinking Water Safe, Protecting our Environment, and Maintaining Reasonable Rates

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Philadelphia PWD Water Department

Philadelphia PWD Water Department

KEY PERFORMANCE MEASUREMENTS

MEASUREMENT	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006
Millions of Gallons of Treated Water	100,505	97,993	96,799	94,139
Percent of Time Philadelphia's Drinking Water Met or Surpassed State & Federal Standards	100%	100%	100%	100%
Miles of Pipeline Surveyed for Leakage	1,420	1,168	1,279	1,301
Water Main Breaks Repaired	988	794	706	770
Average Time to Repair a Water Main Break (in hours)	7.5	7.3	7.8	7.8
Percent of Hydrants Available	98.9%	97.5%	96.2%	98.9%
Number of Storm Drains Cleaned	92,457	86,975	76,865	77,600
CITIZEN SATISFACTION SURVEY RESULTS				
Percent Satisfied with Overall PWD Services	74.8%	78.9%	79.8%	80.0%
Percent Satisfied with Water Overall Quality	72.8%	80.0%	80.2%	80.5%

Letter from the Water Commissioner

To our colleagues:

The Philadelphia Water Department is the nation's oldest water utility (1799), and serves the citizens of the Philadelphia region by providing integrated water, wastewater, and stormwater services. Our primary mission is to operate and maintain the infrastructure necessary to provide high quality, affordable drinking water to protect the public health, to provide an adequate and reliable water supply for all residential, business, and public needs, and to sustain and enhance the region's watersheds and quality of life by managing wastewater and storm water effectively.

Philadelphia's drinking water is safer than ever, substantially better than State and federal regulations for water quality requirements. Further, we are investing in additional improvements to our treatment processes to continue to minimize any risk to public health.

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

In terms of rates, the Philadelphia Water Department continues to have some of the lowest rates in the region for water, wastewater, and stormwater services. We have had great success in containing costs, increasing employee productivity, and improving services. The impact of our cost-saving measures has been to keep services high, and rates low. During the ten year period from Fiscal Year 1996 through Fiscal Year 2005, the Department increased rates in five of ten years adding up to a total increase for residential customers of 22.4 percent versus the Philadelphia Consumer Price Index that measured 28.9 percent during the same period. However, the costs of providing services including personnel, debt-service, environmental mandates, and increased security have continued to rise, and as a result, the PWD has needed to increase rates.

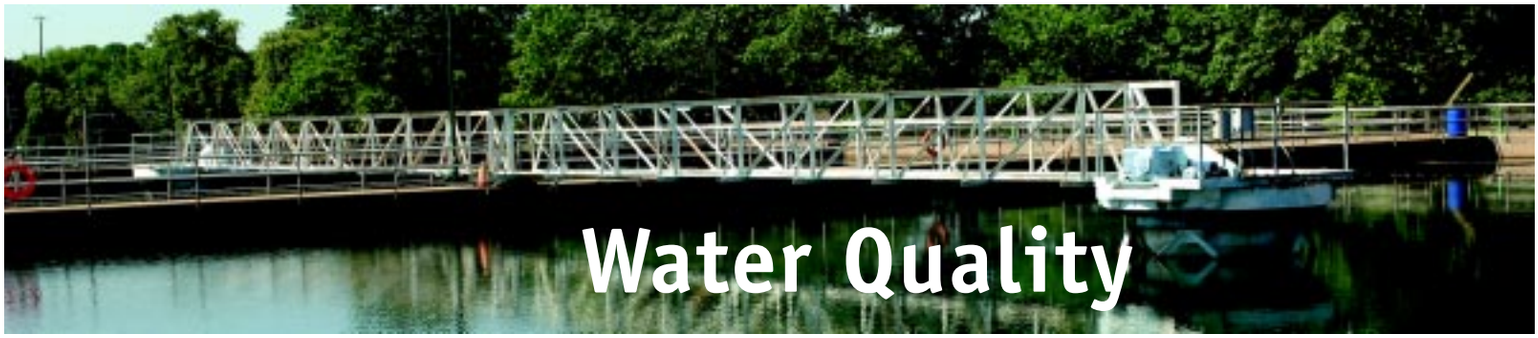
In this report are some of our accomplishments for Fiscal Year 2006.

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

Sincerely,

Bernard Brunwasser

Bernard Brunwasser
Water Commissioner



Water Quality

Partnership for Safe Drinking Water

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

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

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

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

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

Fiscal Year 2006 marked the completion of our move to sodium hypochlorite from chlorine at all of our treatment plants. Sodium hypochlorite, similar to laundry bleach, is a safer substance than chlorine.

Pilot Plant Research

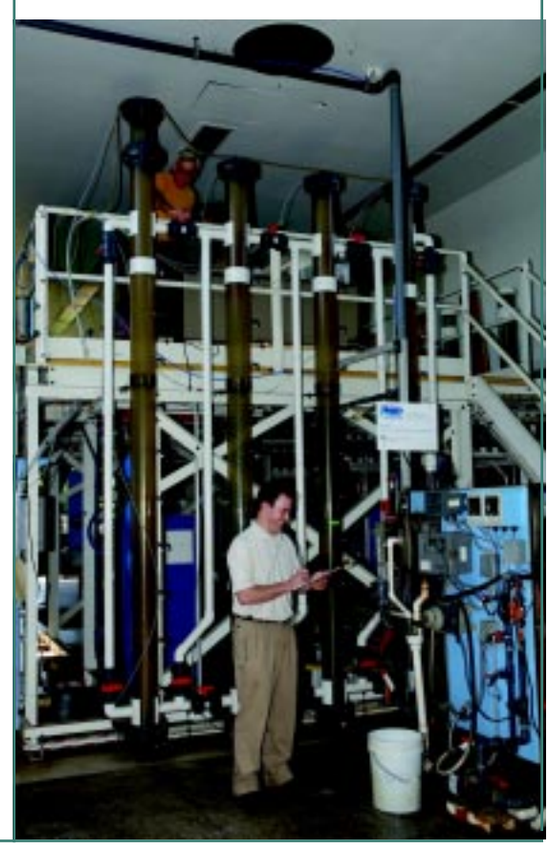
We continue to stay at least one step ahead of drinking water regulations through the operation of our pilot plant research program, which we initiated approximately eight years ago.

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

Our pilot plant studies have been focusing on the effectiveness of different types of coagulants other than ferric chloride, which we use currently during the water treatment process. Coagulants bind to organic particles in the source water, causing these particles to fall out of the water treatment process by virtue of the coagulant's weight.

Due to changes in the coagulant marketplace, it is important for us to evaluate alternative coagulants and determine their suitability in comparison to ferric chloride on the basis of performance and cost.

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



Water Environment

Northeast Water Pollution Control Plant

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

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

Southeast Water Pollution Control Plant

The Southeast Plant was awarded the NACWA Gold Award in May 2006 for perfect effluent permit compliance in calendar year 2005.

The permanent sodium hypochlorite feed system was started up successfully this year at Southeast. This system replaces a temporary storage and feed system that had been in service since February 2002. Sodium hypochlorite replaces the liquid chlorine that had been the primary disinfectant throughout the history of the plant, and is expected to improve risk management.

Fiscal Year 2006 marked the completion of our move to sodium hypochlorite from chlorine at all of our treatment plants. Sodium hypochlorite, similar to laundry bleach, is a safer substance than chlorine.

Southwest Water Pollution Control Plant

The Southwest Plant again received the National Association of Clean Water Agencies' Gold Award for excellence in wastewater treatment for calendar year 2005. This marks the tenth time in eleven years that the plant has earned this award by maintaining perfect compliance under its National Pollutant Discharge Elimination System (NPDES) permit.

This past Fiscal Year saw substantial work completed on our major HVAC project. This project started on April 7, 2003 and, at an estimated cost of $21 million, is the most expensive Southwest project undertaken since the 1970 plant expansion.

The purpose of this project was to replace much of the existing HVAC system on the North side of the plant. This includes the installation of four new boilers in the Sludge Thickener Building; replacement of heat exchangers for the 12 digesters; and repair or replacement of numerous HVAC units for the Preliminary Treatment Building, Compressor Building, Secondary System Gallery, Digester Gallery and Fleet Maintenance Garage.

These improvements allow for enhanced efficiencies, and are part of our ongoing program of preventative maintenance.

Watershed Protection

Many Philadelphians are unaware of the connection between the work of the Water Department and the quality of their local "watershed"—the creeks, streams, rivers, and surrounding land that provide fresh water both for recreational enjoyment and for drinking water supply. After tremendous investment and progress in wastewater treatment sparked by the federal Clean Water Act more than 30 years ago, the City now enjoys watersheds that are cleaner and healthier than they have been in well over a century. Once plagued by federal consent decrees for the failure to operate our wastewater treatment facilities in compliance with environmental regulations, these same plants have been winning national industry awards for the past decade.

For new vitality to continue along our riverfronts — and to ensure the quality and safety of our drinking water supply — the City's major investments will not be enough. Partnerships with other key stakeholders in our region's water environment are absolutely critical because rivers and streams do not recognize political and geographical boundaries.

Our strategy for innovative watershed planning and conservation initiatives parallels a number of emerging State and federal watershed initiatives, and our Office of Watersheds has received over $4.4 million in grant funds to work in Philadelphia and with our surrounding neighbors to improve the quality of our watersheds.

Delaware Valley Early Warning System serves

- **Over 3 million people**
- **Philadelphia, Camden and Trenton Metro areas**
- **10 water utilities, 16 water treatment plants in Pennsylvania**
- **6 water utilities, 7 water treatment plants in New Jersey**

Providing Early Warning Protection

We are leading the development and implementation of the Early Warning System for the Schuylkill and lower Delaware Rivers. This system is an integrated communication and water quality monitoring network that supports the identification, notification and analysis of source water quality events such as chemical spills and other potential hazards.

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

In 2004, when the system was deployed for initial testing, a total of 16 events of significance ranging from a 325,000 gallon oil tanker spill to algae blooms were reported and evaluated.

Since the system became fully deployed in January of 2005, 52 events have been entered into the system, ranging from a 100-million-gallon fly-ash spill on the Delaware and a cyanide discharge in the Wissahickon Creek, to flood warnings and minor sewage discharges.

In each of these cases, the improved awareness, communication, and coordination provided by the system was valuable to our response.

Schuylkill River Source Water Protection Plan

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

One major component of the Plan is a build-out scenario of the Schuylkill River Watershed. The scenario looks at the possible impacts of significant development in the watershed on source water quality. Under current zoning, low-density housing could increase drastically as agricultural and forested lands are developed. If this happens, the amount of impervious cover within the Schuylkill River Watershed is estimated to increase by approximately 8 percent to 18 percent, or roughly 360 square miles. This increase would result in additional stream channel erosion, reduced water quality, and decreased stream diversity. Actions to help upstream communities develop with fewer impacts on streams were identified in the plan.

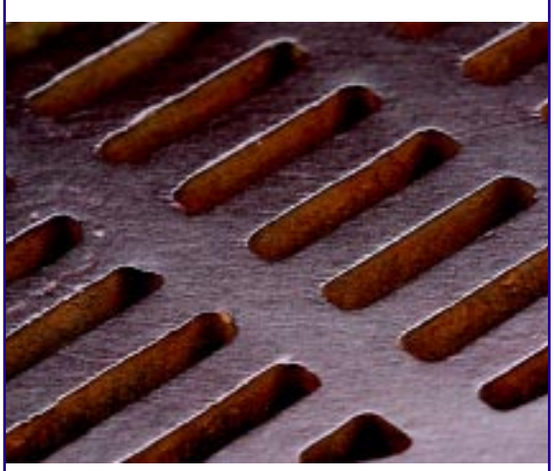
The Plan was finalized in December 2005. After the Pennsylvania Department of Environmental Protection approves the Plan, we will have a state-certified source water protection program, and will install road signage identifying areas of water supply protection. The Department of Environmental Protection has provided a $200,000 grant for work on the protection plan. We began a similar plan for the Baxter Water Treatment Plant's intake and Delaware River Watershed in spring 2006.

From April through June 2006, our new skimmer boat, the Richard Roy, spent over 190 hours collecting debris on the Schuylkill and Delaware Rivers, and removed over 58 tons of debris during that time.

Birds, animals, flowers, and plants live along our river banks. This Black-Eyed Susan, Rudbeckia hirta, Sunflower family (Asteraceae), is found in a meadow near our Belmont Intake on the Schuylkill River. Native Americans used this plant for food and medicinal purposes.

Source: Schuylkill River Source Water Assessment Partnership

Asset Management



Maintaining Today's Assets for Tomorrow's Customers

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

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

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

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

Water Main Replacement

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

Engineering data for over 6,620 miles of water, wastewater, stormwater, and high-pressure fire infrastructure, as well as data from over 250,000 engineering documents are contained in our GIS database.

Sewer Assessment

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

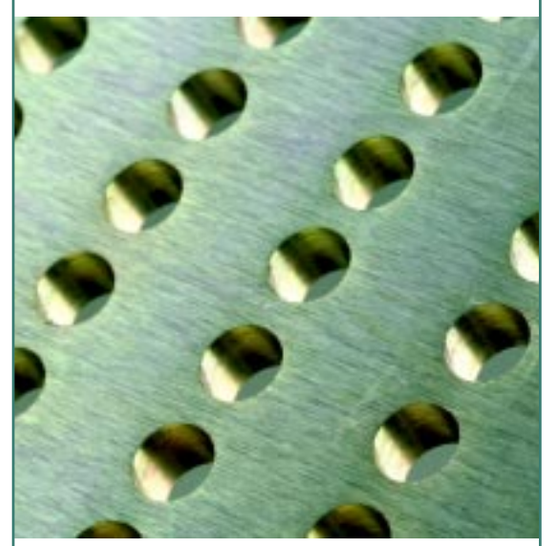
Our specially-trained personnel are continuing collecting information through the sewer assessment surveys. This project has already helped to identify sewers that were in immediate need of repair and it is anticipated that, over time, this project will result in a reduction of costly and disruptive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

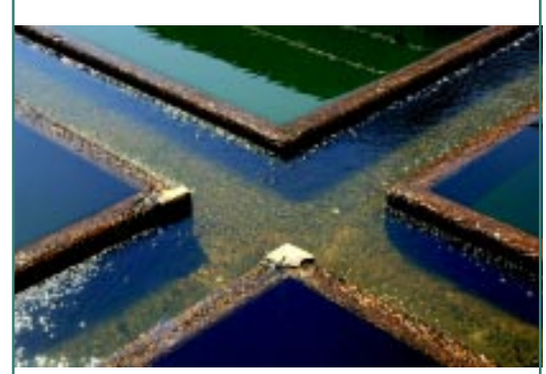
Geographical Information System

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

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

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





Public Education and Outreach

Public Programs and Events Bring Water, Science, and History Alive

Martin Luther King Day of Service

The Fairmount Water Works Interpretive Center teamed up with volunteers from the Martin Luther King Day of Service to honor this great American leader. On January 16, 2006, at the Water Works, volunteers cleaned up, greened up, and learned about our watershed and how to protect it. Neighbors and volunteers tidied up the Esplanade, cleared the hillside between the garden and the Art Museum and tackled trash at the river's edge.

Black History Month: Pride and Progress

Throughout February, visitors viewed the photographic exhibit *Pride and Progress*, taken from the Philadelphia Water Department's photo archives, depicting the contributions African-Americans have made to the construction, maintenance and management of Philadelphia's water and sewer infrastructure. A century of Water Department history was artfully captured in black and white and color images, showing employees at work from 1900 through 2002.

The Ins and Outs of Ice

In March the Interpretive Center welcomed Mariana Gosnell, author of *Ice: The History, the Nature and the Uses of an Astonishing Substance*. Mariana led a lively discussion with distinguished panelists, including Interpretive Center advisor Bob Giegengack, a geologist from the University of Pennsylvania, and meteorologist Amy Freeze, formerly of NBC 10.

Honoring Women in Science and Engineering

To celebrate Women in Science and Engineering Week, the Interpretive Center invited women scientists and engineers to meet high school students and tell them first-hand about their careers, how they got their starts, and the jobs they are now doing. This was a great opportunity for the students to ask questions and learn more about the many opportunities for women scientists. The careers of women scientists and engineers on the staff of the Philadelphia Water Department were highlighted in a series of photographs and career profiles throughout the Interpretive Center's exhibit area.

Shad Story

The return of the shad to the Schuylkill River is a critical indicator of the river's cleanliness. Each spring, the shad come home to the Schuylkill to spawn. When they reach the fish ladder across from the Water Works, they can be seen swimming upstream in real time via the Fish Cam inside the Interpretive Center.

The Fairmount Water Works Interpretive Center

Families, scientists, students, educators – these are just some of the groups who have come to explore Water in Our World at the Fairmount Water Works Interpretive Center. Visitors learn about the role of water in Philadelphia's past, present and future.

The Fairmount Water Works, a National Historic Landmark, once served as the city's second pumping station (1812 to 1909), providing water to the citizens of Philadelphia. The Philadelphia Water Department has transformed these magnificent buildings into an exciting watershed education center where visitors can understand their relationship to the river they drink.

Innovative exhibits and interactive educational programs meld the history, technology and science of providing water to a regional urban watershed, and feature these five themes:

WATERSHEDS

THE WATER CYCLE AND NATURAL ENVIRONMENT

THE WATER USE CYCLE (what you do to water)

HISTORY, SCIENCE and TECHNOLOGY

STORMWATER RUNOFF and POLLUTION

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

Shad was king in pre-industrial Philadelphia. Family fishing dynasties shaped society on both sides of the Delaware in the communities of Fishtown and Gloucester. In the 19th century, shad harvests reached 16 million pounds a year. After 1916 the harvest fell dramatically.

Visitors to the Interpretive Center in April, 2006, learned more about the history of this fascinating fish — called "porcupine-fish-turned-inside-out" by the Lenape — at a joint presentation by the Interpretive Center and the Oliver Evans Chapter of the Society for Industrial Archeology.

The Water Works Wins Architectural Award

The Philadelphia Water Department received the prestigious Henry J. Magaziner Award of AIA/ Philadelphia's Historic Preservation Committee. This award recognizes an individual or organization that has made a significant contribution to the preservation of our built environment. The committee cited two important reasons for choosing the Water Department for this Award:

- Its restoration and appropriate reuse of The Fairmount Water Works buildings as an educational and interpretive center highlighting both the history of Philadelphia's water supply and the importance of good environmental planning for our area's water supply network.
- Its documentation of the buildings' rich history, which has made the Water Department's Philly H2O website a treasure trove of Philadelphia history.

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

Financial Highlights

The Water Department met its bond coverage ratios for the year with a revenue bond coverage ratio of 1.20, a total debt service coverage ratio of 1.08, and a net operating revenue bond coverage ratio of 1.33.

At the end of the current fiscal year, the Water Fund's *Net Assets* totaled $650.5 million resulting from an excess of its assets over its liabilities; its *unrestricted net assets* showed a balance of negative $175.4 million.

The Water Fund's net assets showed an increase of $34.2 million during the current Fiscal Year. This increase was primarily due to the following:

- A 12.8% water and sewer rate increase effective on February 1, 2005 coupled with 1.9% water and sewer rate increase effective on August 1, 2005 which resulted in a $20.2 million increase in revenue collections.
- A $12.3 million increase in interest earnings on the Sinking Fund and other investments.
- A $7.6 million decline in Payroll expenses.
- A $1.8 million decrease in spending for purchased services.
- A 18.0 million decrease in the Allowance for bad debt.

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

- A 13.1 million increase in bond interest payments.
- A $6.3 million increase in employee benefits expense.
- A $3.4 million increase in the purchase of materials and supplies.
- A $5.0 million transfer of year end excess balance of Water Sinking Fund Reserve to the General Fund.
- A $1.2 million increase in the payment of Indemnities and Taxes.

Net Assets

As noted earlier, net assets are useful indicators of a government's financial position. At the close of the current fiscal year, the Water Department's assets exceeded it's liabilities by $650.5 million

Capital assets, such as land, buildings, meters, water mains, and sewer lines, less any outstanding debt issued to acquire these assets, comprise $95.0 million of the Water Department's net assets. Although these capital assets assist in providing services to our customers, they are generally not available to fund the operations of future periods.

In addition, a portion of the Department's net assets, $380.2 million is subject to external restrictions as to use. The remaining component of net assets is the unrestricted net assets, which ended the fiscal year with $175.4 million.

Bond Issuance

During FY2005, the Department issued its Water and Wastewater Revenue Bond Series 2005A in the aggregate principal amount of $250,000,000. The proceeds of the Series 2005A Bonds will be applied to (i) fund capital improvements to the City's Water and Wastewater Systems (as hereinafter defined), (ii) fund a Debt Reserve Account of the Sinking Fund (as hereinafter defined) relating to the Series 2005A Bonds, and (iii) pay costs of issuance relating to the Series 2005A Bonds. The Department also issued $86,105,000 of Water and Wastewater Revenue Refunding Bonds, Variable Rate Series 2005B. The proceeds of the 2005B Bonds was used to refund a portion of the City's Water and Wastewater Revenue Bonds, Series 1995 and to pay costs of issuance relating to the Bonds.

Water and Wastewater Rates

PWD revises rates as necessary to maintain fiscal health. In terms of rates, the PWD continues to have some of the lowest rates in the region for water, wastewater, and stormwater services. The PWD has had great success in containing costs, increasing employee productivity, and improving services. The impact of these cost-saving measures has been to keep services high, and rates low. From FY97 through FY06, the Department increased rates in five of ten years, adding up to a total increase for residential customers of 24.7 percent during the entire ten-year period. This rate of increase is well below the Philadelphia Consumer Price Index that measured 31.4 percent during the same period.

In July of 2005, the Water Department announced a revision of rates for the period covering FY06 through FY08. These rates were needed due to seven major cost factors that impacted the Department from FY05 to FY08: Increased debt service ($72 million); coverage-based required contributions to the Residual Fund ($68 million); loss of state subsidy for wastewater operations ($32 million); increased personnel costs ($28 million); decreased interest earnings ($25 million); inflation on material, supplies, equipment and contracted costs ($20 million); and additional security and related costs ($9 million).

For the typical PWD residential customer, the rate revision translated into an increase of 1.9 percent or a $0.88 monthly increase that began on August 1, 2005; a 6.7 percent or a $3.20 monthly increase starting July 1, 2006; and a 4.2 percent or a $2.14 monthly increase starting July 1, 2007. The increase for a typical senior citizen household, for those seniors who qualify for the Department's 25-percent senior citizen discount, is an average of 4.2 percent annually for three years. A typical senior citizen's monthly bill was $28.50 in FY06. The income test to qualify for this discount has been raised to $26,700. These rates and charges will enable the Philadelphia Water Department to meet its obligations under the Charter of having a balanced budget through FY08. The Department anticipates that further rate revisions will be required in FY09. The Department intends to conduct a rate study beginning in FY08, and the amount of the rate revision will not be known until completion of the study and the mandated rate process.

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

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

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

2006 Area Residential* Water/Sewer Charges

	Monthly Water Bill	Monthly Sewer Bill
Aqua Pennsylvania+	$50.70	N/A
Pennsylvania American Water+	$45.82	N/A
New Jersey American Water+	$34.08	N/A
North Penn Water Authority+	$26.63	N/A
North Wales Water Authority+	$25.54	N/A
Doylestown Township	$33.60	$51.87
CCMUA (Camden County)**	N/A	$26.25
Trenton	$23.09	$26.36
Philadelphia Water Department	$21.52	$20.82

Rates in effect on November 27, 2006. Stormwater charges ($8.83) are excluded from sewer calculation because many jurisdictions fund such services from the general tax base or a separate utility assessment.

* Calculations based on 5,984 gallons/month (800.cu.ft.)
** Sewer-only utility.
\+ Water-only utilities

Source: *Philadelphia Water Department.*

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

City of Philadelphia's Bond Ratings

General Obligation and Revenue Bonds

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

The following excerpt accompanied the A- rating of Fitch:
"Fitch Ratings expects the system to maintain its historical practice of actual results outperforming projections...The Water Department has implemented numerous measures to improve service, reduce costs, and enhance revenues over the past decade. It has greatly reduced the cost of operations at its Biosolids and Wastewater facilities. The Department has greatly contributed to the noticeably improved quality of Philadelphia's rivers and streams. It has re-financed more than $1.7 billion in revenue bonds for net present value savings of $92 million in debt service expense."

The following excerpt accompanied the A- rating of Standard and Poors: "A seasoned management team that emphasizes, and is achieving improved system maintenance, stronger collections, and more comprehensive fiscal monitoring systems."

Pilot Plant Research

The operation of a pilot plant research program has also helped the PWD meet regulatory mandates cost effectively and provide high-quality drinking water to customers. The pilot plants are essentially miniature water treatment plants that allow the PWD to study and test the impact of modifications to water treatment procedures prior to moving forward with system-wide changes. In FY08, pilot plant studies will focus on the effectiveness of coagulants other than ferric chloride, which PWD has used as a coagulant in the water treatment process. Coagulants are used to treat the water to make it more filterable and also to bind to organic particles in the source water and cause these particles to fall out of the water treatment process by virtue of the coagulant's weight. Changes in regulatory requirements and increasing coagulant costs have driven PWD's need to evaluate alternative coagulants. In FY08, PWD will also experiment with a pre-treatment process called MIEX (Magnetically Induced Ion-Exchange). This process removes a significant portion of the dissolved organic component of water prior to coagulation. This technology may offer PWD the freedom to use non-iron based coagulants. The annual cost for operation of the pilot plant is $970,000.

On-line Drinking Water Quality Monitoring

Recent concerns over the safety of our water supply have caused the Department to expand the "Water Quality Monitoring Network" that it began to implement in FY01. This system provides the Department with the ability to track real-time water quality conditions at selected locations throughout the City's water distribution system and to monitor any variations should they occur. Data is transmitted from each site to PWD's central laboratory where technicians check for early warning signs of water quality deterioration and document any unforeseen changes. By the end of FY08 the Department plans to have 24 on-line water quality/security sites. These locations will include water storage tanks and reservoirs, pump stations, the Philadelphia Navy Yard, Philadelphia International Airport, City Hall, hospital trauma centers, selected Police and Fire stations, and two professional sports complexes. For FY09 to FY12 the Department will assess the need for additional locations as well as focusing on the interpretation and organization of data from the existing network. In FY08, the Department has budgeted $150,000 for this program expansion.

Early Warning System

Early notification of changes in river water quality is important to public water suppliers with drinking water intakes on both the Schuylkill and Delaware Rivers. The Delaware Valley Early Warning System, which covers both the Schuylkill and lower Delaware Rivers, is a fully integrated computer-based system that includes three major components: a telephone-based notification system, the website and data management system, and a water quality monitoring network. Philadelphia's EWS has now successfully performed in several major water quality events over the last three years, including a cyanide spill in the Wissahickon Creek in 2006. In FY08, the system will be expanded to include a time of travel spill model, additional phone and email notification, and an upgrade to permit the receipt and processing of data from a new fish monitoring device for toxic spills. The FY08 budget will include an additional $450,000 for these improvements.

New Pumping Station

The construction of a new water pumping station is necessary to enhance local water pressure and water service reliability for our customers in the Northwest section of the City. This new pumping station will house eight energy-efficient pumps, a control room and offices.

Assessing the City's Sewer Infrastructure

Completed in FY05, a $6 million pilot sewer assessment program evaluated the condition of sewer system infrastructure using video technology to inspect over 215 miles of sewers, and use this information to build a database and ranking system to prioritize needed improvements. Trained PWD personnel are continuing the sewer assessment surveys from FY07 to FY11. In FY06 and FY07, the Department began to use data collected through the sewer assessment program to prioritize needed sewer reconstruction and repair, and schedule this work in the capital and operating budgets. This project has already helped to identify sewers that were in immediate need of repair, and it is anticipated that over time this project will result in a reduction of costly and disruptive emergency sewer repairs, such as those that occur when a sewer collapses. In FY08, $4.5 million is budgeted to continue the video inspections and to perform additional excavations and repairs.

Long-term Control Plan for Combined Sewer Overflows

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

possible in our sewer system, and stepping up inspections and monitoring at sites where overflows occur. Since then, we have begun a long-term control plan that includes $48 million in capital improvements so we can capture even more flow in the sewer system. During the next three years, our plan features a "watershed-based" approach, which involves other regional stakeholders in planning efforts that are more comprehensive and reach far beyond city boundaries. We anticipate that these efforts will result in reducing overflow volume from combined sewers approximately 15 percent to 19 percent by late 2007 and early 2008.

Waterways Restoration Program

In FY04, the PWD created the Waterways Restoration Team (WRT), which consists of 2 crews devoted to removing trash and large debris from the streams and tributaries that define our neighborhoods. The teams also perform restoration work around PWD's storm and combined sewer outfalls. In FY05, the teams removed over 700 tons of debris from Philadelphia's streams. In addition, in FY05, the WRT participated in a number of training sessions and workshops that focused on Natural Stream Channel Design (NSCD) sponsored by the Fairmount Park Commission (FPC), the U.S. Army Corps of Engineers, and the engineering firm of Skelly and Loy. A large component of the team's mission is to work in partnership with the FPC to restore tributaries and streams that have been significantly damaged over decades by the volume and velocity of flows from sewer outfalls and from the forces of stormwater runoff. NSCD is the preferred stream restoration methodology of regulatory agencies and citizens as it results in streams that have the potential for supporting habitat and that meet the aesthetic desires of park users. In FY05, the team tackled two restoration projects, providing interim stabilization to sites challenged by stormwater runoff that resulted in projects that were well received by the FPC, regulatory agencies and citizens. From FY08 to FY12, the team will work in partnership with the FPC and related Friends' groups to bolster a public/private partnership that is essential to sustaining the effectiveness of this project. The cost for this program in FY08 will be over $1 million and is expected to remain in this range through FY12.

Advance Regional Source Water Protection Plans

The City now enjoys watersheds that are cleaner and healthier than they have been in over a century. Protecting the source of Philadelphia's drinking water is a multi-faceted task that extends beyond the traditional boundaries of the City. In recognition of this, in FY99, PWD created an Office of Watersheds to implement an integrated approach to water quality management that seeks to reduce water pollution from all sources, in a cost-effective manner that is based on achieving measurable results. In FY05, PWD completed a source water protection plan for the Schuylkill River. The Schuylkill plan is being integrated with that of the Schuylkill Action Network (SAN), a larger group of state and federal regulators, water suppliers, conservation districts, and watershed groups. SAN is working to coordinate regulatory and restoration efforts to protect the Schuylkill River as the premier drinking water resource for the region. In FY05, PWD, the Partnership for the Delaware Estuary, and SAN received a $1.15 million Targeted Watershed Initiative Grant from the US EPA. More than 70 proposed projects will be implemented with these grant funds. Projects include controlling stormwater and agricultural impacts, removing acid mine drainage impacts, and developing market-based incentives for pollution trading.

In FY06, projects addressed abandoned mine drainage (AMD) in the headwaters of the Schuylkill River where projects are being designed and implemented for three major AMD discharges. Funds in FY08-FY12 will also be dedicated to address contamination from agriculture through the installation of vegetated buffers and fencing along impaired streams to reduce runoff and keep livestock out of the streams. Urban and suburban stormwater runoff will be addressed through a series of projects aimed at reducing runoff at sensitive locations through the installation of swales, retention basins and buffers and outfall retrofits. Finally, a significant portion of the grant will be dedicated toward educating the public on source water protection issues and their role in protecting our region's drinking water supply. Based on the success of the Source Water Protection Program, the Water Department has been awarded the USEPA Region III (Mid Atlantic States) 2002 Source Water Protection Award, the American Water Works Association's 2003 Exemplary Source Water Protection Award and the 2005 American Council of Engineering Companies Diamond Award for the Schuylkill River Source Water Assessment. These awards recognize the Water Department as the model for the region and country in the area of Source Water Protection.

In a related program, in FY08 the SAN will continue to operate the Philly RiverCast System. The Philly RiverCast System is a forecast of water quality that predicts potential levels of pathogens in the Schuylkill River between Flat Rock Dam and Fairmount Dam (i.e., between Manayunk and Boathouse Row). The Philly RiverCast System uses a three-tier color scale to designate the suitability of water quality for contact recreational activities.

- Green: Water quality is suitable for all recreational activities.
- Yellow: Water quality may not be suitable for activities involving direct contact with the river.
- Red: Water quality is not suitable for activities involving direct contact with the river.

Requests for Information

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

STATEMENT OF NET ASSETS, JUNE 30, 2006 AND 2005

(amounts in thousands)

	2006	2005
ASSETS		
Current Assets:		
Cash on Deposit and on Hand	$ 30	$ 30
Equity in Treasurer's Account	50,253	47,300
Due from Other Governments	109	109
Accounts Receivable	177,360	199,238
Allowance for Doubtful Accounts	(78,634)	(96,633)
Inventories	14,640	14,077
Total Current Assets	**163,758**	**164,121**
Noncurrent Assets:		
Restricted Assets:		
Equity in Treasurer's Account	368,675	397,406
Sinking Funds and Reserves	174,332	173,031
Grants for Capital Purposes	0	0
Receivables	2,784	1,728
Total Restricted Assets	**545,791**	**572,165**
Net Pension Asset	64,118	71,300
Capital Assets:		
Land	5,919	5,919
Infrastructure	1,752,461	1,740,978
Construction in Progress	146,831	127,140
Buildings and Equipment	1,390,699	1,353,384
Accumulated Depreciation	(1,597,139)	(1,531,943)
Total Capital Assets	**1,698,771**	**1,695,477**
Total Noncurrent Assets	**2,308,680**	**2,338,942**
TOTAL ASSETS	**2,472,438**	**2,503,063**
LIABILITIES		
Current Liabilities:		
Vouchers Payable	5,107	5,358
Accounts Payable	7,377	6,490
Salaries & Wages Payable	2,225	5,453
Construction Contracts Payable	7,038	5,995
Accrued Expenses	18,435	13,609
Deferred Revenue	6,923	6,740
Current Portion of Long Term Obligations	84,002	79,120
Total Current Liabilities	**131,107**	**122,765**
Noncurrent Liabilities:		
Long Term Obligations	1,758,799	1,842,773
Unamortized Discount and Loss	(88,496)	(98,394)
Other Noncurrent Liabilities	20,485	19,573
Total Noncurrent Liabilities	**1,690,788**	**1,763,952**
Total Liabilities	**1,821,895**	**1,886,717**
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	94,958	101,807
Restricted For:		
Capital Projects	51,990	23,942
Debt Service	174,332	173,031
Rate Stabilization	153,910	128,903
Unrestricted	175,353	188,663
Total Net Assets	**$650,543**	**$616,346**

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

(amounts in thousands)

	2006	2005
Operating Revenues:		
Charges for Goods and Services	$465,519	$445,367
Miscellaneous Operating Revenues	5,325	5,245
Total Operating Revenues	**470,844**	**450,612**
Operating Expenses:		
Personal Services	98,773	106,418
Purchase of Services	68,469	70,230
Materials and Supplies	27,526	24,109
Employee Benefits	62,852	56,515
Indemnities and Taxes	3,758	2,607
Depreciation and Amortization	78,855	82,503
Total Operating Expenses	**340,233**	**342,383**
Operating Income (Loss)	**130,611**	**108,230**
Nonoperating Revenues (Expenses):		
Operating Grants	569	552
Interest Income	23,141	10,875
Net Pension Obligation	(7,182)	(7,189)
Debt Service - Interest	(100,682)	(87,567)
Other Expenses	(7,266)	(5,188)
Total Nonoperating Revenues (Expenses):	**(91,420)**	**(88,517)**
Income (loss) before Transfers	39,191	19,713
Transfers Out	(4,994)	(4,401)
Change in Net Assets	34,197	15,312
Net Assets - Beginning of Period	616,346	522,545
Adjustment	0	78,489
Net Assets - End of Period	**$650,543**	**$616,346**

STATEMENT OF CASH FLOWS, JUNE 30, 2006

(amounts in thousands)

	2006	2005
Cash Flows from Operating Activities		
Receipts from Customers	$474,387	$443,058
Payments to Suppliers	(96,672)	(98,871)
Payments to Employees	(163,124)	(159,197)
Claims Paid	(4,176)	(2,408)
Other Receipts (Payments)	0	0
Net Cash Provided by Operating Activities	210,415	182,582
Cash Flows from Non-Capital Financing Activities		
Operating Grants Received	569	602
Operating Subsidies and Transfers to Other Funds	(4,994)	4,401
Net Cash Provided by Non-Capital Financing Activities	(4,425)	5,003
Cash Flows from Capital & Related Financing Activities		
Proceeds from Capital Debt	0	244,566
Capital Contributions Received	0	0
Acquisition and Construction of Capital Assets	(85,213)	(100,477)
Interest Paid on Capital Debt	(87,866)	(85,032)
Principal Paid on Capital Debt	(78,550)	(71,515)
Other Receipts (Payments)	0	0
Net Cash Provided (Used) by Non-Capital Financing Activities	(251,629)	(12,458)
Cash Flows from Investing Activities		
Interest and Dividends	19,861	335
Net Cash Provided by Investing Activities	19,861	335
Net Increase (Decrease) in Cash & Cash Equivalents	(25,778)	175,462
Balances - Beginning of the Year	444,736	269,274
Balances - End of the Year	418,958	444,736
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:		
Operating Income (Loss)	130,611	108,230
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation Expense	78,855	82,503
Change in Assets and Liabilities:		
Receivables, Net	3,360	(10,246)
Inventories	(563)	(738)
Accounts and Other Payables	(2,031)	2,661
Accrued Expenses	0	172
Deferred Revenue	183	0
Net Cash Provided by operating activities	$210,415	$182,582

BUDGETARY COMPARISON SCHEDULE
Water Operating Fund For the Fiscal Year Ended June 30, 2006

(amounts in thousands)

	BUDGETED AMOUNTS			FINAL BUDGET TO ACTUAL
	Original	Final	Actual	Positive (Negative)
REVENUES				
Locally Generated Non-Tax Revenue	$ 463,059	$ 456,766	$ 460,436	$ 3,670
Revenue from Other Governments	1,585	1,709	569	(1,140)
Revenue from Other Funds	41,284	33,850	29,254	(4,596)
Total Revenues	505,928	492,325	490,259	(2,066)
Expenditures and Encumbrances				
Personal Services	108,733	108,733	98,773	(9,959)
Pension Contributions	24,500	27,622	27,622	0
Other Employee Benefits	29,969	28,658	28,658	0
Sub-Total Employee Compensation	163,202	165,013	155,053	(9,960)
Purchase of Services	84,616	84,416	80,813	(3,603)
Materials and Supplies	35,143	35,380	34,016	(1,364)
Equipment	4,791	4,754	2,963	(1,791)
Contributions, Indemnities and Taxes	6,519	4,709	4,209	(500)
Debt Service	180,957	167,520	166,416	(1,104)
Payments to Other Funds	42,700	56,136	60,556	4,420
Total Expenditures and Encumbrances	517,928	517,928	504,026	(13,902)
Operating Surplus (Deficit) for the Year	(12,000)	(25,603)	(13,767)	11,836
Fund Balance Available, July 1, 2006	-	-	0	-
Operations in Respect to Prior Fiscal Years				
Commitments Cancelled - Net	12,000	12,000	13,781	1,781
Prior Period Adjustments			(14)	(14)
Adjusted Fund Balance, July 1, 2005	12,000	12,000	13,767	1,767
Fund Balance Available, June 30, 2006	0	(13,603)	0	$ 13,603

BONDED DEBT FOR THE FISCAL YEAR ENDED JUNE 30, 2006

(amounts in thousands)

Series	ORIGINAL AUTHORIZATION Date	Issued	Outstanding June 30, 2005	Maturities	Interest Rates	FISCAL YEAR 2007 Debt Service Interest	Principal Requirements	Outstanding June 30, 2007
Revenue Bonds:								
Fourteenth Series	05/15/89 *	$ 158,265	$ 53,800	10/2005 to 10/2008	N.A.	$	$ 6,600	$ 47,200
Series 1993	08/01/93 *	1,010,025	264,130	6/2006 to 6/2011	5.50 to 7.00	16,770	38,155	225,975
Series 1995	04/15/95	221,630	79,290	8/2005 to 8/2018	5.30 to 6.25	4,619	9,355	69,935
Series 1997 (A)	10/15/97	250,000	204,785	8/2005 to 8/2027	5.00 to 5.25	10,245	5,520	199,265
Series 1997 (B)	11/25/97	100,000	86,000	8/2005 to 8/2027	Variable	3,310	2,400	83,600
Series 1998	12/25/98	135,185	135,185	12/2011 to 12/2014	5.25	7,097	-	135,185
Series 1999	07/07/99	33,040	16,885	12/2005 to 12/2006	5.00	422	16,135	-
Series 2001	11/15/01	285,920	285,920	11/2011 to 11/2024	3.800 to 5.500	14,566	-	285,920
Series 2003	04/01/03	381,275	373,315	6/2006 to 6/2023	Variable	16,874	1,045	372,270
Series 2005 (A)	05/04/05	250,000	250,000	7/2006 to 7/2035	3.250 to 5.250	12,276	2,125	247,875
Series 2005 (B)	05/04/05	86,105	84,720	8/2005 to 8/2018	Variable	3,830	335	84,385
PennVest	04/30/00	6,700	1,793	7/2005 to 4/2019	1.41 to 2.73	44	420	1,373
Total Revenue Bonds		**$3,065,705**	**$1,835,823**			**90,053**	**82,840**	**1,752,983**
General Obligation Bonds:								
PennVest	06/15/93	20,000	6,950	07/2005 to 04/2012	1.00	64	1,163	5,787
Total Bonded Debt			**$1,842,773**			**90,117**	**84,003**	**1,758,770**

*Partially Refunded

ANNUAL BONDED DEBT SERVICE REQUIREMENT:

Fiscal Year	Interest	Principal	Total
2005	85,049	71,897	156,946
2006	79,841	77,735	157,576
2007	76,109	81,542	157,651
2008	72,635	85,101	157,736
2009	69,298	88,509	157,808
2010	69,298	88,509	157,808

The First Series through the Thirteenth, Fifteenth, and the Sixteenth were refunded.

Capitalized Interest added to Construction in Progress in Fiscal 2006 was $2,809,355. Interest Expense was reduced by the same amount.

SUPPLEMENTAL SCHEDULE OF RATE COVENANT COMPLIANCE FOR FISCAL YEAR ENDED JUNE 30, 2006

(Legally Enacted Basis)

(amounts in thousands)

LINE NO.	2006
1. Total Revenue and Beginning Fund Balance	$490,259
2. Net Operating Expense	(270,480)
3. Transfer (To) From Rate Stabilization Fund	(21,553)
4. Net Revenues	**198,226**
5. Revenue Bonds Outstanding	(165,189)
6. General Obligation Bonds Outstanding	0
7. Pennvest Loan	(1,227)
8. Total Debt Service	**(166,416)**
9. Net Revenue after Debt Service	**31,810**
10. Transfer to General Fund	(4,994)
11. Transfer to Capital Fund	(16,954)
12. Transfer to Residual Fund	(9,862)
13. Total Transfers	**(31,810)**
14. Net Operating Balance for Current Year	**0**

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

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

COVERAGE A:		COVERAGE B:		COVERAGE C:	
Line 4	$198,226	Line 4	$198,226	Line 4 - Line 3	$219,779
/ Line 5	$165,189	/ (Line 8 + Line 11)	$183,370	/Line 5	$165,189
= COVERAGE A:	1.20	= COVERAGE B:	1.08	= COVERAGE C:	1.33

1. THE GOVERNMENT OF PHILADELPHIA

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. Basis of Accounting

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

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

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

B. Legal Compliance

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

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

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

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

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

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

Water Fund

Fund Balance-Legal Basis 6/30/06	$ 0
Assets omitted from the legal basis:	
(1) Receivables from Other Governments or Funds	31,226
(2) Fixed Assets-Net of Depreciation	1,698,771
(3) Restricted Assets	545,791
(4) Proprietary Portion of Net Pension Obligation	64,118
	$ 2,339,906
Liabilities omitted from the legal basis:	
(5) Construction Contracts Payable	(7,038)
(6) Other Current Liabilities	(109,607)
(7) Bonds Payable and Other Long-Term Debt	(1,690,788)
	(1,807,433)
Fund Balance accounts included in the legal basis:	
(8) Reserve for Collectible Receivables	67,087
(9) Reserve for Inventories	14,641
(10) Reserve for Purchase Commitments	36,342
	118,070
Equity accounts omitted from the legal basis:	
(11) Invested in Capital Assets, Net of Related Debt	(94,959)
(12) Restricted for Capital Projects	(51,989)
(13) Restricted for Debt Service	(174,332)
(14) Restricted for Rate Stabilization	(153,910)
	(475,190)
Unrestricted Net Assets – GAAP Basis – 6/30/2006	$175,353

C. Water Account

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

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

D. Pledge of Revenues

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

E. Grants from Other Governments for Capital Purposes

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

F. Property, Plant and Equipment

Property, plant and equipment are stated at cost. Where cost could not be developed from the records available, estimated historical cost was used to record the value of the assets. Upon sale or retirement, the cost of the assets and the related accumulated depreciation are removed from the accounts. Maintenance and repair costs are charged to operations. Capital assets are defined by the City as assets with an initial individual cost of more than $5,000 and an estimated useful life in excess of three years.

G. Depreciation

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

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

H. Construction in Progress

Cost of construction includes all direct contract costs plus overhead charges. Overhead costs include direct and indirect engineering costs and interest incurred during the construction period on projects financed with Revenue Bond proceeds. Interest is capitalized by applying the average financing rate during the year to construction costs incurred. Interest earnings on bond proceeds reduce the amount capitalized. Capitalization of interest during construction for Fiscal Year 2006 was $2,809,355.

I. Amortization of Bond Discount

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

J. Inventories

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

K. Revenues

All billings rendered to general customers through June 30, 2006 are included in accounts receivable. In addition, an amount for services rendered through June 30, 2006, but not billed, has been accrued. Historically, billings and collections for general customers remain relatively constant except for periods when there has been a rate change.

L. Insurance

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

M. Investments

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

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

N. Deferred Revenues

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

O. Interfund Charges

In accordance with an agreement between the Finance Director and the Water Department, the Finance Director may transfer to the General Fund up to a limit of $4,994,000 in any fiscal year in "excess interest earnings" as defined by the Rate Covenants under the Ordinance. In fiscal 2006, excess interest earnings of $4,994,000 were transferred to the General Fund of the City.

3. ACCOUNTS RECEIVABLE

Balances consisted of the Following:

FISCAL YEAR ENDED JUNE 30, 2006	
Accounts Receivable:	
Billed in the Last Twelve Months	$ 86,042,036
Billed in 15-year Cycle Billing	49,448,573
Penalties on Receivables	25,744,039
Other Receivables	**16,124,893**
Total	$177,359,541
Bad Debts Written Off	$ 25,976,583
ALLOWANCE FOR DOUBTFUL ACCOUNTS:	
Billed in the Last Twelve Months	**$ 0**
Billed in 15-year Cycle Billing	**45,884,017**
Penalties on Receivables	21,960,171
Other Receivables	**10,790,077**
Total	$78,634,265

FISCAL YEAR ENDED JUNE 30, 2005	
Accounts Receivable:	
Billed in the Last Twelve Months	$ 90,759,952
Billed in 15-year Cycle Billing	61,383,699
Penalties on Receivables	31,373,383
Other Receivables	15,720,576
Total	**$199,237,610**
Bad Debts Written Off	$ 21,088,811
ALLOWANCE FOR DOUBTFUL ACCOUNTS:	
Billed in the Last Twelve Months	**$ 0**
Billed in 15-year Cycle Billing	**62,946,828**
Penalties on Receivables	22,273,182
Other Receivables	11,413,017
TOTAL	**$96,633,027**

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30, 2006 and 2005 consisted of the following:

Fiscal Years Ended	**June 30, 2006**	**June 30, 2005**
Land	$ 5,919,160	$ 5,919,160
Buildings and related improvements	1,342,281,174	1,301,630,732
Meters and other improvements	79,574,255	78,119,495
Equipment	48,418,422	51,752,814
Transmission and distribution lines	1,672,887,106	1,662,858,187
Construction in progress	**146,831,322**	**127,140,405**
Total	$3,295,911,439	$3,227,420,793
Less: Accumulated Depreciation	(1,597,138,725)	(1,531,943,476)
Total	**$1,698,772,714**	**$1,695,477,317**

5. VACATION

Employees are credited with vacation at rates which vary according to length of service. Vacation may be taken or accumulated up to certain limits until paid upon retirement or termination. Employees' vacation time accrued in Fiscal Year 2006 was $9,339,210 and in 2005 was $9,463,251. The expense for vacation pay is recognized in the year earned.

6. 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.

7. CAPTALIZED LEASES

Leases consist of $2,427,859 in photocopier and computer equipment in Fiscal 2006. Capital leases are defined by the Financial Accounting Standard Board in Statement 13, Accounting for Leases.

8. RATE STABILIZATION FUND

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

During Fiscal 2006 the fund had the following activity:

Balance at July 1, 2005	$128,902,508
Deposit from Operating Fund	21,552,885
Transfer to Operating Fund	0
Interest Earnings	3,454,417
Balance at June 30, 2006	$153,909,810

9. 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, 2006, the assets of the plan are held in trust for the exclusive benefit of the participants and their beneficia-

ries. 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.

10. ARBITRAGE REBATE

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

11. DEBT PAYABLE

Defeased Debt

In prior years, the Water Fund defeased certain bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Water Fund's financial statements. At year end, $22.9 million of bonds outstanding was considered defeased.

In May 2005, the City issued $86.1 million of Water and Wastewater Revenue refunding Series 2005B bonds. The proceeds of the bonds were used to refund a portion of the 1995 Series Water and Wastewater Revenue Bonds maturing from 2014 through 2019 in the amount of $80.7 million. The cash flows required by the new bonds are $18 million less than the cash flows required by the refunded bonds. This early extinguishing of debt resulted in an accounting loss of approximately $3.9 million representing the difference between the reacquisition price of $84.6 million and the amount of debt extinguished of $80.7 million (less $.076 million unamortized discount). The resulting loss will be amortized over the life of the refunded bonds at a rate of $543,433 annually through February 2013.

Interest Rate Swaption

City of Philadelphia 1993 Water and Sewer Swaption/2003 Water and Sewer Swap

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

Terms: Citigroup exercised its option to enter into a swap on March 18, 2003 – the City's 1993 water and sewer bonds' first call date. The swap also commenced on the exercise date of March 18, 2003. Under the swap, the City pays a fixed payment of 4.52% and receives a variable payment computed as the actual bond rate through March 1, 2005 and thereafter computed as the lesser of the actual bond rate or 68.5% of the London Interbank Offered Rate (LIBOR). The swap rate was set at a rate that, based on the swap notional amount and when added to an assumption for remarketing, liquidity costs and cost of issuance will approximate the debt service of the "refunded bonds." The swap has a notional amount of $373.3 million and the associated variable-rate bond has a $373.3 million principal amount. The bonds' variable-rate coupons are not based on an index but on market conditions. The bonds and the related swap agreement mature on June 15, 2023. As of June 30, 2006 rates were as follows:

	Terms	Rates
Interest Rate Swap		
Fixed payment to Citigroup	Fixed	4.52%
Variable payment from Citigroup	Actual Bond Rate	(3.96%)
Net Interest Rate Swap payments		0.56%
Variable Rate bond coupon payments	Market Driven	3.96%
Synthetic interest rate on bonds		4.52%

Fair Value: As of June 30, 2006, the swap had a negative fair value of $17.4 million. Since the coupons on the City's variable rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rated implied by the yield curve correctly anticipate future spot interest rates. The payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap.

Risk: As of June 30, 2006, the City is not exposed to credit risk because the swap had neither negative fair value nor basis risk since Citigroup's payments are currently based on the actual bond rate paid on the variable-rate bonds. The swap uses the International Swap Dealers Association Master Agreement, which includes standard termination events. The Schedule to the Master Agreement includes an "additional termination event." That is, the swap may be terminated if Citigroup's or its Credit Support Provider, or the City has one or more outstanding issues of rated unsecured, unenhanced senior debt and none of such issues has a rating of at least (i) Baa3 or higher as determined by Moody's Investors Service, Inc., or (ii) BBB- or higher as determined by Standard & Poor's Ratings Service, A Division of the McGraw-Hill Companies, Inc. Or (iii) an equivalent investment grade rating determined by a nationally-recognized rating service acceptable to both parties.

Swap payments and associated debt: As of June 30, 2006, debt service requirements of the variable-rate debt and net swap payments for their term, assuming current interest rates remain the same, were as follows. As rates vary, variable rate bond interest payments and net swap payments will vary.

Fiscal Year	Variable Rate Bonds		Interest Rate	Total
Ending June 30	Principal	Interest	Swaps Net	Interest
2007	$1,045,000	$15,395,796	$2,177,183	$17,572,979
2008	1,095,000	15,352,524	2,171,064	17,523,588
2009	1,145,000	15,307,190	2,164,653	17,471,843
2010	1,205,000	15,259,761	2,157,946	17,417,707
2011	1,260,000	15,209,873	2,150,891	17,360,764
2012-2016	275,500,000	57,059,681	8,069,046	65,128,727
2017-2021	62,440,000	13,891,342	1,964,432	15,855,774
2022-2026	29,625,000	1,749,825	247,450	1,997,275
	$ 373,315,000	$149,225,992	$21,102,665	$170,328,657

City of Philadelphia, 1995 Water & Sewer Swaption

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

Terms: Citigroup has the option to exercise the agreement on May 4, 2005 – the City's 1995 water and sewer bonds' first call date. If the swap is exercised, the swap will also commence on May 4, 2005. Under the swap, the City pays a fixed payment of 4.53% and receives a variable payment computed as the lesser of the actual bond rate or 68.5% of the London Interbank Offered Rate (LIBOR) which were set at rates that were based on the swap notional amount and when added to an assumption for remarketing, liquidity costs and cost of issuance will approximate the debt service of the "refunded bonds." The swap has a notional amount of $84.4 million and the associated variable-rate bond has an $84.4 principal amount. The bonds variable-rate coupons are not based on an index but on market conditions. The bonds and the related swap agreement mature on May 4, 2025. As of June 30, 2006, the rates were as follows:

	Terms	Rates
Interest Rate Swap		
Fixed payment to Citigroup	Fixed	4.53%
Variable payment from Citigroup	Actual Bond Rate	(3.95%)
Net Interest Rate Swap payments		0.58%
Variable Rate bond coupon payments	Market Driven	3.95%
Synthetic interest rate on bonds		4.53%

Fair value: As of June 30, 2006, the swaption had a negative fair value of $5.6 million. Its fair value was estimated using the BDT option pricing model. This model takes into consideration probabilities, volatilities, time and underlying prices.

Market access risk and interest rate risk: As of June 30, 2006, the City is not exposed to credit risk because the swap had neither negative fair value nor basis risk since Citigroup's payments are currently based on the actual bond rate paid on the variable-rate bonds. The swap uses the International Swap Dealers Association Master Agreement, which includes standard termination events. The Schedule to the Master Agreement includes an "additional termination event." That is, the swap may be terminated if Citigroup's or its Credit Support Provider, or the City has one or more outstanding issues of rated unsecured, unenhanced senior debt and none of such issues has a rating of at least (i) Baa3 or higher as determined by Moody's Investors Service, Inc., or (ii) BBB- or higher as determined by Standard & Poor's Ratings Service, A Division of the McGraw-Hill Companies, Inc. Or (iii) an equivalent investment grade rating determined by a nationally-recognized rating service acceptable to both parties.

Swap payments and associated debt: As of June 30, 2006, debt service requirements of the variable-rate debt and net swap payments for their term, assuming current interest rates remain the same, were as follows. As rates vary, variable rate bond interest payments and net swap payments will vary.

Fiscal Year Ending June 30	Variable Rate Bonds Principal	Variable Rate Bonds Interest	Interest Rate Swaps Net	Total Interest
2007	$ 0	$ 3,333,208	$ 489,433	$ 3,822,641
2008	350,000	3,320,535	487,572	3,808,107
2009	370,000	3,305,985	485,436	3,791,421
2010	390,000	3,290,646	483,183	3,773,829
2011	405,000	3,274,698	480,842	3,755,540
2012-2016	47,545,000	12,740,412	1,870,744	14,611,156
2017-2021	35,325,000	840,906	123,475	974,381
	84,385,000	30,106,390	4,420,685	34,527,075

12. PENSION PLAN

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

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

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

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

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

Membership
Membership in the plan as of July 1, 2005 was as follows:

Employee Group	Number
Retirees and beneficiaries	
Currently receiving benefits	35,443
Terminated members entitled to	
Benefits but not yet receiving them	802
Active members	27,992
Total Members	**64,237**

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

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

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

- The accrued actuarially determined normal costs;

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

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

Under the City's current funding policy, the total required employer contribution for the current year amounted to $384.5 million or 29.8 % of covered payroll of $1,291.0 million.

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

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

Annual Required Contribution (ARC)	394,950
Interest on Net Pension Obligation (NPO)	(82,068)
Adjustment to ARC	113,135
Annual Pension Cost	426,017
Contributions Made	331,765
Increase in NPO	94,252
NPO at beginning of year	(911,866)
NPO at end of year	(817,614)
Interest Rate	9.00 %
15 Year amortization Factor (EOY)	8.06 %

The actuarial valuation that was used to compute the current year's required contribution was performed as of July 1, 2004. Methods and assumptions used for that valuation include:

- The individual entry age actuarial cost method
- A five-year smoothed market value method for valuing investments
- A level percentage closed method for amortizing the unfunded liability
- An annual investment rate of return of 9%
- Projected annual salary increases of 5% (including inflation)
- Annual inflation of 3.5%
- No post-retirement benefit increases

Under the City's funding policy, the recommended contribution for the City for the current year amounted to $395.0 million. The City's actual contribution was $331.8 million. The City's contribution did meet the Minimum Municipal Obligation (MMO) as required by the Commonwealth of Pennsylvania's Acts 205 and 189. The Annual Pension Cost and related percentage contributed for the three most recent fiscal years are as follows:

Fiscal Year Ended June 30 (In Millions)	Annual Pension Cost (In Millions)	Percentage Contributed	Net Pension Obligation
2004	291.1	69.68%	(1,005.0)
2005	392.3	76.27%	(911.9)
2006	426.0	77.88%	(817.6)

(c) Summary of Significant Accounting Policies
Financial statements of the Plan are prepared using the accrual basis of accounting. Contributions are recognized as revenues when due, pursuant to formal commitments, as well as statutory or contractual

requirements. Benefits and refunds paid are recognized when due and payable in accordance with the terms of the plan. Investments are valued as described in Footnote M.

13. POST EMPLOYMENT BENEFITS

In addition to providing pension benefits, the City provides certain post employment health care and life insurance benefits for retired employees, dependents and/or beneficiaries through provisions of City ordinances, civil service regulations and agreements with its various employee bargaining units. The City provides these benefits from one to five years after retirement depending upon the classification of the employee at his or her retirement. Substantially all of the City's employees may become eligible for those benefits if they reach normal retirement age while working for the City. These and similar benefits for active employees are provided through a combination of a self-insurance program and insurance companies whose premiums are based on the benefits paid during the year. The cost of providing these health benefits and life insurance for approximately 4,754 eligible retirees amounted to $43.5 million and $4.1 million respectively.

14. CLAIMS, LITIGATION AND CONTINGENCIES

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

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

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

15. ENHANCED SECURITY

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

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

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

Honorable John F. Street
Mayor

Honorable Anna C. Verna
President of City Council

Loree Jones
Managing Director

Vincent J. Jannetti
Acting Finance Director

Bernard Brunwasser
Water Commissioner

Joseph Clare
Deputy Water Commissioner
of Finance and Administration

David A. Katz, Esq.
Deputy Water Commissioner
Environmental Policy and Planning

Debra A. McCarty
Deputy Water Commissioner
Operations

J. Barry Davis, Esq.
General Counsel to the
Water Department

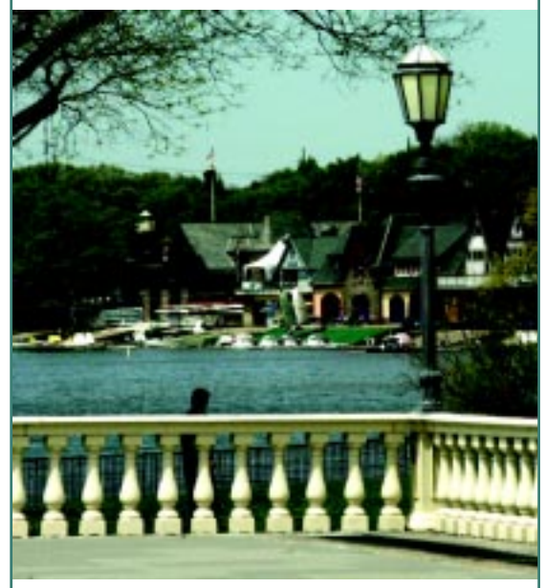
Philip C. Downs
Water Information Center Director
Information Science and Technology

Marleen Duley
Deputy Revenue Commissioner
Water Revenue Bureau

Teresa Vollmer
General Manager
Human Resources

Stephen J. Furtek, P.E.
General Manager
Planning and Engineering

Edward Grusheski
General Manager
Public Affairs



Philadelphia Water Department
Public Affairs Division
ARAMark Tower, 3rd Floor
1101 Market Street
Philadelphia, PA 19107-2994

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