

FINANCIAL STATEMENTS AND REPORT OF  
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

**NEW YORK CITY WATER AND SEWER SYSTEM**

June 30, 2005 and 2004

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**REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS**

To the Members of the Boards of  
**New York City Municipal Water Finance Authority  
and the New York City Water Board**

We have audited the accompanying balance sheets and the related statements of revenues, expenses and changes in net assets, and cash flows 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 and for the years ended June 30, 2005 and 2004. These financial statements, which collectively comprise the basic financial statements of the System, 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 as established by the Auditing Standards Board of the American Institute of Certified Public Accountants. 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 opinions.

In our opinion, the financial statements referred to above 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, 2005 and 2004, 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.

The accompanying management's discussion and analysis ("MD&A") is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. However, we did not audit the information comprising the MD&A and express no opinion on it.

*Grant Thornton LLP*

New York, New York  
October 18, 2005

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, 2005 and 2004. 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 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 by GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis - for State and Local Governments: Omnibus." 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 years 2005, 2004 and 2003.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(in thousands)		
Revenues			
Water supply and distribution	\$ 755,693	\$ 713,097	\$ 690,093
Sewer collection and treatment	1,043,575	984,753	952,985
Other operating revenues	<u>85,459</u>	<u>75,283</u>	<u>68,842</u>
Total operating revenues	1,884,727	1,773,133	1,711,920
Subsidy income	78,834	68,311	65,816
Investment income, net	<u>97,362</u>	<u>86,949</u>	<u>96,236</u>
Total revenues	<u>2,060,923</u>	<u>1,928,393</u>	<u>1,873,972</u>
Expenses			
Operations and maintenance	944,919	933,736	875,762
Bad debt expense	114,702	116,108	89,400
Administration and general	23,168	19,853	15,181
Depreciation and amortization	515,325	451,585	389,626
Loss on retirement of fixed assets	7,971	25,214	-
Interest expense	<u>668,675</u>	<u>612,054</u>	<u>584,347</u>
Total expenses	<u>2,274,760</u>	<u>2,158,550</u>	<u>1,954,316</u>
Net loss before capital contributions (distributions)	(213,837)	(230,157)	(80,344)
Capital (distributions) contributions, net	<u>(185,242)</u>	<u>29,875</u>	<u>7,233</u>
Change in net assets	(399,079)	(200,282)	(73,111)
Net assets - beginning	<u>3,554,183</u>	<u>3,754,465</u>	<u>3,827,576</u>
Net assets - ending	<u>\$3,155,104</u>	<u>\$3,554,183</u>	<u>\$3,754,465</u>

New York City Water and Sewer System

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

2005 -2004

Total operating revenues increased by 6.3%, principally resulting from a rate increase of 5.5%.

2004 - 2003

Total operating revenues increased by 3.6% on a rate increase of 5.5%. Water consumption declined by 1.5% over the previous year.

The following summarizes other operating revenues (in thousands):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Upstate water fees	\$27,290	\$24,611	\$22,790
Late payment fees	47,810	41,767	38,235
Connection fees and permits	<u>10,359</u>	<u>8,905</u>	<u>7,817</u>
Total other revenues	<u>\$85,459</u>	<u>\$75,283</u>	<u>\$68,842</u>

2005 - 2004

The System has increased its collections of past-due amounts, which resulted in an increase in late payments fee revenue of nearly 40% or \$16.4 million.

2005 - 2004

Investment income increased by 11.9%. Total investment balances remained about the same, but there were no additional arbitrage rebate expenses in 2005 and interest rates earned on investments increased.

Total operations and maintenance expenses increased by \$14 million or 1.5%. The rental payment to the City for debt service decreased by over \$6 million, and judgments and claims decreased by over \$25 million. All other operations and maintenance expenses increased by \$44 million or 5.5%.

Bad debt expense decreased by \$1.4 million. Receivable balances have decreased, as the System has collected on past-due amounts, and bad debt expense has leveled as a percentage of revenues.

Interest expense increased by \$56.6 million or 9.25%. Total debt of the System has increased by 10.2% and interest expense has increased by a similar percentage.

In 2005, the System granted back to the City land that had been purchased with bond proceeds. The total granted was \$187.6 million. The System also received grants from other sources of \$2.4 million.

New York City Water and Sewer System

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

2004 - 2003

Investment income decreased by 9.7%. The Authority had \$5.7 million in arbitrage rebates in 2004, which are netted against investment income. Total investments decreased by \$300 million.

Total operations and maintenance expense increased by \$58 million or 6.6%. Expenses for operations of the System increased by \$44 million, and the rental payment to the City for debt service increased by \$14 million. The two major components of the increase in operations and maintenance were increased costs of \$17 million for upstate watershed protection, and an increase of \$12 million in judgments and claims. The rental payment increased primarily due to higher debt service payments coming due on bonds issued by New York City prior to the inception of the System.

Bad debt expense increased by \$27 million. The System continues to evaluate the accounts receivable balances and where required deems uncollectible accounts to be written off to bad debt expense.

Interest expense increased by \$28 million or 4.7%. The total debt of the System has increased by \$550 million or 4%, and interest expense has increased by nearly the same percentage.

A summary of the System's assets, liabilities and net assets (in thousands) follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(in thousands)		
Current assets	\$ 2,436,222	\$ 2,423,309	\$ 2,779,146
Deferred bond and financing expenses	125,582	112,540	111,794
Capital assets	<u>16,008,960</u>	<u>15,174,128</u>	<u>14,163,830</u>
Total assets	<u>18,570,764</u>	<u>17,709,977</u>	<u>17,054,770</u>
Long-term liabilities	13,955,495	12,565,882	11,894,966
Current liabilities	<u>1,460,165</u>	<u>1,589,912</u>	<u>1,405,339</u>
Total liabilities	<u>15,415,660</u>	<u>14,155,794</u>	<u>13,300,305</u>
Net assets			
Invested in capital assets, net of related debt	2,803,031	3,368,355	3,271,440
Restricted for debt service	152,544	179,106	203,695
Restricted for operations and maintenance	145,693	135,701	132,107
Unrestricted (deficit)	<u>53,836</u>	<u>(128,979)</u>	<u>147,223</u>
Total net assets	<u>3,155,104</u>	<u>3,554,183</u>	<u>3,754,465</u>
Total liabilities and net assets	<u>\$18,570,764</u>	<u>\$17,709,977</u>	<u>\$17,054,770</u>

New York City Water and Sewer System

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

2005 - 2004

Current assets increased by \$9 million. Total investments and receivables remained about the same.

Total liabilities increased by \$1.3 billion, which was due to the increase in debt payable.

2004 - 2003

Current assets decreased by \$356 million or 12.8%. Net receivables, including unbilled revenues, decreased by \$32 million, and the System's receivable from the City for overpayment of operations and maintenance expense decreased from 2003 by \$10 million.

The major decrease in investments was \$267 million in the construction fund. The balances in this fund are available to pay for capital projects and vary due to the timing of the reissuance of commercial paper following the issue of long-term bonds. In 2004, \$40 million in principal payments were made from the escrow funds.

Capital assets are described in a separate section of this discussion.

In 2004, the System issued an additional \$100 million of commercial paper and terminated \$125 million, which brought the total program amount to \$800 million. Current liabilities increased by \$184 million primarily due to an increase in payable to the City of \$219 million. Total commercial paper outstanding decreased by \$25 million.

Long-term liabilities increased by \$671 million or 6%. A detailed discussion of the debt issued by the System is provided in the Debt Administration section of this discussion.

Capital Assets

The System's capital assets include buildings, equipment, water treatment systems and water collection systems. Such amounts are detailed as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(in thousands)		
Utility plant construction	\$ <u>4,010,861</u>	\$ <u>3,564,455</u>	\$ <u>2,845,080</u>
Land	-	142,409	116,576
Buildings	22,071	22,071	22,071
Equipment	424,673	378,333	288,250
Water supply and wastewater treatment systems	10,152,707	9,619,222	9,577,106
Water distribution and sewage collection systems	<u>7,579,881</u>	<u>7,196,035</u>	<u>6,676,855</u>
Total utility plant in service	<u>18,179,332</u>	<u>17,358,070</u>	<u>16,680,858</u>
Less accumulated depreciation	<u>6,181,233</u>	<u>5,748,397</u>	<u>5,362,108</u>
Total, net utility plant in service	<u>11,998,099</u>	<u>11,609,673</u>	<u>11,318,750</u>
Total capital assets	<u>\$16,008,960</u>	<u>\$15,174,128</u>	<u>\$14,163,830</u>



New York City Water and Sewer System

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

The net increase in the System's capital assets during fiscal year 2005 was \$834 million or 5.5 %. Net capital asset additions for 2005 were \$1,268 million.

The net increase in the System's capital assets during fiscal year 2004 was \$1.0 billion or 7.1 %. Net capital asset additions for 2004 were \$ 1,397 million.

The capital assets of the System are detailed in footnotes 2-d and 3 of the notes to the accompanying financial statements.

Debt Administration

The Authority issues debt to pay for the capital improvements to the System. 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 issues refunding bonds to refinance higher coupon debt.

At June 30, 2005, the total outstanding debt of the System was \$15.4 billion, of which \$800 million was commercial paper. The remaining \$14.6 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, 2005 was as follows:

	<u>(In thousands)</u>
Issue date	
2005	\$ 2,827,544
2004	1,703,622
2003	2,881,100
2002	2,160,587
2001	1,035,925
2000 and prior	<u>4,025,273</u>
Total long-term debt	<u>\$14,634,051</u>

In the above, bonds retired through refundings in 2005 are removed from the year in which the refunded bonds were issued.

## New York City Water and Sewer System

### MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

In fiscal year 2005, the Authority issued \$2,227,600,000 of water and sewer revenue bonds directly to the public, including \$1,152,600,000 of refunding bonds and \$1,075,000,000 in long-term financing. The Authority also issued \$621,033,499 in Clean Water and Drinking Water State Revolving Fund ("SRF") bonds to EFC, all of which were issued for new money purposes. The new money bond proceeds provided long-term financing of commercial paper notes which had previously financed capital improvements to New York City's Water and Sewer System.

In fiscal year 2005, the Authority closed six bonds. The First Resolution Fiscal 2005 Series A, B, C and D bonds consisted of bond sales directly to the public. The Second Resolution Fiscal 2005 Series 1 and Series 2 bonds were issued to EFC to secure bonds issued by EFC on behalf of the Authority.

On September 5, 2004, the Authority closed its first transaction of fiscal year 2005. The Fiscal 2005 Series A bonds were sold for a par amount of \$150 million. The issue was comprised of a term bond maturing in 2039. Proceeds from the sale were used to defease a portion of the Authority's Series 1 commercial paper notes, fund a portion of the debt service reserve fund and pay costs of issuance.

On September 11, 2004, the Authority closed its first transaction with EFC in fiscal year 2005. The Fiscal 2005 Series 1 bonds, issued to EFC in the amount of \$230,408,946 to secure bonds issued by EFC, were sold in a common plan of finance with the Authority's Series A bonds. Proceeds were used to defease the Authority's commercial paper Series 5 notes and a portion of the Authority's Series 7 notes, which had funded eligible Clean Water and Drinking Water SRF projects. Proceeds were also used to pay the costs of issuance for the bonds.

On November 30, 2004, the Authority closed its second transaction with EFC in fiscal year 2005. The Fiscal 2005 Series 2 bonds, issued to EFC in the amount of \$390,624,553, were to secure bonds issued by EFC. Proceeds were used to defease the Authority's commercial paper Series 5 Lot A and Series 7 notes and a portion of the Authority's Series 5 Lot B notes, which had funded eligible Clean Water and Drinking Water SRF projects. Proceeds were also used to pay the costs of issuance for the bonds.

On December 8, 2004, the Authority issued its Fiscal 2005 Series B bonds. The bonds were sold at a par amount of \$935,480,000. Proceeds from the sale were used to refund a portion of the Fiscal 1997 Series A and Series B bonds, to defease all of the Authority's commercial paper Series 1 and 6 notes, pay certain costs of issuance, and fund a portion of the debt service reserve fund. The issue included serial bonds in years 2005 through 2024 and Term bonds in 2028, 2029 and 2036.

On March 17, 2005, the Authority issued its Fiscal 2005 Series C bonds. The bonds were sold at a par amount of \$582,915,000. Proceeds from the sale were used to refund Fiscal 1997 Series A and Series B bonds, Fiscal 2000 Series A bonds, Fiscal 2002 Series A bonds, and Fiscal 2003 Series A, to pay certain costs of issuance, and to fund a portion of the Authority's capital program. The issue included serial bonds in years 2005 through 2031. A portion of the Fiscal 2005 Series C bonds were insured by the MBIA Insurance Corporation.

New York City Water and Sewer System

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

On April 26, 2005, the Fiscal 2005 Series D bonds were sold for a par amount of \$559,205,000. Proceeds from the sale were used to fund a construction fund, to defease all of the Authority's commercial paper Series 6 and Series 7 and a portion of its Series 5 Lot B notes, pay certain costs of issuance, and fund a portion of the debt service reserve fund. The issue included bonds in years 2037 through 2039. A portion of the 2039 maturity was insured by Ambac Assurance Corporation.

In fiscal 2005, the Authority defeased with revenues, \$183,240,000 of outstanding General Resolution Bonds on June 27, 2005, including portions of Fiscal 1993 Series A, Fiscal 1996 Series C, Fiscal 1997 Series A, Fiscal 1998 Series A, Fiscal 1998 Series C, Fiscal 1998 Series D, Fiscal 1999 Series B, Fiscal 2001 Series D and Fiscal 2003 Series D bonds.

The total of bonds and notes payable are detailed in footnote numbers 7 and 8 of the notes to the financial statements.

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 5.5% for fiscal 2006 became effective July 1, 2004 based on projected revenues and costs.

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, Manager of Public Relations, New York City Municipal Water Finance Authority, 75 Park Place, New York, NY 10007. His phone number is (212) 788-5875 and his fax number is (212) 788-9721.

New York City Water and Sewer System

**BALANCE SHEETS**

June 30, 2005

(in thousands)

Assets	<u>New York City</u>		<u>Eliminations</u>	<u>Total</u>
	<u>Water Board</u>	<u>Municipal Water Finance Authority</u>		
Utility plant in service, less accumulated depreciation of \$6,181,233	\$11,998,099	\$ -	\$ -	\$11,998,099
Utility plant construction	<u>4,010,861</u>	<u>-</u>	<u>-</u>	<u>4,010,861</u>
Total capital assets	<u>16,008,960</u>	<u>-</u>	<u>-</u>	<u>16,008,960</u>
Current assets				
Cash and cash equivalents	83,666	1,015,387	-	1,099,053
Investments	72,427	795,875	-	868,302
Accrued interest receivable	282	2,989	-	3,271
Accounts receivable				
Billed, less allowance for uncollectible receivables of \$207,239	283,139	-	-	283,139
Unbilled	150,806	-	-	150,806
Receivable from the City	31,390	-	-	31,390
Other	<u>-</u>	<u>261</u>	<u>-</u>	<u>261</u>
Total current assets	<u>621,710</u>	<u>1,814,512</u>	<u>-</u>	<u>2,436,222</u>
Revenue requirement to be billed by and received from the Board	-	7,568,568	(7,568,568)	-
Long-term deferred bond and financing expenses	<u>-</u>	<u>125,582</u>	<u>-</u>	<u>125,582</u>
Total assets	<u>\$16,630,670</u>	<u>\$ 9,508,662</u>	<u>\$(7,568,568)</u>	<u>\$18,570,764</u>

New York City Water and Sewer System

**BALANCE SHEETS (continued)**

June 30, 2005  
(in thousands)

Liabilities and Net Assets	New York City		Eliminations	Total
	Water Board	Municipal Water Finance Authority		
<b>Long-term liabilities</b>				
Bonds and notes payable, less current portion	\$ -	\$ 14,396,067	\$ -	\$14,396,067
Net discount on bonds and notes payable	-	(100,304)	-	(100,304)
Deferred bond refunding costs	-	(340,268)	-	(340,268)
Revenue requirement payable to the Authority	<u>7,568,568</u>	<u>-</u>	<u>(7,568,568)</u>	<u>-</u>
<b>Total long-term liabilities</b>	<u>7,568,568</u>	<u>13,955,495</u>	<u>(7,568,568)</u>	<u>13,955,495</u>
<b>Current liabilities</b>				
Accounts payable and accrued expenses	6,510	38,325	-	44,835
Revenues received in advance	70,482	-	-	70,482
Current portion of bonds and notes payable	-	1,037,984	-	1,037,984
Payable to the City	-	288,136	-	288,136
Refunds payable to customers	<u>18,728</u>	<u>-</u>	<u>-</u>	<u>18,728</u>
<b>Total current liabilities</b>	<u>95,720</u>	<u>1,364,445</u>	<u>-</u>	<u>1,460,165</u>
<b>Total liabilities</b>	<u>7,664,288</u>	<u>15,319,940</u>	<u>(7,568,568)</u>	<u>15,415,660</u>
<b>Net assets</b>				
Invested in capital assets, net of related debt	16,008,960	(13,205,929)	-	2,803,031
Restricted for debt service	-	152,544	-	152,544
Restricted for operations and maintenance	145,693	-	-	145,693
Unrestricted (deficit)	<u>(7,188,271)</u>	<u>7,242,107</u>	<u>-</u>	<u>53,836</u>
<b>Total net assets</b>	<u>8,966,382</u>	<u>(5,811,278)</u>	<u>-</u>	<u>3,155,104</u>
<b>Total liabilities and net assets</b>	<u>\$16,630,670</u>	<u>\$ 9,508,662</u>	<u>\$(7,568,568)</u>	<u>\$18,570,764</u>

*The accompanying notes are an integral part of these statements.*

New York City Water and Sewer System

**BALANCE SHEETS**

June 30, 2004  
(in thousands)

Assets	New York City		Eliminations	Total
	Water Board	Municipal Water Finance Authority		
Utility plant in service, less accumulated depreciation of \$5,748,397	\$11,609,673	\$ -	\$ -	\$11,609,673
Utility plant construction	<u>3,564,455</u>	<u>-</u>	<u>-</u>	<u>3,564,455</u>
Total capital assets	<u>15,174,128</u>	<u>-</u>	<u>-</u>	<u>15,174,128</u>
Current assets				
Cash and cash equivalents	81,334	1,067,751	-	1,149,085
Investments	64,905	758,132	-	823,037
Accrued interest receivable	484	3,273	-	3,757
Accounts receivable				
Billed, less allowance for uncollectible receivables of \$242,478	298,322	-	-	298,322
Unbilled	143,625	-	-	143,625
Receivable from the City	3,323	-	-	3,323
Other	<u>1</u>	<u>2,159</u>	<u>-</u>	<u>2,160</u>
Total current assets	<u>591,994</u>	<u>1,831,315</u>	<u>-</u>	<u>2,423,309</u>
Revenue requirement to be billed by and received from the Board	-	6,861,567	(6,861,567)	-
Long-term deferred bond and financing expenses	<u>-</u>	<u>112,540</u>	<u>-</u>	<u>112,540</u>
Total assets	<u>\$15,766,122</u>	<u>\$ 8,805,422</u>	<u>\$(6,861,567)</u>	<u>\$17,709,977</u>

New York City Water and Sewer System

**BALANCE SHEETS (continued)**

June 30, 2004  
(in thousands)

Liabilities and Net Assets	New York City		Eliminations	Total
	Water Board	Municipal Water Finance Authority		
Long-term liabilities				
Bonds and notes payable, less current portion	\$ -	\$ 13,028,277	\$ -	\$13,028,277
Net discount on bonds and notes payable	-	(197,293)	-	(197,293)
Deferred bond refunding costs	-	(265,102)	-	(265,102)
Revenue requirement payable to the Authority	<u>6,861,567</u>	<u>-</u>	<u>(6,861,567)</u>	<u>-</u>
Total long-term liabilities	<u>6,861,567</u>	<u>12,565,882</u>	<u>(6,861,567)</u>	<u>12,565,882</u>
Current liabilities				
Accounts payable and accrued expenses	6,745	30,560	-	37,305
Revenues received in advance	78,231	-	-	78,231
Current portion of bonds and notes payable	-	1,004,640	-	1,004,640
Payable to the City	-	451,162	-	451,162
Refunds payable to customers	<u>18,574</u>	<u>-</u>	<u>-</u>	<u>18,574</u>
Total current liabilities	<u>103,550</u>	<u>1,486,362</u>	<u>-</u>	<u>1,589,912</u>
Total liabilities	<u>6,965,117</u>	<u>14,052,244</u>	<u>(6,861,567)</u>	<u>14,155,794</u>
Net assets				
Invested in capital assets, net of related debt	15,174,128	(11,805,773)	-	3,368,355
Restricted for debt service	-	179,106	-	179,106
Restricted for operations and maintenance	135,701	-	-	135,701
Unrestricted (deficit)	<u>(6,508,824)</u>	<u>6,379,845</u>	<u>-</u>	<u>(128,979)</u>
Total net assets	<u>8,801,005</u>	<u>(5,246,822)</u>	<u>-</u>	<u>3,554,183</u>
Total liabilities and net assets	<u>\$15,766,122</u>	<u>\$ 8,805,422</u>	<u>\$(6,861,567)</u>	<u>\$17,709,977</u>

*The accompanying notes are an integral part of these statements.*

New York City Water and Sewer System

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**

Year ended June 30, 2005

(in thousands)

	<u>New York City</u>		<u>Total</u>
	<u>Water Board</u>	<u>Municipal Water Finance Authority</u>	
Operating revenues			
Water supply and distribution	\$ 755,693	\$ -	\$ 755,693
Sewer collection and treatment	1,043,575	-	1,043,575
Other operating revenues	<u>85,459</u>	<u>-</u>	<u>85,459</u>
Total operating revenues	<u>1,884,727</u>	<u>-</u>	<u>1,884,727</u>
Operating expenses			
Operations and maintenance	944,919	-	944,919
Bad debt expense	114,702	-	114,702
Administration and general	<u>6,840</u>	<u>16,328</u>	<u>23,168</u>
Total operating expenses	<u>1,066,461</u>	<u>16,328</u>	<u>1,082,789</u>
Depreciation and amortization	<u>460,458</u>	<u>54,867</u>	<u>515,325</u>
Operating income (loss)	357,808	(71,195)	286,613
Nonoperating revenue (expense)			
Interest expense	-	(668,675)	(668,675)
Loss on retirement of fixed assets	(7,971)	-	(7,971)
Subsidy income	-	78,834	78,834
Investment income	<u>782</u>	<u>96,580</u>	<u>97,362</u>
Net income (loss) before capital contributions (distributions)	350,619	(564,456)	(213,837)
Capital distributions - net	<u>(185,242)</u>	<u>-</u>	<u>(185,242)</u>
Change in net assets	165,377	(564,456)	(399,079)
Net assets (deficit) at beginning of year	<u>8,801,005</u>	<u>(5,246,822)</u>	<u>3,554,183</u>
Net assets (deficit) at end of year	<u>\$8,966,382</u>	<u>\$(5,811,278)</u>	<u>\$3,155,104</u>

*The accompanying notes are an integral part of these statements.*



New York City Water and Sewer System

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**

Year ended June 30, 2004  
(in thousands)

	<u>New York City</u>		
	<u>Water</u>	<u>Municipal</u>	
	<u>Board</u>	<u>Water</u>	
		<u>Finance</u>	<u>Total</u>
		<u>Authority</u>	
Operating revenues			
Water supply and distribution	\$ 713,097	\$ -	\$ 731,097
Sewer collection and treatment	984,753	-	984,753
Other operating revenues	<u>75,283</u>	<u>-</u>	<u>75,283</u>
Total operating revenues	<u>1,773,133</u>	<u>-</u>	<u>1,773,133</u>
Operating expenses			
Operations and maintenance	933,736	-	933,736
Bad debt expense	116,108	-	116,108
Administration and general	<u>4,970</u>	<u>14,883</u>	<u>19,853</u>
Total operating expense	1,054,814	14,883	1,069,697
Depreciation and amortization	<u>409,139</u>	<u>42,446</u>	<u>451,585</u>
Operating income (loss)	309,180	(57,329)	251,851
Nonoperating revenue (expense)			
Interest expense	-	(612,054)	(612,054)
Loss on retirement of fixed assets	(25,214)	-	(25,214)
Subsidy income	-	68,311	68,311
Investment income	<u>1,237</u>	<u>85,712</u>	<u>86,949</u>
Net income (loss) before capital contributions	285,203	(515,360)	(230,157)
Capital contributions - net	<u>29,875</u>	<u>-</u>	<u>29,875</u>
Change in net assets	315,078	(515,360)	(200,282)
Net assets (deficit) at beginning of year, as restated	<u>8,485,927</u>	<u>(4,731,462)</u>	<u>3,754,465</u>
Net assets (deficit) at end of year	<u>\$8,801,005</u>	<u>\$(5,246,822)</u>	<u>\$3,554,183</u>

*The accompanying notes are an integral part of these statements.*

New York City Water and Sewer System

**STATEMENTS OF CASH FLOWS**

Year ended June 30, 2005  
(in thousands)

	<u>New York City</u>		
	<u>Water</u>	<u>Municipal</u>	
	<u>Board</u>	<u>Water</u>	
		<u>Finance</u>	<u>Total</u>
		<u>Authority</u>	
Cash flows from operating activities			
Receipts from customers	\$1,770,432	\$ -	\$ 1,770,432
Payments for operations and maintenance	(927,391)	-	(927,391)
Payments for administration	<u>(7,075)</u>	<u>(16,727)</u>	<u>(23,802)</u>
Net cash provided by (used in) operating activities	<u>835,966</u>	<u>(16,727)</u>	<u>819,239</u>
Cash flows from capital and related financing activities			
Proceeds from issuing bonds, notes and other borrowings, net of issuance costs	-	4,480,669	4,480,669
Acquisition and construction of capital assets	-	(1,697,125)	(1,697,125)
Payments by the Board to the Authority	(827,097)	827,097	-
Repayments of bonds, notes and other borrowings	-	(3,136,879)	(3,136,879)
Interest paid on bonds, notes and other borrowings	<u>-</u>	<u>(570,415)</u>	<u>(570,415)</u>
Net cash used in capital and related financing activities	<u>(827,097)</u>	<u>(96,653)</u>	<u>(923,750)</u>
Cash flows from investing activities			
Proceeds from sales and maturities of investments	44,815	-	44,815
Purchases of investments	(52,337)	(35,194)	(87,531)
Interest on investments	<u>985</u>	<u>96,210</u>	<u>97,195</u>
Net cash provided by (used in) investing activities	<u>(6,537)</u>	<u>61,016</u>	<u>54,479</u>
Net increase (decrease) in cash and cash equivalents	<u>2,332</u>	<u>(52,364)</u>	<u>(50,032)</u>
Cash and cash equivalents, beginning of year	<u>81,334</u>	<u>1,067,751</u>	<u>1,149,085</u>
Cash and cash equivalents, end of year	<u>\$ 83,666</u>	<u>\$ 1,015,387</u>	<u>\$ 1,099,053</u>

*The accompanying notes are an integral part of these statements.*

New York City Water and Sewer System

**STATEMENTS OF CASH FLOWS (continued)**

Year ended June 30, 2005  
(in thousands)

	<u>New York City</u>		
	<u>Water Board</u>	<u>Municipal Water Finance Authority</u>	<u>Total</u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities			
Operating income (loss)	\$ 357,808	\$ (71,195)	\$ 286,613
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities			
Depreciation and amortization	460,458	54,867	515,325
Bad debt expense	114,702		114,702
Operations and maintenance expense paid with bond proceeds	45,595	-	45,595
Changes in net assets and liabilities			
Receivables, net	(106,701)	-	(106,701)
Receivable from the City	(28,067)	-	(28,067)
Other	1	(18)	(17)
Accounts payable and accrued expenses	(235)	(381)	(616)
Revenues received in advance	(7,749)	-	(7,749)
Refunds payable to customers	<u>154</u>	<u>-</u>	<u>154</u>
Net cash provided by (used in) operating activities	<u>\$ 835,966</u>	<u>\$ (16,727)</u>	<u>\$ 819,239</u>

The following are the noncash capital and related financing activities:

- Interest expense includes the amortization of premium and discount in the amount of \$10,543.
- Capital expenditures in the amount of \$288,136 had been incurred but not paid at June 30, 2005.
- The Board received capital assets of \$2,342 in 2005, which represented capital contributed by the City.

*The accompanying notes are an integral part of these statements.*

New York City Water and Sewer System

**STATEMENTS OF CASH FLOWS**

Year ended June 30, 2004

(in thousands)

	<u>New York City</u>		
	<u>Water Board</u>	<u>Municipal Water Finance Authority</u>	<u>Total</u>
Cash flows from operating activities			
Receipts from customers	\$ 1,696,738	\$ -	\$ 1,696,738
Payments for operations and maintenance	(874,854)	-	(874,854)
Payments for administration	<u>(4,732)</u>	<u>(14,948)</u>	<u>(19,680)</u>
Net cash provided by (used in) operating activities	<u>817,152</u>	<u>(14,948)</u>	<u>802,204</u>
Cash flows from capital and related financing activities			
Proceeds from issuing bonds, notes and other borrowings, net of issuance costs	-	2,728,279	2,728,279
Acquisition and construction of capital assets	-	(1,238,298)	(1,238,298)
Payments by the Board to the Authority	(811,421)	811,421	-
Repayments of bonds, notes and other borrowings	-	(2,174,239)	(2,174,239)
Interest paid on bonds, notes and other borrowings	<u>-</u>	<u>(515,787)</u>	<u>(515,787)</u>
Net cash used in capital and related financing activities	<u>(811,421)</u>	<u>(388,624)</u>	<u>(1,200,045)</u>
Cash flows from investing activities			
Proceeds from sales and maturities of investments	64,422	89,473	153,895
Purchases of investments	(64,845)	(175,659)	(240,504)
Interest on investments	<u>1,142</u>	<u>92,425</u>	<u>93,567</u>
Net cash provided by investing activities	<u>719</u>	<u>6,239</u>	<u>6,958</u>
Net increase (decrease) in cash and cash equivalents	<u>6,450</u>	<u>(397,333)</u>	<u>(390,883)</u>
Cash and cash equivalents, beginning of year	<u>74,884</u>	<u>1,465,084</u>	<u>1,539,968</u>
Cash and cash equivalents, end of year	<u>\$ 81,334</u>	<u>\$ 1,067,751</u>	<u>\$ 1,149,085</u>

New York City Water and Sewer System

**STATEMENTS OF CASH FLOWS (continued)**

Year ended June 30, 2004  
(in thousands)

	<u>New York City</u>		<u>Total</u>
	<u>Water Board</u>	<u>Municipal Water Finance Authority</u>	
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities			
Operating income (loss)	\$ 309,180	\$ (57,329)	\$ 251,851
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities			
Depreciation and amortization	409,139	42,446	451,585
Bad debt expense	116,108		116,108
Operations and maintenance expense paid with bond proceeds	43,230	-	43,230
Changes in net assets and liabilities			
Receivables, net	(83,609)	-	(83,609)
Receivable from the City	9,890	-	9,890
Accounts payable and accrued expenses	5,938	(65)	5,873
Revenues received in advance	9,075	-	9,075
Refunds payable to customers	<u>(1,799)</u>	<u>-</u>	<u>(1,799)</u>
Net cash provided by (used in) operating activities	<u>\$ 817,152</u>	<u>\$ (14,948)</u>	<u>\$ 802,204</u>

The following are the noncash capital and related financing activities:

- Interest expense includes the amortization of premium and discount in the amount of \$8,189.
- Capital expenditures in the amount of \$451,162 had been incurred but not paid at June 30, 2004.
- The Board received capital assets of \$29,875 in 2004, which represented capital contributed by the City.

*The accompanying notes are an integral part of these statements.*

New York City Water and Sewer System

**NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

**NOTE 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 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 water and sewer 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 Board.

In accordance with Statement No. 14, as amended by Statements No. 34 and 39 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.

**NOTE 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. GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Government

New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 2 (continued)

Entities that Use Proprietary Funds," provides proprietary activities with a choice of authoritative guidance issued after November 30, 1989. The System has elected to follow GASB pronouncements exclusively after that date. Other significant accounting policies are:

*a. Investments and Cash Equivalents*

Investments and cash equivalents consist principally of securities of the United States and its agencies, certificates of deposit, and repurchase agreements. Investments with maturity periods of greater than one year are carried at market value. Investments with maturities less than one year are carried at cost 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.

*b. Restricted Assets*

Proceeds from the issuance of debt and monies set aside for the operation and maintenance of the System are classified as restricted by applicable bond indentures.

*c. 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 the straight-line method for bond issuance costs.

*d. 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 over \$35,000. 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:

	<u>Years</u>
Buildings	40 - 50
Water supply and wastewater treatment systems	15 - 50
Water distribution and sewage collection systems	15 - 75
Equipment	5 - 35

New York City Water and Sewer System

**NOTES TO FINANCIAL STATEMENTS (continued)**

June 30, 2005

**NOTE 2 (continued)**

Maintenance and repairs of property are charged to maintenance expense. Replacements and betterments are recorded as utility plant.

*e. 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. 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.

*f. Deferred Revenues*

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

*g. Deferred Bond Refunding Costs*

Deferred bond refunding costs represent the accounting loss incurred in advance refundings of outstanding bonds. In accordance with the provisions of GASB Statement No. 23, "Accounting and Financial Reporting of Debt Reported by Proprietary Activities," 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.

*h. Reclassifications*

Certain reclassifications to the 2004 figures have been made in order to conform to the 2005 financial statement presentation.

*i. 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.



New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 3 - UTILITY PLANT

The following is a summary of utility plant activity for the fiscal years ended June 30, 2005 and 2004 (in thousands):

	Balance at June 30, 2003	Additions	Deletions	Balance at June 30, 2004	Additions	Deletions	Balance at June 30, 2005
Nondepreciable assets							
Utility construction	\$ 2,845,080	\$1,444,655	\$725,280	\$ 3,564,455	\$1,536,441	\$1,090,035	\$ 4,010,861
Land	116,576	25,833	-	142,409	-	142,409	-
Depreciable assets							
Buildings	22,071	-	-	22,071	-	-	22,071
Equipment	288,250	107,364	17,281	378,333	46,535	195	424,673
Water supply and wastewater treatment systems	9,577,106	72,903	30,787	9,619,222	534,474	989	10,152,707
Water distribution and sewage collection systems	<u>6,676,855</u>	<u>519,180</u>	<u>-</u>	<u>7,196,035</u>	<u>418,255</u>	<u>34,409</u>	<u>7,579,881</u>
	19,525,938	2,169,935	773,348	20,922,525	2,535,705	1,268,037	22,190,193
Less accumulated depreciation	<u>5,362,108</u>	<u>409,141</u>	<u>22,852</u>	<u>5,748,397</u>	<u>460,458</u>	<u>27,622</u>	<u>6,181,233</u>
	<u>\$14,163,830</u>	<u>\$1,760,794</u>	<u>\$750,496</u>	<u>\$15,174,128</u>	<u>\$2,075,247</u>	<u>\$1,240,415</u>	<u>\$16,008,960</u>

New York City Water and Sewer System

**NOTES TO FINANCIAL STATEMENTS (continued)**

June 30, 2005

**NOTE 4 - INVESTMENTS AND CASH DEPOSITS**

*a. 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 rate institutions; certain investment agreements with highly rated institutions; certain highly rated money market funds; and certain highly rated municipal obligations.

*b. 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 \$200 thousand on deposit at June 30, 2005 and 2004, which was covered by Federal depository insurance and the remaining balance was uncollateralized.

At June 30, 2005 and 2004, the carrying amounts of bank deposits were \$6,652 million and \$11,028 million, respectively, and the bank balances were \$8,204 million and \$12,745 million, respectively. The System had the following investments and maturities (in thousands):

<u>Investment type</u>	<u>2005</u>	<u>2004</u>	<u>Investment maturity</u>
Certificate of Deposit	\$ 99	\$ 96	Greater than one year
U.S. Government securities	1,138,713	1,233,668	Less than one year
New York State securities	81,170	44,391	Greater than one year
Repurchase agreements	76,376	19,797	Less than one year
Guaranteed investment contracts	<u>667,616</u>	<u>666,899</u>	Greater than one year
	<u>\$1,963,974</u>	<u>\$1,964,851</u>	

New York City Water and Sewer System

**NOTES TO FINANCIAL STATEMENTS (continued)**

June 30, 2005

**NOTE 4 (continued)**

All of the System's investments in U.S. agencies carry the explicit guarantee of the U.S. Government. At June 30, 2005, the System's investment in New York State securities was rated AAA by Standard & Poor's and Aaa by Moody's investment services. The System's investments in guaranteed investment contracts are not rated.

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, 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 the agent.

**NOTE 5 - LEASE AGREEMENT**

The Board is party to a long-term lease (the "Lease") with the City, which transfers all the water and sewer related real and personal 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 provisions 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.

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.

New York City Water and Sewer System

**NOTES TO FINANCIAL STATEMENTS (continued)**

June 30, 2005

**NOTE 5 (continued)**

A summary of operation and maintenance expenses for the years ended June 30, 2005 and 2004 is as follows (in thousands)

	<u>2005</u>	<u>2004</u>
Water transmission and distribution	\$291,488	\$284,461
Sewer collection systems	355,581	338,566
City agency support cost	53,562	52,399
Fringe benefits	83,425	70,466
Payments for watershed improvements	45,595	43,292
Judgments and claims	<u>6,081</u>	<u>27,910</u>
	835,732	817,094
Rental payments to the City	<u>109,187</u>	<u>116,642</u>
	<u>\$944,919</u>	<u>\$933,736</u>

**NOTE 6 - PAYABLE TO AND RECEIVABLE FROM THE CITY**

As of June 30, 2005 and 2004, 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, 2005 and 2004, the System had a net payable of \$256.7 million and \$447.8 million from the City for payments of utility construction and for overpayment of operations and maintenance expense.

New York City Water and Sewer System

**NOTES TO FINANCIAL STATEMENTS (continued)**

June 30, 2005

**NOTE 7 - SHORT-TERM LIABILITIES**

In fiscal years 2004 and 2005, the changes in short-term liabilities were as follows (in thousands):

	Balance at June 30, <u>2003</u>	<u>Additions</u>	<u>Deletions</u>	Balance at June 30, <u>2004</u>	<u>Additions</u>	<u>Deletions</u>	Balance at June 30, <u>2005</u>
Commercial paper (1)	<u>\$825,000</u>	<u>\$964,500</u>	<u>\$989,500</u>	<u>\$800,000</u>	<u>\$1,600,700</u>	<u>\$1,600,700</u>	<u>\$800,000</u>

(1) Commercial paper is used to pay construction costs in advance of long-term bond financing.

Commercial paper activity comprises the following for the year ended June 30, 2005 (in thousands):

	Balance at June 30, <u>2004</u>	<u>Issued</u>	<u>Retired</u>	Balance at June 30, <u>2005</u>
Commercial Paper Series 1 - Variable Rate, Short-term Rolling Maturity Backed by Letter of Credit	\$200,000	\$ 339,500	\$ 339,500	\$200,000
Commercial Paper Series 5 - Variable Rate, Short-term Rolling Maturity Backed by Line of Credit	200,000	434,700	434,700	200,000
Commercial Paper Series 6 - Variable Rate, Short-term Rolling Maturity Backed by Line of Credit	200,000	400,000	400,000	200,000
Commercial Paper Series 7 - Variable Rate, Short-term Rolling Maturity	<u>200,000</u>	<u>426,500</u>	<u>426,500</u>	<u>200,000</u>
Total commercial paper payable	<u>\$800,000</u>	<u>\$1,600,700</u>	<u>\$1,600,700</u>	<u>\$800,000</u>

New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 8 - LONG-TERM LIABILITIES

In fiscal years 2004 and 2005, the changes in long-term liabilities were as follows (in thousands):

<u>Bonds payable</u>	<u>Balance at June 30, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at June 30, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at June 30, 2005</u>	<u>Due within one year</u>
First resolution	\$ 9,634,090	\$1,166,160	\$1,057,437	\$ 9,742,813	\$2,227,600	\$1,335,817	\$10,634,596	\$ 95,814
Second resolution	<u>3,024,061</u>	<u>558,688</u>	<u>92,645</u>	<u>3,490,104</u>	<u>621,034</u>	<u>111,683</u>	<u>3,999,455</u>	<u>142,170</u>
Total bonds payable	<u>12,658,151</u>	<u>1,724,848</u>	<u>1,150,082</u>	<u>13,232,917</u>	<u>2,848,634</u>	<u>1,447,500</u>	<u>14,634,051</u>	<u>\$237,984</u>
Less discounts (net)	296,637	(58,916)	40,428	197,293	(60,464)	36,525	100,304	\$ -
Less deferred refunding costs	<u>234,229</u>	<u>53,534</u>	<u>22,661</u>	<u>265,102</u>	<u>108,924</u>	<u>33,758</u>	<u>340,268</u>	-
Total long-term liabilities	<u>\$12,127,285</u>	<u>\$1,730,230</u>	<u>\$1,086,993</u>	<u>\$12,770,522</u>	<u>\$2,800,174</u>	<u>\$1,377,217</u>	<u>\$14,193,479</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.

During 2005 and 2004, the Authority issued \$2.1 billion and \$949.1 million, respectively, of bonds to refund \$1.1 billion and \$652 million, respectively, of outstanding bonds. The advance refundings resulted in an accounting loss of \$108.9 million and \$21.2 million, respectively. The Authority in effect reduced its aggregate debt service by \$107.4 million and \$102 million, respectively, and obtained an economic benefit of \$62.7 million and \$69.4 million, respectively.

During 2005 and 2004, the Authority defeased \$183.2 million and \$213.3 million, respectively, of outstanding bonds with \$195.9 million and \$215.1 million, respectively, of current revenue, which resulted in an accounting loss of \$13.9 million and \$16.5 million, respectively.

New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 8 (continued)

During 2005, the Authority issued \$50 million of bonds that will refund \$50 million of principal of the 2003 B issue in June 2006. During 2004, the Authority issued \$50 million of bonds that refunded \$50 million of the 2003 B issue in June 2005.

The Authority has defeased cumulatively \$7.936 billion and \$6.664 billion of outstanding bonds as of June 30, 2005 and 2004, respectively, by placing proceeds of refunding bonds issued 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.

As of June 30, 2005 and 2004, \$5.991 billion and \$5.493 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, 2005 are as follows (in thousands):

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest (1)</u>	<u>Total</u>
2006	\$ 1,037,984	\$ 557,039	\$ 1,595,023
2007	194,944	541,389	736,333
2008	208,045	538,795	746,840
2009	232,147	534,896	767,043
2010	261,854	529,278	791,132
2011-2015	1,569,738	2,496,133	4,065,871
2016-2020	2,150,679	2,186,478	4,337,157
2021-2025	2,521,170	1,776,674	4,297,844
2026-2030	3,002,515	1,286,805	4,289,320
2031-2035	3,028,200	674,872	3,703,072
2036-2040	<u>1,226,775</u>	<u>143,521</u>	<u>1,370,296</u>
	<u>\$15,434,051</u>	<u>\$11,265,880</u>	<u>26,699,931</u>

- (1) Includes interest for variable rate bonds estimated at 1.92% 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 sold.

New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 8 (continued)

Bonds, notes payable, and commercial paper comprise the following for the year ended June 30, 2005 (in thousands):

	<u>Balance at June 30, 2004</u>	<u>Issued</u>	<u>Retired/ defeased</u>	<u>Balance at June 30, 2005</u>
1991 Fiscal Series B - 6.00% to 7.25% Serial and Term Bonds maturing in varying installments through 2012	\$ 16,085	\$ -	\$ 3,010	\$ 13,075
1992 Fiscal Series B - 6.66% to 6.86% Serial and Term Bonds maturing in varying installments through 2014	17,683	-	3,441	14,242
1993 Fiscal Series A - 5.875% to 6.0% Serial, Term, and Capital Appreciation Bonds maturing in varying installments through 2013	165,865	-	71,835	94,030
1993 Fiscal Series C - Adjustable Rate Term Bonds maturing 2022	100,000	-	-	100,000
1994 Fiscal Series 1 - 3.00% to 6.00% Serial Bonds maturing in varying installments through 2013	31,805	-	-	31,805
1994 Fiscal Series C - Adjustable Rate Term Bonds maturing in 2023	200,000	-	-	200,000
1994 Fiscal Series G - Adjustable, Auction and Leveraged Reverse Rate Bonds maturing in varying installments through 2024	185,000	-	-	185,000
1995 Fiscal Series A - Adjustable Rate Term Bonds maturing in varying installments through 2025	216,700	-	6,000	210,700
1995 Fiscal Series 1 - 5.25% to 6.875% Serial Bonds maturing in varying installments through 2016	31,215	-	2,285	28,930
1996 Fiscal Series B - 5.75% to 5.875% Serial Bonds maturing in varying installments through 2026	376,610	-	-	376,610
1996 Fiscal Series C - 4.90% to 5.75% Serial Bonds maturing in varying installments through 2017	62,120	-	31,845	30,275
1997 Fiscal Series A - 4.85% to 6.0% Serial Bonds maturing in varying installments through 2026	341,390	-	209,845	131,545
1997 Fiscal Series B - 5.75% to 5.80% Serial Bonds maturing in varying installments through 2029	656,540	-	556,540	100,000



New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 8 (continued)

	Balance at June 30, 2004	Issued	Retired/ defeased	Balance at June 30, 2005
1998 Fiscal Series 1 - 4.00% to 5.35% Serial Bonds maturing in varying installments through 2017	\$ 34,310	\$ -	\$ 1,890	\$ 32,420
1998 Fiscal Series 3 - 4.30% to 6.00% Serial Bonds maturing in varying installments through 2016	380,034	-	31,838	348,196
1998 Fiscal Series 4 - 3.60% to 5.20% Serial Bonds maturing in varying installments through 2018	11,825	-	720	11,105
1998 Fiscal Series 6 - 4.827% to 5.125% Serial Bonds maturing in varying installments through 2019	15,221	-	774	14,447
1998 Fiscal Series A - 4.80% to 5.125% Serial Bonds maturing in varying installments through 2022	283,850	-	24,500	259,350
1998 Fiscal Series B - 5.125% to 5.25% Serial Bonds maturing in varying installments through 2030	449,525	-	-	449,525
1998 Fiscal Series C - 4.30% to 5.125% Serial Bonds maturing in varying installments through 2021	86,765	-	1,090	85,675
1998 Fiscal Series D - 4.25% to 5.00% Serial and Capital Appreciation Bonds maturing in varying installments through 2025	380,875	-	8,580	372,295
1999 Fiscal Series 2 - 4.00% to 5.25% Serial Bonds maturing in varying installments through 2020	103,731	-	4,473	99,258
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	225,830	-	19,960	205,870
2000 Fiscal Series A - 5.50% to 5.75% Serial Bonds maturing in varying installments through 2032	275,735	-	195,735	80,000
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	10,565	-	480	10,085

New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 8 (continued)

	Balance at June 30, 2004	Issued	Retired/ defeased	Balance at June 30, 2005
2001 Fiscal Series A - 5.50% Term Bonds maturing in varying installments through 2033	\$ 328,225	\$ -	\$ -	\$ 328,225
2001 Fiscal Series B - 4.5% to 5.125% Serial and Term Bonds maturing in varying installments through 2031	68,255	-	155	68,100
2001 Fiscal Series C - 5.125% Term Bonds maturing in varying installments through 2033	112,040	-	-	112,040
2001 Fiscal Series D - 4.5% to 5.5% Serial and Capital Appreciation Bonds maturing in varying installments through 2025	283,670	-	26,345	257,325
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 2026	216,305	-	50,000	166,305
2002 Fiscal Series B - 3.625% to 5.00% Serial and Term Bonds maturing in varying installments through 2026	171,455	-	-	171,455
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	41,745	-	80	41,665
2002 Fiscal Series E - 3.4% to 5.0% Serial and Term Bonds maturing in varying installments through 2026	213,850	-	-	213,850
2002 Fiscal Series F - 3.6% to 5.0% Serial and Term Bonds maturing in varying installments through 2029	105,635	-	-	105,635
2002 Fiscal Series G - 5.00% to 5.125% Term Bonds maturing in varying installments through 2034	216,375	-	-	216,375

New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 8 (continued)

	<u>Balance at June 30, 2004</u>	<u>Issued</u>	<u>Retired/ defeased</u>	<u>Balance at June 30, 2005</u>
2002 Fiscal Series 1 - 4.82% to 5.25% Serial Bonds maturing in varying installments through 2031	\$ 191,725	\$ -	\$ 5,496	\$ 186,229
2002 Fiscal Series 2 - 4.22% to 5.00% Serial Bonds maturing in varying installments through 2031	66,677	-	2,396	64,281
2002 Fiscal Series 3 - 4.65% to 5.00% Serial Bonds maturing in varying installments through 2031	490,701	-	13,488	477,213
2002 Fiscal Series 4 - 5.13% to 6.74% Serial Bonds maturing in varying installments through 2023	216,018	-	7,655	208,363
2002 Fiscal Series 5 - 3.82% to 5.21% Serial Bonds maturing in varying installments through 2031	173,832	-	4,716	169,116
2002 Fiscal Series 6 - 3.82% to 5.21% Serial Bonds maturing in varying installments through 2019	90,442	-	4,462	85,980
2002 Fiscal Series 7 - 7.4% to 7.5% Serial Bonds maturing in varying installments through 2012	9,255	-	1,715	7,540
2003 Fiscal Series A - 4.0% to 6.0% Serial, Term and Muni-CP1 Bonds maturing in varying installments through 2034	719,180	-	30,000	689,180
2003 Fiscal Series B - 4.0% to 5.25% Refundable Principal Installment Bonds maturing in varying installments through 2006	100,000	-	50,000	50,000
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	242,825	-	24,680	218,145
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	145,229	-	3,375	141,854

New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 8 (continued)

	Balance at June 30, 2004	Issued	Retired/ defeased	Balance at June 30, 2005
2003 Fiscal Series 2 - 5.27% Serial Bonds maturing in varying installments through 2028	\$ 583,386	\$ -	\$ 10,427	\$ 572,959
2003 Fiscal Series 3 - 5.15% Serial Bonds maturing in varying installments through 2025	21,135	-	645	20,490
2003 Fiscal Series 4 - 5.18% Serial Bonds maturing in varying installments through 2025	33,650	-	1,035	32,615
2003 Fiscal Series 5 - 4.23% to 4.45% Serial Bonds maturing in varying installments through 2032	292,769	-	6,132	286,637
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	341,950	-	1,705	340,245
2004 Fiscal Series C - 2.00% - 5.00% Serial and Term Bonds maturing in varying installments through 2035	596,860	-	550	596,310
2004 Fiscal Series 1 - 4.12% - 4.45% Serial Bonds maturing in 2033	299,179	-	4,267	294,912
2004 Fiscal Series 2 - 4.46% Serial Bonds maturing in 2026	257,400	-	2,246	255,154
2005 Fiscal Series A - 5.00% Serial Bonds maturing in varying installments through 2039	-	150,000	-	150,000
2005 Fiscal Series B - 2.125% - 5.00% Serial Bonds maturing in varying installments through 2036	-	935,480	13,450	922,030
2005 Fiscal Series C - 3.00% - 5.00% Serial Bonds maturing in varying installments through 2036	-	582,915	6,470	576,445
2005 Series D - 5.00% Serial Bonds maturing in varying installments through varying installments through 2039	-	559,205	-	559,205
2005 Fiscal Series 1 - 3.95 - 5.00% Bonds maturing in varying installments through 2034	-	230,409	444	229,965
2005 Fiscal Series 2 - 2.567 - 5.00% Bonds maturing in varying installments through 2026	-	390,625	725	389,900
Total debt payable	<u>13,232,917</u>	<u>\$2,848,634</u>	<u>\$1,447,500</u>	<u>14,634,051</u>
Current portion of bonds and notes payable	<u>204,640</u>			<u>237,984</u>
Bonds and notes payable, less current portion	<u>\$13,028,277</u>			<u>\$14,396,067</u>

New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 8 (continued)

*Derivatives*

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 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 BMA index and the counterparty to pay 3.567%.

In 2003, the Authority sold \$20 million of muni-CPI bonds in the 2013 maturity of its Fiscal 2003 Series A issue. In connection with the muni-CPI 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-CPI 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 for a given period.

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 Authority views termination risk to be remote at this time. 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 exposed to credit risk, i.e., the risk that the counterparty fails to perform its contractual obligations. The appropriate measurement of this risk at the reporting date is the fair value of the swap. The fair value of the swaps at June 30, 2005 and 2004 was approximately \$2.9 million and \$3 million, respectively, in favor of the counterparty. To mitigate credit risk, the agreement requires the counterparty to post collateral for the Authority's benefit if it is downgraded below a designated threshold, as defined in the agreement.

New York City Water and Sewer System

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE 9 - RESTRICTED ASSETS

Certain cash and investments, plus accrued interest and other receivables, of the System are restricted as follows (in thousands):

	<u>2005</u>	<u>2004</u>
<u>The Board</u>		
Operation and maintenance reserve account	\$ 145,683	\$ 135,691
Operation and maintenance reserve general account	<u>10</u>	<u>10</u>
	<u>145,693</u>	<u>135,701</u>
<u>The Authority</u>		
Revenue fund	152,544	179,106
Debt service reserve fund	754,672	698,518
Construction fund	245,070	289,540
Escrow fund	<u>662,732</u>	<u>661,990</u>
	<u>1,815,018</u>	<u>1,829,154</u>
	<u>\$1,960,711</u>	<u>\$1,964,855</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 expense, 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.

New York City Water and Sewer System

**NOTES TO FINANCIAL STATEMENTS (continued)**

June 30, 2005

**NOTE 9 (continued)**

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 bond and note sales. The escrow fund is established as a depository to refund debt in future years. It is funded through bond proceeds.

**NOTE 10 - COMMITMENTS AND CONTINGENCIES**

*a. Construction*

The System has contractual commitments of approximately \$4,395 million and \$4,483 million at June 30, 2005 and 2004, respectively, for water and sewer projects.

*b. 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 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, 2005, the potential future liability attributable to the System for claims outstanding against the City was estimated to be \$121.6 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.

New York City Water and Sewer System

**NOTES TO FINANCIAL STATEMENTS (continued)**

June 30, 2005

**NOTE 10 (continued)**

*c. 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 2005 and 2004, the System paid \$232 thousand and \$1 million, respectively, in rebates. At June 30, 2005, and 2004 the Authority had a liability of \$7.279 million and \$4.745 million, respectively.

**NOTE 11 - POST-EMPLOYMENT BENEFITS AND PENSION PLANS**

The System directly employs six individuals at the Water Authority. Pension expense for these employees totaled \$75,000. All other personnel are employees of the City and are covered under the City's pension plan. The System pays the costs of those employees' pension through an allocation of fringe benefit costs, which are included within operations and maintenance expenses in the accompanying financial statements.

**NOTE 12 - SUBSEQUENT EVENTS**

On October 12, 2005, the Authority issued fiscal 2006 Series 1 Second Resolution Bonds in the aggregate amount of \$229 million to reimburse outstanding commercial paper notes, and to pay certain costs of issuance.

On October 18, 2005, the Authority issued fiscal 2006 Series A first resolution bonds in the aggregate amount of \$524.5 million to refund outstanding bonds, reimburse outstanding commercial paper notes, to pay for certain costs of issuance and to fund certain reserves.