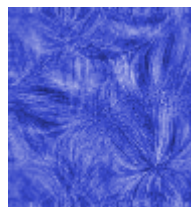
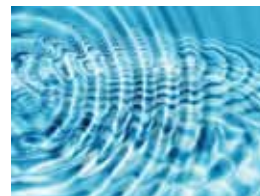
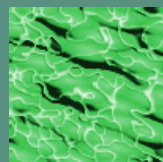


# Philadelphia Water Department

## 2009 Annual Financial Report



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Measurement	FY06	FY07	FY08	FY09	FY10 (Goals)
Millions of Gallons of Treated Water	94,139	95,374	93,679	91,747	94,170
Percent of Time Philadelphia's Drinking Water Met or Surpassed State & Federal Standards	100%	100%	100%	100%	100%
Miles of Pipeline Surveyed for Leakage	1,104	1,024	1,113	931	1,260
Water Main Breaks Repaired	659	824	687	802	850
Avg. Time to Repair a Water Main Break (hrs.)	7.8	7.6	7.6	7.6	8.0
Percent of Hydrants Available	98.9%	99.7%	99.7%	99.7%	99.7%
Number of Storm Drains Cleaned	76,721	76,478	75,804	77,012	109,457
Citizen Satisfaction Survey Results					
Percent Satisfied with Overall PWD Services	80.0%	81.0%	80.0%	81.0%	82.0%
Percent Satisfied with Overall Water Quality	80.2%	82.0%	80.0%	81.0%	82.0%

## Letter From the Commissioner



### *To our colleagues:*

Fiscal Year 2009 presented a range of economic and regulatory challenges to the Philadelphia Water Department (PWD). We continued to encounter some problems in the credit and debt markets, some economy based weakness in bill collections, and higher costs for energy, chemicals and employee benefits.

Our commitment to fiscal responsibility means that, in Fiscal Year 2009, we have drastically scaled back discretionary spending, and delayed some large capital expenditures in order to keep the budget in line with our rate plan and required bond covenants.

Our commitment to public and environmental health and safety means we have diligently worked to reduce costs wherever possible without increasing risks to environmental and public health and safety. As a municipal utility, we serve the citizens of the Philadelphia region by providing integrated water, wastewater and stormwater services. Our primary mission is to operate and maintain the infrastructure necessary to provide high quality affordable drinking water to protect the public health; to provide an adequate and reliable water supply for all residential, business and public needs; and to sustain and enhance the region's watersheds and quality of life by managing wastewater and stormwater effectively.

Our commitment to providing utility services consistent with the highest level of customer service remains strong. Philadelphia's drinking water is safer than ever, substantially better than what State and Federal regulations require. In Fiscal Year 2009, the purity of Philadelphia's drinking water, as measured by the industry standard of turbidity, was better than EPA regulations by 83%. Our water was also 40% better than the most stringent industry standards contained in the Partnership for Safe Water (PFSW), a voluntary program between the EPA and the drinking water industry. These levels of achievement have been recognized by the Partnership, awarding PWD the 10-year Director's Award from the PFSW for complying with the Phase III requirements for over 10 years.

PWD is also treating wastewater to award-winning levels, overseeing the cleanest water environment in 150 years, and making progress in protecting our watersheds to keep our streams and rivers clean. The three WPCPs again met all permit requirements in calendar year 2009 and will receive NACWA Platinum awards. Platinum awards are granted for five or more years of perfect compliance.

This annual financial report contains some of our accomplishments for Fiscal Year 2009.

Our commitments and accomplishments would not be possible without PWD's dedicated and professional staff, many of whom hold leadership positions in the American Water Works Association, National Association of Clean Water Agencies, Delaware River Basin Commission, Eastern Meter Management Association, Partnership for the Delaware Estuary, Coastal Zone Management Steering Committee for PA, Water Environment Federation, Pennsylvania DEP Water Advisory Council and the Pennsylvania section of the American Water Works Association.

Sincerely,

A handwritten signature in black ink that reads "Bernard Brunwasser". The script is fluid and cursive.

Bernard Brunwasser  
Water Commissioner



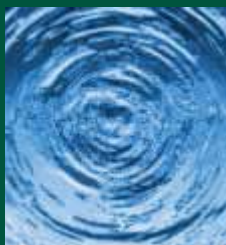
## Partnership for Safe Drinking Water

**T**he Philadelphia Water Department consistently produces high quality drinking water to standards set by the Partnership for Safe Water, a voluntary program which focuses on water treatment excellence. The quality of our water is substantially better than the drinking water quality standards set by State and Federal regulations. Ensuring that our water continues to be of the highest quality is essential for us to eliminate 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 treatment plants.

Today, the turbidity of Philadelphia's water is 80 percent less than the maximum amount allowed by State and Federal regulations (0.30 NTU). Our water's turbidity level averages 0.06 nephelometric turbidity units (NTU), meaning it is also 40 percent less than the Partnership's turbidity goal of 0.10 NTU. Our treatment plants meet this target goal more than 99% of the time and efforts continue to achieve a 100% goal.

The Partnership for Safe Water was initiated through a partnership between the U.S. Environmental Protection Agency, the American Water Works Association, the Association of Metropolitan Water Agencies and other organizations interested in improving water quality through a voluntary optimization program. Since its inception, the Pennsylvania Department of Environmental Protection has joined and advocated the Partnership. Pennsylvania leads the nation in participation in this program and the Philadelphia Water Department is one of Pennsylvania's leaders.

Exceptional improvements in design and operation of the treatment processes have led to continuing optimization at Philadelphia's water treatment plants since joining the Partnership in 1996. In 2008, the Baxter, Queen Lane and Belmont Water Treatment Plants received the Partnership for Safe Water 10-Year Director's Award for achieving Phase III status for 10 consecutive years.





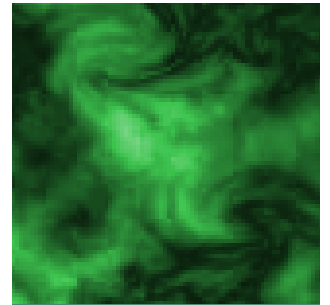
## Stormwater Management Service Charge – Transition to Parcel Based Charge

**T**he Philadelphia Water Department (PWD) has launched the implementation of a new method for stormwater fee recovery designed to more equitably and accurately charge for the cost of stormwater management for all properties within the City. Based on the recommendations of a Stormwater Citizen's Advisory Committee, PWD has spent the last few years developing a stormwater fee database that contains individual parcel information for all non-residential properties with the goal to transition the stormwater charge from a meter based charge to a parcel based charge. The City's approximately 450,000 residential properties are currently charged a flat rate based on the mean residential property area (2,090 square foot gross area and 1,060 square foot impervious area). Residential customers were moved to this parcel based fee in Fiscal Year 2002. At that time, we did not have adequate parcel information to make this transition for our non-residential customers. Now we do.

Beginning July 1, 2010, PWD will transition to a stormwater charge that is assessed based on the square footage of a property's lot size (Gross Area) and on the square footage of impervious surfaces (Impervious Area) on that property. Due to this change in stormwater charge methodology, many customers with large meters, but small impervious areas, will see their fees decrease. Other customers with small size meters but very large impervious

areas will see their stormwater fees increase. In addition, there are approximately 40,000 new stormwater customers that have never been billed for stormwater management fees because they did not have a water meter (i.e. parking lots). To mitigate the monthly bill impact due to this transition, PWD will phase-in this parcel area based stormwater charge over a four year period, from July 1, 2010 through July 1, 2013.

PWD is also instituting a Stormwater Credits program that encourages property owners to retrofit their properties to deploy onsite Stormwater Management Practices (SMPs) or materials that allow for the infiltration or detention of the first one inch of rainfall on their properties. Non-residential properties that contain or build these management features as specified by the PWD stormwater management regulations, can apply for stormwater credits. The stormwater credits will enable the property owner to reduce the monthly stormwater charge. More information on our stormwater parcel based charge and credit program can be found at [http://www.phila.gov/water/stormwater\\_billing.html](http://www.phila.gov/water/stormwater_billing.html).



## Combined Sewer Overflow Long-Term Control Plan Update

The Philadelphia Water Department's Combined Sewer Overflow Long-Term Control Plan Update or Green City, Clean Waters program, aims to put the mechanisms in place over the coming years to equip the City to function as a "Green Machine", by focusing on improving the water resources and revitalizing the City of Philadelphia. Long into the future, every time land is touched by development or redevelopment, the principles of sustainability and stormwater management will be incorporated into the design and engineering of the development.

The basic principles underlying the City's Green City, Clean Waters approach are:

- Utilizing rainwater as a resource by recycling, reusing and recharging groundwater supplies rather than piping it away from our communities into our already stressed tributaries.
- Maintaining and upgrading one of the nation's oldest water infrastructure systems.
- Transforming our rivers and streams to recreation destinations and green open space for visitors and our citizens.
- Preserving and restoring habitat for aquatic species within our urban stream corridors.
- Collaborating to revitalize our City with an emphasis on sustainability.
- Energizing our citizens, partnerships, public and regulatory partners to adopt and join us in this watershed-based strategy.

At the close of the 20-year implementation period, PWD will have invested approximately \$1.6 billion to initiate the largest Green Stormwater Infrastructure Program ever envisioned in this country, thereby providing for the capture of 80 percent of the mixture of sewage and stormwater that would otherwise flow into portions of the Schuylkill and Delaware Rivers, and the Tacony, Frankford and Cobbs Creeks, every time it rains.

This plan commits the City to significantly reducing the negative impacts of stormwater on the effectiveness of our sewer collection system. Our strategy will be to reduce the stormwater burdening our sewers, changing the way that our landscape interacts with stormwater by enhancing our City's impervious cover with natural features. Reducing overflows to our waterways will provide our citizens with destinations to play, fish, relax and reconnect with nature.



# Environment

## Southwest Water Pollution Control Plant

The Southwest Plant received its seventh Platinum Peak Performance Award from the National Association of Clean Water Agencies' (NACWA) for excellence in wastewater treatment for calendar year 2009. The Platinum Award is given to facilities which have achieved five consecutive years of perfect compliance with its National Pollutant Discharge Elimination System (NPDES) permit.

## Southeast Water Pollution Control Plant

The Southeast Plant was awarded the NACWA Platinum Award for perfect effluent permit compliance in calendar year 2009. This is the ninth consecutive NACWA Platinum Award achieved by this facility.

## Northeast Water Pollution Control Plant

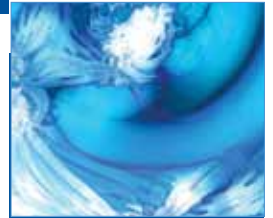
The Northeast Plant received a Platinum Peak Performance Award from NACWA for excellence in wastewater treatment for calendar year 2009.

## Fairmount Dam Fishway Facility

The Philadelphia Water Department and the U.S. Army Corps of Engineers led a multi-agency effort to rehabilitate and reopen the Fairmount Dam Fishway Facility in May of 2009.

The new facility includes an outdoor classroom with amphitheater style seating and a live video feed into the Fairmount Water Works Interpretive Center and the Philadelphia Zoo, for a hands-on, educational experience. The renovations to the Fishway include improved hydraulics and flow velocities to increase accessible habitat for hundreds of thousands of threatened and endangered species. Since its rehabilitation, the number of fish to pass through the new and improved fishway has more than doubled since 2007, with 36 species of fish being identified.

The restoration of the Fairmount Dam Fishway Facility is important because it is the furthest downstream passage of the Delaware River Basin, allowing any fish that travel upstream to spawn a direct passage to their spawning areas. Eliminating any impediments to the Schuylkill drainage will benefit the population growth of American Shad and any other fish that inhabit the Schuylkill.





## Watershed Protection

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

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

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

Philadelphia and with our surrounding neighbors to improve the quality of our watersheds.

## Schuylkill and Delaware River Source Water Protection Plans

The Schuylkill and Delaware River Source Water Protection Plans provide a comprehensive framework for implementing a watershed-wide effort to improve source water quality. The

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

During the past year, the Source Water Program has conducted research to continue to improve our knowledge of the water supply and to help further define priorities for watershed protection. This research includes analysis of flows needed to protect PWD's Baxter plant from saltwater intrusion, a preliminary analysis of water use availability in the Schuylkill River, and tracking of major sources of human infectious pathogens such as *Cryptosporidium*. Information from the latter study will be used to develop a Watershed Control Program for *Cryptosporidium* and help ensure PWD compliance with the Longterm 2 Enhanced Surface Water Treatment Rule for the Queen Lane plant.



# Protection

## Providing Early Warning Protection

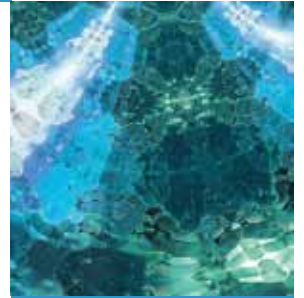
Since 2004, we have led the development and implementation of the Early Warning System for the Schuylkill and lower Delaware rivers. This system is an integrated communication and water quality monitoring network that supports the identification, notification and analysis of source water quality events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

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

Delaware Valley Early Warning System serves

- Over 3 million people
- Philadelphia, Camden and Trenton Metro areas
- 278 users in 50 organizations
- 28 public water suppliers
- 22 industries

Since the system was fully deployed in January of 2005, over 130 events have been entered into the system, ranging from a 100-million-gallon fly-ash spill on the Delaware and a cyanide discharge in the Wissahickon Creek, to flood warnings and sewage discharges. In each of these cases, the improved awareness, communication and coordination provided by the system was valuable to our response. Some alerts have been included in Philadelphia's ReadyNotify network which is a public notification system for major events in the region. During the past year, PWD finalized a Spill Response Tool allowing users to test spill scenarios, determine possible spill pathways, and identify appropriate responses. A large grant is pending for future system improvements, including a tidal spill model and mapping capability enhancements.





## Maintaining Today's Assets for Tomorrow's Customers

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

Another part of our story lies underground. Our water distribution system consists of over 3,100 miles of water mains, 25,200 fire hydrants and 75,000 valves that deliver water to a population of over 1.7 million in Philadelphia and Lower Bucks County. Our extensive sewer system collects wastewater from our residential, commercial and industrial customers and carries it through our sewer system to our three water pollution control plants for treatment. The population served is more than 2.2 million customers – from Philadelphia as well as suburban counties through our wholesale water and wastewater contracts.



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



## Water Main Replacement

There is annual dedicated funding in place for the renewal of our water and wastewater distribution and collector system. This renewal program has been in place for over 20 years and has resulted in our current level of 230 breaks per 1,000 miles of water main compared to the national average of 270 breaks per 1,000 miles. By reducing the emergency repairs required, we are better able to manage our crews and other resources, and continually provide better service to our customers. We also closely monitor the physical condition of our infrastructure to determine that the capital investment provided is adequate to ensure the integrity of the water supply distribution and collector systems.



# Management

## Geographic Information System

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

Using GIS, we have converted all of our existing plans and specifications for all City-wide water and sewer assets into a much more manageable electronic information management system. Quick access to utility infrastructure data through GIS will allow us to make timely management decisions, increasing productivity and reducing risk.

The GIS database will be the key component of our new work order/asset management system, Cityworks Server. This system is set to go live in the second quarter of 2010 and will replace and consolidate many outdated legacy systems. Work orders and service requests will be linked to a GIS feature in the database that will allow us to spatially track all aspects of our field operations and maintenance.

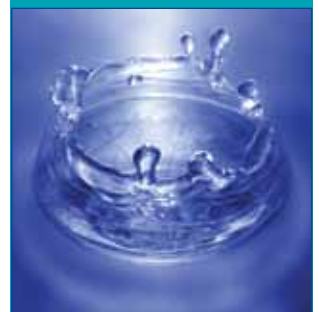
## Sewer Assessment Program

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

The SAP is a systematic methodology used to:

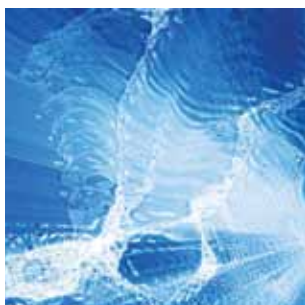
- inspect and evaluate the sewers within the PWD wastewater collection system
- capture and analyze the resulting information in computerized databases
- apply a uniform protocol to prioritizing sewers for repair and replacement

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





# Public Education



## The Fairmount Water Works Interpretive Center (FWWIC)

**T**he Fairmount Water Works, a National Historic Landmark, once served as the city's second pumping station (1815 to 1909), providing water to the citizens of Philadelphia.

The Philadelphia Water Department has transformed these magnificent buildings into an exciting watershed education center. Through a variety of educational programs, interactive exhibits and authentic experiences, FWWIC informs the public about Philadelphia's water resources and its role in protecting them.

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

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

Please visit our website, [www.fairmountwaterworks.org](http://www.fairmountwaterworks.org), for more information about our exhibits and programs.

## Educating Our Public Protects Our Valuable Water Resources

The Fairmount Water Works Interpretive Center continues its remarkable growth as an educational and community resource. The Fairmount Water Works has regained its stature as one of Philadelphia's finest historic institutions, welcoming visitors from around the world. In its early days, back in the 1830s, visitors marveled at the technology that for the

first time, provided clean drinking water to a major city and the beauty of the neoclassical buildings, gardens and fountains.

Today, the Fairmount Water Works



Interpretive Center continues to set a precedent as one of the nation's leading centers for watershed education. The Interpretive Center, set in a former pumping station, with some original machinery still in place, is hailed as an outstanding example of adaptive reuse of an historic site.



# and Outreach



The Center welcomed its 234,000th visitor in March 2009. That number includes visitors from Afghanistan, Argentina, Brazil, Canada, China, Germany, Japan, Mongolia, Switzerland and the U.S. Virgin Islands.

Where the number of visitors has grown, so have the Interpretive Center's programs. The Center's first educational offering was "Water in Our World," the perfect overview for teachers focusing on water issues. Support from foundations and corporations, government agencies, the University of Pennsylvania, Drexel University, other colleges and universities and the public, has allowed the Interpretive Center to expand its scope to educational and recreational opportunities for families, college students and adults as well.

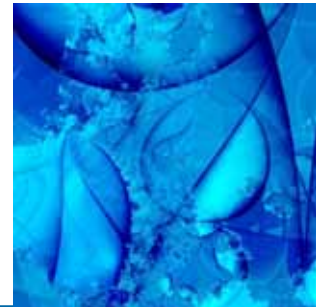


## Educational Programs Bring Science Alive

We have two new educational programs for students that are sure to peak their scientific interests. *History of the Manayunk Canal: Industrial Revolution, Environmental Devolution* is a full day class designed for grades four through eight, with walking tours and examination of 100-year-old documents. Students will understand the devastating impact of industrialization in Manayunk on the drinking water supply in Philadelphia.



Another program, *Seeing is Believing: A Drop in the Bucket*, is a career-based science education program for high school students to explore the microscopic world of water in a laboratory environment through freshwater sampling. The use of state-of-the-art videoconferencing equipment will allow students to communicate directly with PWD's Lab scientists and engineers.



# 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, which began water system service in 1801, supplies water to the City and a portion of each of Montgomery, Delaware and Bucks Counties, Pennsylvania, and wastewater service to the City and to ten municipalities and authorities located in Montgomery, Delaware and Bucks Counties, Pennsylvania. The population served by the water system was approximately 1,728,900 as of the 2000 census, of which 1,518,000 were in the City, 154,000 were in Bucks County and approximately 56,900 in Montgomery and Delaware Counties. The population served by the wastewater system was approximately 2,218,000 as of the 2000 census, of which 1,518,000 were in the City and 700,000 were in the suburbs.

## Water and Wastewater Systems

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

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

PWD's three water treatment plants deliver approximately 260 million gallons of top quality drinking water each day. The Department performs more than 350,000 tests annually at these plants to ensure consistent, optimal treatment and a healthy water supply. In addition, thousands of samples of tap water

are analyzed annually at the Department's state-of-the-art testing laboratory. These samples are collected from City reservoirs and from more than 65 locations throughout the Philadelphia area as well as monitoring water flows and pressures at 40 locations throughout the City.

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

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

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

## Financial Highlights

The Water Department met its bond coverage ratios for the year with a revenue bond coverage ratio of 1.20, a total debt service coverage ratio of 1.09, and a net operating revenue bond coverage ratio of 1.01 prior to the deduction of the transfer to the rate stabilization fund.

At the end of the current fiscal year, the Water Fund's net assets totaled \$715.9 million resulting from an excess of its assets over its liabilities; its unrestricted net assets showed a balance of \$174.2 million.

The Water Fund's net assets showed a decrease of \$6.7 million during the current fiscal year compared with \$29.3 million for the prior fiscal year.

## Net Assets

As noted earlier, net assets are useful indicators of a government's financial position. At the close of the current fiscal year, the Water Department's assets exceeded its liabilities by \$715.9 million.

Capital assets, such as land, buildings, meters, water mains, and sewer lines, less any outstanding debt issued to acquire these assets, comprise \$190.5 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, \$351.1 million is subject to external restrictions as to use. The remaining component of net assets is the unrestricted net assets, which ended the fiscal year with \$174.2 million.

## Bond Issuance, Pennvest Loans and Pennworks Grant

During FY2007, the Department was authorized to issue additional Water and Wastewater Revenue Bonds in the aggregate principal amount of \$325,000,000. A portion of these bonds have not yet been issued (\$180,000,000 of these bonds are tied to a forward starting swap as described below). The proceeds of the



bonds will be applied to (i) fund capital improvements to the City's Water and Wastewater Systems (as hereinafter defined), (ii) fund a Debt Reserve Account of the Sinking Fund (as hereinafter defined) relating to the bonds, and (iii) pay costs of issuance relating to the new bonds. In February 2007, the City entered into a forward starting swap "rate lock" agreement with two counterparties for \$180,000,000 of these bonds. These agreements were extended in February 2008, and now have an execution date of not later than August 1, 2010, unless further extended by the parties.

On May 21, 2009, the Department also issued \$140,000,000 of Water and Wastewater Revenue Bonds, Series 2009A. The proceeds of the 2009A bonds will be applied to (i) fund capital improvements to the City's Water and Wastewater Systems (as hereinafter defined), (ii) fund a Debt Reserve Account of the Sinking Fund (as hereinafter defined) relating to the bonds, and (iii) pay costs of issuance relating to the new bonds. As part of this issuance, all three of the major bond rating agencies (Moody's, Standard and Poor's and Fitch) affirmed their ratings for the Water Department. It should also be noted that in September 2008, Standard & Poor's upgraded the Department's credit rating to "A" as part of their ratings on the offering of the 1997B bonds.

On April 20, 2009, the Water Department was notified that three of its traditional water and sewer applications, totaling \$184.893 million, were approved for funding by Pennvest through low interest loans of 1.193% during the construction period and for the first five years of amortization (interest only payments are due during the construction period, up to three years) and 2.107% for the remaining 15 years. In addition, its \$30 million green infrastructure application was approved for funding through a low interest loan on the same terms. The Department obtained additional bond authorization from City Council to complete these projects through a supplemental ordinance to the Restated General Ordinance authorizing such borrowing and borrowing for other capital projects (the Twelfth Supplemental Water Bond Ordinance No. 090321).

### Rate Lock (Swap) Agreement

In connection with the anticipated issuance of the 2008 New Money bonds, on February 21, 2007, the City entered into two separate forward starting interest rate swap transactions, each evidenced by an ISDA Master Agreement, schedule and confirmation (collectively the "2007 Swap agreements", and together with the 2002 Swap agreement, the "Swap agreements") between the City and each of Merrill Lynch Capital Services, Inc. and Wachovia Bank, National Association (the "2007 Swap providers"). The 2007 Swap agreements are intended to hedge the interest rate risk on \$180,000,000 aggregate principal amount of the 2008 New Money bonds, split equally between the 2007 Swap providers. Under the 2007 Swap agreements, commencing on September 1, 2010, the City will pay interest to the 2007 Swap providers on the notional amount thereof at an amended fixed rate of 4.52275% and the 2007 Swap providers will pay interest to the City on such notional amount at a variable interest rate equal to the Bond Market Association Rate (BMA) or the Securities Industry and Financial Markets Association Rate.

The City's regularly scheduled payments under the Swap agreements are secured on a parity basis by a lien and a security interest in

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

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

### Subsequent Events

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

### Water and Wastewater Rates

In terms of rates, the Philadelphia Water Department continues to have some of the lowest rates in the region for water, wastewater and stormwater services. The PWD has had great success in containing costs, increasing employee productivity and improving services. The Department has initiated numerous measures to improve service, reduce costs and enhance revenues over the past decade. The cost of operating the wastewater facilities has been reduced. The refinancing of more than \$2 billion in revenue bonds has resulted in a cumulative net present value savings in excess of \$106 million in debt service expense. A Revenue Protection Unit, created in fiscal year 2000, has recovered more than \$20 million to date. The Department has steadily improved the credit rating of the revenue bonds. All seven of the major plant facilities have been winning national performance awards on an annual basis.

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

Beginning November 1, 2008, a typical residential customer's bill was changed by an additional \$3.49 a month, or a total monthly bill of \$52.84. This change was for the period of November 1, 2008 to June 30, 2009. A typical senior citizen's monthly bill was changed by an additional \$1.91, or a total monthly bill of \$33.00, for those seniors who qualify for the Department's 25-percent senior citizen discount. The income test to qualify for this discount was changed to \$28,900 on July 1, 2009. In addition, the Department has adopted rate changes to be phased in over a three year period for fiscal years 2010, 2011 and 2012. These changes include:

- \$3.40 increase in the typical monthly bill (total monthly bill of \$56.24) for July 1, 2009 to June 30, 2010;
- \$3.20 increase in the typical monthly bill (total monthly bill \$59.44) from July 1, 2010 to June 30, 2011; and
- \$3.49 increase in the typical monthly bill (total monthly bill \$62.93) from July 1, 2011 to June 30, 2012.

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

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

2009 Regional Residential* Water and Sewer Charges		
	Monthly Water Bill	Monthly Sewer Bill
Aqua Pennsylvania+	\$53.23	N/A
Pennsylvania American Water+	\$54.31	N/A
New Jersey American Water+	\$37.18	N/A
North Penn Water Authority+	\$25.08	N/A
North Wales Water Authority+	\$22.85	\$61.42
Doylestown Township	\$30.23	\$55.84
CCMUA (Camden County)**	N/A	\$26.25
Trenton	\$30.25	\$23.30
<b>Philadelphia Water Department</b>	<b>\$24.56</b>	<b>\$20.88</b>
Rates in effect on December 1, 2009. Stormwater charges (\$10.80) are excluded from sewer calculations, because many jurisdictions fund such services from the general tax base or a separate utility assessment.		
* Calculations based on 5,236 gallons/month (700 cu.ft.)		
** Sewer-only utility		
+ Water-only utilities		
Source: Philadelphia Water Department		

## Bond Ratings

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

City of Philadelphia's Bond Ratings General Obligation and Revenue Bonds			
	Moody's Investors Service	Standard & Poor's Corporation	Fitch IBCA
General Obligation Bonds	Baa1	BBB	BBB+
<b>Water &amp; Sewer Revenue Bonds</b>	<b>A3</b>	<b>A</b>	<b>A-</b>
Aviation Revenue Bonds	A2	A+	A

The following excerpt accompanied the reaffirmed A3 rating of Moody's Investors Service issued on April 23, 2009:

The management team of this large combined water and wastewater system has produced a strong record of operational and financial achievements over the past decade. Operational achievements include continued improvements in environmental compliance, the launch of a proactive water main replacement program that has significantly reduced the number of main breaks, and the installation of automatic meters for a significant proportion of residential customers. In addition to the resulting improvements in billing accuracy, the billing cycle was accelerated to a monthly basis, and both have led to an increase in 120 day payment patterns from 87.3% in fiscal 2000 to 91% consistently for the three fiscal years ending in 2007. Operating costs have been well-managed, with significant reductions in some areas such as contracted electricity costs and a projected \$197 million in savings over the life of a contract for the management outsourcing of the biosolids recycling center. As discussed in detail below, management has been able to maintain significant cash balances that support the system's working capital needs, help with rate stabilization and provide for contingencies.

The following excerpt accompanied the affirmed A- rating of Fitch issued in April 2009:

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

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

Philadelphia's financial operations have been stable, but they are reliant on transfers from a rate stabilization reserve created with the \$69 million series 1993 bond issuance. The use of these reserves and interest earnings allows the system to meet its total obligations and satisfy

# Management Discussion and Analysis

its 1.2x rate covenant coverage. The rate stabilization reserve's purpose is to maintain assets to be drawn down to offset future operating shortfalls and corresponding rate increases in the operating fund.

## Fund Balances

During FY2009, the Department withdrew \$34.7 million from its Rate Stabilization Fund, bringing the cumulative fund balance to approximately \$147.6 million, all of which is available to provide necessary working capital to the Department and to offset future rate increases. In addition, approximately \$14.0 million was transferred to the Residual Fund and \$1.2 million was transferred from the Residual Fund to the Capital Fund. Virtually all of these funds will be used to provide capital funding to reduce the amount of additional bond issues to fund the capital program or to fund the Pennvest Sinking Fund Reserve Requirement. To date, the Department has transferred in excess of \$254 million to its Capital Fund via its annual 1% transfer and \$73 million via additional discretionary transfers to capital from its Residual Fund.

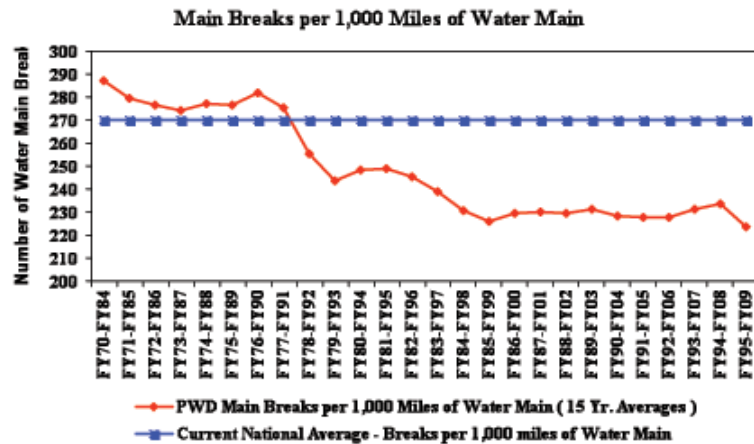
## Maintaining excellence in water purity standards

Philadelphia's drinking water meets or surpasses the requirements of State and Federal standards 100 percent of the time. Since voluntarily joining the U.S. Environmental Protection Agency's (EPA) Partnership for Safe Water (PFSW) in 1996 (a joint program of the EPA and the water industry), the PWD has committed itself to reduced "turbidity," an industry standard measure of water purity. In FY09, the turbidity of Philadelphia's water (.05 ntu) was 83 percent lower than the amount required by State and Federal regulations and 50 percent lower than the Partnership's turbidity goal of 0.1 ntu. Nationally, the Philadelphia Water Department's three water treatment plants are among an elite group of 31 facilities that have received the Director's Award from the Partnership for Safe Water for meeting the Partnership goals for 10 consecutive years. To put this in perspective, there are over 400 water treatment plants enrolled in the PFSW and there are over 4,700 water utilities nationwide.

## Optimize water and sewer main replacement

PWD closely monitors water main conditions to ensure that adequate capital investment is made, the integrity of the water supply system is sustained, and the occurrence of disruptive and costly water main breaks is reduced. In FY09, ten miles of main were replaced.

As shown in the chart at the top of the next column, PWD's FY94-FY09 fifteen year moving average level of 224 breaks per 1,000 miles is less than the national average of 270 breaks per 1,000 miles and is the lowest level in more than 20 years.



## Reducing unbilled or non-revenue water

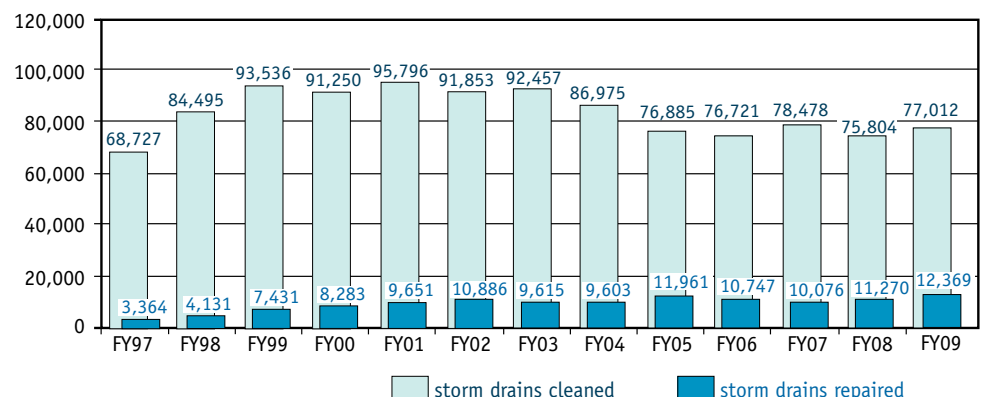
PWD maintains programs to reduce uncaptured revenue and loss of treated water from the distribution system. Over the past 14 years, PWD has cut non-revenue water by 43 percent, from 133 million gallons per day (mgd) to 75 mgd at the close of FY08. PWD continued a number of successful loss control initiatives in FY08, including a leak detection and repair program that surveyed 1,113 miles of pipeline for leaks, and abated over 36 mgd of leakage, representing a cost savings of over \$1,771,000. PWD continued to operate and refine equipment installed in 2007 in its first permanent District Metered Area (DMA) which includes pressure control features to reduce the occurrence of leakage and water main breaks. The results of this project have been impressive, saving over one million gallons of water per day for an annual savings of \$80,000 with full payback projected by 2011. PWD is also one of the few water utilities in the United States employing inline leak detection services on its large-diameter transmission pipelines as a strategy to detect leaks before they become catastrophic ruptures. Through FY09, a total of 45 leaks on 22 miles of large pipelines have been identified and most have been repaired. In addition, the PWD's Revenue Protection Program continued to recover uncaptured revenue from billing errors, lost customer accounts and unauthorized consumption. This program has recovered almost \$20 million since its inception in 2000.

## Improved stormwater flood control

PWD's management of the stormwater system is an important multi-faceted service for both flood control and environmental protection. With approximately 90,000 storm drains to maintain, the Department focuses on keeping them in good condition to prevent blockage of stormwater flow and creation of hazardous conditions for pedestrians. In FY09, PWD cleaned 77,012 storm drains. In addition, the Department reconstructed 11,270 storm drains.

As shown in the following chart, the Department has cleaned over 75,000 storm drains every year since 1998. The chart also shows the significant progress that has been made in the reconstruction and repair of storm drains. The 12,369 repairs completed in FY09 almost quadruples the 3,364 level achieved in FY97. These repairs greatly improve the effectiveness of the City's stormwater management system.

## Productivity Enhancements Led to More Storm Drains Cleaned & Repaired





In January 2006, PWD initiated new Stormwater Regulations. The new regulations are an important tool in the City's efforts to reduce flooding and to protect our rivers and streams. Accordingly, all development projects that disturb more than 15,000 square feet of earth must comply with water quality and non-structural site design requirements that are consistent with State and Federal stormwater best management practices. During FY09, PWD received 525 conceptual submittals for zoning permits and 510 full Post Construction Technical submittals for building permits. Stormwater regulations include four major components: water quality protection, channel protection, flood control and non-structural site design (minimizing impervious land cover). The results of this program since inception have been significant. The program has approved 1,275 acres of proposed development. Based on this area, approximately 1.2 billion gallons of stormwater runoff is managed annually, reducing excess burden and stress on the City's stormwater infrastructure and treatment plants.

### **Sinking Fund Reserve Substitution**

On November 26, 2007, the City deposited a surety policy in the principal amount of \$67 million issued by FSA in the Debt Reserve Account pursuant to the General Ordinance and transferred approximately \$64,325,000 to a Special Water Infrastructure Account to pay the costs of acquiring certain water and sewer infrastructure components of the New River City Program.

The New River City budget includes approximately \$60 million for the expansion and modernization of the water and sewer infrastructure at the Navy Yard, now referred to as the Philadelphia Naval Business Center (PNBC). This initiative, authorized by City Council in ordinance 060005, passed in the fall of 2007. To date, seven asset acquisition agreements totaling approximately \$83.6 million have been executed (actual disbursements will be limited to the \$64,325,000 in currently available funding and may be supplemented with the "Pennworks" grant/loan). Two of the six projects are substantially completed and final disbursement has yet been made. The other five projects are underway and are expected to be completed within the next 12 months. In connection with this program, PWD assumed control of the water, sewer and stormwater systems at the former Philadelphia Naval Shipyard on November 9, 2009.

### **Bond Insurance Ratings**

On November 21, 2008, Moody's Investors Service Inc. ("Moody's") reduced the Aaa insurance financial strength of FSA and its affiliated insurance operating companies to Aa3 with developing outlook. On May 11, 2009, Fitch Ratings reduced its insurance financial strength rating to AA+ from AAA. An explanation of the significance of any rating action should be obtained from the rating agency furnishing the same.

FSA currently meets the credit rating requirements prescribed by the General Ordinance with respect to eligible providers of supply policies for deposit in the Debt Reserve Account. The City and the Water Department are monitoring the financial condition and ratings of FSA in relation to such credit quality requirement, and are considering all options currently available to ensure continued compliance in this respect. The Department is currently working on a remarketing of the Series 2003 bonds which it expects to complete before April 1, 2010. Previously, the Department successfully remarketed both the 1997B Series and the 2005B Series Bonds with a letter of credit, removing both the insurers and the liquidity providers.

### **Protecting Drinking Water Supplies**

PWD operates the Delaware Valley Early Warning System (EWS) to protect our drinking water supplies from chemical spills and other potential hazards in the Delaware and Schuylkill rivers. The system enables communication among water suppliers and emergency agencies to aid decision-making during source water contamination events. Through the EWS, PWD and other utilities have been provided with advanced warning of significant water quality events, such as the discharge of 100 million gallons of an arsenic-laden, fly ash slurry to the Delaware from PP&L in August 2005; a 10,000 gallon leachate discharge into the Delaware from the Tullytown Landfill in March 2006; a cyanide spill into the Wissahickon in

June 2006; and numerous other oil, chemical and sewage spills in PWD's source waters. During 2008-2009, 24 industrial users with water intakes became subscribers to the EWS, and an industrial user fee was assessed adding \$25,000 toward operations and maintenance expenses. The EWS User Agreement was also updated to reflect the addition of industrial users and the addition of the Philadelphia Office of Emergency Management.

### **Long-Term Control Plan for Combined Sewer Overflows**

During heavy rainstorms, the release of some stormwater and sewage overflows from combined sewers (sewers that carry stormwater and sanitary waste in one pipe) to the City's rivers and streams, causes pollution to these waterways. In 1997, PWD submitted its Combined Sewer Overflow Long-Term Control Plan (CSOLTCP) to the PA Department of Environmental Protection. These plans included the incorporation of Nine Minimum Controls (NMCs) - using industry accepted best practices to efficiently operate and maintain our sewer system, in addition to the identification of \$48 million of capital improvement projects that would ensure localized capture and storage of wet weather flows within the existing sewer collection system. These efforts successfully reduced overflow volume by three percent or six billion gallons a year. Initial efforts were focused on detecting and eliminating overflows during dry weather, getting the most storage possible in our sewer system and stepping up inspections and monitoring at sites where overflows occur.

The final component of the CSOLTCP embraces the development of regional watershed partnerships committed to the development of Integrated Watershed Management Plans (IWMs). These plans are guided by a 20-year vision to restore our region's waterways to fishable, swimmable and beautiful rivers and streams that are life-sustaining and are an amenity to our communities. In September 2009, the Philadelphia Water Department released its *Green City, Clean Waters* plan to meet its regulatory obligations while also looking to ensure that investments in the stormwater system also help to revitalize Philadelphia environmentally. The Department determined that a green stormwater management infrastructure approach would provide maximum return in environmental, economic and social benefits within the most efficient timeframe. Green stormwater infrastructure includes: planters, rain barrels, green roofs, permeable pavements, an enhanced network of street trees and restored creek corridors. Over the next five years, the PWD will lay the foundation for achieving the Green City, Clean Waters vision over the full 20-year implementation period of this plan and beyond.

### **Contract and Lease for Operation of Biosolids Recycling Center**

On October 10, 2008, the Department entered into a contract and lease with the Philadelphia Municipal

Authority (PMA) to operate the Department's existing Biosolids Recycling Center (BRC), including a dewatering station, and to construct new thermal drying facilities to produce Class A biosolids products. The contract term is up to 25 years, including a two-year renewal option. PMA has contracted with Philadelphia Biosolids Services, LLC ("PBS") for these services. At the time the contract was executed, the Department transferred the remaining 60 employees at this facility to other assignments. Subsequently, the Department has transferred to other units certain vehicles and equipment that had been part of the existing BRC operation but were no longer needed by the contractor. At this time, most of the fixed assets associated with the facility, except for those related to the discontinued composting operations, remain in service.

Efforts to contract out the facility began in the summer of 2003, when the Water Department decided to move to an entirely Class A biosolids process, one that could operate in Philadelphia without odors. It entered into a contract with the engineering consultant firm Camp, Dresser & McKee to assist with procurement of facilities and services for a long term operation of the dewatering station, and to construct new facilities to produce Class A biosolids products. Alternative processes identified for this procurement process included fully-enclosed composting systems and heat drying technologies. The Request for Qualifications was released in August 2003, and, in response, the City received qualification statements from four teams, of which two were found qualified and invited to receive a Request for Proposals.

One team, Philadelphia Biosolids Services, LLC ("PBS") submitted a proposal on November 24, 2004, to convert existing BRC operations into 100% Class A using a thermal drying process. The contract includes a provision for interim operation of up to five years, during which PBS will take over operation of the existing Biosolids Recycling Center. Within the first three to five years, PBS will finance, design, build, own and operate a thermal drying facility that will handle all of the sludge processed by the Water Department and make a Class A product in the form of pellets that can be used as fertilizer and has potential as a fuel. PBS will be responsible for the disposition of the Class A pellets, thus relieving the Water Department of this burden. The Class A period of operation will last twenty years with a two-year renewal at the option of the Water Department. The project is estimated to result in a savings of approximately \$200 million over the contract life. On June 19, 2008, City Council passed enabling legislation to allow the proposed contract to proceed. Mayor Nutter approved the contract with PBS in October 2008 and PBS has been operating the facility since October 13, 2008. As of December 2009, PBS has received construction financing in the amount of \$68.275 million through the Pennsylvania Economic Development Finance Authority (PEDFA), and intends to begin construction of the thermal drying facilities early in 2010. In FY09, payments to PBS were \$22.7 million, and are expected to be \$22 million in FY10.

### Waterways Restoration Program

In FY04, the PWD created the Waterways Restoration Team (WRT), which consists of four crews devoted to removing trash and large debris from the streams and tributaries that define our neighborhoods. The teams also perform restoration work around PWD's storm and combined sewer outfalls and streambanks that contain exposed infrastructure. In addition,

these teams maintain a number of green infrastructure Best Management Practices (BMPs) that have been installed by PWD and are recognized as a component of the Department's sewer collection system. In FY08, the teams removed 346 tons of debris including 41 cars, 1,969 tires and 83 shopping carts from Philadelphia's streams. In FY09, 658 tons of debris were removed. A large component of the team's mission is to work in partnership with the Fairmount Park Commission to restore tributaries and streams that have been significantly damaged over decades by the volume and velocity of flows from sewer outfalls and from the forces of stormwater runoff.

### Awards and Recognition

The Philadelphia Water Department and the Partnership for the Delaware Estuary Inc. presented "Tivoli: South Philadelphia Style" at the 2009 Philadelphia Flower Show. A rendition of a typical row house backyard, with trees, shrubs, native plants and vegetation was used to demonstrate how the city can be developed into an urban ecosystem that can handle stormwater runoff more naturally and assure clean reliable water for fishing, swimming and drinking.

In FY09, the Philadelphia Water Department's three Water Pollution Control Plants were selected to receive two Platinum and one Gold Peak Performance Award from the National Association of Clean Water Agencies (NACWA). The Southwest Water Pollution Control Plant received a Platinum Peak Performance Award for six years of perfect permit compliance, the Southeast Water Pollution Control Plant received a Platinum Peak Performance Award for nine years of perfect permit compliance, and the Northeast Water Pollution Control Plant received a Gold Peak Performance Award for four years of perfect compliance. NACWA's Peak Performance Awards program recognizes member agency facilities for excellence in wastewater treatment as measured by their compliance with their National Pollutant Discharge Elimination System (NPDES) permits. Gold Awards honor treatment plants that have achieved 100 percent compliance for an entire calendar year. Platinum Awards pay special tribute to member agency facilities that have received Gold Awards for five consecutive years.

The Philadelphia Water Department (PWD) received the Leader in Sustainable Design and Development award from the Pennsylvania Resources Council, Inc. in November 2007. This award recognizes the Department's innovative efforts for effective and sustainable solutions to stormwater management. Pennsylvania Resources Council, Inc. (PRC) is a nonprofit organization formed in 1939 whose mission is to promote conservation of natural resources and protection of scenic beauty through public education and outreach by collaborating with government agencies, businesses, charitable foundations and other nonprofit organizations. In FY09, the Department also received an award from Clean Water Action for the implementation of its Stormwater Parcel Based Charge. This approach to stormwater billing encourages PWD's customers to reduce their stormwater charges through effective on-site management of the stormwater created at their home or business.

### 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, 2009 AND 2008

(amounts in thousands)

	2009	2008
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash on Deposit and on Hand	\$ 30	\$ 30
Equity in Treasurer's Account	56,445	51,016
Due from Other Governments	456	548
Accounts Receivable	209,454	190,855
Allowance for Doubtful Accounts	(89,845)	(80,345)
Inventories	12,800	15,408
Prepaid Insurance – Surety Bond	--	--
<b>Total Current Assets</b>	<b>189,340</b>	<b>177,512</b>
<b>Noncurrent Assets:</b>		
Restricted Assets:		
Equity in Treasurer's Account	377,704	344,646
Sinking Funds and Reserves	116,075	107,098
Grants for Capital Purposes	--	--
Receivables	1,145	2,950
<b>Total Restricted Assets</b>	<b>494,924</b>	<b>454,694</b>
Net Pension Asset	37,878	45,279
Capital Assets:		
Land	5,919	5,919
Infrastructure	1,915,671	1,830,034
Construction in Progress	151,517	138,705
Buildings and Equipment	1,461,682	1,502,137
Accumulated Depreciation	(1,808,339)	(1,762,760)
<b>Total Capital Assets</b>	<b>1,726,450</b>	<b>1,714,035</b>
<b>Total Noncurrent Assets</b>	<b>2,259,252</b>	<b>2,214,008</b>
<b>Total Assets</b>	<b>2,448,592</b>	<b>2,391,520</b>
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
Vouchers Payable	9,172	6,670
Accounts Payable	7,761	10,507
Salaries & Wages Payable	3,320	2,984
Construction Contracts Payable	8,224	8,109
Accrued Expenses	18,416	17,197
Deferred Revenue	7,478	7,723
Funds Held in Escrow	2,820	345
Current Portion of Long Term Obligations	94,778	91,534
<b>Total Current Liabilities</b>	<b>151,969</b>	<b>145,069</b>
<b>Noncurrent Liabilities:</b>		
Long Term Obligations	1,623,779	1,578,275
Unamortized Discount and Loss	(66,395)	(75,252)
Other Noncurrent Liabilities	23,343	20,822
<b>Total Noncurrent Liabilities</b>	<b>1,580,727</b>	<b>1,523,845</b>
<b>Total Liabilities</b>	<b>1,732,696</b>	<b>1,668,914</b>
<b>NET ASSETS</b>		
Invested in Capital Assets, Net of Related Debt	190,535	112,198
Restricted For:		
Capital Projects	87,404	159,611
Debt Service	116,075	107,098
Rate Stabilization	147,637	183,130
Unrestricted	174,245	160,569
<b>Total Net Assets</b>	<b>\$715,896</b>	<b>\$722,606</b>



# STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS FOR THE FISCAL YEARS ENDED JUNE 30, 2009 AND 2008

(amounts in thousands)

	2009	2008
<b>Operating Revenues:</b>		
Charges for Goods and Services	\$494,087	\$499,872
Miscellaneous Operating Revenues	5,566	6,421
<b>Total Operating Revenues</b>	<b>499,653</b>	<b>506,293</b>
<b>Operating Expenses:</b>		
Personal Services	110,324	111,030
Purchase of Services	85,553	88,649
Materials and Supplies	38,795	34,079
Employee Benefits	81,855	74,087
Indemnities and Taxes	5,859	5,295
Depreciation and Amortization	83,996	83,648
<b>Total Operating Expenses</b>	<b>406,382</b>	<b>396,788</b>
<b>Operating Income (Loss)</b>	<b>93,271</b>	<b>109,505</b>
<b>Nonoperating Revenues (Expenses):</b>		
Operating Grants	583	497
Interest Income	21,252	27,849
Net Pension Obligation	(7,401)	(9,745)
Debt Service - Interest	(100,254)	(89,357)
Other Expenses	(16,741)	(8,362)
<b>Total Nonoperating Revenues (Expenses):</b>	<b>(102,561)</b>	<b>(79,118)</b>
Income (loss) before Transfers	(9,290)	30,387
Transfers Out	(4,185)	(4,994)
Capital Contributions	--	2,979
Change in Net Assets	(13,475)	28,372
Net Assets - Beginning of Period	722,606	693,279
Adjustment	6,765	955
<b>Net Assets - End of Period</b>	<b>\$715,896</b>	<b>\$722,606</b>

# STATEMENT OF CASH FLOWS, JUNE 30, 2009

(amounts in thousands)

	2009	2008
<b>Cash Flows from Operating Activities</b>		
Receipts from Customers	\$492,875	\$494,531
Payments to Suppliers	(122,952)	(123,497)
Payments to Employees	(190,137)	(185,175)
Claims Paid	(5,100)	(4,531)
Other Receipts (Payments)	--	--
<b>Net Cash Provided by Operating Activities</b>	<b>174,686</b>	<b>181,328</b>
<b>Cash Flows from Non-Capital Financing Activities</b>		
Operating Grants Received	583	997
Operating Subsidies and Transfers to Other Funds	(4,185)	(4,994)
<b>Net Cash Provided by Non-Capital Financing Activities</b>	<b>(3,602)</b>	<b>(3,997)</b>
<b>Cash Flows from Capital &amp; Related Financing Activities</b>		
Proceeds from Capital Debt	133,039	--
Capital Contributions Received	--	--
Acquisition and Construction of Capital Assets	(100,009)	(100,755)
Interest Paid on Capital Debt	(92,719)	(82,486)
Principal Paid on Capital Debt	(91,534)	(92,501)
Other Receipts (Payments)	--	--
<b>Net Cash Provided (Used) by Non-Capital Financing Activities</b>	<b>(151,223)</b>	<b>(275,742)</b>
<b>Cash Flows from Investing Activities</b>		
Interest and Dividends	18,626	90,609
<b>Net Cash Provided by Investing Activities</b>	<b>18,626</b>	<b>90,609</b>
<b>Net Increase (Decrease) in Cash &amp; Cash Equivalents</b>	<b>38,487</b>	<b>(7,802)</b>
Balances - Beginning of the Year	395,692	403,494
<b>Balances - End of the Year</b>	<b>434,179</b>	<b>395,692</b>
<b>Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:</b>		
Operating Income (Loss)	93,271	109,505
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation Expense	83,996	83,648
Change in Assets and Liabilities:		
Receivables, Net	(6,533)	(12,055)
Inventories	2,608	(224)
Accounts and Other Payables	1,589	161
Accrued Expenses	--	--
Deferred Revenue	(245)	293
<b>Net Cash Provided by operating activities</b>	<b>\$174,686</b>	<b>\$181,328</b>

# BUDGETARY COMPARISON SCHEDULE

## Water Operating Fund For the Fiscal Year

### Ended June 30, 2009

(amounts in thousands)

REVENUES	BUDGETED AMOUNTS			FINAL BUDGET TO ACTUAL Positive (Negative)
	Original	Final	Actual	
Locally Generated Non-Tax Revenue	\$ 513,443	\$ 487,300	\$ 484,538	\$ (2,762)
Revenue from Other Governments	2,500	2,500	674	(1,826)
Revenue from Other Funds	61,441	71,480	58,263	(13,217)
<b>Total Revenues</b>	<b>\$ 577,384</b>	<b>\$ 561,280</b>	<b>\$ 543,475</b>	<b>\$ (17,805)</b>
<b>Expenditures and Encumbrances</b>				
Personal Services	115,609	111,341	105,556	5,785
Pension Contributions	37,435	38,364	38,364	--
Other Employee Benefits	36,371	39,347	39,346	1
Sub-Total Employee Compensation	189,415	189,052	183,266	5,786
Purchase of Services	122,098	113,985	100,511	13,474
Materials and Supplies	48,094	48,095	41,625	6,470
Equipment	5,881	5,880	1,788	4,092
Contributions, Indemnities and Taxes	6,603	5,079	4,977	102
Debt Service	174,254	184,254	184,253	1
Debt Service – Interest	--	--	--	--
Short-Term Interest	--	--	--	--
Payments to Other Funds	46,039	46,039	45,775	264
<b>Total Expenditures and Encumbrances</b>	<b>592,384</b>	<b>592,384</b>	<b>562,195</b>	<b>30,189</b>
<b>Operating Surplus (Deficit) for the Year</b>	<b>\$ (15,000)</b>	<b>\$ (31,104)</b>	<b>\$ (18,720)</b>	<b>\$ 12,384</b>
 Fund Balance Available, July 1, 2008	 --	 --	 --	 --
<b>Operations in Respect to Prior Fiscal Years</b>				
Commitments Cancelled - Net	15,000	16,000	18,720	2,720
Prior Period Adjustments	--	--	--	--
Adjusted Fund Balance, July 1, 2008	15,000	16,000	18,720	2,720
<b>Fund Balance Available, June 30, 2009</b>	<b>--</b>	<b>\$ (15,104)</b>	<b>\$ --</b>	<b>\$ 15,104</b>



# BONDED DEBT FOR THE FISCAL YEAR ENDED JUNE 30, 2009

(amounts in thousands)

ORIGINAL AUTHORIZATION			FISCAL YEAR 2010 DEBT					
Series	Date	Issued	Outstanding June 30, 2009	Maturities	Interest Rates	Service Interest	Principal Requirements	Outstanding June 30, 2010
<b>Revenue Bonds:</b>								
Series 1993	08/01/93*	1,157,585	142,550	06/2008 to 06/2011	5.50 to 7.00	9,979	68,865	73,685
Series 1995	04/15/95	221,630	49,470	08/2007 to 08/2012	5.30 to 6.25	2,741	11,230	38,240
Series 1997 (B)	11/25/97	100,000	78,500	08/2007 to 08/2027	Variable	251	2,700	75,800
Series 1998	12/25/98	135,185	135,185	12/2011 to 12/2014	5.25	7,097	--	135,185
Series 2001	11/15/01	285,920	137,875	11/2011 to 11/2028	3.80 to 5.50	7,069	--	137,875
Series 2003	04/01/03	381,275	370,030	06/2008 to 06/2023	Variable	16,725	1,205	368,825
Series 2005 (A)	05/04/05	250,000	239,440	07/2007 to 07/2035	3.25 to 5.25	11,860	4,440	235,000
Series 2005 (B)	05/04/05	86,105	83,665	08/2007 to 08/2018	Variable	3,781	390	83,275
Series 2007 (A)	05/04/07	191,440	184,325	08/2007 to 08/2027	4.00 to 5.00	8,736	4,480	179,845
Series 2007 (B)	05/04/07	153,595	153,310	11/2007 to 11/2031	4.00 to 5.00	6,968	200	153,110
Series 2009 (A)	05/21/09	140,000	140,000	01/2017 to 01/2036	5.15 to 5.25	4,457	--	140,000
Pennvest	04/30/00	6,700	781	07/2007 to 04/2019	1.41 to 2.73	20	70	711
<b>Total Revenue Bonds</b>		<b>\$3,109,435</b>	<b>\$1,715,131</b>			<b>79,685</b>	<b>93,580</b>	<b>1,621,551</b>
<b>General Obligation Bonds:</b>								
Pennvest	06/15/93	20,000	3,426	07/2007 to 04/2012	1.00	29	1,198	2,228
<b>Total Bonded Debt</b>			<b>\$ 1,718,557</b>			<b>79,713</b>	<b>94,778</b>	<b>1,623,779</b>

\* Partially Refunded

## ANNUAL BONDED DEBT SERVICE REQUIREMENT: (amounts in thousands)

<u>Fiscal Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>
2010	79,713	94,778	174,492
2011	76,541	100,877	177,418
2012	69,051	107,982	177,033
2013	63,612	115,616	179,228
2014	57,923	121,573	179,496

The First Series through the Thirteenth were refunded.

Capitalized Interest added to Construction in Progress in Fiscal 2009 was \$5,118,408. Interest Expense was reduced by the same amount.

## SUPPLEMENTAL SCHEDULE OF RATE COVENANT COMPLIANCE FOR FISCAL YEAR ENDED JUNE 30, 2009 (Legally Enacted Basis)

(amounts in thousands)

### LINE NO.

	2009
1. Total Revenue and Beginning Fund Balance	\$ 527,509
2. Net Operating Expense	(342,564)
3. Transfer (To) From Rate Stabilization Fund	<u>34,686</u>
<b>4. Net Revenues</b>	<b><u>219,631</u></b>
5. Revenue Bonds Outstanding	(183,026)
6. General Obligation Bonds Outstanding	0
7. Pennvest Loan	<u>(1,227)</u>
<b>8. Total Debt Service</b>	<b><u>(184,253)</u></b>
<b>9. Net Revenue after Debt Service</b>	<b>35,378</b>
10. Transfer to General Fund	(4,185)
11. Transfer to Capital Fund	(17,140)
12. Transfer to Residual Fund	<u>(14,053)</u>
<b>13. Total Transfers</b>	<b><u>(35,378)</u></b>
<b>14. Net Operating Balance for Current Year</b>	<b><u>0</u></b>

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

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

#### Coverage A:

Line 4	<u>\$219,631</u>
/Line 5	<u>\$183,026</u>
<b>= COVERAGE A:</b>	<b>1.20</b>

#### Coverage B:

Line 4	<u>\$219,631</u>
/Line 8 + Line 11	<u>\$201,393</u>
<b>= COVERAGE B:</b>	<b>1.09</b>

#### Coverage C:

Line 4 - Line 3	<u>\$184,945</u>
/Line 5	<u>\$183,026</u>
<b>= COVERAGE C:</b>	<b>1.01</b>

## 1. THE GOVERNMENT OF PHILADELPHIA

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

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

There are two principal governmental entities in Philadelphia: (1) the City of Philadelphia, which performs both the ordinary Municipal functions and the traditional County functions; and (2) the School District of Philadelphia, which is part of the Public Education System of the Commonwealth of Pennsylvania. In addition to the School District of Philadelphia, there are a number of other governmental and quasi-governmental entities operating within the City. The financial statements as set forth herein present only the operations of the City of Philadelphia Water Fund.

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

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

The Philadelphia Water Department serves the Greater Philadelphia region by providing an integrated water, wastewater and stormwater system. The utility's primary mission is to plan for, operate and maintain both the infrastructure and the organization necessary to purvey high quality drinking water, to provide an adequate and reliable water supply for all household, commercial and community needs, and to sustain and enhance the region's watersheds and quality of life by managing wastewater and stormwater effectively. In fulfilling its mission, the utility seeks to be customer-focused, delivering services in a fair, equitable and cost-effective manner, with a commitment to public involvement. Having already served the City and region for nearly two centuries, the utility's commitment for the future includes an active role in the economic development of Greater Philadelphia and a legacy of environmental stewardship.

The Water Revenue Bureau, of the Department of Revenue of the City, gathers and processes meter readings of Water Department customers; issues the invoices for the services provided by the Water Department; and processes the revenue collected for these services, thus maintaining the Accounts Receivable of the Water Department. The Director of Finance performs general fiscal accounting and has overall responsibility for the fiscal administration of all City departments, including the Water Department. The audit requirements for the City, including the Water Department, are the responsibility of the Office of the City Controller. Legal matters affecting the Water Department are the responsibility of the Office of the City Solicitor.

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

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

### A. Basis of Accounting

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

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

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

### B. Legal Compliance

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



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

The operating funds of the City – consisting of the General Fund, five Special Revenue Funds (County Liquid Fuels Tax, Special Gasoline Tax, Hotel Room Rental Tax, Grants Revenue and Community Development Funds) and two Enterprise Funds (Water and Aviation Funds) – are subject to annual operating budgets adopted by City Council.

These budgets appropriate funds for all City departments, boards and commissions by major class of expenditure within each department. Major classes are defined as: personal services; purchase of services; materials and supplies; equipment; contributions; indemnities and taxes; debt service; payments to other funds; and miscellaneous. The appropriation amounts for each fund are supported by revenue estimates and take into account the elimination of accumulated deficits and the reappropriation of accumulated surpluses to the extent necessary. All transfers between major classes (except for materials, 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 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 6/30/09	\$	-
Assets omitted from the legal basis:	\$	38,547
(1) Receivables from Other Governments or Funds		1,726,450
(2) Fixed Assets-Net of Depreciation		494,838
(3) Restricted Assets		37,878
(4) Proprietary Portion of Net Pension Obligation	\$	2,297,713
Liabilities omitted from the legal basis:	\$	(8,224)
(5) Construction Contracts Payable		(121,566)
(6) Other Current Liabilities		(1,580,727)
(7) Bonds Payable and Other Long-Term Debt	\$	(1,710,517)
Fund Balance accounts included in the legal basis:	\$	81,518
(8) Reserve for Collectible Receivables		12,800
(9) Reserve for Inventories		34,382
(10) Reserve for Purchase Commitments	\$	128,700
Equity accounts omitted from the legal basis:		(190,535)
(11) Invested in Capital Assets, Net of Related Debt		(87,404)
(12) Restricted for Capital Projects		(116,075)
(13) Restricted for Debt Service		(147,637)
(14) Restricted for Rate Stabilization	\$	(541,651)
Unrestricted Net Assets – GAAP Basis – 6/30/2009	\$	174,245

## C. Water Account

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

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

## D. Pledge of Revenues

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

## E. Grants from Other Governments

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

## F. Property, Plant and Equipment

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

Capital assets are defined by the City as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of three years.

## G. Depreciation

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

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

#### H. Construction in Progress

Cost of construction includes all direct contract costs plus overhead charges. Overhead costs include direct and indirect engineering costs and interest incurred during the construction period on projects financed with Revenue Bond proceeds. Interest is capitalized by applying the average financing rate during the year to construction costs incurred. Interest earnings on bond proceeds reduce the amount capitalized. Capitalization of interest during construction for Fiscal Year 2009 was \$5,118,408.

#### 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, 2009 are included in accounts receivable. In addition, an amount for services rendered through June 30, 2009, 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. Advance Service Charge

The City's Water Fund Regulations provide for the assessment of an "Advance Service Charge" (ASC) at the time a property is initially connected to the system. The initial charge is calculated to be the equivalent of three monthly service charges. This longstanding practice of assessing an initial charge equivalent to the average of three monthly service charges has been consistent whether the billing period was semi-annually (through 1979), quarterly (1979-1994) or monthly (1994-current). The Fund includes these charges in current revenues at the time they are received. Fund regulations also provide for a refund of any advance service charges upon payment of a \$100 fee and permanent disconnection from the system. During FY09, 423 disconnection permits were issued, resulting in a refund or final credit of approximately \$448,000 and 874 new connection permits were issued resulting in additional advance service charges of approximately \$261,000.

#### M. 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.

#### N. 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.

#### O. 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.

#### P. 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 2009, excess interest earnings of \$4,185,462 were transferred to the General Fund of the City.

### 3. ACCOUNTS RECEIVABLE

#### Balances consisted of the following:

##### FISCAL YEAR ENDED JUNE 30, 2009

##### Accounts Receivable:

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

Total \$ 209,454,395

Bad Debts Written Off \$ 9,115,844

##### ALLOWANCE FOR DOUBTFUL ACCOUNTS:

Billed in the Last Twelve Months	\$ 0
Billed in 15-year Cycle Billing	52,808,871
Penalties on Receivables	24,495,304
<b>Other Receivables</b>	<b>12,541,219</b>

**TOTAL** \$ 89,845,394

##### FISCAL YEAR ENDED JUNE 30, 2008

##### Accounts Receivable:

Billed in the Last Twelve Months	\$ 109,550,126
Billed in 15-year Cycle Billing	41,032,082
Penalties on Receivables	21,214,865
<b>Other Receivables</b>	<b>19,057,443</b>

Total \$ 190,854,516

Bad Debts Written Off \$ 5,783,364

##### ALLOWANCE FOR DOUBTFUL ACCOUNTS:

Billed in the Last Twelve Months	\$ 0
Billed in 15-year Cycle Billing	46,335,612
Penalties on Receivables	21,534,272
<b>Other Receivables</b>	<b>12,474,904</b>

**TOTAL** \$ 80,344,788

### 4. THE TEN LARGEST RETAIL CUSTOMERS OF THE PHILADELPHIA WATER DEPARTMENT DURING FISCAL YEAR 2009

Customer	Billings (millions)	% of total Billings	Consumption (MGD)	% of total Consumption
City of Philadelphia	\$24.232	5.07%	8.99	5.27%
Philadelphia Housing Authority	10.454	2.19	4.02	2.35
Philadelphia School District	6.171	1.29	1.59	0.93
University of Penna.	5.205	1.09	2.49	1.46
Temple University	3.509	0.73	1.63	0.96
Trigen Corporation	2.703	0.57	2.15	1.26
Sunoco	2.602	0.54	3.38	2.07
US Government	2.360	0.49	1.07	0.63
SEPTA	1.733	0.36	0.36	0.21
UPHS	1.263	0.26	0.59	0.34
<b>Total Top Ten</b>	<b>\$ 60.232</b>	<b>12.61%</b>	<b>26.43</b>	<b>15.48%</b>
<b>Total Retail Billings</b>	<b>\$477.815</b>		<b>170.78</b>	

## 5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30, 2009 and 2008 consisted of the following:

Fiscal Years Ended	June 30, 2009	June 30, 2008
Land	\$ 5,919,160	\$ 5,919,160
Buildings and related improvements	1,393,076,406	1,437,250,325
Meters and other improvements	85,927,860	81,306,927
Equipment	68,605,739	64,886,823
Transmission and distribution lines	1,829,743,103	1,748,726,640
Construction in progress	151,517,409	138,705,334
Total	\$ 3,534,789,677	\$ 3,476,795,209
Less: Accumulated Depreciation	(1,808,339,469)	(1,762,759,576)
Total	<u>\$ 1,726,450,208</u>	<u>\$ 1,714,035,633</u>

## 6. IMPAIRED ASSETS

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

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

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

In the summer of 2003, the Water Department began a process to move to an entirely Class A biosolids process, and one that could operate in Philadelphia without odors. It entered into a contract with the engineering consultant firm Camp, Dresser & McKee to assist with procurement of facilities and services for Philadelphia to operate for 20 years the dewatering station, and to construct new facilities to produce Class A biosolids products. Alternative processes identified for this procurement process included fully enclosed composting systems and heat drying technologies. The Request for Qualifications was released in August 2003, and, in response, the City received qualification statements from four teams, of which two were found qualified and invited to receive a Request for Proposals. One team, Philadelphia Biosolids Services, LLC ("PBS") submitted a proposal on November 24, 2004. This team offered to build a pair of sludge dryers. The Water Department has negotiated a long term contract with PBS for improvements to the Biosolids Recycling Center. The contract includes a provision for interim operation of up to five years, during which PBS will take over operation of the existing Biosolids Recycling Center. Within the first three to five years, PBS will finance, design, build, own and operate a thermal drying facility that will handle all of the sludge processed by the Water Department and make a Class A product in the form of pellets that can be used as fertilizer and has potential as a fuel. PBS will be responsible for the disposition of the Class A pellets, thus relieving the Water Department of this burden. The Class A period of operation will last twenty years with a five-year renewal at the option of the Water Department. The project is estimated to result in a savings of approximately \$200 million over the contract life. On June 19, 2008, City Council passed enabling legislation to allow the proposed contract to proceed. Mayor Nutter approved the contract with PBS in October 2008 and PBS has

been operating the facility since October 13, 2008. Total payments for Fiscal Year 2009 were \$14,519,457. The Fiscal Year 2010 proposed budget includes \$24,000,000 for payments to PBS.

As a result of the transfer of operations and the discontinuance of composting operations, a total of \$40.5 million of equipment and facilities were retired. The balance of the equipment and facilities being utilized by the contractor remains on the balance sheet.

## 7. VACATION

Employees are credited with vacation at rates which vary according to length of service. Vacation may be taken or accumulated up to certain limits until paid upon retirement or termination. Employees' vacation time accrued in Fiscal Year 2009 was \$9,598,019 and in 2008 was \$9,678,048. The expense for vacation pay is recognized in the year earned.

## 8. SICK LEAVE

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

## 9. CAPITALIZED LEASES

Leases consist of \$2,652,537 in photocopier and computer equipment in Fiscal 2009. Capital leases are defined by the Financial Accounting Standard Board in Statement 13, *Accounting for Leases*.

## 10. RATE STABILIZATION FUND

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

### During Fiscal 2009, the fund had the following activity:

Balance at July 1, 2008	\$ 183,130,078
Transfer to Operating Fund	(34,686,316)
Interest Earnings	4,704,166
Interest Transferred to Water Operating Fund	(5,511,310)
Balance at June 30, 2009	<u>\$ 147,636,618</u>

## 11. RESIDUAL FUND

The Residual Fund was created with the sale of the Series 1993 Revenue Bonds on August 20, 1993. The purpose of the Fund is to maintain the remaining assets after payment of all operating expenses, payment of all debt service obligations including payments under a swap agreement,



scheduled transfers to the Rate Stabilization Fund, and required deposits to the Capital Account of the Construction Fund.

**During Fiscal 2009, the fund had the following activity:**

Balance at July 1, 2008	\$ 66,559,188
Interest income	1,892,152
Deposit from Operating Fund	18,237,875
Transfer to General Fund	(4,185,463)
Transfer to Capital Projects Fund	(1,179,750)
Balance at June 30, 2009	<u>\$ 81,324,002</u>

Note: Currently \$63,140,250 is reserved for prior year encumbrances. (New River City Project)

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

Pursuant to the Water Department's General Bond Ordinance, the Sinking Fund Reserve provides a reserve against default of the payment of principal and interest on Water Revenue Bonds when due. The balance of the Sinking Fund Reserve at 07/01/2007 was \$174,753,704.

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

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

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

**13. DEFERRED COMPENSATION PLAN**

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

**14. ARBITRAGE REBATE**

The City has issued Water Revenue Bonds subject to federal Arbitrage requirements. Federal tax legislation requires the accumulated net excess of interest income on the proceeds of these issues over interest expense paid on the bonds be paid to the federal government at the end of a five-year period. In Fiscal 2005, \$30,077 was paid. As of June 30, 2005 there was no Arbitrage liability. There was no Arbitrage liability incurred during FY 2006. There was no Arbitrage liability incurred during FY 2007. As of June 30, 2008 there was an Arbitrage liability of \$571,496.00. As of June 30, 2009 there was an Arbitrage liability of \$493,111.00.

**15. 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, \$171.9 million of bonds outstanding was considered defeased.

**Financings**

In September 2008, the outstanding balance of \$78.5 million of City Water & Wastewater Revenue Bonds, Variable Rate Series 1997B, was remarketed under an irrevocable direct-pay letter of credit (LOC) from Bank of America. The LOC replaces a bond insurance policy from Ambac Assurance Corp. and a liquidity facility provided by KBC Bank N.V. pursuant to a standby bond purchase agreement, previously issued with the original issuance of the 1997B bonds. The LOC will constitute both a credit facility and liquidity facility and Bank of America, N.A. a credit provider and liquidity provider. The bonds continue to have a weekly interest rate maturing in 2027.

In May 2009, the City issued Water & Wastewater Revenue Bonds, Series 2009A, in the amount of \$140.0 million. There were serial bonds issued for \$80.4 million, with interest rates ranging from 4.0% to 5.75%, maturing in 2033. Term bonds were issued in the amounts of \$25.3 million and \$34.3 million. The term bonds have an interest rate of 5.25%, maturing in 2032 and 2036 respectively. The proceeds of the bonds will be combined with other available funds of the Water Department and will be used (1) to fund capital improvements to the City's water and wastewater systems, (2) to fund the debt reserve account of the sinking fund and (3) to pay costs of issuance relating to the bonds.

**Subsequent Events**

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

**Future Financings**

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

In addition to the \$215 million of Pennvest Loans described earlier, the Capital Improvement Program provides for the issuance of revenue bonds in the anticipated principal amount (exclusive of original issue discount) of \$180,000,000 near the beginning of Fiscal Year 2011. The emphasis of the Capital Improvement Program is on the renewal and replacement of the water conveyance and sewage collection systems along with improvements to the water and wastewater treatment plants. Additional Revenue bond issues are anticipated during or after Fiscal Year 2011 as necessary to fund the approved capital program. Black & Veatch Corporation has made certain assumptions in its Engineering Report with respect to inflation which are not reflected in the formal Capital Improvement Plan of the Water Department.

An additional New Money bond issue is also scheduled for early Fiscal 2014 in the amount of \$135 million. Another \$350 million issue is planned for Fiscal 2015, but has not yet been authorized.

## Interest Rate

### Notes:

(1) The City received an upfront payment of \$24,989,925.68 for the related swaption. Citigroup exercised its option to enter into the swap on 3/18/2003. Under the swap, the City receives the bond rate or 68.5% of 1-month LIBOR in the event of an Alternative Floating Rate Date.

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

(3) On 2/10/2009, the City amended the effective date on the forward starting swaps from 2/17/2009 to 8/1/2010. This resulted in an upward adjustment in the fixed rate from 4.1184% to 4.52275%.

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

City Entity	Water	Water	Water	Water
Related Bond Series	2003 Refunding	2005 Refunding	2010 Forward (3)	2010 Forward (3)
Initial Notional Amount	\$381,275,000	\$86,105,000	\$90,000,000	\$90,000,000
Current Notational Amount	\$370,030,000	\$83,665,000	\$90,000,000	\$90,000,000
Termination Date	6/15/2023	8/1/2018	1/1/2037	1/1/2037
Product	Fixed Payer Swap (1)	Fixed Payer Swap (2)	Fixed Payer Swap	Fixed Payer Swap
Rate Paid by Dealer	Bond Rate/ 68.5% - 1 month LIBOR	Bond Rate/ 68.5% - 1 month LIBOR	SIFMA	SIFMA
Rate Paid by City Entity	4.52%	4.53%	4.52275%	4.52275%
Dealer	Citigroup Financial Products, Inc.	Citigroup Financial Products, Inc.	Wachovia Bank, N.A.	Merrill Lynch Capital Services, Inc.
Dealer Rating	A3/A (Citigroup, Inc.)	A3/A (Citigroup, Inc.)	Aa2/AA	A2/A (Merrill Lynch & Co.)
Fair Value (4)	(51,305,252)	(12,471,289)	(6,908,919)	(6,908,919)

### City of Philadelphia 2003 Water & Sewer Swap

**Objective:** In December 2002, the City entered into a swaption that provided the City's Water and Sewer Department with an up-front payment of \$25.0 million. As a synthetic refunding of all or a portion of its 1993 Bonds, this payment approximated the present value savings, as of December 2002 of a refunding on March 18 2003, based upon interest rates in effect at the time. The swaption gave Citigroup (formerly Salomon Brothers Holding Company, Inc.), the option to enter into an interest rate swap to receive fixed amounts and pay variable amounts.

**Terms:** Citigroup exercised its option to enter into a swap on March 18, 2003 and the swap commenced on that date. Under the terms of the swap, the City pays a fixed rate of 4.52% and receives a variable payment computed as the actual bond rate or alternatively, 68.5% of one-month LIBOR, in the event the average rate on the Bonds as a percentage of the average of the one-month LIBOR has exceeded 68.5% for a period of more than 180 days. Citigroup exercised its option during this fiscal year to pay 68.5% of one-month LIBOR under the swap. The payments are based on an amortizing notional schedule (with an initial notional amount of \$381.2 million) and when added to an assumption for remarketing, liquidity costs and cost of issuance were expected to approximate the debt service of the refunded bonds at the time the swaption was entered into.

As of June 30, 2009, the swap had a notional amount of \$370.0 million and the associated variable-rate bonds had a \$370.0 million principal amount. The bonds' variable-rate coupons are not based on an index but on remarketing performance. The bonds mature June 15, 2023, and the related swap agreement terminates on June 15, 2023.

**Fair Value:** As of June 30, 2009, the swap had a negative fair value of (\$51.3 million). This means that the City's Water and Sewer Department would have to pay this amount if the swap terminated.

**Risk:** As of June 30, 2009, the City was not exposed to credit risk because the swap had a negative fair value. Should interest rates change and the fair value of the swap become positive, the City would be exposed to credit risk in the amount of

the swap's fair value. Since the City is now receiving 68.5% of one-month LIBOR, the City is exposed to (i) basis risk, as reflected by the relationship between the variable rate bond coupon payments and 68.5% of one month LIBOR received on the swap, and (ii) tax risk, a form of basis risk, where the City is exposed to a potential additional interest cost in the event that changes in the federal tax system or in the marginal tax rates causes the rate paid on the bonds to be greater than the 68.5% of LIBOR received on the swap. The swap includes an additional termination event based on credit ratings. The swap may be terminated by the City if the ratings of Citigroup or its Credit Support Provider, falls below A3 and A-, or by Citigroup if the rating of the City's Water & Wastewater Revenue Bonds falls below A3 or A-. There are 30-day cure periods to these termination events. However, because the City's swap payments are insured by FSA, no termination event based on the City's Water & Wastewater Revenue Bond ratings can occur as long as FSA is rated at least A or A2.

As of June 30, 2009, rates were as follows:

Terms	Rates
Fixed payment to Citigroup under Swap	Fixed 4.52%
Variable payment from Citigroup under Swap	68.5% of 1M LIBOR (0.21149%)
Net interest rate swap payments	4.30851%
Variable rate bond coupon payments	Weekly resets 1.00%
Synthetic interest rate on bonds	5.30851%

**Swap payments and associated debt:** As of June 30, 2009, debt service requirements of the variable-rate debt and net swap payments for their term, assuming current interest rates remain the same, were as follows:

Fiscal Year Ending June 30	Variable Rate Bonds Principal	Interest	Interest Rate Swaps Net	Total Interest
2010	\$ 1,205,000	5,624,456	10,483,653	16,108,109
2011	1,260,000	5,606,140	10,449,513	16,055,653
2012	41,195,000	5,586,988	10,413,815	16,000,803
2013	43,205,000	4,960,824	9,246,682	14,207,506
2014	43,305,000	2,831,650	12,200,192	15,031,842
2015 - 2019	181,315,000	6,700,144	28,867,448	35,567,548
2020 - 2023	56,545,000	1,447,400	6,236,137	7,683,537
	<u>370,030,000</u>	<u>25,307,050</u>	<u>109,035,678</u>	<u>134,342,728</u>

## City of Philadelphia, 2005 Water & Sewer Swap

**Objective:** In December, 2002, the City entered into a swaption that provided the City with an up-front payment of \$4.0 million. As a synthetic refunding of all or a portion of its 1995 Bonds, this payment approximated the present value savings, as of December 2002, of a refunding on May 4, 2005. The swaption gave Citigroup (formerly of Salomon Brothers Holding Company, Inc.), the option to enter into an interest rate swap to receive fixed amounts and pay variable amounts.

**Terms:** Citigroup exercised its option to enter into a swap May 4, 2005, and the swap commenced on that date. Under the terms of the swap, the City pays a fixed rate of 4.53% and receives a variable payment computed as the actual bond rate or alternatively, 68.5% of one month LIBOR, in the event the average rate on the Bonds as a percentage of the average of one month LIBOR has exceeded 68.5% for a period of more than 180 days. Citigroup exercised its option during this fiscal year to pay 68.5% of one month LIBOR under the swap. The payments are based on an amortizing notional schedule (with an initial notional amount of \$86.1 million), and when added to an assumption for 36 remarketing, liquidity costs and cost of issuance were expected to approximate the debt service of the refunded bonds at the time the swaption was entered into.

As of June 30, 2009, the swap had a notional amount of \$83.7 million and the associated variable-rate bond had an \$83.7 million principal amount. The bonds' variable-rate coupons are not based on an index but on remarketing performance. The bonds mature on August 1, 2018 and the related swap agreement terminates on August 1, 2018.

**Fair value:** As of June 30, 2009, the swap had a negative fair value of (\$12.5 million). This means that the Water Department would have to pay this amount if the swap terminated.

**Risk:** As of June 30, 2009, the City is not exposed to credit risk because the swap had a negative fair value. Should interest rates change and the fair value of the swap become positive, the City would be exposed to credit risk in the amount of the swap's fair value.

Since the City is now receiving 68.5% of one month LIBOR, the City is exposed to (i) basis risk, as reflected by the relationship between the variable-rate bond coupon payments and 68.5% of one month LIBOR received on the swap, and (ii) tax risk, a form of basis risk, where the City is exposed to a potential additional interest cost in the event that changes in the federal tax system or in marginal tax rates cause the rate paid on the outstanding bonds to be greater than the 68.5% of LIBOR received on the swap. The swap includes an additional termination event based on credit ratings. The swap may be terminated by the City if the ratings of Citigroup or its Credit Support Provider fall below A3 and A-, or by Citigroup if the rating of the City's water and wastewater revenue bonds falls below A3 or A-. There are 30-day cure periods to these termination events.

However, because the City's swap payments are insured by FSA, no termination event based on the City's water and wastewater revenue bond ratings can occur as long as FSA is rated at least A or A2.

Terms	Rates	
Fixed payment to Citigroup under Swap	Fixed	4.53%
Variable payment from Citigroup under Swap	68.5% of 1M LIBOR	(0.21149%)
Net interest rate swap payments		4.31851%
Variable rate bond coupon payments	Weekly resets	6.00%
Synthetic interest rate on bonds		10.31851%

Swap payments and associated debt: As of June 30, 2009, debt service requirements of the variable-rate debt and net swap payments for their term, assuming current interest rates remain the same, were as follows:

Fiscal Year Ending June 30	Variable Rate Bonds Principal	Interest	Interest Rate Swaps Net	Total Interest
2010	\$ 390,000	\$ 5,019,900	\$ 3,613,081	\$ 8,632,981
2011	405,000	4,996,500	3,596,239	8,592,739
2012	425,000	4,972,200	3,578,749	8,550,949
2013	450,000	4,946,700	3,560,396	8,507,096
2014	14,820,000	4,919,700	3,540,962	8,460,662
2015-2019	<u>67,175,000</u>	<u>10,349,100</u>	<u>7,448,782</u>	<u>17,797,882</u>
	<u>\$83,665,000</u>	<u>\$ 35,204,100</u>	<u>\$25,338,209</u>	<u>\$60,542,309</u>

## City of Philadelphia Forward-Starting Water & Wastewater Swaps

**Objective:** In February, 2007, the City entered into two forward starting swaps to take advantage of the current low interest rate environment in advance of the issuance of water and wastewater revenue bonds expected to be issued by the City in 2008.

**Terms:** The notional amount was evenly split between two counterparties, Merrill Lynch Capital Services, Inc. and Wachovia Bank, N.A. Both swap confirmations were amended in December, 2007, to move the swap start date from February, 2008, to February, 2009, as the bond issuance had been delayed. In February 2009, both swap confirmations were amended again to move the swap start date from February 2009 to August 2010, as the bond issuance had been delayed. The termination date is the same for both swaps and is January, 2037. The swaps were priced based on an amortizing notional schedule with a combined \$180.0 million initial notional amount. Under the swaps, the City will pay a fixed rate of 4.52275% and will receive a variable rate equal to the SIFMA Municipal Swap Index.

**Fair value:** As of June 30, 2009, the swap taken together had a negative fair value of (\$13.8 million). This means that the Water and Sewer Department would have to pay this amount to terminate these swaps.

**Risk:** As of June 30, 2009, the City is not exposed to credit risk because the swaps had a negative fair value. Should interest rates change and the fair value of the swap become positive, the City would be exposed to credit risk in the amount of the swap's fair value. The City is subject to traditional basis risk should the relationship between SIFMA and the bonds change, if SIFMA resets at a rate below the variable-rate bond coupon payments, the synthetic interest rate on the bonds will increase. The swaps include additional termination events based on credit ratings. The swaps may be terminated by the City if Merrill Lynch's guarantor (Merrill Lynch & Co.) or Wachovia fails to have a rating of at least Baa2 or higher or BBB or higher, or by Merrill Lynch or Wachovia if the City fails to have a rating of at least Baa2 or higher or BBB or higher.

## 16. BOND RATING UPDATE OF MAY 2009

Moody's Investors Service has assigned the A3 underlying rating and stable outlook to the City of Philadelphia's \$145 million Water and Wastewater Revenue Bonds, Series 2009. The A3 underlying rating reflects the system's strong management, improved financial operations, significant cash balances in the Rate Stabilization Fund, ongoing improvements addressing environmental concerns and an above average debt position.

Although conservative projections show that management may draw on the Rate Stabilization Fund over the next several years to meet the 1.2x net revenue coverage mandated by the rate covenant, recent improvements to financial operations, as well as anticipated ongoing rate increases, will likely mitigate the dependence on this fund. The closed-loop system is effectively segregated financially from the City's general funds and accounts, with a daily sweep of customer revenues to a third party fiscal agent. In addition, a moderate portion of revenues is related to wholesale services provided under contract to various suburban communities outside of the City.



Standard & Poor's Ratings Services assigned its 'A' long-term rating and stable outlook to Philadelphia, PA's Series 2009 Water and Wastewater Revenue bonds and affirmed its 'A' long-term rating and underlying rating (SPUR), with a stable outlook, on the City's existing water and wastewater revenue debt.

In our opinion, positive credit factors include:

- Despite the reliance on rate stabilization support, financial performance has been stable. With the rate stabilization funds, coverage of senior-lien debt service is adequate at 1.20x with 1.08x coverage of revenue debt and transfers into the general, capital, and residual funds.
- Rates, which are currently low, should rise to only moderate levels due to a rate increase that took effect in November 2008. The last rate increase of 3.8% was effective July 1, 2007; and rate increases are expected to range between 5.0% and 10.0% over each of the next five years. Such increases are necessary to allow the maintenance of coverage as rate stabilization funds should continue to be drawn on.
- The well-experienced management team continues to emphasize, and is achieving, improved system maintenance, stronger collections and more comprehensive fiscal monitoring systems.
- Although still below average, collections have continued to improve, resulting in a decline in the significant level of receivables, bad debt write-offs, and service shutoffs for fiscal 2007. In our opinion, despite these positive credit factors, the rating remains restrained by:
  - The City's continued reliance on rate stabilization fund support – projected to continue to be drawn on over forecast period 2009 through 2014 - to meet covenanted coverage, though fiscal 2007 closed out reporting an increase of this fund by nearly \$26 million;
  - The overall service area economy of the City characterized by weak demographic trends, which include a long-term population decline, resulting in overcapacity within the water system;
  - A sizable capital program for the system, totaling \$986 million for fiscals 2009 through 2014; and
  - A highly leveraged system with a debt-to-plant ratio of 88%, which we consider high – this, however, represents a decline from 109% in 2005.

#### CITY OF PHILADELPHIA'S (WATER) BOND RATINGS

YEAR	MOODY'S INVESTOR'S SERVICE	STANDARD & POOR'S CORP	FITCH ICBA
2009	A3	A	A-
2008	A3	A	A-
2007	A3	A-	A-
2006	A3	A-	A-
2005	A3	A-	A-
2004	A3	A-	A-
2003	A3	A-	A-
2002	A3	A-	A-
2001	A3	A-	A-
2000	Baa1	BBB+	A-
1998	Baa1	BBB+	BBB+
1997	Baa1	BBB	BBB+
1995	Baa	BBB	BBB+
1993	Baa	BBB-	BBB
1991	B	BBB	BBB
1990	Baa	BBB	
1974	A	A	

## 17. 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 who reach retirement age may accumulate their monthly service retirement benefit in an interest bearing account at the Board of Pensions for up to four years and continue to be employed by the City of Philadelphia.

#### Death Benefits

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

#### Disability Benefits

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

#### Membership

Membership in the plan as of July 1, 2009 was as follows:

Retirees and beneficiaries currently receiving benefits	35,405
Terminated members entitled to benefits but not yet receiving them	1,263
Active Members	29,215
Total Members	<u>65,883</u>

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

### (b) Funding Policy

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

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

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

Under the City's current funding policy, the total required employer contribution for the current year amounted to \$524.1 million or 35.4 % of covered payroll of \$1,462.5 million. The City's actual contribution was \$440.0 million. The City's contribution met 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:

(Amounts in Millions of USD)

Fiscal Year Ended June 30	Annual Pension Cost	Percentage Contributed	Net Pension Obligation
2007	556.3	75.36%	(680.5)
2008	561.0	76.10%	(559.5)
2009	559.0	81.47%	(456.0)

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

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

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

### (c) Annual Pension Cost and Net Pension Obligation

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

(Amounts in Thousands of USD)

Annual Required Contribution (ARC)	539,464
Interest on Net Pension Obligation (NPO)	(48,957)
Adjustment to ARC	68,399
Annual Pension Cost	558,906
Contributions Made	(455,389)
Increase in NPO	103,517
NPO at beginning of year *	(559,505)
NPO at end of year	(455,988)
Interest Rate	8.75%
15 Year Amortization Factor (EOY)	8.18%

### (d) Summary of Significant Accounting Policies

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

## 18. OTHER POST EMPLOYMENT BENEFITS (OPEB)

### Primary Government

**Plan description:** The City of Philadelphia provides health care for five years subsequent to separation for eligible retirees. Certain union represented employees may defer their coverage until a later date but the amount that the City pays for their health care is limited to the amount that the City would have paid at the date of their retirement. The City also provides lifetime insurance coverage for all eligible retirees. Firefighters are entitled to \$7,500 coverage and all other employees receive \$6,000 in coverage.

**Funding Policy:** The City funds its retiree benefits on a pay-as-you-go basis. To provide health care coverage, the City pays a negotiated monthly premium for retirees covered by union contracts or pays the health care providers directly for non unionized employees. For Fiscal Year 2009, the City paid \$76.6 million for retiree healthcare.

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

The following table shows the components of the City's annual OPEB cost for the year, the amount actually contributed to the plan and changes in the net OPEB obligation (dollar amount in thousands).

Annual required contribution	98,697
Interest on Net OPEB obligation	183
Adjustment to ARC	(147)
Annual OPEB cost	98,733
Payments made	(81,251)
Net OPEB obligation – beginning of year	3,668
Net OPEB obligation – end of year	21,150

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

**Actuarial Methods and Assumptions:** Costs were determined according to the individual entry age actuarial cost method with the attribution period ending at each decrement age. This is consistent with the cost method used for the City of Philadelphia Municipal Retirement System. Unfunded liabilities are funded over a 30 year period as a level percentage of payroll, which is assumed to increase at a compound annual rate of 4% per year. The actuarial assumption included a 3.5% compound annual interest rate on the City's general investments.

## 19. 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 \$2.8 million.

In addition to the above, there are other lawsuits against the Water Department in which some amount of loss is reasonably possible. The aggregate estimate of the loss, which could result if unfavorable legal determinations were rendered against the Water Department with respect to these lawsuits, is \$4.5 million.

## 20. ENHANCED SECURITY

In light of the events of September 11, 2001, when terrorists struck the United States, the Water Department took steps to improve the security of the City's water supply and all other major Water Department facilities and assets. These steps were taken in close coordination with the City's Managing Director's Office and all other appropriate City agencies and departments. The Water Department is a representative agency in the City of Philadelphia Emergency Operations Center (EOC). The EOC is designed to permit City emergency personnel to respond quickly to any major event through specialized computer and communications equipment, including a backup 911 system. This center can accommodate around-the-clock staffing by officials from the Police, Fire, Health, and Water Departments and additional City agencies. The Water Department remains in contact with Federal, State, and local law enforcement and emergency personnel and has performed a vulnerability analysis of its entire potable water system. The work was primarily funded by the EPA and the Water Department delivered its report to the EPA on March 31, 2003. Details of the enhanced security measures already taken and those presently under consideration cannot be disclosed.

It should be noted that the Water Department had an extensive water quality protection and security plan in place prior to the events of September 11, 2001. All finished water basins are completely covered; all plants are fenced in and topped by barbed wire; gates are secured; video surveillance equipment has been installed; and the Water Department continues to draw and conduct nearly one thousand tests on water samples from various locations each day. Municipal Guards were assigned to the main entrance at each water plant in 2002 to control access to the facility to only authorized persons and/or deliveries. Online water quality monitors provide continuous testing of all stages of the treatment process.

To further ensure the safety and quality of the City's drinking water, the Water Department will continue to expand its network to continuously monitor water quality using online instrumentation. The system provides the Department with the ability to track real-time water quality conditions at selected locations throughout the City's water distribution system and to monitor any variations should they occur. Water quality data is currently transmitted from twelve monitoring sites to the Water Department's central laboratory where technicians check for early warning signs of water quality deterioration and document any unforeseen changes. The Water Treatment Plants have online instrument clusters at multiple raw and finished water locations. These monitors will also be connected to the distribution systems monitoring network. The Water Department plans to assess the performance of the monitoring system at the current locations while continuing to investigate alternative technology for further installations at wholesale customer interconnects, pumping stations and other critical points in the distribution system. Recently, the US EPA awarded a grant to the Water Department to install a Contamination Warning System in Philadelphia's distribution system as part of its Water Security initiative program. Philadelphia, New York, San Francisco and Dallas were the cities selected for this research pilot program. The Project included total costs of \$12,599,846. On November 21, 2008, the Department was notified that appropriations for the initial phase of the project totaling \$2,677,963 were approved. The initial phase included \$2.0 million in Federal funds and \$677,963 in local share.

The City of Philadelphia recently received a grant to design and install Emergency Backup Power generation at key facilities. The Water Department's treatment and finished water pumping stations were included. The Belmont High Service Pumping Station was targeted as the initial site for Back-up Power and the generator has been installed. In Fiscal Year 2007, the Water Department began work on an Emergency Back-up Power generation for the Belmont Water Treatment Plant, East Oak Lane Reservoir Pump Station and Fox Chase Booster Pumping Station. The remainder of the Water Department facilities are scheduled for design and construction over the next seven fiscal years, with the final facility being in-service in 2013.







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Mayor

**Honorable Anna C. Verna**  
President of City Council

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Managing Director

**Rob Dubow**  
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## Philadelphia Water Department

