

In the opinion of Bond Counsel, under existing law and assuming continuing compliance by the Authority with certain covenants which relate to the provisions of the Internal Revenue Code of 1986, as amended (the “Code”), interest on the 2007 Bonds is excluded from gross income for Federal income tax purposes and is not an item of tax preference for purposes of Federal alternative minimum tax; provided, however, that certain federal income tax consequences related to the alternative minimum tax may arise from ownership of the 2007 Bonds. The 2007 Bonds are exempt from personal property tax in Pennsylvania and the interest on the 2007 Bonds is exempt from Pennsylvania corporate net income tax and from Pennsylvania personal income tax (See “Tax Matters” herein).

THE PITTSBURGH WATER AND SEWER AUTHORITY

\$158,895,000

Water and Sewer System First Lien Revenue Refunding Bonds, Series of 2007

consisting of

**\$43,720,000 (Fixed Rate) Water and Sewer System First Lien Revenue Refunding Bonds,
Series A of 2007**

**\$57,585,000 (Variable Rate Demand) Water and Sewer System First Lien Revenue Refunding Bonds,
Series B-1 of 2007**

**\$57,590,000 (Variable Rate Demand) Water and Sewer System First Lien Revenue Refunding Bonds,
Series B-2 of 2007**

Dated: Date of Delivery

Due: September 1, of the years shown on inside front cover.

The First Lien Revenue Refunding Bonds, Series of 2007 (the “2007 Bonds”), consisting of (Fixed Rate) First Lien Revenue Refunding Bonds, Series A of 2007 (the “2007A Bonds”), (Variable Rate Demand) First Lien Revenue Refunding Bonds, Series B-1 of 2007 (the “2007B-1 Bonds”) and (Variable Rate Demand) First Lien Revenue Refunding Bonds, Series B-2 of 2007 (the “2007B-2 Bonds”), and together with the 2007B-1 Bonds, the “2007B Bonds”), will be special limited obligations of The Pittsburgh Water and Sewer Authority (the “Authority” or “PSWA”). The 2007 Bonds will be issued under a Trust Indenture dated as of October 15, 1993, as amended and supplemented by a First Supplemental Indenture dated as of July 15, 1995, a Second Supplemental Indenture dated as of March 1, 1998, a Third Supplemental Indenture dated as of March 1, 2002, a Fourth Supplemental Indenture dated as of September 15, 2003, a Fifth Supplemental Indenture dated as of June 1, 2005, and a Sixth Supplemental Indenture dated as of March 1, 2007 (collectively, the “Indenture” or “First Lien Indenture”) between the Authority and The Bank of New York Trust Company, N.A., as Trustee (the “Trustee”). The Indenture provides that the Bonds shall be secured by a first lien pledge of the Receipts and Revenues (as defined therein) of the Authority, after deduction of the proper expenses of the operation, maintenance and repair of the water supply and distribution and wastewater collection systems of the Authority (the “Water and Sewer System”), and reserves therefor as provided in the Indenture.

The 2007 Bonds will mature in the aggregate principal amounts set forth on the inside front cover hereof. The 2007A Bonds will bear interest at the fixed rates set forth on the inside front cover hereof and will be payable on March 1 and September 1 of each year commencing September 1, 2007. The 2007B Bonds will be issued initially as Weekly Rate Bonds. The 2007B Bonds will bear interest at a Weekly Rate to be initially established by the Underwriters from their date of initial delivery to but excluding the first day of the next Weekly Rate Period for the respective series of 2007B Bonds, payable on April 2, 2007 and on each Interest Payment Date (as defined herein) thereafter until maturity or earlier redemption. Thereafter, for each Weekly Rate Period, the 2007B Bonds will bear interest at the respective Weekly Rate determined by the respective Remarketing Agents for the respective series of 2007B Bonds in accordance with the procedures detailed herein (See “THE 2007B BONDS – Rate Modes.”) The 2007B Bonds may bear interest at a Weekly Rate or Fixed Rate. While a 2007B Bond bears interest at any of those rates, such 2007B Bond will be deemed to be operating in a Weekly Mode or a Fixed Mode, respectively. All 2007B Bonds of each series may be in only one Rate Mode at the same time. The Rate Mode in which a series of the 2007B Bonds are operating may be changed from time to time. Initially, all of the 2007B Bonds will be issued in a Weekly Mode and will remain in that Rate Mode until a particular series is converted to the Fixed Mode as described herein.

The 2007 Bonds will be issued in book-entry form registered in the name of Cede & Co., the nominee of The Depository Trust Company, New York, New York (“DTC”). The payment of the principal of and premium, if any, and interest on the 2007 Bonds will be made by the Trustee directly to Cede & Co., as nominee for DTC, as registered owner of the 2007 Bonds, to be subsequently disbursed to DTC Participants and thereafter to beneficial owners of the 2007 Bonds, all as described herein. Purchasers of 2007 Bonds will not receive physical delivery of certificates representing their ownership interests in the 2007 Bonds. See “BOOK-ENTRY ONLY SYSTEM.” The 2007A Bonds will initially be issued in fully registered form in minimum denominations of \$5,000 and integral multiples thereof. The 2007B Bonds will initially be issued in fully registered form in minimum denominations of \$100,000 and integral multiples of \$5,000 in excess thereof.

The 2007 Bonds are subject to redemption prior to maturity as herein described. See “THE 2007A BONDS” and “THE 2007B BONDS – Redemption Prior to Maturity.” The 2007B Bonds while in the Weekly Mode are subject to optional and mandatory tender for purchase as described herein. See “THE 2007B BONDS – Optional Tenders and Mandatory Tenders.” The Weekly Mode for the 2007B Bonds is subject to conversion to the Fixed Mode as described herein, in which case the 2007B Bonds will be subject to mandatory tender for purchase. See “THE 2007B BONDS – Conversion of Rate Mode.”

The scheduled payment of the principal of and interest on the 2007 Bonds when due will be guaranteed under an insurance policy to be issued concurrently with the delivery of the 2007 Bonds by Financial Security Assurance Inc.



This Official Statement describes the terms and provisions of the 2007B Bonds while in the Weekly Mode only. If the Authority converts the 2007B Bonds to the Fixed Mode, a supplement to this Official Statement or a new official statement or remarketing circular describing the Fixed Mode will be prepared.

While in the Weekly Mode, the purchase price of 2007B Bonds tendered or deemed tendered for purchase, and the interest due thereon, will be secured by a liquidity facility in the form of a Standby Bond Purchase Agreement (the “Standby Purchase Agreement”), subject to certain terms and conditions as described herein and in the Standby Purchase Agreement (see “THE 2007B BONDS – Optional Tenders and Mandatory Tenders” and “THE STANDBY PURCHASE AGREEMENT” herein), provided by

JPMorgan Chase Bank, National Association

The 2007 Bonds are being issued to fund the costs of advance refunding the Authority’s 2002 Bonds and 2005 Bonds (the “Refunded Bonds”), to fund the premium for the Bond Insurance Policy insuring payments on the 2007 Bonds, to fund any required deposit to the Debt Service Reserve Fund or, alternatively, the costs of a surety bond to be held by the Trustee in lieu of a funded account in the Debt Service Reserve Fund, and to fund the costs of issuance of the 2007 Bonds.

THE 2007 BONDS ARE LIMITED OBLIGATIONS OF THE AUTHORITY PAYABLE FROM THE RECEIPTS AND REVENUES (AS DEFINED IN THE INDENTURE) PLEDGED THERETO. NEITHER THE CITY OF PITTSBURGH NOR THE COMMONWEALTH OF PENNSYLVANIA NOR ANY POLITICAL SUBDIVISION THEREOF IS OBLIGATED TO PAY THE PRINCIPAL, REDEMPTION PRICE OF, OR INTEREST ON, THE 2007 BONDS, AND NEITHER THE FULL FAITH, CREDIT NOR TAXING POWER OF THE CITY OF PITTSBURGH OR THE COMMONWEALTH OF PENNSYLVANIA OR ANY OTHER POLITICAL SUBDIVISION THEREOF IS PLEDGED TO SUCH PAYMENT. THE AUTHORITY HAS NO TAXING POWER.

The Bonds are offered when, as and if issued by the Authority and received by the Underwriters, subject to the receipt of the approving legal opinion of Pepper Hamilton LLP, Bond Counsel. Certain legal matters will be passed upon for the Authority by Thorp, Reed & Armstrong, LLP, and for the Underwriters by Buchanan Ingersoll & Rooney PC. Certain legal matters will be passed upon for JPMorgan Chase Bank, National Association, by Greenberg Traurig, LLP, Philadelphia, Pennsylvania. The Authority expects that delivery of the 2007 Bonds in definitive form will be made in New York, New York, on or about March 9, 2007.

JPMorgan

Merrill Lynch & Co.

MATURITY SCHEDULE

THE PITTSBURGH WATER AND SEWER AUTHORITY

**(FIXED RATE) WATER AND SEWER SYSTEM
FIRST LIEN REVENUE REFUNDING BONDS
\$43,720,000 Series A of 2007**

Due Date (September 1)	Principal Amount	Interest Rate	Price or Yield
2007	\$2,405,000	4.000%	3.594%
2008	305,000	4.000	3.660
2009	3,815,000	4.000	3.660
2010	3,970,000	4.000	3.670
2011	4,130,000	4.000	3.710
2012	4,290,000	4.000	3.740
2013	4,470,000	5.000	3.740
2014	4,690,000	5.500	3.760
2015	4,945,000	5.500	3.790
2016	5,220,000	5.000	3.820
2017	5,480,000	5.000	3.860

**(VARIABLE RATE DEMAND) WATER AND SEWER SYSTEM
FIRST LIEN REVENUE REFUNDING BONDS**

\$57,585,000 Series B-1 of 2007 – Maturing September 1, 2033

\$57,590,000 Series B-2 of 2007 – Maturing September 1, 2033

(Price 100%)

The 2007B Bonds will bear interest from the date of original delivery at a Weekly Rate initially established by the Underwriters, prior to the date of delivery. Thereafter, each sub-series of the 2007B Bonds will bear interest at the applicable Weekly Rate, determined by the respective Remarketing Agent, until a conversion to a Fixed Rate as described herein. Interest will be payable initially on April 2, 2007, and thereafter, while Weekly Rate Bonds, on the day first Business Day of each month.

THE PITTSBURGH WATER AND SEWER AUTHORITY

Don Walko, Chairman
Robert P. Jablonowski, Vice Chairman
Richard M. Fees, Treasurer
Henry C. Blum, Secretary
Len Bodack, Assistant Secretary/Assistant Treasurer
Don A. Linzer, Member

Gregory F. Tutsock, Executive Director

AUTHORITY COUNSEL

Thorp, Reed & Armstrong, LLP
Pittsburgh, Pennsylvania

AUTHORITY CONSULTING ENGINEER

Chester Engineers
Pittsburgh, Pennsylvania

FINANCIAL ADVISOR and SWAP ADVISOR

PNC Capital Markets LLC
Pittsburgh, Pennsylvania

UNDERWRITERS and REMARKETING AGENTS

J.P. Morgan Securities Inc.
Merrill Lynch & Co.

BOND COUNSEL

Pepper Hamilton LLP
Pittsburgh, Pennsylvania

UNDERWRITERS' COUNSEL

Buchanan Ingersoll & Rooney PC
Pittsburgh, Pennsylvania

TRUSTEE AND PAYING AGENT

The Bank of New York Trust Company, N. A.
Pittsburgh, Pennsylvania

LIQUIDITY FACILITY PROVIDER

JPMorgan Chase Bank, National Association
New York, New York

COUNSEL TO LIQUIDITY FACILITY PROVIDER

Greenberg Traurig, LLP
Philadelphia, Pennsylvania

No dealer, broker, salesperson or other person has been authorized by the Authority to give any information or to make any representation in connection with the Bonds or the matters described herein, other than those contained in this Official Statement, and, if given or made, such other information or representation must not be relied upon as having been authorized by any of the foregoing. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Bonds by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale.

All quotations from and summaries and explanations of provisions of laws herein do not purport to be complete and reference is made to said laws for full and complete statements of their provisions.

This Official Statement is not to be construed as a contract or agreement between the Authority and the purchasers or holders of any of the Bonds. Any statements made in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended merely as opinion and not as representations of fact. The information contained herein is subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority since the date hereof.

The order and placement of materials in this Official Statement, including the Appendices, are not to be deemed to be a determination of relevance, materiality or importance, and this Official Statement, including the Appendices, must be considered in its entirety.

The Authority has deemed this Official Statement to be final for the purposes of Securities and Exchange Commission Rule 15c2-12(b)(3) promulgated under the Securities Exchange Act.

Other than with respect to the information regarding JPMorgan Chase Bank, National Association (the "Bank") contained under the caption "THE BANK," none of the information in this Official Statement has been supplied or verified by the Bank, and the Bank makes no representation or warranty, express or implied as to: (i) the accuracy or completeness of such information; (ii) the validity of the 2007 Bonds; or (iii) the tax-exempt status of the interest on the 2007 Bonds.

Other than with respect to the information regarding Financial Security Assurance Inc. (the "Bond Insurer") contained under the caption "BOND INSURANCE" and in APPENDIX G, none of the information in this Official Statement has been supplied or verified by the Bond Insurer, and the Bond Insurer makes no representation or warranty, express or implied as to: (i) the accuracy or completeness of such information; (ii) the validity of 2007 Bonds; or (iii) the tax-exempt status of the interest on the 2007 Bonds.

The Underwriters have reviewed the information in this Official Statement in accordance with, and as a part of, their responsibilities to investors under federal securities law, as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

THE BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, NOR HAS THE INDENTURE BEEN QUALIFIED UNDER THE TRUST INDENTURE ACT OF 1939, IN RELIANCE UPON EXEMPTIONS CONTAINED IN SUCH ACTS. THE REGISTRATION OR QUALIFICATION OF THE BONDS IN ACCORDANCE WITH APPLICABLE PROVISIONS OF THE SECURITIES LAWS OF THE STATES, IF ANY, IN WHICH THE BONDS HAVE BEEN REGISTERED OR QUALIFIED AND THE EXEMPTION FROM REGISTRATION OR QUALIFICATION IN CERTAIN OTHER STATES CANNOT BE REGARDED AS A RECOMMENDATION THEREOF. NEITHER THESE STATES NOR ANY OF THEIR AGENCIES HAVE PASSED UPON THE MERITS OF THE BONDS OR THE ACCURACY OR COMPLETENESS OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY MAY BE A CRIMINAL OFFENSE.

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THE PITTSBURGH WATER AND SEWER AUTHORITY

\$158,895,000

Water and Sewer System First Lien Revenue Refunding Bonds, Series of 2007

consisting of

\$43,720,000 (Fixed Rate) Water and Sewer System First Lien Revenue Refunding Bonds, Series A of 2007

\$57,585,000 (Variable Rate Demand) Water and Sewer System First Lien Revenue Refunding Bonds, Series B-1 of 2007

\$57,590,000 (Variable Rate Demand) Water and Sewer System First Lien Revenue Refunding Bonds, Series B-2 of 2007

INTRODUCTION

The purpose of this Official Statement, which includes this introductory statement, the cover page, the summary information and the Appendices hereto, is to set forth certain information pertaining to The Pittsburgh Water and Sewer Authority (the "Authority" or "PWSA"), a body corporate and politic duly created and existing under the Pennsylvania Municipality Authorities Act, 53 Pa. C.S.A. §5601 et seq. (the "Act"), and the issuance by the Authority of \$158,895,000 aggregate principal amount, Water and Sewer System First Lien Revenue Refunding Bonds, Series of 2007 (the "2007 Bonds"), consisting of \$43,720,000 (Fixed Rate) Water and Sewer System First Lien Revenue Refunding Bonds, Series A of 2007 (the "2007A Bonds"), \$57,585,000 (Variable Rate Demand) Water and Sewer System First Lien Revenue Refunding Bonds, Series B-1 of 2007 (the "2007B-1 Bonds") and \$57,590,000 (Variable Rate Demand) Water and Sewer System First Lien Revenue Refunding Bonds, Series B-2 of 2007 (the "2007B-2 Bonds," and together with the 2007B-1 Bonds, the "2007B Bonds"). The 2007 Bonds are being issued pursuant to a Trust Indenture dated as of October 15, 1993 as amended and supplemented by a First Supplemental Indenture dated as of July 15, 1995, a Second Supplemental Indenture dated as of March 1, 1998, a Third Supplemental Indenture dated as of March 1, 2002, a Fourth Supplemental Indenture dated as of September 15, 2003, a Fifth Supplemental Indenture dated as of June 1, 2005 and a Sixth Supplemental Indenture dated as of March 1, 2007 (collectively, the "Indenture" or "First Lien Indenture") by and between the Authority and The Bank of New York Trust Company, N.A., as Trustee (the "Trustee").

The 2007B Bonds will initially be issued in the Weekly Mode as more fully described herein. The Indenture provides for conversion of the 2007B Bonds to the Fixed Mode. If converted from the Weekly Mode to the Fixed Mode, the 2007B Bonds will be purchased from the existing Bondholders pursuant to the mandatory tender provisions of the Indenture on the Conversion Date. This Official Statement provides information with respect to the 2007B Bonds in the Weekly Mode only and does not provide information with respect to the 2007B Bonds in the Fixed Mode. If the Authority converts the 2007B Bonds from the Weekly Mode to the Fixed Mode, a supplement to this Official Statement or remarketing circular describing the Fixed Mode will be prepared.

THIS OFFICIAL STATEMENT PROVIDES CERTAIN INFORMATION CONCERNING THE 2007B BONDS PRIOR TO A DATE ON WHICH AN ALTERNATE LIQUIDITY FACILITY IS DELIVERED, A DATE ON WHICH THE STANDBY PURCHASE AGREEMENT EXPIRES, OR A CONVERSION DATE ON WHICH THE RATE MODE IS CHANGED TO A FIXED MODE. OWNERS AND PROSPECTIVE PURCHASERS OF THE 2007B BONDS SHOULD NOT RELY ON THIS OFFICIAL STATEMENT FOR INFORMATION CONCERNING THE 2007B BONDS ON AND AFTER ANY SUCH DATE, BUT SHOULD LOOK TO THE REVISIONS, AMENDMENTS, SUPPLEMENTS OR SUBSTITUTIONS THEREOF FOR INFORMATION CONCERNING THE 2007B BONDS ON OR AFTER ANY SUCH DATE.

THE AUTHORITY

The Authority is a body corporate and politic organized and existing under the Act pursuant to Resolution No. 36 of the Council of the City of Pittsburgh (the "City"), duly enacted on February 6, 1984, approved by the Mayor on February 8, 1984, and effective February 16, 1984. The Secretary of the Commonwealth of Pennsylvania approved the Authority's Articles of Incorporation and issued a Certificate of Incorporation on February 17, 1984. Articles of Amendment were approved and a Certificate of Amendment were issued by the Pennsylvania Department of State on December 11, 1989, to include, among authorized projects, low head dams and facilities for generating surplus electric power.

Under its Articles of Incorporation, the Authority is specifically authorized to acquire, hold, construct, finance, improve, maintain, operate, own and lease, either as lessor or lessee, projects of the following kinds and character: sewers, sewer systems or parts thereof, waterworks, water supply works, and water distribution systems, low head dams and facilities for generating surplus power.

The Authority was established in February 1984 by the City for the purpose of assuming responsibility for the operation of the City's water supply and distribution and wastewater collection systems (the "Water and Sewer System").

Pursuant to a lease and management agreement dated March 29, 1984 between the Authority and the City (the "Lease and Management Agreement"), the Water and Sewer System was leased to the Authority. In 1995, the Lease and Management Agreement was terminated and the Authority is acquiring the portion of the Water and Sewer System owned by the City pursuant to a Capital Lease Agreement dated as of July 15, 1995 between the Authority and the City (the "Capital Lease Agreement"). (See "CAPITAL LEASE AGREEMENT WITH THE CITY OF PITTSBURGH" in APPENDIX A – Description of the Authority and Water and Sewer System.)

The Water and Sewer System provides water to approximately 83,000 customers and wastewater collection and transmission service to approximately 113,000 customers. The Water and Sewer System does not include wastewater treatment facilities; such facilities are the responsibility of Allegheny County Sanitary Authority ("ALCOSAN"), a separate and distinct legal entity. Rates and charges established by the Authority are not subject to the approval of any department, board or agency of the Commonwealth of Pennsylvania or the City.

See APPENDIX A for a description of the Authority.

DEBT OF THE AUTHORITY

In addition to the 2007 Bonds, the Authority has previously issued and there is currently outstanding under the Indenture other series of bonds that have a parity claim to the Receipts and Revenues of the Authority. The other parity issues are the following:

\$50,385,000 Water and Sewer System First Lien Revenue Bonds, Series of 2005, currently outstanding in the aggregate principal amount of \$49,510,000 (the "2005 Bonds"),

\$167,390,000 Water and Sewer System Revenue Refunding Bonds, Series of 2003, currently outstanding in the aggregate principal amount of \$130,060,000 (the "2003 Bonds"),

\$107,500,000 Water and Sewer System First Lien Revenue Bonds, Series of 2002 currently outstanding in the aggregate principal amount of \$101,530,000 (the "2002 Bonds"),

\$93,335,000 Water and Sewer System First Lien Revenue Bonds, Series A of 1998 currently outstanding in the aggregate principal amount of \$92,925,000 (the "1998A Bonds"),

\$36,440,069.70 initial issuance amount of Water and Sewer System First Lien Revenue Bonds, Series B of 1998 (the "1998B Bonds") and

\$278,970,000 Water and Sewer System Revenue Refunding Bonds, Series A of 1993 currently outstanding in the aggregate principal amount of \$49,105,000 (the "1993A Bonds" and collectively with the 2007 Bonds, the 2005 Bonds, the 2003 Bonds, the 2002 Bonds, the 1998A Bonds and the 1998B Bonds, and any additional bonds which are hereafter issued pursuant to the First Lien Indenture, the "First Lien Bonds").

The Authority also has outstanding \$101,970,000 Water and Sewer System Subordinate Revenue Bonds, Series C of 1998 currently outstanding in the aggregate principal amount of \$98,950,000 (the "1998C Bonds" or the "Subordinate Bonds") issued under the Subordinate Trust Indenture dated as of July 15, 1995, as supplemented by the First Supplemental Subordinate Indenture dated as of March 1, 1998 (together, the "Subordinate Indenture") between the Authority and The Bank of New York Trust Company, N.A., as successor trustee, and six loans from the Pennsylvania Infrastructure Investment Authority ("PENNVEST") in the current outstanding principal amount of approximately \$14,689,844, which loans are also subordinated to the First Lien Bonds.

THE 2007A BONDS

The 2007A Bonds will be issued as fully registered bonds in book-entry form. The 2007A Bonds will be issued in denominations of \$5,000 principal amount, or any integral multiple thereof, and will bear interest at the rates and will mature on the dates and in the amounts set forth on the inside cover of this Official Statement. Principal and interest shall be paid in such coin or currency of the United States of America as at the time of payment is legal tender for the payment of public and private debts. Interest on the 2007A Bonds will be computed on the basis of a 360-day year of twelve 30-day months.

Interest shall be payable on the 2007A Bonds on March 1 and September 1 of each year commencing September 1, 2007 (each an "Interest Payment Date"). Each 2007A Bond will be initially dated the date of issuance, and thereafter will be dated as of its date of authentication. The 2007A Bonds shall bear interest from the Interest Payment Date to which interest has been paid next preceding the date of authentication, unless the date of authentication (i) is an Interest Payment Date to which interest has been paid, in which event the Bonds shall bear interest from the date of authentication, or (ii) is on or prior to the Regular Record Date for the first Interest Payment Date for the 2007A Bonds, in which event such 2007A Bonds shall bear interest from the Issue Date, or (iii) is after a Regular Record Date and on or before the succeeding Interest Payment

Date, in which event the 2007A Bonds shall bear interest from the succeeding Interest Payment Date. Interest on the 2007A Bonds shall be paid on each Interest Payment Date. Each 2007A Bond shall bear interest on overdue principal at the rates borne by the 2007A Bonds during the period such principal is overdue. Both principal and interest shall, however, be payable out of the Receipts and Revenues of the Authority derived from the Water and Sewer System and shall be payable at the designated corporate trust office of the Trustee in lawful money of the United States of America.

The 2007A Bonds are payable as to principal at the designated office of the Trustee or any successor trustee or paying agent. Payment of interest on the 2007A Bonds shall be made to the 2007A Bondholders of record on the registration books of the Trustee as of the close of business on the fifteenth day of the month (whether or not such day is a business day) next preceding the Interest Payment Date (the "Record Date") by check mailed to such owner at the address shown on the registration books, by wire transfer under certain circumstances, as described below, or in any other manner as may be mutually acceptable to the owner and the Trustee. Defaulted interest with respect to any Bond shall cease to be payable to the owner thereof on the relevant Record Date and shall be payable instead to the registered Bondholder as of the close of business on a Special Record Date for the payment of such defaulted interest established by the Trustee in accordance with the Indenture.

Payment of interest on any Bond shall be made to any owner of \$1,000,000 or more in aggregate principal amount of such Bonds by wire transfer to such owner on any Interest Payment Date upon written notice from such owner received by the Trustee not later than the Business Day next preceding the Record Date for the applicable Interest Payment Date, such notice to contain the wire transfer address within the continental United States to which such owner wishes to have such wire directed.

The 2007A Bonds are available in book-entry form only. See "BOOK-ENTRY ONLY SYSTEM." So long as Cede & Co. is the registered owner of the 2007A Bonds, as nominee of The Depository Trust Company, New York, New York ("DTC"), references herein to the owners of the 2007A Bonds means Cede & Co. and not the Beneficial Owners (as defined hereafter) of the 2007B Bonds.

The principal of and interest on the 2007A Bonds will be payable by the Trustee to Cede & Co.

The 2007A Bonds are subject to extraordinary optional redemption prior to maturity as described herein under the captions "THE 2007A BONDS - Extraordinary Optional Redemption."

Extraordinary Optional Redemption

The 2007A Bonds are subject to extraordinary redemption prior to maturity at the option of the Authority in whole or in part at any time, in the event of condemnation, damage or destruction of the Water and Sewer System, from moneys deposited with or held by the Trustee for such purpose, upon payment of 100% of the principal amount thereof being redeemed, together with interest accrued to the date fixed for redemption.

The redemption of the 2007A Bonds shall be made in the manner and upon the terms and conditions set forth in the Indenture.

Partial Redemption

If less than all 2007A Bonds are to be redeemed, the particular 2007A Bonds to be redeemed shall be selected by the Trustee by lot or by such other method as the Trustee shall deem fair and appropriate and which may provide for the selection for redemption of portions (in Authorized Denominations) of the principal of 2007A Bonds in a denomination larger than the smallest Authorized Denomination.

Effect of Redemption

2007A Bonds (or portions thereof as aforesaid) for which redemption and payment provision is made in accordance with the Indenture shall cease to bear interest from and after the date fixed for redemption.

Notice of Redemption

Any notice of redemption shall be given by first class mail, postage prepaid, mailed not less than 30 days prior to the redemption date, to each Holder of 2007A Bonds to be redeemed, at his address appearing in the Register. So long as DTC is effecting book-entry transfers of the 2007A Bonds, the Trustee shall provide the notices specified under this heading only to DTC. It is expected that the DTC shall, in turn, notify its Participants and that the Participants, in turn, will notify or cause to be notified the beneficial owners. Any failure on the part of DTC or a Participant, or failure on the part of a nominee of a beneficial owner of a 2007A Bond to notify the beneficial owner of the 2007A Bond so affected, shall not affect the validity of the redemption of such 2007A Bond.

THE 2007B BONDS

General

The 2007B Bonds will be dated the date of authentication and will bear interest from the date of the first authentication and delivery thereof. The 2007B Bonds will initially be issued in fully registered form in the minimum denomination of \$100,000 or any integral multiple of \$5,000 above such amount. The 2007B Bonds shall bear interest from the Interest Payment Date to which interest has been paid next preceding the date of authentication, unless the date of authentication (i) is an Interest Payment Date to which interest has been paid, in which event the 2007B Bonds shall bear interest from the date of authentication, or (ii) is on or prior to the Regular Record Date for the first Interest Payment Date for the 2007B Bonds, in which event such 2007B Bonds shall bear interest from the Issue Date, or (iii) is after a Regular Record Date and on or before the succeeding Interest Payment Date, in which event the 2007B Bonds shall bear interest from the succeeding Interest Payment Date. Interest on the 2007B Bonds shall be paid on each Interest Payment Date. Each 2007B Bond shall bear interest on overdue principal at the rate of 6% per annum during the period such principal is overdue. Both principal and interest shall, however, be payable out of the Receipts and Revenues of the Authority derived from the Water and Sewer System and shall be payable at the designated corporate trust office of the Trustee in lawful money of the United States of America. Principal of and interest payable at Maturity will be payable to the owner of the 2007B Bonds at the designated trust office of the Trustee upon the surrender for cancellation of the 2007B Bonds.

Notwithstanding the foregoing, interest payable on the 2007B Bonds on any Interest Payment Date shall accrue from and including the last Interest Payment Date on which interest has been paid through and including the day next preceding the next Interest Payment Date. The foregoing notwithstanding, no interest shall accrue on any 2007B Bonds prior to their date of initial issuance and delivery or after the maturity thereof or after the redemption date for such 2007B Bond (provided the redemption price is paid or provided for in accordance with the provisions of the Indenture). The holder of any 2007B Bond purchased following the mandatory tender of such 2007B Bond shall be entitled to interest on such 2007B Bond accruing from such mandatory tender date.

See "REGISTRATION, TRANSFER AND EXCHANGE OF THE 2007 BONDS" and "BOOK-ENTRY ONLY SYSTEM" for a description of provisions relating to the registration, transfer and exchange of the 2007B Bonds.

Rate Modes

Each 2007B Bond shall bear interest at the Weekly Rate, the Fixed Rate or the Bank Bond Rate, as described below. Each sub-series of the 2007B Bonds shall bear interest in the same Rate Mode. Both sub-series of the 2007B Bonds shall initially be issued in the Weekly Mode. Each sub-series of the 2007B Bonds may be converted to a Fixed Mode, as provided in the Indenture.

This Official Statement provides information with respect to the 2007B Bonds while bearing interest as a Weekly Rate only. Upon conversion of the 2007B Bonds to the Fixed Rate, a new offering document will be prepared and distributed by the Authority.

Interest Payment Dates and Computation of Interest Accrual

Interest shall be payable in arrears on the following dates with respect to interest on any 2007B Bond payable at the Weekly Rate (other than a Bank Bond for which interest will be paid in accordance with the terms of the Liquidity Facility), interest shall be payable in arrears on the first Business Day of each month (beginning April 2, 2007 in the case of the initial delivery of the 2007B Bonds) while such 2007B Bond bears interest at a Weekly Rate, and (ii) with respect to interest on any 2007B Bond payable at the Fixed Rate commencing on the effective date of conversion of such 2007B Bond from the Weekly Mode to the Fixed Mode, interest shall be payable on March 1 and September 1 of each year (each such date being herein called an "Interest Payment Date").

Interest at the Weekly Rate shall be computed on the basis of a 365-day or 366-day year, as the case may be, for the actual number of days elapsed. Interest at the Fixed Rate shall be computed on the basis of a 360-day year of twelve 30 day months.

Record Date for Interest Payments

The interest payable on any 2007B Bond on any Interest Payment Date will be paid to the person in whose name such 2007B Bond is registered at the close of business on the Regular Record Date for such interest, which shall be the close of business of the Business Day immediately prior to the Interest Payment Date with respect to 2007B Bonds in the Weekly Mode. While in a Fixed Mode the record date will be the close of business on the 15th day of the calendar month immediately preceding the Interest Payment Date. Any interest not paid on the regular Interest Payment Date will cease to be payable to the registered Holder on such Regular Record Date, and shall be paid to the person in whose name the 2007B Bond is registered at the close of business on a Special Record Date for the payment of such defaulted interest to be fixed by

the Trustee, notice of such Special Record Date being given to Holders of the 2007B Bonds not less than 10 days prior to the Special Record Date.

Method of Payment

The 2007B Bonds are available in book-entry form only. See “BOOK-ENTRY ONLY SYSTEM.” So long as Cede & Co. is the registered owner of the 2007B Bonds, as nominee of The Depository Trust Company, New York, New York (“DTC”), references herein to the owners of the 2007B Bonds mean Cede & Co. and not the Beneficial Owners (as defined hereafter) of the 2007B Bonds.

The principal of and interest on the 2007B Bonds will be payable by the Trustee to Cede & Co.

Weekly Rate

The Weekly Rate shall be a fluctuating rate per annum determined weekly by the Remarketing Agent (initially, J.P. Morgan Securities Inc. with respect to the 2007B-1 Bonds and, initially, Merrill Lynch & Co. with respect to the 2007B-2 Bonds.) while any sub-series of the 2007B Bonds is in the Weekly Mode, subject to the following terms and conditions:

(1) The Weekly Rate with respect to any 2007B Bond shall be determined on or before the date of initial issuance of the 2007B Bonds (the “Issue Date”) and thereafter on the last Business Day before each Thursday.

(2) Interest accrual at the Weekly Rate determined on the Issue Date shall begin on (and shall include) the Issue Date and shall continue at such Weekly Rate until (but not including) the next Thursday. Thereafter, interest accrual at the Weekly Rate shall begin on each Thursday (based on the Weekly Rate determined on the immediately preceding Wednesday or, if such Wednesday is not a Business Day, on the first Business Day preceding such Wednesday) and shall continue at such rate until (and including) the next Wednesday; provided, however, that if the Remarketing Agent fails to determine the Weekly Rate on any such determination date, the Weekly Rate for that Weekly Rate Period shall be equal to the Weekly Rate in effect for the immediately preceding Weekly Rate Period. The Weekly Rate for any consecutive succeeding Weekly Rate Period for which the Remarketing Agent does not determine a Weekly Rate shall be determined in accordance with the Indenture.

(3) The Weekly Rate with respect to a 2007B Bond shall be determined by the Remarketing Agent and shall be the lowest interest rate that would, in the opinion of the Remarketing Agent, result in the market value of such 2007B Bond being 100% of the principal amount thereof on the date of such determination, taking into account relevant market conditions and credit rating factors as they exist on such date; provided, however, that the Weekly Rate may never exceed the Maximum Rate (12% per annum or any other maximum interest rate, but not in excess of 12%, for which coverage is provided under the applicable Liquidity Facility).

(4) On each Weekly Rate determination date with respect to a 2007B Bond the Remarketing Agent shall give written notice to the Trustee, the Authority, the Bond Insurer, the Counterparties under the Swap Agreements, as hereinafter defined, and the Bank of the Weekly Rate so determined. Upon the written request of the Holder of any 2007B Bond, the Bank or the Authority, the Remarketing Agent shall confirm the Weekly Rate then in effect. The determination of the Weekly Rate by the Remarketing Agent shall be conclusive and binding upon the Authority, the Trustee, the Remarketing Agent, the Bank, and the Holders.

(5) If for any reason the Remarketing Agent does not determine a Weekly Rate for any Weekly Rate Period as aforesaid, or if a court of competent jurisdiction holds a rate for any Weekly Rate Period to be invalid or unenforceable, the Weekly Rate for that Weekly Rate Period shall be equal to the Weekly Rate in effect for the immediately preceding Weekly Rate Period. The Weekly Rate for any consecutive succeeding Weekly Rate Period for which the Remarketing Agent does not determine a Weekly Rate, or a court of competent jurisdiction holds a rate to be invalid or unenforceable, shall be: the 30-day tax-exempt commercial paper rate published for that Weekly Rate Period by Munifacts Wire System, Inc. (or a replacement publisher of a tax-exempt commercial paper rate designated in writing by the Authority to the Trustee and Remarketing Agent and acceptable to the Bond Insurer) representing, as of the publication date, the average 30-day yield evaluations at par of tax-exempt securities rated by each Rating Service in its highest commercial paper rating category; provided that if Munifacts Wire System, Inc. or such replacement publisher does not publish such a tax-exempt commercial paper rate on a day on which a Weekly Rate is to be set, the Weekly Rate shall be 75% of the interest rate for 30-day taxable commercial paper (prime paper placed through dealers) announced on such day by the Federal Reserve Bank of New York.

Bank Bond Rate

Any 2007B Bonds that are purchased by the Bank pursuant to the Standby Purchase Agreement (“Bank Bonds”) shall bear interest at the Bank Bond Rate (the “Bank Bond Rate”). Interest on Bank Bonds is payable to the Bank or (if applicable) to any other Bank Bondholder (as such term is defined in the Standby Purchase Agreement), notwithstanding any provisions of the Indenture regarding the Regular Record Date or Special Record Date. Interest accrual at the Bank Bond

Rate shall begin on (and shall include) the date such 2007B Bond is purchased by the Bank pursuant to the Standby Purchase Agreement and shall end on (but shall not include) the date such 2007B Bond is remarketed pursuant to the Indenture or redeemed in accordance with the Standby Purchase Agreement.

Conversion of Rate Mode

All 2007B Bonds of a sub-series shall bear interest in the same Rate Mode. The Authority may effect a conversion of the Rate Mode on the 2007B-1 and/or the 2007B-2 Bonds from a Weekly Rate to the Fixed Mode (once converted to the Fixed Mode, the 2007B Bonds may not, thereafter, be converted to another Rate Mode) at its option with the consent of the Bond Insurer and with prior notice to the Bank and the Counterparties, subject to certain terms and conditions in the Indenture. On the Conversion Date, the 2007B Bonds subject to conversion must be purchased by the Bank pursuant to the Mandatory Tender provisions of the Indenture referred to below.

In the case of such a conversion from the Weekly Mode, the Trustee shall give notice by first class mail to the Holders of the series of Weekly Rate 2007B Bonds to be converted not less than 30 days prior to the proposed Conversion Date stating (i) that the Rate Mode for the particular series of Weekly Rate 2007B Bonds will be converted to the Fixed Mode, (ii) the proposed Conversion Date, (iii) that the Authority may determine not to convert the particular series of Weekly Rate 2007B Bonds not later than 10 days prior to the proposed Conversion Date in which case the Trustee shall notify the Holders in writing to such effect, and (iv) that all Outstanding Weekly Rate 2007B Bonds of such series will be subject to a mandatory purchase on the Conversion Date, or if such Conversion Date is not a Business Day, the first Business Day immediately following such Conversion Date, at a price of par plus accrued interest.

The 2007B Bonds are subject to Mandatory Tender on the Conversion Date. See “The 2007B Bonds – Mandatory Tenders.”

Conversion to Fixed Rate Mode Upon Occurrence of Certain Events

The 2007B Bonds will be converted to the Fixed Rate Mode for a Fixed Rate Period extending until the maturity date of the 2007B Bonds, unless the Bond Insurer shall otherwise direct, upon the occurrence of any of the following events: (i) upon failure of the Bank to purchase 2007B Bonds in accordance with the Indenture and the Liquidity Facility; (ii) upon expiration or termination of the Liquidity Facility with no substitution therefor as required by the terms of the Indenture; (iii) if the 2007B Bonds are held as Bank Bonds for forty-five (45) days or more in any 12-month period; (iv) if or twice in a twelve-month period (X) the Remarketing Agent has failed to determine the interest rate on the 2007B Bonds or (Y) the proceeds of the sale by the Remarketing Agent of 2007B Bonds tendered in accordance with the Indenture have been insufficient to pay the Purchase Price of all such 2007B Bonds on any Purchase Date; or (v) the Authority fails to replace the Liquidity Facility when required by the Indenture. Upon the occurrence of any of the events described in either (i), (ii), (iii), (iv) or (v) above, the Trustee is directed and authorized in the Indenture to take such actions, in the name and on behalf of the Authority, as shall be necessary or appropriate to cause such conversion of the 2007B Bonds to the Fixed Rate Mode in accordance with the provisions of the Indenture.

Any conversion to the Fixed Rate Mode as described in this section will be on terms and at a fixed interest rate that will permit the remarketing of all then outstanding 2007B Bonds (including Bank Bonds) at par. If such a remarketing cannot be effected on such terms, the 2007B Bonds shall continue to bear interest at the Weekly Rate then in effect until such time as such a conversion to the Fixed Rate Mode and related remarketing can be effected. Pursuant to the Indenture, the Remarketing Agent will be directed to attempt such a remarketing of fixed rate 2007B Bonds on a weekly basis until either (a) the specified conversion and related remarketing are accomplished or (b) the Bond Insurer consents to the discontinuation of such efforts.

The 2007B Bonds are subject to Mandatory Tender on the Conversion Date. See “The 2007B Bonds – Mandatory Tenders.”

Optional Tenders

The holders of 2007B Bonds bearing interest at variable rates in a Weekly Rate Period may elect to have their 2007B Bonds or portions thereof in whole multiples of Authorized Denominations (\$100,000 and whole multiples of \$5,000 in excess of \$100,000) (any tender of less than all of the holders’ 2007B Bonds shall be made in such a manner that all 2007B Bonds held by such holder after such tender are in Authorized Denominations) purchased at a purchase price equal to 100% of the principal amount of the 2007B Bonds (or portion thereof) tendered plus accrued interest to the specified Purchase Date. During a Weekly Rate Period, 2007B Bonds may be tendered for purchase on any Business Day upon oral or written notice of tender to the Trustee and Remarketing Agent not later than 2:00 p.m., prevailing Eastern time, on a Business Day not less than seven (7) days prior to the Purchase Date.

Any such notice of Optional Tender must be duly executed by the 2007B Bondholder and must specify (i) the principal amount of the 2007B Bond to which the notice relates, (ii) that the Bondholder irrevocably demands purchase of

such 2007B Bond (or a specified portion thereof in an amount equal to a whole multiple of \$5,000 but not less than \$100,000), (iii) the date on which such 2007B Bond (or specified portion) is to be purchased, and (iv) payment instructions with respect to the Purchase Price. The written notice of Optional Tender must be substantially as set forth in the Indenture. Upon delivery of a written notice of Optional Tender, the election to tender shall be irrevocable and binding upon such Holder and may not be withdrawn. The Trustee shall, in its sole discretion, determine whether, with respect to any 2007B Bond, the Holder thereof shall have properly exercised the option to have his 2007B Bond purchased, and such determination shall be conclusive and binding on such Holder.

Any 2007B Bond subject to Optional Tender shall be tendered by the Holder thereof for purchase on the Purchase Date, by delivering such 2007B Bond to the Delivery Office of the Trustee. If only a portion of such 2007B Bond is to be purchased (as a result of the exercise of the Optional Tender right only with respect to such portion), the Authority shall execute and the Trustee shall authenticate and deliver to the holder of such 2007B Bond, without service charge, a new 2007B Bond or 2007B Bonds of the same Maturity and interest rate and of any Authorized Denomination or Denominations as requested by such holder in aggregate principal amount equal to and in exchange for the unpurchased portion of the principal amount of the 2007B Bond surrendered. Any 2007B Bond (or portion thereof) that is subject to purchase but that is not so delivered to the Trustee (i.e., an Undelivered 2007B Bond) shall nevertheless be deemed to have been tendered by the Holder thereof on the Purchase Date.

On each Purchase Date the Trustee shall pay the Purchase Price to the Holder of each 2007B Bond (or portion thereof) properly tendered for purchase. Funds for payment of the Purchase Price of such 2007B Bonds shall be drawn by the Trustee from the Remarketing Proceeds Purchase Account or the Liquidity Facility Purchase Account, as applicable, as provided in the Indenture. If sufficient funds are not available for the purchase of all tendered 2007B Bonds, no purchase shall be consummated.

If the Trustee is in receipt of the Purchase Price of any Undelivered 2007B Bond, such Undelivered 2007B Bond shall be deemed to have been tendered for purchase and purchased from the Holder thereof on such Purchase Date and registration thereof shall be transferred to the purchaser of such Undelivered 2007B Bond. Any Holder who fails to deliver a 2007B Bond subject to tender (i) shall have no further rights thereunder, except the right to receive the Purchase Price thereof upon presentation and surrender of such Undelivered 2007B Bond to the Trustee properly endorsed for transfer in blank and with all signatures guaranteed to the satisfaction of the Trustee and (ii) shall thereafter hold such Undelivered 2007B Bond as agent for the Trustee. The Holder of such Undelivered 2007B Bond shall not be entitled to receive interest on such Undelivered 2007B Bond for any period on and after the Purchase Date. The Trustee shall, as to any tendered 2007B Bonds which are Undelivered 2007B Bonds, (i) promptly notify the Remarketing Agent of such non-delivery and (ii) place a stop transfer against such 2007B Bonds until they are delivered to the Trustee. Upon such delivery, the Trustee shall pay, or cause to be paid, the Purchase Price of such Undelivered 2007B Bond to the Holder thereof and make any necessary adjustments to the Register.

Anything in the Indenture to the contrary notwithstanding, 2007B Bondholders may not exercise their Optional Tender rights at any time when the obligation of the Bank to purchase 2007B Bonds pursuant to the Liquidity Facility has been suspended or terminated in accordance with the provisions of the Liquidity Facility.

Mandatory Tenders

The Holder of each 2007B Bond shall be required to tender such 2007B Bond to the Trustee for purchase on the following dates (each such date being herein called a "Mandatory Tender Date"):

- (1) the Conversion Date with respect to such 2007B Bond;
- (2) on the second (2nd) Business Day preceding the expiration date of the Liquidity Facility then in effect for such 2007B Bonds in the event the Trustee shall not have received from the provider thereof, at least 25 days prior to such expiration date, a written commitment to extend such Liquidity Facility, such extension to be effective on and as of such stated expiration date;
- (3) on the day on which the Liquidity Facility is replaced with an Alternate Liquidity Facility pursuant to the Indenture (with the Purchase Price being paid with moneys drawn on the existing Liquidity Facility); or
- (4) the Business Day selected in writing by the Bank, at least one Business Day prior to such mandatory tender, in the event that the Bank directs the Trustee to call the 2007B Bonds for mandatory purchase after an Event of Default under the Liquidity Facility has occurred and is continuing.

The Trustee shall promptly give notice of mandatory tender for purchase by first-class mail to the Holders of all 2007B Bonds not less than 10 calendar days prior to the Mandatory Tender Date. Such notice of Mandatory Tender shall state that all Outstanding Bonds are subject to mandatory tender for purchase pursuant to the provisions thereof and the

provisions of the Indenture and will be purchased on the Mandatory Tender Date (which date shall be set forth in such notice) by payment of a Purchase Price equal to the principal amount thereof plus accrued interest.

Any 2007B Bond subject to Mandatory Tender shall be tendered by the Holder thereof for purchase on the Mandatory Tender Date, by delivering such 2007B Bond to the Delivery Office of the Trustee. Any such 2007B Bond that is subject to purchase, but that is not so delivered to the Trustee on the Mandatory Tender Date (i.e., an Undelivered 2007B Bond), shall nevertheless be deemed to have been tendered for purchase by the Holder thereof on the Mandatory Tender Date.

On the Mandatory Tender Date with respect to any 2007B Bond, the Trustee shall pay the Purchase Price to the Holder of such 2007B Bond. Funds for payment of the Purchase Price of such 2007B Bond shall be drawn by the Trustee from the Remarketing Proceeds Purchase Account or the Liquidity Facility Purchase Account, as applicable, as provided in the Indenture. If sufficient funds are not available for the purchase of all tendered 2007B Bonds, no purchase shall be consummated.

If the Trustee is in receipt of the Purchase Price of any Undelivered 2007B Bond, such Undelivered 2007B Bond shall be deemed to have been tendered for purchase and purchased from the Holder thereof on such Mandatory Tender Date and the Holder of such Undelivered 2007B Bond shall not be entitled to receive interest on such Undelivered 2007B Bond for any period on and after the Mandatory Tender Date. The Trustee shall, as to any tendered 2007B Bonds which are Undelivered 2007B Bonds, (i) promptly notify the Remarketing Agent of such non-delivery and (ii) place a stop transfer against such 2007B Bonds until they are delivered to the Trustee. Upon such delivery, the Trustee shall pay, or cause to be paid, the Purchase Price of such Undelivered 2007B Bond to the Holder thereof and make any necessary adjustments to the Register.

If the Trustee receives notice that an Automatic Termination Event or an Automatic Suspension Event (as such terms are defined in the Standby Purchase Agreement) exists under the Standby Purchase Agreement, or the Bank is otherwise no longer obligated to purchase Eligible Bonds under the purchase provisions of the Standby Purchase Agreement as described below, the Trustee shall promptly notify the 2007B Bondholders that such notice has been received and that 2007B Bonds tendered for purchase pursuant to the Mandatory Tender provisions of the Indenture will no longer be purchased by the Bank. The 2007B Bonds shall nevertheless be subject to Mandatory Tender under such circumstances in accordance with the provisions for Mandatory Tender discussed herein, but the Purchase Price of 2007B Bonds so tendered will be paid only from remarketing proceeds or funds contributed by the Authority at its option. Failure to pay the Purchase Price shall not constitute a default or Event of Default on the 2007B Bonds. Payment of the Purchase Price of the 2007B Bonds is not insured by the Bond Insurance Policy (as defined below). However, the 2007B Bonds may be required to be converted to a Fixed Rate upon the failure to pay Purchase Price. See “THE 2007B BONDS - Conversion to Fixed Rate Mode Upon Occurrence of Certain Events.”

Redemption Prior to Maturity

The 2007B Bonds shall be subject to redemption prior to Maturity as follows:

Mandatory Sinking Fund Redemption

The 2007B Bonds are subject to mandatory sinking fund redemption at a redemption price of 100% of the principal amount redeemed plus accrued interest to the redemption date, on the dates and in the principal amounts specified in the redemption schedule set forth below:

2007B-1 Bonds

Redemption Date (9/1)	Principal Amount	Redemption Date (9/1)	Principal Amount
2018	\$3,090,000	2026	\$ 3,960,000
2019	4,550,000	2027	4,125,000
2020	3,105,000	2028	4,295,000
2021	3,235,000	2029	4,475,000
2022	3,375,000	2030	4,660,000
2023	3,520,000	2031	4,855,000
2024	3,650,000	2032	1,415,000
2025	3,805,000	2033*	1,470,000*

*Final Maturity

2007B-2 Bonds

Redemption Date (9/1)	Principal Amount	Redemption Date (9/1)	Principal Amount
2018	\$3,095,000	2026	\$3,970,000
2019	4,560,000	2027	4,135,000
2020	3,110,000	2028	4,300,000
2021	3,235,000	2029	4,475,000
2022	3,360,000	2030	4,660,000
2023	3,500,000	2031	4,855,000
2024	3,655,000	2032	1,405,000
2025	3,810,000	2033*	1,465,000*

*Final Maturity

Optional Redemption

While the 2007B Bonds are in the Weekly Mode, the 2007B Bonds may be redeemed by the Authority in whole at any time or in part on any Interest Payment Date, prior to maturity, with the consent of the Bond Insurer and the Bank, at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

Extraordinary Optional Redemption

The 2007B Bonds are subject to extraordinary redemption prior to maturity at the option of the Authority in whole or in part at any time, in the event of condemnation, damage or destruction of all or a substantial portion of the Water and Sewer System, from moneys deposited with or held by the Trustee for such purpose, upon payment of 100% of the principal amount thereof being redeemed, together with interest accrued to the date fixed for redemption.

Partial Redemption

Subject to the provisions of the Indenture requiring redemption of all Bank Bonds eligible for redemption before any other eligible 2007B Bonds are redeemed, if less than all 2007B Bonds are to be redeemed, the particular 2007B Bonds to be redeemed shall be selected by the Trustee by lot or by such other method as the Trustee shall deem fair and appropriate and which may provide for the selection for redemption of portions (in Authorized Denominations) of the principal of 2007B Bonds in a denomination larger than the smallest Authorized Denomination.

Effect of Redemption

2007B Bonds (or portions thereof as aforesaid) for which redemption and payment provision is made in accordance with the Indenture shall cease to bear interest from and after the date fixed for redemption.

Notice of Redemption

Any notice of redemption shall be given by registered or certified mail, mailed not less than 30 days (15 days in the case of 2007B Bonds bearing interest in the Weekly Mode) prior to the redemption date, to each Holder of 2007B Bonds to be redeemed, at his address appearing in the Register. So long as DTC is effecting book-entry transfers of the 2007B Bonds, the Trustee shall provide the notices specified under this heading only to DTC. It is expected that the DTC shall, in turn, notify its Participants and that the Participants, in turn, will notify or cause to be notified the beneficial owners. Any failure on the part of DTC or a Participant, or failure on the part of a nominee of a beneficial owner of a 2007B Bond to notify the beneficial owner of the 2007B Bond so affected, shall not affect the validity of the redemption of such 2007B Bond.

REGISTRATION, TRANSFER AND EXCHANGE OF THE 2007 BONDS

The Trustee has been appointed bond registrar and as such shall keep the bond register at its designated office. The Person in whose name any 2007 Bond shall be registered on the bond register shall be deemed and regarded as the absolute owner of such 2007 Bond for all purposes, and payment of or on account of the principal of and redemption premium, if any, and interest on any such 2007 Bond shall be made only to or upon the order of the Registered Owner thereof or his legal representative. All such payments shall be valid and effectual to satisfy and discharge the liability upon such 2007 Bond, including the interest thereon, to the extent of the sum or sums so paid.

Any 2007 Bond may be transferred only upon the bond register upon surrender thereof to the Trustee duly endorsed for transfer or accompanied by an assignment duly executed by the Registered Owner or his attorney or legal representative in such form as shall be satisfactory to the Trustee. Upon any such transfer, the Authority shall execute and the Trustee shall authenticate and deliver in exchange for such 2007 Bond a new 2007 Bond or 2007 Bonds, registered in the name of the transferee, of any authorized denomination and of the same maturity and series and bearing interest at the same rate.

The Trustee may charge an amount sufficient to reimburse it for any tax, fee or other governmental charge required to be paid in connection with any such transfer, registration, conversion or exchange. The Trustee shall not be required to (i) transfer or exchange any 2007 Bond during a period beginning at the opening of business 15 days before the day of the mailing of a notice of redemption of such 2007 Bond and ending at the close of business on the day of such mailing, or (ii) transfer or exchange any 2007 Bond so selected for redemption in whole or in part, or (iii) during a period beginning at the opening of business on any Record Date for such 2007 Bond and ending at the close of business on the relevant Interest Payment Date therefor. See also "BOOK-ENTRY ONLY SYSTEM" herein for further information regarding registration, transfer and exchange of the 2007 Bonds.

BOOK-ENTRY ONLY SYSTEM

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the 2007 Bonds (the "Securities"). The Securities will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Security certificate will be issued for each issue of the Securities, each in the aggregate principal amount of each maturity of such issue, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instrument from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Securities under the DTC system must be made by or through Direct Participants, which will receive a credit for the Securities on DTC's records. The ownership interest of each actual purchaser of each Security ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Securities are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Securities, except in the event that use of the book-entry system for the Securities is discontinued.

To facilitate subsequent transfers, all Securities deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Securities with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Securities; DTC's records reflect only the identity of the Direct Participants to whose accounts such Securities are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications to Direct Participants by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Securities may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Securities, such as redemptions, tenders, defaults, and proposed amendments to the security documents. For example, Beneficial Owners of Securities may wish to ascertain that the nominee holding the Securities for their benefit has agreed to obtain and transmit

notices to Beneficial Owners, in the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Securities within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Securities unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the Securities will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from Authority or Trustee ("Agent") on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, nor its nominee, Agent, or Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Securities at any time by giving reasonable notice to Authority or Agent. Under such circumstances, in the event that a successor securities depository is not obtained, Security certificates are required to be printed and delivered.

The Authority may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Security certificates will be printed and delivered to DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that Authority believes to be reliable, but Issuer takes no responsibility for the accuracy thereof.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to 2007 Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the 2007 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, premium and interest payments on the 2007 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participant's accounts upon DTC's receipt of funds and corresponding detail information from the Authority, on the payment date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name" and will be the responsibility of such Participant and not of DTC, the Trustee or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payment to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

THE AUTHORITY AND THE TRUSTEE WILL HAVE NO RESPONSIBILITY OR OBLIGATION TO THE DIRECT PARTICIPANTS OR THE PERSONS FOR WHOM THEY ACT AS NOMINEES WITH RESPECT TO THE ACCURACY OF THE RECORDS OF DTC, ITS NOMINEE OR ANY DIRECT PARTICIPANT PERTAINING TO OWNERSHIP IN THE 2007 BONDS OR THE PAYMENTS TO, OR THE PROVIDING OF NOTICE FOR, TO THE DIRECT PARTICIPANTS, OR THE INDIRECT PARTICIPANTS OR THE BENEFICIAL OWNERS.

SO LONG AS CEDE & CO., AS NOMINEE OF DTC, IS THE REGISTERED OWNER OF THE 2007 BONDS, REFERENCES HEREIN TO THE HOLDERS OF THE 2007 BONDS, OR OWNERS OF THE 2007 BONDS, SHALL MEAN CEDE & CO., AND SHALL NOT MEAN THE BENEFICIAL OWNERS.

Discontinuation of Book-Entry Only System

DTC may determine to discontinue providing its service with respect to the 2007 Bonds at any time by giving notice to the Authority and the Trustee and discharging its responsibilities with respect thereto under applicable law. Upon the

giving of such notice, the book-entry only system for the 2007 Bonds will be discontinued unless a successor securities depository is appointed by the Authority.

If the Authority and the Trustee concur that it would be in the best interests of the Holders of the 2007 Bonds for the book-entry only system to be discontinued (in whole or in part), such book-entry only system shall be discontinued (in whole or in part) in accordance with the provisions of the applicable procedures of DTC.

BOND INSURANCE

Bond Insurance Policy

Concurrently with the issuance of the 2007 Bonds, Financial Security Assurance Inc. ("Financial Security") will issue its Municipal Bond Insurance Policy for the Bonds (the "Policy"). The Policy guarantees the scheduled payment of principal of and interest on the 2007 Bonds when due as set forth in the form of the Policy included as an exhibit to this Official Statement.

The Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

Financial Security Assurance Inc.

Financial Security is a New York domiciled financial guaranty insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. ("Holdings"). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation, and of Dexia Credit Local, a direct wholly-owned subsidiary of Dexia, S.A. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance, banking and asset management in France, Belgium and other European countries. No shareholder of Holdings or Financial Security is liable for the obligations of Financial Security.

At September 30, 2006, Financial Security's combined policyholders' surplus and contingency reserves were approximately \$2,581,107,000 and its total net unearned premium reserve was approximately \$1,992,163,000 in accordance with statutory accounting principles. At September 30, 2006, Financial Security's consolidated shareholder's equity was approximately \$3,058,987,000 and its total net unearned premium reserve was approximately \$1,590,538,000 in accordance with generally accepted accounting principles.

The consolidated financial statements of Financial Security included in, or as exhibits to, the annual and quarterly reports filed after December 31, 2005 by Holdings with the Securities and Exchange Commission are hereby incorporated by reference into this Official Statement. All financial statements of Financial Security included in, or as exhibits to, documents filed by Holdings pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 after the date of this Official Statement and before the termination of the offering of the Bonds shall be deemed incorporated by reference into this Official Statement. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

The Policy does not protect investors against changes in market value of the 2007 Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. Financial Security makes no representation regarding the 2007 Bonds or the advisability of investing in the 2007 Bonds. Financial Security makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that Financial Security has provided to the Issuer the information presented under this caption for inclusion in the Official Statement.

STANDBY PURCHASE AGREEMENT

General

The purchase price of 2007B Bonds which are tendered or deemed tendered for purchase will be payable, to the extent that remarketing proceeds are not sufficient therefor, from funds made available by the Bank pursuant to the Standby Purchase Agreement. The Standby Purchase Agreement will provide liquidity for the purchase of those 2007B Bonds which are optionally tendered for purchase or are subject to mandatory purchase, but not remarketed by the Remarketing Agent. The Standby Purchase Agreement is scheduled to expire on September 1, 2015, but may terminate earlier upon the occurrence of certain Events of Default described herein. The enforceability of the Standby Purchase Agreement may be limited by the bankruptcy, insolvency or reorganization of the Bank. No assurances can be given that in such event the obligations of the Bank under the Standby Purchase Agreement would survive.

For purposes of this section and as otherwise used in this Official Statement, the following terms have the meanings ascribed to them:

“Bank Bond” means each 2007B Bond purchased by the Bank pursuant to the Standby Purchase Agreement and held by or for the account of a Bank Bondholder in accordance with the terms of the Standby Purchase Agreement, until purchased from or retained in accordance with the Standby Purchase Agreement or redeemed in accordance with the Standby Purchase Agreement or otherwise.

“Bank Bondholder” means the Bank and any other Person to whom the Bank has sold Bank Bonds pursuant to the Standby Purchase Agreement (or the Bond Insurer, to the extent of payments made on Bank Bonds under the Bond Insurance Policy).

“Default” means the occurrence of any event which, with the passage of time, the giving of none, or both, would become an Event of Default (as defined below).

“Eligible Bonds” means any 2007B Bonds bearing interest at a Weekly Rate other than 2007B Bonds owned by, for the account of, or on behalf of the Authority.

“Indebtedness” of the Authority means at any date, without duplication, (a) all obligations of the Authority for borrowed money, (b) all obligations of the Authority evidenced by bonds, debentures, notes or other similar instruments, (c) all obligations of the Authority to pay the deferred purchase price of property or services, except trade accounts payable arising in the ordinary course of business, (d) all obligations of the Authority as lessee under capital leases, (e) all obligations of the Authority to purchase securities (or other assets) that arise out of or in connection with the sale of the same or substantially similar securities or assets, (f) all obligations of the Authority to reimburse any bank or any other Person in respect of amounts paid under a letter of credit or any other similar instrument, (g) all Indebtedness of others secured by a lien on any asset of the Authority, whether or not such Indebtedness is assumed by the Authority and (h) all guarantees by the Authority of Indebtedness of other Persons.

“Insurer Adverse Change” occurs when the financial strength ratings assigned to the Bond Insurer by Moody’s, S&P and Fitch shall fall below “Aa3”, “AA-” and “AA-”, respectively, and such financial strength ratings shall remain below “Aa3”, “AA-” and “AA-”, respectively, for a period of 90 consecutive days.

“Related Documents” means the Standby Purchase Agreement, the Indenture, the 2007B Bonds, the Official Statement, the Purchase Contract, the Bond Insurance Policy, the Custody Agreement and the Remarketing Agreement, as the same may be amended or modified from time to time in accordance with their respective terms and the terms of the Standby Purchase Agreement.

Purchase of Tendered 2007B Bonds by the Bank

From time to time during the period prior to the expiration or earlier termination of the Standby Purchase Agreement (the “Purchase Period”) the Bank will purchase 2007B Bonds in the Weekly Mode that have been optionally tendered for purchase pursuant to the Indenture, but not remarketed, or which are tendered pursuant to a mandatory tender under the Indenture, upon receipt of an appropriate notice from the Trustee pursuant to the Indenture and the Standby Purchase Agreement on the date specified for purchase (the “Purchase Date”). See “THE 2007B BONDS – Optional Tenders” and “-Mandatory Tenders.” The price to be paid by the Bank for such 2007B Bonds will be equal to the aggregate principal amount of such tendered 2007B Bonds, plus interest accrued thereon to the date of such purchase calculated at the applicable interest rate for the 2007B Bonds. The Bank’s commitment with respect to interest shall be equal to 34 days’ interest on the principal amount of 2007B Bonds outstanding (assuming an interest rate of 12% per annum).

UNDER CERTAIN CIRCUMSTANCES DESCRIBED BELOW, THE OBLIGATION OF THE BANK TO PURCHASE 2007B BONDS OPTIONALLY TENDERED BY THE OWNERS THEREOF OR SUBJECT TO MANDATORY PURCHASE MAY BE AUTOMATICALLY TERMINATED OR SUSPENDED WITHOUT PRIOR NOTICE TO ANY PERSON, INCLUDING HOLDERS OF THE 2007B BONDS. IN SUCH EVENT, HOLDERS OF 2007B BONDS SHALL NOT HAVE THE RIGHT TO TENDER THEIR 2007B BONDS. IN ADDITION, SUFFICIENT FUNDS MAY NOT BE AVAILABLE TO PURCHASE 2007B BONDS SUBJECT TO MANDATORY PURCHASE. THE INSURANCE POLICY DOES NOT INSURE PAYMENT OF THE PURCHASE PRICE OF THE 2007B BONDS. FAILURE TO PAY THE PURCHASE PRICE OF TENDERED 2007B BONDS IS NOT AN EVENT OF DEFAULT UNDER THE INDENTURE.

Events of Default and Remedies

Each of the following events constitutes an “Event of Default” under the Standby Purchase Agreement:

(a) Any principal or interest due on any 2007B Bond is not paid by the Authority when due and such principal or interest is not paid by the Bond Insurer when, as, and in the amounts required to be paid pursuant to the terms of the Bond

Insurance Policy or the Bond Insurer defaults in any payment of amounts payable by it when due under any bond insurance policy (other than the Bond Insurance Policy) with respect to publicly-rated debt representing an obligation of the Bond Insurer on a parity with or senior to the Bond Insurer's obligations under the Bond Insurance Policy, and such default continues for a period of seven (7) days; or

(b) (i) The President or any Executive Vice President of the Bond Insurer claims, in writing, that the Bond Insurance Policy, with respect to the payment of principal of or interest on the 2007B Bonds, is not valid and binding on the Bond Insurer in accordance with its terms, or repudiates the obligations of the Bond Insurer under the Bond Insurance Policy with respect to the payment of principal of and interest on the 2007B Bonds, or denies that the Bond Insurer has any or further liability or obligation under the Bond Insurance Policy to the extent set forth in the Bond Insurance Policy, (ii) any material provision relating to payment of principal of or interest on the 2007B Bonds under the Bond Insurance Policy at any time for any reason ceases to be valid and binding on the Bond Insurer in accordance with the terms of the Bond Insurance Policy or is declared to be null and void by a court or other governmental agency of appropriate jurisdiction, or (iii) the validity or enforceability of the Bond Insurance Policy with respect to payment of principal of or interest on the 2007B Bonds is contested by the Bond Insurer; or

(c) (i) A proceeding is instituted in a court having jurisdiction in the premises seeking an order for relief, rehabilitation, reorganization, conservation, liquidation or dissolution in respect to the Bond Insurer or for any substantial part of its property under any applicable bankruptcy, insolvency or other similar law now or hereafter in effect, or for the appointment of a receiver, liquidator, assignee, custodian, trustee or sequestrator (or other similar official) and such proceeding is not terminated for a period of sixty (60) consecutive days or such court enters an order granting the relief sought in such proceeding; (ii) the Bond Insurer institutes or takes any corporate action for the purpose of instituting any such proceeding; or (iii) the Bond Insurer becomes insolvent or unable to pay its debts as they mature or claims under any of its insurance policies as such claims are made, commences a voluntary case under any applicable bankruptcy, insolvency or other similar law now or hereafter in effect, consents to the entry of an order for relief in an involuntary case under any such law or consents to the appointment of or taking possession by a receiver, liquidator, assignee, trustee, custodian or sequestrator (or other similar official) of the Bond Insurer or for any substantial part of its property, or makes a general assignment for the benefit of creditors, or fails generally to pay its debts or claims as they become due, or takes any corporate action in furtherance of any of the foregoing; provided, however, that the Bond Insurer's failure to make payments on any debt or financial guaranty insurance policies or surety bonds because of a legitimate dispute between the Bond Insurer and a creditor or the beneficiary of such policies or surety bonds will not in and of itself constitute a failure of the Bond Insurer to generally pay its debts or claims as they become due; or

(d) Any representation or warranty made by the Authority under or in connection with the Standby Purchase Agreement or any of the Related Documents proves to be untrue in any material respect on the date as of which it was made; or

(e) Nonpayment of any facility fees payable under the Standby Purchase Agreement within fifteen (15) Business Days after the Authority and the Bond Insurer have received notice from the Bank that the same were not paid when due; or

(f) Nonpayment of any other fees, or other amounts when due under the Standby Purchase Agreement, if such failure to pay when due continues for fifteen (15) Business Days after written notice thereof to the Authority by the Bank; or

(g) The breach by the Authority of any of the other terms or provisions of the Standby Purchase Agreement which are not remedied within thirty (30) days after written notice thereof has been received by the Authority from the Bank; provided however that there will be no 30-day cure period for a failure to observe or perform certain covenants and agreements made by the Authority and set forth in the Standby Purchase Agreement; or

(h) Any material provision of the Standby Purchase Agreement or any Related Document (other than the Bond Insurance Policy) at any time for any reason ceases to be valid and binding on the Authority or the then current Remarketing Agent, as applicable, or is declared to be null and void, or the validity or enforceability thereof is contested by the Authority or the then current Remarketing Agent, as applicable, or by any Governmental Authority having jurisdiction, or the Authority or the then current Remarketing Agent, as applicable, deny that it has any or further liability or obligation under any such document and the occurrence of such event would have a material adverse effect on the security for the 2007B Bonds or the Authority's ability to pay its obligations under the Standby Purchase Agreement or the Bank Bonds; or

(i) The occurrence of an "event of default" as defined in the Indenture or any "event of default" which is not cured within any applicable cure period under any of the Related Documents and which, if not cured, could give rise to remedies available thereunder; or

(j) (i) The Authority's commencement of any case, proceeding or other action (A) under any existing or future law of any jurisdiction, domestic or foreign, relating to bankruptcy, insolvency, reorganization or relief of debtors, seeking to

have an order for relief entered with respect to it, or seeking to adjudicate it a bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding-up, liquidation, dissolution, composition or other relief with respect to it or its debts, or (B) seeking appointment of a receiver, trustee, custodian or other similar official for it or for all or any substantial part of its assets, or the Authority's making a general assignment for the benefit of its creditors; or (ii) there is commenced against the Authority, any case, proceeding or other action of a nature referred to in clause (i) above which (x) results in an order for such relief or in the appointment of a receiver or similar official or (y) remains undismissed, undischarged or unbonded for a period of sixty (60) days; or (iii) there is commenced against the Authority, any case, proceeding or other action seeking issuance of a warrant of attachment, execution, distraint or similar process against all or any substantial part of its assets, which results in the entry of an order for any such relief which is not vacated, discharged, or stayed or bonded pending appeal within sixty (60) days from the entry thereof; or (iv) the Authority takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the acts set forth in clause (i), (ii) or (iii) above; or (v) the Authority is generally not, or is unable to, or so admits in writing its inability to, pay its debts; or

(k) Nonpayment of principal and interest due (whether by scheduled maturity, required prepayment, demand or otherwise) on any bonds or other obligations payable by the Authority from Revenues and Receipts; or

(l) (i) Default by the Authority in any payment of principal of or premium, if any, or interest on any Indebtedness which is on a parity with, or senior to, the Authority's obligation to make payments on the 2007B Bonds (the "Parity Debt") in excess of \$1,000,000 which continues beyond the expiration of the applicable grace period, if any, (ii) the failure by the Authority to perform any other agreement, term or condition contained in any agreement, mortgage or other instrument under which any such obligation is created or secured, which results in Parity Debt in excess of \$1,000,000 becoming due and payable or which enables (or, with the giving of notice or lapse of time, or both would enable) the holder of Parity Debt in excess of \$1,000,000 or any Person acting on such holder's behalf to accelerate the maturity thereof; provided, however, that in either case, the Bank will not be entitled to pursue any remedies if, within the time allowed for service of a responsive pleading in any proceeding to enforce payment of such Parity Debt under the laws governing such proceeding, (A) the Authority in good faith commences proceedings to contest the existence or payment of such Indebtedness and the opposing party in such proceedings is stayed from exercising remedies, or (B) a surety bond in the amount of such Indebtedness is obtained or sufficient moneys are escrowed with a bank or trust company for the payment of such Indebtedness, but only so long as, in the case of either (A) or (B), such default does not result in the occurrence of an event of default under any of the Related Documents or with respect to other Parity Debt; or (iii) a final judgment or order for the payment of money in an amount in excess of \$1,000,000 has been rendered against the Authority and such judgment or order is not (x) satisfied, stayed or bonded pending appeal or (y) subject to a written agreement by the judgment holder thereof pursuant to which such judgment holder has agreed that such judgment or order will not in any manner be executed upon pending appeal, in each case within a period of thirty (30) days from the date on which such judgment or order was first so rendered.

If any Event of Default occurs and is continuing under the Standby Purchase Agreement:

(a) In the case of an Automatic Suspension Event (described in paragraphs (b) and (c)(i) under "Events of Default" above), the Bank's obligation to purchase 2007B Bonds will immediately be suspended without notice or demand to any person, and thereafter, the Bank will be under no obligation to purchase 2007B Bonds until its obligation to purchase 2007B Bonds is reinstated as described below. Promptly upon an Event of Default specified in paragraph (b) above or a Default specified in paragraph (c)(i) above, the Bank will notify the Authority, the Trustee, the Bond Insurer and the Remarketing Agent of such suspension in writing. With respect to an Event of Default specified in paragraph (b) above, if (i) a court with jurisdiction to rule on the validity of the Bond Insurance Policy thereafter enters a final, nonappealable judgment that the Bond Insurance Policy is not valid and binding on the Bond Insurer or (ii) a period of two years elapses since the commencement of the suspension under the Standby Purchase Agreement, then the obligation of the Bank under the Standby Purchase Agreement will immediately terminate and the Bank will be under no further obligation to purchase 2007B Bonds (a "7.1(b) Final Suspension Event"). With respect to a Default specified in paragraph (c)(i) above, if such Default becomes an Event of Default, then the obligation of the Bank under the Standby Purchase Agreement will immediately terminate and the Bank will be under no further obligation to purchase 2007B Bonds (together with a 7.1(b) Final Suspension Event, a "Final Suspension Event"). If with respect to an Event of Default under paragraph (b) above, a court with jurisdiction to rule on the validity of the Bond Insurance Policy finds or rules that the Bond Insurance Policy is valid and binding on the Bond Insurer or if the proceeding triggering an Event of Default under paragraph (c)(i) above is terminated on or prior to the end of the 60-day period, then upon such ruling or termination, as applicable, the Bank's obligation under the Standby Purchase Agreement will be automatically reinstated and the terms of the Standby Purchase Agreement will continue in full force and effect as if there had been no such suspension.

(b) In the case of an Automatic Termination Event (described in paragraphs (a), (c)(ii) and (c)(iii) under "Events of Default" above), the Available Commitment and the obligation of the Bank to advance funds for the purchase of Eligible Bonds will immediately terminate without notice or demand to any Person, and thereafter the Bank will be under no

obligation to advance funds for the purchase of 2007B Bonds. Promptly after the occurrence of an Automatic Termination Event, the Bank will give written notice of same to the Trustee, the Bond Insurer, the Authority, the Counterparties, and the Remarketing Agent; provided, that the Bank will incur no liability or responsibility whatsoever by reason of its failure to give such notice and such failure will in no way affect the termination of the Bank's Available Commitment and of its obligation to advance funds for the purchase of 2007B Bonds pursuant to the Standby Purchase Agreement.

(c) In the case of an Event of Default specified in paragraph (e) above or an Insurer Adverse Change, the Bank may terminate its obligation to advance funds for the purchase of Eligible Bonds by giving written notice (a "Notice of Termination") to the Authority, the Trustee, the Counterparties, the Remarketing Agent and the Bond Insurer, specifying the date on which the Available Commitment and the obligation of the Bank to advance funds for the purchase of Eligible Bonds will terminate (the "Noticed Termination Date"), which will be not less than twenty-five (25) days from the date of receipt of such notice by the Trustee and, on and after the Noticed Termination Date the Bank will be under no further obligation to purchase 2007B Bonds under the Standby Purchase Agreement other than 2007B Bonds which are the subject of the mandatory tender pursuant to the Indenture, which the Bank will be required to purchase on or prior to the Noticed Termination Date.

(d) In addition to the rights and remedies set forth above, upon the occurrence of any Event of Default, the Bank will have all the rights and remedies available to it under the Standby Purchase Agreement, the Related Documents or otherwise pursuant to law or equity, provided, however, that the Bank will not have the right to terminate its obligation to purchase 2007B Bonds, to declare any amount due under the Standby Purchase Agreement due and payable, or to accelerate the maturity date of any 2007B Bonds except as described above. Without limiting the generality of the foregoing, the Bank has agreed that, so long as no Automatic Suspension Event or Automatic Termination Event has occurred, to purchase 2007B Bonds on the terms and conditions of the Standby Purchase Agreement notwithstanding the institution or pendency of any bankruptcy, insolvency or similar proceeding with respect to the Authority. The Bank will not assert as a defense to its obligation to purchase 2007B Bonds under the Standby Purchase Agreement (i) the institution or pendency of a bankruptcy, insolvency or similar proceeding with respect to the Authority or (ii) a determination by a court of competent jurisdiction in a bankruptcy, insolvency or similar proceeding with respect to the Authority that the Standby Purchase Agreement is not enforceable against the Authority under applicable bankruptcy, insolvency or similar laws.

Extension, Reduction, Adjustment or Termination of the Standby Purchase Agreement

Upon any redemption, repayment or other payment of all or any portion of the principal amount of the 2007B Bonds, the Bank's purchase commitment under the Standby Purchase Agreement with respect to principal of 2007B Bonds shall automatically be reduced by the principal amount of the 2007B Bonds so redeemed, repaid or otherwise paid, as the case may be.

The renewal or extension of the Standby Purchase Agreement is subject to agreement by the Bank and the Authority. The Bank has no obligation to extend or renew the Standby Purchase Agreement beyond its initial term and may determine whether to extend or renew the Standby Purchase Agreement in its sole discretion. The Authority has the right under certain circumstances to terminate the Standby Purchase Agreement.

Substitute Liquidity Facility Agreement

The Indenture provides that, with the approval of the Bond Insurer, a Substitute Liquidity Facility may be substituted for the existing Standby Purchase Agreement. The 2007B Bonds are subject to Mandatory Tender on the date of delivery of a Substitute Liquidity Facility. Notice of any such Mandatory Tender shall be given by the Trustee by registered or certified mail, mailed to the Holder of each affected 2007B Bond not less than 15 days prior to the Mandatory Tender Date. See "THE 2007B BONDS – Mandatory Tenders."

In event that the short-term rating of the 2007 Bonds is downgraded to below "VMIG-2" by Moody's or "A-1" by S&P (or then-equivalent short-term ratings from either such Rating Service or other Rating Service then maintaining a short-term rating on the 2007 Bonds), the Authority will provide for delivery of an Alternate Liquidity Facility.

THE BANK

JPMorgan Chase Bank, National Association (the "Bank") is a wholly owned bank subsidiary of JPMorgan Chase & Co., a Delaware corporation whose principal office is located in New York, New York. The Bank is a commercial bank offering a wide range of banking services to its customers, both domestically and internationally. It is chartered and its business is subject to examination and regulation by the Office of the Comptroller of the Currency.

As of September 30, 2006, JPMorgan Chase Bank, National Association had total assets of \$1,173.7 billion, total net loans of \$401.9 billion, total deposits of \$613.3 billion, and total stockholder's equity of \$92.0 billion. These figures are extracted from the Bank's unaudited Consolidated Reports of Condition and Income as at September 30, 2006, which are filed with the Federal Deposit Insurance Corporation.

Additional information, including the most recent Form 10-K for the year ended December 31, 2005, of JPMorgan Chase & Co., the 2005 Annual Report of JPMorgan Chase & Co., as amended, and additional annual, quarterly and current reports filed with or furnished to the Securities and Exchange Commission by JPMorgan Chase & Co., as they become available, may be obtained without charge by each person to whom this Official Statement is delivered upon the written request of any such person to the Office of the Secretary, JPMorgan Chase & Co., 270 Park Avenue, New York, New York 10017.

The information contained in this Section relates to and has been obtained from the Bank. The delivery of the Official Statement shall not create any implication that there has been no change in the affairs of the Bank since the date hereof, or that the information contained or referred to in this Section is correct as of any time subsequent to its date.

ESTIMATED SOURCES AND USES OF FUNDS

SOURCES OF FUNDS

Principal	\$ 158,895,000.00
Original Issue Premium	<u>2,659,548.45</u>
TOTAL	<u>\$161,554,548.45</u>

USES OF FUNDS

Deposit to Escrow Deposit Agreements re: Refunded Bonds	\$ 159,187,690.00
Debt Service Reserve Fund Surety Bond Premium	241,118.76
Costs of Issuance*	<u>2,125,739.69</u>
TOTAL	<u>\$161,554,548.45</u>

*Includes the bond insurance premium, underwriters' discount, fees of the financial advisor, bond counsel, issuer's counsel, underwriters' counsel, counsel to the liquidity provider, rating agencies, trustee, verification agent, dissemination agent, auditor, printing costs and other miscellaneous fees and expenses.

USE OF PROCEEDS; THE REFUNDING PROGRAM

The Refunding Program

The 2007 Bonds are being issued to fund (i) the costs of advance refunding the Authority's 2002 Bonds and the 2005 Bonds (the "Refunded Bonds"), (ii) the premium for the Bond Insurance Policy securing payments on the 2007 Bonds, (iii) any required deposit to the Debt Service Reserve Fund or, alternatively, the costs of a surety bond to be held by the Trustee in lieu of a funded account in the Debt Service Reserve Fund, and (iv) the costs of issuance of the 2007 Bonds.

A portion of the proceeds from the sale of the 2007 Bonds will be irrevocably deposited with The Bank of New York Trust Company, N.A. (the "Escrow Agent") under the terms of two Escrow Deposit Agreements, dated as of March 1, 2007 (the "Escrow Agreement") between the Escrow Agent and the Authority, and will be applied towards the purchase of direct obligations of the United States of America, State and Local Government Series (the "Government Obligations"), which will mature at such times and in such amounts to provide funds from maturing principal, interest income and any cash balances, sufficient to pay interest and principal on the Refunded Bonds, until maturity or earlier redemption, on June 1, 2012 in the case of the 2002 Bonds and September 1, 2015 in the case of the 2005 Bonds.

Verification Agent

The accuracy of arithmetic computations supporting the conclusion that the principal amounts of and interest earned on, the Government Obligations are sufficient to pay the periodic interest on the Refunded Bonds when due and the redemption price of the Refunded Bonds on each respective redemption date will be independently verified by Maher Duessel, Certified Public Accountants.

SECURITY FOR THE 2007 BONDS

Limited Obligations

The 2007 Bonds are limited obligations of the Authority. The 2007 Bonds do not pledge the general credit or taxing power of the City of Pittsburgh, the Commonwealth of Pennsylvania (the "Commonwealth") or any political subdivision thereof; nor shall the 2007 Bonds be deemed an obligation of the City, the Commonwealth or any political subdivision thereof; nor shall the City, the Commonwealth or any political subdivision thereof (other than the

Authority) be liable for payment of the principal of, premium, if any, or interest on the 2007 Bonds. The Authority has no taxing power.

Pledge of Receipts and Revenues

The 2007 Bonds, together with the other First Lien Bonds and the Authority's obligation to make Periodic Payments under Qualified Interest Rate Swap Agreements, if any, are secured, on a parity, by a first lien pledge of the Receipts and Revenues of the Water and Sewer System after payment of Current Expenses, each as defined in the First Lien Indenture, together with cash and investments from time to time held in certain funds pursuant to the First Lien Indenture. (See "DEBT OF THE AUTHORITY" and APPENDIX B – "Summary of Indenture".)

Debt Service Reserve Fund

The First Lien Indenture requires that a Debt Service Reserve Fund be funded in an amount equal to the maximum annual debt service requirements on the First Lien Bonds. Upon issuance of the 2007 Bonds, the Authority will purchase a surety bond to fund the Debt Service Reserve Fund in an amount sufficient, together with amounts on deposit therein, to equal the maximum annual debt service requirements on the First Lien Bonds. Currently, the Debt Service Reserve Fund for such First Lien Bonds is fully funded as required under the First Lien Indenture and is comprised of cash and Municipal Bond Debt Service Reserve Fund Policies.

Municipal Bond Insurance

Payments of principal and interest on the 2007 Bonds when due are insured by a municipal bond insurance policy to be issued by the Bond Insurer simultaneously with the issuance of the 2007 Bonds. See "BOND INSURANCE" herein.

Additional Debt

The Authority may issue additional bonds on a parity with the Bonds for the purposes of financing the cost of acquiring, constructing or completing capital additions or refunding outstanding indebtedness incurred under the First Lien Indenture, upon satisfaction of the conditions set forth in the First Lien Indenture.

Covenants of the Authority

Under the Indenture, the Authority covenants, among other things: (1) to insure the property of the Water and Sewer System in accordance with customary practice, (2) to employ a consulting engineer to make recommendations annually concerning, among other things, the proper maintenance, repair and operation of the Water and Sewer System, (3) to maintain the Water and Sewer System in good repair, working order and condition and (4) to maintain its rates and charges at a specified level. (See "Summary of Indenture" – APPENDIX B herein.) (Also, see "RATE COVENANT" herein.)

Rights of Bond Insurer.

Upon the occurrence of an event of default under the Indenture, the 2007 Bonds may be accelerated only with the consent of, or at the direction of, the Bond Insurer, for so long as it is not in default under the Bond Insurance Policy. In addition, for so long as it is not in default under the Bond Insurance Policy, the Bond Insurer may, on behalf of all 2007 Bondholders, direct the Trustee in the pursuit of remedies available upon default and may approve certain amendments to the financing documents on behalf of 2007 Bondholders. See APPENDIX A – "Definitions of Certain Terms and Summaries of Certain Provisions of the Indenture." If Bond Insurer pays the principal of or interest on any 2007 Bonds pursuant to the terms of the Bond Insurance Policy, the Bond Insurer will be subrogated to all of the rights of the Holders of such 2007 Bonds granted under the Indenture, including the right to receive payment of principal of and interest on the 2007 Bonds.

FLOW OF FUNDS

The Authority has heretofore established a special fund (the "Revenue Fund") with Authorized Depositories into which it deposits its Receipts and Revenues. The Authority will withdraw from the Revenue Fund for deposit to the credit of the following funds in the order, on the dates and for the following purposes:

1. **Operation and Maintenance Fund – Established Under First Lien Indenture**
On or before the first day of each month, the Authority shall transfer from the Revenue Fund to the Operation and Maintenance Fund an amount equal to the amount budgeted by the Authority for that month for payment of the Current Expenses as the same become due.
2. **Operating Reserve Account – Established Under First Lien Indenture**
There is a special account within the Operation and Maintenance Fund called the "Operating Reserve Account," which is held by the Trustee under the First Lien Indenture. There shall be maintained in the Operating Reserve Account one-sixth of the amount equal to the Authority's budgeted Current Expenses for

the current Fiscal Year. Amounts in the Operating Reserve Account shall be applied to pay the Current Expenses of the Authority to the extent that the amounts on deposit in the Operation and Maintenance Fund are insufficient.

3. *Debt Service Fund* – Established Under First Lien Indenture

After making the foregoing transfers, on or before each Interest Payment Date and Periodic Payment Date, moneys in the amount of the interest to come due on the First Lien Bonds on such Interest Payment Date and Periodic Payments owed, if any, to such Counterparty under a Qualified Swap Agreement on such Periodic Payment Date, and on or before the first day of each month moneys in the amount of 1/12 of the principal to come due on the First Lien Bonds on the next principal payment date are to be transferred to the Debt Service Fund of the First Lien Indenture.

4. *Debt Service Reserve Fund and Deficiency in Operating Reserve Account* – Established Under First Lien Indenture

Next, on the first day of each month in which there is a deficiency in the Debt Service Reserve Fund or the Operating Reserve Account, both established under the First Lien Indenture, or if there has been a draw on the surety bond held in the Debt Service Reserve Fund of the First Lien Indenture, amounts sufficient to repay any deficiency or repay any such draw, together with expenses due, in not more than 12 equal monthly payments shall be transferred, as applicable, to the Debt Service Reserve Fund or the Operating Reserve Account or paid to the surety provider.

3. *Renewal and Replacement Fund* – Established Under First Lien Indenture

After the foregoing transfers, on the dates and in the amounts set forth in the annual consulting engineer's report moneys are to be transferred to the Renewal and Replacement Fund held pursuant to the First Lien Indenture.

4. *Debt Service for Subordinated Debt* – Held outside of the First Lien Indenture

After making the foregoing transfers, on the first day of each month moneys shall be transferred in amounts sufficient to make:

- (a) all payments due on Subordinate Bonds and Periodic Payments on swaps related to Subordinate Bonds, and
- (b) all payments due on any other subordinated debt and other payments due on Qualified Swap Agreements other than Periodic Payments.

5. *Depreciation Reserve Account* – Held outside of the First Lien Indenture

On December 1 of each year, after making the foregoing transfers, moneys shall be transferred to the Depreciation Reserve Account held by an Authorized Depository as an account within the Revenue Fund required to be established by the First Lien Indenture, in an amount equal to the excess of the depreciation on the Water and Sewer System during such year over the principal payments on the Bonds outstanding during such year and the amount of Capital Additions funded from the Authority's Gross Revenues during such year. Moneys in the Depreciation Reserve Account may be used by the Authority to pay (i) principal on the Bonds of the Authority; (ii) Capital Additions; and (iii) the costs of construction, acquisition and improvements to the Water and Sewer System.

RATE COVENANT

Under the Indenture, the Authority has covenanted with the owners of the Bonds to adopt rates complying with either (1) or (2) of the following in each fiscal year:

(1) The Authority will maintain, charge and collect, so long as any Bonds are outstanding, reasonable rates, rentals and other charges for the use of the facilities of the Water and Sewer System which (after making due and reasonable allowances for contingencies and a margin of error in the estimates) together with other Receipts and Revenues, including any unrestricted cash and investments accumulated in the Revenue Fund at the beginning of each Fiscal Year, shall be at all times at least sufficient to provide annually:

- (a) Amounts sufficient to pay all of the Current Expenses of the Authority; and

- (b) An amount equal to 120% of the debt service requirements with respect to the Authority Bonds (i.e., the Bonds and bonds issued under the Subordinate Indenture) and other Authority Long Term Indebtedness during the then current fiscal year of the Authority.

(2) The Authority will maintain, charge and collect, so long as any Bonds are outstanding, reasonable rates, rentals and other charges for the use of the facilities of the Water and Sewer System which (after making due and reasonable allowances for contingencies and a margin of error in the estimates), together with other Receipts and Revenues, for the then current fiscal year (exclusive of interest income earned by the Authority on funds other than the Debt Service Reserve Fund; provided, however, that earnings on the construction/acquisition funds may also be included during any construction period, but only to the extent such earnings are expressly required to be either retained in the construction/acquisition funds and may be used to pay debt service on the Authority Bonds or other Authority Long Term Indebtedness or are applied directly to payment of debt service on the Authority Bonds or other Authority Long Term Indebtedness), shall be at all times at least sufficient to provide annually:

- (a) Funds to pay all of the Current Expenses of the Authority; and
- (b) An amount equal to 100% of the debt service requirements with respect to the Authority Bonds and other Authority Long Term Indebtedness during the then current fiscal year of the Authority.

Calculation of compliance with the covenant shall be made on the following basis: (a) operating revenue, construction/acquisition fund income, earnings on the Debt Service Reserve Fund, expenses, required deposits to replenish any withdrawals from the Debt Service Reserve Fund and the Renewal and Replacement Fund which have not been capitalized shall be accounted for on the accrual basis; (b) costs of issuance of the Authority Bonds and other Authority Long Term Indebtedness may be treated as if such amounts are amortized over the life of the Authority Bonds and other Authority Long Term Indebtedness irrespective of any shorter period over which such costs are actually amortized; and (c) depreciation is specifically excluded from the calculation. In the event that any Policy Costs are due and owing at the time of the calculation of the rate covenant, Gross Revenues of the Authority shall be reduced by the amount of any Policy Costs then due and owing.

The Authority also covenants with the holders of the Bonds that if at any time the revenues collected shall not be sufficient to enable the Authority to comply with the provisions set forth above, it will promptly revise its water or sewer rates, rents and other charges so that the Authority will be in compliance and so that any deficiencies in transfers of funds required to be made pursuant to the First Lien Indenture will be remedied before the end of the next ensuing fiscal year.

INTEREST RATE SWAP AGREEMENTS

In connection with the issuance of the 2007B Bonds, the Authority will enter into two International Swaps and Derivatives Association (ISDA) Master Agreements, together with supporting schedules and confirmations (each a “Swap Agreement” and together, the “Swap Agreements”), one with JPMorgan Chase Bank, National Association, and one with Merrill Lynch Capital Services, Inc. (each a “Counterparty” and together, the “Counterparties”). The Swap Agreements provide, in general, that the Authority will pay to the respective Counterparties periodic fixed amounts (“Periodic Payments”) based on a fixed percentage on an initial aggregate notional amount equal to \$115,175,000 and that the respective Counterparties will pay to the Authority periodic floating amounts based on the Securities Industry and Financial Market Association (“SIFMA”) Municipal Swap Index times the same notional amount until September 1, 2033, unless earlier terminated. The execution and delivery of the Swap Agreements will not alter the Authority’s obligation to pay the principal of, premium, if any, and interest on the 2007 Bonds. However, as the Swap Agreements will be “Qualified Interest Rate Swap Agreements” as defined in the Indenture, the obligations of the Authority to make Periodic Payments (but not Settlement Amounts (defined below) payable under the Swap Agreements) will be secured on parity with the Authority’s obligations to make payments on the 2007 Bonds and other Bonds issued under the Indenture. In addition to the foregoing transactions, the Authority anticipates entering into four additional forward starting confirmations (the “Forward Swaps”) under the Swap Agreements with the Counterparties with respect to other outstanding Authority Bonds. Periodic Payments (but not Settlement Amounts) due in respect of the Forward Swaps will be secured on a parity with the Authority’s obligation to make payments on the 2007 Bonds. See “FUTURE INDEBTEDNESS – Future Refunding Transactions” below.

Under certain circumstances (including certain events of default with respect to the Authority or either of the Counterparties), the Swap Agreements could terminate in whole or in part prior to their respective stated termination dates. Following any such early termination of the Swap Agreements, either the Authority or the Counterparties, as applicable, may owe a termination payment (“Settlement Amounts”) to the other, depending upon market conditions. If at the time of an early termination of the Swap Agreements long-term interest rates are significantly lower than they were when the Swap Agreements were executed and delivered, the Authority could owe substantial Settlement Amounts to the Counterparties. The Authority’s obligation to pay any Settlement Amounts will be subordinate to the Authority’s obligation to make all

payments due and owing on the 2007B Bonds, any other outstanding First Lien Bonds and Periodic Payments due under the Swap Agreements and the Forward Swaps.

The Authority's payment obligation with respect to Periodic Payments, but not any Settlement Amounts, under the Swap Agreements will be guaranteed by Financial Security Assurance Inc. under one or more swap insurance policies. The provider of the swap insurance policy will be given certain rights under the Swap Agreements, including rights to consent to the designation of an early termination date (which may result in the payment of a Settlement Amount) upon the occurrence of certain events and the right to designate an early termination date with respect to the Authority, if an event of default under the Swap Agreements occurs with respect to the Authority as the defaulting party.

There are a number of risks associated with the Swap Agreements that could affect the value of the Swap Agreements, the ability of the Authority to accomplish its objectives in entering into the Swap Agreements and the ability of the Authority to meet its obligations under the Swap Agreements and with respect to the 2007 Bonds. These risks include, among others, the following: counterparty risk – the failure of the Counterparty to make required payments; credit risk – the occurrence of an event modifying the credit rating of the Authority or the respective Counterparties; termination risk – the need to terminate the transaction in a market that dictates a payment of a Settlement Amount by the Authority; and basis risk – the mismatch between actual variable rate debt service on the 2007B Bonds and variable rate indices used to determine swap payments.

The Authority has adopted a policy relating to interest rate management agreements ("Policy") to establish guidelines for the use and management of all interest rate management agreements, including, but not limited to, interest rate swaps, swaptions, caps, collars and floors (collectively "Swaps" or "Agreements") incurred in connection with the incurrence of debt. The Authority may change the Policy at any time in its sole discretion.

The Policy authorizes the Authority to use Swaps to hedge interest rate movement, basis risk and other risks, to lock-in a fixed rate or, alternatively, to create synthetic variable rate debt. Swaps may also be used to produce interest rate savings, limit or hedge variable rate payments, alter the pattern of debt service payments, manage exposure to changing market conditions in advance of anticipated bond issues (through the use of anticipatory hedging instruments) or for asset/liability matching purposes. The Policy includes provisions relating to the credit quality of counterparties, the term and notional amount of Swaps, monitoring of existing Swaps, the engagement of advisors to assist the Authority in monitoring the Swaps, disclosure and reporting of amounts, value and issues relative to existing Swaps, and other related matters. Pursuant to the Policy, the Authority will actively monitor the degree of risk and exposure associated with Swaps to which it is a party but can offer no assurances that compliance with its Policy will prevent the Authority from suffering adverse financial consequences as a result of these transactions.

FUTURE INDEBTEDNESS

Projected Capital Borrowings

The Authority has established a five (5) year capital improvement program encompassing years 2005 to 2009 (the "Capital Improvement Program"). The primary objectives of the Authority's Capital Improvement Program are to assure uninterrupted service to the Authority's customers and to enhance the Water and Sewer System's capabilities. The Capital Improvement Program was designed to maintain a satisfactory level of service to Water and Sewer System users, to improve operating efficiency, to address future requirements and to assure a safe supply of water to its users. The current program was initially implemented in 1984 and has resulted in major improvements, additions and rehabilitation to all components of the Water and Sewer System.

The Consulting Engineer has forecasted a First Lien Bond issue in the approximate amount of \$50,000,000 to complete the funding for the 2005 - 2009 Capital Improvement Program to be issued sometime in 2008 (the "Projected 2008 Bonds").

As more fully discussed under "CERTAIN BONDHOLDERS' RISKS, *Certain Environmental Matters*" herein, the Authority is subject to a U.S. Environmental Protection Agency Combined Sewer Overflow Policy ("CSO Policy") regarding overflows from combined sewers during events that result in the discharge to receiving water of untreated sanitary sewage. Pursuant to the January 2004 Consent Order and Agreement (the "Order"), the Authority is developing a long-term plan (the "CSO Long-Term Control Plan") to comply with the CSO Policy and expects to submit its CSO Long-Term Control Plan to the Department of Environmental Protection (DEP) by January 2008. The cost of the studies and construction activities that will be required to reach target goals that are to be established through the CSO Policy is currently preliminarily estimated by the Authority at \$300,000,000, but will be more accurately determined when the CSO Long-Term Control Plan is finally approved. The amount is dependent, in part, on coordination with other regional providers and ALCOSAN. Funding of a portion of the amount needed to address the combined sewer overflow issue and achieve compliance with the Clean Water Act was provided with proceeds of the 2002 Bonds and the 2005 Bonds. Additional funding will include approximately \$2.7 million for manhole inspections and sewer televising, \$3.5 million to gunite sewers and conduct cured-in-place pipe linings,

\$3 million to conduct point repairs and address deteriorated sewers, \$3.4 million for sewer separation projects and \$8 million to finalize the CSO Long-Term Control Plan. The final years of the current improvement program contemplate additional expenditures for sewer compliance issues and infrastructure improvements. It is anticipated that funding for these expenditures, as well as implementation of the CSO Long-Term Control Plan will be provided, in all or in part, through the issuance of additional debt.

Future Refunding Transactions

It is expected that the Authority, contemporaneously with the execution and delivery of the Swap Agreements, will enter into four additional confirmations under the Swap Agreements on a forward delivery basis with each of the Counterparties in the aggregate initial notional amount of approximately \$194,530,000 (the "Forward Swaps"). The purpose of the Forward Swaps is to lock interest rates on a forward basis for the current refunding of the Authority's outstanding Series of 1998A and Series of 1998C Bonds.

The Forward Swaps will provide, in general, that the Authority will pay to the Counterparties periodic fixed amounts based on a fixed percentage on an aggregate initial notional amount expected to be equal to \$194,530,000 and that the Counterparties will pay to the Authority periodic floating amounts based on the SIFMA Municipal Swap Index until September 1, 2025.

The delivery of the Forward Swaps is anticipated to be March 1, 2008. Depending upon market conditions at that time, the Authority may elect to terminate the Forward Swap agreements and not effect the refunding of the Series of 1998A and Series of 1998C Bonds

The execution and delivery of the Forward Swaps will not alter the Authority's obligation to pay the principal of, premium, if any, and interest on the 2007 Bonds. However, the obligation of the Authority to make Periodic Payments (but not termination payments) due under the Forward Swaps will be on parity with the Authority's obligations to make payments on the 2007 Bonds.

Under certain circumstances (including certain events of default with respect to the Authority or either of the Counterparties), a Forward Swap could terminate in whole or in part prior to its stated termination date. Following any such early termination of a Forward Swap, either the Authority or the respective Counterparty, as applicable, may owe a termination payment ("Settlement Amounts") to the other, depending upon market conditions. If at the time of an early termination of a Forward Swap long-term interest rates are significantly lower than they were when the Forward Swap was executed and delivered, the Authority could owe a substantial Settlement Amount to the Counterparty. Likewise, if at the time of an early termination of a Forward Swap, interest rates are significantly higher than when the Forward Swap was executed, the Counterparties may owe the Authority a substantial Settlement Amount.

Any Settlement Amounts payable by the Authority will be subordinate to the Authority's obligation to make all payments due and owing on the 2007 Bonds, any other outstanding First Lien Bonds and Periodic Payments due under the Swap Agreements and Forward Swaps.

The Authority's Periodic Payments, but not any Settlement Amounts, under the Forward Swaps will be guaranteed by Financial Security Assurance Inc. under a Swap Insurance Policy. The provider of the Swap Insurance Policy will be given certain rights under the Forward Swaps, including rights to consent to the designation of an Early Termination Date upon the occurrence of certain events and the right to designate an Early Termination Date with respect to the Authority if an event of default under the Forward Swap occurs with respect to the Authority as the defaulting party.

See "INTEREST RATE SWAP AGREEMENTS," above for a summary discussion of swap risks, which are also relevant to the Forward Swaps.

CERTAIN BONDHOLDERS' RISKS

Investment in the 2007 Bonds may involve certain risks and each investor should carefully consider the risks involved to determine whether to purchase any of the 2007 Bonds. Each prospective investor should carefully examine this Official Statement and his or her own financial condition (including the diversification of his or her investment portfolio) in order to make a judgment as to whether the 2007 Bonds are an appropriate investment.

The Authority has identified and summarized below certain "bondholders' risks" that could adversely affect the finances of the Authority, the operation of the Water and Sewer System and/or the funds available for payment of the 2007 Bonds, which should be considered by prospective investors. The following discussion is not intended to be exhaustive, but includes certain major factors, which should be considered along with other factors set forth elsewhere in this Official Statement, including the Appendices hereto. See APPENDIX A – "DESCRIPTION OF THE AUTHORITY AND WATER AND SEWER SYSTEM" – "Government Regulation."

Certain Environmental Matters

The Authority is subject to a variety of federal, state and local environmental laws and regulations governing discharges to air and water, treatment of sanitary wastewaters and the storage and disposal of solid waste materials. (See APPENDIX A – “*Government Regulation*”.) The Sewer System conveys wastewater generated within the City boundaries, and from certain other municipalities connected to the Sewer System to ALCOSAN interceptors located along the rivers of the City for conveyance to ALCOSAN's wastewater treatment facility for processing prior to discharge into the Ohio River. (See APPENDIX A – “*The Sewer System*”.) The Sewer System is designed so that during wet weather, a portion of the collected storm water and diluted wastewater is discharged to natural watercourses by diversion chambers located throughout the Sewer System and at connections to the ALCOSAN interceptors. The Sewer System operates satisfactorily and has adequate capacity for the dry weather wastewater flows; during wet weather, however, the Sewer System is often taxed beyond its capacity, resulting in overflows, bypassing and flooding.

The U.S. Environmental Protection Agency (“USEPA”) has adopted regulations governing discharges to surface bodies of water under the Federal Clean Water Act, coupled with a Combined Sewer Overflow Policy (the “CSO Policy”) regarding overflows from combined sewers during wet weather events that result in the discharge to receiving water of untreated sanitary sewage. These combined sewer overflows (“CSOs”) contain pollutants that are present in domestic and industrial wastewater, as well as those in the urban storm water runoff that enter the combined sewer system. Most of the Authority’s sewers are combined sewers and there are well over 200 CSOs within the Authority’s Sewer System and at connections to ALCOSAN’s interceptors. The CSO Policy requires owners of any sewer system having CSOs to acquire National Pollutant Discharge Elimination System (“NPDES”) discharge permits for each overflow site. On January 29, 2004, pursuant to a resolution adopted by its Board on December 19, 2003, the Authority entered into the Order regarding alleged wet weather sewer overflows within the City of Pittsburgh, Allegheny County, Pennsylvania. The other signatories to the Order are the City of Pittsburgh, the Pennsylvania Department of Environmental Protection (“DEP”) and the Allegheny County Health Department (“ACHD”).

The Order was developed as part of a two-year process of negotiation and consensus-building among the DEP, the ACHD, the Authority and eighty-two other municipalities and municipal authorities whose sewage is ultimately treated by ALCOSAN at its Woods Run Sewage Treatment Plant. In the negotiations and consensus-building, the participants developed proposed orders to be used by the municipalities served by ALCOSAN to address regional concerns regarding wet weather sewer overflows.

Generally, the Order requires the Authority and the City to assess the combined and separate sanitary sewers within the City in order to develop a plan to address alleged wet weather sewer overflows within the City. The assessment activities required under the Order include performing: (1) a physical survey and visual inspection; (2) sewer line cleaning and closed circuit television internal inspections; (3) sewer system mapping; (4) sewer system dye testing; (5) a system of hydraulic characterization; and (6) flow monitoring. The Order provides a very specific schedule for the completion of assessment activities. Most assessment activities for critical sewers and the separate sanitary portion of the sewer system are to be completed in 2010. Assessment activities for non-critical sewers are to be completed on a longer schedule with some tasks to be completed in 2012.

In addition to assessment activities, the Order requires the Authority and the City to implement the Nine Minimum Controls for the control of combined sewer overflows (“CSOs”), and to perform repairs and maintenance to the deficiencies in the sewer system revealed by the assessment activities. Such deficiency corrections include eliminating the conveyance of streams by the sewer system and repairing or replacing sewer lines that restrict flows causing unpermitted overflows. Generally, deficiency corrections in the critical sewers and the separate sanitary sewer system are to be completed in 2010. Deficiency corrections in the assessed, non-critical sewers are to be completed by 2012.

The Authority is currently developing a CSO Long-Term Control Plan to address the combined sewer overflow issue and achieve compliance with water quality standards and the Clean Water Act and expects to submit its Long Term Control Plan to DEP by January 2008.

The Order called for collection system investigations, repairs and further studies. The collection system investigation and repairs are reflected in the Capital Improvement Program. Included within this program for the 2005-2007 period are approximately \$2.7 million for manhole inspections and sewer televising, \$3.5 million to gunite sewers and conduct cured-in-place pipe linings, \$3 million to conduct point repairs and address deteriorated sewers, \$3.4 million for sewer separation projects and \$8 million to finalize the Long Term Control Plan.

Ultimately the Long Term Control Plan must be developed for the elimination of sanitary sewer overflows and the reduction of combined sewer overflows to acceptable levels. The cost of the studies and construction activities to reach target goals is currently preliminarily estimated by the Authority to cost at least \$300,000,000, but will be more accurately determined when the Long Term Control Plan is finally approved. The amount is dependent, in part, on coordination with other regional providers and ALCOSAN. The details of the plan and the time required for full implementation of the plan

have not yet been determined. As of this date the regulatory agencies, the Authority, the other municipalities, and ALCOSAN have not reached concurrence with regard to the details of the plan and the schedule for implementation.

The DEP has issued to the Authority and the City a National Pollutant Discharge Elimination System ("NPDES") permit regarding the CSOs within the City. The Authority is permitted for a total of 194 CSOs in the sewage collection system. Of these, the Authority operates and maintains 40 of the CSOs. The remainder of CSOs are operated by the regional treatment provider, ALCOSAN.

Water Supply

Although the quantity of water available from the Authority's sole source of water, the Allegheny River, is believed to be adequate, it is possible that circumstances could change this condition. The total flow of the river could, for example be limited by drought conditions, and any constraints that may be imposed on withdrawals in drought conditions, such as pass-by flow conditions designed to leave sufficient water in the stream for navigation and fisheries.

Geographic Concentration

The number of customers using the Water and Sewer System may be adversely affected by regional and local economic conditions, competitive conditions, changes in population and general market conditions. There can be no assurance that the Water and Sewer System will be able to maintain the current number of existing users, if there are changes in the resident and/or commercial population of the service area.

Insurance and Legal Proceedings

The Authority carries property and general liability insurance in amounts deemed adequate by the Board and consistent with industry practices. Since January 1, 2002, the Authority has been self-insured as to general liability claims. While there are no current claims in excess of liability limits, there can be no assurance that future claims will be covered by applicable insurance coverage. A claim against the Authority not covered by, or in excess of, the Authority's insurance could have a material adverse effect upon the financial affairs of the Authority.

Governmental Regulation

The federal and local government significantly regulates providers of water and sewer systems. Future regulations and conditions affecting the acquisition, development ownership and operation of the Water and Sewer System could increase the operating expenses of the Water and Sewer System or could otherwise have a material adverse effect on the financial condition of the Authority. (See APPENDIX A – "DESCRIPTION OF THE AUTHORITY AND WATER AND SEWER SYSTEM" – "Government Regulation.")

LITIGATION

In the opinion of Authority Counsel, there is no litigation pending or threatened seeking to enjoin the issuance, sale or delivery of the 2007 Bonds or affecting the security pledged therefor.

There are no pending claims or actions against the Authority arising from the operation and maintenance of the Water and Sewer System, that, if determinations or settlements were made adverse to the Authority, and upon consideration of available insurance coverage, would have, in the opinion of the Authority's Counsel, a material adverse effect on the Authority's financial position.

TAX MATTERS

Federal Tax Exemption

In the opinion of Bond Counsel, assuming compliance with certain covenants of the Authority, interest on the 2007 Bonds is excluded from the gross income of the owners of the 2007 Bonds for federal income tax purposes under existing law, as currently enacted and construed. Interest on the 2007 Bonds will not be an item of tax preference under the Internal Revenue Code of 1986, as amended (the "Code"), for purposes of determining the alternative minimum tax imposed on individuals and corporations. Interest on a 2007 Bond held by a corporation (other than an S corporation, regulated investment company, real estate investment trust or real estate mortgage investment conduit) may be indirectly subject to alternative minimum tax because of its inclusion in the earnings and profits of the corporate holder. Interest on a 2007 Bond held by a foreign corporation may be subject to the branch profits tax imposed by the Code.

The initial public offering prices of the 2007A Bonds is greater than the amount payable on such 2007A Bonds at maturity. Bond Counsel expresses no opinion herein with respect to the treatment of such excess of offering price over amounts payable at maturity ("original issue premium"). Investors should seek advice from their own tax advisor.

Ownership of the 2007 Bonds may give rise to collateral federal income tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry the 2007 Bonds. Bond Counsel expresses no opinion as to any such collateral federal income tax consequences. Purchasers of the 2007 Bonds should consult their own tax advisors as to collateral federal income tax consequences.

The Code sets forth certain requirements which must be met subsequent to the issuance and delivery of the 2007 Bonds for interest thereon to remain excludible from the gross income of the owners of the 2007 Bonds for federal income tax purposes. The Authority covenants to comply with such requirements in the Indenture and in the Authority's Non-Arbitrage Certificate, and noncompliance with such requirements may cause the interest on the 2007 Bonds to be includible in the gross income of the owners of the 2007 Bonds for federal income tax purposes, retroactive to the date of issue of the 2007 Bonds. The opinion of Bond Counsel assumes compliance with such covenants and Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring) after the date of issuance of the 2007 Bonds may affect the tax status of interest on the 2007 Bonds.

Pennsylvania Tax Exemption

Bond Counsel is of the opinion that, under the laws of the Commonwealth of Pennsylvania, as currently enacted and construed, the 2007 Bonds are exempt from personal property taxes in Pennsylvania, and the interest on the 2007 Bonds is exempt from Pennsylvania personal income tax and Pennsylvania corporate net income tax.

Pursuant to the provisions of Act 68 of 1993 of the Commonwealth of Pennsylvania ("Act 68"), profits, gain or income from the sale of the 2007 Bonds shall be subject to Pennsylvania personal income tax and Pennsylvania corporate net income tax. Bond Counsel expresses no opinion as to the treatment of original issue premium in the computation of profits, gain or income from the sale of the 2007A Bonds pursuant to Act 68.

THE TRUSTEE

The obligations and duties of the Trustee are described in the Indenture, and the Trustee has undertaken only those obligations and duties which are expressly set out in the Indenture. The Trustee has not independently passed upon the validity of the 2007 Bonds, the security therefor, the adequacy of the provisions for payment thereof or the tax-exempt status of the interest on the 2007 Bonds. The Trustee has relied upon the opinion of Bond Counsel for the validity and tax-exempt status of the interest on the 2007 Bonds. The Indenture expressly provides that the Trustee shall not be responsible for any loss or damage resulting from any action or inaction taken in good faith in reliance upon an opinion of counsel.

Under the terms of the Indenture, the Trustee is liable only for those damages caused by its gross negligence or willful misconduct. Under the Indenture, the Trustee is not required to take notice and is not deemed to have notice, of any default under the Indenture, except failure by the Authority to cause to be made any of the payments required to be made for payment of principal of the 2007 Bonds, when due at maturity or earlier redemption, or interest on the 2007 Bonds, or unless the Trustee has been specifically notified in writing of such default by the Authority or the owners of at least 25% in aggregate principal amount of the Outstanding Bonds affected by such default. All notices or other instruments required by the Indenture to be delivered to the Trustee must be delivered at the corporate trust office of the Trustee in Pittsburgh, Pennsylvania. In the absence of any such notice, the Trustee may conclusively assume no Event of Default (as defined in the Indenture) exists, except as expressly stated above and in the Indenture.

LEGAL OPINIONS

Purchase of the 2007 Bonds by the Underwriter is subject to the receipt of the approving legal opinion of Pepper Hamilton LLP, Pittsburgh, Pennsylvania, Bond Counsel. The unqualified approving opinion of Bond Counsel will be substantially in the form attached to this Official Statement as APPENDIX F. Certain legal matters for the Authority will be passed upon by its Counsel, Thorp, Reed & Armstrong, LLP, Pittsburgh, Pennsylvania, for the Underwriters by Buchanan Ingersoll & Rooney PC, Pittsburgh, Pennsylvania. Certain legal matters will be passed upon by Greenberg Traurig, LLP, Philadelphia, Pennsylvania, which has been retained by, and acts as counsel to the Bank and the Counterparties.

INDEPENDENT AUDITORS

The audited financial statements of the Authority, as of and for the years ended December 31, 2005 and 2004, included in APPENDIX C - "Authority Financial Statements" have been audited by Maher Duessel, independent certified public accountants, as indicated in their report with respect thereto, which report also appears in APPENDIX C.

RATINGS OF THE 2007 BONDS

Standard & Poor's Rating Group and Moody's Investors Service are expected to assign their municipal bond ratings of "AAA", and "Aaa," respectively, to the 2007 Bonds, with the understanding that upon delivery of the 2007 Bonds, a policy insuring the payment when due of the principal of and interest on the 2007 Bonds will be issued by Bond Insurer.

Standard & Poor's Rating Group and Moody's Investors Service are expected to assign their short term ratings of "A-1+" and "VMIG 1," respectively, to the 2007B Bonds, with the understanding that upon delivery of the 2007B Bonds, (i) the Standby Purchase Agreement supporting the payment of the tender purchase price of the 2007B Bonds will be executed and delivered by the Bank and (ii) the Bond Insurance Policy will be delivered by the Bond Insurer to the Trustee.

An explanation of the significance of each of such ratings may be obtained from the rating agency furnishing the same at the following addresses: Standard & Poor's Rating Group, 25 Broadway, New York, NY 10004, and Moody's Investors Service, 99 Church Street, New York, NY 10007. There is no assurance that such ratings will continue for any given period of time or that they may not be lowered or withdrawn entirely by the rating agencies, or any of them, if, in their or its judgment, circumstances so warrant. Any such downward change in or withdrawal of such ratings, or any of them, may have an adverse effect on the market price of the 2007 Bonds.

The Authority has not applied for an underlying rating based upon its own creditworthiness.

CONTINUING DISCLOSURE; DISCLOSURE DISSEMINATION

Pursuant to Securities and Exchange Commission Rule 15c2-12 under the Securities Exchange Act of 1934, as amended (the "Rule"), the Authority will enter into a Disclosure Dissemination Agent Agreement ("Disclosure Dissemination Agreement") for the benefit of the holders of the 2007 Bonds with Digital Assurance Certification, L.L.C. ("DAC"), under which the Authority has designated DAC as Disclosure Dissemination Agent (the "Disclosure Dissemination Agent"), and which includes an undertaking for the benefit of the holders of the 2007 Bonds to provide certain financial information and operating data on an annual basis (the "Annual Report") and to provide notice of certain enumerated events if such events are determined to be material under the federal securities laws

The Annual Report is to be filed by the Disclosure Dissemination Agent not later than 200 days after the end of the Authority's fiscal year with each Nationally Recognized Municipal Securities Information Repository as defined in the Rule ("NRMSIR"). Notices of material events are to be filed with each NRMSIR or with the Municipal Securities Rulemaking Board ("MSRB") and any State Information Depository established by the Commonwealth under the Rule, if any ("SID"). The Authority has complied with its continuing disclosure obligations under the Rule since 1995.

Annual Information. The Annual Information concerning the Authority shall consist of (1) audited financial statements or the disclosure of the absence of such an audit, prepared in accordance with generally accepted accounting principles ("GAAP"), or accompanied by a quantified explanation of material deviations from GAAP or a full explanation of the accounting principles used, and a certificate regarding annual debt service coverage; (2) operating data regarding the Authority substantially of the type included in the tables appearing under the following headings and subheadings of this Official Statement or in APPENDIX A hereto entitled "Water and Sewer Rates," "Water Consumption by Customer Classification," and "Survey of 10 Largest Users"; and (3) a narrative discussion that analyzes the Authority's financial condition and results of operations, as well as facts likely to have a material impact on the Authority.

Notice of Material Events. The notices to be provided under the Rule, which the Authority will undertake to provide as described above, include written or notice of the occurrence of any of the following events, if material, with respect to the 2007 Bonds:

- (i) Principal and interest payment delinquencies;
- (ii) Non-payment related defaults;
- (iii) Unscheduled draws on debt service reserves reflecting financial difficulties;
- (iv) Unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) Substitution of credit or liquidity providers, or their failure to perform;
- (vi) Adverse tax opinions or events affecting the tax-exempt status of the 2007 Bonds;
- (vii) Modifications to rights of holders of the 2007 Bonds;
- (viii) Bond calls (other than mandatory sinking fund redemptions);
- (ix) Defeasances;
- (x) Release, substitution or sale of property securing repayment of the 2007 Bonds; and
- (xi) Rating changes.

The Securities and Exchange Commission requires the listing of (i) through (xi), although some of such events may not be applicable to the 2007 Bonds.

Amendments. The Disclosure Dissemination Agreement may be amended, without the consent of the holders of the 2007 Bonds, but only upon the Authority obtaining an opinion of counsel expert in federal securities laws acceptable to both the Authority and the Disclosure Dissemination Agent to the effect that such amendment, and giving effect thereto, will not materially impair the interests of the holders of the 2007 Bonds and would not, in and of itself, cause the undertakings therein to violate the Rule; provided neither the Authority nor the Disclosure Dissemination Agent shall be obligated to agree to any amendment modifying their respective duties or obligations without their consent thereto. Notwithstanding the foregoing, the Disclosure Dissemination Agent shall have the right to adopt amendments to the Disclosure Dissemination Agreement necessary to comply with modifications to and interpretations of the provisions of the Rule as announced by the Securities and Exchange Commission from time to time by giving not less than 20 days written notice of the intent to do so together with a copy of the proposed amendment to the Authority. Not such amendment shall become effective if the Authority shall, within 10 days following the giving of such notice, sends a notice to the Disclosure Dissemination Agent in writing that it objects to such amendment.

Termination. The continuing obligation of the Authority and the Disclosure Dissemination Agent under the Disclosure Dissemination Agreement shall terminate upon the legal defeasance, prior redemption or payment in full of all of the 2007 Bonds, when the Authority is no longer an Obligated Person with respect to the 2007 Bonds, or upon delivery by the Authority to the Disclosure Dissemination Agent of an opinion of nationally recognized bond counsel to the effect that continuing disclosure is no longer required.

Obligated Persons. At this time, only the Authority is an “Obligated Person” for annual reporting purposes under the criteria described in the Disclosure Agreement.

Any failure by the Authority to comply with the provisions of the Disclosure Dissemination Agreement shall not be an event of default with respect to the 2007 Bonds (although any available remedy in equity may be pursued to compel the Authority’s compliance). Nevertheless such failure must be reported in accordance with the Rule and must be considered by any broker, dealer or municipal securities dealer before recommending the purchase or sale of the 2007 Bonds in the secondary market. Consequently, any such failure may adversely affect the transferability and liquidity of the 2007 Bonds and their market price.

The Authority has not failed to comply with any prior such undertaking under the Rule. A failure by the Authority to comply with the Disclosure Dissemination Agreement will not constitute an Event of Default under the Indenture (although Bondholders will have any available remedy at law or in equity). Nevertheless, such a failure must be reported in accordance with the Rule and must be considered by any broker, dealer or municipal securities dealer before recommending the purchase or sale of the 2007 Bonds in the secondary market. Consequently, such a failure may adversely affect the transferability and liquidity of the 2007 Bonds and their market price.

Bondholders are advised that the Disclosure Dissemination Agreement, copies of which are available at the office of the Authority, should be read in its entirety for more complete information regarding its contents.

The Disclosure Dissemination Agent has only the duties specifically set forth in the Disclosure Dissemination Agreement. The Disclosure Dissemination Agent's obligation to deliver the information at the times and with the contents described in the Disclosure Dissemination Agreement is limited to the extent the Authority has provided such information to the Disclosure Dissemination Agent as required by the Disclosure Dissemination Agreement. The Disclosure Dissemination Agent has no duty with respect to the content of any disclosures or notice made pursuant to the terms of the Disclosure Dissemination Agreement. The Disclosure Dissemination Agent has no duty or obligation to review or verify any information in the Annual Report, Audited Financial Statements, notice of Notice Event or Voluntary Report (as defined in the Disclosure Dissemination Agreement), or any other information, disclosures or notices provided to it by the Authority and shall not be deemed to be acting in any fiduciary capacity for the Authority, the holders of the 2007 Bonds or any other party. The Disclosure Dissemination Agent has no responsibility for the Authority's failure to report to the Disclosure Dissemination Agent a Notice Event or a duty to determine the materiality thereof. The Disclosure Dissemination Agent shall have no duty to determine or liability for failing to determine whether the Authority has complied with the Disclosure Dissemination Agreement. The Disclosure Dissemination Agent may conclusively rely upon certifications of the Authority at all times.

UNDERWRITING

The 2007 Bonds are being purchased from the Authority by J.P. Morgan Securities Inc. and Merrill Lynch & Co. (together, the “Underwriter”). The Underwriter has agreed to purchase (i) the 2007A Bonds for an aggregate purchase price of \$46,182,808.45 (representing the aggregate principal amount of the 2007A Bonds, less underwriters’ discount of \$196,740.00 plus a net original issue premium of \$2,659,548.45); and (ii) the 2007B Bonds for an aggregate purchase price

of \$114,887,062.50 (representing the aggregate principal amount of the 2007B Bonds, less underwriters' discount of \$287,937.50). The Underwriter will purchase all the 2007 Bonds if any are purchased.

REMARKETING

J.P. Morgan Securities Inc. has been appointed initially as exclusive Remarketing Agent (as defined in the Indenture) for the 2007B-1 Bonds. Subject to certain conditions, upon the delivery or deemed delivery of 2007B-1 Bonds tendered for purchase by any owners thereof in accordance with the provisions of the Indenture, the Remarketing Agent will offer for sale and use its best efforts to remarket such tendered 2007B-1 Bonds, any such remarketing to be made on the date such tendered 2007B-1 Bonds are to be purchased, at a price equal to 100% of the principal amount thereof plus accrued interest, if any. The Remarketing Agent may be removed or replaced by the Authority and the Remarketing Agent may also resign in accordance with the provisions of the Indenture.

Merrill Lynch & Co. has been appointed initially as exclusive Remarketing Agent for the 2007B-2 Bonds. Subject to certain conditions, upon the delivery or deemed delivery of 2007B-2 Bonds tendered for purchase by any owners thereof in accordance with the provisions of the Indenture, the Remarketing Agent will offer for sale and use its best efforts to remarket such tendered 2007B-2 Bonds, any such remarketing to be made on the date such tendered 2007B-2 Bonds are to be purchased, at a price equal to 100% of the principal amount thereof plus accrued interest, if any. The Remarketing Agent may be removed or replaced by the Authority and the Remarketing Agent may also resign in accordance with the provisions of the Indenture.

FINANCIAL ADVISOR AND SWAP ADVISOR

PNC Capital Markets LLC has served as the financial advisor (the "Financial Advisor") to the Authority in connection with the preparation, authorization and issuance of the 2007 Bonds. PNC Capital Markets LLC has also provided additional advisory services to the Authority with respect to the Swap Agreements and the Forward Swaps referenced herein (the "Swap Advisor"). Neither the Financial Advisor nor the Swap Advisor are obligated to undertake, and neither has undertaken to make an independent verification or to assume responsibility for the accuracy, completeness or fairness of the information contained in this Official Statement. The Financial Advisor and the Swap Advisor will each receive a fee for its respective services with regard to the issuance of the 2007 Bonds and the execution of the Swap Agreements and any Forward Swaps. See "INTEREST RATE SWAP AGREEMENTS" and "FUTURE INDEBTEDNESS – Future Refunding Transactions" herein.

CERTAIN RELATIONSHIPS

J.P. Morgan Securities Inc. is an underwriter and the initial Remarketing Agent for the 2007B-1 Bonds. JPMorgan Chase Bank, National Association is providing the liquidity facility in the form of the Standby Purchase Agreement and will also act as a Counterparty under a Swap Agreement and two of the Forward Swaps. J.P. Morgan Securities Inc. and JPMorgan Chase Bank, National Association are each wholly-owned subsidiaries of JPMorgan Chase & Co. Merrill Lynch & Co. is an underwriter and the initial Remarketing Agent for the 2007B-2 Bonds. Merrill Lynch Capital Services, Inc. will act as a Counterparty under a Swap Agreement and two of the Forward Swaps. Merrill Lynch & Co. and Merrill Lynch Capital Services, Inc. are each wholly-owned subsidiaries of Merrill Lynch & Co., Inc. See "INTEREST RATE SWAP AGREEMENTS" and "FUTURE INDEBTEDNESS – Future Refunding Transactions" herein.

PNC Capital Markets LLC has served as both Financial Advisor and Swap Advisor in connection with the issuance of the 2007 Bonds and the execution of the Swap Agreements and the Forward Swaps. See "FINANCIAL ADVISOR AND SWAP ADVISOR" above.

Maher Duessel, Certified Public Accountants, serves both as the Authority's auditor and will provide the verification report in connection with the advance refunding of the Refunded Bonds.

MISCELLANEOUS

The references, excerpts and summaries of all documents referred to herein do not purport to be complete statements of the provisions of such documents, and reference is made to all such documents for full and complete statements of all matters of fact relating to the 2007 Bonds, the security for the payment of the 2007 Bonds and the rights of the owners thereof. All capitalized terms used herein are used with the meaning set forth in the Indenture unless otherwise so specified.

The information contained in this Official Statement has been compiled from official and other sources deemed to be reliable and, while not guaranteed as to completeness or accuracy, is believed to be correct as of its date.

Any statement made in this Official Statement involving matters of opinion or of estimates, whether or not expressly so stated, are set forth as such and not as representations of fact, and no representation is made that any of the estimates will

be realized. The information and expressions of opinion herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority since the date hereof.

This Official Statement has been duly executed and delivered on behalf of the Authority by an Authorized Representative.

THE PITTSBURGH WATER AND SEWER AUTHORITY

By: /s/ Don Walko
Chairman

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APPENDIX A

DESCRIPTION OF THE AUTHORITY AND THE WATER AND SEWER SYSTEM

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Governance

The Board of the Authority consists of seven (7) members with no fewer than six (6) members appointed by the Mayor of the City and approved by City Council. The terms of Office of the members commence on the date of appointment, and the members serve staggered five (5) year terms from the first Monday in January next succeeding the date of appointment or until appointment of a successor, whichever is later. The Authority currently has one vacant position. The present members of the Board and officers of the Authority and their principal private affiliations are as follows:

Member	Occupation
Don Walko, Chairman	Member, Pennsylvania General Assembly
Robert P. Jablonowski, Vice Chairman	Retired (formerly Chemist, Duquesne Light Co.)
Richard M. Fees, Treasurer	Treasurer, City of Pittsburgh
Henry C. Blum, Secretary	1 st Vice President, Public Events Employees Union Local No. 188
Len Bodack, Jr., Asst. Secretary/Asst. Treasurer	Member, City Council City of Pittsburgh
Don A. Linzer	Shareholder, Schneider Downs & Co., Inc.

Organization Summary

The Authority is organized into three operating divisions: Administration, Water and Sewer Operations, and Engineering and Construction.

The Administration Division is responsible for the various administrative and support functions within the Authority. These include: customer service, billing and collections, personnel and finance, procurement, and management and data information systems.

The Water and Sewer Operations Division is responsible for the production and transmission of potable water and the collection and transmission of wastewater. Operating sections within this Division are: "Water Quality Operations" which ensures that the water produced meets all health and safety requirements; "Distribution and Collection" which is responsible for maintaining and repairing the water distribution system and repairing and maintaining the sewer collection system; "Treatment Process" which includes the water treatment plant and storage facilities; "Facilities Support" which is responsible for overseeing capital and scheduled facility repairs, system safety and security and "Stores Management" which is responsible for inventory.

The Engineering and Construction Division is responsible for developing, designing, initiating and monitoring all of the Authority's Capital Improvement Projects. In addition, this Division is responsible for reviewing plans prior to issuing permits for any connection into, or modification of, the water and sewer system; and for the maintenance and updating of the Authority's geographical information system.

Key Management Personnel

Executive Director -- Gregory F. Tutsock was appointed by the Board to the position of Executive Director in December 2000. Mr. Tutsock began his employment by the Authority and its predecessor, the City of Pittsburgh, Department of Water, in 1991 and has since held various management positions. Prior to his appointment to Executive Director, Mr. Tutsock served as the Authority's Deputy Executive Director (1997-2000) and Acting Executive Director (1996-1997). Mr. Tutsock has an Associate Degree in Engineering Technology and a Bachelor of Science Degree in Public Administration, both from Point Park University, Pittsburgh, Pennsylvania. He is a member of the American Water Works Association and the Pennsylvania Water Works Operator Association.

Accounting Manager -- Stephen Simcic joined the Authority's Administrative Division in September 2001. Mr. Simcic is responsible for Accounting and Financial Reporting of the Authority and in the absence of the Finance Director has assisted the Executive Director in all other financial matters of the Authority. Mr. Simcic came to the Authority with 10 years experience in the corporate accounting field with two major energy companies followed by 8 years as Controller with an environmental remediation engineering consulting firm subcontracting with the DOD and DOE. Mr. Simcic has a Bachelor of Science Degree in Business Administration from Robert Morris University, with a primary focus in Accounting. He is a member of the Government Financial Officer's Association.

Water Quality Manager -- Stanley States, Ph.D., has been the Water Quality Manager for the Authority and its predecessor the City of Pittsburgh, Department of Water, since 1977. In that position he is responsible for the laboratory; compliance with federal, state, and county water quality regulations; and the actual treatment process. He holds an MS in Forensic Chemistry and a Ph.D. in Environmental Biology from the University of Pittsburgh. Dr. States has conducted research and published extensively in the areas of water quality and treatment. He has served as an adjunct professor and has taught in the Graduate School of Public Health and the School of Engineering at the University of Pittsburgh. Most recently Dr. States has

been involved in authoring and delivering counterterrorism security courses, to water and wastewater personnel across the nation, for the Department of Homeland Security and the Environmental Protection Agency. Dr. States is a member of the American Water Works Association, the Water Works Operators Association of Pennsylvania, the American Society for Microbiology, and the American Chemical Society.

Director of Engineering and Construction -- Michael Lichte, PE, joined the Authority in September 1999 after three years with the Allegheny County Health Department and 7 years with the U.S. Geological Survey. Mr. Lichte is responsible for the overall coordination and management of the Engineering and Construction Division's involvement in the Capital Improvement Program. Mr. Lichte graduated from Allegheny College with a Bachelor of Science Degree in Aquatic Environments. He earned a Master of Science in Civil Engineering from the University of Pittsburgh. He is a Registered Professional Engineer in the Commonwealth of Pennsylvania and is a member of the Water Environment Federation and American Water Works Association.

Capital Lease Agreement with the City of Pittsburgh

In 1984, pursuant to the Lease and Management Agreement, the Authority leased the Water and Sewer System from the City and assumed responsibility for establishing and collecting user fees and charges and for maintaining and improving the Water and Sewer System. The Lease and Management Agreement further provided that the Water and Sewer System was to be operated and maintained for the Authority by the City, subject to the general supervision of the Authority. In 1995, the Authority and the City terminated the Lease and Management Agreement, and the Authority is acquiring the Water and Sewer System pursuant to the terms of the Capital Lease Agreement. The Capital Lease Agreement, which has a term of thirty (30) years, provides for payments totaling Ninety-Six Million Seventeen Thousand Two Hundred Forty-Nine Dollars and Sixty Cents (\$96,017,249.60), which, payments were made to the City during the initial three (3) years of said contract and further provides that on September 1, 2025, upon payment of One Dollar (\$1.00), the Authority will acquire title to the Water and Sewer System.

Concurrently with entering into the Capital Lease Agreement, the City and the Authority entered into a Cooperation Agreement, dated as of June 15, 1995 (the "Cooperation Agreement"). Pursuant to the Cooperation Agreement, the City provides certain specified engineering, communications, vehicle maintenance, legal, information and financial services to the Authority on a fee for services basis and the Authority makes certain other payments to the City to reimburse it for costs and capital expenses incurred by the City in regard to the operation and maintenance of the Sewer System. The Cooperation Agreement may be terminated by either party, upon ninety (90) days written notice.

The Water Supply and Distribution System

The water supply and distribution system (the "Water System") consists of a 117 million gallon per day rapid sand type treatment plant which was placed in service in 1969, 1,200 miles of mains and service lines, 30,000 valves, 8,000 fire hydrants, nine pumping stations, five reservoirs, and eleven storage tanks. The total storage capacity of the reservoirs and tanks is approximately 455 million gallons. Based on the average usage over the past several years, this capacity is sufficient to provide storage equivalent to approximately five to seven days of normal water usage. In the opinion of the Authority's Consulting Engineer, Chester Engineers, Inc. (the "Consulting Engineer"), the Water System's treated water quality exceeds all the current standards and levels of the federal Safe Drinking Water Act and the Pennsylvania Department of Environmental Protection (PADEP).

The sole source of water for the Water System is the Allegheny River for which the Authority and its predecessors have held withdrawal permits since 1943. In March 1989, the then Pennsylvania Department of Environmental Resources (now the "PADEP") issued the Authority a Water Allocation Permit under the 1939 Water Rights Act. This permit authorizes the withdrawal of up to 100 million gallons per day and the PADEP determined that this would cause no major impact on navigation. The current average withdrawal of water from the Allegheny River is approximately 70.5 million gallons per day, and the maximum withdrawal made on any one day was approximately 99 million gallons during the past year. The Authority's Consulting Engineer is of the opinion that the Allegheny River's water is of good quality, and that there is ample quantity to meet foreseeable demands given current allocation permit conditions and foreseeable river flow conditions.

The Water System currently provides approximately 83,000 residential, commercial, industrial and public customers with potable water and water for fire protection within the geographic boundaries of the City. This represents approximately 84 percent of the total population within the City with the balance served by three independent water purveyors.

In 2005, the total amount of water supplied by the Authority was approximately 26 billion gallons, an average of 73 million gallons per day. Approximately 1.2 billion gallons were sold to adjacent municipalities for resale to customers within their service areas.

No material decreases in customers or water usage are anticipated in the foreseeable future. The Authority's water treatment plant is capable of providing more water than is currently being used by its existing customers. The Authority has

undertaken a marketing effort to sell potable water to municipalities and municipal authorities within the region. It is also investigating the opportunity to purchase existing water systems located in municipalities adjacent to its current service area. Sale of this available water to additional regional communities would be a source of new revenue to the Authority. To realize this potential revenue the Authority would be required to construct water lines or improve pumping facilities to serve some regional communities; and those communities would need to obtain subsidiary water allocation permits from PADEP.

The Authority's Consulting Engineer is of the opinion that the Water System is in adequate operating condition and has adequate capacity to meet demands in the foreseeable future, provided the Authority continues the rehabilitation and replacement program provided for in its ongoing Capital Improvement Program.

Drinking Water Quality Regulatory Requirements

The Authority monitors water drinking quality on a continuous basis, 365 days a year. Tests are conducted for contaminants that may be present in source water prior to treatment, during treatment and on finished water. The Authority meets or exceeds all current Federal and State water quality requirements and anticipates compliance with future proposed regulations, including the pending Stage 2 Disinfection Byproducts Rule and the Long-term Enhanced Surface Water Treatment Rule. Results of water quality measurements and regulatory compliance are reported annually in the Authority's Consumer Confidence Report.

The Authority operates an on site water quality laboratory capable of conducting analysis and detection on numerous contaminants. The PADEP has certified the laboratory to conduct and certify results for a number of these contaminants. The Authority routinely provides analysis for other water providers and the Allegheny County Health Department. The Federal Safe Drinking Act requires each state to prepare a comprehensive Source Water Protection Plan to identify potential sources of contaminants. The Authority, working with the PADEP, has prepared the plan for the Allegheny River.

The Pilot Plant

The pilot plant, located at the Pittsburgh Water Treatment Facility, was designed to simulate treatment and hydraulic conditions in the Authority's main plant. Constructed in 2000, the pilot plant enables the Authority to determine process control parameters and chemical applications and to conduct stress testing the plant to achieve the best effective and efficient plant operations to meet current and future regulatory compliance issues. The Authority has addressed the new regulations for Stage 1, the disinfection byproduct rule and the interim enhanced surface water treatment rule. The Authority has met the requirements for both rules. This was accomplished through studies by utilizing the pilot plant. The Authority is confident it will meet requirements for the pending long-term enhanced surface water treatment rule and Stage 2 disinfection byproducts rule, again through studies utilizing the pilot plant, once the requirements are finalized.

The Microfiltration Facility

Pennsylvania's Department of Environmental Protection Regulations based on the Federal Safe Drinking Water Act of 1984 require all finished drinking water reservoirs to be covered by December 31, 1995. In order that Highland #1 reservoir could remain uncovered for environmental and limited recreational considerations, a 20 million gallon a day Microfiltration Facility was designed to provide further treatment before water is put into distribution. Microfiltration is a pressure-driven membrane process and consists of (0.1 micron pore size) membrane series for removal of suspended matter, turbidity, algae, fungi, protozoa, some microorganisms and cysts (including Cryptosporidium and Giardia). The Microfiltration Facility was placed into production in July 2002.

The Sewer System

The wastewater collection and transmission system (the "Sewer System") is part of a regional system that provides service to about 550,000 people, of whom nearly 325,000 live within the City. The total drainage area served by the regional system is approximately 80 square miles, of which the City comprises about 55 square miles, or nearly 70 percent of the total. The Sewer System is primarily a combined system designed to carry both storm and sanitary flows. The Sewer System is comprised of an extensive network of approximately 1,400 miles of sewer lines and four wastewater-pumping stations. The average age of the sewer lines is between 60 and 70 years old, with some portions reaching nearly 150 years in age.

The Sewer System conveys wastewater generated within the City boundaries to Allegheny County Sanitary Authority ("ALCOSAN") interceptors along the rivers of the City for conveyance to ALCOSAN's wastewater treatment facility for processing prior to discharge into the Ohio River. The ALCOSAN treatment facility, which is not part of the Water and Sewer System, is operated by ALCOSAN pursuant to the National Pollutant Discharge Elimination System ("NPDES").

The Sewer System also is utilized by 24 suburban municipalities pursuant to agreements with the City and/or the Authority to convey their wastewater to the ALCOSAN treatment facility. Many of the agreements with the suburban

municipalities provide for the sharing of maintenance or reconstruction costs of the Sewer System. Typically, the sharing of maintenance costs applies only to the trunk sewer lines through which the wastewater flows to the ALCOSAN interceptor.

The Sewer System is designed so that during wet weather, a portion of the collected storm water and diluted wastewater is discharged to natural water courses by diversion chambers located throughout the Sewer System and at connections to the ALCOSAN interceptors. The Sewer System is in satisfactory operating condition and has adequate capacity for the dry weather wastewater flows; however, in the past during wet weather, the Sewer System has often been taxed beyond its capacity and has resulted in overflow, bypassing and flooding. Some of these conditions have been or will be eliminated through the implementation of the Authority's ongoing Capital Improvement Program. Federal and State Combined Sewer Overflow requirements are expected to have some future impact on the Authority and, so far as possible at this stage, this has been taken into account in the Authority's 5 year Business Plan. The Authority's Consulting Engineer is of the opinion that the Sewer System is in adequate operating condition but is in need of the ongoing Capital Improvement Program in order to correct existing deficiencies and maintain and upgrade the system to meet regulatory requirements (see discussion below under the heading "Government Regulation"). With the continuation of the Capital Improvement Program, it is anticipated that the Sewer System will be sufficient to meet foreseeable future demands and provide uninterrupted service to its users. See "CERTAIN BONDHOLDERS' RISKS, Certain Environmental Matters" above.

Description of Service Area

A description of the area served by the Water and Sewer System and selected demographics of the service area are set forth in APPENDIX D.

Water and Sewer Rates

The following tables present the Authority's Water and Sewer Rates and certain data with respect thereto and have been prepared by the Authority.

Ten Year Historical Rates (1998–2007)

YEAR	Residential ⁽¹⁾		Commercial ⁽¹⁾		Industrial ⁽¹⁾		Wholesale ⁽²⁾		Health & Education ⁽¹⁾	
	Rate \$	Increase ⁽³⁾ %	Rate \$	Increase ⁽³⁾ %	Rate \$	Increase ⁽³⁾ %	Rate \$	Increase ⁽³⁾ %	Rate \$	Increase ⁽⁴⁾ %
1998	3.85	2.5	3.79	2.5	3.54	2.5	2.59	2.5	0	0
1999	3.95	2.5	3.88	2.5	3.63	2.5	2.65	2.5	5.31	(4)
2000	3.95	0	3.88	0	3.63	0	2.65	0	5.31	0
2001	3.95	0	3.88	0	3.63	0	2.65	0	5.31	0
2002	4.34	9.8	4.26	9.8	3.99	9.8	2.91	9.8	5.83	9.8
2003	4.64	7.0	4.56	7.0	4.26	7.0	3.11	7.0	6.24	7.0
2004	5.52	19.0	5.43	19.0	5.07	19.0	3.70	19.0	7.43	19.0
2005	6.46	17.0	6.35	17.0	5.93	17.0	4.33	17.0	8.69	17.0
2006	6.99	6.7	6.79	6.7	6.30	6.7	3.69	6.7	9.25	6.7
2007	7.50	5.4	7.19	5.4	6.74	5.4	3.69	--	9.83	5.4

- (1) Rate per 1,000 gallons over minimum use per month.
- (2) Up to 500,000 gallons
- (3) Represents percentage increase over prior year
- (4) New Rate Classification, rate per 1,000 gallons over minimum use per month.

2005 Water Consumption by Customer Classification (1)

<u>Classification</u>	<u>Customer</u>	<u>Percentage of usage</u>
Residential	74,148	39.2%
Commercial (2)	7,851	46.2%
Industrial	118	5.9%
Wholesale	18	8.7%
TOTAL	82,135	100.0%

- (1) Excludes customers of other water purveyors.
- (2) The "Commercial" category includes water usage by health and education sector, as well as various units of government.

2005 Survey of 10 Largest Users

<u>User</u>	<u>% of Total Usage for 2005</u>
1. Fox Chapel Water Authority	5.5
2. DLM Foods	1.9
3. Borough of Millvale	1.1
4. West Penn Allegheny Health System	0.7
5. Pittsburgh Housing Authority	0.6
6. Reserve Water Dept.	0.6
7. Keystone Brewers Inc.	0.4
8. Mercy Hospital	0.3
9. UPMC health Systems (site 22)	0.3
10. University of Pittsburgh	0.3

Source: Pittsburgh Water and Sewer Authority

2005 Water Rate Survey of Major Area Suppliers

	Rate 1,000 Gal.	Minimum Monthly Charge	Minimum Gallons Per Month	Average Charge 5,000 Gal. Per Month
Aspinwall Borough	\$6.25	\$ -	-	\$31.25
Fox Chapel Authority	6.20	3.93	-	34.93
Monroeville Authority	3.92	7.84	2,000	19.60
Pittsburgh Water and Sewer Authority (1)	5.00	12.42	1,000	32.42
Plum Borough Municipal authority	2.95	10.73	1,875	19.90
Richland Township Municipal Authority	4.13	15.42	2,000	27.81
Shaler Township	3.57	4.17	1,000	22.02
Southwestern – Penn Water Authority	4.11	7.00	-	27.55
Westmoreland Authority – Forward Township	3.84	15.00	2,000	26.52
Westmoreland Authority – McKeesport	6.41	12.82	2,000	32.05
Westmoreland Authority – White Oak	3.36	8.72	1,000	23.24
Wilkinsburg – Penn Joint Water Authority	4.05	11.13	2,750	20.25

(1) Excluding \$1.46 for Sewer Use Rate

Relations with Other Municipalities

In addition to the Authority's sales to residential, commercial and industrial customers, the Authority has entered into contracts with eight adjacent municipalities and one wholesale customer for the sale of water. The Authority is the primary source of water for three municipalities, pursuant to long-term contracts expiring in 2012 through 2015, which establish pricing structures with each municipality. Four municipalities and one wholesale customer each have entered into contracts with the Authority for peak capacity needs. Four of these contracts require monthly minimum charges to be received by the Authority and one is on an emergency basis only.

Prospective Water Sales and Sewer Services

The Authority is capable of producing up to 100 million gallons of potable water each day. With current demand (including the requirements (and reserves) of other municipalities) at 70.5 million gallons per day the Authority has available surplus capacity. Also, in order to comply with current regulatory requirements the Authority will be making enhancements to the Sewer System through the Capital Improvement Program. These Sewer System enhancements will involve interaction with other municipalities (See "The Sewer System" for additional detail) and in connection therewith the Authority is continuing an initiative to market its surplus water capacity and extend its sewer services to other municipalities and water authorities in the region.

Expenses of Operation

Salaries and related expenses account for approximately nineteen percent (19%) of the 2007 Budget for current expenses. In 2007 the Authority's budget provides for two hundred seventy-four (274) positions as follows: thirty-nine (39) in billing and collections; twenty-five (25) in administrative and accounting positions; one hundred ninety-four (194) in water and sewer operations and sixteen (16) in engineering. Payments to the City of Pittsburgh for services to be provided to the Authority under the Cooperation Agreement are approximately eight percent (8%) of the 2007 budgeted current expenses. In addition, utility fees and the cost of chemicals account for approximately nine (9%) of the 2007 current expense budget.

Financial Operations

The Authority's income statement and annual debt service requirements are set forth in the following Financial History table. The table was prepared by the Authority using information contained in the audited financial statements for the years ended December 31, 2001 through December 31, 2005. The audited financial statements and management discussion and analysis for the years ended December 31, 2005 and 2004 are included as APPENDIX C.

Financial History*
(Dollars expressed in thousands)

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Operating revenues:					
Residential, commercial and industrial water sales	\$ 82,726	\$ 71,559	\$ 63,242	\$ 62,236	\$ 58,892
Utility water sales	--	--	--	--	--
Other	2,305	2,241	1,945	1,680	1,509
Total operating revenues	<u>85,031</u>	<u>73,800</u>	<u>65,187</u>	<u>63,916</u>	<u>60,401</u>
Operating Expenses:					
Direct operating expenses	31,160	29,607	30,011	26,367	27,364
Cooperation agreement operating expenses:					
Wastewater direct expenses	--	--	--	2,300	2,300
Indirect cost allocation - wastewater	3,000	3,000	3,000	3,000	3,000
Indirect cost allocation - water	4,150	4,150	4,150	1,850	1,850
Transfer costs, net					
Expense of water provided by other entities:					
Subsidy of customers located in the City	1,093	2,543	3,186	3,886	3,864
Depreciation	13,795	12,647	11,922	9,877	8,201
Amortization of capitalized lease assets	2,557	2,557	2,557	2,554	2,554
Total operating expenses	<u>55,755</u>	<u>54,504</u>	<u>54,826</u>	<u>49,834</u>	<u>49,133</u>
Operating income	<u>29,276</u>	<u>19,296</u>	<u>10,361</u>	<u>14,082</u>	<u>11,268</u>
Other revenues (expenses):					
Interest revenue	1,348	685	1,322	1,480	1,770
Interest expense	(27,500)	(26,727)	(28,355)	(25,944)	(23,459)
Unrealized gain/(loss) on trust investments	(160)	(84)	(53)	84	(94)
Amortization of bond issue costs	(643)	(628)	(401)	(496)	(267)
Total other revenue (expense)	<u>(26,955)</u>	<u>(26,754)</u>	<u>(27,487)</u>	<u>(24,876)</u>	<u>(21,956)</u>
Increase/(Decrease) in Net Assets	2,321	(7,458)	(17,126)	(10,794)	(10,688)
Net Asset Surplus/(Deficit):					
Beginning of year	<u>(41,590)</u>	<u>(34,132)</u>	<u>(17,006)</u>	<u>(6,212)</u>	<u>4,476</u>
End of year	<u>\$ (39,269)</u>	<u>\$ (41,590)</u>	<u>\$ (34,132)</u>	<u>\$ (17,006)</u>	<u>\$ (6,212)</u>
Annual debt service requirement					
Principal	\$ 17,159	\$ 12,079	\$ 14,055	\$ 10,065	\$ 9,635
Interest	23,180	23,325	26,631	25,738	22,123
Total annual debt service requirement	<u>\$ 40,339</u>	<u>\$ 35,404</u>	<u>\$ 40,686</u>	<u>\$ 35,803</u>	<u>\$ 31,758</u>

* Financial history restated to conform with new requirements of Governmental Accounting Standards Board 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* adopted by the Authority as of January 1, 2001.

The Financial History table reflects the results of past operations and is not necessarily indicative of results of future operations. Future operations will be affected by various factors, including, but not limited to, regulatory mandates, rate changes, weather, labor contracts, population changes, business environment and other matters, the nature and effect of which cannot now be determined. See "CERTAIN BONDHOLDERS’ RISKS".

Billings, Collections and Enforcement

All bills are due 20 days after the billing date and a penalty is applied 10 days past that date. The penalty is reflected on dunning notices generated and mailed to customers above a certain dollar threshold (dependent on customer class), and all unpaid balances and penalty are reflected on the next regularly monthly scheduled statement. In addition specified

delinquent accounts are also issued to a collection agency, as a matter of routine, as part of the overall collection process. Termination is dependent on customer class and time of year.

In March 2003, as Phase 1 of an information technology ("IT") implementation plan, the Authority upgraded to an SAP billing and customer information system which has the ability to combine water and delinquent waste water charges on a single customer account, and has dunning abilities never before used by the Authority. This new system has enabled the Authority to better manage metering, billing and collection of customer accounts, as well as improving management of revenue forecasting and service work processing.

Also as part of the Phase 1 IT implementation, the Authority upgraded to an SAP finance and materials management system. The second phase of the IT implementation plan, which was completed in mid-2004, included additional enhancements to billing and collection capabilities and implementation of a comprehensive IT asset management system.

Effective May 2004, the Authority began direct-billing City residents for current wastewater treatment charges. The intent of this operational change (from purchasing delinquent wastewater receivables and billing) is to reduce delinquencies by providing for more timely billing and collection activities.

In order to effect this billing change, the Authority has entered into a tentative agreement with ALCOSAN relating to direct billing by the Authority of the ALCOSAN wastewater treatment charges. Under that agreement, the Authority is obligated to create and fund an escrow account covering a two-month billing period. That account has been funded.

Employee Relations and Retirement System

The majority of employees of the Authority are represented by a labor organization under Act 195 of 1970 of the Commonwealth of Pennsylvania. The Pittsburgh Joint Collective Bargaining Committee represents blue-collar employees, the American Federation of State, County and Municipal Employees, Local 2719 represents white-collar employees and Local 2037 represents the foreman. Act 195 requires that bargaining start at least six months prior to the date on which the Authority's budget is adopted and that mediation be used if an impasse is reached. Since the time they were certified, the Authority has concluded numerous negotiations with these bargaining units without any labor stoppages. Four-year agreements were reached with each of the American Federation of State, County and Municipal Employees Locals. Local 2719 received salary increases on January 1, 2002, 2003, 2004 and 2005; and Local 2037 received salary increases effective January 1, 2002, 2003, 2004 and 2005. A five-year agreement was reached with the Pittsburgh Joint Collective Bargaining Committee, which provide for salary increases effective January 1, 2003, followed by additional increases on January 1, 2004, 2005, 2006, and 2007.

Government Regulation

The Authority is subject to Federal, State and County regulations in connection with water treatment, water distribution, wastewater collection, construction activities, and storage tank use and air emissions. At the Federal level, regulatory oversight is provided by the United States Environmental Protection Agency ("USEPA"); at the State level, oversight is provided by the PADEP; and at the local level, oversight is provided by the Allegheny County Health Department ("ACHD"). The system meets or is in the process of planning and implementing improvements to meet all applicable regulations, permits and licenses. The major regulatory programs governing the Authority's operations are discussed below, grouped by subject matter.

Drinking Water

Large municipal water suppliers, such as the Authority, provide drinking water in accordance with the Federal Safe Drinking Water Act, which was passed in 1974 and was amended in 1986 and 1996, regulating all systems which provide water for human consumption through at least 15 service connections, or regularly serve at least 25 individuals. The Federal Act gave USEPA the authority to establish drinking water standards to control the level of contaminants in drinking water, rules prescribing minimum methods of drinking water treatment, and requirements for monitoring and reporting of drinking water quality. Pennsylvania has adopted a corresponding Pennsylvania Safe Drinking Water Act in 1984, and the state regulatory program has received USEPA primary approval, meaning that PADEP primarily administers the permitting and regulatory program in Pennsylvania.

The Authority holds permits issued by PADEP for the operation of a public water supply system, and is required to comply with federal and state requirements for treatment, monitoring of water quality, reporting of monitoring results and notification of exceedances, and issuance of consumer confident reports to our customers.

Water Quality

Federal regulations adopted under the Federal Clean Water Act, and State rules enacted under the Pennsylvania Clean Streams Law, govern discharges of wastewater and stormwater. Any facility which discharges sewage, process wastewater, non-contact cooling water, stormwater from municipal separate storm sewer systems or stormwater associated

with an industrial activity must obtain a National Pollutant Discharge Elimination System ("NPDES") Permit. Under program approval from USEPA, PADEP administers the NPDES Permit program in Pennsylvania.

The Authority and the City of Pittsburgh have been issued an NPDES Permit for discharge from the municipal separate storm sewer systems within the City.

The PWSA Water Treatment Plant recently applied for an NPDES Permit to allow treated process water discharges to the Allegheny River. The PWSA has been asked by the PADEP to provide additional information for their review of the permit application. Discharges have occurred prior and subsequent to submission of the application. The PWSA will determine what action, if any, is required once the permit has been issued.

An NPDES permit is also required for discharges from sewage treatment facilities and combined sewer overflows ("CSO"). Such a permit establishes discharge limitations, monitoring, and reporting requirements and compliance schedules. The PWSA has been issued its NPDES CSO Permit for its combined sewer overflows.

On January 29, 2004, the Authority entered into a Consent Order and Agreement which contains detailed requirements for addressing wet weather sewer overflows (see "CERTAIN BONDHOLDERS' RISKS, *Certain Environmental Matters*").

The City of Pittsburgh, ACHD and the Authority have rules and regulations prohibiting the introduction of hazardous chemicals or materials, including industrial byproducts, into the sewer collection and conveyance system. Enforcement is through the Allegheny County Health Department, the City of Pittsburgh, Department of Public Safety, and the PADEP. Under USEPA requirements governing pre-treatment of industrial wastewaters discharged to publicly owned treatment works, pretreatment regulations and monitoring of those regulations are the responsibility of ALCOSAN and the ACHD.

Section 303(d) of the federal Clean Water Act requires Pennsylvania to identify all impaired waters within the Commonwealth where technology-based treatment requirements for point and non point sources of pollution are not stringent enough to attain and or maintain applicable water quality standards. This is an ongoing evaluation program being conducted by the PADEP. At this time, the PWSA has not been notified of any identified problems.

Storage Tanks

The Pennsylvania Storage Tank and Spill Prevention Act established a comprehensive regulatory program for both aboveground and underground storage tanks and facilities. The Act allows the PADEP to develop environmental protection programs to prevent and clean up storage tank product releases and spills. The Act includes both enforcement provisions and a strong reliance on the private sector to implement the major program elements. PADEP has received approval to administer the state storage tank program in lieu of most corresponding provisions of the Federal Resource Conservation and Recovery Act underground storage tank program.

The Authority currently has 12 tanks requiring frequent inspections under the regulatory provisions.

All Authority storage tanks have been upgraded to meet current regulatory requirements for protection, monitoring and containment.

Air Quality

The Authority has completed a \$3 million upgrade to the chemical treatment facility at the water treatment plant. This upgrade addresses storage, handling and distribution, containment and monitoring. These improvements will ensure compliance with current and proposed water quality and environmental regulations. A major aspect of the upgrade has been the conversion of the chlorination system from one utilizing gaseous chlorine to one utilizing liquid chlorine. Chlorine in a liquid form is safer to handle and store.

ACHD administers the air quality permitting program under the provisions of the Federal Clean Air Act and the Pennsylvania Air Pollution Control Act. Under Article XXI of the ACHD Air Pollution Control Regulations, pollution prevention is recognized as the preferred strategy (over pollution control) for reducing risk to air resources. Stack emission standards are set for specific air quality parameters and enforced by permit. On January 29, 1996 the Allegheny Health Department, Air Quality Program, issued the Authority an Annual Air Quality Operating Permit, # 96-0117. This permit covers emissions generated at the Water Treatment Plant and is reviewed and renewed annually. PWSA is required to periodically sample and meet stack air emission standards at the treatment plant from its boilers.

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APPENDIX B

SUMMARY OF INDENTURE

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SUMMARY OF INDENTURE

The 2007 Bonds are being issued and secured under the Trust Indenture dated as of October 15, 1993 (the "Original Indenture"), as amended and supplemented by the First Supplemental Indenture, dated as of July 15, 1995, the Second Supplemental Indenture, dated as of March 1, 1998, the Third Supplemental Indenture, dated as of March 1, 2002, the Fourth Supplemental Indenture, dated as of September 15, 2003, the Fifth Supplemental Indenture dated as of June 1, 2005 and the Sixth Supplemental Indenture dated as of March 1, 2007 (collectively, the "Indenture" or "First Lien Indenture"). All bonds issued under the First Lien Indenture are hereinafter referred to as "Bonds."

This summary of the First Lien Indenture is qualified in all respects by specific reference to the First Lien Indenture. A copy of the First Lien Indenture may be reviewed at the offices of the Authority or the Trustee. Capitalized terms and phrases, not otherwise defined herein, shall have the meanings ascribed to them in the First Lien Indenture.

Defined Terms.

Authorized Investments. The funds of the First Lien Indenture may be invested in the following:

(a) Direct obligations of the United States of America and securities fully and unconditionally guaranteed as to the timely payment of principal and interest by the United States of America, provided, that the full faith and credit of the United States of America must be pledged to any such direct obligation or guarantee ("Direct Obligations").

(b) Direct obligations and fully guaranteed certificates of beneficial interest of the Export-Import Bank of the United States; consolidated debt obligations and letter of credit-backed issues of the Federal Home Loan Banks; participation certificates and senior debt obligations of the Federal Home Loan Mortgage Corporation ("FHLMCs"); debentures of the Federal Housing Administration; mortgage-backed securities (except stripped mortgage securities which are valued greater than par on the portion of unpaid principal) and senior debt obligations of the Federal National Mortgage Association ("FNMA's"); participation certificates of the General Services Administration; guaranteed mortgage-backed securities and guaranteed participation certificates of the Government National Mortgage Association ("GNMA's"); guaranteed participation certificates and guaranteed pool certificates of the Small Business Administration; debt obligations and letter of credit-backed issues of the Student Loan Marketing Association; local authority bonds of the U.S. Department of Housing and Urban Development; guaranteed Title XI financings of the U.S. Maritime Administration; guaranteed transit bonds of the Washington Metropolitan Area Transit Authority; Resolution Funding Corporation securities.

(c) Direct obligations of any state of the United States of America or any subdivision or agency thereof whose unsecured, uninsured and unguaranteed general obligation debt is rated, at the time of purchase, "A" or better by Moody's and "A" or better by S&P, or any obligation fully and unconditionally guaranteed by any state, subdivision or agency whose unsecured, uninsured and unguaranteed general obligation debt is rated, at the time of purchase, "A" or better by Moody's and "A" or better by S&P.

(d) Commercial paper (having original maturities of not more than 270 days) rated, at the time of purchase, "P-1" by Moody's and "A-1" or better by S&P.

(e) Federal funds, unsecured certificates of deposit, time deposits or bankers acceptances (in each case having maturities of not more than 365 days) of any domestic bank including a branch office of a foreign bank which branch office is located in the United States, provided legal opinions are received to the effect that full and timely payment of such deposit or similar obligation is enforceable against the principal office or any branch of such bank, which, at the time of purchase, has a short-term "Bank Deposit" rating of "P-1" by Moody's and a "Short-Term CD" rating of "A-1" or better by S&P.

(f) Deposits of any bank or savings and loan association which has combined capital, surplus and undivided profits of not less than \$3 million, provided such deposits are continuously and fully insured by the Bank Insurance Fund or the Saving Association Insurance Fund of the Federal Deposit Insurance Corporation ("FDIC").

(g) Investments in money-market funds rated "AAAm" or "AAAm-G" by S&P.

(h) Repurchase agreements collateralized by Direct Obligations, GNMA's, FNMA's or FHLMC's with any registered broker/dealer subject to the Securities Investors' Protection Corporation jurisdiction or any commercial bank insured by the FDIC, if such broker/dealer or bank has an uninsured, unsecured and unguaranteed obligation rated "P-1" or "A3" or better by Moody's and "A-1" or "A-" or better by S&P, provided:

- (i) a master repurchase agreement or specific written repurchase agreement governs the transactions; and
- (ii) the securities are held free and clear of any lien by the Trustee or an independent third party acting solely as agent ("Agent") for the Trustee, and such third party is (i) a Federal Reserve Bank, (ii) a bank which is a member of the Federal Deposit Insurance Corporation and which has combined

capital, surplus and undivided profits of not less than \$50 million, or (iii) a bank approved in writing for such purpose by the Bond insurers, and the Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee; and

- (iii) a perfected first security interest under the Uniform Commercial Code, or book entry procedures prescribed at 31 C.F.R. 306.1 et seq. or 31 C.F.R. 350.0 et seq. in such securities is created for the benefit of the Trustee; and
 - (iv) the repurchase agreement has a term of 180 days or less, and the Trustee or the agent will value the collateral securities no less frequently than weekly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within two Business Days of such valuation; and
 - (v) the fair market value of the securities in relation to the amount of the repurchase obligation, including principal and interest, is equal to at least 103%.
- (i) Investment agreements approved by the Bond Insurers.

Current Expenses. The term "Current Expenses" shall mean the reasonable, proper and necessary costs of operation, maintenance and repair of the Water and Sewer System and Capital Additions and shall include, but without limiting the generality of the foregoing, administrative, engineering, legal, auditing and insurance expenses, liquidity facility fees and expenses, fees and expenses of the Trustee, any paying agent, and authorized depositories, an allowance for depreciation, any payments to pension or retirement funds and taxes, and payments payable by the Authority to the City under the Cooperation Agreement.

Debt Service Requirements. The term "Debt Service Requirements" shall mean, in respect of any Fiscal Year, the sum of the amount required to be paid in such Fiscal Year by the Authority in respect of the interest on and the principal of the Bonds outstanding or to be outstanding, as the case may be, and the amounts required to be paid to any sinking, purchase or analogous fund established for such Bonds and any Periodic Payments to be paid in connection with any Qualified Interest Rate Swap Agreement to the extent not taken into account in calculating the Debt Service Requirements on Bonds bearing interest at a variable rate pursuant to the immediately following sentence; provided, however, that the Debt Service Requirements in respect of any Fiscal Year for a series of Bonds for which there shall have been established a sinking, purchase or analogous fund shall be determined after projecting the operation of such fund to the retirement of Bonds by redemption and giving effect to the reduction in the payments to be made in such Fiscal Year in respect of the principal of and interest on such Bonds by reason of such redemption. To the extent any Bonds under consideration bear interest at a variable rate, and a Qualified Interest Rate Swap Agreement is in place with respect to such Bonds, the Debt Service Requirements on those Bonds shall be calculated by substituting the fixed rate used to determine amounts payable by the Authority under the Qualified Interest Rate Swap Agreement in lieu of the variable rate on the Bonds (except as such calculation relates to amounts to be deposited into the Debt Service Reserve Fund); provided, the Counterparty to such Qualified Interest Rate Swap Agreement maintains a rating by Standard & Poor's of at least "AA-" and by Moody's of at least "Aa3", otherwise the Debt Service Requirements for such Bonds shall be assumed to bear interest at the highest of: (i) the actual rate on the date of calculation, or if the indebtedness is not yet outstanding, the initial rate (if established and binding); (ii) if the indebtedness has been outstanding for at least twelve (12) months, the average rate over the twelve (12) months immediately preceding the date of calculation; and (iii) (1) if the interest on the indebtedness is excludable from gross income under the applicable provisions of the Internal Revenue Code of 1986, as amended, the most recently published Bond Buyer 25 Bond Revenue Index (or comparable index if no longer published) plus fifty (50) basis points, or (2) if interest is not so excludable, the interest rate on direct U.S. Treasury Obligations with comparable maturities plus fifty (50) basis points.

Periodic Payment Date. The term "Periodic Payment Date" means the date on which a Fixed Swap Payment is required under any Qualified Swap Agreement until the termination or maturity of the Qualified Interest Rate Swap Agreement.

Periodic Payments. The term "Periodic Payments" means any regularly scheduled payment payable by the Authority to the Counterparty pursuant to the terms of any Qualified Interest Rate Swap Agreement(s); however, Periodic Payments shall not include any termination payments, costs and fees or any other sums payable under the Qualified Swap Agreement that are not regularly scheduled payments payable by the Authority.

Qualified Interest Rate Swap Agreement. The term "Qualified Interest Rate Swap Agreement" or "Qualified Swap Agreement" means any agreement relating to any Bonds issued or to be issued under the Indenture with a Counterparty whereby the Authority will pay to the Counterparty periodic fixed amounts based upon a fixed percentage on a notional amount specified in such agreement and such Counterparty will pay to the Authority certain periodic floating payments; provided, that (i) the underwriter or the Authority's financial advisor shall certify to the Authority and the Trustee that (based

on current market conditions) such Qualified Swap Agreement creates an overall lower Debt Service Requirement than attained through the sole issuance of Additional Bonds bearing interest at fixed rates through maturity in lieu of that Qualified Swap Agreement and (ii) there is in place a municipal bond insurance policy with respect to the Bonds to which the agreement relates guaranteeing payment of amounts owed on the Bonds and a swap insurance policy guaranteeing the payment of Periodic Payments due with respect to such agreement respectively. Periodic Payments under a Qualified Interest Rate Swap Agreement may be on parity with the Bonds to which the agreement relates.

Receipts and Revenues. The term "Receipts and Revenues" shall mean any and all rates, fees, rents and charges established or to be established, levied and collected in connection with, and all other payments, receipts and revenues of whatever kind or character arising from, the operation or ownership of any property of the Authority or any part thereof (except tap or connection fees and charges to the extent such fees or charges are pledged in accordance with the Act as a refund to such person who has paid for the construction of any extension of the Water and Sewer System or assessment revenues which are subject to the lien of assessment bonds then outstanding), any income earned on the moneys or investments on deposit in the Debt Service Fund, Debt Service Reserve Fund, Construction Fund, Revenue Fund, Operation and Maintenance Fund and any sinking, purchase or analogous fund created under the First Lien Indenture.

Pledge and Security

Pursuant to the First Lien Indenture, the Receipts and Revenues after payment of the Authority's Current Expenses, together with all cash and investments from time to time held in any fund (other than the Rebate Fund) by the Trustee, is pledged by the Authority to the Trustee, its successors and assigns, to secure the payment of principal of and interest on all Bonds issued under the First Lien Indenture, the observance and performance of all the terms, provisions and conditions of the First Lien Indenture, and for the equal and ratable benefit and security of all and singular the present and future holders of the Bonds, without preference, priority or distinction as to lien or otherwise, except as otherwise provided in the First Lien Indenture, of any one Bond over any other Bond by reason of priority in the issue, sale or authentication thereof or otherwise. The municipal bond insurance policy issued with respect to a particular series of the Bonds is for the sole benefit and security of the holders of the particular series of Bonds to which such policy relates. Holders of Bonds of another series shall have no rights or protection under a bond insurance policy issued with respect to another series of the Bonds.

Additional Bonds

The Authority may issue additional Bonds, on a parity with the 2005 Bonds, the 2003 Bonds, the 2002 Bonds, the 1998A Bonds, the 1998B Bonds and the 1993 Bonds, for the purpose of financing the cost of acquiring or constructing capital additions or improvements, or for the purpose of refunding outstanding Bonds upon the conditions and terms set forth in the First Lien Indenture. In addition to the foregoing, the Authority may incur or assume additional debt provided that the security for such debt is subordinate to the lien of and security interests granted by the First Lien Indenture.

Funds Established Under the Indenture

Revenue Fund. All Receipts and Revenues and all other amounts received by the Authority from any source (except as otherwise provided in the First Lien Indenture) shall be deposited in the Revenue Fund established by the Authority with one or more Authorized Depositaries.

Operation and Maintenance Fund. On or before the first day of each month, the Authority shall transfer from the Revenue Fund to the Operation and Maintenance Fund an amount equal to the amount budgeted by the Authority for that month for payment of the Current Expenses as the same become due. The Authority shall pay out of the Operation and Maintenance Fund its Current Expenses as the same shall become due. There is a special account within the Operation and Maintenance Fund called the "Operating Reserve Account." There shall be maintained in the Operating Reserve Account one-sixth of the amount equal to the Authority's budgeted Current Expenses for the current Fiscal Year. Amounts in the Operating Reserve Account shall be applied to pay the Current Expenses of the Authority to the extent that the amounts on deposit in the Operation and Maintenance Fund are insufficient.

Debt Service Fund. On or before each interest payment date, the Authority will transfer from the Revenue Fund for deposit in the Debt Service Fund an amount equal to the amount of interest accrued and payable to date and an amount equal to the Periodic Payments for that Periodic Payment Date, and on or before the first day of each month, the Authority shall transfer from the Revenue Fund to the Trustee for deposit in the Debt Service Fund an amount equal to 1/12th of the principal due on the Bonds on the next following principal payment date.

Debt Service Reserve Fund. There shall be maintained in the Debt Service Reserve Fund an amount equal to the maximum annual debt service requirements on the Bonds, subject to restrictions of federal tax laws. The amount required to be maintained in the Debt Service Reserve Fund may be in the form of cash, a letter of credit or other credit instrument, a surety bond, or a combination thereof.

Redemption Fund. The Authority may transfer to the Trustee for deposit to the credit of the Redemption Fund such amounts as it may elect for the purchase or redemption of Bonds at the option of the Authority and the Trustee shall apply such moneys to the purchase or redemption of Bonds in the amounts directed by the Authority. Upon any such purchase or redemption, the Trustee shall transfer from the Debt Service Fund to the Redemption Fund any amount deposited to the Debt Service Fund with respect to interest on the Bonds being redeemed and shall pay the interest due on the redemption date out of such moneys.

Renewal and Replacement Fund. On the dates and in the amounts set forth in the consulting engineer's report, money is transferred to the Renewal and Replacement Fund. The moneys at any time on deposit to the credit of the Renewal and Replacement Fund may be used by the Authority for extraordinary maintenance and repair of the Water and Sewer System or to pay the cost of capital additions or construction, or, to the extent of any insufficiency therein, to the Debt Service Fund or to any sinking, purchase or analogous fund.

Rebate Fund. Separate and apart from the pledge of the First Lien Indenture is a Rebate Fund. Within the Rebate Fund there is a separate account for each series of Outstanding Bonds. Deposits, transfers and payments from the particular rebate accounts shall be made in accordance with tax regulatory agreements entered into with respect to the respective series of Bonds.

Rate Covenant

The Authority covenants that it will comply with (1) or (2) below in any fiscal year:

(1) The Authority will maintain, charge and collect, so long as any Bonds are outstanding, reasonable rates, rentals and other charges for the use of the facilities of the Water and Sewer System which (after making due and reasonable allowances for contingencies and a margin of error in the estimates) together with other Receipts and Revenues, including any unrestricted cash and investments accumulated in the Revenue Fund at the beginning of each Fiscal Year, shall be at all times at least sufficient to provide annually:

- (a) Amounts sufficient to pay all of the Current Expenses of the Authority; and
- (b) An amount equal to 120% of the debt service requirements with respect to the Authority Bonds (i.e., the Bonds and any bonds issued under the Subordinate Indenture) and other Authority Long Term Indebtedness during the then current fiscal year of the Authority.

(2) The Authority will maintain, charge and collect, so long as any Bonds are outstanding, reasonable rates, rentals and other charges for the use of the facilities of the Water and Sewer System which (after making due and reasonable allowances for contingencies and a margin of error in the estimates), together with other Receipts and Revenues, for the then current fiscal year (exclusive of interest income earned by the Authority on funds other than the Debt Service Reserve Fund; provided, however, that earnings on the construction/acquisition funds may also be included during any construction period, but only to the extent such earnings are expressly required to be either retained in the construction/acquisition funds and may be used to pay debt service on the Authority Bonds or other Authority Long Term Indebtedness or are applied directly to payment of debt service on the Authority Bonds or other Authority Long Term Indebtedness), shall be at all times at least sufficient to provide annually:

- (a) Funds to pay all of the Current Expenses of the Authority; and
- (b) An amount equal to 100% of the debt service requirements with respect to the Authority Bonds and other Authority Long Term Indebtedness during the then current fiscal year of the Authority.

Calculation of compliance with the covenant shall be made on the following basis: (a) operating revenue, construction/acquisition fund income, earnings on the Debt Service Reserve Fund, expenses, required deposits to replenish any withdrawals from the Debt Service Reserve Fund and the Renewal and Replacement Fund which have not been capitalized shall be accounted for on the accrual basis; (b) costs of issuance of the Authority Bonds and other Authority Long Term Indebtedness may be treated as if such amounts are amortized over the life of the Authority Bonds and other Authority Long Term Indebtedness irrespective of any shorter period over which such costs are actually amortized; and (c) depreciation is specifically excluded from the calculation. In the event that any Policy Costs are due and owing at the time of the calculation of the rate covenant, Gross Revenues of the Authority shall be reduced by the amount of any Policy Costs then due and owing.

The Authority also covenants with the holders of the Bonds that if at any time the revenues collected shall not be sufficient to enable the Authority to comply with the provisions set forth above, it will promptly revise its water or sewer rates, rents and other charges so that the Authority will be in compliance and so that any deficiencies in transfers of funds required to be made pursuant to the First Lien Indenture will be remedied before the end of the next ensuing fiscal year. In addition, with respect to the 2003 Bonds, (a) failure by the Authority to meet at least one of the requirements set forth in (1) and (2) above will constitute a breach requiring the Authority to engage a consultant within 60 days of the determination that

such breach has occurred, and failure to engage and follow the recommendations of the consultant in a prompt manner will constitute an Event of Default as to the 2003 Bonds, and (b) failure to meet the test contained in (1) above when substituting "100%" for "120%" in (1)(b) will constitute an Event of Default as to the 2003 Bonds.

Insurance of Water and Sewer System. The Authority will at all times cause all the property of the Water and Sewer System which is of a character usually insured by persons operating properties of a similar nature to be properly insured and kept insured by a reputable insurance company or companies against loss or damage by fire or other hazards to the extent that such properties are usually insured by persons operating properties of a similar nature in the same or similar localities. Such policies of insurance shall be for the benefit of the Trustee and the Authority, as their respective interests may appear. All claims in excess of \$500,000 shall be made payable to the Trustee and shall be held by the Trustee as additional security until paid out by it as provided therein. All claims of \$500,000 or less shall be paid to the Authority.

Employment of Independent Accountant; Annual Financial Report. The Authority covenants to employ an independent auditor to perform such duties as are imposed on the independent auditor by the First Lien Indenture, including preparation of an audit report for the preceding fiscal year.

Events of Default. Each of the following events is hereby declared an "Event of Default" for any Bond issued under the First Lien Indenture:

(a) failure by the Authority to pay the principal of, or the premium (if any) payable upon the redemption of, any Bond when due and payable either at maturity, declaration, or by proceedings for redemption, or otherwise (no effect being given to payments made under the Bond insurance policies); or

(b) failure by the Authority to pay any installment of interest on any Bond when due and payable (no effect being given to payments made under the Bond insurance policies); or

(c) the entry of an order or decree appointing a receiver or receivers of the Water and Sewer System or of the Receipts and Revenues with the consent or acquiescence of the Authority, or, if such order or decree shall have been entered without the acquiescence or consent of the Authority, the failure of the Authority to cause such order or decree to be vacated or discharged or stayed on appeal within 90 days after entry; or

(d) the institution of any proceeding with the consent or acquiescence of the Authority for the purpose of effecting a composition between the Authority and its creditors, or for the purpose of adjusting the claims of such creditors pursuant to any Federal or State statute now or hereafter enacted, if the claims of such creditors are under any circumstances payable out of the Receipts and Revenues, or if such proceeding shall have been instituted without the consent or acquiescence of the Authority, the failure of the Authority to have such proceeding withdrawn, or any order entered therein vacated or discharged, within 90 days after the institution of such proceeding or the entry of such order; or

(e) the entry of a final judgment against the Authority, which judgment constitutes or could result in a lien or charge upon the Water and Sewer System or the Receipts and Revenues, or which materially and adversely affects the ownership, control or operation of the Water and Sewer System, if such judgment shall not be discharged within 90 days from the entry thereof, or if an appeal shall not be taken therefrom, or from the order, decree or process upon which or pursuant to which such judgment was granted or entered, in such manner as to conclusively set aside the execution or levy under such judgment, order, decree or process, or the enforcement thereof; or

(f) the failure of the Authority to repair or replace, with reasonable dispatch, any part of the Water and Sewer System necessary for its efficient operation which shall have been destroyed or damaged (whether such failure promptly to repair or replace the same be due to the impracticability of such repair or replacement or the lack of funds therefor or for any other reason); or

(g) the failure or refusal of the Authority to comply with any provisions of the Municipality Authorities Act, as amended and supplemented, or the rendering of the Authority, for any reason, incapable of fulfilling its obligations thereunder or under the First Lien Indenture; or

(h) the failure of the Authority to observe any other covenant, condition or agreement of the Authority contained in the Bonds or in the First Lien Indenture and the continuation of such failure for a period of 60 days after written notice of such failure from the Trustee, which may give such notice in its discretion and shall give such notice at the written request of the holders of not less than 25% in aggregate principal amount of the Bonds then outstanding, provided that (except as summarized under "Rate Covenant") the failure of the Authority to meet the rate covenant set forth in the First Lien Indenture shall not constitute an event of default thereunder, and provided further that if such failure is not capable of being remedied within 60 days after such notice, no Event of Default shall exist if the Authority commences the actions necessary for the cure of such failure within such 60 day period and diligently pursues such actions thereafter; or

(i) failure by the Authority to pay principal of, or premium (if any) payable upon the redemption of any Subordinate Bond when due and payable either at maturity or otherwise or to pay any installment of interest on any such

Subordinate Bond when due and payable (no effect being given to payments made under a bond insurance policy) or any default under the Subordinate Indenture.

Acceleration of Principal. Upon the occurrence and continuance of any Event of Default, the Trustee may, and at the written request of Bondholders of not less than 25% in principal amount of the Bonds then outstanding shall, by written notice to the Authority, declare the Bonds to be immediately due and payable, whereupon they shall, without further action, become and be immediately due and payable. In addition, the Trustee shall be entitled to exercise any or all of the remedies granted to a trustee or under the Bond insurance policy or the Municipality Authorities Act. In no event, so long as the Bond insurance policy is in effect and the bond insurer is not in default thereunder, shall the Trustee accelerate the payment of the Bonds without the written consent of each bond insurer with respect to the series of Bonds it insures. The above provision, however, is subject to the condition that if, after the principal of said Bonds shall have been so declared to be due and payable, all arrears of interest, if any, upon the Bonds and interest on overdue installments of interest at the rate of interest specified therein, and the principal of all Bonds which have matured other than by reason of such declaration, shall have been paid by the Authority, and the Authority shall also have performed all other things in respect to which it may have been in default hereunder, and shall have paid the reasonable charges of the Trustee and its counsel and of the holders of said Bonds, including reasonable attorneys' fees paid or incurred, then, and in every such case, the holders of not less than a majority in aggregate principal amount of the Bonds then outstanding, by written notice to the Authority and to the Trustee, may waive such default and its consequences and such waiver shall be binding upon the Trustee and upon all holders of Bonds; but no such waiver shall extend to or affect any subsequent default or impair any rights or remedy consequent thereon. In no event, so long as a Bond insurance policy is in effect and the Bond insurer is not in default thereunder, shall the Trustee waive a default without the prior written consent of the bond insurer with respect to the series of Bonds it insures.

Remedies of Trustee and Bondholders; Right of Entry. Subject to the acceleration of principal provision above, upon the happening and during the continuance of any event of default, the Trustee may and, upon written request of the holders of not less than 25% in aggregate principal amount of the Bonds then outstanding, shall enter into and upon and take possession of the Water and Sewer System and each and every part thereof as for a condition broken and may exclude the Authority, its agents and employees and all persons claiming under them wholly therefrom and have, hold, use, operate, manage and control the same and each and every part thereof, and in the name of the Authority or otherwise as the Trustee shall deem best, conduct the business thereof and exercise all the rights and powers of the Authority with respect to the Water and Sewer System and use all its then existing property, assets and franchises for that purpose and out of the Receipts and Revenues, maintain, restore, insure and keep insured, the Water and Sewer System against such hazards as are ordinarily insured against by a person operating a water and sewer system similar to the Water and Sewer System and from time to time may make all such necessary or proper repairs as to it may seem expedient, and establish, levy, maintain and collect such rates, rents and charges in connection with the Water and Sewer System as it may deem necessary, proper, desirable and reasonable, and collect and receive Receipts and Revenues, and after deducting therefrom the expenses of operation, maintenance and repair and all expenses incurred thereunder and all other proper outlays herein authorized and all such payments which may be made for insurance and other proper charges, including just and reasonable compensation for its own services, and for the services of such attorneys, agents and employees as it may, in the exercise of its discretion, employ for any of the purposes aforesaid, the Trustee shall apply the rest and residue of the moneys received by it, as well as all cash and investments held by the Trustee in any fund under the First Lien Indenture subject to the provisions thereof with respect to claims for principal and interest, to the payment of the principal of and interest on the Bonds. Whenever all that is due upon such Bonds and installments of interest and under any of the terms of the First Lien Indenture have been paid or deposited with the Trustee and all defaults made good, the Trustee in possession shall surrender possession to the Authority, its successors or assigns. However, the same right of entry shall exist upon any subsequent default or defaults. For purposes of this section, the bond insurer shall, so long as no default has occurred under its respective insurance policy, be deemed to be the owner of the series of Bonds which it insures.

Judicial Action. In case of the breach of any of the covenants or conditions of the First Lien Indenture, the Trustee shall have the right and power to take appropriate judicial proceedings for the enforcement of its rights and the rights of the Bondholders thereunder. Upon the happening of an Event of Default, the Trustee may either after entry, or without entry, proceed by suit or suits, actions or special proceedings at law or in equity to enforce its rights and the rights of the Bondholders under the First Lien Indenture, and it will be obligatory upon the Trustee to take action to that end, either by such proceedings or by the exercise of its powers with respect to entry or otherwise, as it may determine, upon being requested to do so by the holders of 25% in aggregate principal amount of the Bonds then outstanding and upon being indemnified. For purposes of this provision, each Bond insurer shall, so long as no event of default has occurred under its respective insurance policy, be deemed to be the owner of the Bonds it has insured.

So long as the Bond insurance policy is in effect and the Bond Insurer is not in default thereunder, the Bond insurer may direct the Trustee with respect to the taking of each remedy and the Trustee may not take any action directed by the respective series of the Bondholders without the prior written consent of the Bond insurer.

Limitations on Bondholders. No holder of any Bonds shall have any right to institute any suit, action, or proceeding in equity or at law for the enforcement of the First Lien Indenture or for the execution of any trust thereof or for the appointment of a receiver or to exercise any other remedy thereunder, unless such holder shall have previously given to the Trustee written notice of an event of default and of the continuance thereof nor unless also the holders of at least 25% in aggregate principal amount of the Bonds shall have made written request of the Trustee and shall have offered it reasonable opportunity either to proceed to exercise the powers hereinbefore granted or to institute such action, suit or proceeding in its own name nor unless also they shall have offered to the Trustee adequate security and indemnity against the costs, expenses and liability to be incurred therein or thereby; and such notification, request and offer of indemnity are, at the option of the Trustee, conditions precedent to the execution of the powers and trusts of the First Lien Indenture or for the appointment of a receiver or for any other remedy thereunder; no one or more holders or registered owners of Bonds, however, have any right to affect, disturb or prejudice the lien of the First Lien Indenture by their action or to enforce any right thereunder except in the manner therein provided. Subject to the following paragraph, nothing shall affect or impair the right of any Bondholder, which is absolute and unconditional, to enforce the payment of the principal of and interest on its Bonds, or the obligation of the Authority, which is also absolute and unconditional, to pay the principal of and interest on the Bonds to the respective holders or registered owners thereof at the time and place in said Bonds expressed.

So long as any Bond insurance policy is in effect and the Bond insurer is not in default thereunder, the Bond insurer may direct the Trustee with respect to the series of Bonds which it insures with respect to the taking of each remedy and the Trustee may not take any action directed by such Bondholders without the prior written consent of the Bond insurer.

Waivers and Supplemental Indentures Not Requiring Consent of Bondholders. In addition to any supplemental indenture otherwise authorized by the First Lien Indenture, the Authority (with the prior written consent of the Bond insurer), and the Trustee may, from time to time and at any time, enter into such indentures or agreements supplemental to the First Lien Indenture as shall not be inconsistent with the terms and provisions thereof and which shall not adversely affect the rights of the holders of the Bonds (which supplemental indentures or agreements shall thereafter form a part thereof) for the following purposes:

- (a) to cure any ambiguity, formal defect or omission in the First Lien Indenture or any supplemental indenture;
- (b) to grant or confer upon the Trustee for the benefit of the Bondholders any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Bondholders or the Trustee;
- (c) to add to the covenants and agreements of the Authority in the First Lien Indenture other covenants and agreements thereafter to be observed, or to surrender any right or power therein reserved to or conferred upon the Authority;
- (d) to modify any of the provisions of the First Lien Indenture or to relieve the Authority of any of the obligations, conditions or restrictions contained in the First Lien Indenture, provided that such modification or relief shall not, by the express terms of the particular supplemental indenture, become effective until all Bonds outstanding on the date of the execution and delivery of such supplemental indenture shall no longer be outstanding;
- (e) to make such provision in regard to matters or questions arising under the First Lien Indenture as may be necessary or desirable and not inconsistent with the First Lien Indenture; or
- (f) to close the First Lien Indenture against, or to restrict, in addition to the limitations and restrictions therein contained, the issue of additional bonds thereunder, by imposing additional conditions and restrictions to be thereafter observed, whether applicable in respect of all Bonds issued and to be issued thereunder or in respect of one or more series of Bonds, or otherwise.

Supplemental Indentures Requiring Consent of Bondholders. With the consent of the holders of not less than 66-2/3% in aggregate principal amount of the Bonds then outstanding or, in the case one or more but less than all of the series of the Bonds then outstanding are affected, then, in addition, with the consent of the holders of not less than 66-2/3% of the principal amount of the Bonds of each series so affected then outstanding, and with the consent of any guarantor of principal of and interest on any series of Bonds, the Authority and the Trustee may from time to time and at any time enter into an indenture or indentures supplemental to the First Lien Indenture for the purpose of eliminating any of the provisions of the First Lien Indenture or of any supplemental indenture or of modifying in any manner the rights of the holders of the Bonds so affected; provided, however, that no such supplemental indenture shall (i) extend the fixed maturity date of any Bond, or reduce the principal amount thereof, or reduce the rate or extend the time of payment of interest thereon, or reduce any premium payable upon the redemption thereof, without the consent of the holder of each Bond so affected, or (ii) permit the creation by the Authority of any lien prior to the lien of the First Lien Indenture upon any part of the Receipts and Revenues, or reduce the aforesaid percentage of Bonds, the holders of which are required to consent to any such supplemental indenture, without the consent of the holders of all Bonds then outstanding; provided, however, that in no event shall the provisions on Authorized Investments be amended. No supplemental indenture shall be effective unless it has been consented to in writing by the Bond insurers.

Discharge of First Lien Indenture. If the Authority, its successors or assigns, shall pay or cause to be paid unto the holders of all Bonds outstanding the principal and interest to become due thereon and the premium thereon, if any, then the First Lien Indenture and the estate and rights therein granted shall cease, determine and be void, and the Trustee shall, upon the request of the Authority, deliver to the Authority such instruments as shall be requisite to satisfy the lien thereof, and reconvey to the Authority the estate and title thereby conveyed, and assign and deliver to the Authority any property at the time subject to the lien of the First Lien Indenture which may then be in the possession of the Trustee.

Bonds for the payment or redemption of which there shall have been deposited with the Trustee cash or direct non-callable obligations of the United States of America and securities fully and unconditionally guaranteed as to the timely payment of principal and interest by the United States of America, to which direct obligation or guarantee the full faith and credit of the United States of America has been pledged, Refcorp interest strips, CATS, TIGRS, STRPS, or defeased municipal bonds rated "AAA" by S&P or "Aaa" by Moody's, any combination thereof or any other security approved by the Bond insurer), the principal of and interest on which when due will, without reinvestment of principal or interest, provide sufficient moneys to pay the Bonds in full at maturity or the date fixed for redemption, shall be deemed to be paid. In the event of an advance refunding, the Authority shall cause to be delivered a verification report of an independent nationally recognized certified public accountant.

Removal of Trustee. The Trustee may be removed at any time by an instrument in writing signed by not less than a majority in aggregate principal amount of Bonds outstanding and filed with the Authority. No such removal shall become effective until a successor trustee is appointed and has accepted the duties of Trustee.

APPENDIX C

AUTHORITY FINANCIAL STATEMENTS

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PITTSBURGH
WATER AND SEWER
AUTHORITY

FINANCIAL STATEMENTS
AND
REQUIRED SUPPLEMENTARY AND
ADDITIONAL INFORMATION

YEARS ENDED DECEMBER 31, 2005 AND 2004

WITH

INDEPENDENT AUDITOR'S REPORT

MAHER DUESSEL

CERTIFIED PUBLIC ACCOUNTANTS

PITTSBURGH WATER AND SEWER AUTHORITY

YEARS ENDED DECEMBER 31, 2005 AND 2004

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MAHER DUESSEL
CERTIFIED PUBLIC ACCOUNTANTS

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Independent Auditor's Report

Board of Directors
Pittsburgh Water and Sewer Authority

We have audited the accompanying financial statements of the Pittsburgh Water and Sewer Authority (Authority), a component unit of the City of Pittsburgh (City), Pennsylvania, as of and for the years ended December 31, 2005 and 2004 as listed in the accompanying table of contents. These financial statements are the responsibility of the Authority'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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the 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, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2005 and 2004, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis Section is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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 the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying additional information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



March 20, 2006

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THE PITTSBURGH WATER AND SEWER AUTHORITY

2005 Financial Statements Management Discussion and Analysis

The Pittsburgh Water and Sewer Authority (the "Authority") comparative 2005 and 2004 fiscal year financial statements enclosed have been conformed to meet the requirements of Governmental Accounting Standards Board ("GASB") Statement No. 34, "*Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*". The financial statements incorporate three basic statements: the Statements of Net Assets, the Statements of Revenues, Expenses and Changes in Net Assets, and Statements of Cash Flows.

This Management's Discussion and Analysis (MD&A) is based upon facts, decisions, and conditions known as of the date of the audit report. Please note that the historical information provided in the financial statements and MD&A reflect the results of past operations and is not necessarily indicative of results of future operations. Future operations will be affected by various factors, including, but not limited to, regulatory mandates, rate changes, weather, labor contracts, population changes, business environment, and other matters, the nature and effect of which cannot now be determined.

Using This Financial Report – Overview of Reporting Changes

The Statements of Net Assets present information about the resources which are available to the Authority and claims against these resources. Both assets and liabilities are classified in a format which segregates current from long-term. In addition, assets available for special purposes – labeled "restricted assets" are segregated from those assets available for operations. The Authority's restricted assets represent money on deposit with the bond trustee to meet indenture, debt service, and construction program requirements. Liabilities have a similar classification segregating claims on restricted assets from claims on assets available for operations. The net asset section of the Statements of Net Assets classify the total net assets deficit, as invested in capital assets, restricted for capital activity and debt service, and unrestricted.

The Statement of Revenues, Expenses and Changes in Net Assets summarize operating and non-operating activity for the fiscal year and the resulting impact on the Authority's net assets.

The Statements of Cash Flows have been prepared using the direct method. The statements provide an analysis of the Authority's cash by operating, investing, and capital and related financing activities over the respective fiscal year.

Financial Highlights

In 2005, the Authority increased operating income by 51.7% or \$9.98 million resulting in a net income of \$2.3 million from a \$7.5 million net loss in 2004. Below are the 2005 financial highlights:

Operating revenues in 2005 increased \$11.2 million or 15.2% to \$85.0 million from \$73.8 million in 2004. Operating revenues were influenced by several factors:

- Effective January 1, 2005, consumption rates increased by 17% and effective March 1, 2006, rates increased by 6.7%.
- Due to a final settlement with the Capital Asset Research Corporation regarding prior year water and sewer buybacks, an associated liability reserve was cleared which resulted in a non-recurring gain of \$644,000 to Other Operating revenues.
- In 2005, consumption decreased by approximately 4% to 11.7 billion gallons from 12.2 billion gallons in 2004. This consumption decrease is attributed to a return to a more normal level of consumption in 2005, as opposed to the higher consumption in 2004 due to area flooding.

Total operating expenses increased by \$1.3 million or 2% to \$55.8 million from \$54.5 million in 2004. Operating expenses were impacted by the following factors:

- Salary and employee benefit expense was up \$309,000 or 2.5%. The increase is attributed to an average 2.5% salary increase for employees. Medical insurance premiums increased by \$148,000 or 8.3% while Workers Compensation insurance premiums decreased by \$73,000 or 23.3%.

The majority of Authority employees are represented by one of three labor unions. The Pittsburgh Joint Collective Bargaining Committee (PJCBC) represents blue-collar employees, The American Federation of State, County, and Municipal Employees (AFSCME), Local 2719 represent white-collar employees, and Local 2037 represents foreman. The four-year AFSCME agreement expired in December 2005. However, a new three-year agreement was signed in March 2006. The five-year PJCBC agreement expires in December 2007.

- Operating contract and repair and maintenance expenses were up \$1,226,000 or 46.5% due to increased levels of in-house management of operating contracts on sewer, catch basin cleaning, and repairs. These efforts will further reduce the need to fund these expenditures through the Capital Improvement Program.
- Professional service expenses were down by 7.3% or \$210,000 due in large part to the completion of the SAP IT Systems implementation project with United Water Resources. Legal fees were up by 34% or \$206,000 mostly driven by a water main break at the Gateway Center Plaza. The increase in legal fees was offset with a reduction in meter services expenses of \$209,000 or 23.3%.
- In 2005, collections increased by \$15.5M or 15% and the accounts receivable aggregate reserve adjustment for bad debt expense decreased 39.7% or \$718,000. These results are directly related to billing ALCOSAN Sewage Treatment charges on a monthly basis versus quarterly. This decrease in bad debt reserves was offset with a \$500,000 maximum reserve for future claims on the water main break at the Gateway Center Plaza and a \$211,000 increase in Lien Buybacks. On December 7th, the Keystone Brewing Company, a large commercial customer having a significant delinquent sewage receivable balance with the Authority, declared bankruptcy. The Authority's bad debt reserves were increased by 15% to 65%. The Authority is a secured creditor and is currently negotiating with the courts to recoup the remaining balances associated with the prior years' ALCOSAN sewage treatment charges.
- Utility expenses were up 5.3% or approximately \$210,000. The increase was due to a 28.5% or \$176,000 increase in natural gas costs and a 1.3 percent or \$42,000 increase in electricity costs. The electricity contract with Strategic Energy expired on January 31, 2006. Effective February 1st, the Authority partnered with the City of Pittsburgh signing a new contract with Reliant Energy. Prices are estimated to increase by approximately 20% in 2006.
- Depreciation expense increased by 9.1% or \$1,148,000 due to 12 months of expense on significant projects completed and capitalized in late 2004. These projects included the IT Systems Implementation Phase II, Pennvest Streets Run, Water Systems Improvement Phases II and III, and a \$9.5M phase of the Combined Sewer Overflow (CSO) Study, Engineering, and Flow Monitoring project.
- The Authority's 2005 rate increase exceeded the rate increase of other water providers in the City. This differential resulted in a decrease of the rate equalization subsidy by 57% or \$1,450,000.

Non-operating revenues/expenses increased by less than 1% or \$201,000 to \$26.9 million from \$26.7 million in 2004. Non-operating expenses were impacted by the following factors:

- In May 2005, the Authority issued \$50.385 million in First Lien Revenue Bonds ("2005 Bonds") having an average yield of 4.2%. The proceeds will primarily be used to provide funds for capital improvements to the water and sewer systems. The Authority also

negotiated a new contract with Digital Assurance Certification (DAC) to ensure that all of the Authority's required disclosure information, on all outstanding Authority Bonds, is distributed in a timely manner.

- Interest expense increased by \$773,000 or 2.8% from 2004 due to a decrease in capitalized interest of \$498,000 and a net increase of \$275,000 in bond debt expense. However, the increase was offset with a 97.0% or \$663,000 increase in interest revenue due to returns on higher cash balances in operating funds of \$381,000 and an increase of \$282,000 due to a rise in average interest earnings rates which neared 4% by year-end on non-trust and trust investments. Interest on Pennsylvania State Pennvest program loans doubled to \$160,000 from \$84,000 in 2004. The Authority began receiving loan reimbursements from participating municipalities for costs incurred on the Pennvest Streets Run Trunk Sewer project. These reimbursements will serve to offset approximately 64% or \$1.4 million of the Authority's principal and interest installments over the 20-year life of this loan.

Additional operating highlights include the following:

- Debt service coverage in 2005 and 2004 was 1.70 and 1.60, respectively. These coverage factors exceed the 1.2 coverage factor required by bond covenant. The 6% improvement is due to the 17% consumption rate increase in 2005 while holding the growth in operating costs to an unusual low level of 2.2%.
- The City of Pittsburgh is the largest of the 83 municipalities that convey raw sewage to ALCOSAN for treatment. In January 2004, the Authority and the City of Pittsburgh executed a Consent Order and Agreement (the Order) regarding sanitary and combined sewer overflows within the City of Pittsburgh. The other signatories to the Order are the Pennsylvania Department of Environmental Protection and Allegheny County Health Department which executed the Order on April 21, 2004. The intent of the Order is to develop a regional Long-Term Control Plan to address combined and sanitary sewer overflows and ultimately improve water quality.

The Order does not contain fines or penalties for past non-compliance, but does propose binding obligations for work on a going-forward basis. The Authority continues to meet the requirements of the Order. See Note 12, Commitments and Contingencies, for additional details.

- The City of Pittsburgh remained under financial stress in 2005. The Authority has three agreements with the City of Pittsburgh. The Authority leases the water and sewer system under the Capital Lease which was fully funded in 1998. The Authority makes payments to the City for direct and indirect services under the Cooperation Agreement. Under this Agreement, the Authority also funds on behalf of the City a rate equalization subsidy to other City water companies. Under separate agreement, the Authority, also on behalf of the City, is required to purchase delinquent wastewater treatment receivables. The Authority is financially self-sufficient and should not be adversely affected by any bankruptcy filing by the City. Any other actions by the City of Pittsburgh to increase Authority funding would require Board approval. Various public officials have been asking the City to consider selling some of its assets, including the water system; however, there has been no action taken to date on this matter.

CONDENSED FINANCIAL STATEMENTS

CONDENSED STATEMENTS OF NET ASSETS

(Dollars expressed in thousands)

	December 31,		Variance	
	2005	2004	Dollars	%
	Increase (Decrease)			
Capital assets:				
Producing assets	\$ 424,708	\$ 424,309	\$ 399	0.1%
Construction in progress	9,843	17,413	(7,570)	-43.5%
Restricted assets	83,759	41,847	41,912	100.2%
Current assets and bond costs	58,451	51,967	6,484	12.5%
Total Assets	\$ 576,761	\$ 535,536	\$ 41,225	7.7%
Liabilities:				
Current liabilities	\$ 41,609	\$ 44,049	\$ (2,440)	-5.5%
Long term liabilities	574,421	533,077	41,344	7.8%
Total Liabilities	616,030	577,126	38,904	6.7%
Net Assets (Deficit):				
Invested in capital assets, net of related liabilities	(65,381)	(52,022)	(13,359)	25.7%
Restricted for capital activity and debt service	9,393	7,726	1,667	21.6%
Unrestricted	16,719	2,706	14,013	517.8%
Total Net Assets (Deficits)	(39,269)	(41,590)	2,321	-5.6%
Total Liabilities and Net Assets (Deficits)	\$ 576,761	\$ 535,536	\$ 41,225	7.7%

CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

(Dollars expressed in thousands)

	Year Ended December 31,		Variance	
	2005	2004	Dollars	%
	Increase (Decrease)			
Operating Revenues	\$ 85,031	\$ 73,800	\$ 11,231	15.2%
Operating Expenses:				
Direct operating	31,160	29,607	1,553	5.2%
Cooperation Agreement	7,150	7,150	-	0.0%
Subsidy of non-customer City residents	1,093	2,543	(1,450)	-57.0%
Depreciation and amortization	16,352	15,204	1,148	7.6%
Total Operating Expenses	55,755	54,504	1,251	2.3%
Operating Income	29,276	19,296	9,980	51.7%
Non-operating revenue (expense):				
Interest revenue	1,348	685	663	96.8%
Interest expense and other	(28,303)	(27,439)	(864)	3.1%
Total Non-operating Revenue (Expenses)	(26,955)	(26,754)	(201)	0.8%
Net Gain/(Loss)	\$ 2,321	\$ (7,458)	\$ 9,779	-131.1%

Financial Condition

The financial condition in 2005 improved for the third year in a row. With actions taken by management and the Board of Directors, operating expenses remained flat, and subsidy expenses continued to decline. This coupled with a higher consumption rate increase, enabled the Authority to realize a net income of \$2.3 million. The Authority recognizes the importance of restoring financial health and continues to take action. Effective March 1, 2006, rates increased 6.7%. This rate increase will help offset costs associated with increased existing debt service and continue to meet regulatory and other mandates. It should also help to offset operating costs. During 2005, the Authority completed a cost-of-service study and accepted a bid to begin a water-loss study.

The Authority continues to address financial issues as part of its ongoing strategic plan. The business plan which has been introduced to the entire organization is focused on improving financial condition, customer service and internal effectiveness; maintaining regulatory compliance and security; and providing a culture that encourages employee development and safety. Key performance indicators have been developed and applied throughout the entire organization to measure and refine performance and expenses. Performance is monitored weekly and updates are provided to the entire organization quarterly. The Authority will continue to examine all work practices in order to find more effective and efficient methods of operation and remains fully committed to its vision of providing water and waste water services that meet or exceed regulations and customer expectations at the lowest possible cost.

The Authority contracted with the Municipal & Financial Services Group to conduct a cost of service/rate study. The study was completed in December. Among its findings, the group determined that the Authority's consumption rates for water would remain sufficient to cover revenue requirements in 2006 and for several more years. However, current rates for wastewater were roughly 73% less than the revenue required for 2006. Cash reserves were adequate for the establishment of a formal O&M Reserve and an Infrastructure Renewal Reserve. Recommendations arising out of the study included:

- Adoption of rate adjustments for water and sewer over the next five years to ensure that revenues equal expenses going forward.
- Designate the reserves for O&M and Infrastructure Renewal as "restricted" with clear policies on the use of the funds. The objective is to maximize the use of operating funds for M&O expenses, while dedicating the use of the Infrastructure Renewal Program funds for major capital investments. An important result should be a reduction in the rate of growth in long-term debt financing with bond issues.
- Develop a standard wholesale agreement to use in future arrangements with new or existing customers. The rate should be adjusted annually for inflation.
- Adoption of monthly fire-line charges to cover the cost of providing fire protection services to customers having fire lines.

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PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF NET ASSETS

(Dollars expressed in thousands)

DECEMBER 31, 2005 AND 2004

<u>Assets</u>	<u>2005</u>	<u>2004</u>
Current assets:		
Cash and cash equivalents	\$ 26,344	\$ 20,617
Accounts receivable, net:		
Water:		
Billed	9,022	8,078
Unbilled	4,237	4,395
Total water	13,259	12,473
Wastewater treatment:		
Billed	5,311	4,949
Unbilled	2,274	2,505
Total wastewater treatment	7,585	7,454
Other receivables	1,791	2,332
Total accounts receivable, net	22,635	22,259
Prepaid expenses	247	179
Inventory	1,563	1,555
Total current assets	50,789	44,610
Noncurrent assets:		
Restricted assets:		
Accrued interest receivable	667	86
Cash and cash equivalents	9,931	25,757
Investments	73,161	16,004
Total restricted assets	83,759	41,847
Capital assets, not being depreciated	9,843	17,413
Capital assets, net of accumulated depreciation	424,708	424,309
Bond issue costs, net of accumulated amortization	7,662	7,357
Total noncurrent assets	525,972	490,926
Total Assets	\$ 576,761	\$ 535,536

(Continued)

The notes to the financial statements are an integral part of this statement.

PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF NET ASSETS

(Dollars expressed in thousands)

DECEMBER 31, 2005 AND 2004

(Continued)

	2005	2004
Liabilities and Net Assets (Deficit)		
Liabilities:		
Current liabilities:		
Bonds and loans payable, current portion	\$ 17,600	\$ 16,180
Accrued payroll and related obligations	912	810
Accounts payable wastewater treatment	10,104	11,965
Accounts payable and other accrued expenses	4,998	6,186
Accounts payable from restricted assets	1,324	2,357
Accrued interest payable from restricted assets	6,671	6,551
Total current liabilities	41,609	44,049
Noncurrent liabilities:		
Deferred revenue	420	442
Accrued payroll and related obligations	830	962
Bonds and loans payable, net of current portion	573,171	531,673
Total noncurrent liabilities	574,421	533,077
Total Liabilities	616,030	577,126
Net Assets (Deficit):		
Invested in capital assets, net of related debt	(65,381)	(52,022)
Restricted for capital activity and debt service	9,393	7,726
Unrestricted	16,719	2,706
Total Net Assets (Deficit)	(39,269)	(41,590)
Total Liabilities and Net Assets (Deficit)	\$ 576,761	\$ 535,536

(Concluded)

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

PITTSBURGH WATER AND SEWER AUTHORITY

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

(Dollars expressed in thousands)

YEARS ENDED DECEMBER 31, 2005 AND 2004

	2005	2004
Operating Revenues:		
Residential, commercial, and industrial water sales	\$ 82,726	\$ 71,559
Other	2,305	2,241
	85,031	73,800
Operating Expenses:		
Direct operating expenses	31,160	29,607
Cooperation agreement operating expenses:		
Indirect cost allocation - wastewater	3,000	3,000
Indirect cost allocation - water	4,150	4,150
Expense of water provided by other entities:		
Subsidy of customers located in the City	1,093	2,543
Depreciation	13,795	12,647
Amortization of capitalized lease assets	2,557	2,557
	55,755	54,504
Operating Income	29,276	19,296
Non-operating Revenues (Expenses):		
Interest revenue	1,348	685
Interest expense - bonds	(27,500)	(26,727)
Interest expense - other	(160)	(84)
Amortization of bond issue costs	(643)	(628)
	(26,955)	(26,754)
Net Income (Loss)	2,321	(7,458)
Net Assets (Deficit):		
Beginning of year	(41,590)	(34,132)
End of year	\$ (39,269)	\$ (41,590)

The notes to the financial statements are an integral part of this statement.

PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF CASH FLOWS

(Dollars expressed in thousands)

YEARS ENDED DECEMBER 31, 2005 AND 2004

	2005	2004
Cash Flows From Operating Activities:		
Cash received from customers	\$ 118,492	\$ 103,010
Cash paid to suppliers and employees and customer refunds	(35,352)	(32,395)
Cash paid to City of Pittsburgh under the Cooperation Agreement	(7,150)	(7,150)
Cash paid to other water companies for subsidy of customers located in the City of Pittsburgh	(1,093)	(2,606)
Cash paid to ALCOSAN for sewage receivables	(33,836)	(25,548)
Net cash provided by (used in) operating activities	41,061	35,311
Cash Flows From Investing Activities:		
Purchase of investment securities	(118,644)	(88,862)
Proceeds from sale and maturities of investment securities	61,487	139,464
Interest income	767	1,076
Net cash provided by (used in) investing activities	(56,390)	51,678
Cash Flows From Capital and Related Financing Activities:		
Purchase/construction of property, plant, and equipment	(9,140)	(32,815)
Proceeds from issuance of long-term debt	55,657	-
Payment of bond issuance costs	(948)	(1,602)
Principal payment on debt	(17,159)	(12,079)
Interest paid on borrowings	(23,180)	(23,325)
Net cash provided by (used in) capital and related financing activities	5,230	(69,821)
Increase (Decrease) in Cash and Cash Equivalents	(10,099)	17,168
Cash and Cash Equivalents:		
Beginning of year	46,374	29,206
End of year	\$ 36,275	\$ 46,374
Consists of:		
Restricted cash and cash equivalents	\$ 9,931	\$ 25,757
Unrestricted cash and cash equivalents	26,344	20,617
	\$ 36,275	\$ 46,374
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities:		
Operating income	\$ 29,276	\$ 19,296
Adjustments:		
Depreciation and amortization	16,352	15,204
Reserve for uncollectible amounts	490	1,808
Change in assets and liabilities:		
Change in:		
Accounts receivable	(1,406)	(5,034)
Other accounts receivable	541	(974)
Wastewater accounts payable	(1,861)	8,367
Accounts payable and other accrued expenses	(1,188)	(714)
Accrued interest on restricted assets	(1,033)	321
Accounts payable restricted assets	120	(2,582)
Other	(230)	(381)
Net cash provided by (used in) operating activities	\$ 41,061	\$ 35,311

The notes to the financial statement are an integral part of this statement.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

1. ORGANIZATION

The Pittsburgh Water and Sewer Authority (Authority) provides water to approximately 83,000 residential, commercial, and industrial customers located in the City of Pittsburgh (City) and collects wastewater throughout the City.

A Board appointed by the Mayor of the City governs the Authority.

The Authority is a body politic and corporate organized and existing under the Pennsylvania Municipalities Authorities Act. The Authority was established by the City in 1984 to assume responsibility from the City for management, operation, maintenance, and improvement of virtually the entire City water supply, distribution, and wastewater collection systems (the "Water and Wastewater System" or "System"). At inception, the City contributed \$5.3 million to the Authority in the form of customer accounts receivable.

The Authority has the right to establish user fees and charges without being subject to the approval of any department, board, or agency of Pennsylvania or the City. The Authority is also authorized to issue bonds and notes payable solely from the Authority's revenues.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

These financial statements present the financial position, income, changes in net assets, and cash flows of the Authority. The Authority is a component unit of the City as defined in Governmental Accounting Standards Board (GASB) Statement No. 14, "Financial Reporting Entity." The Authority's financial statements are not intended to present the financial position or results of operations of the City taken as a whole.

Basis of Accounting and Measurement Focus

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, as prescribed by GASB. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. The Authority applies only the Financial Accounting Standards Board pronouncements issued before November 30, 1989.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

The Authority functions as a Business-Type Activity, as defined by GASB. The significant GASB standards followed by the Authority are described as follows:

Classification of Net Assets

In accordance with the provision of GASB Statement No. 34, "*Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments,*" net assets are classified into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted – This component of net assets consists of constraints placed on net asset use through external restrictions.
- Unrestricted – This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.” The net investment in joint ventures is also reflected here.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the Authority’s policy is to first apply the expense towards restricted resources and then towards unrestricted resources.

Deferred Interest

Earnings on funds restricted for the purpose of capital improvements, net of related interest expense, are deferred and allocated to the cost of capital assets. Accordingly, during 2005 and 2004, the Authority’s interest expense of \$1,506 and \$1,929 respectively, net of deferred interest earnings of \$1,354 and \$434, respectively, resulted in capitalized interest expense of \$152 and \$1,495, respectively.

Earnings on forward float agreements are recorded as deferred revenue and recognized as interest revenue ratably over the life of each agreement.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments, both restricted and unrestricted, with maturity of three months or less at date of purchase.

Bond Issue Costs, Premiums, and Discounts

Bond issue costs are deferred and amortized over the life of the related bonds using the effective interest method. The unamortized balance is an asset on the statements of net assets.

Original issue bond premiums and discounts are amortized over the life of the related bonds using the effective interest method of amortization. The unamortized balance of premiums and discounts is presented net on the statements of net assets as a decrease to bonds payable.

Deferred Refunding Loss

In accordance with GASB Statement No. 23, "Accounting and Reporting for Refunding of Debt by Proprietary Activities," the excess of the reacquisition price over the net carrying amount of debt refunded with proceeds from the Series 1993, 1998, and 2003 Bonds were recorded as deferred refunding losses. The deferred refunding losses are being amortized using the effective interest method over the originally scheduled life of the defeased issues which extend to 2016, 2028, and 2023, respectively. The unamortized balances are reflected as a reduction of bonds payable.

Capital Assets

Capital assets owned by the Authority are recorded at cost including that portion of deferred interest that is ultimately capitalized. Depreciation of fixed assets owned by the Authority is provided on the straight-line method based on the estimated useful lives of the various classes of assets. Utility assets have estimated useful lives ranging from 30 to 40 years. Non-utility assets have estimated useful lives ranging from 5 to 10 years.

The water and sewer system represents the assets leased from the City. Amortization of capital lease assets is provided on the straight-line basis applying an estimated average remaining useful life of forty years from the inception of the lease.

Maintenance and repairs are charged to expense as incurred.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

Clarification of Revenues

The Authority has classified its revenues as either operating or non-operating revenues according to the following criteria:

- Operating revenues – Operating revenues include activities that have the characteristics of exchange transactions, such as residential, commercial, and industrial water sales.
- Non-operating revenues – Non-operating revenues include activities that have the characteristics of non-exchange transactions, such as interest income and expense, and other revenue sources that are defined as non-operating revenues by GASB No. 9, *“Reporting Cash Flows of Proprietary and Non-expendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting”* and GASB No. 34.

Compensated Absences

A liability for vacation, personal, and sick days is accrued when related benefits are attributable to services rendered and to the extent it is probable that the Authority will ultimately compensate employees.

Inventory

Inventory is stated at cost, on a moving average price basis.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported 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.

3. TRANSACTIONS WITH THE CITY OF PITTSBURGH

In 1984, pursuant to a Lease and Management Agreement, the Authority leased the System from the City and assumed responsibility for establishing and collecting user fees and

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

charges and for maintaining and improving the System. The Lease and Management Agreement provided for the City to operate and maintain the System for the Authority subject to the general supervision of the Authority.

The City and the Authority agreed to terminate the Lease and Management Agreement in July 1995 and concurrently entered into a Capital Lease Agreement and a Cooperation Agreement (collectively referred to as the "Agreements").

Cooperation Agreement

Under the terms of the Cooperation Agreement, City water department employees became employees of the Authority. As a result, the Authority assumed various personnel-related obligations from the City's water department. Other direct costs of the System's water operations are now generally paid directly by the Authority under the Cooperation Agreement, rather than paid by the City and reimbursed by the Authority. The City provides the Authority with various services in accordance with the Cooperation Agreement and the Authority reimburses the City for direct and indirect costs attributed by the City to the operation and maintenance of the System.

Under the Agreements, the Authority provides up to 600 million gallons of water annually for the City's use without charge. Also, the Authority assumes the City's obligation for the cost of subsidizing water service to residents of the City situated beyond the Authority's service area so that those water users pay charges which mirror the rates of the Authority.

System Leases

The Capital Lease Agreement stipulates minimum lease payments of approximately \$101 million, all of which were satisfied during the initial three years of the capital lease.

The Capital Lease Agreement has a term of thirty years and provides the Authority with the option to purchase the System for one dollar in 2025.

Pension

Employees of the Authority participate in the City's Municipal Pension Fund Plan (Plan).

Employees who became members of the Plan prior to January 1, 1988 are required to contribute 5% of pre-tax pay. Those joining thereafter are required to contribute 4%.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

Substantially, all the Authority's 2005 payroll of \$9,803 was covered by the Plan. Employee contributions for the year amounted to approximately \$382.

The City's obligations relative to the Plan are determined in accordance with various Pennsylvania statutes. The extent of the Authority's participation in such obligations with respect to those former City employees whose membership continued upon becoming employees of the Authority is determined by the shared interpretation of the City and Authority of the intent of the Cooperation Agreement.

The 2005 Minimum Municipal Obligation calculated for the City's Plan indicated a 2005 normal cost of \$481 associated with those former City employees whose participation continued upon becoming employees of the Authority as provided by the Cooperation Agreement. The Authority estimates that the normal cost for 2005, together with other elements of expense for employee service during 2005 would not exceed the sum of the 2005 contributions made by the Authority and employees.

Uncertainty exists about the future obligation of the Authority and its employees to make contributions to the Plan. Such contributions are contingent upon the continuing eligibility of the Authority's employees to participate in the City's Plan. Eligibility for ongoing employee participation in the City's Plan could end if the Authority were to introduce another pension plan. At this time, the Authority and City have no definite plans to establish another pension plan for the Authority, other than an agreement in principle that the Authority should have its own plan in the future. Future obligations of the Authority to make contributions to the Plan may also be subject to other amendments of the existing arrangement agreed-upon by the Authority and the City.

Normal retirement benefits are available upon attainment of age sixty and completion of twenty service years. Early retirement benefits are available upon attainment of age fifty and completion of eight service years. Early retirement benefits may be deferred until age sixty or may be obtained upon retirement at a reduced level. A member who terminates employment after attaining age forty and completing eight service years can sustain eligibility for benefits by continuing contributions through age fifty. A member who terminates employment after attaining fifteen service years, but has been a member since before January 1, 1975, can be vested by continuing contributions through age fifty.

Retirement benefits for employees who were members of the Plan are based upon a percentage of either three-year or four-year average pay, depending on date of hire, subject to certain specified minimum monthly benefit amounts. Special membership and benefit rules apply to those experiencing disability.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

The "pension benefit obligation," which is an actuarial present value of credited projected benefits, is a standardized measure for financial statement disclosure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future by the Plan as a result of members' service to date. The measure is intended to help users assess the Plan's funding status on a going concern basis, assess progress made in accumulating sufficient assets to pay benefits when due and make comparisons among public employee retirement systems. The Plan has not reported or attributed measurements of assets or the pension benefit obligation on the basis of the group of members who are Authority employees.

Additional information about the Plan and ten-year historical trend information showing the Plan's progress in accumulating sufficient assets to pay benefits when due is presented in the City's Comprehensive Annual Financial Report.

4. REVENUE AND ACCOUNTS RECEIVABLE

Water

Water sales revenue is recognized as earned during the period when water is supplied to customers. Customers are billed on a monthly billing cycle by the Authority based on actual or estimated meter readings. The Authority recognizes unbilled accounts receivable for water service provided prior to year-end that is billed during the following year.

Water accounts receivable are presented net of a reserve for uncollectible amounts. This reserve, based upon historical experience, is recognized coincident with recognition of revenue. At December 31, 2005 and 2004, the reserve for uncollectible water accounts was approximately \$12.9 million and \$12.4 million, respectively. The Authority has rights to utilize collection agencies, service terminations, liens, and real property sales to protect its interests, limit further losses, and motivate payments from delinquent customers.

Wastewater Treatment

Although the Authority does not provide wastewater treatment, it assumed responsibility for certain wastewater treatment receivables beginning in 1996. Pursuant to a 1955 agreement, the City was responsible for paying the Allegheny County Sanitary Authority (ALCOSAN) face amounts for delinquent wastewater treatment receivables. Until 1996, the City undertook to bill and collect these delinquent accounts directly. In 1996, the City and the Authority entered into a memorandum of understanding (MOU) whereby the Authority

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

received assets including rights to wastewater treatment receivables assigned by the City and assumed the City's obligation to pay ALCOSAN for delinquencies. During 2004, the Authority and ALCOSAN executed a first amendment to the 1955 agreement whereby the Authority elected to change the billing structure. Effective May 2004, the Authority began direct billing City residents for current and delinquent wastewater treatment charges and remitting to ALCOSAN the aggregate amount of service charges billed. Related assets and liabilities appear on the statements of net assets. At December 31, 2005 and 2004, the reserve for uncollectible wastewater accounts was approximately \$7.7 million and \$7.6 million, respectively.

5. CAPITAL ASSETS

Capital assets consisted of the following at December 31, 2005 and 2004:

	Balance at December 31, 2004	Additions	Transfers	Balance at December 31, 2005
Capital assets not being depreciated:				
Construction in progress	\$ 17,413	\$ 12,097	\$ (19,667)	\$ 9,843
Capital assets being depreciated:				
Water and sewer system	102,167	-	-	102,167
Utility assets	427,677	17,954	(1,394)	444,237
Non-utility assets	16,477	157	-	16,634
Total capital assets being depreciated	546,321	18,111	(1,394)	563,038
Total capital assets	563,734	30,208	(21,061)	572,881
Accumulated depreciation	(122,012)	(16,352)	34	(138,330)
Capital assets, net	\$ 441,722	\$ 13,856	\$ (21,027)	\$ 434,551

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

	Balance at December 31, 2003	Additions	Transfers	Balance at December 31, 2004
Capital assets not being depreciated:				
Construction in progress	\$ 21,655	\$ 30,302	\$ (34,544)	\$ 17,413
Capital assets being depreciated:				
Water and sewer system	102,167	-	-	102,167
Utility assets	394,370	33,307	-	427,677
Non-utility assets	14,067	2,410	-	16,477
Total capital assets being depreciated	510,604	35,717	-	546,321
Total capital assets	532,259	66,019	(34,544)	563,734
Accumulated depreciation	(106,808)	(15,204)	-	(122,012)
Capital assets, net	\$ 425,451	\$ 50,815	\$ (34,544)	\$ 441,722

6. PAYROLL AND RELATED OBLIGATIONS

Payroll and related obligations presented on the statements of net assets comprise:

	Balance at December 31, 2004	Additions	Reductions	Balance at December 31, 2005	Current Portion
Compensated absences	\$ 732	\$ 61	\$ -	\$ 793	\$ 68
Workers' compensation	424	-	(101)	323	226
Early retirement incentive	22	-	(7)	15	7
Payroll, withholdings, and taxes	594	17	-	611	611
	\$ 1,772	\$ 78	\$ (108)	\$ 1,742	\$ 912

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

	Balance at December 31, 2003	Additions	Reductions	Balance at December 31, 2004	Current Portion
Compensated absences	\$ 902	\$ -	\$ (170)	\$ 732	\$ 49
Workers' compensation	495	-	(71)	424	151
Early retirement incentive	54	-	(32)	22	16
Payroll, withholdings, and taxes	501	93	-	594	594
	<u>\$ 1,952</u>	<u>\$ 93</u>	<u>\$ (273)</u>	<u>\$ 1,772</u>	<u>\$ 810</u>

7. REVENUE BONDS

To finance its initial capital improvement program, the Authority issued Daily Adjustable Demand Water and Wastewater System Revenue Bonds of \$93,600 in 1984 ("1984 Bonds"). In 1985, the Authority issued Water and Wastewater System Adjustable Rate Tender Revenue Bonds ("1985 Bonds") that accomplished an advance refunding which defeased the 1984 Bonds. In 1986, the Authority issued \$134,700 Water and Wastewater System Adjustable Rate Tender Revenue Bonds ("1986 Bonds") to finance the next phase of its capital improvement program. In July 1991, the Authority issued \$248,329 Water and Wastewater System Revenue Refunding Bonds, Series A of 1991 ("1991 Bonds") which currently refunded all outstanding 1985 and 1986 Bonds. The principal of defeased 1986 Bonds still outstanding at December 31, 2005 and 2004 is \$170,310 and \$180,255, respectively.

In November 1993, the Authority issued \$278,970, Series A Refunding Bonds, ("Series A-1993 Bonds") and \$10,785 Series B Revenue Bonds, ("Series B-1993 Bonds") to finance additional capital improvements. Series A-1993 Bond proceeds of \$276,613 (net of \$3,402 in underwriting fees, FGIC insurance, and other issuance costs) defeased the 1991 Bonds through an advance refunding. The principal of defeased 1991 Bonds still outstanding at December 31, 2005 and 2004 was \$38,820 and \$51,760, respectively.

The Series A-1993 Bonds bear interest at a fixed rate of 6.5%, payable semiannually at March 1 and September 1.

Fair value of the 1993 Bonds at December 31, 2005 and 2004, with carrying amounts of \$49 million for both year-ends, based on quoted market prices, is approximately \$58 million and \$59 million, respectively.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

In July 1995, the Authority issued \$89,850, Series A Bonds ("1995 Series A Bonds"), the proceeds of which are dedicated to a capital improvement program for the System and \$103,020, Series B Bonds ("1995 Series B Bonds") to fund certain obligations of the Authority to the City under the Capital Lease Agreement for the System.

In March 1998, the Authority issued \$93,355, Series A First Lien Revenue Bonds ("1998 Series A Bonds"), the proceeds of which were used to defease through an advance refunding the entire balance of 1995 Series A Bonds outstanding (\$89,850), \$36,440 Series B First Lien Revenue Bonds ("1998 Series B Bonds"), the proceeds of which are dedicated to a capital improvements program, and \$101,970 Series C Subordinate Revenue Bonds ("1998 Series C Bonds"), the proceeds of which were used to defease through an advance refunding the entire balance of the 1995 Series B Bonds outstanding (\$98,410). In connection with the advance refunding, a portion of the proceeds of the 1998 Bonds was deposited into an irrevocable trust with an escrow agent to provide for the future debt payments. At December 31, 2005 and 2004, the remaining unamortized deferred refunding loss of \$3,438 and \$3,720, respectively, on the transaction is shown as a reduction of the long-term debt and will be amortized through 2028. At December 31, 2005 and 2004, the principal of the defeased 1995 Bonds outstanding was \$76,726 and \$154,221, respectively.

Fair value of the 1998 Bonds at December 31, 2005 and 2004, with carrying amounts of \$247 million and \$244 million, respectively, based on quoted market prices, is approximately \$262 million and \$248 million, respectively.

The 1998 Series A Bonds and 1998 Series C Bonds bear interest at fixed rates ranging from 5.0% to 5.25%, payable semiannually at March 1 and September 1. The 1998 Series B Bonds are capital appreciation bonds with an original issuance amount of \$36,440. The 1998 Series B Bonds have maturity values of \$2.3 million to \$31.8 million from 2017 to 2030. The bonds were issued to yield rates from 5.18% to 5.3%. The 1998 Series B Bonds accrue and compound interest on a semiannual basis and are carried at cost plus accrued interest. Total maturity value of the 1998 Series B Bonds is \$166.1 million.

The outstanding 1993 Bonds are not subject to optional or mandatory redemption. A portion of the 1998 Bonds are subject to optional redemption in various face amounts beginning March 1, 2008.

In March 2002, the Authority issued \$107,500 in Water and Sewer First Lien Revenue Bonds ("2002 Bonds"). The net proceeds of the bond issuance (approximately \$90 million) have been used to fund additional capital improvements. Principal began maturing December 2003, and continues through December 2031. Another \$7.3 million was funded to the debt

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

service reserve account. Bond issuance costs included \$668 in underwriting fees, \$500 insurance, and \$532 in other issuance costs.

The 2002 Bonds bear interest at rates ranging from 4.00% to 5.50%. Interest is payable in semiannual installments on June 1 and December 1 until maturity. Stated maturities for the 2002 Bonds are at various face amounts on September 1 of each year beginning December 1, 2004 through 2031. The 2002 Bonds which mature after September 1, 2012, are subject to redemption prior to maturity at the option of the Authority.

The fair market value of the 2002 Bonds at December 31, 2005 and 2004, with carrying amounts of \$104 million and \$106 million, respectively, based on quoted market prices, is approximately \$110 million and \$111 million, respectively.

On September 23, 2003, the Authority issued \$167,390,000 of Water and Sewer System Revenue Refunding Bonds ("2003 Bonds"). The proceeds of the 2003 Bonds were used to provide funds for the current refunding of a portion of the 1993 Bond Series. In connection with the 2003 debt refundings, the Authority recorded a deferred refunding loss of \$3,162 which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method. The unamortized balance of the deferred refunding adjustment is \$2,661 and \$2,878 at December 31, 2005 and 2004, respectively.

The 2003 Bonds were issued at a bond discount of \$830, which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method.

The 2003 Bonds bear interest at rates ranging from 1.45% to 4.75%. Interest is payable in semiannual installments on March 1 and September 1 until maturity. Stated maturities for the 2003 Bonds are at various face amounts on September 1 of each year beginning September 1, 2004 through 2023. The 2003 Bonds which mature after September 1, 2014, are subject to redemption prior to maturity at the option of the Authority.

The fair market value of the 2003 Bonds at December 31, 2005 and 2004, with carrying amounts of \$144 million and \$157 million, respectively, based on quoted market prices, is approximately \$145 million and \$158 million, respectively.

On May 24, 2005, the Authority issued \$50,385,000 of Water and Sewer System First Lien Revenue Bonds ("2005 Bonds"). The proceeds of the 2005 Bonds were primarily used to provide funds for capital improvements to the Authority's water and sewer system.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

The 2005 Bonds were issued at a bond premium of \$2,236, which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method. Bond issuance costs of \$765 are also being amortized over the life of the 2005 Bonds using the effective interest method.

The 2005 Bonds bear interest at rates ranging from 3.00% to 5.00%. Interest is payable in semiannual installments on March 1 and September 1 until maturity. Stated maturities for the 2005 Bonds are at various face amounts on September 1 of each year beginning September 1, 2006 through 2033. The 2005 Bonds which mature after September 1, 2015, are subject to redemption prior to maturity at the option of the Authority. The 2005 Bonds that mature on September 1 of each of 2017, 2019, 2023, 2029, and 2033 are subject to mandatory sinking fund redemption.

The fair market value of the 2005 Bonds at December 31, 2005, with a carrying amount of \$50 million, based on quoted market prices, is approximately \$53 million.

8. BONDS AND LOANS PAYABLE

Bonds and state loans payable (PENNVEST), consisted of the following at December 31, 2005 and 2004:

	Balance at December 31, 2004	Additions	Reductions	Balance at December 31, 2005
Bonds and loans payable:				
Revenue bonds	\$ 556,011	\$ 53,161	\$ (15,631)	\$ 593,541
State loans (PENNVEST)	14,000	2,496	(1,528)	14,968
	<u>570,011</u>	<u>55,657</u>	<u>(17,159)</u>	<u>608,509</u>
Less: deferred refunding loss	(18,833)	-	2,062	(16,771)
Unamortized bond discount	(3,325)	2,236	122	(967)
Total bonds and loans	<u>\$ 547,853</u>	<u>\$ 57,893</u>	<u>\$ (14,975)</u>	<u>\$ 590,771</u>

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

	Balance at December 31, 2003	Additions	Reductions	Balance at December 31, 2004
Bonds and loans payable:				
Revenue bonds	\$ 565,137	\$ 2,639	\$ (11,765)	\$ 556,011
State loans (PENNVEST)	5,239	9,074	(313)	14,000
	570,376	11,713	(12,078)	570,011
Less: deferred refunding loss	(20,974)	-	2,141	(18,833)
Unamortized bond discount	(3,564)	-	239	(3,325)
Total bonds and loans	\$ 545,838	\$ 11,713	\$ (9,698)	\$ 547,853

The funds to make debt service payments of \$5,126 and \$4,713 for 2005 and 2004, respectively, are included in "Restricted Assets" at year-end.

Debt service payments of the State Loans at December 31, 2005 are as follows:

	State Loans		
	Principal	Interest	Total
2006	\$ 770	\$ 170	\$ 940
2007	781	167	948
2008	786	161	947
2009	789	167	956
2010	799	235	1,034
2011-2015	4,158	627	4,785
2016-2020	4,446	339	4,785
2021-2024	2,439	55	2,494
	\$ 14,968	\$ 1,921	\$ 16,889

Debt service payments of the 1993, 1998, 2002, 2003, and 2005 Bonds at December 31, 2005 are as follows:

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

	Revenue Bonds		Total
	Principal	Interest	
2006	\$ 16,780	\$ 25,280	\$ 42,060
2007	17,220	24,908	42,128
2008	17,655	24,468	42,123
2009	18,170	23,953	42,123
2010	18,755	23,370	42,125
2011-2015	109,025	101,586	210,611
2016-2020	131,025	79,571	210,596
2021-2025	160,508	50,107	210,615
2026-2030	70,756	122,759	193,515
2031-2033	15,305	1,206	16,511
	<u>575,199</u>	<u>\$ 477,208</u>	<u>\$ 1,052,407</u>
Accretion	18,342		
Total	<u>\$ 593,541</u>		

Interest incurred for the years ended December 31, 2005 and 2004 on bonds payable, exclusive of capitalized interest and amortization of refunding losses was approximately \$27.5 million and \$26.2 million, respectively. Interest costs for 2005 and 2004 included \$2.1 million of amortization of the deferred refunding losses.

In accordance with the provisions of the trust indentures for the 1993, 1998, and 2002 Bonds, the Authority has created a number of funds that are restricted for specific purposes. The complement of these restricted funds, collectively referred to on the statements of net assets as "Restricted Assets" at December 31, 2005 and 2004, was:

	2005	2004
Capital project funds	\$ 55,517	\$ 14,835
Debt service and reserve funds	18,849	19,286
Operating reserve account	7,490	7,274
Other funds	1,903	452
Total	<u>\$ 83,759</u>	<u>\$ 41,847</u>

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

Among the Authority's debt covenants is one which requires that rates charged by the Authority will be sufficient to satisfy a formula which is intended to ensure that the Authority will be able to satisfy debt service requirements. The trust indenture also requires that revenue collections be deposited into a Revenue Fund and disbursed therefrom as provided for in the trust indenture. This Revenue Fund constitutes the vast majority of unrestricted funds cash and cash equivalents.

9. INVESTMENTS AND DEPOSITS WITH FINANCIAL INSTITUTIONS

The Authority is authorized to invest in: obligations of the U.S. Government and government-sponsored agencies and instrumentalities; fully insured or collateralized certificates of deposits; commercial paper of the highest rating; repurchase agreements collateralized by government obligations or securities; highly rated bank promissory notes or investment funds or trusts; and, as to trustee assets, as otherwise permitted by the trust indenture as supplemented and amended in 1998. Throughout the years ended December 31, 2005 and 2004, the Authority invested its funds in such authorized investments. The Authority does not have a formal investment policy which addresses custodial credit risk, interest rate risk, credit risk, or concentration of credit risk.

GASB Statement No. 40, "*Deposit and Investment Risk Disclosures*," requires disclosures related to the following deposit and investment risks: credit risk (including custodial credit risk and concentration of credit risk), interest rate risk, and foreign currency risk. The following is a description of the Authority's deposit and investment risks.

Custodial Credit Risk – Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. As of December 31, 2005, \$26,347 of the Authority's bank balance of \$26,647 was exposed to custodial credit risk. These amounts are collateralized in accordance with Act 72 of the Pennsylvania state legislature which requires the institution to pool collateral for all governmental deposits and have the collateral held by an approved custodian in the institution's name. These deposits have carrying amounts of \$26,344 as of December 31, 2005, all of which is reported as current assets in the statements of net assets.

In addition to the deposits noted above, included in cash and cash equivalents as non-current restricted assets on the statements of net assets are the following short-term investments: money market funds of \$3,112 and repurchase agreements of \$6,819. Of the Authority's \$6,819 investment in repurchase agreements, all of the underlying securities are held by the investment's counterparty, not in the name of the Authority.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

At December 31, 2005, the Authority held the following investment balances:

	Fair market value	<u>Maturity in years</u> Less than 1 year
Guaranteed Investment		
Contracts	\$ 49,657	\$ 49,657
Money market	3,112	3,112
Repurchase agreements	6,819	6,819
Commercial paper	15,482	15,482
INVEST	8,022	8,022
Total	<u>\$ 83,092</u>	<u>\$ 83,092</u>

The fair value of the Authority's investments is the same as their carrying amount. Investments of \$73,161 are included as non-current restricted investments on the statement of net assets. Investments of \$9,931, consisting of money market funds of \$3,112 and repurchase agreements of \$6,819, are included as non-current restricted cash and cash equivalents on the statement of net assets. The fair value of the Authority's investments in the external investment pool (INVEST) is the same as the value of the pool shares.

Interest Rate Risk – Interest rate risk, the risk that changes in the interest rates will adversely affect the fair market value of the Authority's investments. The Authority is not subject to interest rate risk as all of its investments at December 31, 2005 had maturities of less than one year.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. As of December 31, 2005, the Authority's investments in the state investment pool (INVEST) and the guaranteed investment contracts were rated AAA by Standard & Poor's. The Authority's investments in commercial paper at December 31, 2005 was rated A1+ by Standard & Poor's. Additionally, at December 31, 2005, the Authority had various repurchase agreements. The underlying securities of these repurchase agreements consist primarily of U.S. Treasuries, and are therefore not subject to credit risk.

Concentration of Credit Risk – Concentrations of credit risk is the risk of loss attributed to the magnitude of a government's investments in a single issuer. The Authority places

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

no limit on the amount it may invest in any one issuer. More than 5 percent of the Authority's investments are in Trinity Plus Fund guaranteed investment contracts, Tri-Party repurchase agreements, and General Electric commercial paper. These investments are 59.8%, 8.2%, and 18.6%, respectively, of the Authority's total investments.

10. NET ASSETS (DEFICIT)

Net assets represent the difference between assets and liabilities. An analysis of net asset (deficit) amounts is as follows:

	December 31,	
	2005	2004
Invested in capital assets, net of related liabilities:		
Net property, plant, and equipment in service	\$ 434,551	\$ 441,722
Debt as disclosed in footnote	(590,771)	(547,853)
Deferred amount on refunding	16,771	18,833
Bonds/loans issuance costs and discounts, net	967	3,325
Accounts payable for capital items	(1,265)	(2,170)
Funded debt from restricted assets:		
Unspent debt proceeds:		
Capital projects	55,517	14,835
Debt service and reserve funds	18,849	19,286
	<u>(65,381)</u>	<u>(52,022)</u>
Restricted for capital activity and debt service:		
Restricted cash and cash equivalents	9,931	25,756
Restricted investments	73,161	16,005
Restricted receivables	667	86
Liabilities payable from restricted assets:		
Unspent debt proceeds:		
Capital projects	(55,517)	(14,835)
Debt service and reserve funds	(18,849)	(19,286)
	<u>9,393</u>	<u>7,726</u>
Unrestricted	<u>16,719</u>	<u>2,706</u>
Total Net Assets (Deficit)	<u>\$ (39,269)</u>	<u>\$ (41,590)</u>

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

11. OPERATING LEASE

The Authority leases office space from an unrelated party under a non-cancelable lease. The general terms of the lease requires the lessor to provide for utilities, building repairs, maintenance, and real estate taxes. The lease provides for renewal options with similar terms at the then fair rental value negotiated in good faith. The total annual rental for the office space, in dollars, was approximately \$330,000 for 2005 and 2004.

The total minimum future commitments, in dollars, under the lease for year ending December 31, 2006 is \$192,546.

The current lease period ends July 31, 2006. The Authority has not entered into a new lease agreement, however the Authority has the option to continue to lease the office space on a month to month basis.

12. COMMITMENTS AND CONTINGENCIES

The Authority is proceeding with a capital improvement program which the Authority's independent engineer has estimated will entail expenditure of the existing construction funds and potential future bond issues. As of December 31, 2005, \$42 million of the program is complete and \$75 million is under active contract.

In addition to the matters discussed in Note 14, Consent Agreement, various other claims and lawsuits are pending against the Authority. The ultimate outcome of these claims and lawsuits cannot presently be determined and, accordingly, no provision for amounts arising from settlements has been made in these financial statements. In the opinion of management, the effect on the financial statements of potential losses associated with any such claim and/or lawsuit should not be material.

The Authority was insured for general liability coverage through 2001, however, effective January 1, 2002 became self-insured. In previous years, the Authority established a fund to pay for deductibles, small claims, and other litigation costs. At year-end, the balance in this fund was approximately \$516. This fund is grouped with "Restricted Assets" on the statements of net assets. During 2005 and 2004, the Authority paid \$0 from this fund for claims, and there is \$1,000 and \$500 accrued as of December 31, 2005 and 2004, respectively.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

(Dollars expressed in thousands unless otherwise indicated)

YEARS ENDED DECEMBER 31, 2005 AND 2004

13. SUBSEQUENT EVENTS

Usage rates increased by 6.7% effective March 1, 2006.

14. CONSENT AGREEMENT

The Authority is subject to federal regulation under the Clean Water Act (1977) and regulations adopted under that Act. Among the specific requirements applicable to the Authority's system are those imposed by the United States Environmental Protection Agency's Combined Sewer Overflow (CSO) Policy (1994). On January 29, 2004, the Authority and the City of Pittsburgh executed a Consent Order and Agreement (Order) regarding wet weather sewer overflows within the City. The other signatories to the Order are the Pennsylvania Department of Environmental Protection (DEP) and the Allegheny County Health Department (ACHD).

Generally, the Order requires the Authority and the City to assess the City sewers in order to develop a plan with ALCOSAN to address wet weather sewer overflows within the City. The Order is part of a sewer assessment program for all municipalities served by ALCOSAN. Most assessment activities for critical sewers and separate sanitary sewers are to be completed by 2010. Assessment activities for non-critical sewers are to be completed on a longer schedule with some tasks to be completed by 2012. In addition to the assessment, the Order requires the Authority and the City to implement the Nine Minimum Controls to reduce combined sewer overflows, and to perform repairs and maintenance of deficiencies revealed by the assessment. Deficiency corrections identified during assessment in critical sewers and separate sanitary sewers are to be completed by 2010, and in non-critical sewers are to be completed by 2012.

Given the scope of the Order, the size of the City sewer system, and the various conditions and/or deficiencies that may be discovered by the assessment, it is difficult to predict the total cost of compliance with the Order. Moreover, it is difficult to predict what, if any, large-scale and/or regional capital improvements may be required after the completion of the assessment to address wet weather sewer overflows in the City and in the ALCOSAN service area. Large-scale and/or regional capital improvements are not covered by the Order. The Authority has hired two engineering firms to assess and model the sewer system, and it is moving forward with its plans to comply with the Order. Costs associated with Order compliance will be reflected in the capital improvement program and funded by proceeds of potential future bond issuances.

ADDITIONAL INFORMATION

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PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS COMPOSITION - SCHEDULE I

(Dollars expressed in thousands)

DECEMBER 31, 2005

	Total	Cash Equivalents			Commonwealth of PA Revenue Bonds	Investments		Trinity Plus Funding (1)
		Unrealized Gain/(Loss)	Accrued Interest Receivable	Tri-Party Repurchase Agreement		General Electric Capt. Corp (2)		
Capital project and construction funds:								
1995 Capital Project Fund	\$ 552	\$ -	1	\$ -	\$ 551	\$ -	\$ -	\$ -
2002 Capital Project Fund	5,869	-	16	5,853	-	-	-	-
2005 Capital Project Fund	49,096	-	592	-	-	-	-	48,504
	<u>55,517</u>	<u>-</u>	<u>609</u>	<u>5,853</u>	<u>551</u>	<u>-</u>	<u>-</u>	<u>48,504</u>
Debt service funds:								
1993 Debt Service Fund	1,071	2	2	269	-	-	798	-
1998 C Debt Service Fund	1,686	3	2	424	-	-	1,257	-
1998 A Debt Service Fund	1,576	3	2	396	-	-	1,175	-
2002 Debt Service Fund	609	-	1	608	-	-	-	-
2002 Debt Service Reserve Fund	7,364	55	10	1	-	-	7,298	-
2003 Debt Service Fund	6,251	11	7	1,571	-	-	4,662	-
2005 Debt Service Fund	292	1	-	74	-	-	217	-
	<u>18,849</u>	<u>75</u>	<u>24</u>	<u>3,343</u>	<u>-</u>	<u>-</u>	<u>15,407</u>	<u>-</u>
1993 Operating Reserve Fund	7,490	-	18	1	7,471	-	-	-
2005 Capitalized Interest	1,387	-	14	220	-	-	-	1,153
Self-Insured Escrow Fund	516	-	2	514	-	-	-	-
	<u>\$ 83,759</u>	<u>\$ 75</u>	<u>\$ 667</u>	<u>\$ 9,931</u>	<u>\$ 8,022</u>	<u>\$ 15,407</u>	<u>\$ 49,657</u>	<u>\$ -</u>

(1) Trinity Plus Funding GIC, 4.01%

(2) As per Debt Service Forward Delivery Agreement with JP Morgan and Sun Trust

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS ACTIVITY - SCHEDULE II

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2005

	Series 1993 Bonds		Series 1995 Bonds		Series 1998 Bonds		Series 2002 Bonds		Series 2003 Bonds		Series 2005 Bonds		Self-Insured Escrow Account	Total
	Debt Service Fund	Operating Reserve Account	Capital Projects Fund	Debt Service Fund	Series A Debt Service Fund	Series C Debt Service Fund	Capital Projects Fund	Debt Service Fund	Debt Service Fund	Debt Service Fund	Debt Service Fund	Capitalized Interest Fund		
Increases:														
Interest	\$ 21	\$ 215	\$ 16	\$ 28	\$ 31	\$ 62	\$ 300	\$ 207	\$ 990	\$ 29	\$ 16	\$ 2,179		
New Refunding Bond issue	-	-	-	-	-	-	-	-	-	-	-	-	-	-
New Revenue Bond issue	-	-	-	-	-	-	-	-	-	-	-	51,885	-	51,885
Decreases:														
Capital projects	-	-	-	-	-	-	-	-	1,678	-	-	-	-	10,101
Interest	3,192	-	-	4,704	5,029	5,308	-	5,017	-	-	-	-	-	23,781
Bond principal/refunding escrow	-	-	-	-	-	1,990	-	13,640	-	-	-	-	-	15,630
Other	-	-	-	-	-	-	-	-	-	-	-	212	-	212
Total decreases	3,192	-	-	4,704	5,029	7,298	-	18,657	1,678	-	212	-	-	49,724
Interfund Transfers:														
Nontrusteed accounts														
2002 Capital Interest Fund	3,172	-	-	4,680	5,004	5,906	-	18,468	-	-	-	-	50	37,572
2002 Debt Service Fund	-	-	-	-	-	649	(378)	-	-	-	-	-	-	-
2002 Debt Service Reserve Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2003 Debt Service Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2003 Redemption Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2005 Clearing Fund	-	-	-	-	-	-	-	-	49,784	-	-	-	-	-
2005 Capital Project Fund	-	-	-	-	-	-	-	-	-	1,358	-	(51,673)	-	-
2005 Debt Service Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2005 Capitalized Interest Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Interfund transfers	3,172	-	-	4,680	5,004	6,555	(378)	18,468	49,784	825	1,358	(51,673)	50	37,572
Net activity	1	215	16	4	6	(681)	(78)	18	49,096	292	1,387	-	66	41,912
Balance:														
Beginning of year	1,070	7,275	536	1,572	1,680	1,290	7,442	6,233	-	-	-	-	450	41,847
End of year	\$ 1,071	\$ 7,490	\$ 552	\$ 1,576	\$ 1,686	\$ 609	\$ 7,364	\$ 6,251	\$ 49,096	\$ 292	\$ 1,387	\$ -	\$ 516	\$ 83,759

APPENDIX D
CERTAIN DEMOGRAPHIC AND ECONOMIC
INFORMATION PERTAINING TO THE CITY OF PITTSBURGH

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CITY OF PITTSBURGH, PENNSYLVANIA

The City of Pittsburgh located in Western Pennsylvania, is the county seat of Allegheny County. As of the 2000 census, the City had a total population of 334,563 (metropolitan area 2,358,695), making it the second-largest city in the state.

THE GOVERNMENT OF PITTSBURGH

Three principal government entities provide services in the Pittsburgh area: the City, the County and the School District. Information relating to the County and the School District may be found in the “**OTHER GOVERNMENTAL ENTITIES**” section below.

The City was incorporated in 1816, and became a home rule community on January 5, 1976. Its powers are set forth in the Charter which became effective January 5, 1976. The Charter was adopted by the electorate pursuant to Article IX, Section 2 of the Constitution of the Commonwealth and the Home Rule Charter and Optional Plans Law, Act of April 13, 1972, P.L. 184, No. 162. Under the Charter, the City has all home rule powers and may perform any function and exercise any power not denied by the Constitution of the Commonwealth, the laws of the Commonwealth or the Charter. The Charter provides, among other things, for the election of the Mayor and the powers and duties of the executive and administrative branch; the election, organization, powers and duties of the legislative branch; the method by which the City’s capital and operating budgets are adopted; the rules which govern City personnel; and the financial disclosure requirements for elected officials.

Under the Charter, the executive, administrative and law enforcement powers of the City are vested in the Mayor, who is directed to control and be accountable for the executive branch of the City government. The Charter establishes a “strong mayor” form of government in which the Mayor controls and has wide powers of appointment over the units of the City government, and has the power to initiate and veto legislation and to propose the City’s operating and capital budgets, to which proposals the City’s legislative body, the City Council, must react within a definite time period. The Mayor is elected to a four-year term and may be re-elected for subsequent consecutive terms without limitation.

The Controller of the City is elected to a four-year term in a different municipal election year from the mayoral election, and may be re-elected for subsequent consecutive terms without limitation. As provided in the Charter, the Controller audits all units of City government, countersigns all City contracts, controls all City disbursements and prepares reports on revenues, expenditures, debt and the financial condition of the City. The Controller serves ex-officio as controller of the School District.

The City’s financial management functions are carried out by the Department of Finance, headed by the Director of Finance who is appointed by the Mayor, subject to confirmation by City Council. The Department of Finance is responsible for the treasury functions of revenue and tax collection, certain real estate functions, the investment of City funds, and debt management, and for preparing and monitoring the operating and capital budgets. The City Treasurer serves as ex-officio treasurer of the School District where his sole responsibility is the collection of taxes.

The legislative power of the City is vested by the Charter in the City Council, which consists of nine members, all of whom are elected by district to four-year terms that are staggered so that four members are elected at the same time as the Mayor. Members may be re-elected for subsequent and consecutive terms without limitation. Under the Charter, the members of the City Council elect, by majority vote, one member to serve as President. The President of Council presides at meetings of City Council, appoints all committees, and refers proposed legislation to the proper committee.

City Officials

LUKE RAVENSTAHL, Mayor - Mr. Ravenstahl became the 59th Mayor of Pittsburgh on September 1, 2006. Mr. Ravenstahl was elected to City Council on November 4, 2003 and was elected President of City Council in December 2005. Mr. Ravenstahl became Mayor following the death of Mayor Bob O’Connor. Mayor Ravenstahl is a graduate of North Catholic High School and received his B.A. Degree in Business Administration from Washington and Jefferson College in December 2002.

ANTHONY POKORA, Controller - Mr. Pokora oversees the City Controller’s Office. Mr. Pokora assumed the helm of the Controller’s Office in January 2006 when Controller Tom Flaherty resigned from office after being elected to be a Judge of the Court of Common Pleas of Allegheny County. Mr. Pokora will serve out the remainder of the controller’s term through 2007.

SCOTT KUNKA, Director of Finance – Mr. Kunka was appointed Director of the Office of Management and Budget in March 2006 and as Director of Finance in November 2006. He is responsible for overseeing the operating and capital budgets. Previously, Mr. Kunka held positions in the Controller’s Office, Office of Management and Budget and Department of General Services, and as the Budget Director for City Council.

GEORGE SPECTER, ESQ., Acting City Solicitor - Mr. Specter serves as counsel for the City of Pittsburgh. He is responsible for rendering legal opinions and advice to the Mayor, City officials, City Council, and the administrative units of City government. The City Solicitor also functions as Solicitor for the Comprehensive Municipal Trust Fund Board. Mr. Specter was appointed to his position in July 2006 following a long career in the City Law Department.

Members of City Council

President of City Council

DOUG SHIELDS – Mr. Shields was elected to Pittsburgh City Council in 2003, after having served on the staff of former Councilman Bob O’Connor. Mr. Shields assumed the position of Chair of the Finance and Budget Committee in 2005. He was elected President of City Council on September 5, 2006.

Members of Council

LEONARD BODACK, JR. – Mr. Bodack was elected to City Council in February of 2003 in a special election to fill the seat that was left vacant by former Councilman Jim Ferlo, who was elected to the Commonwealth of Pennsylvania State Senate. Mr. Bodack is the Chair of the Planning, Zoning and Land Use Committee. He is a member of the Pittsburgh Water & Sewer Authority. Prior to serving on City Council, Mr. Bodack was the Director of Operations for the County of Allegheny Democratic Party.

TWANDA CARLISLE – Ms. Carlisle was elected to City Council in March of 2002 in a special election to fill the seat that was left vacant by former Councilwoman Valerie McDonald, who was elected to be the Recorder of Deeds for the County of Allegheny. Ms. Carlisle is the Chair of the Public Safety Services Committee. She is a member of the board of the Pittsburgh Housing Authority and is on the Board of Trustees of the Carnegie Library.

DANIEL DEASY – Mr. Deasy was elected to Pittsburgh City Council on May 17, 2005 in a special election to fill the seat that was left vacant by former Councilman Alan Hertzberg, who was elected to be a Judge of the Court of Common Pleas of Allegheny County. Mr. Deasy took office on June 10, 2005. He was appointed as the Chairman of the Public Works and Environmental Services Committee. He is a member of the Pittsburgh Parking Authority Board of Directors and serves on the Board of Trustees of the Carnegie Library.

JEFFREY KOCH – Mr. Koch was elected to City Council in March of 2006 in a special election to fill the vacant seat left vacant by Eugene Ricciardi, who was elected as a District Magistrate. Mr. Koch took office on March 27, 2006.

JIM MOTZNIK – Mr. Motznik was elected to City Council in February of 2001 in a special election to fill the vacant seat left by Michael Diven who was elected to the Pennsylvania State House of Representatives. He serves as Chairman of the Committee on Parks, Recreation and Youth Policy. Mr. Motznik is a member of the Allegheny County Sanitary Authority Board of Directors and serves on the Board of Trustees of the Carnegie Library of Pittsburgh.

TONYA PAYNE – Ms. Payne was elected to City Council in November of 2005 and took office on January 3, 2006. Ms. Payne is Chair of the Housing, Economic Development and Promotion Committee. She is a member of the Pittsburgh Urban Redevelopment Authority and serves on the Board of Trustees of the Carnegie Library of Pittsburgh.

WILLIAM PEDUTO – Mr. Peduto was elected to City Council in 2001, after having served on the staff of former Councilman Dan Cohen. He is the Chair of the General Services, Technology and the Arts Committee. Mr. Peduto is on the board of the Stadium Authority of the City of Pittsburgh.

DARLENE M. HARRIS – Ms. Harris was elected in a special election in November 2006 to represent District 1 following Mr. Ravenstahl’s inauguration as Mayor in 2006.

City Departments and Services

The Charter provides that all units of the City government, except those mandated by the Charter as described below, may be established, revised, or abolished by ordinance, which may be introduced by the Mayor or City Council. Under the Charter, the Mayor appoints the heads of all major administrative units, subject to the approval of City Council. The Charter also provides that the Mayor shall, subject to the approval of City Council, appoint the City Solicitor, the members of all boards and commissions, and, except as otherwise required by law, all board members of authorities. Under the Charter, a member of City Council must serve on each authority board, but no member may serve concurrently on more than one board.

The Charter mandates the establishment of a 15-member Human Relations Commission, which is directed to investigate, report, hold hearings and otherwise enforce the rights of citizens in connection with unlawful discrimination. The Charter also mandates the appointment by the Mayor, subject to the approval of City Council, of City Magistrates who preside in the City’s Magistrate Courts, which are part of the Commonwealth’s unified judiciary system. The Mayor is required to designate a Chief Magistrate to administer the Magistrate Courts.

The City Solicitor acts as counsel for the City and its officials, although the City Controller, City Council and the Human Relations Commission are empowered to retain their own counsel. The Department of Personnel and the Civil Service

Commission administer all the City's personnel policies, civil service requirements and the City's Workforce Investment Act (formerly JTPA) Program. The Department of Personnel and the Civil Service Commission are also responsible for City payroll, benefits, and workers' compensation matters. The Department of City Planning makes recommendations to the Mayor and City Council regarding the allocation of resources for the orderly development and redevelopment of the City. It also assists the Department of Finance in formulating the City's Capital Improvement Program, undertakes planning studies and administers zoning requirements.

The Department of Public Safety, created in 1985, carries out the traditional police, fire and emergency medical service functions, as well as the enforcement of building codes. The Department of Public Works exercises responsibility for the maintenance of all the City's streets, sewers, parks, bridges and steps, for the construction of minor public works capital improvements, and operates sanitation services and is responsible for engineering and the design of projects in the City's Capital Improvement Program. The Department of Parks and Recreation provides recreational opportunities to the City's residents.

COMMONWEALTH FISCAL OVERSIGHT

Background.

Changes in the economic geography of the City, its population and demographics occurring over several decades have eroded the tax base that supports necessary municipal services, while significant growth has occurred in sectors wholly or substantially exempt from local tax, such as hospitals and universities, financial institutions and utilities. In addition, although the City's major economic and physical transformation continued, the translation of various economic development initiatives into higher tax revenues (real estate, earned income, business privilege, and parking) has not yet been fully realized.

As a matter of administration policy, since 1994 there had been no increase in the rate of earned income tax on residents or in the tax rate on real estate, although the rate was modified in 2001 by the adoption of a unitary tax rate structure. Debt refinancings and other one-time revenue and cost cutting measures were used to balance the annual operating budgets. The working capital fund of \$109 million created by the 1995 capital lease agreement between the City and the Pittsburgh Water and Sewer Authority and the sale of tax liens provided a fiscal cushion through 2003.

Notwithstanding workforce reductions and efficiencies in service delivery, structural deficits persisted and grew over time as recurring revenues were outpaced by expenditure increases averaging 3-4% per year. Many of these annual cost increases were beyond the fiscal control of the City as they related to legacy costs, such as pension and retiree health care benefits and workmen's compensation claims, and to historic debt service costs.

Act 47. As part of its fiscal recovery and tax restructuring strategy, on or about December 29, 2003, the City successfully sought to be declared a "distressed" municipality by the Secretary of the Department of Community and Economic Development ("DCED") under the Municipalities Financial Recovery Act ("Act 47"). Act 47 requires the Secretary of DCED (the "Secretary") to appoint a Coordinator to "prepare and administer a plan designed to relieve the financial distress" of the City. The Act 47 Coordinator is charged with the duty of developing and implementing a plan, which includes, among other things, assurance that "the recommendations in the plan are being accomplished by the dates set in the plan." In January 2004, the Secretary made the dual appointment of the law firm of Eckert Seamans Cherin & Mellot, LLC and Public Financial Management, Inc. as Act 47 Coordinators (collectively, the "Act 47 Coordinators"). A total of 19 municipalities in the Commonwealth of Pennsylvania had been granted relief under Act 47 prior to the City's petition.

Act 11. The Pennsylvania General Assembly also reacted to the City's financial crisis by enacting the Intergovernmental Cooperation Authority Act for Cities of the Second Class ("Act 11"), which is likewise intended to help the City recover from its financial crisis and to bring long-term fiscal health and stability to the City. For its implementation, Act 11 establishes the Intergovernmental Cooperation Authority for Cities of the Second Class (the "ICA"), which is charged with fiscal oversight and approval of a financial plan for the City, which includes projected revenues and expenditures of the principal operating funds of the City for five (5) fiscal years. In accordance with Act 11, the City and the ICA entered into an Intergovernmental Cooperation Agreement (the "Cooperation Agreement") on September 21, 2004.

The ICA has five members. The President Pro Tempore and the Minority Leader of the Senate, the Speaker and the Minority Leader of the House of Representatives, and the Governor each appoint one member who serves at their respective pleasures. The Pennsylvania Secretary of Administration and Budget, and the City's Finance Director are ex officio, nonvoting members of the ICA.

The Pennsylvania General Assembly contemplated that the Act 47 Coordinators and the ICA would operate concurrently and equally in their separate legal capacities to assist the City in its return to fiscal stability.

A recovery plan prepared by the Act 47 Coordinator (the "Act 47 Plan") was approved and adopted by City Council on June 29, 2004 and approved by the Mayor of the City on June 30, 2004. The Act 47 Plan is available at http://www.city.pittsburgh.pa.us/council/assets/ACT_47_Recovery_Plan_Final_Filing_June_11_FINAL.pdf.

In accordance with Act 11, the City and the ICA entered into an Intergovernmental Cooperation Agreement (the "Cooperation Agreement") on September 21, 2004. Similarly, the ICA approved the City's 2005 Operating and Capital Budgets and Five-Year Financial Forecast and Performance Plan (the "Financial Plan") on December 21, 2004. The Financial Plan took into account the Act 47 Coordinator's implementation of the recommendations and the provisions of the Act 47 Plan with respect to financial requirements and collective bargaining workforce rules and recommendations critical to the City's sustainable financial recovery. The Cooperation Agreement and the Financial Plan were duly adopted by City Ordinance. The Financial Plan established operating and capital budgets for fiscal year 2005 and budgetary forecasts for fiscal years 2006 through 2009.

In September of 2005, the City presented the 2006 operating and capital budgets as well as the five year financial plan as prescribed in the Cooperation Agreement to the ICA. However, the ICA rejected the budget and plan. On January 3, 2006, Bob O'Connor was sworn in as the Mayor of Pittsburgh. On March 15, 2006, the Mayor presented to the ICA the City's 2006 amended Operating Budget which the ICA approved on March 16, 2006, subject to certain conditions. On April 11, 2006, City Council passed the amended 2006 Budget. The ICA has granted an extension to the City to formulate and present the plan portion of the budget which would include the years 2007 through 2010. A copy of the Cooperation Agreement is available at <http://www.pghica.org/>.

Certain Provisions of Act 11.

Under Act 11, after the Financial Plan is approved, the City is required to implement the Financial Plan.

If the ICA determines, based upon reports and information submitted by the City, that the City's actual revenues and expenditures vary from those estimated in the Financial Plan, the ICA shall require the City to provide such additional information as the ICA deems necessary to explain the variation.

In response to the request for additional information concerning the variation, the Mayor of the City shall provide to the ICA reports describing actual or current estimates of revenues and expenditures compared to budgeted revenues and expenditures for such period reflected in its cash flow forecast. Each such report shall indicate any variance between actual or current estimates and budgeted revenues, expenditures and cash for the period covered by such report.

Additionally, if, after the approval of the Financial Plan, the City executes a collective bargaining agreement, which is not in compliance with the Financial Plan, the City shall submit to the ICA a proposed revision to the Financial Plan which demonstrates that revenues sufficient to pay the costs of the collective bargaining agreement will be available in the affected fiscal years of the Financial Plan.

If the City fails to submit to the ICA a revision to a Financial Plan, report or other information required to be filed pursuant to Act 11, the ICA, in addition to all other rights which the ICA may have at law or in equity, shall have the right by mandamus to compel the City and the officers, employees and agents thereof to file with the ICA the Financial Plan, revision to a Financial Plan, report or other information which the City has failed to file.

Certain Provisions of the Cooperation Agreement.

Under the provisions of the Cooperation Agreement, if the ICA determines – based upon reports submitted by the City, as well as reports necessitated by changed conditions or unexpected events which may affect the City's adherence to its then-current Financial Plan – that the City's actual revenues and expenditures vary from the Financial Plan, the ICA shall notify the City, in writing, of its determination that a variance exists. In response, the City shall within ten (10) days after the request by the ICA, provide the ICA such additional information as the ICA deems necessary to explain the variance. The Cooperation Agreement provides that a "variance" for this purpose, which would change the reporting requirement from quarterly to monthly, shall be deemed to have occurred as of the end of a reporting period based on the reports submitted for such period if: (i) a net adverse change of more than one percent (1%) of the revenues or expenses for such fiscal year is reasonably projected to occur; or (ii) the actual net cash flows of the City for that fiscal year are reasonably projected to be less than ninety-eight percent (98%) of the net cash flows originally forecast at the time of the adoption of the budget.

In the event that the ICA, by a majority vote, determines that the City's written explanation for the variance is unsatisfactory, the ICA shall certify such non-compliance with the Secretary of the Budget and shall notify the City. Upon receipt of the prescribed notice, the City's Director of Finance and the Controller shall certify to the ICA forthwith the amount of New Revenue, and shall cause such certified amount to be aggregated, transferred and deposited as directed by the ICA in trust for the exclusive benefit of the City in an account designated as the "New Revenue Account" established under the Cooperation Agreement.

"New Revenue" is defined as "in the aggregate, any revenues received by the City with respect to any taxes or fees from any source whatsoever which are not solely derived by virtue of existing taxing or legislative power possessed by the City under its Home Rule Charter or applicable law, it being the intent of this provision that New Revenue shall not include taxes or fees, including any increases thereof, which the City presently levies or has the power to levy. New Revenue shall not be

reduced, diminished or offset by any existing taxes or fees which may be eliminated or reduced in connection with the City's financial recovery. New Revenues shall not include (1) any moneys received by the City as grants from public or private entities, whether for profit or non profit, as a conduit for third parties, 2) any revenues pledged or held as security for bonded indebtedness or related insurance existing on the effective date of Act 11 and approved by the ICA as part of the City's Financial Plan"

New Revenue received after the date of initial deposit into the New Revenue Account shall also be deposited to the credit of the New Revenue Account.

Under the Cooperation Agreement, the City further agreed that as soon as they become available, it shall provide to the ICA copies of all significant or requested reports, documents, budgetary and financial planning data and any other information prepared by or on behalf of the City regarding the revenues, expenditures, budgets, costs, plans, operations, estimates and any other financial or budgetary matters of the City.

Additionally, if, after the approval of the Financial Plan, the City executes a collective bargaining agreement which is not in compliance with the plan, the City shall as soon as practicable (but in no event later than fifteen (15) Days after the execution by the City of such contract) submit to the ICA a proposed revision to the Financial Plan which demonstrates to the reasonable satisfaction of the ICA that revenues sufficient to pay the costs of the contract will be available in the affected fiscal years of the Financial Plan.

Both Act 47 and Act 11 have specific provisions relating to the content and form of any approved Financial Plan. Similarly, both provide mechanisms for intercepting and escrowing of certain funds (with the exception of funds for capital projects under contract, disaster relief funds, pension fund disbursements, and funds pledged to repay bonds and notes) due the City from the Commonwealth in the event the City fails to adhere to the Act 47 Plan or permits a certain financial variance from the ICA approved Financial Plan.

New Tax Structure.

On November 21, 2004, the State legislature passed legislation eliminating the occupational privilege tax payable by residents and nonresident employees at \$10 per year and replaced it with the Emergency and Municipal Services Tax, now named the Municipal Services Tax, payable by residents and nonresident employees at \$52 per year and authorized the City to levy a gross payroll tax at the rate of 0.55% on all non-charitable businesses. Previously, a significant portion of businesses located in the City had been exempt from paying any business tax. The State legislature also required the City to reduce the City's business privilege tax from 6 mills to 2 mills and to eliminate the 2 mill mercantile tax. The Governor signed the legislation in December, 2004.

Termination of Oversight. Under Act 47, termination of municipal financial distress status may be initiated either by the Secretary of DCED or by the City. This process is designed to determine whether or not the conditions which led to the earlier determination of distressed status have been addressed adequately, including the elimination of accrued deficits and municipal operations for a period of at least one year under a positive current operating fund balance.

Under Act 11, the ICA was established for a minimum term of seven years. If after seven years the City has had annual operating budgets and financial plans which satisfy prescribed standards, the ICA's existence and the status of the City as an "assisted city" may be terminated.

Under both Act 11 and Act 47, the core functions and management of the City remain the responsibility of the Mayor and City Council. As confirmed in the Cooperation Agreement, the City retains all of its powers and authority granted under the Home Rule Charter of the City of Pittsburgh, except as specifically set forth in the Cooperation Agreement.

Extraordinary Contracts. The Cooperation Agreement established a new requirement that the City provide notice to the ICA of the intention to enter into any "Extraordinary Contract." The term Extraordinary Contract is defined to mean, among other things, any agreement which relates to the borrowing of money by the City. Prior to entering into any Extraordinary Contract, the City must deliver to the ICA: (i) a summary of the terms of such Extraordinary Contract; and (ii) a written statement by the City's Director of Finance stating whether or not in the opinion of said officer the performance of the Extraordinary Contract would be consistent with the Financial Plan of the City then in effect. In the case of a bond purchase agreement, the City is required to provide such information regarding the agreement not less than three days prior to the execution of the agreement. The Cooperation Agreement provides that the ICA may make comments and suggestions with respect to such Extraordinary Contracts, which comments and suggestions the City is obligated to consider prior to its execution of the Extraordinary Contract. The Cooperation Agreement does not, however, grant the ICA the power to approve or disapprove Extraordinary Contracts.

Reporting Requirements. On an ongoing basis, the City will be subject to the financial reporting requirements described in Act 11 and Act 47, and to the continuing financial oversight of the ICA. The financial reporting requirements now in effect provide, among other things, that within 45 days after the end of each fiscal quarter, the City will provide reports to the ICA

describing actual or current estimates of revenues and expenditures compared to budgeted revenues and expenditures for the quarter as reflected in its cash flow forecast.

REVENUE SOURCES OF THE CITY

General

In 2004, Real Estate Taxes accounted for approximately 31.5% of the receipts of the General Fund, followed by Earned Income Tax at 12%, Business Privilege Tax at 11.1% and all other taxes at 21.2%. The remaining 24.2% of receipts was from miscellaneous non-tax revenue. In 2005, under a restructured taxing system, Real Estate Taxes accounted for approximately 30% of the receipts of the General Fund, followed by Earned Income Tax at 11.4%, Parking Tax at 12%, Payroll Preparation Tax at 9% and the remaining taxes at 16%. The remaining 21.6% of receipts was from miscellaneous non-tax revenue. In 2006, Real Estate Taxes accounted for 29% of the receipts of the General Fund, followed by Earned Income at 11%, Parking Tax at 11%, Payroll Tax at 9%, Business Privilege at 3% and the remaining taxes at 11%. The remaining 26% of receipts was from non-tax revenue. Under the City’s new tax structure, it is expected that Real Estate Taxes will continue to be the City’s most significant source of revenue. The Business Privilege Tax was lowered by two-thirds in 2005 and will be eliminated in 2010. Payroll Preparation Tax revenues are expected to offset the loss of Business Privilege Tax revenues in the coming years.

Real Estate Taxes

The City has the power to levy and collect ad valorem taxes, without limitation as to rate or amount, on all taxable real estate located within the City. The City shares the real estate tax base with the County of Allegheny (the “County”) and the School District of Pittsburgh (the “School District”), separate taxing bodies. A ten-year history of real estate tax rates levied by the City, the County and the School District is presented in Table 1 below.

**TABLE 1
CITY OF PITTSBURGH
REAL ESTATE TAX RATES OF THE CITY
AND ITS OVERLAPPING JURISDICTIONS
(mills)**

Year	Land	Building	Total City ⁽¹⁾	School District	County ⁽²⁾	Total
1997	184.5	32.00	58.569	59.700	25.500	143.769
1998	184.5	32.00	58.569	59.700	25.500	143.769
1999	184.5	32.00	58.569	59.700	25.500	143.769
2000	184.5	32.00	59.000	59.700	25.500	144.200
2001 ⁽³⁾	10.8	10.8	10.8	13.92	4.72	29.44
2002	10.8	10.8	10.8	13.92	4.72	29.44
2003	10.8	10.8	10.8	13.92	4.72	29.44
2004	10.8	10.8	10.8	13.61	4.72	29.13
2005	10.8	10.8	10.8	13.92	4.72	29.44
2006	10.8	10.8	10.8	13.92	4.72	29.44
2007	10.8	10.8	10.8	13.92	4.72	29.44

(1) Determined by multiplying the respective assessed valuation by the millage rate and dividing by the total assessed valuation.
(2) Includes levy by Allegheny County Institution District (the “Institution District”).
(3) Four changes took place that affected the 2001 real estate tax rates: (i) the County conducted a property revaluation program that resulted in an approximate 57% increase in taxable property values for the City; (ii) the County changed the ratio of assessed value to market value from 25% to 100%; (iii) the City changed from a bifurcated (land and building) tax rate to a single, unified tax rate for both land and buildings; and (iv) the School District raised its effective millage rate by approximately 27%.

Sources: City; School District; County.

Table 2 below sets forth information regarding assessed values, tax rates and budgeted and actual levies and assessments from 1996 to 2005.

Table 2
CITY OF PITTSBURGH, PENNSYLVANIA
ASSESSED VALUE, TAX RATE, LEVY, AND COLLECTIONS
LAST TEN YEARS
(\$'s In Thousands)

Fiscal Year	Assessed valuation of land and buildings	Land millage	Building millage	Original net levy	Adjusted net levy (1)	Budgeted	Receipts ⁽³⁾	Year of original levy			Delinquent taxes		
								Percent of original net levy collected	Percent of adjusted net levy collected	Percent of budget collected	Budget	Receipts	Percent of budget collected
1996	\$ 2,036,489	184.50	32.00	\$118,952	\$115,898	\$109,720	\$110,276	92.7%	95.1%	100.5%	\$ 8,773	\$ 12,130	138.3%
1997	2,047,441	184.50	32.00	119,741	111,066	109,180	113,251	94.6	101.9	103.7	13,675	13,018	95.2
1998	2,085,013	184.50	32.00	121,674	105,822	110,715	112,562	92.5	99.3	101.6	5,521	6,644	120.3
1999	2,096,829	184.50	32.00	122,053	117,382	113,715	112,569	92.2	95.9	99.0	5,686	5,397	94.9
2000	2,125,768	184.50	32.00	125,422	119,649	112,010	110,644	88.2	92.5	98.8	4,500	2,967	65.9
2001	13,346,238	10.80	10.80	144,139	127,784	115,900	118,150	81.9	92.9	101.9	3,500	2,689	76.8
2002	14,677,667	10.80	10.80	158,454	131,245	121,500	123,692	78.1	94.2	102.0	4,300	4,359	101.0
2003	13,578,918	10.80	10.80	146,652	131,484	123,132	123,015	83.9	93.6	99.9	3,139	1,069	34.1
2004	13,237,682	10.80	10.80	142,966	127,864	122,500	119,918	83.9	93.8	97.9	5,500	4,435	80.6
2005	13,234,645	10.80	10.80	142,934	126,124	124,000	124,906	87.4	99.0	100.7	4,500	3,173	70.5

Notes:

(1) Represents net levy as of December 31 of the tax year (i.e., net of exonerations, discounts, and additions granted in that year).

(2) In 2001, assessed value percent of market value increased to 100% and a unified millage rate was enacted.

(3) 2001 through 2005 receipts are net of refunds.

Table 3 below shows the ten largest real estate taxpayers in the City as of December 31, 2005.

**TABLE 3
CITY OF PITTSBURGH
TEN LARGEST REAL ESTATE TAXPAYERS
DECEMBER 31, 2005**

TAXPAYER	LAND ASSESSMENT	BUILDING ASSESSMENT	TOTAL ASSESSMENT	PERCENTAGE OF TOTAL TAX LEVIED
1) 500 Grant St. Associates One Mellon Bank Center	\$14,709,900	\$415,676,200	\$430,386,100	3.25%
2) Market Associates Limited Partnership (PPG)	14,590,400	170,409,600	185,000,000	1.40%
3) 600 Grant Street Associates	10,000,000	150,000,000	160,000,000	1.21%
4) Buncher Company	14,099,700	125,030,700	139,103,400	1.05%
5) PNC Corporation	10,629,400	115,358,400	125,987,800	0.95%
6) Oxford Development	4,186,800	107,813,200	112,000,000	0.85%
7) Grant Liberty Development Group	9,020,600	100,979,400	110,000,000	0.83%
8) Gateway Trizec, Inc.	20,903,700	72,096,300	93,000,000	0.70%
9) Penn Liberty Holding Company	3,248,600	81,721,200	84,969,800	0.64%
10) Harrah's Forest City Associates	19,638,600	26,159,100	54,797,700	0.41%

Source: City Finance Department.

Real Estate Assessments

The City has the power to levy and collect ad valorem taxes on all taxable real estate within its boundaries without limitation as to rate or amount. The City does not have a statutory limit on real estate taxes.

In recent years, changes have occurred to the system by which real estate taxes are assessed by the County. These changes have affected revenues from taxable real property in the City.

Beginning in 2001, the County changed the ratio of assessed value to market value to 100% from 25%. As a result of the County's related assessment, land values in the City significantly increased. To lessen the burden on residential property owners while maintaining an adequate tax base, the City determined to change from a bifurcated system of taxation (where land was taxed at a higher rate than buildings) to a unified system. Thus in February of 2001, the City of Pittsburgh amended its City Code to provide for a unified tax rate of 10.8 mills, while also enacting a Homestead Exemption (which allowed qualifying homeowners to exempt the first \$10,000 of property value from taxation) to lessen the burden the unified system would have on neighborhoods where the land values did not significantly increase.

Currently, the County is using 2002 as a "base year" for assessments (i.e. generally setting a property's assessment value at its worth in 2002, with exceptions for situations such as improvements having been made to the property). Legal challenges to the current system of assessment are ongoing and no conclusion can be reached at this time as to the likelihood that such challenges will prevail. In addition, there have been, and will continue to be, appeals to assessed values. City real estate tax refunds for 2004, 2005 and 2006 were approximately \$2.4 million, \$3.6 million and \$3.0 million, respectively.

The City makes tax abatements available for commercial and industrial properties for the assessment increase attributable to rehabilitation and abates new construction at varying degrees. The abatements have not had a substantial impact on the City's revenues.

Properties with delinquent taxes of one year or more are liened and are subject to Treasurer's sales.

Non-Real Estate Taxes

In addition to ad valorem taxes on real estate, the City is empowered by the Local Tax Enabling Act and the Home Rule Charter and Optional Plans Law to levy taxes for general revenue purposes, on persons, transactions, occupations, privilege, and upon the transfer of real property or interest therein. All non-real estate taxes, except the Deed Transfer Tax, which is payable at the time of transfer, are payable annually, by April 15, quarterly or monthly depending on the tax.

The City currently levies the following non-real estate taxes:

Earned Income Tax - The Earned Income Tax or “Wage-Tax” is levied at the rate of 1.00% on the wages or net profits earned by residents of the City. The majority of the tax payments are deducted from payrolls and remitted by employers to the City.

Business Privilege Tax - The Business Privilege Tax is presently levied at the rate of 1 mills on the gross receipts of businesses operating in the City. Under the City’s Act 47 Recovery Plan, the tax was reduced to 1 mill in 2007, it will continue at 1 mill for 2008 and 2009 and will be eliminated in 2010.

Parking Tax - A tax equal to 45% of the consideration paid for each parking transaction is levied on the patrons of non-residential parking places in the City. There is a planned reduction of this tax to 37.5% in 2008 and 35% in 2009, where it is expected to remain.

Amusement Tax - This tax is levied at the rate of 5% on the admission price paid by patrons of all manner and forms of amusement except for nonprofit charitable performing arts groups where the tax is levied at 1.25%.

Deed Transfer Tax – The Deed Transfer Tax is levied on real property sales within the City at the rate of 2% of the gross sales price.

Emergency and Municipal Services Tax - This \$52 annual tax is levied upon each individual whose principal place of employment is located in the City, regardless of residence.

Facility Usage Fee – The Facility Usage Fee is levied on all non-resident individuals who use the City’s sport stadiums or arena to engage in an athletic event or otherwise render a performance for which they receive remuneration. The fee is assessed at 3% of payroll amounts generated as a result of the business activity.

Institution Service Privilege - This 6 mill tax is levied on certain receipts of non-profit, non-charitable organizations providing a service within the City.

Payroll Preparation Tax - This tax is imposed on all for-profit companies in an amount equal to .55% of the total wages of all employees who perform work in the City.

RAD Tax Revenues

The Allegheny Regional Asset District (the “RAD”), a special purpose area wide unit of local government created in 1993 to provide supplemental sources of revenue for local governments in the southwestern region of Pennsylvania, imposes a 1% regional sales tax (the “RAD Tax”) on sales of products and services in the County that are subject to the Pennsylvania State Sales Tax. The proceeds of the RAD Tax are distributed as follows: one-half to the RAD, one-fourth to the County and one-fourth to all other eligible municipalities, including the City.

For 2005 and 2006, the City’s share of the RAD Tax proceeds, which are classified as General Fund revenues, amounted to \$20,293,495 and \$20,262,328, respectively. From its share of RAD Tax proceeds, the City pledged \$7.5 million through 2014 to provide for debt service payments on certain Urban Redevelopment Authority of Pittsburgh bonds issued to create a \$60 million development fund.

In addition to the City’s share of RAD Tax proceeds, the RAD provides support payments to the City with respect to certain regional assets located in the City.

Municipal Service Payments

As a result of negotiations with the non-profit community to contribute funds to offset the cost of police, fire, emergency medical services as well as other services provided by the City, the non-profit community created the Pittsburgh Public Service Fund in 2005 and pledged contributions for three years. The amount to be contributed to the City may vary yearly. The first year the Pittsburgh Public Service Fund contributed \$4.6 million to the City. The first contribution, earmarked as a 2005 contribution, arrived at the City in January and was not able to be taken into 2005 revenue. Consequently, the City’s 2006 financial reports may show a double contribution.

Other Revenues

Locally generated non-tax revenues primarily include federal and state grants, licenses and fees, charges for the provision of services, fines and forfeits, investment earnings and revenues from City self-supporting trust funds. These revenues generated \$89.2 million in 2005 and \$108.4 million in 2006. The increase in 2006 revenues is a result of the changes in reporting requirements under Act 47. Prior to 2005, State pension aid was recorded as an offset against pension expense and the State liquid fuels reimbursement, which was part of a trust fund, was treated as an offset against salaries. In addition, all licenses and fees are increased yearly in accordance with the Act 47 Recovery Plan recommendations.

MANAGEMENT DISCUSSION OF 2005 AND 2006 FINANCIAL OPERATIONS

In 2005, actual General Fund revenues were below the budgeted revenues by \$3 million and actual expenditures were below budgeted amounts by \$22.3 million.

In accordance with specific requirements under Act 11 and with the support and approval of both the Act 47 coordinators and ICA Board, the City submitted its 2005 Operating and Capital Budgets and Five-Year Financial Forecast and Performance Plan. The Plan called for both expenditure reductions and proposed a new tax levy structure.

Expenditure reductions and controls included: salary freezes city-wide for at least two years, Public Safety cost reduction achieved primarily through the renegotiation of the Firefighter contract, reductions to all elected officials' budgets and regular reporting requirements verifying adherence to the Plan's budget.

Based on unaudited revenues and expenditures, the City finished 2006 with a \$38.8 million surplus. The most notable surpluses were within the salary line where the surplus totaled \$6.6 million and the Employee Benefits line where the surplus totaled \$6.2 million. Other notable expenditure surpluses occurred in equipment and miscellaneous services across all departments.

The City collected 103% of budgeted revenue in 2006. Revenues from Real Estate, Deed Transfer, Earned Income, EMS tax, Interest Earnings, Fines & Forfeits and Federal & State Grants all exceeded budgeted amounts.

A Summary of Operations for the years 2002 – 2006 on a cash basis is shown in Table 4 on the following page.

Table B-1
GENERAL FUND
SUMMARY OF OPERATIONS (CASH BASIS)
(in thousands)
Fiscal Years 2002 through 2006 (Actual) and 2007 Budgeted

	2002	2003	2004	2005	2006 Unaudited	2007 Budget
Revenues:						
Taxes, including penalty and interest	292,115	291,786	300,447	337,218	353,480	331,095
Interest earnings	962	505	605	1,538	4,310	3,100
Fines and forfeits	7,869	7,160	6,691	4,274	6,723	5,061
Licenses and fees	5,867	5,844	4,944	5,370	5,712	6,469
Water & Sewer Authority						
Intergovernmental	18,653	17,914	17,711	33,566	38,343	49,760 **
Miscellaneous	3,346	298	0	905	872	325
Provision of services, break even and joint operations	24,565	25,822	24,331	31,590	28,746	29,848
Total revenues	<u>353,377</u>	<u>349,329</u>	<u>354,729</u>	<u>414,461</u>	<u>438,186</u>	<u>425,658</u>
Expenditures						
Current operating:						
General government	26,622	23,453	20,273	19,188	20,740	34,182 ***
Public safety	142,880	140,882	131,468	125,677	121,305	131,956
General services	13,112	15,530	11,980	12,188	0	0 ***
Public works	25,238	23,929	19,797	25,636	36,295	30,930 ***
Sanitation (a)	0					
Water	0					
Citizens Review Board	420	404	363	371	357	434
Community, recreational and cultural	5,727	4,941	2,089	3,128	3,573	3,779
Employee benefits	72,267	81,819	90,102	115,398	120,087	121,132 **
Claims and judgements	12,638	1,475	1,698	1,369	698	1,960
Computer System	0	0	0	0	0	0
Utilities	0	7,474	6,706	6,949	7,155	8,375
Miscellaneous	4,040	3,619	1,052	4,886	1,874	1,715
Debt service:						
Debt Service	58,938	73,669	86,009	81,444	88,808	91,195
Bond issuance costs						
Debt Service Subsidy	0	4,040	3,613	717	0	0
Transfers	0	0	0	0	647	0
Total expenditures	<u>361,882</u>	<u>381,235</u>	<u>375,150</u>	<u>396,951</u>	<u>401,539</u>	<u>425,658</u>
Excess (deficiency) of revenues over (under) expenditures	(8,505)	(31,906)	(20,421)	17,510	36,647	
Other financing sources (uses):						
Neighborhood Needs, unbudgeted equity transfer						
Contribution to pension fund						
Bond proceeds						
Capital lease obligation proceeds						
Transfer to pension fund	(16,000)	(18,214)	(17,902)	(17,166)	(14,630)	
State pension aid	16,000	18,214	17,902	17,166	14,630	**
Net other financing sources	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(8,505)	(31,906)	(20,421)	17,510	36,647	
Fund balances-budgetary basis, beginning of year	61,305	52,800	20,894	473	17,983	
Fund balances-budgetary basis, end of year	<u>52,800</u>	<u>20,894</u>	<u>473</u>	<u>17,983</u>	<u>54,630</u>	
Adjustment to generally accepted accounting principles (GAAP) basis (b):						
Cumulative difference between budgetary basis and GAAP basis beginning of year	34,661 *	31,859	36,705	36,462		
Net effect of GAAP basis recognition of revenues	15,445	21,701	25,448	11,867		
Net effect of GAAP basis recognition of expenditures	(18,247)	(16,855)	(25,691)	(5,775)		
Net effect of GAAP basis recognition of other financing sources (uses)	0	0				
Residual equity transfers	0	0				
Fund balances-GAAP basis, end of year	<u>\$ 84,659</u>	<u>\$ 57,599</u>	<u>\$ 36,935</u>	<u>\$ 60,537</u>		

Source: City of Pittsburgh Comprehensive Annual Financial Reports; City of Pittsburgh 2007 Budget

* Fund balances-GAAP basis beginning of year were restated for the effects of changes in accounting principle as outlined in GASB Statement No. 34

** Beginning in 2005, State Pension Aid is shown as a revenue as required by the Act 47 Plan. In prior years, it was budgeted as an offset to Pension.

*** Beginning in 2006, the Department of General Services was eliminated and redistributed to Finance and Public Works

CITY EMPLOYMENT

Employees

As of January 1, 2006, the City had approximately 3,298 employees, more than 82% of whom were represented by labor organizations. A ten-year history of City employment is set forth in Table 5 below.

**TABLE 5
CITY OF PITTSBURGH
CITY EMPLOYMENT**

<u>Year</u>	<u>Actual January Payroll</u>
1997	4,131
1998	4,133
1999	4,314
2000	4,098
2001	4,212
2002	4,142
2003	4,232
2004	3,632
2005	3,294
2006	3,298
2007	3,163

Source: City of Pittsburgh - Department of Finance

Collective Bargaining Agreements

The City's workforce is represented by nine collective bargaining units. Membership data and collective bargaining agreement expiration dates are shown in Table 6 below. While the agreement with the Fraternal Association of Professional Paramedics expired on December 31, 2005, the existing contract was extended to June 30, 2006. The City is currently in negotiations with the Teamsters.

**TABLE 6
Collective Bargaining Agreements**

Collective Bargaining Unit	Membership as of 4/1/2006	Contract Expiration
Fraternal Order of Police	849	12/31/2009
Firefighters I.A.F.F. Local No. 1	586	12/31/2009
Pittsburgh Joint Collective Bargaining Committee	339	Contract Pending
Teamsters	176	Contract Pending
AFSCME White Collar	289	12/31/2009
AFSCME Foremen	47	12/31/2009
SEIU Rec. Teachers	54	12/31/2009
SEIU School Guards	133	12/31/2009
Fraternal Association of Professional Paramedics	161	Contract Pending

Employee Retirement System

The City of Pittsburgh is responsible for the funding of retirement benefits for three funds: the Municipal Pension Fund, the Policemen's Relief and Pension Fund and the Firemen's Relief and Pension Fund. Investments of the funds are held by the Comprehensive Municipal Pension Trust Fund in accordance with the Municipal Pension Plan Funding Standard and Recovery Act of 1984 (Act 205), and are administered under the direction of that Fund's Board. In accordance with Act 205 and the Acts under which the Municipal Pension Fund, the Policemen's Fund and the Firemen's Fund were established, a separate accounting for the activities of these three funds is maintained as well as a calculation of each Fund's undivided interest in the investments held by the Comprehensive Trust.

The Municipal Pension Fund

The Municipal Pension Fund was established by Act 259 of 1915, P.L. 596. Every full-time employee of the City and the Pittsburgh Water and Sewer Authority that is not covered by the Policemen's Fund or the Firemen's Fund is required to join the Municipal Plan after serving a 90 day probationary period. The Fund is a single employer defined benefit plan and its purpose is to provide retirement, disability and other benefits to its members. Retirement benefits are dependent upon the tier within which the employee is placed. There are three tiers in the plan that are governed by the date of hire. Employee contributions to the fund also are dependent on date of hire. Those employees hired prior to January 1, 1988 contribute 5% and those hired after January 1, 1988 contribute 4%.

The Policemen's Relief and Pension Fund

The Policemen's Pension Fund was established by Act 99 of 1935, P. L. 233. The Fund is a single employer defined benefit plan and its purpose is to provide retirement, disability and other benefits to its members. All employees of the Bureau of Police, including substitute uniformed employees, are eligible for membership in the Fund. The regular pension is equal to 50% of the highest twelve consecutive months' pay at the time of retirement. Employees hired after December 31, 1991 receive a pension benefit based on 36 months' average pay. Employee contributions to the fund are 6% of pay plus \$1 per month. Those electing the surviving spouse benefit contribute an additional one-half percent of pay.

The Firemen's Relief and Pension Fund

The Firemen's Pension Fund was established by Act of May 25, 1933, P. L. 1050. The Fund is a single employer defined benefit plan and its purpose is to provide retirement, disability and other benefits to its members. All employees of the Bureau of Fire, including commanding officers and the Chief of the Bureau are eligible for membership in the Fund. The regular pension benefit is equal to 50% of the wages earned during any three calendar years of service or the last 36 months' average pay immediately preceding retirement. Employee contributions to the fund are 6% of pay plus \$1 per month. Those electing the surviving spouse benefit contribute an additional one-half percent of pay.

As of January 1, 2006, the Comprehensive Municipal Pension Trust Fund was 42.8% funded with an actuarial accrued liability of \$862,261,038. Table 7 on the following page provides detail on pension membership, assumptions and cost as of December 31, 2005.

**TABLE 7
CITY OF PITTSBURGH
PENSION MEMBERSHIP**

Status	Municipal	Police	Fire	Total
Retirees and beneficiaries of deceased retirees currently receiving benefits	1,679	1,663	1,029	4,371
Terminated employees vested	66	10	1	77
Total	1,745	1,673	1,030	4,448
Active members	1,819	804	737	3,360
Total membership	3,564	2,477	1,767	7,808

PENSION ASSUMPTIONS

	Municipal	Police	Fire
Valuation Date	1/1/2005	1/1/2005	1/1/2005
Actuarial Cost method	Entry age normal	Entry age normal	Entry age normal
Amortization method	Level dollar Closed	Level dollar closed	Level dollar closed
Remaining amortization method	36 years	36 years	36 years
Asset valuation method	Market related		
Actuarial assumptions:			
Investment return	8.75%	8.75%	8.75%
Projected salary increases	4.00%	5.75%	5.75%
Cost of living adjustments	3.50%	3.50%	3.50%

ANNUAL PENSION COST

	Municipal	Police	Fire
Annual required contribution	\$ 10,143	\$ 17,531	\$ 9,046
Contribution made	\$ 10,143	\$ 17,531	\$ 9,046

In addition to pension benefits, the City provides for certain postretirement healthcare benefits to retirees or their beneficiaries. The City accounts for all City contributions on a pay-as-you-go basis. Such benefits are primarily funded through annual appropriations from the City's General Fund and trusts designated for those purposes. The type and amount of healthcare benefit received by individual retirees varies based upon the year of retirement and collective bargaining unit.

APPENDIX E

CONSULTING ENGINEER'S REPORT

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The Pittsburgh Water
and Sewer Authority
Allegheny County, Pennsylvania

Consulting Engineer's Annual Report

January 2006



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The Pittsburgh Water and Sewer Authority
Allegheny County, Pennsylvania

Consulting Engineer's Annual Report

January 2006

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**THE PITTSBURGH WATER AND SEWER AUTHORITY
CONSULTING ENGINEER'S ANNUAL REPORT
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PITTSBURGH WATER AND SEWER AUTHORITY CONSULTING ENGINEER'S ANNUAL REPORT

EXECUTIVE SUMMARY

This annual report, prepared for The Pittsburgh Water and Sewer Authority (Authority), presents a review of the Water and Sewer Systems' operations and the status of the Capital Improvements Program (CIP) for Fiscal Year 2005.

A summary of the conclusions and recommendations as contained herein are as follows:

1. The existing Water and Sewer Systems have been properly maintained and are in adequate operating condition; however, the systems are in need of certain improvements and/or replacements which are being carried out under the Authority's CIP. The Operating Budget for 2006, as adopted by the Authority Board of Directors at a regular meeting on December 16, 2005, and reviewed herein, is sufficient for maintaining proper operations in 2006.
2. Work has continued during the past year on the CIP implemented in 1984. Current capital project fund resources were made available in March 2002 through the issuance of additional bonds (2002 Bond Issue) and in June 2005 through the issuance of additional bonds (2005 Bond Issue). Details as to the use of these funds are included in Exhibits "A" and "B" appended to this report.
3. During 2006, work should continue on the projects identified in the CIP. In addition to current ongoing projects, other projects will have to be undertaken for the replacement of old and worn facilities, emergencies, and new facilities, including projects being undertaken by the City of Pittsburgh, the Urban Redevelopment Authority (URA) and the Sports and Exhibition Authority (S&EA).
4. During 2002, the Authority established a Capital Improvements Committee to oversee the capital projects of the Authority. This includes evaluating projects presented to the Authority by the City of Pittsburgh, URA and S&EA and reviewing change orders and work directives. In early 2006, the Committee should prioritize projects identified for inclusion in the next phase of the CIP program.
5. A comparison as to the status of the CIP as of December 1, 2004 and December 1, 2005 is indicated in Table 1.

Table 1
Capital Improvement Program
Bond Fund Status Report - 2004 vs. 2005

	December 2004	December 2005
Completed Contracts	\$372,069,712.00	384,417,806.50
Active Contracts	67,525,647.00	61,348,094.68
TOTAL	\$439,595,359.00	445,765,901.20
TOTAL BUDGET	\$506,620,257.00	
Percent of Budget	96.7%	
Funds Paid from Construction Fund	\$456,995,475.00	
Percent of Budget	100.2%	

6. Current deposits in the Authority's 2002 Bond and 2005 Bond Construction Funds are at **\$15,609,918**. It is estimated that these funds will carry the Capital Improvements Program through mid-2007 according to the current Capital Expenditure Plan.
7. Inasmuch as current deposits in the Authority's 2002 Bond and 2005 Bond Construction Funds are well in excess of \$7,000,000, there is no need for the Authority to deposit any funds into the Renewal and Replacement Fund during the next fiscal year.
8. Projected 2005 end-of-year Revenues and Operating Expenses as presented in this report indicate that the Authority will satisfy the 2005 Rate Covenant Test as provided for in the Trust Indenture.
9. It is the Consulting Engineer's opinion, based upon estimated 2006 Revenues, Operating Expenses, and Operating Cash Reserves, that the existing schedule of rates will provide sufficient funds in 2006 to cover operating expenses and to satisfy the Rate Covenant Test as provided for in the Trust Indenture.

A summary of the Rate Covenant Test is indicated in Table 2.

Table 2
Debt Service Coverage Factor

	<u>Actual 2004</u>	<u>Projected 2005</u>
Cash -- Beginning of Year	\$20,894,712	\$20,894,712
Operating Revenue	70,269,968	65,975,000
Interest Earnings	3,131,867	1,750,000
Fund Transfer	1,021,300	1,354,000
Tap Fee Collections	1,240,563	800,000
Sewage Collections	28,001,090	4,140,000
Other Collections	<u>9,573,863</u>	<u>15,549,000</u>
Total Available Funds	\$134,133,363	\$110,462,712
Operating Expenses	64,860,102	47,909,771
Capital Projects	<u>10,912,097</u>	<u>15,316,000</u>
Net Available for Debt Service	\$58,361,164	\$47,236,941
Debt Service Requirements	<u>37,744,898</u>	<u>35,747,660</u>
Coverage Factor	1.55	1.32

PITTSBURGH WATER AND SEWER AUTHORITY CONSULTING ENGINEER'S ANNUAL REPORT

HISTORY AND BACKGROUND

General

In February 1984, the City of Pittsburgh established The Pittsburgh Water and Sewer Authority (Authority) under the provisions of the Commonwealth of Pennsylvania. The City charged the Authority with the responsibility of carrying out a major Capital Improvements Program (CIP) recommended in a comprehensive study report entitled "Evaluation of the Water and Sewer Systems of the City of Pittsburgh," dated December 9, 1983.

Initial Authority Operation

The Authority took over operations of the Water and Sewer Systems on May 1, 1984 pursuant to the terms of a Lease and Management Agreement between the City of Pittsburgh and the Authority. Under this agreement, the City leased the Water and Sewer Systems to the Authority for a term of fifty years with renewal provisions. The Authority was authorized to operate and maintain the Water and Sewer Systems, construct all necessary improvements, establish and collect rates and charges for its service, and finance its operations and improvements through revenue collections and sale of bonds and notes payable solely from the Authority's revenues. The Authority appointed and designated the City as the Authority's agent to manage, operate, and maintain the Water and Sewer Systems for the term of the lease, subject to the general supervision, direction, and control of the Authority.

First Bond Issue

On April 19, 1984 the Authority Board adopted a major CIP by Resolution No. 19 of 1984. The Program was designed to maintain a satisfactory level of service to the Water and Sewer Systems' current users, to improve operating efficiency of the Water and Sewer Systems, and to address future user requirements. In July 1984, the Authority issued \$93,600,000 Daily Adjustable Demand Water and Sewer System Revenue Bonds, Series of 1984 in order to implement the initial phase of this program. From proceeds of this bond issue, \$78,777,000 was deposited into the Construction Fund for the initial phase of the CIP. In June 1986, the Authority issued an additional \$134,700,000 Revenue Bonds, Series of 1986. From the 1986 Bond Issue, \$115,000,000 was available to continue the program. An additional \$7,000,000 was made available for capital

improvements by Resolution No. 72 of 1993, adopted August 18, 1993. These additional funds were provided through a transfer from the Debt Service Reserve Fund in accordance with Section 6.04 of the Trust Indenture, which provided for the required funds for Debt Service Reserve Fund to be in the form of cash, a letter of credit or other credit instrument, a surety bond or a combination thereof. The Authority Board elected to replace the monies in the fund with a surety bond. As a result, \$7,000,000 was transferred to the Construction Fund for capital improvements, and the balance of monies were transferred to the Debt Service Fund.

1993 Bond Issue and Refinancing

In 1993, the Authority issued two series of Water and Sewer System Revenue Bonds to: (i) advance refund all of the outstanding previously issued bonds, (ii) provide additional funds for capital improvements to the Authority's Water and Sewer Systems, and (iii) pay all fees and expenses incurred in connection with issuance of the 1993 Bonds. Series A of 1993 Bonds, in the aggregate principal amount of \$278,970,000 was for the advanced refunding of outstanding bonds and Series B of 1993 Bonds, in the aggregate principal amount of \$10,785,000, was for additional capital improvements.

The new Trust Indenture dated October 15, 1993 and applicable to the Series A and B of 1993 Bond Issues eliminated the requirements for a fund balance to be maintained in the "Renewal and Replacement Fund" unless determined necessary annually by the Consulting Engineer. Therefore, the \$2,009,523 which was being maintained in the Fund under the previous Trust Indenture was transferred to the "Prior Bonds Construction Fund" for use for capital improvements. From the Series B of 1993 Bond Issue, \$9,990,477 was deposited into the 1993 Bond Construction Fund for additional capital improvements.

1995 Bond Issue

In 1995, the Authority recognized that the funding for the CIP implemented in 1984 was almost depleted. In order to ensure a continued supply of safe drinking water and proper sewer service to the Authority's current and future users and to address future demands on the Water and Sewer Systems, a new CIP was developed and adopted.

The Authority also negotiated a Capital Lease Agreement with the City of Pittsburgh, which terminated the Lease and Management Agreement and provided for the Authority to acquire the Water and Sewer Systems from the City.

The Authority issued additional bonds in 1995 to fund the 1995 CIP and to pay certain obligations of the Authority to the City of Pittsburgh under the Capital Lease Agreement. Water and Sewer System First Lien Revenue Bonds, Series A of 1995 in the aggregate principal amount of \$89,850,000 were issued on July 15, 1995 to pay for capital improvements as identified in a new CIP. On July 15, 1995, the Authority issued Water

and Sewer System Subordinate Revenue Bonds, Series B of 1995, in the aggregate principal amount of \$103,020,000 in order to pay the obligation of the Authority to the City of Pittsburgh under the Capital Lease Agreement. From the 1995 Series A Bonds, \$80,000,000 was deposited into the Series A 1995 Capital Project Fund to fund the new CIP of the Authority.

1998 Bond Issue and Refinancing

Early in 1998, additions to the CIP were proposed that addressed future needs of the Authority. These centered on covering Highland Reservoir No. 1, City of Pittsburgh and Urban Redevelopment Authority projects, and improvements to the water distribution and sewerage systems.

The Authority issued 1998 Series A, B, and C Water and Sewer Revenue Bonds on March 2, 1998. The 1998 Series A Bonds were used to provide for the refunding of the Authority's outstanding 1995 Series A Bonds. The 1998 Series B Bonds were used to fund additions to the CIP, and the 1998 Series C Bonds were used to refund the Authority's outstanding 1995 Series B Bonds. The Series B Bonds enabled \$36,001,908 to be deposited in the 1998 Capital Projects Fund, funding the CIP into the year 2000.

2002 Bond Issue

At the end of 2000, the capital project funds of the Authority were largely spent with only about \$345,000 in reserve for the construction of capital projects. The Authority had anticipated this draw down of funds and had begun work to issue additional bonds in early 2002. The Capital Projects Fund provided through this issue provided \$90,494,400 to provide for the construction of capital projects and to meet the needs of emergencies that may require the use of capital funds.

2003 Bond Refinancing

During the fourth quarter of 2003, the Authority issued revenue refunding bonds in the amount of \$167.4 million for the purpose of partially refunding the 1993 Bond Issue. The 2003 Refunding Bonds, with an average yield of 3.8%, generated a reduction in annual debt service payment of approximately \$4.0 million for 2004.

2005 Bond Issue

In June of 2005, the Authority issued first lien revenue bonds in the amount of \$50,385,000 to provide for continuation of the capital improvements program and to meet the needs of emergencies that may require the use of capital funds. The 2005 Revenue Bonds, with an average yield of 4.23%, created an increase in annual debt service payments of approximately \$3.2 million for the first 12 years.

PENNVEST Funding

Act 16 of 1988 established the Pennsylvania Infrastructure Investment Authority (PENNVEST) to assist local governments in financing sewer and water projects. The PENNVEST program provides loans and grants for acquisition, construction, improvement, expansion, extension, repair, and/or rehabilitation of all or part of any water or sewage system. Funding under the PENNVEST program is primarily in the form of low-interest, twenty-year loans.

To date, the Authority has secured a total of six PENNVEST loans totaling \$15,451,875. Three water projects, two sewage projects and one storm sewer project have been funded through this program. Construction of all projects has been completed.

Summary of Funding Sources

Because of the various bond issues and PENNVEST loans that have been secured, a total of **\$438,595,932** has been made available for capital improvements since the establishment of the Authority in 1984. Table 3 contains a summary of the source of these funds:

Table 3
Sources of Capital Improvement Funds

<u>Source</u>	<u>Amount</u>
1984 Bond Issue	\$ 78,777,000
1986 Bond Issue	115,000,000
Transfer from Debt Service Reserve Fund	7,000,000
Transfer from Renewal and Replacement Fund	2,009,523
1993 Series B Bond Issue	9,990,477
1995 Series A Bond Issue	80,000,000
1998 Series B Bond Issue	36,001,908
2002 Bond Issue	90,494,400
2005 Bond Issue	50,385,000
Sub-Total (Bond Funds)	\$469,658,308
PENNVEST Funds	<u>19,322,624</u>
TOTAL (Total Funds)	\$488,980,932

WATER SYSTEM

The water supply and distribution system consists of a 117 million gallon per day (mgd) rapid sand type treatment plant that was placed into service in 1969, 1,200 miles of mains and service lines, 30,000 valves, 8,000 fire hydrants, nine pumping stations, four

reservoirs, and twelve storage tanks. The total storage capacity of the reservoirs and tanks is approximately 455 million gallons. Based on the average usage over the past several years, this capacity is sufficient to provide storage equivalent of approximately three to five days of normal water usage.

The sole source of water for the Water System is the Allegheny River. The Pennsylvania Department of Environmental Resources (now DEP) issued a Water Allocation Permit to the Authority in March 1989. This permit allows for water withdrawal of up to 100 mgd from the river. The DEP has advised that the permitted allocation would be reevaluated in the future should the Authority's demand increase as a result of growth within the City or through the sale of water to surrounding municipalities. The current average water withdrawal from the Allegheny River is approximately 72.8 mgd, and the maximum withdrawal made on any one day was approximately 99.170 million gallons during the past year.

The Water System currently provides approximately 81,250 residential, commercial, industrial, and public customers with potable water and water for fire protection within the geographic boundaries of the City. This represents approximately 84 percent of the total customers within the City.

The Pennsylvania-American Water Company provides service to approximately 30,150 customers in the southern and western sections of the City, while two small areas, one in the eastern and the other in the western end of the City, are served by the Wilkesburg-Penn Joint Water Authority and the West View Water Authority, respectively. In each of these areas, the distribution system elements (waterlines, valves, hydrants, etc.) are owned and maintained by the respective independent water purveyor. In addition, the Authority, through a number of interconnections with other systems, provides water for supply and/or emergency use to several adjacent municipalities.

SEWER SYSTEM

The wastewater collection system is part of a regional system that provides service to about 550,000 people, nearly 325,000 of whom live within the City. The total drainage area served by the regional system is approximately 80 square miles. The City of Pittsburgh comprises about 55 square miles, or nearly 70 percent of the total drainage area. The Sewer System comprises an extensive network of approximately 1,400 miles of sewer lines and four wastewater pumping stations. The average age of the sewer lines is between 60 and 70 years old, with some portions reaching nearly 150 years in age.

The Sewer System conveys wastewater generated within the City boundaries to the Allegheny County Sanitary Authority (ALCOSAN) interceptors located along the rivers for conveyance to ALCOSAN's wastewater treatment facility for treatment prior to discharge into the Ohio River. The ALCOSAN treatment facility is operating in

compliance with the National Pollutant Discharge Elimination System (NPDES) under Permit No. 0025984.

The Sewer System also is utilized by 24 suburban municipalities pursuant to agreements with the City to convey their wastewater to the ALCOSAN treatment facility. Many of the agreements with the suburban municipalities do not provide for sharing Sewer System maintenance and reconstruction costs.

The Sewer System is designed so that during wet weather a portion of the collected stormwater and diluted wastewater is discharged to natural watercourses by diversion chambers located throughout the Sewer System and at connections to the ALCOSAN interceptors. The Sewer System is in satisfactory operating condition and has adequate capacity for the dry weather wastewater flows; however, during wet weather events the Sewer System has often been taxed beyond its capacity and has resulted in overflows, bypassing, and flooding.

The U.S. Environmental Protection Agency (EPA) has adopted regulations regarding overflows from combined sewers during events that result in the discharge to receiving water of untreated sanitary sewage. These combined sewer overflows (CSOs) contain pollutants that are present in domestic and industrial wastewater, as well as those in the urban stormwater runoff that enter the combined Sewer System. The EPA regulations require owners of any sewer system having CSOs to acquire NPDES discharge permits for each site. In addition, the owner must implement the EPA's "Nine Minimum Control Measures" by January 1, 1997.

Essentially all of the Authority sewers are combined sewers, and there are well over 100 CSOs within the system. The most efficient and cost-effective method of eliminating or controlling the CSOs is unknown; however, the Authority has undertaken the task of inventorying and monitoring CSOs and the sewer collection and conveyance system in an effort to evaluate the impact of the CSO discharges on receiving streams. The Authority has commissioned detailed studies from two engineering consultants in an effort to develop a long-term control plan (LTCP) for addressing all CSO related issues. The Authority entered into an administrative consent order during 2004 in order to address the EPA regulations and extend deadlines for compliance. This is discussed further later in this report.

PITTSBURGH WATER AND SEWER AUTHORITY CONSULTING ENGINEER'S ANNUAL REPORT

ADVICE AND RECOMMENDATIONS AS TO MAINTENANCE, REPAIR, AND OPERATION

Water System

The Pittsburgh Water and Sewer Authority (Authority) is directly responsible for the operation and maintenance of the Water System, including intake, treatment, pumping, distribution, storage, and metering. The overall procedures and programs established and currently being followed by the Authority in the operation of the Water System are satisfactory and should be continued during the coming fiscal year.

The Authority has renovated and replaced treatment equipment, chemical feed equipment, pumps, motors, waterlines, valves, hydrants, and storage tanks under the current Capital Improvements Program (CIP). These projects have been implemented at a cost of hundreds of millions of dollars. In order to realize the full life of these improvements and to maintain and improve the condition of the existing system, the Authority has used outside consultants to develop a computerized maintenance program that will enable tracking and reporting of scheduled and unscheduled maintenance and repairs of pumps, motors, valves, mechanical equipment, and electrical and control systems at the treatment plant and pumping stations.

In 2005, the following work was performed in repair and replacement of capital facilities outside of normal operations:

Water Distribution System

- Performed preventive maintenance on 1,456 gate valves.
- Repaired or replaced 72 large water meters.
- Repaired or replaced 3,398 residential water meters.

Water Pump Stations

Bruecken Pump Station

- Repaired leak on Rising Main #1
- Retrofitted flow meter transmitters
- Rebuilt the control valve on Pump #6

- Repaired the motor ring on Pump #7
- Installed anew basement level sump pump
- Replaced packing on Pump #5

Fox Chapel Pump Station

- Repaired level controller on Wise Hill Tank
- Repaired valve at Pump #4

Herron Hill Pump Station

- Replaced motor on Pump #6
- Replaced bearings and packing on Pump #4
- Rebuilt valve on Pump #3 and placed pump in service
- Repaired main pump station power feed

Howard Street Pump Station

- Repaired control valves for Pumps #4 and #5

Lincoln Pump Station

- Repacked Pump #3 and placed pump in service
- Rebuilt Pump #1 and placed pump in service
- Installed new sump pump

Mission Street Pump Station

- Repaired Pumps #1 and #5

Saline Pump Station

- Replaced motor coupling, bearings and packing on Pump #2
- Replaced motor coupling on Pump #3

Water Storage Tanks

Herron Hill Tank

- Corrected RTU #5 malfunctions

Water Treatment Plant

- Repaired clarifier joints and masonry

- Repaired broken steam line between the clarifier building and the operations center
- Replaced soda ash feed line
- Drained and cleaned Clarifier Basins #1, 2, 3, and 4. Inspected, repaired or replaced screw conveyor shafts, chains, and flights.
- Repaired lime machines
- Repaired broken valve in Clarifier Basin #2
- Replaced 2 sump pumps
- Repaired north east sluice gate and limiting torque operators for all 4 sluice gates
- Refurbished motors for Pumps #2 and #3 in the Ross Pump Station
- Repaired sedimentation basin fencing.

As Consulting Engineer for the Authority, ATS-Chester Engineers recommends the following actions be undertaken in the coming year to further enhance the Authority's ability to provide a reliable source of potable water to City residents:

1. The Authority should develop a schedule for inspecting water storage facilities within the existing water system.
2. The Authority should enter into a contract to update the computerized Supervisory Control and Data Acquisition (SCADA) Control System for the water system. An annual maintenance program should be instituted to keep this technology up to date and in good working order.
3. The Authority should aggressively continue tracking "lost and unaccounted for" water through increased leak detection efforts, a routine annual meter replacement program, installing meters on unmetered uses, and scheduling regular calibrations of large meters (both internal and point-of-sale). The Operations and Engineering Departments should continue to combine resources and develop a detailed long-range program for tracking and controlling "lost and unaccounted for" water.
4. The Authority should continue updating and calibrating the existing computerized hydraulic water model of the Water System. The updated model is an efficient and effective tool for evaluating current and future needs in the water system.
5. The Authority should evaluate existing electrical motor control centers and other electrical equipment at its pump stations and plan for replacement of outdated equipment.

It is the engineer's opinion that sufficient funds are provided in the proposed 2006 Operating Budget of the Authority to continue the current procedures and programs for operation, maintenance, and routine repair of the Water System.

Sewer System

The Authority assumed operation and maintenance responsibilities for the Sewer System in 1999.

In conjunction with developing the computerized maintenance program for the Water System, the Authority has developed a similar computerized system to track and report inspection, cleaning, and maintenance activities related to sewer lines, manholes, and catch basins throughout the sewer system.

The Authority owns and operates equipment for cleaning, flushing, and internally televising sewer lines on an as-needed basis. The equipment is used to identify needed repairs and/or replacements throughout the system. When required, Authority efforts are supplemented by the use of outside contractors to promptly address problem areas in the Sewer System.

The funding provided under the Authority's 2006 Operating Budget will provide for the proper maintenance, routine repair, and operation of the Sewer System during the coming fiscal year.

Regulatory Agency Orders and Problem Areas

2004 Consent Order and Agreement (COA)

During 2004, the Authority and City of Pittsburgh jointly executed a COA with the PA DEP and Allegheny County Health Department (ACHD). This COA closely resembles COAs that were proposed and executed between the regulatory agencies and the other 82 communities that currently convey sewage to the Allegheny County Sanitary Authority (ALCOSAN) for treatment. The long-term intent of the order is to develop a regional Long Term Control Plan (LTCP) for addressing combined and sanitary sewer overflows and ultimately improve water quality within Western Pennsylvania.

The COA requires that the Authority extensively inventory and inspect the entire sewer collection and conveyance system over a three year period. In addition, flow monitoring must be performed and deficiencies identified as a result of the sewer system inspections must be corrected.

As previously noted, the Authority has commissioned two engineering consultants to perform detailed system investigations and flow monitoring

within the COA schedule. The Consultants have also been tasked with developing a LTCP for the Authority so that it may adequately comply with the requirements of the COA.

Nine Mile Run

The Authority entered into a Consent Order and Agreement (COA) with the DEP on May 22, 2000 concerning problems identified in the Nine Mile Run Interceptor. PWSA was ordered to complete necessary repairs of its Nine Mile Run Interceptor sewer and to provide access to maintain the interceptor by November 30, 2004.

The Authority completed comprehensive mapping of the system and developed a plan for rehabilitating the sewer. Rehabilitation of the Upper Nine-Mile Run Interceptor was completed in August 2002 at a cost of \$1,210,908.65. Rehabilitation of the Lower Nine-Mile Run Interceptor was completed in June 2005 at a total cost of \$2,500,094.07.

The requirements of the Nine Mile Run COA were incorporated into the 2004 COA and this project is considered complete.

Saw Mill Run Corrective Action Plan and Streets Run Corrective Action Plan

Corrective Action Plans (CAPs) were developed in the Saw Mill Run and Streets Run Watersheds to address sewer surcharging problems. CAPs are agreements to perform a series of tasks to eliminate sewer problems. The DEP imposed sewer tap restrictions in both of these watersheds, and the Authority has undertaken a series of projects to correct surcharging in each of these watersheds. Projects range from small sewer separation projects to lining and replacement of sewers. The Authority is continuing its efforts to resolve problems in these two watersheds. Like the Nine Mile Run COA, these watershed specific CAPs are incorporated into the 2004 COA.

Sewage Pumping Stations

The Authority has also received orders to address problems at its four sewage pumping stations. These stations have been identified as having chronic bypassing problems that must be addressed. The first stage in this process was to install flow monitoring devices at each of the pumping stations. These devices were ordered and placed into operation during January 2002. Flow monitoring results have been tabulated and reviewed. The Authority has entered into an Engineering Services Agreement to

develop rehabilitation plans for each station, and the costs are included in the current Capital Expenditure Plan.

Future Needs

In addition to routine maintenance and the work that has taken place through the CIP in the past, both the water and sewerage systems are in need of repair, replacement, and improvement.

A broad list of projects was prepared for the 2002 CIP that included needs throughout the water and sewerage systems. Because of the extensive nature of the list, it was prioritized into five levels. The projects that were identified as having the highest priority level were included in the list of projects to be funded through the 2002 Bonds.

A Capital Expenditure Plan was developed in November 2004 in anticipation of the CIP Bond issue during 2005. The Plan includes brief project descriptions, classifications, estimated costs, and ratings to identify critical projects through 2009. The Capital Expenditure Plan will be a valuable tool for the CIP committee to use in determining future capital funding requirements.

Of key importance is the continued funding of the Combined Sewer Overflow (CSO) program. In anticipation of awarding contracts for the preparation of the LTCP, the Authority appropriated \$4,800,000 as a part of the 2002 CIP funding program. Two contracts are now in place totaling \$15,589,285 for the preparation of the LTCP. As of December 1, 2005 a total of \$9,541,698 has been paid toward completing this work. The two contracts, originally scheduled to be completed by May 1, 2005, were recently extended to April 30, 2008. At the completion of this study phase, the Authority will have a proposed plan and schedule to meet its CSO obligations, as well as an estimate of the cost of implementation.

A partial list of projects for future CIP funding consideration is as follows:

- Water Distribution System
 - Replacing 4- and 6-inch waterlines.
 - Inspecting river crossings.
 - Highland No. 2 to Highland No. 1 emergency feed.
 - Oakland water system improvements.
 - Replacing waterlines – Water Treatment Plant to Montrose.
 - Miscellaneous small fire protection projects.
- Pumping and Storage
 - Rehabilitating booster pump stations.

- Inspecting and painting water storage tanks.
- Oakland pressure districts restructuring study.
- Replacing pump station switchgear and motor control centers.
- Lining Highland No. 1 Reservoir.
- Water Treatment Plant
 - Constructing filter backwash sludge handling facilities.
 - SCADA system improvements.
 - Repair and upgrade clearwell (currently under study).
 - Replacing raw water intake facilities and screens.
 - Replacing switchgear and motor control centers.
 - Sedimentation basin fencing/security upgrades.
- Miscellaneous
 - Engineering computer upgrades.
 - GIS hardware.
 - Records management software and support.
- Sewer System
 - Sewer rehabilitation contracts.
 - Constructing sanitary sewers in unsewered areas.
 - Rehabilitating sewage pump stations.
 - Sewer separation where economically feasible.
 - Eliminating small CSOs.

PITTSBURGH WATER AND SEWER AUTHORITY CONSULTING ENGINEER'S ANNUAL REPORT

CAPITAL ADDITIONS

General

The initial Capital Improvements Program (CIP) was recommended in a report entitled "Evaluation of the Water and Sewer Systems of the City of Pittsburgh," dated December 9, 1983, prepared by Green International, Inc. This program has been continually reviewed and modified as required to reflect changing conditions in order to maintain a satisfactory level of service to current users, to improve operating efficiency, and to address future requirements.

The CIP was developed to ensure a continued supply of safe drinking water and proper sewer service to the Authority's current and future users and to address future demands on both the Water and Sewer Systems. In developing this program, the following factors and conditions were considered:

- Identification of improvements not currently funded.
- Rehabilitation and/or replacement of existing facilities that exceed their useful lives.
- Improvements required for sale of water to communities within the region.
- Water and Sewer system improvements required in association with planned City of Pittsburgh capital improvement projects, Urban Redevelopment Authority planned redevelopment projects, and Sports & Exhibition Authority projects.
- Improvements required under current and anticipated safe drinking water standards.
- Implementation of combined sewer overflow controls (CSOs) as required by the U.S. Environmental Protection Agency.

The Authority has provided \$469,658,308 through various Revenue Bond Issues to fund the CIP since 1984 to ensure that the above noted objectives are met.

Table 4 presents a summary of the CIP Budget by major components for both the Water System and the Sewer System.

Table 4
Capital Improvements Program Budget

	Funds Budgeted
WATER SYSTEM	
Distribution System	\$ 16,606,239
Pumping and Storage	4,341,536
Treatment Plant	2,033,263
Tools and Equipment	1,074,990
Miscellaneous	5,711,778
TOTAL WATER SYSTEM	\$ 29,767,807
SEWER SYSTEM	24,371,676
CITY AND URA PROJECTS	19,962,187
ENGINEERING & CONSTRUCTION MANAGEMENT	12,248,783
REIMBURSEMENT TO REVENUE FUND	5,173,000
CONTINGENCIES	53,509
TOTAL 2002 BOND ISSUE	\$ 91,576,962
TOTAL 2005 BOND ISSUE	50,385,000
COMPLETED BOND ISSUES	344,371,204
TOTAL BOND FUNDS APPROPRIATED	\$

Exhibit "A," attached to this report, provides details by individual projects that are included in the CIP as of December 1, 2005.

As of December 1, 2005, contracts have been completed having a value of approximately **\$372,069,712**. Current active contracts are valued at approximately **\$67,525,647**. Included herein is a graph (*Figure 1*) that shows the monthly status and progress of the program since January 1, 2002 through November 2005. It is noted that this graph also indicates the accumulated amounts paid by month from the 2002 Bond Issue funds.

Table 5 presents a summary of the status of the 2002 Bond Issue funds for capital improvements as of December 1, 2004 and December 1, 2005.

Table 5
Capital Improvement Program
2002 Bond Fund Status Report - 2004 vs. 2005

	December 2004	December 2005
Completed Contracts	\$27,698,508	\$41,205,002.25
Active Contracts	67,525,647 ¹	60,189,694.97 ²
TOTALS	\$95,224,155	101,394,703.10
Percent of Budget (1)	105.2%	110.73%

Exhibit "A" provides details on each active and closed individual project paid from the 2002 Bond Issue. A copy of the 2002 Bond Issue Status Report as of December 1, 2005 is attached as Exhibit C.

In order to continue funding future capital improvements, the Authority issued Revenue Bonds in June 2005. The 2005 Bond Issue provides \$49,799,037 for capital improvements.

Contract Awards and Authorizations for Bidding

During 2005, the Authority awarded nearly \$3.7 million in construction contracts for water treatment, water distribution, and sewage collection facilities. A summary of these contract awards is shown in Table 6. In addition, the Authority authorized a number of projects to be advertised for bidding. Some of these projects have been awarded as construction contracts, while others are still pending. A list of authorizations for bidding that were made during 2005 is shown in Table 7.

Table 6 - 2005 Contract Awards

Resolution No.	Project No.	Description	Original Contract Value
01-05	R-A1.04009	Purchase Fire Hydrants	\$61,500.00
23-05	I-B2.04009	Sewer Jetting and Video Inspection	519,010.00
24-05	R-F1.05010	Laboratory Information Management System (LIMS)	69,800.00
39-05	I-B2.04005	Sewer Lining	387,545.50
40-05	R-F1.05010	Purchase Hardware (related to LIMS)	50,000.00
62-05	I-E1.02018	2005 Street Repaving Sewer Risers and Lids	207,198.25
73-05	I-B2.05014	Sewer Improvements	974,030.00
93-05	N/A	Purchase Vactor Truck (PACC Contract)	277,305.43
109-05	R-A2.05017	MH, CB, and Sewerline Point Repair Contract	814,395.00



123-05	N/A	Purchase Fassi Model F270A.22 Articulated Crane (PACC)	195,439.00
124-05	N/A	Purchase Fassi Model F45A.22 Articulated Crane (PACC)	92,857.00
		TOTAL CONTRACT VALUE	\$3,649,079.68

Table 7 - 2005 Authorizations to Advertise

Resolution No.	PWSA Project Number	Description	Project Budget
10-05	R-A3.05002	Replace Lime Machines	\$250,000
10-05	R-B2.05003	Purchase Vactor Truck	250,000
63-05	I-B2.05014	Sewer Improvement Contract	1,000,000
63-05	P-A1.05015	Upper Oakland Water System Upgrade	1,000,000
72-05	I-B2.05016	Sewer Cleaning, Televising and MH Inspections	650,000
72-05	I-B2.05017	MH, CB and Sewer Point Repairs	750,000
92-05	R-B2.05023	Jacks Run/Belgium Street Sewer	2,100,000
92-05	R-B3.05024	12 th Street Storm Sewer	500,000
92-05	R-B2.05021	Sewer Improvement Project (Banksville Rd, Kemper St, and Woodward Ave)	258,000
92-05	R-A2.05025	Mission Street PS Boiler Replacement	500,000
92-05	I-B2.05022	Sewer Lining Contract	1,000,000
107-05	N/A	Chlorine Monitoring System at WTP	N/A
108-05	R-A3.05026	Chlorine Booster Stations	150,000
122-05	R-A1.05027	Water Valve and Fire Hydrant Replacement Contract	N/A

2005 Requisitions

Table 8 shows the total drawdown of capital funds during fiscal year 2005 from the 2002 Bond Issue and the 2005 Bond Issue. This information is presented for each month of the year 2005.

**Table 8
2005 Requisition Drawdown by Month**

Month	2002 Bond Issue	2005 Bond Issue
January	\$ 750,242.37	
February	509,707.91	
March	1,848,455.90	
April	511,641.02	
May	541,806.42	
June	990,929.27	
July	369,412.13	

August	666,391.51	
September	715,481.96	
October	832,169.09	\$ 71,844.00
November	390,283.46	44,419.07
December	575,256.47	1,561,949.25
TOTAL	\$ 8,701,777.51	\$ 1,678,212.32

Pennvest Financing

To date, the Authority has applied for and obtained six PENNVEST loans for a variety of water, sewage, and stormwater projects at various locations in the City of Pittsburgh. Two projects have been postponed pending additional study of existing facilities. No applications are planned for the January 2006 application cycle. Four additional application cycles will occur in 2006 during which the PWSA may make application. Table 9 presents a list of the projects for which PENNVEST funding has been obtained. A copy of the PENNVEST Program Budget as of December 1, 2005 is attached as Exhibit B and a copy of the PENNVEST Status Report as of December 1, 2005 is attached as Exhibit D.

Table 9
PENNVEST Loans
Annual Debt Payment (Principal and Interest)

Loan No.	Project Name	PENNVEST Loan Amount	Debt Service Payment Start Date	Estimated Annual Debt Service³
71911	Railside Street Sanitary Sewer Extension	\$ 158,399.23	February 2002	\$ 9,456.00
58066	Ollie Street and Overbrook Boulevard Storm Sewer	800,963.48	May 2002	47,449.44
25074	Water System Improvements No. 1	3,940,113.91	January 2003	216,217.80
71217	Streets Run Interceptor	*3,505,100.00	May 2003	105,965.61
12587	Water System Improvements No. 2	5,112,263.50	January 2004	296,981.16
12608	Water System Improvements No. 3	*4,821,500.00	July 2004	266,085.65
	TOTAL PENNVEST	\$18,338,340.12		\$942,155.66

³

* Loan amount at time of closing. Final loan amount to be determined by Pennvest.

PITTSBURGH WATER AND SEWER AUTHORITY CONSULTING ENGINEER'S ANNUAL REPORT

RENEWAL AND REPLACEMENT FUND

Initial bond issues of the Authority created the "Renewal and Replacement Fund" to be held in trust by the Trustee to be used by the Authority for extraordinary maintenance and repair of the Water and Sewer Systems or to pay the cost of Capital Additions. These Trust Indentures provided that the Consulting Engineer shall annually establish the amount, if any, to be on deposit in this Fund.

The previous Trust Indenture provided that so long as the aggregate amount of funds on deposit in the Construction Fund(s) and the Renewal and Replacement Fund were not less than \$7,000,000, the Authority was not required to make any deposits into the Renewal and Replacement Fund. It further required that if this aggregate amount was less than \$7,000,000, the Authority shall transfer, on or before the first day of each month, a sum of \$100,000 from the Revenue Fund to the Renewal and Replacement Fund until the aggregate amounts equal \$7,000,000. In addition, if the aggregate amounts on deposit in these two funds were less than \$5,000,000, the Authority shall, on each September 1, transfer to the Renewal and Replacement Fund all surplus moneys remaining in the Revenue Fund after all payments required to be made on such September 1 have been made until such time as the aggregate amounts on deposit in these funds are equal to not less than \$5,000,000.

Section 6.06 of the Trust Indenture dated October 15, 1993 eliminated the requirements of the Revenue and Replacement Fund unless determined necessary annually by the consulting engineer. Since the balance available in current Construction Funds exceeds \$54,000,000, there is no need for the Authority to deposit any funds into the Renewal and Replacement Fund during the next fiscal year.

PITTSBURGH WATER AND SEWER AUTHORITY CONSULTING ENGINEER'S ANNUAL REPORT

FINDINGS ON CURRENT CONDITIONS

The Pittsburgh Water and Sewer Authority (Authority) is beginning the twenty-second year of a Capital Improvements Program (CIP) that was recommended as a result of an "Evaluation of the Water and Sewer Systems of the City of Pittsburgh" conducted in 1983. This evaluation report indicated that the Water and Sewer Systems were in adequate operating condition, although both systems exhibited the need for certain improvements and replacements to ensure continued adequate service to the existing users and to meet foreseeable future demands.

As Consulting Engineer for the Authority, we find that both the Water and Sewer Systems are in adequate operating condition and are, in general, being adequately maintained. As discussed previously in this report, we recommend that the preventive maintenance program developed by the Authority be fully implemented to ensure full realization of the life of the improvements that have been part of the CIP.

An annual facilities inspection program was instituted two years ago as part of the annual report process. With the assistance of Authority staff, we have inspected treatment, pump station, and storage facilities within the operating Water and Sewer Systems. Facilities Inspection Reports are included in Exhibit E of this Report. These Inspection Reports provide valuable information that can be used to develop future capital programs for repair, maintenance, and replacement of facilities.

With implementation of these programs, and continuation of the CIP, the systems should be capable of continuing to provide uninterrupted service to the users and provide for future demands.

At the beginning of 2001, the Authority entered into a contract with U. S. Water, L.L.C. to provide professional consulting services in connection with the operations and management of the Authority. The main focus of U. S. Water's services was the development of a five-year Business Plan to assess the overall operation of the Authority, make recommendations, and to help guide the Authority's management staff. Under their leadership, a Five-Year Capital Expenditure Plan and a Capital Investment Program Policy and Procedures Manual were also developed and implemented by the Authority.

U. S. Water completed its on-site consultation in June 2004, leaving in its place a system to constantly monitor and improve upon the Authority's operations.

An analysis of the fiscal year 2005 Budget and the projected operating results for 2005 along with the adopted Budget⁴ for 2006 (with respect to the requirements of the Trust Indenture) follows.

It is the Consulting Engineer's opinion that the adopted 2006 Operating Budget as included in this report will provide sufficient funds for the proper operation and maintenance of both the water and sewer systems during the next fiscal year, and that the coverage requirement of the trust indenture will be met.

⁴ The Operating Budget for 2006 was adopted at the December 16, 2005 monthly meeting of the Board of Directors.

PITTSBURGH WATER AND SEWER AUTHORITY CONSULTING ENGINEER'S ANNUAL REPORT

ESTIMATE ON REVENUES AND CURRENT EXPENSES

General

Section 7.11 of the Trust Indenture, dated as of October 15, 1993, provides that the Consulting Engineer shall include in his annual report:

"His estimate of Receipts and Revenues and Current Expenses for the next Fiscal Year and his recommendation as to any necessary revision of water and sewer rates, rents or other charges."

ATS-Chester Engineers has worked with The Pittsburgh Water and Sewer Authority (Authority) staff in developing the 2006 Operating Budget for the Authority as contained herein. The Operating Budget was adopted at the Authority Board monthly meeting of December 16, 2005.

Estimated Receipts and Revenues

Determination of the Total Funds Available in 2006 for Operating Expenses and Debt Service Requirements are based on the following:

1. Revenue Fund Cash as of January 1, 2006.
2. Operating Revenues from water sales, collection of delinquent sewage treatment fees, and miscellaneous charges.
3. Interest Earnings on the following funds:
 - Construction Funds
 - Debt Service Funds
 - Debt Service Reserve Funds
 - Revenue Fund
4. Transfer from the Capital Projects Fund to reimburse the Authority for labor and expenses of the Authority's engineering staff working on Capital Improvement Projects (CIP) during the year.
5. Transfer from the Capital Projects Fund to reimburse Authority operating funds for the funding of capital projects.

Table 10 presents the Actual 2001 2002, 2003, 2004, Projected 2005 and Adopted 2006 Budget of Total Funds Available.

A rate increase was adopted by Resolution No. 9 on January 16, 2004 and amended by Resolution No. 19 on February 13, 2004. This rate increase was effectively implemented in two steps. The first step of the increase was an approximate 19 percent increase that became effective February 1, 2004. The second step was an additional 17 percent increase that was placed into effect January 1, 2005. The charges for metered consumption are as noted below.

METERED QUARTERLY WATER AND SEWER RATES				
<u>Minimum Monthly Charge</u>				
Meter Size <u>(Inches)</u>	Monthly Minimum Usage <u>(1,000 gallons)</u>	<u>Rate per 1,000 Gallons</u>		
		<u>February 1, 2004</u>	<u>January 1, 2005</u>	
5/8 or 5/8 x3/4	1	\$ 11.86	\$ 13.88	
3/4	2	20.52	24.01	
1	5	39.28	45.96	
1-1/4	7	61.65	72.13	
1-1/2	10	76.98	90.07	
2	17	119.02	139.25	
3	40	254.04	297.23	
4	70	452.65	529.60	
6	175	1,087.87	1,272.81	
8	325	1,861.85	2,178.36	
10 or larger	548	3,202.06	3,746.41	
		<u>February 1, 2004</u>	<u>January 1, 2005</u>	
Residential		\$ 5.52	\$ 6.46	
Commercial		5.43	6.35	
Industrial		5.07	5.93	
Health and Education		7.43	8.69	
Wholesale or Resale:				
Daily Consumption:				
0 to 3,000,000 gallons		3.70	4.32	
3,000,001 gallons and over		3.65	4.27	

The implementation of automated meter reading continues to aid the Authority in improving collections.

Current Expenses

Table 11 presents the Actual 2001, 2002, and 2003, 2004, Projected 2005, and Adopted 2006 Budget of Operating Expenses.

Of particular note on this table is line item "Sewage" for 2006. This reflects an expense of \$3,200,000 per month for 12 months as noted in the 2006 Operating Budget. In previous years, the Authority purchased delinquent collections from ALCOSAN for \$4,000,000 annually. In 2004, the Authority began paying ALCOSAN current treatment charges thereby creating a sewage collection expense of \$38,400,000. By doing so, the Authority will be in a position to improve delinquent sewer collections and better plan for

the future. This expense figure is offset by an Operating Revenue increase of \$40,992,000 in the 2006 Budget.

Rate Covenant Calculations

Table 12 presents the Actual 2002, 2003, and 2004, and the Budgeted 2005 and 2006 Coverage Factors based upon Revenues and Earnings, Operating Expenses and Debt Service Requirements.

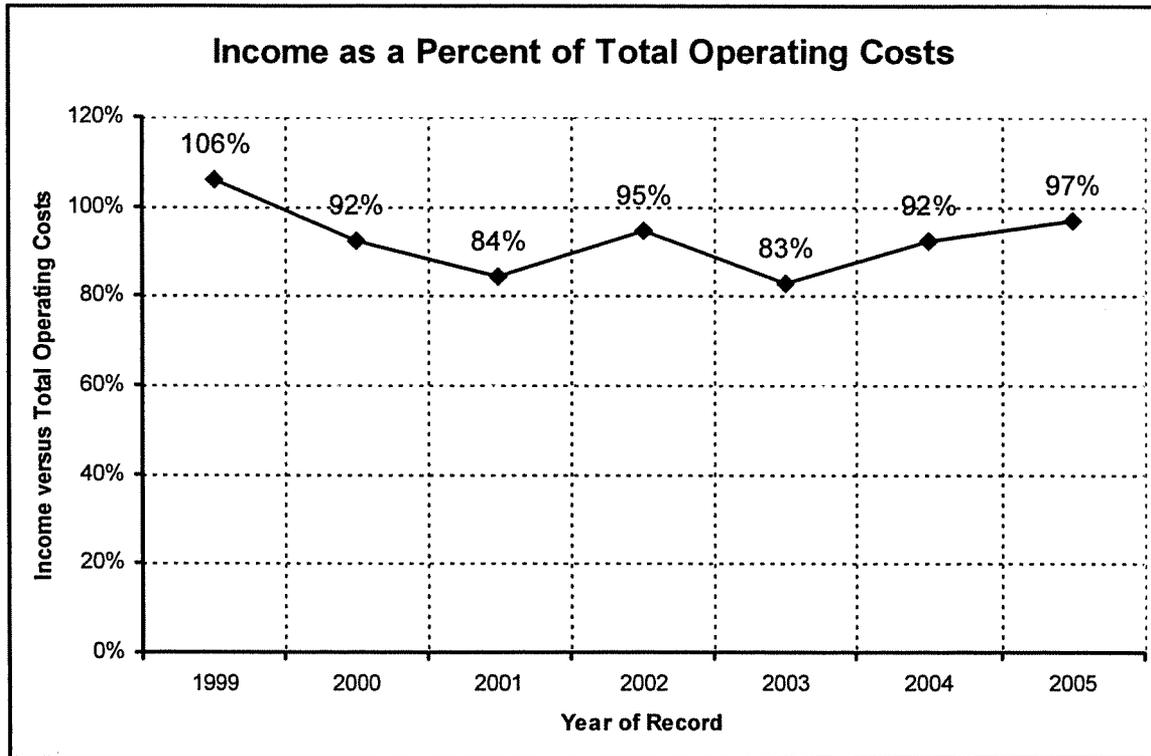
The Authority's Trust Indenture requires that water rates be established in order to provide a minimum Coverage Factor (ratio of net funds available for Debt Service to actual Debt Service Requirements) of 1.20.

As can be seen from Table 12, the projected Coverage Factor for 2005 is 1.41 and the 2006 Coverage Factor based on the adopted budget is 1.58. Based upon the above analysis, it is the Consulting Engineer's opinion that the existing water and sewer rates, together with available cash and interest earnings, will provide sufficient funds to cover operating expenses and to satisfy the Rate Covenant Test during 2006, as provided for in the Authority's Trust Indenture.

It is noted that since 1999, Operating Revenues (Water Sales and Miscellaneous Charges) plus recurring Interest Revenues (Interest Income from the Debt Service Funds and Debt Service Revenue Funds) have fallen from where they addressed approximately 105.9 percent of the Authority Total Expenses (Operating Expenses and Debt Service Requirements) in 1999 to 86.6 percent in 2003 and a projected 88.7 percent in 2004. As a result of increased revenues, which offset the operating costs, 98.9 percent of the Operating Costs in 2005 should be covered by revenues.

Although Figure 2 shows the decline in this ratio since 1999, the situation appears to have stabilized. Due to the rate increases over the past several years, this ratio is approaching 100 percent. A ratio below 100 percent indicates that the Authority's cash reserves will continue to decline. A regression analysis was performed in order to forecast revenues and expenses for 2006 through 2008 (three years). This forecast, which provides a "snapshot" of the future using historical data that is available, indicates that a user fee adjustment may be needed in 2006.

Figure 2
Income as a Percentage of Total Operating Costs



The Authority has been able to maintain the required Coverage Factor and satisfy the financial obligations as a result of the past buildup of cash reserves and the interest earnings on the Authority's Construction Funds. As Construction Funds are spent, interest income from these funds will be reduced.

One of the reasons that the rate increases adopted for the past two years have not been sufficient to increase this ratio above 100 percent is the fact that the Authority has begun to fund certain Sewer and Water System maintenance and repair programs from its Operating Budget as opposed to using capital funds. These contracts are annual in nature and should be funded from operations. Recognizing this, the Authority has begun to set aside money in the Operating Budget for maintenance and repair of the system that has traditionally been funded from the Capital Program. This value will be approximately \$2,000,000 for 2006.

To ensure future financial stability, the Authority will have to adjust rates at some time in the future to a level whereby Operating Revenue and recurring Interest Revenue will exceed Operating Expenses plus Debt Service Requirements. This should reduce the reliance on debt markets and reduce debt service.

The Authority undertook a cost of service study in 2005 to assist in establishing guidelines for future rate adjustments. The study is nearing completion.

APPENDIX F

FORM OF BOND COUNSEL OPINION

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PEPPER HAMILTON LLP

March __, 2007

The Pittsburgh Water and Sewer Authority
Pittsburgh, Pennsylvania

Re: \$_____ The Pittsburgh Water and Sewer Authority
Water and Sewer System First Lien Revenue Refunding Bonds,
Series of 2007

You have requested our opinion as to the legality of the above designated series of bonds (the "2007 Bonds"), issued by The Pittsburgh Water and Sewer Authority (the "Authority") under the provisions of the Pennsylvania Municipality Authorities Act, 53 Pa. Cons. Stat. §§ 5601-5622, as amended (the "Act"), and pursuant to a Trust Indenture dated as of October 15, 1993, as supplemented as of July 15, 1995, March 1, 1998, March 1, 2002, September 15, 2003 and June 1, 2005 (collectively, the "Original Indenture") and as further supplemented by a Sixth Supplemental Trust Indenture thereto dated as of March 1, 2007 (the "Sixth Supplemental Indenture"; together with the Original Indenture, the "Indenture"); from the Authority to The Bank of New York Trust Company, N.A., as successor trustee (the "Trustee").

The 2007 Bonds are additional bonds being issued under the Indenture. The net proceeds of the 2007 Bonds, together other available funds of the Authority, will be applied pursuant to the Indenture for the purpose of providing funds for (i) the advance refunding of the Authority's outstanding Water and Sewer System First Lien Revenue Bonds, Series of 2002 and Water and Sewer Revenue Refunding Bonds, Series of 2005; and (ii) the payment of the costs issuing and insuring the 2007 Bonds.

All bonds issued under the Indenture, except as may otherwise be provided therein, are equally and ratably secured by the assignment and pledge to the Trustee of all Receipts and Revenues, as defined in the Indenture.

In addition, payment of the principal of, and interest on, the 2007 Bonds will be insured under a municipal bond insurance policy (the "Bond Insurance Policy") issued by Financial Security Assurance.

As Bond Counsel for the Authority, we have examined such law and such certified proceedings and other documents as we have deemed necessary to express this opinion.

In rendering this opinion we have examined and relied upon the opinions of counsel to the Authority with respect, *inter alia*, to the due organization, existence and good

standing of the Authority; the authorization, execution and delivery of the documents to which they are parties; the validity and binding effect thereof on the Authority; and the accuracy of the statements and representations and the performance of the covenants of the Authority set forth in the Indenture and in the Authority's Tax-Regulatory Certificate, each as delivered on this date in connection with the issuance of the 2007 Bonds.

As to questions of fact material to our opinion, we have relied upon the representations of the Authority contained in the Indenture and in the certified proceedings and other certifications of public officials and others furnished to us without undertaking to verify the same by independent investigation.

Based upon the foregoing, we are of the opinion that, under existing law:

1. The Authority has been duly and legally incorporated and validly exists under the Act and has corporate power and lawful authority to execute and deliver the Sixth Supplemental Indenture and to issue and deliver the 2007 Bonds.

2. The purposes for which the 2007 Bonds have been issued are authorized purposes for which additional bonds may be issued under Section 3.04 of the Original Indenture.

3. The Sixth Supplemental Indenture has been duly authorized, executed and delivered by the Authority and, assuming the due authorization, execution and delivery thereof by the other parties thereto, is a valid and binding obligation of the Authority, enforceable in accordance with its terms.

4. All conditions precedent provided for in the Original Indenture and the Sixth Supplemental Indenture relating to the authentication and delivery of the 2007 Bonds have been complied with by the Authority.

5. The 2007 Bonds have been validly authorized, executed and delivered by the Authority and, when authenticated by the Trustee, constitute valid and binding limited obligations of the Authority entitled to the benefits and security of the Indenture and are enforceable in accordance with their terms.

6. Under the laws of the Commonwealth of Pennsylvania, as currently enacted and construed, the 2007 Bonds are exempt from personal property taxes in Pennsylvania and the interest on the 2007 Bonds is exempt from Pennsylvania personal income tax and Pennsylvania corporate net income tax.

7. Interest on the 2007 Bonds is excluded from gross income of the owners of the 2007 Bonds for federal income tax purposes under existing law, as currently enacted and construed. Interest on the 2007 Bonds is not an item of tax preference for purposes of the federal alternative minimum tax imposed upon individuals and corporations. Interest on a 2007 Bond

held by a corporation (other than an S corporation, regulated investment company, real estate investment trust or real estate mortgage investment conduit) may be indirectly subject to alternative minimum tax because of its inclusion in the earnings and profits of the corporate holder. Interest on a 2007 Bond held by a foreign corporation may be subject to the branch profits tax imposed by the Code.

Ownership of the 2007 Bonds may give rise to collateral federal income tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry the 2007 Bonds. We express no opinion as to such collateral federal income tax consequences.

In providing this opinion, we advise you as follows:

a. It may be determined in the future that interest on the 2007 Bonds, retroactive to the date of issuance thereof or prospectively, will not be excluded from the gross income of the owners of the 2007 Bonds for federal income tax purposes if certain requirements of the Code are not met subsequent to the issuance of the 2007 Bonds. The Authority has covenanted in the Indenture to comply with such requirements.

b. The enforceability (but not the validity) of the documents mentioned herein may be limited by bankruptcy, insolvency, reorganization, moratorium or other laws now or hereafter enacted by any state or the federal government affecting the enforcement of creditors' rights generally, and "enforceable in accordance with its (their) terms" shall not mean that specific performance would necessarily be available as a remedy in every situation.

c. The obligations of the Authority under the Indenture and the 2007 Bonds do not create an indebtedness or pledge the credit or taxing power of the United States of America, the Commonwealth of Pennsylvania or any political subdivision thereof, and the 2007 Bonds are limited obligations of the Authority payable solely from the moneys pledged therefor under the Indenture and from payments under the Bond Insurance Policy.

We express no opinion herein as to the accuracy, adequacy or completeness of the Official Statement relating to the 2007 Bonds.

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APPENDIX G

FORM OF MUNICIPAL BOND INSURANCE POLICY

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**FINANCIAL
SECURITY
ASSURANCE®**

MUNICIPAL BOND DEBT SERVICE RESERVE INSURANCE POLICY

ISSUER:

BONDS:

Policy No.: -R

Effective Date:

Premium: \$

Termination Date:

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") as set forth in the documentation (the "Bond Document") providing for the issuance of and securing the Bonds, for the benefit of the Owners, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Financial Security will make payment as provided in this Policy to the Trustee or Paying Agent on the later of the Business Day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, in a form reasonably satisfactory to it. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Issuer, as appropriate, who may submit an amended Notice of Nonpayment. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy. Upon such payment, Financial Security shall become entitled to reimbursement of the amount so paid (together with interest and expenses) pursuant to the **[Bond Document] [Insurance Agreement]**.

The amount available under this Policy for payment shall not exceed the Policy Limit. The amount available at any particular time to be paid to the Trustee or Paying Agent under the terms of this Policy shall automatically be reduced by any payment under this Policy. However, after such payment, the amount available under this Policy shall be reinstated in full or in part, but only up to the Policy Limit, to the extent of the reimbursement of such payment (exclusive of interest and expenses) to Financial Security by or on behalf of the Issuer. Within three Business Days of such reimbursement, Financial Security shall provide the Trustee, the Paying Agent and the Issuer with notice of the reimbursement and reinstatement.

Payment under this Policy shall not be available with respect to (a) any Nonpayment that occurs prior to the Effective Date or after the Termination Date of this Policy or (b) Bonds that are not outstanding under the Bond Document. If the amount payable under this Policy is also payable under another insurance policy or surety bond insuring the Bonds, payment first shall be made under this Policy to the extent of the amount available under this Policy up to the Policy Limit. In no event shall Financial Security incur duplicate liability for the same amounts owing with respect to the Bonds that are covered under this Policy and any other insurance policy or surety bond that Financial Security has issued.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York are, or the Insurer's Fiscal Agent is, authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to

interest on a Bond, payable on the stated date for payment of interest. "Insurance Agreement" means the Insurance Agreement dated as of the effective date hereof in respect of this Policy, as the same may be amended or supplemented from time to time. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment made to an Owner by or on behalf of the Issuer that has been recovered from such Owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from the Issuer, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment of principal or interest thereunder, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds. "Policy Limit" shall be the dollar amount of the debt service reserve fund required to be maintained for the Bonds by the Bond Document from time to time (the "Debt Service Reserve Requirement"), but in no event shall the Policy Limit exceed \$. The Policy Limit shall automatically and irrevocably be reduced from time to time by the amount of each reduction in the Debt Service Reserve Requirement, as provided in the Bond Document.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud), whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be cancelled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By _____

By _____

Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.
31 West 52nd Street, New York, N.Y. 10019

(212) 826-0100