

New York City Water and Sewer System

(A Component Unit of The City of New York)

Financial Statements as of and for the
Years Ended June 30, 2009 and 2008, and
Independent Auditors' Report

NEW YORK CITY WATER AND SEWER SYSTEM

TABLE OF CONTENTS

| | Page |
|---|-------------|
| INDEPENDENT AUDITORS' REPORT | 1 |
| MANAGEMENT'S DISCUSSION AND ANALYSIS | 2-8 |
| FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008: | |
| Combining Balance Sheets | 9-12 |
| Combining Statements of Revenues, Expenses and Changes in Net Assets | 13-14 |
| Combining Statements of Cash Flows | 15-18 |
| Notes to Financial Statements | 19-42 |

INDEPENDENT AUDITORS' REPORT

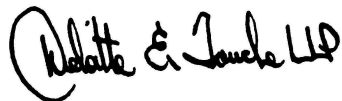
To the Audit Committees of
New York City Municipal Water Finance Authority
And the New York City Water Board

We have audited the accompanying combining balance sheets of the business-type activities of the New York City Municipal Water Finance Authority and the New York City Water Board, which collectively comprise the New York City Water and Sewer System (the "System"), a component unit of the City of New York, New York, as of June 30, 2009 and 2008, and the related combining statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the respective financial position of the business-type activities of the New York City Municipal Water Finance Authority and the New York City Water Board of the System as of June 30, 2009 and 2008, and the respective changes in their net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. As discussed in Note 2 to the financial statements, in 2009 the System changed its method of accounting for pollution remediation obligations to conform to Governmental Accounting Standards Board ("GASB") Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*.

The accompanying management's discussion and analysis (MD&A) on pages 2-8 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the System's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information, and we do not express an opinion on it.



October 9, 2009

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview of the Financial Statements

The following is an overview of the financial activities of the New York City Water and Sewer System (the "System") for the fiscal years ended June 30, 2009 and 2008. The System is a joint operation consisting of two legally separate and independent entities, the New York City Municipal Water Finance Authority (the "Authority") and the New York City Water Board (the "Board"). The System is a component unit of The City of New York (the "City").

The basic financial statements of the System, which include the balance sheets, the statements of revenues, expenses and changes in net assets and the statements of cash flows, are presented for the purposes of displaying entity-wide information, in accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as amended. These financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting.

Financial Analysis and Results of Operations

The following summarizes the activities of the System for the fiscal years 2009, 2008 and 2007 (in thousands):

| | 2009 | 2008 | 2007 | Variance | |
|--|------------|--------------|--------------|--------------|--------------|
| | | | | 2009 v 2008 | 2008 v 2007 |
| REVENUES: | | | | | |
| Water supply and distribution | \$ 920,033 | \$ 784,856 | \$ 796,404 | \$ 135,177 | \$ (11,548) |
| Sewer collection and treatment | 1,430,588 | 1,220,653 | 1,238,612 | 209,935 | (17,959) |
| Other operating revenues | 97,946 | 97,778 | 98,061 | 168 | (283) |
| Total operating revenues | 2,448,567 | 2,103,287 | 2,133,077 | 345,280 | (29,790) |
| Subsidy income | 108,708 | 104,234 | 90,601 | 4,474 | 13,633 |
| Investment income | 99,122 | 108,892 | 98,132 | (9,770) | 10,760 |
| Total revenues | 2,656,397 | 2,316,413 | 2,321,810 | 339,984 | (5,397) |
| EXPENSES: | | | | | |
| Operations and maintenance | 1,448,268 | 1,320,439 | 1,147,157 | 127,829 | 173,282 |
| Bad debt expense | 36,060 | - | 226,028 | 36,060 | (226,028) |
| Administration and general | 50,581 | 44,027 | 35,493 | 6,554 | 8,534 |
| Depreciation and amortization | 696,345 | 646,377 | 579,860 | 49,968 | 66,517 |
| Capital distribution | 51,921 | 24,619 | 33,133 | 27,302 | (8,514) |
| Loss on retirement of capital assets | 299,450 | 14,598 | 23,257 | 284,852 | (8,659) |
| Interest expense | 929,333 | 834,085 | 771,656 | 95,248 | 62,429 |
| Total expenses | 3,511,958 | 2,884,145 | 2,816,584 | 627,813 | 67,561 |
| Net loss before capital contributions | (855,561) | (567,732) | (494,774) | (287,829) | (72,958) |
| CAPITAL CONTRIBUTIONS | 11,529 | 7,340 | 12,357 | 4,189 | (5,017) |
| CHANGE IN NET ASSETS | (844,032) | (560,392) | (482,417) | (283,640) | (77,975) |
| NET ASSETS — Beginning | 1,165,891 | 1,726,283 | 2,899,381 | (560,392) | (1,173,098) |
| Restatement of beginning net assets (note 2) | (61,608) | - | (690,681) | (61,608) | 690,681 |
| NET ASSETS — Ending | \$ 260,251 | \$ 1,165,891 | \$ 1,726,283 | \$ (905,640) | \$ (560,392) |

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating Revenue

2009–2008

Operating revenues increased by 16.4% primarily due to a rate increase of 14.5%

2008–2007

Operating revenues decreased by 1.4% on a rate increase of 11.5%. The System changed the method for the recognition of bad debt expense and the allowance for doubtful accounts in Fiscal 2008. This change resulted in a decrease in revenue although there was an increase in cash receipts in Fiscal 2008 compared to Fiscal 2007.

The following summarizes other operating revenues for Fiscal 2009, 2008, and 2007 (in thousands):

| | 2009 | 2008 | 2007 | Variance | |
|---|------------------|------------------|------------------|---------------|-----------------|
| | | | | 2009 v 2008 | 2008 v 2007 |
| Upstate water fees | \$ 42,197 | \$ 45,978 | \$ 42,197 | \$ (3,781) | \$ 3,781 |
| Late payment fees | 18,708 | 24,261 | 43,286 | (5,553) | (19,025) |
| Change in residual interest in sold liens | 21,681 | 16,896 | - | 4,785 | 16,896 |
| Connection fees and permits | <u>15,360</u> | <u>10,643</u> | <u>12,578</u> | <u>4,717</u> | <u>(1,935)</u> |
| Total other operating revenues | <u>\$ 97,946</u> | <u>\$ 97,778</u> | <u>\$ 98,061</u> | <u>\$ 168</u> | <u>\$ (283)</u> |

2009–2008

Overall, other operating revenues remained level for Fiscal 2009. Late payments fees decreased by \$5.5 million or 23%. The residual interest in sold liens increased because as of June 30, 2009 the tax lien trust which received water and sewer liens from the Board in Fiscal 2009 had not yet issued bonds or made payment to the Board for those liens.

2008–2007

Other operating revenues remained relatively level for Fiscal 2008. Late payments fees decreased by \$19 million or 44% due to forgiveness of these charges related to leaks and due to a payment incentive program which allowed reduced fees for payment of outstanding receivables.

The System implemented Government Accounting Standards Board (“GASB”) Statement No. 48 (“GASB 48”) *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* in Fiscal 2008, which resulted in the recording of a miscellaneous revenue and an asset, residual interest in sold liens, of \$16.9 million. This represents the estimated amount, as of June 30, 2008, to be received by the Board for tax liens secured by water and sewer rents and surcharges which have been sold by the City to one or more trusts, if and when liens held by the trusts generate cash flows to the trusts above the amounts needed by the trusts to pay their bondholders and satisfy reserve requirements.

Investment Income

2009–2008

Investment income decreased by \$9.8 million or 9%. The decrease was due to lower interest rates on invested assets.

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

2008-2007

Investment income increased by \$10.7 million or 11%. The increase was due to the recognition of \$18 million of unrealized gains in the fair value of forward purchase agreements offset by decreases in income earned on escrow balances of \$6 million.

Operating Expenses

2009-2008

The System has implemented GASB Statement 49, (GASB 49) *Accounting and Financial Reporting for Pollution Remediation Obligations* requiring the reporting of pollution remediation obligations ("PROs"). As of June 30, 2009, the System reported \$119 million of liabilities for known PROs and has restated its fiscal year 2009 beginning net assets (as disclosed in note 2) to reflect a June 30, 2008 liability of \$61.6 million for known PROs.

Total operations and maintenance expenses increased by \$127.8 million or 10%. An expense of \$132.7 million for pollution remediation, recognized for the first time in Fiscal 2009 due to the implementation of GASB 49, was partially offset by a decrease in judgments and claims. Fringe benefits increased by \$27 million, reflecting the increased cost of employee benefits for City workers which is a component of the operations and maintenance cost paid by the System.

Bad debt expense increased by \$36 million due to increased estimated customer delinquencies.

2008-2007

Total operation and maintenance expenses increased by \$173.3 million or 15%. Fringe benefits increased by \$37 million reflecting the increased cost of employee benefits for City workers which is a component of the operations and maintenance cost paid by the System.

Bad debt expense decreased by \$226 million. As discussed above, the System changed the method by which it recognized bad debts expense in Fiscal 2008.

Non-operating Expenses

2009-2008

The System recognized \$299 million of losses on retirement of fixed assets that were disposed of or taken out of service as of June 30, 2009.

Interest expense increased by \$95 million or 11% due primarily to an increase in bonds outstanding of \$2.6 billion or 14%.

2008-2007

Interest expense increased by \$62.4 million or 8% due primarily to an increase in bonds outstanding of \$1.9 billion or 11%.

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Following is a summary of the System's assets, liabilities and net assets as of June 30, (in thousands):

| | 2009 | 2008 | 2007 | Variance | |
|--|---------------------|---------------------|---------------------|---------------------|--------------------|
| | | | | 2009 v 2008 | 2008 v 2007 |
| Current Assets | \$ 2,388,478 | \$ 2,091,480 | \$ 2,075,754 | \$ 296,998 | \$ 15,726 |
| Residual Interest in Sold Liens | 38,578 | 16,896 | - | 21,682 | 16,896 |
| Deferred Bond and Financing Expenses | 152,516 | 137,508 | 134,673 | 15,008 | 2,835 |
| Capital Assets | <u>21,139,238</u> | <u>19,347,150</u> | <u>17,745,015</u> | <u>1,792,088</u> | <u>1,602,135</u> |
| Total Assets | <u>\$23,718,810</u> | <u>\$21,593,034</u> | <u>\$19,955,442</u> | <u>\$ 2,125,776</u> | <u>\$1,637,592</u> |
| Long-Term Liabilities | \$21,421,197 | \$18,668,449 | \$16,691,440 | \$ 2,752,748 | \$1,977,009 |
| Current Liabilities | <u>2,037,362</u> | <u>1,758,694</u> | <u>1,537,719</u> | <u>278,668</u> | <u>220,975</u> |
| Total liabilities | <u>23,458,559</u> | <u>20,427,143</u> | <u>18,229,159</u> | <u>3,031,416</u> | <u>2,197,984</u> |
| Net Assets: | | | | | |
| Invested in capital assets — net of related debt | 1,253,882 | 1,737,181 | 2,056,879 | (483,299) | (319,698) |
| Restricted for debt service | 285,348 | 209,130 | 161,661 | 76,218 | 47,469 |
| Restricted for operations and maintenance | 195,844 | 200,438 | 175,161 | (4,594) | 25,277 |
| Unrestricted (deficit) | <u>(1,474,823)</u> | <u>(980,858)</u> | <u>(667,418)</u> | <u>(493,965)</u> | <u>(313,440)</u> |
| Total net assets | <u>260,251</u> | <u>1,165,891</u> | <u>1,726,283</u> | <u>(905,640)</u> | <u>(560,392)</u> |
| Total Liabilities and Net Assets | <u>\$23,718,810</u> | <u>\$21,593,034</u> | <u>\$19,955,442</u> | <u>\$ 2,125,776</u> | <u>\$1,637,592</u> |

2009–2008

Current assets increased by \$297 million or 14%. Investments including cash equivalents increased by \$253 million primarily in the construction and revenue funds, due to the timing of bond issuances and payments to the City for capital costs. Net receivables increased by \$51.5 million.

The residual interest in sold liens increased by \$22 million, as discussed above.

Long term liabilities increased by \$2.7 billion due to the increase in bonds payable of \$2.6 billion and the pollution remediation obligation of \$119 million, as discussed above.

Current liabilities increased by \$279 million or 16% primarily due to an increase in the amount payable to the City for capital costs.

2008–2007

Current assets have remained relatively level.

As discussed above, the implementation of GASB 48 in Fiscal 2008 resulted in the recording of a residual interest in sold liens of \$16.9 million.

Long term liabilities increased by \$2 billion primarily due to the increase in bonds payable of \$1.9 billion.

Current liabilities increased by \$221 million or 14% primarily due to an increase in the amount payable to the City for capital costs.

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Capital Assets

The System's capital assets include buildings, equipment, water treatment systems and water collection systems. Capital assets as of June 30, are detailed as follows (in thousands):

| | 2009 | 2008 | 2007 | Variance | |
|--|------------------|------------------|---------------------|---------------------------|--------------|
| | | | | 2009 v 2008 | 2008 v 2007 |
| Utility plant under construction | \$ 5,072,496 | \$ 4,011,216 | \$ 4,338,126 | \$ 1,061,280 | \$ (326,910) |
| Buildings | 24,193 | 23,493 | 23,493 | 700 | - |
| Equipment | 1,362,215 | 953,311 | 629,384 | 408,904 | 323,927 |
| Water supply and wastewater treatment systems | 14,382,431 | 13,629,051 | 11,865,211 | 753,380 | 1,763,840 |
| Water distribution and sewage collection systems | 8,334,620 | 8,408,040 | 8,014,647 | (73,420) | 393,393 |
| Total utility plant in service | 24,103,459 | 23,013,895 | 20,532,735 | 1,089,564 | 2,481,160 |
| Less accumulated depreciation | 8,036,717 | 7,677,961 | 7,125,846 | 358,756 | 552,115 |
| Total — net utility plant in service | 16,066,742 | 15,335,934 | 13,406,889 | 730,808 | 1,929,045 |
| Total capital assets | \$21,139,238 | \$19,347,150 | \$17,745,015 | \$ 1,792,088 | \$1,602,135 |
| | <u>Buildings</u> | <u>Equipment</u> | <u>Water Supply</u> | <u>Water Distribution</u> | <u>Total</u> |
| Accumulated depreciation | 16,138 | 592,785 | 4,701,459 | 2,726,335 | 8,036,717 |

The net increase in the System's capital assets during Fiscal 2009 was \$1.8 billion or 9%. Net capital asset additions for Fiscal 2009 were \$2.1 billion.

The net increase in the System's capital assets during Fiscal 2008 was \$ 1.6 billion or 9%. Net capital asset additions for Fiscal 2008 were \$2.2 billion.

Debt Administration

The Authority issues debt to pay for the capital improvements to the System and certain related costs. The debt program of the Authority includes commercial paper and long-term debt of the Authority and subsidized bonds issued through the New York State Environmental Facilities Corporation ("EFC"). The commercial paper program is the main source of financing to reimburse the City for payments made for water and sewer projects. The Authority then issues long-term debt of its own or through EFC to retire outstanding commercial paper. The Authority also periodically issues refunding bonds to refinance higher-coupon debt.

At June 30, 2009, the total outstanding debt of the System was \$22.5 billion, of which \$700 million was commercial paper. The remaining \$21.8 billion consisted of variable and fixed-rate bonds and notes maturing in varying installments through 2040. The total outstanding long-term debt at June 30, 2009 was as follows (in thousands):

| Issue Date | |
|----------------------|---------------------|
| 2009 | \$ 3,503,375 |
| 2008 | 2,900,689 |
| 2007 | 2,167,547 |
| 2006 | 2,532,130 |
| 2005 | 2,749,742 |
| 2004 and prior | 7,981,314 |
| Total long-term debt | <u>\$21,834,797</u> |

In the summary above, bonds retired through refundings in Fiscal 2009 are removed from the year in which the refunded bonds were issued and the refunding bonds are included in the Fiscal 2009 amount.

In Fiscal 2009, the Authority issued \$3.1 billion of water and sewer revenue bonds directly to the public, including \$612.3 million of refunding bonds and \$2.4 billion of new money bonds. The Authority also issued

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

\$448.4 million of Clean Water and Drinking Water State Revolving Fund (“SRF”) bonds to EFC which were issued for new money purposes. The new money bond proceeds were used to finance capital improvements to the water and sewer system as well as to provide long-term financing of commercial paper notes which had previously financed capital improvements to the system.

On July 23, 2008, the Authority issued \$334.1 million of tax-exempt fixed-rate Water and Sewer System Second General Resolution Bonds, Fiscal 2009 Series AA bonds to refund its Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 2008 Series CC-1, Fiscal 2008 Series CC-2, Fiscal 2008 Series CC-3 and Fiscal 2008 Series CC-4. The 2008 Series CC bonds were issued as adjustable rate bonds in the auction rate mode and were insured by MBIA Insurance Corporation at the time of their initial offering. The Authority executed this transaction in response to constrained liquidity in the auction rate market, precipitated by credit downgrades of several financial guarantors, including MBIA, which led to a substantial rise in interest rates for these bonds. The Fiscal 2009 Series AA bonds included serial bonds maturing 2013 through 2022.

On August 7, 2008, the Authority closed its first new money offerings of Fiscal 2009. The Authority issued \$200.9 million of tax-exempt, adjustable rate Water and Sewer System Second General Resolution Bonds, Fiscal 2009 Series BB-1 and BB-2 bonds. Bond proceeds were used to defease the Authority’s commercial paper notes Series 1 notes and to pay the costs of issuance of the bonds. Liquidity support for the Fiscal 2009 Series BB-1 and BB-2 bonds is provided through a standby bond purchase agreement with Landesbank Hessen-Thüringen Girozentrale. The Series BB-1 and BB-2 adjustable rate bonds are remarketed by Citi and Morgan Stanley, respectively.

The Authority also issued \$150 million of tax-exempt, fixed rate Fiscal 2009 Series CC bonds under the Authority’s second general resolution on August 7, 2008. The Fiscal 2009 Series CC bonds included term bonds maturing 2029, 2030 and 2034. Bond proceeds were used to defease a portion of the Authority’s commercial paper notes Series 7 and to pay the costs of issuance of the bonds.

On October 29, 2008, the Authority issued \$536 million of tax-exempt, fixed rate Water and Sewer System Revenue Bonds Fiscal 2009 Series A bonds under the Authority’s general (first) resolution. This bond issue included serial bonds maturing 2017 through 2024 and term bonds maturing 2040. Bond proceeds were used to pay costs for improvements to the water and sewer system, pay for cost of issuance of the bonds and fund certain reserves.

On December 11, 2008, the Authority issued \$325.6 million of tax-exempt, fixed rate Water and Sewer System Second General Resolution Bonds Fiscal 2009 Series DD bonds. This bond issue included serial bonds maturing 2023 through 2028 and term bonds maturing in 2035 and 2040. Bond proceeds were used to defease a portion of the Authority’s commercial paper notes Series 7, pay costs for improvements to the water and sewer system and to pay the costs of issuance of the bonds.

On January 29, 2009, the Authority issued \$645.5 million of tax-exempt, fixed rate Water and Sewer System Second General Resolution Bonds Fiscal 2009 Series EE bonds. The purpose of the issue was to fund costs of improvements to the water and sewer system and pay costs of issuance of the bonds. A portion of the issue was also used to refund the Authority’s outstanding Adjustable Rate Fiscal 2003 Series C-1 and C-2 adjustable rate bonds. The refunding was undertaken in response to the deteriorating credit quality of the bank providing liquidity support on the 2003 C bonds, which caused a substantial rise in interest rates on the bonds. The structure of the issue included serial bonds maturing 2014 through 2018 and term bonds maturing 2039 and 2040.

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

On February 26, 2009, the Authority issued \$362.8 million of tax-exempt, fixed rate Water and Sewer System Second General Resolution Bonds Fiscal 2009 Series FF-1 and FF-2 bonds. The Series FF-1 bonds were issued to refund the Authority's Adjustable Rate Fiscal 2003 Series C-3 bonds in response to the deteriorating credit quality of the bank providing liquidity support on the bonds. The purpose of the Series FF-2 issue was to fund costs of improvements to the water and sewer system, defease the Authority's outstanding commercial paper notes Series 6 and pay costs of issuance of the bonds. The Series FF-1 issue included serial bonds maturing 2014 through 2018. The Series FF-2 issue included term bonds maturing 2040.

On June 17, 2009, the Authority issued \$500 million of tax-exempt, fixed rate Water and Sewer System Second General Resolution Bonds Fiscal 2009 Series GG-1 and GG-2. The Series GG-1 bonds were issued to defease the Authority's outstanding commercial paper notes Series 1 and a portion of its Series 7 notes and to pay for certain costs of issuance. This issue included serial bonds maturing 2024 through 2032 and term bonds maturing 2039. The Series GG-2 bonds included term bonds maturing 2035 and 2040 and were issued to pay costs of improvements to the water and sewer system and to pay certain costs of issuance.

Economic Factors and Next Year's Rates

Rates are adopted each year by the Board in May for the following fiscal year. A rate increase of 14.5% for Fiscal 2009 based on projected revenues and costs, became effective July 1, 2008.

Request for Information

This financial report is provided as an overview of the System's finances. Questions concerning any of the information in this report or requests for additional information should be directed to Raymond Orlando, Director of Media and Investor Relations, New York City Municipal Water Finance Authority, 75 Park Place, New York, New York 10007. His phone number is (212) 788-5875 and his fax number is (212) 788-9721.

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING BALANCE SHEET

June 30, 2009

(In thousands)

| | New York City | | | Total |
|--|----------------------|-----------------------------------|------------------------|----------------------|
| | Water Board | Municipal Water Finance Authority | Eliminations | |
| ASSETS | | | | |
| CURRENT ASSETS: | | | | |
| Cash and cash equivalents | \$ 109,990 | \$ 1,060,452 | \$ - | \$ 1,170,442 |
| Investments | 91,746 | 675,875 | - | 767,621 |
| Accrued interest receivable | 360 | 3,296 | - | 3,656 |
| Accounts receivable: | | | | |
| Billed — less allowance for uncollectible water and sewer receivables of \$219,445 | 218,246 | - | - | 218,246 |
| Unbilled | 215,185 | - | - | 215,185 |
| Receivable from the City of New York | 13,328 | - | - | 13,328 |
| Total current assets | <u>648,855</u> | <u>1,739,623</u> | <u>-</u> | <u>2,388,478</u> |
| UTILITY PLANT IN SERVICE — Less accumulated depreciation of \$8,036,717 | 16,066,742 | - | - | 16,066,742 |
| UTILITY PLANT CONSTRUCTION | <u>5,072,496</u> | <u>-</u> | <u>-</u> | <u>5,072,496</u> |
| Total capital assets | 21,139,238 | - | - | 21,139,238 |
| REVENUE REQUIREMENT TO BE BILLED BY AND RECEIVED FROM THE BOARD | - | 12,763,380 | (12,763,380) | - |
| RESIDUAL INTEREST IN SOLD LIENS | 38,578 | - | - | 38,578 |
| LONG-TERM DEFERRED BOND AND FINANCING EXPENSES | <u>-</u> | <u>152,516</u> | <u>-</u> | <u>152,516</u> |
| Total non current assets | <u>21,177,816</u> | <u>12,915,896</u> | <u>(12,763,380)</u> | <u>21,330,332</u> |
| TOTAL | <u>\$ 21,826,671</u> | <u>\$ 14,655,519</u> | <u>\$ (12,763,380)</u> | <u>\$ 23,718,810</u> |

See notes to combining financial statements

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING BALANCE SHEET

JUNE 30, 2009

(In thousands)

| | New York City | | Eliminations | Total |
|--|----------------------|-----------------------------------|------------------------|----------------------|
| | Water Board | Municipal Water Finance Authority | | |
| LIABILITIES AND NET ASSETS | | | | |
| LONG-TERM LIABILITIES: | | | | |
| Bonds and notes payable — net of current portion | \$ - | \$ 21,568,771 | \$ - | \$ 21,568,771 |
| Net discount on bonds and notes payable | - | 50,699 | - | 50,699 |
| Unamortized deferred bond refunding costs | - | (317,628) | - | (317,628) |
| Pollution remediation obligation | 118,960 | - | - | 118,960 |
| OPEB Liability | - | 395 | - | 395 |
| Revenue requirements payable to the Authority | 12,763,380 | - | (12,763,380) | - |
| Total long-term liabilities | 12,882,340 | 21,302,237 | (12,763,380) | 21,421,197 |
| CURRENT LIABILITIES: | | | | |
| Accounts payable and accrued expenses | 46,946 | 50,109 | - | 97,055 |
| Revenues received in advance | 77,672 | - | - | 77,672 |
| Commercial paper payable | - | 700,000 | - | 700,000 |
| Current portion of bonds and notes payable | - | 266,026 | - | 266,026 |
| Payable to The City of New York | - | 880,664 | - | 880,664 |
| Refunds payable to customers | 15,945 | - | - | 15,945 |
| Total current liabilities | 140,563 | 1,896,799 | - | 2,037,362 |
| Total liabilities | 13,022,903 | 23,199,036 | (12,763,380) | 23,458,559 |
| NET ASSETS: | | | | |
| Invested in capital assets — net of related debt | 21,139,238 | (19,885,356) | - | 1,253,882 |
| Restricted for debt service | - | 285,348 | - | 285,348 |
| Restricted for operations and maintenance | 195,844 | - | - | 195,844 |
| Unrestricted (deficit) | (12,531,314) | 11,056,491 | - | (1,474,823) |
| Total net assets | 8,803,768 | (8,543,517) | - | 260,251 |
| TOTAL | \$ 21,826,671 | \$ 14,655,519 | \$ (12,763,380) | \$ 23,718,810 |

See notes to combining financial statements.

(Concluded)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING BALANCE SHEET

JUNE 30, 2008

(In thousands)

| | New York City | | Eliminations | Total |
|--|----------------------|-----------------------------------|------------------------|----------------------|
| | Water Board | Municipal Water Finance Authority | | |
| ASSETS | | | | |
| CURRENT ASSETS: | | | | |
| Cash and cash equivalents | \$ 125,984 | \$ 1,123,417 | \$ - | \$ 1,249,401 |
| Investments | 90,225 | 354,475 | - | 444,700 |
| Accrued interest receivable | 126 | 2,028 | - | 2,154 |
| Accounts receivable: | | | | |
| Billed — less allowance for uncollectible water and sewer receivables of \$183,884 | 184,366 | - | - | 184,366 |
| Unbilled | 187,934 | - | - | 187,934 |
| Receivable from The City of New York | <u>22,925</u> | <u>-</u> | <u>-</u> | <u>22,925</u> |
| Total current assets | <u>611,560</u> | <u>1,479,920</u> | <u>-</u> | <u>2,091,480</u> |
| UTILITY PLANT IN SERVICE — Less accumulated depreciation of \$7,677,961 | 15,335,934 | - | - | 15,335,934 |
| UTILITY PLANT CONSTRUCTION | <u>4,011,216</u> | <u>-</u> | <u>-</u> | <u>4,011,216</u> |
| Total capital assets | 19,347,150 | - | - | 19,347,150 |
| REVENUE REQUIREMENT TO BE BILLED BY AND RECEIVED FROM THE BOARD | - | 10,880,165 | (10,880,165) | - |
| RESIDUAL INTEREST IN SOLD LIENS | 16,896 | - | - | 16,896 |
| LONG-TERM DEFERRED BOND AND FINANCING EXPENSES | <u>-</u> | <u>137,508</u> | <u>-</u> | <u>137,508</u> |
| Total non current assets | <u>19,364,046</u> | <u>11,017,673</u> | <u>(10,880,165)</u> | <u>19,501,554</u> |
| TOTAL | <u>\$ 19,975,606</u> | <u>\$ 12,497,593</u> | <u>\$ (10,880,165)</u> | <u>\$ 21,593,034</u> |

See notes to combining financial statements

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING BALANCE SHEET

JUNE 30, 2008

(In thousands)

| | New York City | | Eliminations | Total |
|--|---------------|-----------------------------------|-----------------|---------------|
| | Water Board | Municipal Water Finance Authority | | |
| LIABILITIES AND NET ASSETS | | | | |
| LONG-TERM LIABILITIES: | | | | |
| Bonds and notes payable — net of current portion | \$ - | \$ 18,983,922 | \$ - | \$ 18,983,922 |
| Net discount on bonds and notes payable | - | 26,377 | - | 26,377 |
| Unamortized deferred bond refunding costs | - | (342,166) | - | (342,166) |
| OPEB liability | - | 316 | - | 316 |
| Revenue requirements payable to the Authority | 10,880,165 | - | (10,880,165) | - |
| Total long-term liabilities | 10,880,165 | 18,668,449 | (10,880,165) | 18,668,449 |
| CURRENT LIABILITIES: | | | | |
| Accounts payable and accrued expenses | 79,032 | 34,141 | - | 113,173 |
| Revenues received in advance | 74,676 | - | - | 74,676 |
| Commercial paper payable | - | 800,000 | - | 800,000 |
| Current portion of bonds and notes payable | - | 235,015 | - | 235,015 |
| Payable to The City of New York | - | 518,467 | - | 518,467 |
| Refunds payable to customers | 17,363 | - | - | 17,363 |
| Total current liabilities | 171,071 | 1,587,623 | - | 1,758,694 |
| Total liabilities | 11,051,236 | 20,256,072 | (10,880,165) | 20,427,143 |
| NET ASSETS: | | | | |
| Invested in capital assets — net of related debt | 19,347,150 | (17,609,969) | - | 1,737,181 |
| Restricted for debt service | - | 209,130 | - | 209,130 |
| Restricted for operations and maintenance | 200,438 | - | - | 200,438 |
| Unrestricted (deficit) | (10,623,218) | 9,642,360 | - | (980,858) |
| Total net assets | 8,924,370 | (7,758,479) | - | 1,165,891 |
| TOTAL | \$ 19,975,606 | \$ 12,497,593 | \$ (10,880,165) | \$ 21,593,034 |

See notes to combining financial statements.

(Concluded)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2009

(In thousands)

| | New York City | | Total |
|--|---------------------|-----------------------------------|-------------------|
| | Water Board | Municipal Water Finance Authority | |
| OPERATING REVENUES: | | | |
| Water supply and distribution | \$ 920,033 | \$ - | \$ 920,033 |
| Sewer collection and treatment | 1,430,588 | - | 1,430,588 |
| Other operating revenues | 97,946 | - | 97,946 |
| Total operating revenues | <u>2,448,567</u> | <u>-</u> | <u>2,448,567</u> |
| OPERATING EXPENSES: | | | |
| Operation and maintenance | 1,448,268 | - | 1,448,268 |
| Bad debt expense | 36,060 | - | 36,060 |
| Administration and general | 26,858 | 23,723 | 50,581 |
| Total operating expenses | <u>1,511,186</u> | <u>23,723</u> | <u>1,534,909</u> |
| DEPRECIATION AND AMORTIZATION | <u>659,733</u> | <u>36,612</u> | <u>696,345</u> |
| OPERATING INCOME | 277,648 | (60,335) | 217,313 |
| NONOPERATING REVENUE (EXPENSES): | | | |
| Interest expense | - | (929,333) | (929,333) |
| Loss on retirement of capital assets | (299,450) | - | (299,450) |
| Subsidy income | - | 108,708 | 108,708 |
| Capital distribution | (51,921) | - | (51,921) |
| Investment income | 3,200 | 95,922 | 99,122 |
| NET (LOSS) BEFORE CAPITAL CONTRIBUTIONS | (70,523) | (785,038) | (855,561) |
| CAPITAL CONTRIBUTION | <u>11,529</u> | <u>-</u> | <u>11,529</u> |
| CHANGE IN NET ASSETS | (58,994) | (785,038) | (844,032) |
| NET ASSETS (DEFICIT) — Beginning of year | 8,924,370 | (7,758,479) | 1,165,891 |
| Restatement of beginning net assets (note 2) | <u>(61,608)</u> | <u>-</u> | <u>(61,608)</u> |
| NET ASSETS (DEFICIT) — End of year | <u>\$ 8,803,768</u> | <u>\$ (8,543,517)</u> | <u>\$ 260,251</u> |

See notes to combining financial statements.

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2008

(In thousands)

| | New York City | | Total |
|--|---------------------|-----------------------------------|---------------------|
| | Water Board | Municipal Water Finance Authority | |
| OPERATING REVENUES: | | | |
| Water supply and distribution | \$ 784,856 | \$ - | \$ 784,856 |
| Sewer collection and treatment | 1,220,653 | - | 1,220,653 |
| Other operating revenues | <u>97,778</u> | <u>-</u> | <u>97,778</u> |
| Total operating revenues | <u>2,103,287</u> | <u>-</u> | <u>2,103,287</u> |
| OPERATING EXPENSES: | | | |
| Operation and maintenance | 1,320,439 | - | 1,320,439 |
| Administration and general | <u>22,351</u> | <u>21,676</u> | <u>44,027</u> |
| Total operating expenses | <u>1,342,790</u> | <u>21,676</u> | <u>1,364,466</u> |
| DEPRECIATION AND AMORTIZATION | <u>604,437</u> | <u>41,940</u> | <u>646,377</u> |
| OPERATING INCOME | 156,060 | (63,616) | 92,444 |
| NONOPERATING REVENUE (EXPENSES): | | | |
| Interest expense | - | (834,085) | (834,085) |
| Loss on retirement of fixed assets | (14,598) | - | (14,598) |
| Subsidy income | - | 104,234 | 104,234 |
| Capital distribution | (24,619) | - | (24,619) |
| Investment income | <u>4,169</u> | <u>104,723</u> | <u>108,892</u> |
| NET INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS | 121,012 | (688,744) | (567,732) |
| CAPITAL CONTRIBUTION | <u>7,340</u> | <u>-</u> | <u>7,340</u> |
| CHANGE IN NET ASSETS | 128,352 | (688,744) | (560,392) |
| NET ASSETS (DEFICIT) — Beginning of year | <u>8,796,018</u> | <u>(7,069,735)</u> | <u>1,726,283</u> |
| NET ASSETS (DEFICIT) — End of year | <u>\$ 8,924,370</u> | <u>\$ (7,758,479)</u> | <u>\$ 1,165,891</u> |

See notes to combining financial statements.

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2009

(In thousands)

| | New York City | | Total |
|---|--------------------|-----------------------------------|---------------------|
| | Water Board | Municipal Water Finance Authority | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Receipts from customers | \$ 2,331,041 | \$ - | \$ 2,331,041 |
| Payments for operations and maintenance | (1,273,908) | - | (1,273,908) |
| Payments for administration | (24,952) | (22,737) | (47,689) |
| Net cash provided by (used in) operating activities | <u>1,032,181</u> | <u>(22,737)</u> | <u>1,009,444</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES: | | | |
| Proceeds from issuing bonds, notes and other borrowings — net of issuance costs | - | 4,448,758 | 4,448,758 |
| Acquisition and construction of capital assets | - | (2,570,868) | (2,570,868) |
| Payments by the Board to the Authority | (1,049,850) | 1,049,850 | - |
| Repayments of bonds, notes and other borrowings | - | (1,943,379) | (1,943,379) |
| Interest paid on bonds, notes and other borrowings | - | (805,667) | (805,667) |
| Net cash (used in) provided by capital and related financing activities | <u>(1,049,850)</u> | <u>178,694</u> | <u>(871,156)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Proceeds from sales and maturities of investments | - | 398,074 | 398,074 |
| Purchases of investments | - | (683,935) | (683,935) |
| Interest on investments | 1,675 | 66,939 | 68,614 |
| Net cash provided by (used in) investing activities | <u>1,675</u> | <u>(218,922)</u> | <u>(217,247)</u> |
| NET (DECREASE) IN CASH AND CASH EQUIVALENTS | (15,994) | (62,965) | (78,959) |
| CASH AND CASH EQUIVALENTS — Beginning of year | <u>125,984</u> | <u>1,123,417</u> | <u>1,249,401</u> |
| CASH AND CASH EQUIVALENTS — End of year | <u>\$ 109,990</u> | <u>\$ 1,060,452</u> | <u>\$ 1,170,442</u> |

See notes to combining financial statements

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2009

(In thousands)

| | New York City | | Total |
|--|---------------------|-----------------------------------|---------------------|
| | Water Board | Municipal Water Finance Authority | |
| RECONCILIATION OF OPERATING (LOSS) INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | | |
| Operating income | \$ 277,648 | \$ (60,335) | \$ 217,313 |
| Adjustments to reconcile operating income (loss) to net cash provided by operating activities: | | | |
| Depreciation and amortization | 659,733 | 36,612 | 696,345 |
| Operations and maintenance expense paid for with bond proceeds | 141,405 | - | 141,405 |
| Changes in assets and liabilities (net): | | | |
| Pollution remediation liability | 57,352 | - | 57,352 |
| Receivables — net | (60,473) | - | (60,473) |
| Receivable from the City | 9,597 | - | 9,597 |
| Residual interest in sold liens | (21,681) | - | (21,681) |
| Accounts payable | (32,086) | 986 | (31,100) |
| Revenues received in advance | 2,428 | - | 2,428 |
| Accrued interest receivable | (234) | - | (234) |
| Refunds payable | (1,508) | - | (1,508) |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | <u>\$ 1,032,181</u> | <u>\$ (22,737)</u> | <u>\$ 1,009,444</u> |

The following are the noncash capital and related financing activities:

Interest expense includes the amortization of net (premium) and discount in the amount of (\$3,423) in 2009.

Capital expenditures in the amount of \$739,435 had been incurred but not paid at June 30, 2009.

The Board received capital assets of \$11,279 in 2009 which represented capital contributed by the City.

See notes to combining financial statements.

(Concluded)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2008

(In thousands)

| | New York City | | Total |
|---|-------------------|-----------------------------------|---------------------|
| | Water Board | Municipal Water Finance Authority | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Receipts from customers | \$ 2,166,236 | \$ - | \$ 2,166,236 |
| Payments for operations and maintenance | (1,209,396) | - | (1,209,396) |
| Payments for administration and general | (28,429) | (21,798) | (50,227) |
| Net cash provided by (used in) operating activities | <u>928,411</u> | <u>(21,798)</u> | <u>906,613</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES: | | | |
| Proceeds from issuing bonds, notes and other borrowings — net of issuance costs | - | 5,328,294 | 5,328,294 |
| Acquisition and construction of capital assets | - | (2,149,092) | (2,149,092) |
| Payments by the Board to the Authority | (904,726) | 904,726 | - |
| Repayments of bonds, notes and other borrowings | - | (3,381,124) | (3,381,124) |
| Interest paid on bonds, notes and other borrowings | - | (726,864) | (726,864) |
| Net cash used in capital and related financing activities | <u>(904,726)</u> | <u>(24,060)</u> | <u>(928,786)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Proceeds from sales and maturities of investments | 83,405 | 17,746 | 101,151 |
| Purchases of investments | (89,421) | - | (89,421) |
| Interest on investments | <u>3,203</u> | <u>81,375</u> | <u>84,578</u> |
| Net cash (used in) provided by investing activities | <u>(2,633)</u> | <u>99,121</u> | <u>96,488</u> |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 21,052 | 53,263 | 74,315 |
| CASH AND CASH EQUIVALENTS — Beginning of year | <u>104,932</u> | <u>1,070,154</u> | <u>1,175,086</u> |
| CASH AND CASH EQUIVALENTS — End of year | <u>\$ 125,984</u> | <u>\$ 1,123,417</u> | <u>\$ 1,249,401</u> |

See notes to combining financial statements

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2008

(In thousands)

| | New York City | | Total |
|--|------------------|-----------------------------------|------------------|
| | Water Board | Municipal Water Finance Authority | |
| RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES: | | | |
| Operating income (loss) | \$156,060 | \$(63,616) | \$ 92,444 |
| Adjustments to reconcile operating income (loss) to net cash provided by operating activities: | | | |
| Depreciation and amortization | 604,437 | 41,940 | 646,377 |
| Operations and maintenance expense paid for with bond proceeds | 67,249 | - | 67,249 |
| Changes in assets and liabilities (net): | | | |
| Receivables — net | 75,189 | - | 75,189 |
| Receivable from the City | (7,207) | - | (7,207) |
| Residual interest in sold liens | (16,896) | - | (16,896) |
| Accounts payable | 44,922 | (122) | 44,800 |
| Revenues received in advance | 948 | - | 948 |
| Refunds payable | 3,709 | - | 3,709 |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | <u>\$928,411</u> | <u>\$(21,798)</u> | <u>\$906,613</u> |

The following are the noncash capital and related financing activities:

Interest expense includes the amortization of net (premium) and discount in the amount of (\$1,029) in 2008.

Capital expenditures in the amount of \$518,467 had been incurred but not paid at June 30, 2008.

The Board received capital assets of \$7,340 in 2008 which represented capital contributed by the City.

See notes to combining financial statements.

(Concluded)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008

1. ORGANIZATION

The New York City Water and Sewer System (the “System”) provides water supply and distribution, sewage collection, treatment, and disposal for The City of New York (the “City”). The System, as presented in the accompanying financial statements, began operations on July 1, 1985 and is a joint operation consisting of two legally separate and independent entities, the New York City Municipal Water Finance Authority (the “Authority”) and the New York City Water Board (the “Board”). The Authority is a public benefit corporation created in accordance with the New York City Municipal Water Finance Act (the “Act”), duly enacted into law as Chapter 513 of the laws of 1984 of the State of New York, as amended by Chapter 514 of the laws of 1984 of the State of New York. The Board was created by Chapter 515 of the laws of 1984 of the State of New York. The Act empowers the Authority to issue bonds or notes to finance the cost of capital improvements to the System, and to refund any and all outstanding bonds and general obligation bonds of the City issued for water and sewer purposes. The Act empowers the Board to lease the System from the City and to fix and collect rates, fees, rents and other charges for the use of, or for services furnished, rendered, or made available by, the System, to produce cash sufficient to pay debt service on the Authority’s bonds and to place the System on a self-sustaining basis.

The Financing Agreement (the “Agreement”) provides that the Authority will issue bonds to finance the cost of capital investment and related costs in the water and sewer system serving the City. It also sets forth the funding priority for the debt service costs of the Authority, operating costs of the System, and the rental payment to the City.

The physical operation and capital improvements of the System are performed by the City’s Department of Environmental Protection subject to contractual agreements with the Authority and the Board.

In accordance with Statement No. 14 of the Governmental Accounting Standards Board (“GASB”), the Board and the Authority are considered to be part of the same reporting entity (the “System”) since they are fiscally interdependent. Accordingly, the accompanying financial statements for the System present the individual financial statements of the Board and the Authority as major funds. In addition, the accompanying financial statements present a total column which represents the entity-wide financial statements of the System. Transactions and balances between the Board and the Authority are eliminated in the entity-wide financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the System have been prepared on the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. Private sector standards of accounting and financial reporting issued by the Financial Accounting Standards Board (“FASB”) prior to December 1, 1989 are followed by the System to the extent that those standards do not conflict with or contradict guidance of GASB. GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Government Entities that Use Proprietary Fund Accounting*, provides the option to follow subsequent FASB standards, subject to the same limitation. The System has elected to follow GASB pronouncements exclusively after that date. Other significant accounting policies are:

Investments and Cash Equivalents — Investments and cash equivalents consist principally of securities of the United States and its agencies, certificates of deposit, guaranteed investment contracts, and repurchase agreements. Investments with maturity periods of greater than one year are carried at fair

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

value. Investments with maturities less than one year are carried at cost plus accrued interest, which approximates fair value. For purposes of the statements of cash flows, the System generally considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Restricted Assets — Proceeds from the issuance of debt and monies set aside for the operation and maintenance of the System are classified as restricted based on the requirements of the applicable bond indentures.

Bond Discount and Bond Issuance Costs — Bond discount and bond issuance costs are amortized over the life of the related bond issue, using the effective yield method of amortization for bond discount and bond issuance costs.

Utility Plant — Utility plant acquired through purchase or internal construction is recorded at cost, net of retirements. It is the Board's policy to capitalize assets with a cost of \$35,000 or more and a useful life of five years or longer. Contributed utility plant is recorded at its estimated historical cost based on appraisals or other methods when historical cost information is not available, net of depreciation. Depreciation is computed using the straight-line method based upon estimated useful lives, as follows:

| | Years |
|--|--------------|
| Buildings | 40–50 |
| Water supply and wastewater treatment systems | 15–50 |
| Water distribution and sewage collection systems | 15–75 |
| Equipment | 5–35 |

Maintenance and repairs of property are charged to maintenance expense. Replacements and betterments are recorded as additions to utility plant. The System pays for some improvements for assets that are not owned by the City or the System, as well as certain pollution remediation activities, through bond proceeds. These costs are shown as operations and maintenance expenses in the statements.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Operating Revenues and Operating Expenses — Operating revenues consist of customer payments for services of the System. Revenues are based on billing rates imposed by the Board and upon customers' water and sewer usage or, in some cases, characteristics of customer properties. The System records estimated unbilled revenue at year-end. Operating expenses consist of administration, maintenance, repair and operations of the System; administration costs of the Board and the Authority; rental payments to the City and bad debt expense.

Deferred Revenues — Revenues received in advance of the period to which they relate are deferred and recorded as revenue when earned.

Deferred Bond Refunding Costs — Deferred bond refunding costs represent the accounting gains or losses incurred in advance refundings of outstanding bonds. Gains or losses arising from debt refundings are deferred and amortized over the lesser of the remaining life of the old debt or the life of the new debt.

Use of Estimates — The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions in determining the amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Newly Adopted Standards and Standards Issued But Not Yet Effective

In September 2006 GASB issued Statement No. 48, (GASB 48), *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. The Statement established criteria to ascertain whether certain transactions should be regarded as sales or collateralized borrowings, and provides guidance for the reporting and disclosures required when governmental entities have such transactions. The System implemented GASB 48 in Fiscal 2008, which resulted in the recording of a residual interest in sold liens of \$16.9 million as of June 30, 2008 and \$38.6 million as of June 30, 2009. These amounts represent the estimated amount to be received by the Board for tax liens secured by water and sewer rents and surcharges which have been sold by the City to one or more trusts, if and when liens held by the trusts generate cash flows to the trusts above the amounts needed by the trusts to pay their bondholders and satisfy reserve requirements.

In November 2006 GASB issued Statement No. 49, (GASB 49), *Accounting and Financial Reporting for Pollution Remediation Obligations*. The Statement established accounting and financial reporting standards for obligations to address current or potential detrimental effects of existing pollution. GASB 49 is effective for financial statements for periods beginning after December 15, 2007, and was implemented by the System for its Fiscal 2009. The implementation of GASB 49 resulted in a restatement (discussed further below) of the Fiscal 2009 beginning net asset balance of \$61.6 million, reflecting the pollution remediation obligation as of June 30, 2008. For further information pertaining to pollution remediation obligations also see note 13.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In May 2007 GASB issued Statement No. 50, (GASB 50), *Pension Disclosures (an amendment of GASB Statements No. 25 and No. 27)*. The Statement establishes and modifies requirements related to financial reporting by pension plans and by employers that provide defined benefit and defined contribution pensions. The City and the City's pension plans in which System employees may participate implemented GASB 50 for Fiscal 2008. As discussed in Note 11, the System has very few direct employees who participate in a pension plan and the thus the pension disclosures are not material to the System's financial statements.

In June 2007 GASB issued Statement No. 51, (GASB 51) *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that intangible assets generally be classified as capital assets.

Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. GASB 51 is effective for financial statements for periods beginning after June 15, 2009. The System had not completed the process of evaluating GASB 51, but does not expect GASB 51 to have a material impact on its financial statements.

In November 2007 GASB issued Statement No. 52, (GASB 52), *Land and Other Real Estate Held as Investments by Endowments*. This Standard requires endowments to report their land and other real estate investments at fair value. GASB 52 is effective for financial statements for periods beginning after June 15, 2008. The System has no endowments and therefore GASB 52 will not impact the System's financial statements.

In June 2008 GASB issued Statement No. 53, (GASB 53), *Accounting and Financial Reporting for Derivative Instruments*. This Standard established guidance on the recognition, measurement, and disclosures related to derivative instruments entered into by governmental entities. GASB 53 requires that most derivative instruments be reported at fair value, and requires governmental entities to determine if derivatives are effective hedges of risks associated with related hedgeable items. Generally, for derivatives that are effective hedges, changes in fair values are deferred whereas for others the changes in fair value are recognized in the current period. GASB 53 is effective for financial statements for periods beginning after June 15, 2009. The System has not completed the process of evaluating the impact of GASB 53 on its financial statements.

In February 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The Statement affects the display of fund balances and refines the definitions of each of the governmental fund types. The requirements for GASB 54 are effective for periods beginning after June 15, 2010. The System does not use fund accounting and therefore GASB 54 will not impact the System's financial statements.

Restatement of Beginning Net Assets — The implementation of GASB 49 (discussed above) has resulted in a restatement to reduce the Fiscal 2009 beginning net asset balance by \$61.6 million, reflecting the pollution remediation obligation as of June 30, 2008. The System has not restated its Fiscal 2008 financial statements to reflect GASB 49, as sufficient information to apply the provisions of the standard in the prior period was not readily available. For further information pertaining to the pollution remediation obligations see note 13.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

3. UTILITY PLANT

The following is a summary of utility plant activity for the fiscal years ended June 30, 2009 and 2008, as adjusted as per note 13 (in thousands):

| | Balance at June 30, 2007 | Additions | Deletions | Balance at June 30, 2008 | Additions | Deletions | Balance at June 30, 2009 |
|---|-----------------------------|-------------|-------------|-----------------------------|--------------|-------------|-----------------------------|
| Nondepreciable assets — utility construction | \$ 4,338,126 | \$2,313,039 | \$2,639,949 | \$ 4,011,216 | \$ 2,758,716 | \$1,697,436 | \$ 5,072,496 |
| Depreciable assets: | | | | | | | |
| Buildings | \$ 23,493 | \$ - | \$ - | \$ 23,493 | \$ 700 | \$ - | \$ 24,193 |
| Equipment | 629,384 | 326,405 | 2,478 | 953,311 | 412,069 | 3,165 | 1,362,215 |
| Water supply and wastewater treatment systems | 11,865,211 | 1,787,249 | 23,409 | 13,629,051 | 754,824 | 1,444 | 14,382,431 |
| Water distribution and sewage collection systems | 8,014,647 | 434,426 | 41,033 | 8,408,040 | 337,964 | 411,384 | 8,334,620 |
| Total depreciable assets | 20,532,735 | 2,548,080 | 66,920 | 23,013,895 | 1,505,557 | 415,993 | 24,103,459 |
| Less accumulated depreciation (1) | 7,125,846 | 604,437 | 52,322 | 7,677,961 | 659,732 | 300,976 | 8,036,717 |
| Total utility plant | \$13,406,889 | \$1,943,643 | \$ 14,598 | \$15,335,934 | \$ 845,825 | \$ 115,017 | \$16,066,742 |

(1) At June 30, 2009 accumulated depreciation was comprised of the following:

| Buildings | Equipment | Water Supply | Water Distributio | Total |
|-----------|------------|--------------|-------------------|--------------|
| \$ 16,138 | \$ 592,785 | \$4,701,459 | \$2,726,335 | \$ 8,036,717 |

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

4. INVESTMENTS AND CASH DEPOSITS

Investments — Pursuant to the Water and Sewer General Revenue Bond Resolution and the Authority's and the Board's investment guidelines, the Authority and the Board may generally invest in obligations of, or guaranteed by, the U.S. government, certain highly rated obligations of the State of New York or any subdivision or instrumentality thereof, certain certificates of deposit and similar instruments issued by highly rated commercial banks; certain highly rated corporate securities or commercial paper securities, certain repurchase agreements with highly rated institutions; certain investment agreements with highly rated institutions; certain highly rated money market funds; and certain highly rated municipal obligations.

Cash Deposits — The System follows the New York City Banking Commission designations for the System's bank depositories. The Commission consists of the Comptroller, the Mayor, and the Finance Commissioner of the City and uses independent bank rating agencies in part to assess the financial soundness of each bank, and the banking relationships are under constant operational and credit reviews. Each bank in which the System's cash is deposited is required to have its principal office in New York State and have capital stock, surplus, and undivided earnings aggregating at least \$100 million. The System had \$7.2 million and \$574 thousand, respectively, on deposit at June 30, 2009 and 2008, which was covered by Federal depository insurance. The remaining balance at June 30, 2008 was uncollateralized and uninsured.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

4. INVESTMENTS AND CASH DEPOSITS (Continued)

Cash and cash equivalents were comprised of the following at June 30, 2009 and 2008 (in thousands):

| | 2009 | 2008 |
|---------------------------|---------------------|---------------------|
| Cash | \$ 7,167 | \$ 16,002 |
| Cash equivalents | <u>1,163,275</u> | <u>1,233,399</u> |
| Cash and cash equivalents | <u>\$ 1,170,442</u> | <u>\$ 1,249,401</u> |

The System had the following investments at June 30, 2009 and 2008 (in thousands):

| Investments | Fair Value | |
|---|-------------------|-------------------|
| | 2009 | 2008 |
| U.S. Government Sponsored Entities | \$ 1,356,684 | \$ 1,366,063 |
| New York State instrumentality | 339,380 | 78,466 |
| New York City authority securities | 64,635 | - |
| Repurchase agreements | - | 3,000 |
| Dreyfus Government Money Market | 8,942 | - |
| Guaranteed investment contracts | 132,171 | 215,480 |
| Forward Purchase Agreements Market Value Adjustment | <u>29,084</u> | <u>15,090</u> |
| Total investments including cash equivalents | 1,930,896 | 1,678,099 |
| Less amounts reported as cash equivalents | <u>1,163,275</u> | <u>1,233,399</u> |
| Investments | <u>\$ 767,621</u> | <u>\$ 444,700</u> |

The System's management invests funds which are not immediately required for operations, debt service or capital project expenses and funds that are held for debt service and operations and maintenance reserves. Each account of the Authority is held pursuant to the Resolution and may be invested in securities or categories in investments that are specifically enumerated as permitted investments for such account pursuant to the Resolution. The Board invests the reserves for operations and maintenance as permitted by the Board's investment guidelines.

Credit Risk — All investments held by the System at June 30, 2009 and 2008 are obligations of, or guaranteed by, the United States of America, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association or the Federal Farm Credit System, or are shares of money market funds, and are rated "AAA" or "A-1+" by S&P and "Aaa" or "P-1" by Moody's.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

4. INVESTMENTS AND CASH DEPOSITS (Continued)

Interest Rate Risk — Approximately 35% of the System's investments at June 30, 2009 are Forward Purchase Agreements or Guaranteed Investment Contracts with guaranteed fixed rates of return. The fair value of the Forward Purchase Agreements is highly susceptible to changes in market interest rates; however the System does not expect these Agreements to terminate. Approximately 15% of the System's investments are in investments that are expected to be held to maturity. The remainder of the System's investments will mature within a year after June 30, 2009; for these investments the System's risk that changes in interest rates will adversely affect the fair value of investments is very limited.

Custodial Credit Risk — For an investment, custodial credit risk is the risk that, in the event of the failure of the custodian, the System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The System's investments, other than repurchase agreements, are not collateralized. All investments and collateral are held in the Authority's name by the trustee or in the Board's name by its custodian bank.

5. LEASE AGREEMENT

The Board is party to a long-term lease (the "Lease") with the City, which transfers the water and sewer related property to the Board for the term of the lease. The Lease term commenced on July 1, 1985, and continues until the later of the fortieth anniversary of the commencement of the lease or the date on which all bonds, notes or other obligations of the Authority are paid in full or provision for such payment have been made pursuant to the applicable debt instrument. The Lease provides for payments to the City to cover the following:

- a. an amount sufficient to pay the cost of administration, maintenance, repair and operation of the leased property, which includes overhead costs incurred by the City attributable to the leased property, net of the amount of any Federal, State, or other operating grants received by the City;
- b. an amount sufficient to reimburse the City for capital costs incurred by the City for the construction of capital improvements to the leased property which are not paid or reimbursed from any other source.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

5. LEASE AGREEMENT (Continued)

In addition to the payments described above, the Board pays rent to the City in each fiscal year in an amount not to exceed the greater of (a) the principal and interest payable on general obligation bonds issued by the City for water and sewer purposes certified by the City to be paid within such fiscal year or (b) 15% of principal and interest payable on the bonds of the Authority to be paid within such fiscal year. A summary of operation and maintenance and rental expenses for the years ended June 30 is as follows (in thousands):

| | 2009 | 2008 |
|--|---------------------|---------------------|
| Water transmission and distribution | \$ 414,646 | \$ 381,011 |
| Sewer collection systems | 438,512 | 458,021 |
| City agency support cost | 61,832 | 58,692 |
| Fringe benefits | 174,113 | 147,593 |
| Pollution remediation | 132,682 | |
| Payments for watershed improvements | 66,072 | 67,249 |
| Judgments and claims | <u>8,975</u> | <u>68,088</u> |
| Operations and maintenance | 1,296,832 | 1,180,654 |
| Rental payments to the City | <u>151,436</u> | <u>139,785</u> |
| Total operations maintenance and rental payments | <u>\$ 1,448,268</u> | <u>\$ 1,320,439</u> |

6. PAYABLE TO AND RECEIVABLE FROM THE CITY

As of June 30, 2009 and 2008, all utility construction recorded by the System which has not been reimbursed to the City has been recorded as a payable to the City, net of the amount of any State or Federal capital grants received by the City.

As of June 30, 2009 and 2008, the System had a net payable of \$867.3 million and \$495.5 million, respectively, from the City for payments of utility construction and for overpayment of operations and maintenance expense.

7. SHORT TERM DEBT

In Fiscal 2009 and 2008, the changes in short-term debt were as follows (in thousands):

| | Balance at June 30, 2007 | Additions | Deletions | Balance at June 30, 2008 | Additions | Deletions | Balance at June 30, 2009 |
|----------------------|-----------------------------|--------------------|--------------------|-----------------------------|------------------|--------------------|-----------------------------|
| Commercial paper (1) | <u>\$800,000</u> | <u>\$2,040,000</u> | <u>\$2,040,000</u> | <u>\$800,000</u> | <u>\$950,000</u> | <u>\$1,050,000</u> | <u>\$700,000</u> |

- (1) Commercial paper is used to pay construction costs in advance of long-term bond financing. It is reported as part of the current portion of bonds and notes payable on the System's balance sheets.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

7. SHORT TERM DEBT (Continued)

Commercial paper activity comprises the following for the year ended June 30, 2009 (in thousands):

| | Balance at June 30, 2008 | Issued | Retired | Balance at June 30, 2009 |
|--|-----------------------------|------------------|--------------------|-----------------------------|
| Commercial Paper Series 1 — Variable Rate, Short-term Rolling Maturity Backed by Letter of Credit | \$200,000 | \$200,000 | \$ 400,000 | \$ - |
| Commercial Paper Series 5 — Variable Rate, Short-term Rolling Maturity Backed by Letter of Credit | 200,000 | - | - | 200,000 |
| Commercial Paper Series 6 — Variable Rate, Short-term Rolling Maturity Backed by Letter of Credit | 200,000 | 200,000 | 200,000 | 200,000 |
| Commercial Paper Series 7 — Variable Rate, Short-term Rolling Maturity | 200,000 | 250,000 | 350,000 | 100,000 |
| Commercial Paper Series 8 — Variable Rate, Short-term Rolling Maturity | <u>-</u> | <u>300,000</u> | <u>100,000</u> | <u>200,000</u> |
| Total commercial paper payable | <u>\$800,000</u> | <u>\$950,000</u> | <u>\$1,050,000</u> | <u>\$700,000</u> |

8. LONG-TERM DEBT

In Fiscal 2009 and 2008, the changes in long-term liabilities were as follows (in thousands):

| Bonds Payable | June 30, 2007 | Additions | Deletions | June 30, 2008 | Additions | Deletions | June 30, 2009 |
|-------------------------------|---------------------|--------------------|--------------------|---------------------|--------------------|------------------|---------------------|
| First resolution | \$10,933,460 | \$1,126,190 | \$1,067,753 | \$10,991,897 | \$ 536,030 | \$353,437 | \$11,174,490 |
| Second resolution | <u>6,337,724</u> | <u>2,153,715</u> | <u>264,399</u> | <u>8,227,040</u> | <u>2,967,345</u> | <u>534,078</u> | <u>10,660,307</u> |
| Total bonds payable | <u>17,271,184</u> | <u>3,279,905</u> | <u>1,332,152</u> | <u>19,218,937</u> | <u>3,503,375</u> | <u>887,515</u> | <u>21,834,797</u> |
| Due within one year | <u>(210,971)</u> | | | <u>(235,015)</u> | | | <u>(266,026)</u> |
| Less discounts (net) | 13,838 | (31,934) | 8,281 | (26,377) | (20,920) | 3,402 | (50,699) |
| Less deferred refunding costs | <u>354,935</u> | <u>17,791</u> | <u>30,559</u> | <u>342,167</u> | <u>1,748</u> | <u>26,286</u> | <u>317,629</u> |
| Total long-term debt | <u>\$16,902,411</u> | <u>\$3,294,048</u> | <u>\$1,293,312</u> | <u>\$19,299,712</u> | <u>\$3,522,547</u> | <u>\$857,827</u> | <u>\$21,964,432</u> |

With respect to all series, the Board has agreed to maintain rates and charges to provide revenues at levels sufficient to pay principal and interest requirements as well as to meet certain debt service coverage and operating cost funding requirements. All series are specific obligations of the Authority payable solely from and secured by a pledge of and lien on the gross revenue of the System, as defined.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

8. LONG-TERM DEBT (Continued)

During Fiscal 2008, the Authority issued \$448.1 million of bonds to refund \$436.7 million of outstanding bonds. These refundings resulted in an accounting loss of \$17.8 million. The Authority in effect reduced its aggregate debt service by \$18.0 million, and obtained an economic benefit of \$14.5 million.

In addition, in Fiscal 2009 and Fiscal 2008, the Authority issued \$612.3 million and \$679.9 million, respectively of bonds to refund \$652.5 million and \$683.7 million, respectively, of adjustable rate bonds.

The Authority has defeased cumulatively \$11.0 billion and \$10.4 billion of outstanding bonds as of June 30, 2009 and 2008, respectively, by placing proceeds of refunding bonds issued or Authority cash in an irrevocable escrow account to provide for all future debt service payments on defeased bonds. Proceeds were used to purchase U.S. Government securities that were placed in the irrevocable escrow account. Accordingly, the escrow account assets and liabilities for the defeased bonds are not included in the Authority's financial statements. Additionally, the Authority has economically defeased an additional \$19.5 million of bonds from its cash. The escrow account assets and the liabilities for these economically defeased bonds are included in the assets and liabilities of the Authority's financial statements until their respective maturity dates.

As of June 30, 2009 and 2008, \$10.1 billion and \$8.9 billion of the defeased bonds, respectively, had been retired from the assets of the escrow accounts.

Debt service requirements to maturity, including amounts relating to commercial paper, at June 30, 2009 are as follows (in thousands):

| June 30 | Principal (1) | Interest (2) | Total |
|-----------|---------------------|---------------------|---------------------|
| 2010 | \$ 966,026 | \$ 874,641 | \$ 1,840,667 |
| 2011 | 354,407 | 857,282 | 1,211,689 |
| 2012 | 350,422 | 844,966 | 1,195,388 |
| 2013 | 341,460 | 829,693 | 1,171,153 |
| 2014 | 432,323 | 820,850 | 1,253,173 |
| 2015–2019 | 2,500,309 | 3,879,241 | 6,379,550 |
| 2020–2024 | 2,962,730 | 3,393,218 | 6,355,948 |
| 2025–2029 | 3,493,585 | 2,813,571 | 6,307,156 |
| 2030–2034 | 4,456,020 | 2,049,629 | 6,505,649 |
| 2035–2039 | 5,440,975 | 1,088,216 | 6,529,191 |
| 2040–2040 | 1,236,540 | 68,387 | 1,304,927 |
| | <u>\$22,534,797</u> | <u>\$17,519,694</u> | <u>\$40,054,491</u> |

(1) Includes \$700 million of commercial paper due in 2010.

(2) Includes interest for variable rate bonds estimated at 1.69%, which is the rate at the end of the fiscal year. Variable rate bonds are sold daily or weekly and interest rates are determined by the market on the day of sale.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

8. LONG-TERM DEBT (Continued)

Bonds, notes payable, and commercial paper comprise the following for the year ended June 30, 2009 (in thousands):

| | Balance at June 30, 2008 | Issued | Retired/ defeased | Balance at June 30, 2009 |
|--|-----------------------------|--------|----------------------|-----------------------------|
| 1991 Fiscal Series B — 6.00% to 7.25% Serial and Term Bonds maturing in varying installments through 2012 | \$ 5,350 | \$- | \$ 1,990 | \$ 3,360 |
| 1992 Fiscal Series B — 6.66% to 6.86% Serial and Term Bonds maturing in varying installments through 2014 | 6,192 | - | 2,107 | 4,085 |
| 1993 Fiscal Series A — 5.875% to 6.0% Serial, Term, and Capital Appreciation Bonds maturing in varying installments through 2013 | 49,985 | - | 30,485 | 19,500 |
| 1994 Fiscal Series 1 — 3.00% to 6.00% Serial Bonds maturing in varying installments through 2013 | 30,840 | - | 360 | 30,480 |
| 1995 Fiscal Series 1 — 5.25% to 6.875% Serial Bonds maturing in varying installments through 2016 | 21,160 | - | 2,930 | 18,230 |
| 1997 Fiscal Series A — 4.85% to 6.0% Serial Bonds maturing in varying installments through 2026 | 25,000 | - | - | 25,000 |
| 1998 Fiscal Series D — 4.25% to 5.00% Serial and Capital Appreciation Bonds maturing in varying installments through 2025 | 350,965 | - | - | 350,965 |
| 1998 Fiscal Series 1 — 4.00% to 5.35% Serial Bonds maturing in varying installments through 2017 | 26,155 | - | 2,315 | 23,840 |
| 1998 Fiscal Series 3 — 4.30% to 6.00% Serial Bonds maturing in varying installments through 2016 | 120,135 | - | - | 120,135 |
| 1998 Fiscal Series 4 — 3.60% to 5.20% Serial Bonds maturing in varying installments through 2018 | 8,850 | - | 790 | 8,060 |
| 1999 Fiscal Series A — 4.75% to 5.00% Serial Bonds maturing in varying installments through 2031 | 301,470 | - | - | 301,470 |
| 1999 Fiscal Series B — 4.0% to 5.25% Serial, Term and Capital Appreciation Bonds maturing in varying installments through 2020 | 171,910 | - | - | 171,910 |
| 2000 Fiscal Series B — 6.00% to 6.10% Serial Bonds maturing in varying installments through 2033 | 131,865 | - | - | 131,865 |
| 2000 Fiscal Series C — Adjustable Rate Term Bonds maturing in 2033 | 107,500 | - | - | 107,500 |
| 2000 Fiscal Series 2 — 3.80% to 5.96% Serial Bonds maturing in varying installments through 2019 | 8,495 | - | 585 | 7,910 |
| 2001 Fiscal Series B — 4.5% to 5.125% Serial and Term Bonds maturing in varying installments through 2031 | 67,225 | - | - | 67,225 |
| 2001 Fiscal Series C — 5.125% Term Bonds maturing in varying installments through 2033 | 112,040 | - | - | 112,040 |

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

8. LONG-TERM DEBT (Continued)

Bonds, notes payable, and commercial paper comprise the following for the year ended June 30, 2009 (in thousands):

| | Balance at June 30, 2008 | Issued | Retired/ defeased | Balance at June 30, 2009 |
|---|-----------------------------|--------|----------------------|-----------------------------|
| 2001 Fiscal Series D — 4.5% to 5.5% Serial and Capital Appreciation Bonds maturing in varying installments through 2025 | \$232,940 | \$- | \$ 880 | \$232,060 |
| 2001 Fiscal Series E — 4.5% to 5.25% Serial and Term Bonds maturing in varying installments through 2031 | 86,105 | - | - | 86,105 |
| 2001 Fiscal Series F — Adjustable Rate Bonds maturing in varying installments through 2033 | 184,130 | - | - | 184,130 |
| 2002 Fiscal Series A — 5.00% to 5.75% Serial and Term Bonds maturing in varying installments through 2033 | 116,305 | - | - | 116,305 |
| 2002 Fiscal Series B — 3.625% to 5.00% Serial and Term Bonds maturing in varying installments through 2026 | 170,975 | - | 255 | 170,720 |
| 2002 Fiscal Series C — 4.1% to 5.125% Serial and Term Bonds maturing in varying installments through 2032 | 46,580 | - | - | 46,580 |
| 2002 Fiscal Series D — 3.0% to 4.90% Serial and Term Bonds maturing in varying installments through 2020 | 41,405 | - | 95 | 41,310 |
| 2002 Fiscal Series E — 3.4% to 5.0% Serial and Term Bonds maturing in varying installments through 2026 | 213,635 | - | 115 | 213,520 |
| 2002 Fiscal Series F — 3.6% to 5.0% Serial and Term Bonds maturing in varying installments through 2029 | 105,480 | - | 165 | 105,315 |
| 2002 Fiscal Series G — 5.00% to 5.125% Term Bonds maturing in varying installments through 2034 | 216,375 | - | - | 216,375 |
| 2002 Fiscal Series 1 — 4.82% to 5.25% Serial Bonds maturing in varying installments through 2031 | 169,167 | - | 5,896 | 163,271 |
| 2002 Fiscal Series 2 — 4.22% to 5.00% Serial Bonds maturing in varying installments through 2031 | 56,768 | - | 2,626 | 54,142 |
| 2002 Fiscal Series 3 — 4.65% to 5.00% Serial Bonds maturing in varying installments through 2031 | 433,688 | - | 15,028 | 418,660 |
| 2002 Fiscal Series 4 — 5.13% to 6.74% Serial Bonds maturing in varying installments through 2023 | 183,794 | - | 12,678 | 171,116 |
| 2002 Fiscal Series 5 — 3.82% to 5.21% Serial Bonds maturing in varying installments through 2031 | 152,935 | - | 1,476 | 151,459 |
| 2002 Fiscal Series 6 — 3.82% to 5.21% Serial Bonds maturing in varying installments through 2019 | 71,351 | - | 6,481 | 64,870 |

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

8. LONG-TERM DEBT (Continued)

Bonds, notes payable, and commercial paper comprise the following for the year ended June 30, 2009 (in thousands):

| | Balance at June 30, 2008 | Issued | Retired/ defeased | Balance at June 30, 2009 |
|---|-----------------------------|--------|----------------------|-----------------------------|
| 2002 Fiscal Series 7 — 7.4% to 7.5% Serial Bonds maturing in varying installments through 2012 | \$ 3,100 | \$- | \$ - | \$ 3,100 |
| 2003 Fiscal Series A — 4.0% to 6.0% Serial, Term and Muni-CP1 Bonds maturing in varying installments through 2034 | 681,645 | - | 4,415 | 677,230 |
| 2003 Fiscal Series C — Adjustable Rate Bonds maturing in 2018 | 300,300 | - | 300,300 | - |
| 2003 Fiscal Series D — 2.0% to 5.25% Serial and Term Bonds maturing in varying installments through 2017 | 214,525 | - | - | 214,525 |
| 2003 Fiscal Series E — 5% Term Bonds maturing in 2034 and 2038 | 367,265 | - | - | 367,265 |
| 2003 Fiscal Series F — Adjustable Rate Bonds maturing in 2035 | 201,655 | - | - | 201,655 |
| 2003 Fiscal Series 1 — 4.23% to 4.375% Serial Bonds maturing in varying installments through 2032 | 127,840 | - | 4,986 | 122,854 |
| 2003 Fiscal Series 2 — 5.27% Serial Bonds maturing in varying installments through 2028 | 538,140 | - | 13,027 | 525,113 |
| 2003 Fiscal Series 3 — 5.15% Serial Bonds maturing in varying installments through 2025 | 18,410 | - | 745 | 17,665 |
| 2003 Fiscal Series 4 — 5.18% Serial Bonds maturing in varying installments through 2025 | 29,285 | - | 1,190 | 28,095 |
| 2003 Fiscal Series 5 — 4.23% to 4.45% Serial Bonds maturing in varying installments through 2032 | 259,706 | - | 9,221 | 250,485 |
| 2004 Fiscal Series A — 5.0% Term Bonds maturing in 2027 and 2035 | 217,000 | - | - | 217,000 |
| 2004 Fiscal Series B — 2.00%–5.00% Serial and Term Bonds maturing in varying installments through 2023 | 336,720 | - | - | 336,720 |
| 2004 Fiscal Series C — 2.00%–5.00% Serial and Term Bonds maturing in varying installments through 2035 | 594,585 | - | 600 | 593,985 |
| 2004 Fiscal Series 1 — 4.12%–4.45% Serial Bonds maturing in varying installments through 2033 | 269,719 | - | 9,147 | 260,572 |
| 2004 Fiscal Series 2 — 4.46% Serial Bonds maturing in varying installments through 2026 | 233,496 | - | 7,959 | 225,537 |
| 2005 Fiscal Series A — 5.00% Serial Bonds maturing in varying installments through 2039 | 150,000 | - | - | 150,000 |

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

8. LONG-TERM DEBT (Continued)

Bonds, notes payable, and commercial paper comprise the following for the year ended June 30, 2009 (in thousands):

| | Balance at June 30, 2008 | Issued | Retired/ defeased | Balance at June 30, 2009 |
|--|-----------------------------|--------|----------------------|-----------------------------|
| 2005 Fiscal Series B — 2.125%–5.00% Serial Bonds maturing in varying installments through 2036 | \$918,890 | \$- | \$ 1,095 | \$917,795 |
| 2005 Fiscal Series C — 3.00%–5.00% Serial Bonds maturing in varying installments through 2036 | 574,255 | - | 775 | 573,480 |
| 2005 Series D — 5.00% Serial Bonds maturing in varying installments through 2039 | 559,205 | - | - | 559,205 |
| 2005 Fiscal Series 1 — 3.95%–5.00% Bonds maturing in varying installments through 2034 | 210,374 | - | 6,818 | 203,556 |
| 2005 Fiscal Series 2 — 2.567%–5.00% Bonds maturing in varying installments through 2026 | 357,712 | - | 12,006 | 345,706 |
| 2006 Series A — 3.50%–5.00% Serial Bonds maturing in varying installments through 2039 | 518,525 | - | 380 | 518,145 |
| 2006 Series B — 5.00% Term Bonds maturing in 2036 | 150,000 | - | - | 150,000 |
| 2006 Series C — 4.50%–4.75% Term Bonds maturing in 2033 | 350,345 | - | - | 350,345 |
| 2006 Fiscal Series D — 4.5%–5.00% Serial Bonds maturing in varying installments through 2038 | 406,205 | - | - | 406,205 |
| 2006 Fiscal Series AA — Adjustable rate bonds maturing in varying installments through 2032 | 400,000 | - | - | 400,000 |
| 2006 Fiscal Series BB — 3.25%–5.00% Serial Bonds maturing in varying installments through 2016 | 80,000 | - | 10,000 | 70,000 |
| 2006 Fiscal Series 1 — Adjustable rate bonds maturing in varying installments through 2036 | 213,458 | - | 6,938 | 206,520 |
| 2006 Fiscal Series 2 — Adjustable rate bonds maturing in varying installments through 2036 | 194,790 | - | 5,438 | 189,352 |
| 2006 Fiscal Series 3 — Adjustable rate bonds maturing in varying installments through 2036 | 248,288 | - | 6,725 | 241,563 |
| 2007 Fiscal Series A — 4.25%–4.75% Serial Bonds maturing in varying installments through 2039 | 587,975 | - | - | 587,975 |
| 2007 Fiscal Series AA — 4.50%–5.00% Serial Bonds maturing in varying installments through 2037 | 199,910 | - | - | 199,910 |
| 2007 Fiscal Series BB — 3.75%–5.00% Serial Bonds maturing in varying installments through 2021 | 131,745 | - | - | 131,745 |

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

8. LONG-TERM DEBT (Continued)

Bonds, notes payable, and commercial paper comprise the following for the year ended June 30, 2009 (in thousands):

| | Balance at June 30, 2008 | Issued | Retired/ defeased | Balance at June 30, 2009 |
|--|-----------------------------|---------|----------------------|-----------------------------|
| 2007 Fiscal Series CC — Adjustable rate bonds maturing in varying installments through 2038 | \$210,500 | \$ - | \$ - | \$210,500 |
| 2007 Fiscal Series DD — 4.75%–5.00% Serial Bonds maturing in varying installments through 2039 | 395,000 | - | - | 395,000 |
| 2007 Fiscal Series 1 — 4.35%–4.40% Serial Bonds maturing in varying installments through 2036 | 222,652 | - | 5,788 | 216,864 |
| 2007 Fiscal Series 2 — 4.45%–4.50% Serial Bonds maturing in varying installments through 2036 | 283,457 | - | 7,235 | 276,222 |
| 2007 Fiscal Series 3 — 4.90% Serial Bonds maturing in varying installments through 2024 | 162,405 | - | 13,075 | 149,330 |
| 2008 Fiscal Series A — 5.00% Serial Bonds maturing in varying installments through 2038 | 446,245 | - | - | 446,245 |
| 2008 Fiscal Series B — Adjustable Rate Bonds maturing in varying installments through 2025 | 535,000 | - | - | 535,000 |
| 2008 Fiscal Series C — 3.00%–5.25% Serial Bonds maturing in varying installments through 2021 | 138,125 | - | 9,780 | 128,345 |
| 2008 Fiscal Series AA — 4.50%–5.00% Serial Bonds maturing in varying installments through 2039 | 400,000 | - | - | 400,000 |
| 2008 Fiscal Series BB — Adjustable Rate Bonds maturing in varying installments through 2036 | 401,000 | - | - | 401,000 |
| 2008 Fiscal Series CC — Auction Rate Bonds maturing in varying installments through 2022 | 352,200 | - | 352,200 | - |
| 2008 Fiscal Series DD — 4.50%–5.00% Serial Bonds maturing in varying installments through 2039 | 504,905 | - | - | 504,905 |
| 2008 Fiscal Series 1 — 3.69%–4.64% Serial Bonds maturing in varying installments through 2037 | 270,907 | - | 8,282 | 262,625 |
| 2008 Fiscal Series 2 — 4.67%–4.73% Serial Bonds maturing in varying installments through 2037 | 224,703 | - | 2,133 | 222,570 |
| 2009 Fiscal Series A — 4.50%–5.00% Serial Bonds maturing in varying installments through 2039 | - | 536,030 | - | 536,030 |
| 2009 Fiscal Series AA — 4.50%–5.00% Serial Bonds maturing in varying installments through 2037 | - | 334,075 | - | 334,075 |

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

8. LONG-TERM DEBT (Continued)

Bonds, notes payable, and commercial paper comprise the following for the year ended June 30, 2009 (in thousands):

| | Balance at June 30, 2008 | Issued | Retired/ defeased | Balance at June 30, 2009 |
|--|-----------------------------|------------------|----------------------|-----------------------------|
| 2009 Fiscal Series BB — 3.75%–5.00% Serial Bonds maturing in varying installments through 2021 | \$ - | \$ 200,870 | \$ - | \$ 200,870 |
| 2009 Fiscal Series CC — Adjustable rate bonds maturing in varying installments through 2038 | - | 150,100 | - | 150,100 |
| 2009 Fiscal Series DD — 4.75%–5.00% Serial Bonds maturing in varying installments through 2039 | - | 325,580 | - | 325,580 |
| 2009 Fiscal Series EE — 4.75%–5.00% Serial Bonds maturing in varying installments through 2039 | - | 645,455 | - | 645,455 |
| 2009 Fiscal Series FF — 4.75%–5.00% Serial Bonds maturing in varying installments through 2039 | - | 362,830 | - | 362,830 |
| 2009 Fiscal Series 1 — 3.69%–4.64% Serial Bonds maturing in varying installments through 2037 | - | 368,451 | - | 368,451 |
| 2009 Fiscal Series 2 — 4.67%–4.73% Serial Bonds maturing in varying installments through 2037 | - | 79,984 | - | 79,984 |
| 2009 Fiscal Series GG — 4.13%–5.25% Serial Bonds maturing in varying installments through 2040 | - | <u>500,000</u> | - | <u>500,000</u> |
| Total bonds payable | 19,218,937 | <u>3,503,375</u> | <u>887,515</u> | <u>21,834,797</u> |
| Current portion of bonds and notes payable | <u>235,015</u> | | | <u>266,026</u> |
| Bonds and notes payable — less current portion | <u>\$18,983,922</u> | | | <u>\$21,568,771</u> |

(Concluded)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

8. LONG-TERM DEBT (Continued)

Derivatives — In October 2007, the Authority entered into two interest rate exchange agreements for a combined notional amount of \$401 million in conjunction with its sale of Adjustable Rate Fiscal 2008 Series BB Second General Resolution Bonds. Under the terms of these agreements, the Authority pays a fixed rate of 3.439% in exchange for a floating rate based on 67% of one-month LIBOR. These agreements effectively converted the Adjustable Rate Fiscal 2008 Series BB Second General Resolution Bonds to a fixed rate; however a mismatch between the rate paid on the bonds and the rate received under the interest rate exchange agreements can occur.

In 2004, the Authority entered into a \$200 million interest rate exchange agreement under which the Authority receives a fixed rate in exchange for a floating rate based on the SIFMA Index (formerly the BMA Municipal Swap Index). This effectively converted a portion of the Authority's second resolution bonds issued through the New York State Environmental Facilities Corporation to variable rate bonds. The terms of this agreement require the Authority to pay the SIFMA index and the counterparty to pay 3.567%.

In 2003, the Authority sold \$20 million of muni-CP bonds in the 2013 maturity of its Fiscal 2003 Series A issue. In connection with the muni-CP bonds, the Authority entered into an interest rate exchange agreement under which the Authority receives a floating rate tied to the consumer price index, which matches the rate on the bonds, and pays a fixed interest rate. This allowed the Authority to achieve a yield 10 basis points lower than traditional fixed rate debt with a 2013 maturity. The terms of this transaction require the counterparty to pay the Authority the muni-CP rate, which is set at 1.53% plus a floating rate CPI, with the CPI being equal to the change in the consumer price index.

In keeping with market standards, the Authority or the counterparty may terminate the swap if the other party fails to perform under its terms as defined in the agreements. The counterparties may terminate the agreement only upon certain events, which are unlikely given the Authority's high credit ratings. Depending on the fair value at the time of termination, the Authority may have a liability to the counterparties. Through the swap agreements the Authority is also exposed to counterparty credit risk; the risk that the counterparty's credit deteriorates or that the counterparty defaults under the agreement. To mitigate counterparty credit risk, the agreement requires the counterparty to post collateral for the Authority's benefit if it is downgraded below a designated threshold, and if the fair value is in the authority's favor, as defined in the agreement.

The appropriate measurement of these risks at the reporting date is the fair value of the swap. The fair value of the swaps at June 30, 2009 and 2008 was approximately \$36.8 million and \$7.7 million in favor of the counterparty, respectively.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

9. RESTRICTED ASSETS

As of June 30, 2009 and 2008, certain cash, investments, and accrued interest of the System are restricted as follows (in thousands):

| | 2009 | 2008 |
|---|---------------------|---------------------|
| The Board: | | |
| Operation and maintenance reserve account | \$ 195,834 | \$ 200,428 |
| Operation and maintenance reserve general account | <u>10</u> | <u>10</u> |
| Total Board | <u>195,844</u> | <u>200,438</u> |
| | | |
| The Authority: | | |
| Revenue fund | 285,348 | 209,130 |
| Debt service reserve fund | 878,121 | 836,028 |
| Debt service fund | 11,061 | 7,766 |
| Construction fund | 397,946 | 247,730 |
| Escrow fund | 158,171 | 179,243 |
| Operating fund | <u>8,967</u> | <u>-</u> |
| Total Authority | <u>1,739,614</u> | <u>1,479,897</u> |
| | | |
| Total restricted assets | <u>\$ 1,935,458</u> | <u>\$ 1,680,335</u> |

The operation and maintenance reserve account is established as a depository to hold the operations and maintenance reserve fund as required by the Resolution. It is required to hold one-sixth of the operating expenses as set forth in the annual budget. It is funded through the cash receipts of the Board. The operation and maintenance reserve general account is established as a depository to hold all excess funds of the Board after all legally mandated transfers have been made. It is available to meet any deficiencies in the flow of funds including debt service and alternatively can be used as a financing source for capital expenditures.

The revenue fund is established as a depository to fund the debt service, Authority expenses, debt service reserve and escrow funds. It is funded through cash transfers from the Board. The debt service reserve fund is established as a depository to hold the maximum annual debt service requirement for the next current or any future fiscal year. It is funded through revenue bond proceeds and the revenue fund.

The debt service fund is established as a depository to pay all principal and interest payments on the Authority's debt for the current fiscal year. It is funded through the revenue fund. The construction fund is established as a depository to pay all capital construction costs incurred by the City and reimbursed by the Authority. It is funded through the proceeds of commercial paper, bond and note sales. The escrow fund is established as a depository to refund debt in future years. It is funded through bond proceeds.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

10. COMMITMENTS AND CONTINGENCIES

- a. **Construction** — The System has contractual commitments of approximately \$7.2 billion and \$7.8 billion at June 30, 2009 and 2008, respectively, for water and sewer projects.
- b. **Risk financing activities** — The System is self insured and carries no commercial or insurance policies other than Directors and Officers insurance for the Water Authority. Any claims made against the System are resolved through the City's legal support and the amounts of the maximum liability for such judgments are described in (c) below. The System is subject to claims for construction delays, property damage, personal injury and judgments related to delays in construction deadlines under consent agreements.
- c. **Claims and Litigation** — In accordance with the Lease, the Board is required to reimburse the City for any judgment or settlement paid by the City arising out of a tort claim to the extent that the City's liability is related to capital improvements and the operation or maintenance of the System. However, in no event shall the payment made to the City, in any fiscal year, exceed an amount equal to 5% of the aggregate revenues shown on the prior year's audited financial statements of the System. In addition, the System is required to reimburse the City, to the extent requested by the City, for the payment of any judgment or settlement arising out of a contract claim with respect to the construction of capital improvements. In addition, the City has agreed, subject to certain conditions, to indemnify the Authority, the Board and their staffs against any and all liability in connection with any act done or omitted in the exercise of their powers which is taken or omitted in good faith in pursuance of their purposes under the Act. Currently, the City is a defendant in a significant number of lawsuits pertaining to the System. The litigation includes, but is not limited to, actions commenced and claims asserted against the City arising out of alleged torts, alleged breaches of contract, condemnation proceedings and other alleged violations of law. As of June 30, 2009, the potential future liability attributable to the System for claims outstanding against the City was estimated to be \$200 million. This amount is included in the estimated liability for unsettled claims, which is reported in the City's balance sheet. The potential future liability is the City's best estimate based on available information. The estimate may be revised as further information is obtained and as pending cases are litigated.
- d. **Arbitrage Rebate** — To maintain the exemption from Federal income tax of interest on bonds issued subsequent to January 1, 1986, the System will fund amounts required to be rebated to the Federal Government pursuant to Section 148 of the Internal Revenue Code of 1986, as amended (the "Code"). The Code requires the payment to the United States Treasury of the excess of the amount earned on all nonpurpose obligations over the amount that would have been earned if the gross proceeds of the issue were invested at a rate equal to the yield on the issue, together with any earnings attributable to such excess. Construction funds, debt service funds or any other funds or accounts funded with proceeds of such bonds, including earnings, or pledged to or expected to be used to pay interest on such bonds are subject to this requirement. Payment is to be made after the end of the fifth bond year and after every fifth bond year thereafter, and within 60 days after retirement of the bonds. During Fiscal 2009 and 2008, the System paid \$2.46 million and \$7.16 million, respectively, in rebates. At June 30, 2009 and 2008, the Authority had a liability of \$6.3 million and \$2.80 million, respectively.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

11. PENSION PLANS

During Fiscal 2009, the System was billed and contributed \$52 thousand for 8 employees who participate in the defined benefit pension plan. All other personnel are employees of the City and are covered under the City's pension plan. The System pays the costs of the City employees' pension through an allocation of fringe benefit costs, which is included principally within operations and maintenance expenses in the accompanying financial statements.

12. OTHER POST-EMPLOYMENT BENEFITS

Plan Description — The Authority's policy is to provide certain health and related benefits to eligible retirees of the Authority, which constitutes another postemployment benefit ("OPEB") plan (the "Plan") in accordance with GASB Statement No. 45, (GASB 45) *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

The Authority's policy is to follow the eligibility criteria applicable to retirees of the City and to provide benefits substantially the same as those provided to City retirees and eligible beneficiaries/dependents. OPEB benefits include health insurance, Medicare Part B premium reimbursements, and employee welfare fund contributions.

Funding Policy — The Authority is not required to provide funding for OPEB, other than the pay-as-you-go amount necessary to provide current benefits to retirees and eligible beneficiaries/dependents. For the years ended June 30, 2009 and 2008, the Authority had two retirees and made a contribution of \$7.4 thousand. Members are not required to contribute, although retirees may elect basic health insurance programs and/or optional coverage that require contributions.

Annual OPEB Cost and Net OPEB Obligation — The Authority's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer ("ARC"), an amount that was actuarially determined in accordance with the parameters of GASB 45. The frozen entry age cost method was used in the actuarial valuation prepared as of June 30, 2009, which was the basis for the Fiscal 2009 ARC calculation.

The following table shows the elements of the Authority's annual OPEB cost, the amounts actually contributed, and changes in the Authority's net OPEB obligation for the fiscal year ended June 30, 2009:

| | |
|--|---------------|
| Annual required contribution | \$ 402 |
| Interest on net OPEB obligations | 13 |
| Adjustment to annual required contribution | <u>(329)</u> |
| Annual OPEB cost | 86 |
| Payments | (7) |
| Net OPEB obligation — beginning of year | <u>316</u> |
| Net OPEB obligation — end of year | <u>\$ 395</u> |

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

12. OTHER POST-EMPLOYMENT BENEFITS (Continued)

The Authority's annual OPEB cost, the percentage of annual OPEB cost contributed, and the net OPEB obligation for the fiscal years ended June 30, 2009, June 30, 2008 and June 30, 2007 were as follows:

| Fiscal Years | Annual OPEB cost | Percentage of Annual OPEB Cost Contributed | Net OPEB Obligation |
|---------------------|-----------------------------|---|------------------------------------|
| June 30, 2009 | \$ 86 | 8.6 % | \$ 395 |
| June 30, 2008 | 88 | - | 316 |
| June 30, 2007 | (168) | - | 229 |
| June 30, 2006 | 398 | - | 398 |

The OPEB cost for Fiscal 2007 was negative, reflecting the reduction of the Authority's OPEB liability that resulted from the transfer of a large portion of the Authority's administrative staff members to the City, which assumed the OPEB obligations for the transferred staff members.

Funded Status and Funding Progress — As of June 30, 2009, the most recent actuarial valuation date, the cost was 0% funded. The actuarial accrued liability for benefits was \$317 thousand, and the actuarial value of assets was \$0, resulting in an unfunded actuarial accrued liability ("UAAL") of \$317 thousand. The covered payroll (annual payroll of active employees covered by the Plan) was \$729 thousand, and the ratio of the UAAL to the covered payroll was 43.5%.

Actuarial Methods and Assumptions — Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future, such as assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the Plan and the annual required contributions of the Authority are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. Projections of benefits for financial reporting purposes are based on the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and employees to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

The schedule of funding progress, shown as required supplementary information below, presents the results of OPEB valuations as of June 30, 2008, 2007, 2006 and 2005 to provide multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

12. OTHER POST-EMPLOYMENT BENEFITS (Continued)

Required Supplementary Information (unaudited)

Schedule of Funding Progress

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Liability (AAL) — Entry Age | Unfunded AAL (UAAL) | Funded Ratio | Covered Payroll | UAAL as a Percentage of Covered Payroll |
|--------------------------|---------------------------|---------------------------------------|---------------------|--------------|-----------------|---|
| June 30, 2008 | \$ - | \$ 317 | \$ 317 | - % | \$ 729 | 43.5 % |
| June 30, 2007 | - | 242 | 242 | - | 486 | 50.0 |
| June 30, 2006 | - | 173 | 173 | - | 306 | 56.0 |
| June 30, 2005 | - | 308 | 308 | - | 1,041 | 29.6 |

13. POLLUTION REMEDIATION OBLIGATIONS

As previously discussed, the System has implemented GASB 49, requiring the reporting of pollution remediation obligations (“PROs”). The System’s PROs arise as a result of: (1) federal, state and local laws and regulations, (2) violations of pollution-related permits or licenses, (3) because the System has determined that there is an imminent endangerment to public health and safety as a result of an existing pollution condition, (4) because the System has been named in a lawsuit to compel remediation or has been identified by a regulator as a party responsible or potentially responsible for remediation and/or (5) because the System has voluntarily commenced remediation. As of June 30, 2009, the System reported \$119.0 million of liabilities for known PROs and has restated its fiscal year 2009 beginning net assets (as disclosed in note 2) to reflect a June 30, 2008 liability of \$61.6 million for known PROs, in accordance with GASB 49.

The System has estimated these amounts based on the current value of outlays expected to be incurred for pollution remediation which it is currently obligated to perform. Actual future outlays will differ from the estimated amounts if the prices or techniques for remediation measures change or differ from estimates, if and when additional information about existing pollution conditions becomes known to the System in the future and/or if applicable laws or regulations change.

Remediation outlays for certain pollution conditions currently known to the System are not included in the reported liabilities because they are not yet reasonably estimable. These include certain locations that the System has been informed may be designated, under federal law, as Superfund sites, to address hazardous substances, pollutants, or contaminants at these sites and for which the System may be named as a potentially responsible party for the remediation because there are System facilities operated at these locations.

14. RELATED PARTY TRANSACTIONS

During Fiscal 2009 the Authority bought \$ 189.9 million of New York City Transitional Finance Authority (“TFA”) bonds. At June 30, 2009, the Authority held \$64.6 million in TFA bonds.

15. SUBSEQUENT EVENTS

On August 11 2009 the Authority issued \$200 million of commercial paper notes, Series 1 to pay for construction costs of the System.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (CONTINUED)

On September 3, 2009 the Authority issued \$100 million of commercial paper notes, Series 7 to pay for construction costs of the System.

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