

NEW ISSUE

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Fiscal 2009 EE Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986. In the further opinion of Bond Counsel, interest on the Fiscal 2009 EE Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel is also of the opinion that interest on the Fiscal 2009 EE Bonds is exempt from personal income taxes imposed by the State of New York and any political subdivision thereof (including The City of New York). Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Fiscal 2009 EE Bonds. See "TAX MATTERS."

\$645,455,000
New York City
Municipal Water Finance Authority
Water and Sewer System Second General Resolution Revenue Bonds,
Fiscal 2009 Series EE

Dated: Date of Delivery

Due: June 15, as shown on the inside cover

The Fiscal 2009 EE Bonds will be issued as registered bonds and will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York which will act as securities depository for the Fiscal 2009 EE Bonds. Purchases of beneficial interests in such Fiscal 2009 EE Bonds will be made in book-entry-only form. Purchasers will not receive certificates representing the ownership interest in the Fiscal 2009 EE Bonds purchased by them. See "APPENDIX F—BOOK-ENTRY-ONLY FORM."

Interest on the Fiscal 2009 EE Bonds will accrue from their date of delivery and will be payable semiannually on each December 15th and June 15th, commencing June 15, 2009. The Fiscal 2009 EE Bonds will be issued in authorized denominations of \$5,000 and integral multiples thereof. The Fiscal 2009 EE Bonds are subject to redemption prior to maturity as described herein. The proceeds of the Fiscal 2009 EE Bonds are expected to be applied (i) to pay principal and interest on certain of the Authority's Outstanding Water and Sewer System Revenue Bonds, (ii) to pay costs of improvements to the System and (iii) to pay certain costs of issuance.

The Fiscal 2009 EE Bonds are special obligations of the Authority, payable solely from and secured by a pledge of and subordinate lien on the gross revenues of the System. The Authority has no taxing power. The Fiscal 2009 EE Bonds are not a debt of the State of New York, The City of New York or the New York City Water Board and none of the State of New York, The City of New York or the New York City Water Board is liable on the Fiscal 2009 EE Bonds.

The Fiscal 2009 EE Bonds are offered when, as and if issued by the Authority and received by the Underwriters and subject to the approval of legality by Orrick, Herrington & Sutcliffe LLP, New York, New York, Bond Counsel. Certain legal matters will be passed upon for the Underwriters by Nixon Peabody LLP, New York, New York. It is anticipated that the Fiscal 2009 EE Bonds will be available for delivery to The Depository Trust Company in New York, New York, on or about January 29, 2009.

Siebert Brandford Shank & Co., LLC

DEPFA First Albany Securities LLC

Merrill Lynch & Co.

M.R. Beal & Company

Banc of America Securities LLC

Barclays Capital

Citi

Goldman, Sachs & Co.

J.P. Morgan

Loop Capital Markets LLC

Morgan Stanley

Raymond James & Associates, Inc.

Wachovia Bank, National Association

Piper Jaffray

**Prager, Sealy & Co., LLC
Roosevelt & Cross Incorporated**

RBC Capital Markets

January 23, 2009

\$645,455,000

New York City Municipal Water Finance Authority

**Water and Sewer System Second General Resolution Revenue Bonds,
Fiscal 2009 Series EE**

| <u>Due June 15</u> | <u>Principal Amount</u> | <u>Rate</u> | <u>Yield</u> | <u>CUSIP Number⁽¹⁾</u> |
|------------------------|-----------------------------|-------------|--------------|---------------------------------------|
| 2014 | \$ 7,840,000 | 2½% | 2.34% | 64972FYYX8 |
| 2014 | 13,060,000 | 3 | 2.34 | 64972FYY6 |
| 2014 | 5,955,000 | 4 | 2.34 | 64972FYZ3 |
| 2015 | 1,435,000 | 2½% | 2.58 | 64972FZA7 |
| 2015 | 5,080,000 | 3 | 2.58 | 64972FZC3 |
| 2015 | 2,635,000 | 5 | 2.58 | 64972FZB5 |
| 2016 | 8,900,000 | 3 | 2.86 | 64972FZD1 |
| 2016 | 33,060,000 | 5 | 2.86 | 64972FZE9 |
| 2017 | 3,870,000 | 3 | 3.09 | 64972FZF6 |
| 2017 | 28,205,000 | 5 | 3.09 | 64972FZG4 |
| 2018 | 3,070,000 | ¾ | 3.33 | 64972FZH2 |
| 2018 | 15,220,000 | ¾ | 3.33 | 64972FZJ8 |
| 2018 | 57,125,000 | 5 | 3.33 | 64972FZK5 |

\$100,000,000 5% Term Bond Maturing June 15, 2039, Yield 5.45% CUSIP⁽¹⁾: 64972FZL3

\$250,000,000 5¼% Term Bond Maturing June 15, 2040, Yield 5.50% CUSIP⁽¹⁾: 64972FZM1

\$110,000,000 5½% Term Bond Maturing June 15, 2040, Price 100% CUSIP⁽¹⁾: 64972FZN9

⁽¹⁾ Copyright 2007, American Bankers Association. CUSIP data herein are provided by Standard & Poor's, CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. The CUSIP numbers listed above are being provided solely for the convenience of Bondholders only at the time of issuance of the Fiscal 2009 EE Bonds and the Authority and the Underwriters do not make any representation with respect to such numbers or undertake any responsibility for their accuracy now or at any time in the future. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Fiscal 2009 EE Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part of such maturity or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of certain maturities of the Fiscal 2009 EE Bonds.

New York City Municipal Water Finance Authority
75 Park Place, 6th Floor
New York, New York 10007
212-788-5889

| | |
|---|---------------|
| Mark Page, <i>ex officio</i> | <i>Member</i> |
| Alexander B. Grannis, <i>ex officio</i> | <i>Member</i> |
| Martha E. Stark, <i>ex officio</i> | <i>Member</i> |
| Steven Lawitts, <i>ex officio</i> | <i>Member</i> |
| Arthur B. Hill | <i>Member</i> |
| Peter J. Kenny | <i>Member</i> |
| Marc V. Shaw | <i>Member</i> |

| | |
|----------------------|---|
| Alan L. Anders | <i>Chief Executive Officer</i> |
| Thomas G. Paolicelli | <i>Executive Director</i> |
| Marjorie E. Henning | <i>Secretary</i> |
| Michele Mark Levine | <i>Comptroller</i> |
| Eileen T. Moran | <i>Deputy Comptroller</i> |
| Robert L. Balducci | <i>Assistant Comptroller</i> |
| Prescott D. Ulrey | <i>Assistant Secretary</i> |
| Jeffrey M. Werner | <i>Assistant Secretary</i> |
| Raymond Orlando | <i>Director of Media and Investor Relations</i> |

New York City Water Board
59-17 Junction Boulevard, 8th Floor
Flushing, New York 11373-5108
718-595-3586

| | |
|---------------------|---------------|
| Alan Moss | <i>Chair</i> |
| Marcia Bystryn | <i>Member</i> |
| Donald Capoccia | <i>Member</i> |
| Dawn S. Davis | <i>Member</i> |
| Amaziah Howell | <i>Member</i> |
| Mehul Patel | <i>Member</i> |
| Benjamin A. Tisdell | <i>Member</i> |

| | |
|------------------------|---------------------------|
| Steven Lawitts | <i>Executive Director</i> |
| William Kusterbeck | <i>Treasurer</i> |
| Carmelo Emilio | <i>Deputy Treasurer</i> |
| Albert F. Moncure, Jr. | <i>Secretary</i> |

Authority Consultants

| | |
|---------------------|--|
| Bond Counsel | <i>Orrick, Herrington & Sutcliffe LLP</i> |
| Consulting Engineer | <i>Metcalf & Eddy of New York, Inc.</i> |
| Financial Advisors | <i>Lamont Financial Services Corporation/Ramirez & Co., Inc.</i> |
| Rate Consultant | <i>Amawalk Consulting Group LLC</i> |

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This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy any of the Fiscal 2009 EE Bonds in any jurisdiction to any person to whom it is unlawful to make such offer in such jurisdiction. No dealer, salesperson or any other person has been authorized to give any information or make any representation, other than those contained herein, in connection with the offering of any of the Fiscal 2009 EE Bonds and if given or made, such information or representation must not be relied upon. Information contained on the Authority's web page, on the City's web site, or on any other web page is not a part of this Official Statement. Neither the delivery of this Official Statement nor the sale of any of the Fiscal 2009 EE Bonds implies that there has been no change in the affairs of the Authority, the Board or the City or the other matters described herein since the date hereof.

If and when included in this Official Statement, the words "expects," "forecasts," "projects," "intends," "anticipates," "estimates" and analogous expressions are intended to identify forward-looking statements as defined in the Securities Act of 1933, as amended, and any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include, among others, general economic and business conditions, changes in political, social and economic conditions, regulatory initiatives and compliance with governmental regulations, litigation and various other events, conditions and circumstances, many of which are beyond the control of the Authority. These forward-looking statements speak only as of the date of this Official Statement. The Authority disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any change in the Authority's expectations with regard thereto or any change in events, conditions or circumstances on which any such statements are based.

Deloitte & Touche LLP, the Authority's independent auditor has not reviewed, commented on or approved, and is not associated with, this Official Statement. The report of Deloitte & Touche LLP relating to the Authority's financial statements for the fiscal years ended June 30, 2008 and 2007, which is a matter of public record, is included in this Official Statement. However, Deloitte & Touche LLP has not performed any procedures on any financial statements or other financial information of the Authority, including without limitation any of the information contained in this Official Statement, since the date of such report and has not been asked to consent to the inclusion of its report in this Official Statement.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE FISCAL 2009 EE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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SUMMARY STATEMENT

The following is a brief summary of the information contained in this Official Statement and is subject in all respects to the additional information contained herein, including the appendices attached hereto. Defined terms have the same meaning herein as elsewhere in this Official Statement.

| | |
|---------------------------|---|
| Use of Proceeds: | The proceeds of the Authority Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 2009 Series EE Bonds (the “Fiscal 2009 EE Bonds”) are expected to be applied (i) to pay principal and interest on certain of the Authority’s Outstanding Water and Sewer System Revenue Bonds, (ii) to pay costs of improvements to the System and (iii) to pay certain costs of issuance. |
| Description of the Bonds: | The Fiscal 2009 EE Bonds are being issued by the Authority in the principal amount of \$645,455,000 pursuant to its Water and Sewer System Second General Revenue Bond Resolution adopted on March 30, 1994, as amended the “Second Resolution,” and its Supplemental Resolution No. 58 adopted on January 21, 2009. The Fiscal 2009 EE Bonds are issued in book-entry only form and in authorized denominations of \$5,000 and integral multiples thereof. |
| Redemption Provisions: | The Fiscal 2009 EE Bonds are subject to redemption as described herein. |
| The System: | The Water System provides approximately 1,237 million gallons per day (mgd) of water to approximately 833,000 accounts. It supplies water to approximately 9 million people, of which approximately 8 million are in the City and the balance are in Westchester, Putnam, Orange and Ulster Counties. The Sewer System is comprised of an extensive network of sewage collection and treatment facilities that treat over 1,300 mgd of wastewater. Under the Act, the Lease and the Agreement, the Board is obligated to pay the operating expenses of the System. The City is obligated to operate and maintain the System regardless of payment by the Board. |

Summary Financial Information:

| | <u>Historical</u> | | | <u>Projected (1)</u> | |
|--|-----------------------|----------------|----------------|----------------------|----------------|
| | <u>FY 2006</u> | <u>FY 2007</u> | <u>FY 2008</u> | <u>FY 2009</u> | <u>FY 2010</u> |
| | (Millions of Dollars) | | | | |
| Revenues Available for Debt Service (2) | \$1,931.9 | \$1,994.9 | \$2,236.5 | \$2,543.6 | \$2,870.0 |
| Net Operating Expenses (2) | 864.5 | 963.0 | 1,121.8 | 1,142.2 | 1,196.8 |
| Other Expenses (including Rental Payments to New York City) (2) | <u>253.8</u> | <u>173.8</u> | <u>134.1</u> | <u>268.6</u> | <u>301.6</u> |
| Total Expenses (2) | 1,118.3 | 1,136.8 | 1,255.9 | 1,410.8 | 1,498.5 |
| Total First Resolution Bond Debt Service | 513.8 | 521.4 | 529.1 | 591.8 | 620.6 |
| Net Debt Service on Subordinated Indebtedness (3) | <u>123.7</u> | <u>163.0</u> | <u>229.3</u> | <u>445.4</u> | <u>628.0</u> |
| Net Surplus | 176.2 | 173.6 | 222.3 | 95.6 | 122.9 |
| First Resolution Debt Service Coverage | 3.76x | 3.83x | 4.23 | 4.30x | 4.62x |
| First and Second Resolution Debt Service Coverage (3) | 3.03x | 2.91x | 2.95x | 2.45x | 2.3x |
| Rate Increase | 3.0% | 9.4% | 11.5% | 14.5%(4) | 14.0% |

Totals may not add due to rounding.

- (1) Projections are as of May 1, 2008.
- (2) Historical figures, which are derived from the accounting records used to prepare the statements of cash flows contained in the annual financial statements, and projected figures are shown on a cash basis.
- (3) Includes interest on Commercial Paper Notes and reflects offset of carryforward revenues.
- (4) Actual rate increase.

Total Authority Debt Outstanding: As of the date of this Official Statement, the Authority has approximately \$11.3 billion of First Resolution Bonds (defined below) and \$8.9 billion of Second Resolution Bonds (defined below) Outstanding. See “CAPITAL IMPROVEMENT AND FINANCING PROGRAM—Debt Service Requirements.” In addition, the Authority currently has a \$1 billion commercial paper program.

Ratings: Fitch: AA
 Moody’s: Aa3
 Standard & Poor’s: AA+

Capital Program: The City’s Preliminary Ten Year Capital Strategy, which is updated every two years, was released on November 26, 2008 (the “Preliminary Ten Year Capital Strategy”). The Preliminary Ten Year Capital Strategy includes the projected capital improvements to the System for Fiscal Years 2010 through 2019. The City’s Current Capital Plan (the “Current Capital Plan”), which covers Fiscal Years 2009 through 2013, published on November 5, 2008, is updated three times each Fiscal Year and is consistent with the Preliminary Ten Year Capital Strategy for Fiscal Years 2010 through 2013. The Current Capital Plan is expected to be updated in late January 2009. The Preliminary Ten Year Capital Strategy, together with the Current Capital Plan, comprises the Capital Improvement Program (the “CIP”). The CIP is designed to maintain a satisfactory level of service, to improve operation of the System and to address future System requirements.

Bond Financing Program:

The following table shows, as of May 1, 2008, total Authority indebtedness expected to be issued, excluding refunding bonds, from Fiscal Year 2010 to Fiscal Year 2012. As of the date of this Official Statement, during Fiscal Year 2009 the Authority has issued approximately \$536 million of First Resolution Bonds and \$1 billion of Second Resolution Bonds, including \$334.1 million of Second Resolution Bonds issued to refund outstanding debt, and expects to issue an additional \$1.5 billion of bonds for capital purposes.

| <u>FY 2010</u> | <u>FY 2011</u> | <u>FY 2012</u> | <u>Period Total</u> |
|-----------------------|----------------|----------------|---------------------|
| (Millions of Dollars) | | | |
| \$2,319.8 | \$2,305.4 | \$2,206.3 | \$6,831.5 |

Security for the Bonds:

Revenue Pledge:

The Second Resolution Bonds are special obligations of the Authority, payable solely from and secured by a pledge of amounts on deposit in the Subordinated Indebtedness Fund established under the First Resolution and all moneys and securities in any of the funds and accounts established under the Second Resolution, except the Arbitrage Rebate Fund and Debt Service Reserve Fund.

Debt Service Reserve Fund:

The Fiscal 2009 EE Bonds will not be secured by the Debt Service Reserve Fund.

Rate Covenant:

The Board has covenanted to establish and collect rates, fees and charges sufficient in each Fiscal Year so that Revenues collected in such Fiscal Year will be at least equal to the sum of 115% of Aggregate Debt Service on all First Resolution Bonds Outstanding and on any Projected Series of First Resolution Bonds (excluding Refundable Principal Installments for the payment of which funds are held in trust) payable in such Fiscal Year, and 100% of the Operating Expenses and Required Deposits (which includes debt service on the Second Resolution Bonds and other Subordinate Indebtedness) to the extent required to be paid from Revenues for such Fiscal Year.

Additional Bonds Test:

Additional Second Resolution Bonds may be issued under the Second Resolution only if the Revenues for either of the last two Fiscal Years preceding the Fiscal Year in which the Second Resolution Bonds are to be issued were at least equal to the sum of (i) 110% of the Aggregate Debt Service for such Fiscal Year on the First Resolution Bonds, the Second Resolution Bonds and certain other Subordinated Indebtedness (excluding any Debt Service paid from sources other than the Revenues) and (ii) 100% of the sum of Operating Expenses and Required Deposits for such Fiscal Year (excluding Required Deposits for the payment of Outstanding Second Resolution Bonds and certain other Subordinated Indebtedness). Second Resolution Refunding Bonds may be issued under the Second Resolution either upon satisfaction of such conditions or other conditions.

Summary of Certain Legal Opinions:

Bond Counsel has rendered opinions to the effect that, in the event of a bankruptcy of the City, (i) a court, exercising reasonable judgment after full consideration of all relevant factors, would not hold that the Revenues are property of the City and would not order the substantive consolidation of the assets and liabilities of either the Board or the Authority with those of the City and (ii) the Board, in the event the City should reject the Lease, would be entitled to remain in possession of the System for the balance of the Lease term. Bond Counsel has also opined that under current law neither the Board nor the Authority qualifies as a debtor under the United States Bankruptcy Code.

Rates:

Rates, fees and charges are imposed by the Board and are not subject to regulatory approval except for those rates charged to a limited class of upstate users representing approximately 1.7% of Revenues.

The Authority:

The Authority, a separate legal entity established in 1984, has the power to (i) issue bonds, bond anticipation notes and other obligations for the purpose of financing the renovation and improvement of the System, (ii) refund its bonds and notes and general obligation bonds of the City issued for water or sewer purposes, (iii) require the Board to fix rates sufficient to pay the costs of operating and financing improvements to the System and (iv) require the City to maintain the System adequately. The Authority has no taxing power.

The Board:

The Board, a separate legal entity established in 1984, has leased the System from the City. It is authorized to fix and collect rates, fees and charges adequate to pay the cost of operating and financing the System.

The Agreement:

Pursuant to the Agreement, the Authority has agreed to finance capital projects for the System, both current work and work commenced in prior years, through the issuance of bonds, notes or other indebtedness secured by revenues of the System.

The Lease:

Pursuant to the Lease, the Board has acquired the System from the City for a term continuing until provision has been made for the repayment of all Outstanding Bonds or other indebtedness of the Authority.

OFFICIAL STATEMENT

\$645,455,000

NEW YORK CITY MUNICIPAL WATER FINANCE AUTHORITY WATER AND SEWER SYSTEM SECOND GENERAL RESOLUTION REVENUE BONDS, FISCAL 2009 SERIES EE

INTRODUCTORY STATEMENT

General

The purpose of this Official Statement is to set forth certain information pertaining to the New York City Municipal Water Finance Authority (the “Authority”), a public benefit corporation duly created and existing under the New York City Municipal Water Finance Authority Act, as amended (the “Act”); the New York City Water Board (the “Board”), a public benefit corporation created and existing under Chapter 515 of the Laws of 1984, both of which laws were enacted by the Legislature of the State of New York (the “State”); and the Authority’s Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 2009 Series EE (the “Fiscal 2009 EE Bonds”). Capitalized terms used in this Official Statement and not defined herein shall have the meanings ascribed thereto in “APPENDIX C—GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS—Glossary.”

Pursuant to a lease agreement (the “Lease”) between the Board and The City of New York (the “City”), dated as of July 1, 1985, as amended, the Board has leased from the City its facilities for the collection, transmission and distribution of water (the “Water System”) and its facilities for the collection, treatment and disposal of sewage (the “Sewer System”) (collectively, the “System”). As required by the Act and the Lease, the System is operated and maintained by the Department of Environmental Protection of the City (“DEP”). The Board has also entered into a financing agreement, dated as of July 1, 1985, as amended (the “Agreement”), with the Authority and the City for the financing of capital improvements to the System through the issuance of bonds, notes and other obligations under the Authority’s Water and Sewer System General Revenue Bond Resolution adopted on November 14, 1985, as amended (the “First Resolution” and, when issued thereunder the “First Resolution Bonds”), or subordinate obligations of the Authority under its Second Resolution (defined below). Pursuant to the Lease and the Agreement, the Board has agreed to levy and collect rates, fees and charges. Pursuant to the Lease, the City may, with the prior written consent of the Board, grant interests in the Leased Property which, in the reasonable judgment of the Board, do not interfere with the operation and maintenance of the System and the collection of the Revenues from the System.

The Fiscal 2009 EE Bonds will be issued by the Authority pursuant to its Water and Sewer Second General Revenue Bond Resolution adopted on March 30, 1994, as amended (the “Second Resolution”) and its Supplemental Resolution No. 58, adopted on January 21, 2009 (the “Supplemental Resolution”). All bonds issued under the Second Resolution, are referred to herein as “Second Resolution Bonds.” The Second Resolution and the Supplemental Resolution are collectively referred to herein as the “Resolutions.” The Bank of New York Mellon serves as trustee under the Resolutions (in such capacity, the “Trustee”) and will continue to serve as Trustee unless a successor is appointed in accordance with the Second Resolution.

The Second Resolution Bonds are special obligations of the Authority, payable solely from and secured by a pledge of amounts on deposit in the Subordinated Indebtedness Fund established by the First Resolution and all moneys or securities in any of the funds and accounts established under the Second Resolution, subject only to provisions of the Second Resolution and the Agreement relating to the use and application thereof. The Board has covenanted in the Agreement to maintain rates, fees and charges at sufficient levels to produce in each twelve-month period beginning on July 1 (a “Fiscal Year”) an amount equal to 115% of the Aggregate Debt Service and Projected Debt Service on the First Resolution Bonds to become due in such Fiscal Year on all First Resolution Bonds, plus 100% of the operation and maintenance expenses of the System certified by the City and of Required Deposits (which includes the debt service on the Second Resolution Bonds and other subordinate debt) to the extent required to be paid from Revenues. The Agreement requires a report of the Rate Consultant setting forth its recommendations as to any revisions of the rates, fees and charges necessary or advisable to meet the requirements of the rate covenant. The Board is obligated to take necessary action to cure or avoid any deficiency. See “SECURITY FOR THE BONDS—Rate Covenant.” The

Agreement also requires a Consulting Engineer to review the operation and maintenance of the System, and further requires the City to operate and maintain the System in accordance with the advice and recommendations of the Consulting Engineer. See “SECURITY FOR THE BONDS.”

Rates, fees and charges are imposed by the Board and are not subject to regulatory approval under current law except for the rates charged to a limited class of upstate users, representing approximately 1.7% of Revenues. See “RATES AND BILLINGS.”

The Authority has relied upon Metcalf & Eddy of New York, Inc. (“Metcalf & Eddy”), its Consulting Engineer, for certain engineering feasibility information and upon Amawalk Consulting Group LLC (“Amawalk Consulting”), its Rate Consultant, for certain financial estimates and projections. See “ENGINEERING FEASIBILITY REPORT AND FORECASTED CASH FLOWS.”

Financial Projection Assumptions

The estimates and projections contained in this Official Statement are based on, among other factors, evaluations of historical revenue and expenditure data and analyses of economic trends affecting the Authority’s finances. The financial projections contained herein are subject to certain contingencies that cannot be quantified and are subject to the uncertainties inherent in any attempt to predict the results of future operations. Accordingly, such projections are subject to periodic revision which may involve substantial change. Consequently, the Authority makes no representation or warranty that these estimates and projections will be realized.

The financial projections contained in this Official Statement, including bond financings, operating and maintenance expenses, debt service, revenues, sources and uses of funds, and forecasted cash flows and rate increases, were prepared as of May 1, 2008, and are expected to be updated annually. Actual financial results will differ from these projections.

PLAN OF REFUNDING

A portion of the proceeds of the Fiscal 2009 EE Bonds is expected to be applied to redeem the Authority’s Water and Sewer System Revenue Bonds of the Series and maturing on the dates and in the aggregate principal amounts set forth in “APPENDIX G—TABLE OF REFUNDED BONDS” (the “Refunded Bonds”). Pursuant to an Escrow Agreement between the Authority and The Bank of New York Mellon (the “Escrow Trustee”) the Authority will deposit Defeasance Securities in trust with the Escrow Trustee. The Defeasance Securities will bear interest at such rates and will mature at such times and in such amounts so that, together with any uninvested cash held by the Escrow Trustee, sufficient moneys will be available to make full and timely payment on the principal of, and interest on, the Refunded Bonds at the maximum rate of 9% to the redemption dates set forth in “APPENDIX G—TABLE OF REFUNDED BONDS” (the “Redemption Dates”). Upon such irrevocable deposit, the Refunded Bonds will be deemed to be no longer Outstanding and will no longer be entitled to the benefit of the pledge and lien established by the First Resolution, or to payment from Revenues of the System. The Authority will direct the Trustee to pay the principal of, and interest and redemption premium on the Refunded Bonds on their Redemption Dates unless the Refunded Bonds have been previously purchased and retired. See “APPENDIX G—TABLE OF REFUNDED BONDS.”

USE OF PROCEEDS

The estimated proceeds of the Fiscal 2009 EE Bonds are anticipated to be applied in the following manner:

| | |
|--|-----------------------------|
| Deposit to Construction Fund | \$441,155,640 |
| Deposit to Escrow Account for Refunded Bonds | 203,161,863 |
| Underwriters’ Discount | 3,699,454 |
| Costs of Issuance | <u>367,572</u> |
| Total Uses of Proceeds. | 648,384,529 |
| Net Original Issue Premium | <u>(2,929,529)</u> |
| Par Amount of the Fiscal 2009 EE Bonds | <u><u>\$645,455,000</u></u> |

THE FISCAL 2009 EE BONDS

General

The Fiscal 2009 EE Bonds initially delivered to the Underwriters will be dated their date of delivery. The Fiscal 2009 EE Bonds will mature on and will bear interest payable on the dates and at the rates shown on the inside cover of this Official Statement.

Principal of, redemption premium, if any, and interest on the Fiscal 2009 EE Bonds will be payable in lawful money of the United States of America. The Fiscal 2009 EE Bonds will be issued only as fully registered bonds without coupons in denominations of \$5,000 and integral multiples thereof.

Book-Entry Only

The Fiscal 2009 EE Bonds will be issued as registered bonds and will be registered in the name of Cede & Co., as nominee of The Depository Trust Company (“DTC”), which will act as securities depository for the Fiscal 2009 EE Bonds. Purchases of beneficial interests in such Fiscal 2009 EE Bonds will be made in book-entry-only form. Purchasers will not receive certificates representing the ownership interest in the Fiscal 2009 EE Bonds purchased by them. See “APPENDIX F—BOOK-ENTRY-ONLY FORM.”

Redemption of Fiscal 2009 EE Bonds

Optional Redemption.

The Fiscal 2009 EE Bonds are subject to redemption prior to maturity at the option of the Authority from any moneys available therefor on and after June 15, 2019 in whole or in part, at any time, by lot at the redemption price of par plus accrued interest to the redemption date.

Notice of Redemption

Notice of redemption is to be given by first class mail, postage prepaid, at least 30 days prior to the date fixed for redemption, to the registered owners of Fiscal 2009 EE Bonds to be redeemed at their addresses shown on the books of registry. So long as Cede & Co., as nominee of DTC, is the registered owner of the Fiscal 2009 EE Bonds, notice of redemption is to be sent to DTC. No assurance can be given by the Authority that DTC and DTC participants will promptly transmit notices of redemption to Beneficial Owners. See “APPENDIX F—BOOK-ENTRY-ONLY FORM.”

If, on any redemption date, moneys for the redemption of the Fiscal 2009 EE Bonds to be redeemed, together with interest thereon to the redemption date, are held by the Trustee so as to be available therefor on such date, and if notice of redemption has been mailed, then interest on the Fiscal 2009 EE Bonds to be redeemed will cease to accrue from and after the redemption date and such Fiscal 2009 EE Bonds will no longer be considered to be Outstanding under the Second Resolution.

The notice of redemption may provide that the Fiscal 2009 EE Bonds will be due and payable on the redemption date only if moneys sufficient to accomplish such redemption are held by the Trustee on the scheduled redemption date.

SECURITY FOR THE BONDS

Revenues

The Act empowers the Board to establish and collect rates, fees and charges for the use of service provided by the System in order to receive Revenues, which together with other available amounts, will be sufficient to place the System on a self-sustaining basis. All Revenues of the System are deposited by the Board in the Local Water Fund held by the Board. The Authority holds a statutory first lien on the Revenues for the payment of all amounts due to the Authority under the Agreement. In the event that the Board fails to make any required payment to the Authority, the Authority or the Trustee may petition for the appointment, by any court having jurisdiction, of a receiver to administer the affairs of the Board, and, with court approval, establish rates and charges to provide Revenues sufficient to make required payments. However, no holder or owner of any bond or note issued by the Authority, or any receiver of the System, may compel the sale of any part of the System.

The City has covenanted in the Agreement to operate and maintain the System in accordance with the advice and recommendations of the Consulting Engineer. Such obligation to operate and maintain the System may be enforced by the Authority in accordance with the provisions of the Act and the terms of the Agreement and the Lease and is not contingent on payment by the Board. The amounts required to operate and maintain the System are certified to the Board by the City and reviewed by the Consulting Engineer.

Beginning on the first day of each month the Board is required to pay to the Trustee under the First Resolution the Revenues in the Local Water Fund, for deposit in the Revenue Fund established under the First Resolution until the amount so deposited equals the Minimum Monthly Balance and the Required Deposits for such month. The Minimum Monthly Balance is the amount required to accumulate the funds necessary for timely payment of all debt service on Outstanding Bonds. Required Deposits are the amounts required to be paid from Revenues for deposit to the Authority Expense Fund (including both periodic and termination payments under Interest Rate Exchange Agreements (see “APPENDIX D — FINANCIAL STATEMENTS — Note 10”)), the Debt Service Reserve Fund and the Subordinated Indebtedness Fund, including amounts required for payment of the Second Resolution Bonds and other subordinate debt. See “APPENDIX C — GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS — Summary of the Agreement — Minimum Monthly Balance.”

After the Board makes the deposits described above to the First Resolution Revenue Fund in such month from the balance remaining in the Local Water Fund, the Board is required, after paying monthly Board Expenses, to pay the City $\frac{1}{2}$ of the Operating Expenses for such Fiscal Year. After making such payments, any amounts remaining in the Local Water Fund in each month are paid proportionately (a) to the Trustee for deposit in the First Resolution Revenue Fund until the total of all amounts deposited in the First Resolution Revenue Fund equals the Cash Flow Requirement for such Fiscal Year and (b) to the City until all amounts required to be paid to the City for Operating Expenses for such Fiscal Year have been paid. Pursuant to the Second Resolution, amounts deposited into the First Resolution Revenue Fund in any Fiscal Year in excess of the amounts required to be deposited into the First Resolution’s Debt Service Fund, Authority Expense Fund, Debt Service Reserve Fund, and Arbitrage Rebate Fund are to be deposited into the Subordinated Indebtedness Fund established under the First Resolution until the amount on deposit therein, together with the amounts on deposit in the Revenue Fund and Debt Service Fund established under the Second Resolution, equals the Aggregate Debt Service for such Fiscal Year on Second Resolution Bonds, Parity Bond Anticipation Notes and Parity Reimbursement Obligations. For a more complete description of the required payments from the Local Water Fund, see “APPENDIX C — GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS — Summary of the First Resolution” and “Summary of the Agreement.”

Amounts on deposit in the Subordinated Indebtedness Fund will be available to pay debt service on Second Resolution Bonds to the extent not otherwise required under the terms of the First Resolution. On the first day of each calendar month a portion of the amounts on deposit in the Subordinated Indebtedness Fund will be transferred free and clear of the lien of the First Resolution to the Revenue Fund under the

Second Resolution in an amount sufficient, together with the amount on deposit in the Revenue Fund and Debt Service Fund established under the Second Resolution, to make the amount on deposit therein equal the Monthly Balance (as defined in the Second Resolution). The Monthly Balance is the amount required to provide for timely payment of all Debt Service on Outstanding Second Resolution Bonds, Parity Bond Anticipation Notes and Parity Reimbursement Obligations. See “APPENDIX C — GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS — Definition of Certain Terms Used in Second Resolution — Monthly Balance.”

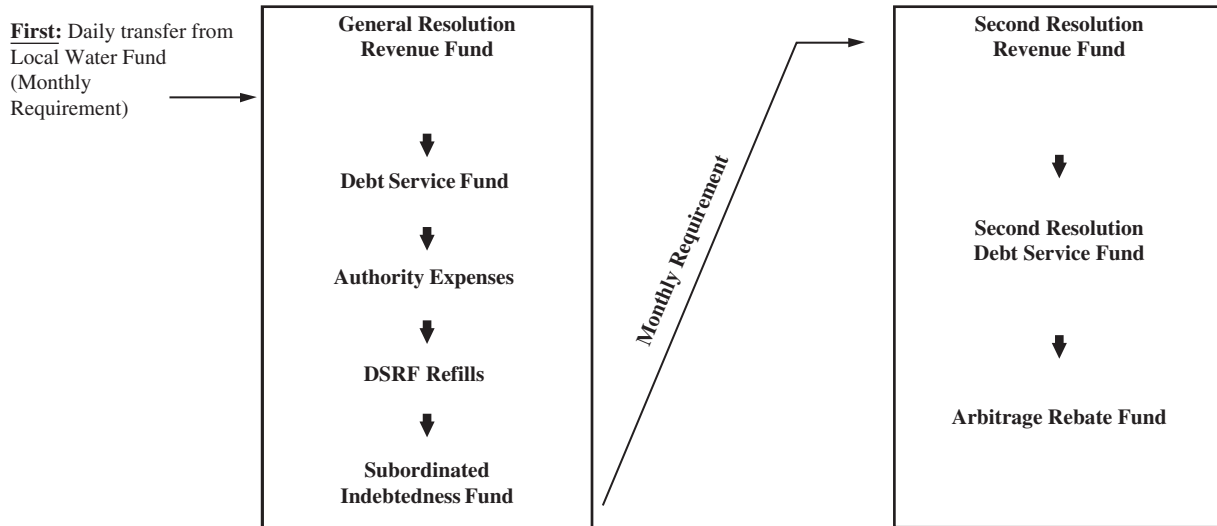
In addition, beginning on the day when no First Resolution Bonds are Outstanding, Revenues are to be deposited from the Local Water Fund into the Revenue Fund established under the Second Resolution. As described below, such Revenues will be used to make payments to the Authority Expense Fund, the Arbitrage Rebate Fund and the Subordinated Indebtedness Fund established under the Second Resolution.

Amounts on deposit in the Revenue Fund established under the Second Resolution are to be paid to the following funds established under the Second Resolution in the following order of priority: first, to the Debt Service Fund; second, if no First Resolution Bonds are then Outstanding, to the Authority Expense Fund; third, to the Debt Service Reserve Fund to replenish any deficiency therein; fourth, to the Arbitrage Rebate Fund; and fifth, if no First Resolution Bonds are then Outstanding, to the Subordinated Indebtedness Fund established under the Second Resolution, the amount required to be deposited in such Fund for such month in accordance with the Authority Budget. See “APPENDIX C — GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS — Summary of the Second Resolution — Payments into Certain Funds.”

The Fiscal 2009 EE Bonds will be on a parity with all other outstanding Second Resolution Bonds heretofore and hereafter issued. The Fiscal 2009 EE Bonds are payable from and secured by a pledge of (a) amounts on deposit in the Subordinated Indebtedness Fund, subject, however, to the first lien on such amounts in favor of First Resolution Bonds and (b) except as described below under the heading “Debt Service Reserve Fund,” all moneys or securities in any of the funds and accounts established under the Second Resolution, except the Arbitrage Rebate Fund. See “APPENDIX C — GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS — Summary of the Second Resolution” and “Summary of the Agreement.”

Pursuant to the Agreement, the First Resolution and the Second Resolution, the Revenues received by the Board will be applied in the manner set forth in the following chart. The information contained in such chart is qualified by reference to the Agreement, the First Resolution and the Second Resolution.

Consolidated Flow of Funds



Second: Daily transfer from Local Water Fund (Monthly Requirement)

- • Water Board Expenses

Third: Daily transfer from Local Water Fund (Monthly Requirement)

- • System Operations and Maintenance

Fourth: Daily transfer from Local Water Fund (Up to Annual Requirement)

- Pro rata to:
 - First Resolution Revenue Fund: for annual Debt Service, Authority expenses, DSRF, Subordinate Indebtedness (Second Resolution)
 - System Operations and Maintenance

Fifth - Seventh: Daily transfer from Local Water Fund (After Debt Service is set aside; typically funded during the last few months of the fiscal year)

- • City lease payment, operating and maintenance reserve replenishment, surplus including pay as you go capital

Debt Service Reserve Fund

No deposit will be made to the Debt Service Reserve Fund established under the Second Resolution upon the issuance of the Fiscal 2009 EE Bonds, and the Fiscal 2009 EE Bonds will not be secured by any amounts on deposit in such Debt Service Reserve Fund in the future. For a discussion of the Debt Service Reserve Fund established under the Second Resolution, see “APPENDIX C – GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS – Summary of the Second Resolution – Debt Service Reserve Fund.”

Rate Covenant

The Board has covenanted in the Agreement to establish, fix, revise and collect rates, fees and charges for the use of, or the services furnished by the System, adequate, together with other available funds, to provide for (i) the timely payment of Principal Installments of and interest on all First Resolution Bonds, and the principal of and interest on any other indebtedness of the Authority (which includes Second Resolution Bonds and other subordinate debt) payable from Revenues, (ii) the proper operation and maintenance of the System, (iii) all other payments required for the System not otherwise provided for, and (iv) all other payments required pursuant to the Agreement and the Lease.

Without limiting the generality of the foregoing, the Board has covenanted to establish and collect rates, fees and charges sufficient in each Fiscal Year so that Revenues collected in such Fiscal Year will be at

least equal to the sum of 115% of Aggregate Debt Service and Projected Debt Service on all First Resolution Bonds (excluding Refundable Principal Installments that are payable from funds held in trust therefor) payable in such Fiscal Year, and 100% of the Operating Expenses and Required Deposits (including debt service on Second Resolution Bonds and other subordinate debt) required to be paid from Revenues for such Fiscal Year (the “Rate Covenant”).

Under the First Resolution and the Second Resolution, the Authority is required to submit to the Board by May 1 of each year the Authority Budget for the ensuing Fiscal Year showing the itemized estimated Cash Flow Requirement for such Fiscal Year. At the beginning of each month, the Authority is to recalculate the Cash Flow Requirement for the then current Fiscal Year and to submit any revisions to the Authority Budget required as a consequence to the Board. The Authority Budget and Cash Flow Requirement are to be used by the Board to set rates, fees and charges.

The Board has covenanted in the Agreement to review the adequacy of rates, fees and charges at least annually. If such annual review, or the report of the Rate Consultant required pursuant to the Agreement, indicates that the rates, fees and charges are or will be insufficient to meet the requirements of the Rate Covenant described above, the Board will promptly take the necessary action to cure or avoid any such deficiency. In addition, under the Agreement, the City, which is responsible for billing, collecting and enforcing collections of rates and charges established by the Board, has agreed that it will diligently pursue all actions necessary to cure or avoid any such deficiency.

The Board has covenanted in the Agreement that it will not furnish or supply or cause to be furnished or supplied any product, use or service of the System free of charge or at a nominal charge, and will enforce (or cause the City to enforce) the payment of any and all amounts owing to the Board for use of the System, except to the extent required by the Act, as in effect on July 24, 1984.

Additional Second Resolution Bonds

The Authority may issue additional Second Resolution Bonds to pay for capital improvements to the System, to pay or provide for the payment of First Resolution Bonds, Second Resolution Bonds, bond anticipation notes, including commercial paper notes, to refund general obligation bonds of the City issued for water or sewer purposes and to fund certain reserves. Under the Second Resolution such additional Second Resolution Bonds may be issued on a parity with all Second Resolution Bonds Outstanding only upon satisfaction of certain requirements including receipt by the Trustee of a certificate by an Authorized Representative of the Authority to the effect that the Revenues for either of the last two Fiscal Years immediately preceding the Fiscal Year in which such Second Resolution Bonds are to be issued were at least equal to the sum of 110% of the Aggregate Debt Service on Outstanding First Resolution Bonds, Second Resolution Bonds, Parity Bond Anticipation Notes and Parity Reimbursement Obligations during such Fiscal Year (excluding from Aggregate Debt Service the amount thereof paid from a source other than Revenues), and 100% of the sum of the Operating Expenses of the System certified by the City and the Required Deposits for such Fiscal Year (excluding Required Deposits for the payment of Outstanding Second Resolution Bonds, Parity Bond Anticipation Notes and Parity Reimbursement Obligations).

The Authority may issue additional Second Resolution Bonds for the purpose of refunding Outstanding Bonds without satisfaction of the requirements described above only if:

- (a) the average annual debt service on the refunding Second Resolution Bonds does not exceed the average annual debt service on the Bonds to be refunded, and
- (b) the maximum debt service in any Fiscal Year on the refunding Second Resolution Bonds does not exceed the maximum debt service in any Fiscal Year on the Second Resolution Bonds to be refunded.

See “APPENDIX C — GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS — Summary of the Second Resolution.”

Authority Debt

At the date of this Official Statement, the Authority has approximately \$11.3 billion aggregate principal amount of Outstanding First Resolution Bonds (Capital Appreciation Bonds are included at their accreted value as of January 14, 2009). In addition, at the date of this Official Statement, the Authority has

approximately \$8.9 billion aggregate principal amount of Outstanding Second Resolution Bonds. Of such First Resolution Bonds and Second Resolution Bonds, approximately \$2.5 billion are variable rate demand bonds, none of which is insured, and none of which is an auction rate bond. The Authority is authorized to have outstanding up to \$1 billion of commercial paper notes (the “Commercial Paper Notes”).

Second Resolution Bonds are payable from, among other sources, and secured by, a pledge of amounts on deposit in the Subordinated Indebtedness Fund, subject to the first lien on such amounts in favor of the First Resolution Bonds. Amounts on deposit in the Subordinated Indebtedness Fund will be available, to the extent not utilized for First Resolution Bonds, to pay debt service on Second Resolution Bonds.

The Commercial Paper Notes are special obligations of the Authority, the proceeds of which are used to pay the costs of capital improvements to the System. The Commercial Paper Notes, Series One, Series Five and Series Six are each secured by standby line of credit agreements which provide liquidity for such Commercial Paper Notes. The Authority has authorized its Extendable Municipal Commercial Paper Notes, Series Seven and Extendable Municipal Commercial Paper Notes, Series Eight (collectively, the “EMCP Notes”). Principal of and interest on the EMCP Notes are not secured by any liquidity or credit facility and are payable from remarketing proceeds and the proceeds of additional EMCP Notes, First Resolution Bonds or Second Resolution Bonds. Interest on the Commercial Paper Notes is secured by the Revenues of the System and the moneys and investments from time to time on deposit in the Subordinated Indebtedness Fund and the funds and accounts established under the respective commercial paper resolutions authorizing their issuance. However, the pledge of the Revenues and the moneys and investments from time to time on deposit in the Subordinated Indebtedness Fund is subject and subordinate to the pledge thereof made by the First Resolution for the benefit of the holders of First Resolution Bonds. The Authority’s obligations to the banks providing standby lines of credit in connection with outstanding Commercial Paper Notes, including the Authority’s obligation to pay interest on moneys advanced, are secured by a pledge of the moneys and investments on deposit in the Subordinated Indebtedness Fund on a parity with the pledge to secure the Second Resolution Bonds. Interest on such advances is also secured by a pledge of Revenues which is subordinate to the pledge securing the First Resolution Bonds.

Other Authority Indebtedness

The Authority has outstanding \$132,685,000 of its Crossover Refunding Bonds that it had previously issued (the “Crossover Bonds”). Each series of Crossover Bonds was issued pursuant to a separate Crossover Refunding Bond Resolution of the Authority. Each series of Crossover Bonds is secured by the proceeds of such series of Crossover Bonds and any investment income thereon, until such Crossover Bonds’ respective tender dates. Guaranteed investment contracts are expected to provide sufficient amounts to pay debt service on the Crossover Bonds until their respective tender dates. The Crossover Bonds have a subordinate lien on the Subordinated Indebtedness Fund under the Second Resolution but have no lien on Revenues. If certain conditions are met on the relevant tender date, the Crossover Bonds of the respective series will be exchanged for First Resolution Bonds to be issued pursuant to the First Resolution and the proceeds of the respective series of Crossover Bonds will be applied to redeem other Outstanding Bonds of specified series. The final exchange of its Crossover Bonds for First Resolution Bonds is to occur on June 15, 2010.

Derivatives

In an effort to reduce its borrowing costs over the life of its bonds, the Authority has entered into interest rate exchange agreements. For more information on the Authority’s interest rate exchange agreements, see “APPENDIX D — FINANCIAL STATEMENTS — Note 8.”

Covenant of the State

Section 1045-t of the Act constitutes a pledge of the State to the holders of First Resolution Bonds and Second Resolution Bonds not to limit or alter the rights vested in the Authority or the Board by the Act to fulfill the terms of any agreement made with or for the benefit of the holders of the First Resolution Bonds and Second Resolution Bonds until such obligations together with the interest thereon are fully met and discharged.

THE AUTHORITY

Purpose and Powers

The Authority is a public benefit corporation created pursuant to the Act. Among its powers under the Act, the Authority may borrow money, issue debt and enter into the Agreement, and refund its bonds and notes and general obligation bonds of the City issued for water or sewer purposes. Additionally, the Authority has the power to require that the Board charge and collect sufficient rates to pay the costs of operating and financing the System and to enforce the obligation of the City to adequately operate and maintain the System, regardless of reimbursement by the Board of costs incurred by the City for operation and maintenance.

Pursuant to the Act, there is a statutory first lien on the Revenues in favor of the payment of all amounts due to the Authority under the Agreement. The Revenues remain subject to this lien until provision for payment of all indebtedness issued by the Authority has been made. See “Certain Legal Opinions” for a description of the opinion rendered by Bond Counsel that in the event of a City bankruptcy, a court, exercising reasonable judgment after full consideration of all relevant factors, would not hold that the Revenues are property of the City.

Membership

The Act authorizes a seven-member board to administer the Authority. Four of the members of the Board of Directors are designated in the Act as *ex officio* members: the Commissioner of Environmental Protection of the City, the Director of Management and Budget of the City, the Commissioner of Finance of the City and the Commissioner of Environmental Conservation of the State. Of the three remaining public members, two are appointed by the Mayor and one is appointed by the Governor. The public members have terms of two years. Pursuant to the Act, all members continue to hold office until their successors are appointed and qualified.

The current members of the Board of Directors are:

| <u>Member</u> | <u>Occupation</u> |
|-----------------------------------|---|
| Mark Page(1) | Director of Management and Budget of the City |
| Alexander B. Grannis(1) | Commissioner of Environmental Conservation of the State |
| Martha E. Stark(1). | Commissioner of Finance of the City |
| Steven Lawitts(1) | Acting Commissioner of Environmental Protection of the City |
| Arthur B. Hill(3) | Retired, United Parcel Service |
| Peter J. Kenny(2) | Retired Partner, Willkie Farr & Gallagher |
| Marc V. Shaw(2). | Senior Advisor to the Governor of the State |

- (1) *Ex officio*.
- (2) Appointed by the Mayor.
- (3) Appointed by the Governor.

The following is a brief description of certain officers and staff members of the Authority:

Alan L. Anders, Chief Executive Officer

Mr. Anders was appointed Chief Executive Officer in March 2007 after serving as Executive Director from June 2002 and Treasurer from October 1990 to June 2002. Mr. Anders also serves as Deputy Director for Finance of the Office of Management and Budget of the City. Prior to joining the Authority and the City in September 1990, Mr. Anders had been a senior investment banker for J.P. Morgan Securities since 1977. Prior to that date, he was Executive Director of the Commission on Governmental Efficiency and Economy in Baltimore, Maryland. Mr. Anders is a graduate of the University of Pennsylvania and the University of Maryland Law School.

Thomas G. Paolicelli, Executive Director

Mr. Paolicelli was appointed Executive Director in August 2008. Prior to joining the Authority, Mr. Paolicelli was a Vice President/Senior Analyst for Moody's Investors Service ("Moody's") in their U.S. Public Infrastructure Team. Prior to joining Moody's, Mr. Paolicelli worked at the Authority for nearly 5 years where he served in several capacities, including most recently as Treasurer. He has a Master's in Public Administration from the University of Albany and a Bachelor's in Civil Engineering from the University of Buffalo and is also a Professional Engineer.

Marjorie E. Henning, Secretary

Ms. Henning was appointed Secretary in November 1993. Ms. Henning also serves as General Counsel to the Office of Management and Budget of the City. Ms. Henning is a graduate of the State University of New York at Buffalo and the Harvard Law School.

Michele Mark Levine, Comptroller

Ms. Levine was appointed Comptroller in February 2008 after serving as Assistant Comptroller since February 2005. She is a graduate of the State University of New York at Binghamton and the Maxwell School of Citizenship and Public Administration at Syracuse University.

Eileen T. Moran, Deputy Comptroller

Ms. Moran was appointed Deputy Comptroller commencing in November 2007. She is a graduate of Hunter College and Pace University.

Robert L. Balducci, Assistant Comptroller

Mr. Balducci was appointed Assistant Comptroller in December 2008. He is a graduate of Baruch College of the City University of New York.

Prescott D. Ulrey, Assistant Secretary

Mr. Ulrey was appointed Assistant Secretary in February 1998. Mr. Ulrey also serves as Counsel to the Office of Management and Budget of the City. He is a graduate of the University of California at Berkeley, the Fletcher School of Law and Diplomacy of Tufts University and Columbia Law School.

Jeffrey M. Werner, Assistant Secretary

Mr. Werner was appointed Assistant Secretary in March 2004. Mr. Werner also serves as Deputy Counsel to the Office of Management and Budget of the City. He is a graduate of Bowdoin College and Columbia Law School.

Raymond Orlando, Director of Media and Investor Relations

Mr. Orlando was appointed Director of Media and Investor Relations in June 2000. He is a graduate of the University of Pennsylvania and the John F. Kennedy School of Government at Harvard University.

THE BOARD

Purpose and Powers

The Board is a public benefit corporation of the State created by Chapter 515 of the Laws of 1984. The primary responsibility of the Board is to fix, revise, charge, collect and enforce rates and other charges for the System.

The Board is required under the Act to establish rates that will provide adequate funds to pay the debt service on outstanding Authority indebtedness and the City's cost of operating and maintaining the System. In each Fiscal Year, any amounts remaining in the Local Water Fund, after making the required payments under the Agreement, shall be deposited in the General Account in the Operation and Maintenance Reserve Fund and shall be available either as a source of funding for System expenditures or upon certification of the City for deposit to the Authority's Construction Fund to pay for the costs of System capital projects. See "APPENDIX C — GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS — Summary of the Agreement—Application of Moneys in the Operation and Maintenance Reserve Fund."

Pursuant to the Lease, the Board has a leasehold interest in the System for a term continuing until all Bonds or other obligations issued by the Authority are paid in full or provision for payment has been made. Under the Lease, the City is required to provide billing, collection, enforcement and legal services to the Board. The Board is required to compensate the City for the cost of these services.

Membership

The Board consists of seven members who are appointed by the Mayor for terms of two years. The Act provides that at least one member will have experience in the science of water resource development and that no member of the Board will be a member of the Authority. The Chairman is appointed by the Mayor. Pursuant to the Act, all members continue to hold office until their successors are appointed and qualified.

The current members of the Board are:

| <u>Member</u> | <u>Occupation</u> |
|-------------------------------|--|
| Alan Moss, Chair | Retired |
| Marcia Bystryn | President, New York League of Conservation Voters |
| Donald Capoccia | Principal, BFC Partners, L.P. |
| Dawn S. Davis | Bronx Pro Real Estate Management |
| Amaziah Howell | President, Howell Petroleum Products, Inc. |
| Mehul J. Patel | Vice President, Moynihan Station Development Corporation |
| Benjamin A. Tisdell | Associate, Lazard Freres & Co. |

The following is a brief description of the staff members of the Board:

Steven Lawitts, Executive Director

Mr. Lawitts was appointed Executive Director in May 2006. He was appointed First Deputy Commissioner to DEP in May 2006 and Acting Commissioner of DEP in November 2008. Prior to joining DEP, Mr. Lawitts served as Senior Vice President at the New York City School Construction Authority for three years. Mr. Lawitts previously served as Deputy Commissioner of the New York City Department of Sanitation for nearly ten years. Prior to that, Mr. Lawitts served sixteen years in the transportation industry, including the MTA (where he was Chief Financial Officer of the Long Island Railroad), Conrail and Amtrak. Mr. Lawitts is a graduate of Columbia College and received an MBA from Columbia University.

William Kusterbeck, Treasurer

Mr. Kusterbeck was appointed Treasurer in November 1985. Mr. Kusterbeck has worked for DEP since 1979. He has served in various positions in DEP including Director of Rates and Revenue, and

Director of the Office of Planning. Mr. Kusterbeck is a graduate of Hunter College of the City University of New York and Columbia University Graduate School of Business.

Carmelo Emilio, Deputy Treasurer

Mr. Emilio was appointed Deputy Treasurer in June 2000. He has worked for the City since 1976, and has served as the Chief of Financial Operations at the Water Board from 1996. Prior to joining the Water Board, Mr. Emilio worked with the New York City Office of Management and Budget as a Revenue Analyst. Mr. Emilio is a graduate of Baruch College of the City University of New York.

Albert F. Moncure, Jr., Secretary

Mr. Moncure was named Acting Secretary in February 1997 and Secretary in April 1997. Mr. Moncure also serves as Chief of the Municipal Finance Division of the New York City Law Department. Mr. Moncure has worked for the Law Department since 1986. Mr. Moncure is a graduate of Dartmouth College and the Yale Law School.

THE DEPARTMENT OF ENVIRONMENTAL PROTECTION

Organization

Over 5,600 DEP staff members are assigned to the System. Approximately 800 people within the System staff are assigned to the design and construction of ongoing capital projects, including projects within the CIP, as hereinafter defined, and approximately 500 provide administrative and support services to both System and non-System staff. There are approximately 300 additional employees within the DEP staff whose duties are not related to water and sewer service and whose cost is not included as a System cost.

The New York City Department of Design and Construction (the “DDC”) has responsibility for the construction and reconstruction of water and sewer mains in the City. Based upon current workloads, a proportion of DDC’s staff equivalent to 350 full-time positions is devoted to System construction projects.

DEP is managed by a Commissioner, who is appointed by the Mayor. It is organized into nine bureaus: Customer Services; Water and Sewer Operations; Water Supply; Engineering Design and Construction; Wastewater Treatment; Environmental Planning; Human Resources, Administration; Legal Affairs; and Executive.

The following are brief descriptions of certain management personnel responsible for the operation of the System.

Steven Lawitts, Acting Commissioner

Mr. Lawitts was appointed Acting Commissioner in November 2008, prior to serving as First Deputy Commissioner to DEP since May 2006. Prior to joining DEP, Mr. Lawitts served as Senior Vice President at the New York City School Construction Authority for three years. Mr. Lawitts previously served as Deputy Commissioner of the New York City Department of Sanitation for nearly ten years. Prior to that, Mr. Lawitts served sixteen years in the transportation industry, including the MTA (where he was Chief Financial Officer of the Long Island Railroad), Conrail and Amtrak. Mr. Lawitts is a graduate of Columbia College and received an MBA from Columbia University.

Douglas S. Greeley, P.E., Deputy Commissioner

Mr. Greeley was appointed Director of the Bureau of Wastewater Treatment in February 2006. He has been with DEP since 1973 and has served in numerous capacities, including Chief of System Operations, Chief of the Maintenance Division, Chief of the Repairs Division of DEP’s Bureau of Water Supply and Wastewater Collection and Director of the Bureau of Water and Sewer Operations. Mr. Greeley is a graduate of the Stevens Institute of Technology. He is a Professional Engineer.

Angela Licata, Deputy Commissioner

Ms. Licata was appointed Deputy Commissioner of the Bureau of Environmental Planning in December 2005. She has been with DEP since 1988 and has served in numerous positions within the Office of Environmental Planning and Assessment, including Project Manager, Director of Program Management and most recently as Deputy Director. Ms. Licata is a graduate of Harpur College, Binghamton University.

Jim Mueller, Deputy Commissioner

Jim Mueller, was appointed Deputy Commissioner of the Bureau of Engineering Design and Construction in April 2008. Mr. Mueller has been with DEP since 1993 serving in a variety of roles, most recently as Director of Facilities Planning and Design for the Bureau of Engineering Design and Construction. Mr. Mueller holds a B.A. in Civil Engineering from Manhattan College and a Master of Science degree in Environmental Engineering and an MBA in Finance and Statistics from the Stern School of Business at New York University.

James Roberts, Deputy Commissioner

James J. Roberts, P.E. was appointed Deputy Commissioner of the Bureau of Water and Sewer Operations in November 2006. Mr. Roberts has been with DEP since 1986 and has served in numerous capacities including Borough Construction Engineer in the Borough of Queens and Chief of Shaft and Tunnel Maintenance and Operations for the Bureau of Water and Sewer Operations. Mr. Roberts is a Registered Professional Engineer and a graduate of Manhattan College's School of Engineering.

Paul Rush, P.E., Deputy Commissioner

Mr. Rush was appointed Deputy Commissioner of the Bureau of Water Supply in December 2006. He has been with the DEP since 1992. Most recently, Mr. Rush served as the Director, West of Hudson Operations Division of the Bureau of Water Supply and prior to that he held positions as District Engineer and Chief of Operations for the City's Delaware Water Supply System. Prior to joining DEP, Mr. Rush served on active duty with the United States Army as an Engineer Officer. Mr. Rush holds a Master of Science degree in Civil Engineering from Michigan Technological University and Bachelor of Science degree in Civil Engineering from the United States Military Academy. He is a Registered Professional Engineer in the State of New York.

Joseph Singleton, Deputy Commissioner

Mr. Singleton was appointed Deputy Commissioner for the Bureau of Customer Services in August 2006. He has been with DEP since 1995, serving in a variety of roles, including as Director of the Capital Budget. Mr. Singleton graduated with a B.A. in Economics from The State University of New York at Albany and received an MBA from St. John's University.

Labor Relations

During the last decade, there have been no strikes or major work stoppages of DEP employees affecting the System. Approximately 95% of DEP's employees are members of labor unions which represent such employees in collective bargaining with the City. The majority of DEP employees who are members of unions are members of District Council 37 of the American Federation of State, County and Municipal Employees ("DC 37"). An agreement with DC 37, covering the period from March 3, 2008 through March 2, 2010, was ratified on December 8, 2008.

CAPITAL IMPROVEMENT AND FINANCING PROGRAM

Ten Year Capital Strategy, Current Capital Plan and the Capital Improvement Program

The City's Preliminary Ten Year Capital Strategy, which is updated every two years, was released on November 26, 2008 (the "Preliminary Ten Year Capital Strategy"). The Preliminary Ten Year Capital Strategy includes the projected capital improvements to the System for Fiscal Years 2010 through 2019. The Preliminary Ten Year Capital Strategy will be finalized in connection with the release of the City's budget in June 2009. The City's Current Capital Plan (the "Current Capital Plan"), which covers Fiscal Years 2009 through 2013, published on November 5, 2008, is updated three times each Fiscal Year and is consistent with the Preliminary Ten Year Capital Strategy for Fiscal Years 2010 through 2013. The Current Capital Plan is expected to be updated in late January 2009.

The Preliminary Ten Year Capital Strategy, together with the Current Capital Plan, comprises the Capital Improvement Program (the "CIP"). The CIP establishes long range programmatic goals for the System and reflects a review of the present condition and long-term needs of the plant and equipment constituting the System. The CIP incorporates the present replacement cycle for System facilities, extensions to the present service area, and programs to enhance and optimize the operation of the System. Allowances are included in the CIP for emergency repair and replacement. The value of the actual work done in any given year will differ from that outlined in the CIP. Expected capital commitments for the years beyond the Current Capital Plan will differ from those shown in the CIP due to the addition of new projects, as well as due to changes in project schedules and costs.

The CIP was evaluated independently by Metcalf & Eddy. Metcalf & Eddy concluded that the CIP is responsive to the long-term operating requirements of the area served by the System. See "APPENDIX A—LETTER METCALF & EDDY, CONSULTING ENGINEERS."

Although Amawalk Consulting, the Authority's rate consultant, has not performed a detailed independent review of the capital program elements and has not made an engineering evaluation of the System, Amawalk Consulting has concluded that the gross level of anticipated commitments through Fiscal Year 2019 as reflected in the CIP appears to be reasonable compared to other large water and wastewater utilities.

Implementation of the CIP is dependent upon the ability of the Authority to market successfully its bonds and notes. Recent turmoil in the financial markets has led to constraints on the availability of credit to all borrowers including governmental entities. The success of projected public sales of Authority bonds and notes will be subject to prevailing market conditions. Future developments in the financial markets generally, as well as future developments concerning the Authority and the System, may affect the market for outstanding Authority bonds and notes.

The CIP is presented in the following table.

**CAPITAL IMPROVEMENT PROGRAM
(Thousands of Dollars)**

| CITY FUNDS | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Total |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| WATER SUPPLY AND TRANSMISSION | | | | | | | | | | | | |
| Conveyance | \$ 58,243 | \$ 71,759 | \$ 108,761 | \$ 160,607 | \$ 313,425 | \$ 215,289 | \$ 183,465 | \$ 139,280 | \$ 209,897 | \$ 25,000 | \$ 611,922 | \$ 2,097,648 |
| Kensico-City Tunnel | — | — | — | — | — | 323,453 | 28,217 | — | 24,744 | — | 21,676 | 74,637 |
| City Tunnel No. 3, Stage 1 | 1,597 | 11,810 | 56,293 | 39,198 | 81,411 | — | — | — | — | 250,000 | — | 763,762 |
| City Tunnel No. 3, Stage 2 | 250,356 | 218,906 | 320 | 43,884 | 45,332 | 24,469 | 9,446 | 85,007 | 467 | 475 | 482 | 679,144 |
| City Tunnel No. 1 Reconstruction | 2,737 | — | 3,608 | 30,179 | — | 30,095 | — | 13,213 | 136,090 | — | 10,838 | 226,760 |
| Miscellaneous Programs | — | — | — | — | — | — | — | — | — | — | — | — |
| Subtotal | 312,933 | 302,475 | 168,982 | 273,868 | 440,168 | 593,306 | 221,128 | 237,500 | 371,198 | 275,475 | 644,918 | 3,841,951 |
| WATER DISTRIBUTION | | | | | | | | | | | | |
| Brooklyn-Queens Aquifer | 2,000 | — | 5,000 | — | 4,104 | — | — | — | — | — | — | 11,104 |
| Croton Filtration Project | 358,278 | 77,300 | 37,000 | — | — | 90,000 | — | — | — | — | — | 562,578 |
| Dam Safety Program | 37,422 | 107,000 | 435,976 | 141,461 | 138,098 | — | — | — | — | — | — | 859,957 |
| Trunk Distribution and Main Extension | 8,505 | 4,277 | 9,453 | 6,931 | 44,110 | — | 12,090 | — | — | — | — | 85,366 |
| Trunk Distribution and Main Replacement | 74,153 | 152,860 | 206,121 | 125,920 | 164,774 | 104,905 | 201,029 | 201,029 | 142,384 | 48,795 | 138,205 | 1,595,835 |
| Water Quality Preservation | 389,609 | 139,574 | 418,132 | 145,726 | 41,770 | 28,797 | 236,689 | 200,442 | 25,962 | 34,138 | 25,482 | 1,484,645 |
| Extensions | 2,045 | 3,268 | 860 | 4,500 | 4,500 | — | 35,011 | — | — | — | — | 10,673 |
| Other System Improvements | 8,225 | 1,209 | 8,699 | 15,556 | 16,383 | — | — | — | — | — | — | 50,072 |
| Subtotal | 880,237 | 485,488 | 1,121,241 | 435,594 | 413,739 | 223,702 | 283,790 | 401,471 | 168,346 | 82,933 | 163,687 | 4,660,228 |
| WATER POLLUTION CONTROL | | | | | | | | | | | | |
| Consent Decree Upgrading & Construction | 907,072 | 570,678 | 71,425 | 22,000 | 15,158 | 16,000 | — | 8,000 | — | — | 8,000 | 1,618,333 |
| Plant Upgrading & Reconstruction | 239,339 | 32,316 | 169,124 | 129,304 | 143,535 | 172,033 | 257,939 | 240,586 | 185,000 | 185,000 | 128,991 | 1,883,167 |
| Sludge Disposal | 523 | — | — | — | — | — | — | — | — | — | — | 523 |
| Plant Component Stabilization(1) | 170,062 | 9,985 | 40,769 | 18,867 | 15,800 | 30,095 | 91,017 | 133,020 | 550,140 | 309,049 | 110,466 | 2,855,578 |
| Water Quality Mandates | 292,835 | 44,924 | 27,444 | 138,285 | 268,596 | 134,044 | 91,017 | 381,606 | 735,140 | 494,049 | 247,457 | 2,099,820 |
| Subtotal | 1,609,831 | 657,903 | 308,762 | 308,456 | 443,089 | 352,172 | 348,956 | 381,606 | 735,140 | 494,049 | 247,457 | 5,887,421 |
| SEWERS | | | | | | | | | | | | |
| Replacement or Augmentation | 34,823 | 33,735 | 67,786 | 43,456 | 104,467 | 35,452 | 65,416 | 38,168 | 39,504 | 40,254 | 41,020 | 544,081 |
| Extensions to Accommodate New Development | 82,548 | 44,354 | 91,337 | 91,250 | 96,181 | 190,085 | 183,885 | 183,224 | 133,654 | 86,979 | 7,648 | 1,191,145 |
| Programmatic Response to Regulatory Mandates | 540 | — | — | — | — | — | — | — | — | — | — | 540 |
| Programmatic Replacement and Reconstruction | — | 21,581 | 1,000 | 11,365 | 3,507 | — | — | — | — | — | — | 37,453 |
| Replacement of Chronically Failing Components | 86,319 | 16,707 | 63,141 | 57,977 | 78,980 | 63,344 | 62,665 | 63,297 | 63,962 | 64,227 | 64,498 | 685,117 |
| Trunks | 2,717 | — | 4,802 | 100 | 4,088 | 1,284 | — | — | — | — | — | 12,991 |
| Subtotal | 206,947 | 116,377 | 228,066 | 204,148 | 287,223 | 290,165 | 311,966 | 284,689 | 237,120 | 191,460 | 113,166 | 2,471,327 |
| EQUIPMENT | | | | | | | | | | | | |
| Conservation | 140,907 | — | 28,371 | 24,300 | 17,000 | 17,000 | — | — | — | — | — | 227,578 |
| Management Information Systems | 25,518 | 33,197 | 5,726 | 17,525 | 15,527 | 12,885 | — | — | — | — | — | 110,378 |
| Facility Purchases & Reconstruction | 37,285 | 8,549 | 7,345 | 44,799 | — | — | — | — | — | — | — | 97,976 |
| Utility Relocation | 20,669 | 9,294 | 11,736 | 11,823 | 5,901 | 30,080 | 3,662 | — | — | — | — | 93,165 |
| Vehicles and Equipment | 22,567 | 8,456 | 5,630 | 11,370 | 15,527 | 12,885 | — | — | — | — | — | 76,435 |
| Subtotal | 246,946 | 59,496 | 58,806 | 109,817 | 53,955 | 72,850 | 3,662 | — | — | — | — | 605,352 |
| TOTAL CITY FUNDS | 3,256,894 | 1,621,739 | 1,885,857 | 1,331,883 | 1,638,174 | 1,532,195 | 1,169,502 | 1,305,266 | 1,511,804 | 1,043,917 | 1,169,228 | 17,466,459 |
| STATE, FEDERAL, AND PRIVATE FUNDS | | | | | | | | | | | | |
| Water Quality Preservation | — | — | 10,000 | — | — | — | — | — | — | — | — | — |
| Management Information Systems | 3,170 | — | — | — | — | — | — | — | — | — | — | 13,170 |
| Plant Upgrading & Reconstruction | 2,563 | 742 | — | — | — | — | — | — | — | — | — | 2,563 |
| Plant Component Stabilization(1) | — | — | — | — | — | — | — | — | — | — | — | 742 |
| Water Quality Mandates | 45 | — | — | — | — | — | — | — | — | — | — | 45 |
| Other System Improvements | — | — | — | — | — | — | — | — | — | — | — | — |
| Subtotal | 6,520 | — | 10,000 | — | — | — | — | — | — | — | — | 16,320 |
| TOTAL NON-CITY FUNDS | \$3,263,414 | \$1,621,739 | \$1,895,857 | \$1,331,883 | \$1,638,174 | \$1,532,195 | \$1,169,502 | \$1,305,266 | \$1,511,804 | \$1,043,917 | \$1,169,228 | \$17,482,979 |

(1) Plant Component Stabilization includes amounts for the biological nutrient removal program.

Following is an explanation of the major capital program elements within the CIP.

Water Supply and Transmission

Conveyance and Water Supply. This program will research and develop alternate conveyance conduits and/or water supplies for the City in order to provide more dependability within the Water System. The alternate water supplies could be used during drought situations, to augment the City's daily water supply, or during repairs and inspections of existing aqueducts and tunnels.

Tunnel 3. Stages I and II of Tunnel 3 include completion of the Brooklyn/Queens and Manhattan segments. Stage I became operational in July 1998 and has improved the reliability of the transmission system. Stage I amounts also relate to facility improvements at Hillview Reservoir. Completion of the Brooklyn/Queens segment of Stage II will improve services to Staten Island, Brooklyn and Queens. Activation of the Brooklyn and Queens segment of Stage II will follow activation of the Manhattan segment of Stage II which is expected to be completed in 2013. The entire Stage II is scheduled to be completed in 2015. See "THE SYSTEM — The Water System — Water Collection and Distribution."

Kensico-City Tunnel. The Kensico-City Tunnel will be a 16 mile long tunnel from the Kensico Reservoir to the Van Cortlandt Park Valve Chamber, bypassing the Hillview Reservoir. This tunnel will provide redundancy for the sections of the Catskill and Delaware Aqueducts that run from the Kensico Reservoir to the City.

Water Distribution

Croton Filtration Project. The City is a party to a federal court consent decree with the United States and the State which sets out a timetable for the design and construction of a full-scale water treatment facility to filter Croton System water. See "THE SYSTEM — The Water System — Governmental Regulation."

Dam Safety Program. Engineering reports sponsored by the U.S. Army Corps of Engineers indicated that the dams and reservoirs in service in the Catskill, Croton and Delaware Systems are safe but in need of rehabilitation and reconstruction. An ongoing dam reconstruction program has been established for rehabilitation of dams within the Catskill, Croton and Delaware watersheds and the Kensico Dam.

Trunk Distribution and Main Extension and Replacement. This program includes the improvement and extension of the water distribution network for both trunk and distribution water mains. The program facilitates the replacement of undersized or failing system elements, as well as enhancing network reliability.

Water Quality Preservation. The City provides for improvements to the upstate watersheds including projects undertaken pursuant to the FADs (as hereinafter defined) in the Catskill and Delaware watersheds such as the acquisition of environmentally sensitive property, the upgrade of non-City owned water pollution control facilities and the construction of an ultraviolet water treatment facility. Other projects in the upstate watersheds include enhanced security systems and planing for the repair of the leak in the Rondout-West Branch Tunnel. See "THE SYSTEM — Overview," "THE SYSTEM — The Water System — Water Collection and Distribution," and "THE SYSTEM — The Water System — Governmental Regulation."

Water Pollution Control

Consent Decree Upgrading and Construction. The Clean Water Act (as hereinafter defined) and the State Consent Decrees (as hereinafter defined) require construction of an intercepting sewer for one of the fourteen plants, and the upgrading of six plants. The plant upgrades include the retrofitting of five plants to achieve additional nitrogen treatment and upgrades at the Newtown Creek plant to achieve secondary treatment and improve plant operations. In addition, during periods of heavy rainfall, a combination of stormwater and sewage bypasses treatment and is released into the City's waterways through the City's combined sewer overflow ("CSO") outfalls. Pursuant to a consent order between DEP and the New York State Department of Environmental Conservation ("NYSDEC"), DEP is implementing projects necessary

to control the polluting effects of such releases. See “THE SYSTEM — The Sewer System — Government Regulation.

Plant Upgrading and Reconstruction. This program includes various projects undertaken to upgrade or reconstruct treatment plants, sewage pump stations, motor vessels, regulators and components of the plant treatment system.

Plant Component Stabilization. This program includes the replacement and reconstruction of failing components within the fourteen plants and their related facilities necessary to maintain reliability and the retrofit of five water pollution control plants to decrease the amount of nitrogen discharged into the surrounding water.

Sewers

Replacement of Chronically Failing Components. This program provides for the replacement of sewers that have already collapsed or experience chronic malfunctions (for example, sagging, bends or improper alignment) that cannot be overcome through maintenance or experience chronic malfunction due to inadequate capacity.

Extensions to Accommodate New Development. The City must provide acceptable sewage disposal methods for residents within its jurisdiction and must therefore construct new sewers as required. The construction of sewers to replace septic tanks in populated areas avoids health problems associated with viruses, bacteria and other sewage-related pollutants and minimizes stormwater flooding.

Equipment

Utility Relocation for Sewers and Water Main Projects. Under the City’s cost-sharing agreement with gas utilities, the City is required to pay 51% of utility work required as a result of water main and sewer construction projects.

Historical Capital Program

The following table presents capital commitments and capital expenditures of the System for Fiscal Years 2004 through 2008. Capital commitments are contractual obligations entered into during the Fiscal Year while capital expenditures represent cash payments made during the Fiscal Year.

**System Capital Commitments and Expenditures
(Millions of Dollars)**

| | FY 2004 | | FY 2005 | | FY 2006 | | FY 2007 | | FY 2008 | |
|---|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|
| | System Funds(1) | All Funds(2) | System Funds(1) | All Funds(2) | System Funds(1) | All Funds(2) | System Funds(1) | All Funds(2) | System Funds(1) | All Funds(2) |
| Commitments | | | | | | | | | | |
| Water Supply and Transmission (3) | \$ 39 | \$ 39 | \$ 746 | \$ 746 | \$ 26 | \$ 26 | \$ 64 | \$ 64 | \$ 20 | \$ 20 |
| Water Distribution | 480 | 481 | 499 | 498(4) | 568 | 568 | 2,253 | 2,253 | 1,839 | 1,838 |
| Water Pollution Control | 877 | 935 | 838 | 839 | 843 | 848 | 1,071 | 1,071 | 843 | 842 |
| Sewers | 216 | 216 | 186 | 187 | 192 | 192 | 177 | 177 | 200 | 200 |
| Equipment | 41 | 41 | 63 | 64 | 73 | 107 | 92 | 92 | 149 | 150 |
| Total | \$1,653 | \$1,711 | \$2,332 | \$2,334 | \$1,702 | \$1,741 | \$3,657 | \$3,690 | \$3,051 | \$3,051 |

| | FY 2004 | | FY 2005 | | FY 2006 | | FY 2007 | | FY 2008 | |
|---|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|
| | System Funds(1) | All Funds(2) | System Funds(1) | All Funds(2) | System Funds(1) | All Funds(2) | System Funds(1) | All Funds(2) | System Funds(1) | All Funds(2) |
| Expenditures (5) | | | | | | | | | | |
| Water Supply and Transmission (3) | \$ 124 | \$ 133 | \$ 147 | \$ 167 | \$ 245 | \$ 261 | \$ 272 | \$ 272 | \$ 868 | \$ 868 |
| Water Distribution | 273 | 371 | 390 | 401 | 445 | 451 | 493 | 493 | 211 | 211 |
| Water Pollution Control | 742 | 810 | 846 | 804 | 778 | 812 | 793 | 805 | 917 | 929 |
| Sewers | 221 | 219 | 213 | 223 | 215 | 216 | 213 | 213 | 190 | 190 |
| Equipment | 44 | 98 | 40 | 85 | 68 | 101 | 76 | 94 | 65 | 71 |
| Total | \$1,404 | \$1,631 | \$1,636 | \$1,680 | \$1,751 | \$1,841 | \$1,847 | \$1,878 | \$2,251 | \$2,269 |

Totals may not add due to rounding.

- (1) System Funds include the proceeds of Authority bonds sold directly to the public and those privately placed with the EFC (as defined below) under the revolving fund program and System revenues.
- (2) All Funds include federal and State capital grants.
- (3) Includes capital costs for improvements to upstate water pollution control plants which were paid for with the proceeds of Authority bonds but which are reported as operating expenses in the System's financial statements because such plants are owned by municipalities outside the City.
- (4) A prior year, non-City contract, which was subsequently cancelled, caused the All-Funds commitment level for FY 2005 to fall below the System Funds level.
- (5) System Funds are shown on a cash basis. All Funds are shown on an accrual basis.

Financing Program

Prior Financing. Since the first issuance of bonds by the Authority in 1985, capital improvements to the System have been financed primarily with (1) proceeds of bonds sold directly to the public and privately placed with New York State Environmental Facilities Corporation (“EFC”) in connection with the revolving loan fund program described below, (2) federal and State capital grants, and (3) cash-financed capital construction paid from System revenues. See “Debt Service Requirements” below.

Future Financing. The Authority estimates that nearly 100% of the System’s capital costs will be paid from: (1) proceeds of bonds and other forms of indebtedness sold to the public and privately placed with EFC and (2) System revenues. Implementation of the CIP is dependent upon the Authority’s ability to market its securities successfully in the public credit markets. For purposes of forecasting revenue requirements for the System, the principal amount of bonds estimated to be issued for capital purposes as of May 1, 2008, excluding refunding bonds, in each of the Fiscal Years 2009 through 2012 averages approximately \$2.3 billion per year. Projected Authority capital spending reflects commitments from both current and prior years. See the table entitled “Sources and Uses of Capital Funds” below.

Historically, federal grant funds were provided pursuant to the federal Water Pollution Control Act, as amended by the Clean Water Act of 1977 and by the Water Quality Act of 1987 (the “Clean Water Act”), in a program administered by the states, for construction and reconstruction of water pollution control facilities. The City has used these grant funds for five water pollution control plants: Oakwood Beach, Coney Island, Owls Head, Red Hook and North River. The Clean Water Act currently requires states to use federal funds in revolving loan programs in lieu of a federal grant program for water pollution control facilities. To this end, a revolving loan program has been established by the State and administered by EFC in order to use federal financial assistance together with State matching grants in a program to assist municipalities to construct eligible sewage facilities by providing subsidized loans. In addition, pursuant to the Safe Drinking Water Act Amendments of 1996, the State has also initiated a revolving loan program, also administered by EFC, to provide loans for drinking water projects. The Authority has participated in loans under both of the revolving loan programs and anticipates further borrowing under the programs. These revolving loan programs have routinely featured the public sale of bonds by EFC to finance the purchase by EFC of Second Resolution Bonds.

Sources and Uses of Capital Funds

The following table presents the projected sources and uses of the funds for the System as of May 1, 2008. See “INTRODUCTORY STATEMENT — Financial Projection Assumptions.”

Sources and Uses of Capital Funds (Millions of Dollars)

| <u>Line No.</u> | <u>Description</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> | <u>Period Total</u> |
|-------------------|--|------------------|------------------|------------------|------------------|---------------------|
| Sources of Funds | | | | | | |
| 1 | Proceeds from Sale of Bonds (1)(2) | \$ 2,514.2 | \$ 2,452.5 | \$ 2,305.4 | \$ 2,206.3 | \$ 9,478.4 |
| 2 | Proceeds from Commercial Paper Notes | <u>2,362.5</u> | <u>2,181.0</u> | <u>2,167.5</u> | <u>2,075.0</u> | <u>8,786.0</u> |
| 3 | Total Sources of Funds | 4,876.7 | 4,633.5 | 4,472.9 | 4,281.3 | 18,264.4 |
| Uses of Funds | | | | | | |
| 4 | Refunding of Prior Bonds (2) | 0.0 | 132.7 | 0.0 | 0.0 | 132.7 |
| 5 | Retirement of Commercial Paper Notes | 2,362.5 | 2,181.0 | 2,167.5 | 2,075.0 | 8,786.0 |
| 6 | Deposit to Construction Fund | 2,362.5 | 2,181.0 | 2,167.5 | 2,075.0 | 8,786.0 |
| 7 | Other (3) | <u>151.7</u> | <u>138.8</u> | <u>137.9</u> | <u>131.3</u> | <u>559.7</u> |
| 8 | Total Uses of Funds | 4,876.7 | 4,633.5 | 4,472.9 | 4,281.3 | 18,264.4 |
| Construction Fund | | | | | | |
| 9 | Beginning Balance | 480.0 | 480.0 | 480.0 | 480.0 | |
| 10 | Transfer from Proceeds from Commercial Paper Notes . . . | 2,362.5 | 2,181.0 | 2,167.5 | 2,075.0 | 8,786.0 |
| 11 | Cash Financed Capital Construction (4)(5) | <u>120.5</u> | <u>100.0</u> | <u>99.5</u> | <u>100.0</u> | <u>420.0</u> |
| 12 | Total Available Construction Funds | 2,963.0 | 2,761.0 | 2,747.0 | 2,655.0 | 11,126.0 |
| 13 | Less: Total Capital Spending (6) | <u>(2,483.0)</u> | <u>(2,281.0)</u> | <u>(2,267.0)</u> | <u>(2,175.0)</u> | <u>(9,206.0)</u> |
| 14 | Ending Balance | <u>\$ 480.0</u> | <u>\$ 480.0</u> | <u>\$ 480.0</u> | <u>\$ 480.0</u> | |

- (1) Includes proceeds from sale of First and Second Resolution Bonds.
- (2) For Fiscal Year 2010, includes Bonds to be issued to refund Crossover Bonds.
- (3) Includes issuance costs and Debt Service Reserve Fund requirements.
- (4) Funds projected for Cash Financed Capital Construction may be used for the defeasance of bonds and may be increased or decreased by the Authority from the amounts projected in each year.
- (5) Based on the results of previous defeasances of bonds, the Authority expects to receive the following amounts in 2009 and 2011, respectively: \$30.5 million and \$19.5 million. These amounts are included in the above table and are expected to be added to the Construction Fund as the funds become available in each year.
- (6) Capital spending reflects commitments from current and prior years.

The following table shows projected debt service requirements, including payments on outstanding bonds and on future bonds projected to be issued as of May 1, 2008. For additional information, see “– Debt Service Requirements.”

**Projected Future Debt Service Requirements
(Millions of Dollars)**

| <u>Line No.</u> | <u>Description</u> | <u>Bond Issues</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> |
|--|---|--------------------|------------------|------------------|------------------|------------------|
| First Resolution Debt Service | | | | | | |
| 1 | Outstanding Bonds (1) | | \$ 565.5 | \$ 555.5 | \$ 619.1 | \$ 596.9 |
| Anticipated Future Bonds | | | | | | |
| 2 | Fiscal Year 2009 Bonds | \$ 630.7 | 26.3 | 39.4 | 39.4 | 39.4 |
| 3 | Fiscal Year 2010 Bonds | 569.7 | — | 25.6 | 38.5 | 38.5 |
| 4 | Fiscal Year 2011 Bonds | 565.2 | — | — | 25.4 | 38.1 |
| 5 | Fiscal Year 2012 Bonds | 534.1 | — | — | — | 24.1 |
| 6 | Total First Resolution Debt Service | | 591.8 | 620.6 | 722.3 | 737.0 |
| Subordinated Obligations | | | | | | |
| Second Resolution Authority Debt Service | | | | | | |
| 7 | Outstanding Authority Bonds Issued to the Public. | | 125.1 | 124.8 | 124.4 | 124.0 |
| Anticipated Future Second Resolution Bonds | | | | | | |
| 8 | Fiscal Year 2008 Bonds | 837.2 | 80.0 | 52.3 | 52.3 | 52.3 |
| 9 | Fiscal Year 2009 Bonds | 1,583.5 | 27.3 | 100.5 | 100.5 | 100.5 |
| 10 | Fiscal Year 2010 Bonds | 1,450.1 | — | 25.0 | 91.5 | 91.5 |
| 11 | Fiscal Year 2011 Bonds | 1,440.2 | — | — | 24.8 | 90.9 |
| 12 | Fiscal Year 2012 Bonds | 1,372.2 | — | — | — | 23.7 |
| 13 | Interest Payments on Commercial Paper Notes | | 42.5 | 51.0 | 51.0 | 51.0 |
| 14 | Outstanding Second Resolution Bonds Issued to EFC | | 394.1 | 416.4 | 425.5 | 421.7 |
| Anticipated Future Second Resolution EFC Bonds | | | | | | |
| 15 | Fiscal Year 2008 Bonds | 400.0 | 31.7 | 29.7 | 29.7 | 29.7 |
| 16 | Fiscal Year 2009 Bonds | 300.0 | 7.4 | 30.8 | 22.9 | 22.9 |
| 17 | Fiscal Year 2010 Bonds | 300.0 | — | 7.8 | 31.4 | 23.5 |
| 18 | Fiscal Year 2011 Bonds | 300.0 | — | — | 7.8 | 31.4 |
| 19 | Fiscal Year 2012 Bonds | 300.0 | — | — | — | 7.8 |
| 20 | Less: Current EFC Subsidy (2) | | (98.2) | (95.6) | (92.0) | (88.3) |
| 21 | Less: Future EFC Subsidy (3) | | (10.9) | (19.1) | (25.6) | (32.0) |
| 22 | Actual Debt Service on Subordinated Indebtedness | | 599.0 | 723.6 | 844.3 | 950.8 |
| 23 | Less: Carryforward Revenues | | (153.6) | (95.6) | (122.9) | (148.3) |
| 24 | Net Debt Service on Subordinated Indebtedness | | 445.4 | 628.0 | 721.4 | 802.4 |
| 25 | Total Debt Service Payable from Current Revenues (Line 6+Line 24) (4) | | <u>\$1,037.2</u> | <u>\$1,248.6</u> | <u>\$1,443.7</u> | <u>\$1,539.5</u> |

(1) Beginning in Fiscal Year 2010, includes debt service on First Resolution Bonds expected to be issued in exchange for Crossover Bonds. See “SECURITY FOR THE SECOND RESOLUTION BONDS — Other Authority Indebtedness.”

(2) Includes the estimated EFC subsidy on outstanding Second Resolution Bonds.

(3) Includes the estimated EFC subsidy on anticipated future Second Resolution Bonds.

(4) Includes Total First Resolution Debt Service plus Net Debt Service on Subordinated Indebtedness.

For purposes of these projections, the Authority has assumed that interest rates on Authority First Resolution Bonds and Second Resolution Bonds issued to the public were 6.25% in the second half of Fiscal Year 2008, and will increase by 0.5% on January 1, 2009, remaining stable at 6.75% each year thereafter. The Authority further has assumed that interest rates on future Authority Second Resolution Bonds issued to EFC will be 0.05% lower than the rate assumed on its other bonds.

Debt Service Requirements

The following schedule sets forth the amount required during each Fiscal Year (ending June 30) shown below for the payment of the principal of and the interest (including the Accreted Value of all Capital Appreciation Bonds) on Outstanding First Resolution Bonds and Second Resolution Bonds assuming that all variable rate bonds bear interest at an average rate of 4.25% per annum through maturity. The schedule does not include debt service on any outstanding Commercial Paper Notes.

Debt Service Requirements

| Fiscal Year Ending June 30 | Debt Service on Outstanding Authority First Resolution Bonds(1)(3) | Debt Service on Outstanding Authority Second Resolution Bonds(2) | Debt Service on Fiscal 2009 EE Bonds | | Debt Service on Second Resolution Bonds, including Fiscal 2009 EE Bonds(2) | Total Debt Service (1)(2)(3) |
|-------------------------------------|--|--|---|----------------------|--|---------------------------------|
| | | | Principal | Interest | | |
| | | | 2009 | \$ 580,281,914 | | |
| 2010 | 577,362,545 | 526,175,336 | — | 32,370,250 | 558,545,586 | 1,135,908,131 |
| 2011 | 640,896,680 | 538,556,985 | — | 32,370,250 | 570,927,235 | 1,211,823,915 |
| 2012 | 618,721,882 | 538,080,086 | — | 32,370,250 | 570,450,336 | 1,189,172,219 |
| 2013 | 610,637,810 | 521,896,753 | — | 32,370,250 | 554,267,003 | 1,164,904,813 |
| 2014 | 681,359,786 | 507,382,641 | 26,855,000 | 32,370,250 | 566,607,891 | 1,247,967,677 |
| 2015 | 718,835,235 | 502,516,346 | 9,150,000 | 31,544,250 | 543,210,596 | 1,262,045,831 |
| 2016 | 654,604,963 | 521,791,546 | 41,960,000 | 31,224,225 | 594,975,771 | 1,249,580,734 |
| 2017 | 685,284,894 | 539,540,716 | 32,075,000 | 29,304,225 | 600,919,941 | 1,286,204,835 |
| 2018 | 667,467,269 | 500,450,711 | 75,415,000 | 27,777,875 | 603,643,586 | 1,271,110,855 |
| 2019 | 700,448,091 | 565,565,108 | — | 24,175,000 | 589,740,108 | 1,290,188,199 |
| 2020 | 690,755,218 | 569,488,437 | — | 24,175,000 | 593,663,437 | 1,284,418,655 |
| 2021 | 691,848,890 | 569,674,437 | — | 24,175,000 | 593,849,437 | 1,285,698,327 |
| 2022 | 735,509,865 | 495,768,857 | — | 24,175,000 | 519,943,857 | 1,255,453,722 |
| 2023 | 783,476,959 | 447,815,072 | — | 24,175,000 | 471,990,072 | 1,255,467,030 |
| 2024 | 789,388,640 | 413,177,215 | — | 24,175,000 | 437,352,215 | 1,226,740,855 |
| 2025 | 782,778,903 | 415,758,780 | — | 24,175,000 | 439,933,780 | 1,222,712,682 |
| 2026 | 790,645,025 | 427,178,797 | — | 24,175,000 | 451,353,797 | 1,241,998,822 |
| 2027 | 795,893,788 | 423,070,720 | — | 24,175,000 | 447,245,720 | 1,243,139,508 |
| 2028 | 775,268,775 | 441,116,996 | — | 24,175,000 | 465,291,996 | 1,240,560,771 |
| 2029 | 752,992,369 | 457,334,004 | — | 24,175,000 | 481,509,004 | 1,234,501,373 |
| 2030 | 731,772,613 | 467,514,739 | — | 24,175,000 | 491,689,739 | 1,223,462,352 |
| 2031 | 775,196,050 | 415,775,466 | — | 24,175,000 | 439,950,466 | 1,215,146,516 |
| 2032 | 786,245,356 | 413,873,614 | — | 24,175,000 | 438,048,614 | 1,224,293,970 |
| 2033 | 765,654,225 | 428,047,144 | — | 24,175,000 | 452,222,144 | 1,217,876,369 |
| 2034 | 742,718,825 | 452,174,978 | — | 24,175,000 | 476,349,978 | 1,219,068,803 |
| 2035 | 742,717,625 | 430,305,427 | — | 24,175,000 | 454,480,427 | 1,197,198,052 |
| 2036 | 795,377,038 | 400,281,812 | — | 24,175,000 | 424,456,812 | 1,219,833,849 |
| 2037 | 789,283,338 | 402,296,459 | — | 24,175,000 | 426,471,459 | 1,215,754,796 |
| 2038 | 783,172,338 | 418,408,525 | — | 24,175,000 | 442,583,525 | 1,225,755,863 |
| 2039 | 709,841,338 | 432,226,500 | 100,000,000 | 24,175,000 | 556,401,500 | 1,266,242,838 |
| 2040 | 413,292,150 | 169,808,750 | 360,000,000 | 19,175,000 | 548,983,750 | 962,275,900 |
| Total | \$22,759,730,393 | \$14,840,450,451 | \$645,455,000 | \$820,780,586 | \$16,306,686,037 | \$39,066,416,430 |

- (1) Assumes that on the respective tender dates, the Crossover Bonds will be exchanged for First Resolution Bonds and the proceeds of the respective series of Crossover Bonds will be applied to redeem certain Outstanding Bonds.
- (2) Net of projected subsidy, surplus and capitalized interest payments from EFC.
- (3) Does not include debt service on the First Resolution Bonds to be refunded with the proceeds of the Fiscal 2009 EE Bonds.

FINANCIAL OPERATIONS

The following tables present certain historical data relating to the System which have been derived from the books and records of the City, the Authority and the Board. For more information, see “INTRODUCTORY STATEMENT — Financial Projection Assumptions.”

Revenues

The following table presents, on a cash basis, the System revenues received during Fiscal Years 2004 through 2008, as derived from the accounting records utilized in preparation of the statement of cash flows, which is contained in the annual financial statements for Fiscal Years 2004 through 2008.

System Revenues (Millions of Dollars)

| <u>Line No.</u> | <u>Description</u> | <u>FY 2004</u> | <u>FY 2005</u> | <u>FY 2006</u> | <u>FY 2007</u> | <u>FY 2008</u> |
|------------------------------|---|------------------|------------------|------------------|------------------|------------------|
| Operating Revenues | | | | | | |
| 1 | User Payments (1) | \$1,691.8 | \$1,732.8 | \$1,811.5 | \$1,862.4 | \$2,109.6 |
| 2 | Upstate Revenues | 22.2 | 27.3 | 42.7 | 42.2 | 46.0 |
| 3 | Subtotal Service Revenue | 1,714.0 | 1,760.1 | 1,854.1 | 1,904.6 | 2,155.6 |
| 4 | Miscellaneous Revenues (2) | 9.0 | 10.4 | 12.1 | 12.6 | 10.6 |
| 5 | Subtotal Operating Revenue | <u>1,722.9</u> | <u>1,770.4</u> | <u>1,866.2</u> | <u>1,917.2</u> | <u>2,166.2</u> |
| Nonoperating Revenues | | | | | | |
| 6 | Interest Income on System Funds (3) | 93.6 | 97.1 | 110.9 | 101.1 | 84.6 |
| 7 | Total Revenues | <u>\$1,816.5</u> | <u>\$1,867.5</u> | <u>\$1,977.2</u> | <u>\$2,018.9</u> | <u>\$2,250.8</u> |

Totals may not add due to rounding.

- (1) Includes both current payments and payments relating to accounts in arrears.
- (2) Miscellaneous Revenues does not include subsidy payments from EFC on First Resolution Bonds or Second Resolution Bonds.
- (3) Includes interest income on the Construction Fund, Debt Service Fund, the Debt Service Reserve Fund, the Subordinated Debt Service Fund, the Revenue Fund and interest earned in escrow accounts for economically defeased debt.

The table above records actual cash received by the System and does not reflect either accounts receivable or billing accruals. The System has consistently realized collections of cash revenues in amounts exceeding costs for debt service, current operations and required levels of coverage. This has been achieved while maintaining residential water and sewer service costs at a level which is below the average of comparable large cities.

Expenses

The following table presents System expenses for Fiscal Years 2004 through 2008 on an accrual basis which have been derived from the accounting records utilized in preparation of the annual financial statements for Fiscal Years 2004 through 2008. These expenses represent operation, maintenance and general expenses excluding the lease rental payment to the City, bad debt expense and capital costs for improvements to upstate water pollution control plants that are reported as operating expenses in the System’s financial statements because such plants are owned by municipalities outside the City.

**System Expenses
(Millions of Dollars)**

| <u>Expense Category</u> | <u>FY 2004</u> | <u>FY 2005</u> | <u>FY 2006</u> | <u>FY 2007</u> | <u>FY 2008</u> |
|--|----------------|----------------|----------------|----------------|------------------|
| Water Operations(1) | | | | | |
| Personal Service(2) | \$141.9 | \$137.2 | \$152.3 | \$170.2 | \$ 202.2 |
| Other Than Personal Service(3) | <u>171.8</u> | <u>188.8</u> | <u>211.8</u> | <u>201.8</u> | <u>238.1</u> |
| Total Water Operations | 313.7 | 326.0 | 364.1 | 372.0 | 440.2 |
| Wastewater Operations(1) | | | | | |
| Personal Service(2) | 199.6 | 199.2 | 222.9 | 256.7 | 301.5 |
| Other Than Personal Service(3) | <u>190.3</u> | <u>205.3</u> | <u>220.5</u> | <u>235.7</u> | <u>244.8</u> |
| Total Wastewater Operations | <u>389.9</u> | <u>404.5</u> | <u>443.4</u> | <u>492.4</u> | <u>546.4</u> |
| Administrative and General(4) | 19.9 | 23.4 | 26.7 | 35.5 | 44.0 |
| Indirect Expenses(5) | <u>70.2</u> | <u>59.6</u> | <u>62.6</u> | <u>88.5</u> | <u>126.8</u> |
| Total System | <u>\$793.7</u> | <u>\$813.5</u> | <u>\$896.8</u> | <u>\$988.4</u> | <u>\$1,157.4</u> |

Totals may not add due to rounding.

- (1) Certain historical, administrative and overhead costs of DEP were allocated to the water and sewer functions based upon the proportion of applicable personnel within DEP.
- (2) Personal Service costs include salaries, fringe benefits and pension costs.
- (3) Other Than Personal Service costs include real estate taxes paid to upstate communities for watershed properties, sludge disposal costs and for electricity, chemicals and supply costs.
- (4) Administrative and General costs include Authority and Board expenses, excluding Authority expenses for the defeasance of debt.
- (5) Indirect Expenses include City agency support, and judgments and claims costs.

Projected Revenues

As indicated in the table below, “Subtotal Service Revenue” is projected as of May 1, 2008 to increase from approximately \$2.5 billion in Fiscal Year 2009 to approximately \$3.3 billion in Fiscal Year 2012. Projected rate increases in future Fiscal Years provide the majority of the increase in user payments. Upstate revenues are projected to increase from approximately \$42.5 million in Fiscal Year 2009 to approximately \$55.3 million in Fiscal Year 2012. This revenue growth is due to expected increases in the cost of water supply services.

City-wide water consumption declined each year from Fiscal Year 2001 through Fiscal Year 2006 with an aggregate reduction of 10.4%. The rate of decline from Fiscal Year 2003 to Fiscal Year 2006 averaged 0.8% per year. City-wide water consumption increased by 0.9% in Fiscal Year 2007 and 1.6% in Fiscal Year 2008 compared to prior year usage. The projected revenues assume that water consumption by metered customers will decline by 0.5% annually for Fiscal Year 2009 through Fiscal Year 2012.

For the first six months of Fiscal Year 2009, water and sewer payments were approximately \$38 million, or 2.7%, less than projected in May 2008 for this six month period. Current economic conditions could have a negative effect on future Revenue collections.

**Projected Revenues
(Millions of Dollars)**

| Line No. | Description | FY 2009 | FY 2010 | FY 2011 | FY 2012 |
|------------------------------|-------------------------------------|------------------|------------------|------------------|------------------|
| Operating Revenues | | | | | |
| 1 | User Payments (1) | \$2,412.8 | \$2,720.2 | \$3,007.6 | \$3,220.3 |
| 2 | Upstate Revenues | 42.5 | 47.1 | 51.2 | 55.3 |
| 3 | Subtotal Service Revenue | 2,455.4 | 2,767.4 | 3,058.8 | 3,275.6 |
| 4 | Miscellaneous Revenues (2) | 12.0 | 11.3 | 10.5 | 9.7 |
| 5 | Subtotal Operating Revenue | 2,467.4 | 2,778.6 | 3,069.4 | 3,285.3 |
| Nonoperating Revenues | | | | | |
| 6 | Interest Income on System Funds (3) | 76.2 | 91.3 | 100.4 | 106.4 |
| 7 | Total Revenues | <u>\$2,543.6</u> | <u>\$2,870.0</u> | <u>\$3,169.8</u> | <u>\$3,391.7</u> |

Totals may not add due to rounding. Figures are calculated on a cash basis.

Source: Amawalk Consulting.

- (1) Includes late payment charges.
- (2) Miscellaneous Revenue includes subsidy payments from EFC on First Resolution Bonds, but does not include subsidy payments from EFC on Second Resolution Bonds.
- (3) Includes interest income on the Construction Fund, Debt Service Fund, the Debt Service Reserve Fund and the Subordinated Debt Service Fund.

Projected Operating and Maintenance Expenses

The table set forth below shows, for Fiscal Years 2009 through 2012, the System’s projected operation and maintenance expenses as of May 1, 2008. See “RATES AND BILLING — Rates — Projected Rates.”

Total operating expenses for Fiscal Year 2009 through Fiscal Year 2012 reflect the expansion of DEP health and safety programs, the results of recent collective bargaining agreements, increased costs for pension contributions and fringe benefits and other factors. See “INTRODUCTORY STATEMENT — Financial Projection Assumptions.”

**Projected Operation and Maintenance Expense
(Millions of Dollars)**

| Line No. | Description | FY 2009 | FY 2010 | FY 2011 | FY 2012 |
|----------|--|------------------|------------------|------------------|------------------|
| 1 | Authority/Board Operations (1) | \$ 48.3 | \$ 39.5 | \$ 40.9 | \$ 42.4 |
| | Water Operations | | | | |
| 2 | Personal Services | 207.4 | 211.7 | 217.0 | 229.0 |
| 3 | Other Than Personal Services | 285.2 | 307.5 | 319.2 | 353.9 |
| 4 | Total Water Operations | 492.6 | 519.2 | 536.2 | 582.9 |
| | Wastewater Operations | | | | |
| 5 | Personal Services | 330.9 | 338.4 | 346.9 | 355.5 |
| 6 | Other Than Personal Services | 310.2 | 306.6 | 312.5 | 320.8 |
| 7 | Total Wastewater Operations | 641.0 | 645.0 | 659.3 | 676.3 |
| 8 | Indirect Expenses | 18.3 | 18.3 | 18.3 | 18.3 |
| 9 | Judgments and Claims | 8.0 | 8.0 | 8.0 | 8.0 |
| 10 | Total Operating Expenses | 1,208.2 | 1,229.9 | 1,262.7 | 1,327.9 |
| 11 | Less: Trust Account Withdrawals | (66.0) | (33.1) | — | — |
| 12 | Net Operating Expenses | 1,142.2 | 1,196.8 | 1,262.7 | 1,327.9 |
| 13 | Less: Credit for Prior Year Excess O&M Payment | — | — | — | — |
| 14 | Net Operating Expense Payments | <u>\$1,142.2</u> | <u>\$1,196.8</u> | <u>\$1,262.7</u> | <u>\$1,327.9</u> |

(1) Includes Authority/Board operations, Authority receipts (payments) under its interest rate exchange agreements, and Authority arbitrage rebate payments.

Totals may not add due to rounding. Figures are calculated on a cash basis.
Source: Amawalk Consulting.

Operation and Maintenance Expenses include administrative costs associated with the Authority and the Board, direct operating costs for the System, indirect operating costs of DEP, and other expenses and adjustments to annual operating expenses. Each of these is explained more fully below.

The Authority/Board Operations. Administrative expenses of the Authority and the Board, shown on Line 1 of the table above, include annual fees required by EFC in connection with the Authority’s participation in the State Revolving Fund Program. These fees are projected to be \$13.1 million in Fiscal Year 2009 and are expected to increase in future years as the outstanding principal of bonds issued to EFC increases. The Authority also expects to make arbitrage rebate payments of \$1.2 million in Fiscal Year 2009. Other expenses of the Authority include but are not limited to payments under interest rate exchange agreements (net of receipts), fees related to adjustable rate bonds and commercial paper notes and the management of investments. The expenses of the Board include payments for lock box services as well as consulting services for the following: the environmental health and safety program, capital program management, customer service and rates and charges.

Water Operations. The operating costs of the Water System include direct operation and maintenance costs applicable to one or more functional areas of the Water System and the distribution system as well as certain indirect operating costs of the DEP which are allocated between the Water System and the Sewer System. The operating costs of the Water System are divided into personal services costs and other than personal services costs.

Personal services costs include direct salary costs plus fringe benefit and pension costs. The projected personal services costs for Fiscal Years 2009 through 2012 reflect allowances for changes in staffing, salary and wage adjustments, the increased cost of fringe benefit and pension contributions, and other factors.

“Other than personal services costs” include property taxes paid to upstate communities for watershed properties as well as chemicals, electricity, and other expenses.

All but a small percentage of the Water System functions by gravity so that electricity costs necessary to maintain normal water transmission and distribution are relatively small. In drought conditions, additional pumping is necessary for optimal distribution of water available from the System, thereby causing increased electricity costs.

Other than personal services costs, excluding property taxes, are generally assumed to increase at an estimated rate of 3% per year for the forecast period. Allowances have been made for higher increases in the cost of chemicals and fuels in Fiscal Year 2009. Property tax payments for City-owned watershed lands are expected to be \$110 million in Fiscal Year 2009. It is assumed that such payments will increase at the rate of 6% annually reflecting both the addition of new watershed properties and increasing tax rates.

In accordance with the watershed protection agreement, DEP will implement additional programs which will enhance the ability of the City and the communities located in the watershed area to protect the quality of the water supply. Such programs will include certain capital investments which are contained within the CIP. The forecasted operation and maintenance expenses for the Water System reflect operation and maintenance costs due to the Watershed Agreement.

Wastewater Operations. The operating costs of the Sewer System include direct operation and maintenance costs applicable to one or more functional areas of the Sewer System as well as certain indirect operating costs of DEP allocated to the Water System and the Sewer System. The operating costs of the Sewer System are also divided into personal services and other than personal services costs. Personal services costs include direct salary costs plus fringe benefits and pension costs.

Other than personal services costs include electricity for the water pollution control plants, pump stations and service yards, chemicals, and other expenses. Electricity, which represents a significant expense in operating the treatment plants and pump stations, is supplied primarily by the Power Authority of the State of New York. The budgeted costs for heat, light and power for the Water System and the Sewer System in Fiscal Year 2009 are \$91 million. The vast majority of such expenses are for electricity for the Sewer System. Another major component of other than personal services costs for the Sewer System is biosolids management, which is anticipated to require \$77 million in expenses in Fiscal Year 2009. Certain other cost adjustments are reflected in the forecasted cash flow as adjustments are made to specific operating programs based upon System needs.

Projected operating expenses for the System do not include provisions for the payment of any potential fines or penalties. See "THE SYSTEM." In the event that fines or penalties are required to be paid, operating expenses will increase in the year in which such payments are made.

Other Expenses. Other expenses of the System include indirect expenses and judgments and claims. Indirect expenses, shown on Line 8 of the table, reflect costs allocated to the System for support provided by various City agencies and departments. Services provided include budget preparation and review, cost and revenue accounting, billing and collection, and legal support. The method of allocating these costs to the System is based upon costs initially allocated to DEP and subsequently divided between those attributable to water and sewer and those costs associated with other activities of DEP. The costs allocated to DEP as a whole are derived from the total costs of City support agencies and departments and a formalized cost allocation plan which distributes the costs to affected departments and agencies. DEP's billing and collection expenses are included in the operation and maintenance costs of the Water System and the Wastewater System.

Credits Against Operation and Maintenance Expense. Pursuant to a consent decree (the "1989 Consent Decree") entered into in 1989 under the Marine Protection Research and Sanctuaries Act of 1972 ("MPRSA"), as amended by the Ocean Dumping Ban Act of 1988 (the "Ban Act"), DEP ceased the ocean disposal of sludge in June 1992. The Ban Act and the 1989 Consent Decree provide that 85% of the fees and penalties paid shall be deposited into a trust account and shall be available to reimburse the City for costs incurred for developing alternative biosolids management facilities. As of November 30, 2008, the value of the trust account was \$98.4 million. It is assumed that this value will increase with interest earnings at the rate of 2% per annum, until withdrawals are made. It is anticipated that \$66 million in Fiscal Year 2009 and \$33.1 million in Fiscal Year 2010 will be available as an offset to operation and maintenance expenses. The Funds in the trust account are administered by DEP.

Projected Financial Operations

The following table shows a summary of the forecasted cash flows for the Authority as of May 1, 2008 for Fiscal Year 2009 through Fiscal Year 2012. See “CAPITAL IMPROVEMENT AND FINANCING PROGRAM — Debt Service Requirements.” See “RATES AND BILLING — Rates — Projected Rates.” The projected rate increases described herein under “RATES AND BILLING — Rates” have been assumed in order to meet projected cash expenditures in compliance with the Rate Covenant. See “FINANCIAL OPERATIONS — Projected Revenues.” As shown on Line 31 of the table, positive net surpluses are projected to be maintained throughout the reporting period. Additionally, carryforward revenues shown on line 16 for FY 2009 were \$222.3 million, \$68.7 million higher than forecasted. Line 32 illustrates the projected coverage of First Resolution debt service by current revenues available for debt service. Line 33 illustrates the projected coverage of First Resolution and Second Resolution debt service by current revenues available for debt service.

Forecasted Cash Flows
(Millions of Dollars)

| Line No. | Description | FY 2009 | FY 2010 | FY 2011 | FY 2012 |
|--------------------------------------|---|-----------|-----------|-----------|-----------|
| Operating Revenues | | | | | |
| 1 | Water and Sewer User Payments | \$2,412.8 | \$2,720.2 | \$3,007.6 | \$3,220.3 |
| 2 | Upstate Revenue | 42.5 | 47.1 | 51.2 | 55.3 |
| 3 | Miscellaneous Revenue | 12.0 | 11.3 | 10.5 | 9.7 |
| Other Revenues | | | | | |
| 4 | Interest on Funds | 76.2 | 91.3 | 100.4 | 106.4 |
| 5 | Current Revenues Available for Debt Service | 2,543.6 | 2,870.0 | 3,169.8 | 3,391.7 |
| First Resolution Debt Service | | | | | |
| 6 | Outstanding Bonds | 565.5 | 555.5 | 619.1 | 596.9 |
| 7 | Anticipated Future Bonds | 26.3 | 65.0 | 103.3 | 140.1 |
| 8 | Total First Resolution Debt Service | 591.8 | 620.6 | 722.3 | 737.0 |
| Subordinated Obligations | | | | | |
| 9 | Outstanding Second Resolution Bonds Issued to the Public | 125.1 | 124.8 | 124.4 | 124.0 |
| 10 | Anticipated Future Second Resolution Bonds Issued to the Public | 107.3 | 177.8 | 269.2 | 359.0 |
| 11 | Interest Payments on Commercial Paper Notes | 42.5 | 51.0 | 51.0 | 51.0 |
| 12 | Outstanding Second Resolution Bonds issued to EFC | 394.1 | 416.4 | 425.5 | 421.7 |
| 13 | Anticipated Future Second Resolution EFC Bonds | 39.0 | 68.3 | 91.7 | 115.2 |
| 14 | Less: EFC Subsidy and Capitalized Interest on Subordinated Bonds | (109.1) | (114.7) | (117.6) | (120.2) |
| 15 | Actual Debt Service on Subordinated Indebtedness | 599.0 | 723.6 | 844.3 | 950.8 |
| 16 | Less: Carryforward Revenues | (153.6) | (95.6) | (122.9) | (148.3) |
| 17 | Net Debt Service on Subordinated Indebtedness | 445.4 | 628.0 | 721.4 | 802.4 |
| 18 | Total Debt Service Payable from Current Revenues (line 8 + line 17) | 1,037.2 | 1,248.6 | 1,443.7 | 1,539.5 |
| Operating Expenses | | | | | |
| 19 | Authority/Board Operations | 48.3 | 39.5 | 40.9 | 42.4 |
| 20 | Water System | 492.6 | 519.2 | 536.2 | 582.9 |
| 21 | Wastewater System | 641.0 | 645.0 | 659.3 | 676.3 |
| 22 | Indirect Expense | 18.3 | 18.3 | 18.3 | 18.3 |
| 23 | Judgments and Claims | 8.0 | 8.0 | 8.0 | 8.0 |
| 24 | Total Operating Expenses | 1,208.2 | 1,229.9 | 1,262.7 | 1,327.9 |
| 25 | Less: Trust Account Withdrawals | (66.0) | (33.1) | — | — |
| 26 | Net Operating Expenses | 1,142.2 | 1,196.8 | 1,262.7 | 1,327.9 |
| 27 | Less: Credit for Prior Year Excess O&M Payment | — | — | — | — |
| 28 | Rental Payment to the City of New York | 178.6 | 201.6 | 235.0 | 253.2 |
| 29 | Cash Financed Capital Construction(1) | 90.0 | 100.0 | 80.0 | 100.0 |
| 30 | Total Expenses | 1,410.8 | 1,498.5 | 1,577.7 | 1,681.1 |
| 31 | Net Surplus (line 5—line 18—line 30) | \$ 95.6 | \$ 122.9 | \$ 148.3 | \$ 171.1 |
| 32 | First Resolution Debt Service Coverage (line 5/line 8) | 4.30x | 4.62x | 4.39x | 4.60x |
| 33 | First and Second Resolution Debt Service Coverage (line 5/line 18) | 2.45x | 2.30x | 2.20x | 2.20x |

Source: Amawalk Consulting.

Column subtotals and totals may reflect adjustments for rounding of amounts shown in individual line items.

(1) Funds projected for Cash Financed Capital Construction may be used for the defeasance of bonds in addition to funds otherwise provided for the defeasance of bonds and may be increased or decreased by the Authority from the amounts projected in each year.

RATES AND BILLINGS

Rates

The Board is responsible for setting rates in compliance with the Rate Covenant. See “SECURITY FOR THE BONDS — Rate Covenant.” The Board retains the firm of Amawalk Consulting for the purpose of conducting a detailed review of the structure of water and sewer rates. The Board considers the results of Amawalk Consulting rate studies in establishing its rates and charges for service.

The System’s rates and charges are largely exempt from federal and State regulation. Water rates, fees and charges for water supply are the responsibility of the Board and are not subject to further approval or regulation except for rates for upstate users. Currently approximately 1.7% of System Revenues are collected from such upstate users. Sewer charges are established by the Board as a percentage of water charges. Participation in the Construction Grants Program, however, requires the maintenance of sewer charges sufficient to defray costs of operation, maintenance and replacement. The Board, as a matter of policy, conforms with these requirements when setting sewer charges. The Board uses data compiled from meter readings for billings and to determine the effectiveness of City-mandated conservation measures.

The following table sets forth the changes in rates for water and sewer service since 1999:

History of Water and Sewer Rate Increases

| Effective Date | Increase in Flat-Rate Water | Increase in Metered Water | Metered Water Rate (per ccf)(1) | Change in Sewer(2) |
|----------------|-----------------------------|---------------------------|---------------------------------|--------------------|
| July 1, 1999 | 4 % | 4 % | \$1.30 | No change |
| July 1, 2000 | 1 | 1 | 1.31 | No change |
| July 1, 2001 | 3 | 3 | 1.35 | No change |
| July 1, 2002 | 6.5 | 6.5 | 1.44 | No change |
| July 1, 2003 | 5.5 | 5.5 | 1.52 | No change |
| July 1, 2004 | 5.5 | 5.5 | 1.60 | No change |
| July 1, 2005 | 3 | 3 | 1.65 | No change |
| July 1, 2006 | 9.4 | 9.4 | 1.81 | No change |
| July 1, 2007 | 11.5 | 11.5 | 2.02 | No change |
| July 1, 2008 | 14.5 | 14.5 | 2.31 | No change |

(1) ccf: 100 cubic feet.

(2) For the period shown, the sewer charge has been a constant 159% of the water charge.

Projected Rates. Although the Board sets rates for an annual period, it may increase rates during such period, as required. As of May 1, 2008, forecasted debt service, operating and other costs for the System indicated that the anticipated future rate increases to be set by the Board for water and sewer services combined were 14.0% in Fiscal Year 2010, 12.0% in Fiscal Year 2011 and 7.5% in Fiscal Year 2012.

Basic Sewer Charge. For all properties connected to the Sewer System, or legally required to be connected after receiving proper notice, there is a charge imposed equal to a fixed percentage of the property’s water charge. Since July 1, 1992, the sewer charge has remained at 159% of the water charge.

Sewer Allowances. Certain commercial customers use water in their products and thus return less waste to the Sewer System than their water consumption might indicate. Upon application and approval, these commercial users are entitled to an effective rate reduction which reflects the proportion of water which is retained in their products or evaporated and not returned as sewage.

Sewer-only Customer Charges. In the case of premises which receive water service from alternative sources, a sewer charge is determined by DEP. For the current Fiscal Year, the sewer charge to such premises is equal to 159% of the dollar amount that would be charged for water usage if it were supplied by the Water System.

Upstate Water Rates. Rates for water supply service provided to municipalities and water districts located north of the City are established in accordance with the provisions of the Water Supply Act of 1905 (the “1905 Act”). The 1905 Act provides that such rates shall be based on the System’s actual cost of service. The sale of water and the rates and charges for these accounts are regulated by State law as well as by individual agreements between these communities and the City. Each contract provides for the metering of water sales to individual communities and the application of a specific charge per unit of metered volume. In most cases, per capita consumption in the upstate communities is less than that of customers within the City. In those instances where the community per capita consumption exceeds that of the City, the specified rate of charge for the excess is increased to match the rates and charges applied to retail service in the City. As of July 1, 2008, water taken from either the Croton or Catskill/Delaware systems is charged at a rate of \$900.31 per million gallons for daily per capita amounts not in excess of daily per capita consumption within the City.

Comparative Charges. The following table presents comparative annual water and sewer charges in 24 large cities based upon a survey conducted in February 2008. Using a ranking system where 1 represents the lowest rates, the City’s ranking relative to these cities is: for Single-Family Residential – 10, for Commercial – 12, and for Industrial – 15.

Comparative Annual Water and Sewer User Charges⁽¹⁾⁽²⁾

| Single Family Residential | | Commercial | | Industrial | |
|----------------------------------|----------------------|---------------------------|----------------------|---------------------------|----------------------|
| City | Annual Charge | City | Annual Charge | City | Annual Charge |
| Chicago | \$ 282 | Chicago | \$ 3,717 | Chicago | \$ 371,728 |
| Milwaukee | 604 | St. Louis | 4,750 | St. Louis | 374,950 |
| St. Louis | 629 | Dallas | 4,887 | Indianapolis | 396,385 |
| San Antonio | 640 | Indianapolis | 4,942 | Dallas | 420,947 |
| Indianapolis | 655 | Milwaukee | 5,310 | Milwaukee | 429,021 |
| Newark | 656 | San Antonio | 5,655 | San Antonio | 471,759 |
| San Jose | 673 | Baltimore | 5,872 | Philadelphia | 488,360 |
| Baltimore | 683 | San Jose | 6,289 | Baltimore | 515,444 |
| Dallas | 691 | Newark | 6,297 | Detroit | 532,079 |
| New York | 699 | Detroit | 6,590 | San Jose | 552,405 |
| Houston | 706 | Jacksonville | 6,740 | Newark | 575,772 |
| Detroit | 728 | New York | 6,994 | Jacksonville | 592,157 |
| Los Angeles | 758 | Los Angeles | 7,212 | New Orleans | 651,116 |
| Jacksonville | 772 | Columbus | 7,386 | Columbus | 681,847 |
| Washington, D.C. | 812 | New Orleans | 7,565 | New York | 699,439 |
| Columbus | 821 | Houston | 7,670 | Los Angeles | 713,733 |
| New Orleans | 841 | Washington, D.C. | 7,966 | Houston | 751,674 |
| Honolulu | 877 | San Diego | 8,167 | San Diego | 756,623 |
| Cleveland | 890 | Philadelphia | 8,392 | Washington, D.C. | 794,627 |
| San Diego | 1,015 | Honolulu | 8,758 | Honolulu | 873,056 |
| Boston | 1,137 | Cleveland | 9,085 | Cleveland | 910,541 |
| Philadelphia | 1,212 | San Francisco | 11,546 | San Francisco | 1,142,153 |
| San Francisco | 1,341 | Boston | 12,438 | Boston | 1,370,657 |
| Atlanta | 1,477 | Atlanta | 16,204 | Atlanta | 1,636,204 |
| Average | \$ 817 | Average | \$ 7,518 | Average | \$ 695,945 |

- (1) User Charges are based upon information provided by the identified cities and standardized assumptions regarding water consumption, wastewater discharge, stormwater drainage area and other factors. Actual charges in each city will vary in accordance with local usage patterns. Some cities bill for sewer use on the basis of winter water consumption which could affect sewer billings if a customer’s use was not uniform throughout the year. Sewer charges include stormwater charges in those cities where separate stormwater fees are assessed. Some cities use property tax revenue or other revenues to pay for part of the cost of water, wastewater or stormwater services. In such situations, the user charges will not reflect the full cost of water, wastewater or stormwater services.
- (2) Charges for all cities reflect rate schedules in effect on February 15, 2008.

Accounts, Billing and Collection

The Bureau of Customer Services of DEP renders bills to customers of the System and collects payments of such bills. This bureau installs and reads meters, verifies meter accuracy, and maintains current information for those customers on the flat-rate system of billing described below.

The System has approximately 833,000 water and sewer accounts, nearly all of which are for water and sewer service. Approximately 91% of the System's water and sewer customers are residential. The remainder are primarily commercial and industrial users, with industrial users accounting for only a small portion of water and sewer usage.

Approximately 53,500 accounts, representing 6% of total accounts, are billed annually through the flat-rate system. These accounts are charged for water either on a per unit charge or through a computation which incorporates, among other factors, the width of the front of the building ("frontage"), the number of stories, the number of dwelling units, and the number of water-using fixtures (such as bathtubs, showers and toilets) in the building. The frontage rate is computed when the building is first constructed, and amended upon notice from the City Department of Buildings ("DOB") of building alterations or when a DEP inspector determines that the basis for charges is incorrect. Flat-rate annual bills are normally sent to customers prior to the start of each Fiscal Year and are due at the end of the first month of the Fiscal Year.

Since 1988, the basis for service charges for residential properties has been in a continuous process of transition from a frontage or flat-rate basis of annual billing to a meter-based billing system which relies on the actual measurement of usage. The Universal Metering Program is designed to improve water conservation, water supply system management, and rate equity. Approximately 780,000 accounts, representing 94% of total accounts, are billed on a metered basis. Approximately 97% of all water and sewer accounts have meters installed, although some accounts that have meters installed are not yet billed on that basis. The City has issued contracts for the installation of meters for the remaining unmetered accounts and is testing and replacing meters where necessary. Since July 2000, unmetered properties which have not taken steps to install a meter have been required to pay a surcharge doubling their annual water and sewer charge. A surcharge was levied on approximately 9,000 accounts in their most recent bills. Commercial accounts are required by the Board and the City to have meters installed for all water services. Substantially all of these accounts are in compliance with this requirement. Meters are read and billed on a quarterly basis except meters for some larger accounts which are read and billed more frequently. Unlike flat-rate charges which were commonly paid through mortgage escrow accounts, metered charges are billed directly to customers which, among other factors, has required DEP to handle a substantially higher volume of customer account inquiries.

Revenues from newly metered accounts may increase or decrease somewhat depending on how closely the flat-rate billing factors previously used compare to actual metered consumption for these accounts. Based upon recent experience, a one-time decrease in collections will occur for each account as it is metered due to the transition from billing in advance under flat rates to billing after consumption occurs. The one-time effect is taken into account in the forecasted revenues of the System.

Billing based on actual usage has affected the level of charges to certain large multiple-family residential buildings, in particular, those buildings with above-average population density and those with improperly maintained plumbing fixtures. The result is often a significant increase in charges to such buildings. In response to the needs of this segment of the customer base, the Board has adopted a transitional program whereby owners of multiple-family buildings that have had meters installed under the Universal Metering Program will continue to be billed on a flat-rate basis during the transition period. The transitional program allows owners time to review their water usage, educate tenants regarding conservation, repair leaky plumbing, and install low-flow fixtures in order to reduce consumption and charges. There are approximately 30,300 accounts in the transitional program.

On May 11, 1993, the Board adopted a program that provides for a cap on the per-unit charge on multiple-family dwellings. The cap is set at approximately 150% of the average per-family unit charge. In order to be eligible for this program, building owners must submit to a water audit by DEP and take measures to eliminate leakage and waste.

On May 3, 2001, the Board adopted its Conservation Program for Multiple Family Residential Buildings which replaces the existing transitional program and meter billing cap program referred to above for residential buildings consisting of six or more dwelling units. It provides that owners of such buildings who replace or have replaced at least 70% of the toilet, sink and showerhead fixtures in such

buildings with low-flow fixtures may elect to be billed on the basis of metered consumption or a fixed charge per dwelling unit per year. The program became effective July 1, 2001. To date, approximately 700 applications for the program have been approved. The program is designed to be revenue neutral.

Most meter readings are captured electronically through the use of hand-held computers and a universal probe. Data from meter readings are relayed to computers in field offices and transmitted to a centralized computer billing system on a daily basis. Some older meters, however, must be read manually. Still other meters transmit consumption data to the billing system via telephone lines. DEP has contracted with a vendor to provide technology for an automatic meter reading system in which meters transmit usage information by radio signal to DEP. DEP began installing transmitters in the second half of 2008, with substantial completion of installation at all locations by the end of 2012. The cost of implementing this program is fully funded in the CIP.

Certain institutions are exempt under State law from the payment of all or a portion of their water and sewer charges depending upon usage. These institutions include religious corporations and certain educational institutions, charitable institutions, homes for the aged, hospitals and other non-profit or charitable corporations.

DEP manages its account and billing information through its Customer Information System (“CIS”), which incorporates both frontage and metered accounts. DEP has identified weaknesses in the ability of the CIS to identify and report account errors and corrections on a comparable basis over time. In addition, DEP continues to issue a high percentage of estimated bills and continues to have difficulty in verifying the accuracy of a significant proportion of its overall receivable balances. DEP is working to reduce estimated bills and correct billing inaccuracies.

The Board and DEP have undertaken initiatives to enhance the collection of water and sewer billings. In September 2007, the Board authorized a payment incentive program for delinquent single-family accounts that provides for service termination if payment is not made in accordance with the program. In October 2007, the Board authorized and approved modifications to the regulations governing service terminations, including reducing the dollar amount and the delinquent period thresholds determining an account’s eligibility for service termination and narrowing the period of time during the year when water cannot be shut off. DEP has issued water shut-off notices to single family residential customers pursuant to the Board’s regulations governing service terminations. Although most customers receiving such notices pay their bills or enter into payment agreements, DEP has terminated service for a small number of single family residential properties. In December 2007, the City Council and the Mayor reauthorized the City’s lien sale program which had expired in 2006, and expanded it to allow the City, on behalf of the Board, to sell, with certain exceptions, liens from unpaid water and sewer charges on multi-family houses and commercial businesses, independent of the existence of property tax liens.

THE SYSTEM

Overview

DEP supplies water and sewer service to the Boroughs of the Bronx, Brooklyn, Manhattan, Queens, Staten Island, an area of over 300 square miles, and serves over eight million people. The City is also required by State law to sell water in counties where its water supply facilities are located and where it currently provides water to an additional approximately one million people. The Water System provides an average of approximately 1,237 mgd of water. Water consumption has decreased since 1990 when an average of approximately 1,500 mgd was provided by the Water System. The amount of water that can be safely drawn from a watershed during the worst period in the drought of record is the “Dependable Yield.” DEP has determined that the System could have furnished an average of 1,290 mgd during the drought of record in the mid-1960s. During periods of normal rainfall, watersheds supply more than the Dependable Yield. The Sewer System collects and treats an average of approximately 1,300 mgd of wastewater. Sewer service is provided to virtually the entire City, except for significant parts of the Borough of Staten Island, the Borough of Queens communities of Breezy Point and Douglaston, and the Borough of Brooklyn community of Seagate. Sewer service is also provided to certain upstate communities in System watershed areas. According to Metcalf & Eddy, the System is in adequate condition (the highest rating category). See “APPENDIX A — LETTER OF METCALF & EDDY, CONSULTING ENGINEERS.”

In recent years, DEP has taken a number of steps to enhance and augment its security arrangements to protect the System, including water supply structures and facilities. These steps include, among others, increasing the size of the DEP police force to approximately 200 officers; obtaining legislation authorizing the DEP police to function as police officers within the City, as well as in the upstate watersheds; purchasing additional police vehicles and surveillance equipment; and further securing facilities through additional locks, fences and other physical barriers to prevent access by unauthorized persons. In addition, DEP has been consulting with other governmental agencies, including the Federal Bureau of Investigation and the U.S. Army Corps of Engineers, on longer-term plans to modernize and improve security systems. In response to the attacks on the World Trade Center, DEP, in concert with law enforcement authorities, immediately implemented certain further measures to protect the System. These include, among others, increased frequency of patrols, restricting vehicular access to certain facilities, and more frequent monitoring of the water supply for contaminants. Increased security requirements have resulted in additional labor costs and related expenses in the System.

The Water System

Water Collection and Distribution

Water for the System is derived from three upstate reservoir systems (the Croton, Catskill and Delaware Systems) and a system of wells in Queens that were acquired as part of the City’s acquisition of the Jamaica Water Supply Company (“Jamaica Water”). The three upstate water collection systems include 18 reservoirs and three controlled lakes with a total storage capacity of approximately 550 billion gallons. They were designed and built with various interconnections to increase flexibility by permitting exchange of water from one system to another. This feature mitigates localized droughts and takes advantage of excess water in any of the three watersheds.

The Water System is currently furnishing water to users in portions of four of the eight eligible northern counties. The Water System provides approximately 85% of the water used in Westchester County and approximately 75% of the water used in Putnam, Orange and Ulster Counties.

Approximately 95% of the total water supply is delivered to buildings by gravity. Only about 5% of the water is regularly pumped by DEP to maintain the desired pressure. As a result, operating costs are relatively insensitive to fluctuations in the cost of power. When drought conditions exist, additional pumping is required.

The three main reservoir systems are the Croton, Catskill and Delaware Systems. See “New York City Water Supply System” map in Appendix G.

The following tables set forth the capacities and original in-service dates of the System’s collecting and balancing reservoirs and distribution facilities based on the City records.

Collecting Reservoirs

| <u>Name</u> | <u>Available Capacity(1) (Billion Gallons)</u> | <u>Original In-Service Date</u> |
|--------------------------------|--|---|
| Croton | | |
| New Croton | 19.0 | 1905 |
| Croton Falls Main | 14.2 | 1911 |
| Cross River | 10.3 | 1908 |
| West Branch..... | 10.1 | 1895 |
| Titicus..... | 7.2 | 1893 |
| Amawalk | 6.7 | 1897 |
| East Branch..... | 5.2 | 1891 |
| Muscoot | 4.9 | 1905 |
| Bog Brook | 4.4 | 1892 |
| Middle Branch..... | 4.0 | 1878 |
| Boyds Corner..... | 1.7 | 1873 |
| Croton Falls Diverting | <u>0.9</u> | 1911 |
| Total | 88.6 | |
| Catskill | | |
| Ashokan..... | 122.9 | 1915 |
| Schoharie | <u>17.6</u> | 1926 |
| Total | 140.5 | |
| Delaware | | |
| Pepacton | 140.2 | 1955 |
| Cannonsville..... | 95.7 | 1964 |
| Rondout | 49.6 | 1950 |
| Neversink | <u>34.9</u> | 1954 |
| Total | <u>320.4</u> | |
| Total Available Capacity | <u><u>547.5</u></u> | |

(1) Capacity above minimum operating level.

Balancing Reservoirs and Distribution Facilities

| <u>Name</u> | <u>Storage Capacity (billion gallons)</u> | <u>Original In-Service Date</u> |
|-------------------------------------|---|---------------------------------|
| Balancing Reservoirs | | |
| Kensico | 30.6 | 1915 |
| Hillview | <u>0.9</u> | 1915 |
| Total Balancing Reservoirs | 31.5 | |
| Distribution Facilities | | |
| Central Park | 1.0 | 1862 |
| Jerome Park | 0.8 | 1905 |
| Silver Lake (tanks) | <u>0.1</u> | 1970 |
| Total Distribution Facilities | <u>1.9</u> | |
| Total Storage Capacity | <u><u>33.4</u></u> | |

The following table sets forth the Dependable Yield and storage capacity for each of the water supply systems.

Water System Dependable Yield and Capacity

| <u>System</u> | <u>Dependable Yield (mgd)</u> | <u>Storage Capacity(1) (billion gallons)</u> |
|--------------------|-----------------------------------|--|
| Croton | 240 | 86.6 |
| Catskill | 470 | 140.5 |
| Delaware | 580 | 320.4 |
| Queens wells | <u>33</u> | <u>2.6</u> |
| Total | <u><u>1,323</u></u> | <u><u>550.1</u></u> |

(1) Capacity above minimum operating level.

When operating at full capacity, the Croton System provides approximately 10% of the City’s daily water supply and can provide substantially more of the daily water supply during drought conditions. Due to abundance of higher quality water from the Catskill and Delaware Systems, the Croton System has not been operating at full capacity for several years. It was shut down entirely from the summer of 2007 to the fall of 2008 and is expected to be turned on only intermittantly and for short periods over the next few years. The completion of the Croton filtration plant is expected to eliminate the water quality problems of the Croton System water. With completion of the Croton filtration plant, the Croton System will be able to operate at full capacity. See “— Governmental Regulation — *Croton Filtration.*” The Croton System consists of 12 reservoirs and three controlled lakes on the Croton River, its three branches and three other tributaries. The water in the Croton System flows from upstream reservoirs through natural streams to downstream reservoirs, terminating at the New Croton Reservoir. The watershed which supplies the Croton System has an area of 375 square miles. It lies almost entirely within the State, approximately 45 miles north of lower Manhattan, with a small portion in the State of Connecticut.

The Catskill System watersheds occupy sparsely populated areas in the central and eastern portions of the Catskill Mountains and normally provide approximately 40% of the City’s daily water supply. Water in the Catskill System comes from the Esopus and Schoharie Creek watersheds, located approximately 100 miles north of lower Manhattan and 35 miles west of the Hudson River. The Catskill System is comprised of the Schoharie Reservoir (formed by the Gilboa Dam across Schoharie Creek) and Ashokan Reservoir (formed by the Olivebridge Dam across Esopus Creek) and the Catskill Aqueduct.

Gilboa Dam is comprised of an earthen dam and a concrete gravity dam, with the concrete portion also acting as the spillway. In 2005, an engineering analysis of the dam showed that the spillway had lost some mass over time and that the dam did not meet NYSDEC safety guidelines applicable to the reconstruction of existing dams. In December 2006, DEP completed a series of interim steps to bring the dam into compliance with NYSDEC safety guidelines for the reconstruction of existing dams.

Although there is no evidence that the dam is facing imminent risk of failure, DEP has determined that the rehabilitation of the dam should be advanced. Work on the crest gates, which will increase DEP's ability to manage the Schoharie Reservoir and maintain it at proper levels is scheduled to begin in Fiscal Year 2009. Site preparation work is scheduled to begin in Fiscal Year 2010, with full reconstruction, which is anticipated to bring the dam up to compliance with NYSDEC safety guidelines for new dams, beginning in Fiscal Year 2011. The estimated cost to complete the rehabilitation is \$623 million, all of which is currently included in the CIP.

The Delaware System, located approximately 125 miles north of lower Manhattan, normally provides approximately 50% of the City's daily water supply. Three Delaware System reservoirs collect water from a sparsely populated region on the branches of the Delaware River: Cannonsville Reservoir (formed by the Cannonsville dam on the West Branch of the Delaware River); Pepacton Reservoir (formed by the Downsview Dam across the East Branch of the Delaware River); and Neversink Reservoir (formed by the Neversink Dam across the Neversink River, a tributary to the Delaware River).

In addition, wells in Queens provide approximately 1% of the City's daily water supply. The wells could be used to provide more of the daily supply during drought conditions. Unlike the rest of the City's water supply, which is a surface and gravity-supplied system originating in a network of upstate reservoirs, well water is pumped from extensive underground aquifers. The acquisition of wells in Queens from Jamaica Water in 1996 represented the first new water supply source for the City since the 1960s when the Delaware surface water system initially came on line. DEP is currently planning improvements to the ground water system which will augment the supply of water from underground aquifers.

Current demand/flow projections show that if conservation programs, including metering, toilet replacement, hydrant locking, leak detection, and public information, remain effective there will be no immediate need for the City to find additional long-term water supply sources to meet normal demand.

The System's water supply is transported through an extensive system of tunnels and aqueducts. See "New York City Water Tunnels" map in Appendix G. Croton System water is delivered from the New Croton Reservoir by the New Croton Aqueduct to the Jerome Park Reservoir in the Bronx. From Jerome Park Reservoir and from direct connections to the New Croton Aqueduct, trunk mains carry water to the service area. The Catskill and Delaware Aqueducts convey water from Ashokan Reservoir and Rondout Reservoir to Kensico Reservoir and then to Hillview Reservoir in Yonkers. Both Kensico and Hillview Reservoirs serve as balancing reservoirs. Water from the Catskill and Delaware Systems is mixed in the Kensico Reservoir, and is conveyed to Hillview Reservoir where water enters Tunnels 1, 2 and 3. Trunk mains carry water from tunnel shafts and from the distribution facilities (Jerome Park and Hillview Reservoirs and Silver Lake Tanks) to the service area.

Rondout-West Branch Tunnel. The Rondout-West Branch Tunnel carries water 45 miles from the Delaware System under the Hudson River and into West Branch Reservoir. It has a capacity of 900 mgd and normally contributes 50% of the City's water supply. It has the highest pressures and the highest velocities in the Water System. In addition, a portion of the tunnel crosses a fractured rock formation, which is potentially subject to greater stress than the deep rock tunnels located in the City. DEP regularly assesses the condition and integrity of the System's tunnels and aqueducts to determine the extent and effect of water loss. In particular, since the early 1990s, DEP has monitored the condition of the Rondout-West Branch Tunnel, which comprises a portion of the Delaware Aqueduct. As a result of DEP's flow tests, visual observations and other analyses, it has been determined that approximately 15 mgd to 36 mgd of water is being lost from the tunnel and is surfacing in the form of springs or seeps in the area. This amounts to a loss of approximately 4% of the daily volume of water provided by the tunnel under peak flow conditions. DEP has initiated the engineering work to determine the nature and extent of repairs which may be necessary to

remedy the water loss. DEP has also determined that the situation in the tunnel and amount of water loss is stable. In the opinion of the professional engineering firm retained by DEP in conjunction with that investigation, there is very little immediate risk of failure of the tunnel. DEP intends to make the necessary repairs. The costs to perform such repairs could be substantial depending on the nature of the required repair. To perform the repair work, the tunnel will have to be shut down and de-watered for a period of up to three years. During any such period, it will be necessary for the City to increase reliance on its other water supplies, and to implement more stringent measures to encourage conservation and decrease demand. Under an extended shutdown of this tunnel, water quality in the remaining reservoirs could potentially suffer as storage volumes are drawn down. In general, the Delaware System continues to demonstrate a high degree of reliability after 55 years of continuous service. Nevertheless, DEP considers it prudent to conduct regular tunnel and aqueduct inspections and surveys to detect any problems that might arise so that corrective actions can be taken if needed.

On August 15, 2007, the Office of the State Comptroller issued a report detailing its audit of DEP's plans and preparation for the repair and monitoring of the Rondout-West Branch Tunnel. The audit report contained seven recommendations which are largely reflected in current DEP policy. DEP commented that three assertions made in the audit should be corrected: (i) that the leak causes lost revenue; (ii) the leak has increased over time; and (iii) DEP has not upgraded its emergency plan. DEP submitted the following corrections to the three assertions: (i) the leak does not result in lost revenue; (ii) tests and monitoring have established that the tunnel structure and the leakage rate are stable; and (iii) although the leak is stable, DEP is upgrading its emergency plan. Although the final report appended these comments, the text of the report was not adjusted to correct these inaccuracies.

DEP has begun to evaluate additional strategies and projects for improving dependability of water supplies, which could entail the development of additional or interim supplies to meet demands during periods of extended facility outages due to planned or unplanned inspection, repair or rehabilitation. DEP has retained a consultant to develop a long term dependability plan. DEP intends to evaluate various alternative projects which, when combined, could allow for any portion of the Water System to be taken out of service for a period of up to one year. Elements of that plan may include: interconnections with other neighboring jurisdictions; increased use of groundwater supplies; storage and recovery of existing supplies within underground aquifers; increased storage at existing reservoirs; withdrawals and treatment from other surface waters; hydraulic improvements to existing aqueducts; and additional tunnels.

Tunnel 1. From Hillview Reservoir, water from the Catskill and Delaware Systems is delivered into the City by a circular, cement-lined, pressurized, bedrock tunnel that narrows in diameter from 15 to 11 feet. Tunnel 1 is 18 miles in length and extends south from Hillview Reservoir through the West Bronx to Manhattan and Brooklyn. Tunnel 1 is 200 to 750 feet underground and thus avoids interference with streets, buildings, subways, sewers, pipes and other underground infrastructure. These depths are necessary to ensure substantial rock covering necessary to withstand the bursting pressure of the water inside and to ensure watertightness. Tunnel 1 has a capacity of approximately 1,000 mgd. Shafts placed along the tunnel connect with surface mains which deliver water to the distribution system.

Tunnel 2. The second tunnel also delivers Catskill and Delaware System water from Hillview Reservoir. It is a circular, cement-lined, pressurized, bedrock tunnel, 200 to 800 feet below the street surface and 15 to 17 feet in diameter. Tunnel 2 extends south from Hillview Reservoir, east of Tunnel 1, through the Bronx, under the East River at Rikers Island, through Queens and Brooklyn, and connects with Tunnel 1 in Brooklyn. Tunnel 2 has a capacity of more than 1,000 mgd and is 20 miles in length. Shafts placed along the tunnel connect with surface mains which deliver water to the distribution system.

Richmond Tunnel. Connecting to Tunnel 2 in Brooklyn is the ten-foot diameter, five-mile long Richmond Tunnel, which was completed in 1970 and carries water 900 feet beneath Upper New York Bay to Staten Island. The Richmond Tunnel, the Richmond Distribution Chamber, the Richmond Aqueduct and the underground Silver Lake Tanks were designed to improve the water supply facilities of Staten Island. The underground storage tanks (among the world's largest) have a combined capacity of 100 million gallons and replaced the Silver Lake Reservoir (now Silver Lake).

Tunnel 3. A new water tunnel, Tunnel 3, connecting the reservoir system to the City is presently under construction to increase capacity to meet a growing demand in the eastern and southern areas of the City, permit inspection and rehabilitation of Tunnels 1 and 2, and provide water delivery alternatives to the City in the event of disruption in Tunnel 1 or 2. Tunnel 3 is being built in four stages. Stage I commenced operation in July 1998. It follows a 13-mile route which extends south from Hillview Reservoir in Yonkers under Central Park Reservoir in Manhattan, and east under the East River and Roosevelt Island to Long Island City in Queens. Stage II is currently under construction and is expected to be completed by 2015. It will extend from the end of Stage I to supply Queens, Brooklyn and the Richmond Tunnel and from the valve chamber at Central Park into lower Manhattan. Upon completion, and with the installation of additional surface mains or the construction of additional shafts, Stage II will enable the system to maintain full service even if Tunnel 1 or 2 was shut down. The Stage III project is now referred to as the Kensico-City Tunnel (the “Kensico Tunnel”). Stage IV is intended to deliver additional water to the eastern parts of the Bronx and Queens. It would extend southeast from the northern terminus of Stage I in the Bronx to Queens and then southwest to interconnect with the Queens portion of Stage II.

Kensico-City Tunnel. The Kensico-City Tunnel will extend from the Kensico Reservoir to the interconnecting chamber of Tunnel 3, Stage I, south of Hillview Reservoir. The design work for the tunnel is estimated to cost \$119 million. The estimated cost to design and construct the tunnel is expected to be between \$4 billion and \$6 billion, most of which would be incurred in the years beyond the CIP. The amount currently included in the CIP for this project is \$75 million.

The water distribution system consists of a grid network of over 6,700 miles of pipe, as well as valves, fire hydrants, distribution facilities, gatehouses, pump stations, and maintenance and repair yards. Approximately 35% of the pipe in the System was laid before 1930, 35% between 1930 and 1969, and the remainder thereafter. The CIP provides for the programmatic replacement of water mains in accordance with certain established criteria. These criteria were reviewed and confirmed by the U.S. Army Corps of Engineers in its independent study of the City’s distribution system completed in November 1988.

Various facilities provide storage to meet the hourly fluctuations in demand for water throughout the City, as well as any sudden increase in draft that might arise from fire or other emergencies. With the exception of some communities in the outlying areas of the City which may experience low pressure service during peak hours in summer months, the water distribution system provides generally excellent service.

Drought Response Measures

From time to time the Water System experiences drought conditions caused by significantly below-normal precipitation in the watershed areas. The most recent drought was in 2002. As of January 9, 2009, the System’s reservoirs were filled to 95% of capacity. Normal levels at this time of year are approximately 79% of capacity.

The Water System relies upon a surface water supply, and is sensitive to major fluctuations in precipitation. Throughout even the worst droughts, the Water System has continued to supply sufficient amounts of water to the City. To ensure adequate water supply during drought conditions, DEP, in conjunction with other City, State and interstate agencies, maintains a Drought Management Plan. The Drought Management Plan defines various drought phases that trigger specific management and operational action. Three defined phases are: “Drought Watch,” “Drought Warning,” and “Drought Emergency.” A Drought Emergency is further subdivided in four stages based on the projected severity of the drought and provides increasingly stringent and restrictive measures.

A Drought Watch is declared when there is less than a 50% probability, based on the existing record since 1927, that either the Catskill or Delaware reservoir system will be filled by the following June 1. This phase initiates the pumping of water from the Croton System. In addition, during this phase a public awareness program begins and users, including upstate communities taking water from the System, are requested to initiate conservation measures. New York State Department of Health (“NYSDOH”), NYSDEC, and the Delaware River Basin Commission (the “DRBC”) are advised of the Water System’s

status, and discussions are held with City agencies concerning their prospective participation in the event of a declaration of a Drought Warning.

A Drought Warning is declared when there is less than a 33% probability that either the Catskill or Delaware reservoir system will fill by June 1. All previous efforts are continued or expanded and additional programs are initiated, including the coordination of specific water saving measures by other City agencies.

A Drought Emergency is declared when it becomes necessary to reduce consumption by imposing even more stringent measures. In addition to the imposition of restrictions, DEP may enhance existing System management and public awareness programs, expand its inspection force and perform additional leak and waste surveys in public and private buildings. DEP may also require communities outside of the City that are served by the System to adopt similar conservation measures.

Governmental Regulation

The System is subject to federal, State, interstate and municipal regulation. At the federal level regulatory jurisdiction is vested in USEPA; at the State level in NYSDEC and NYSDOH; at the interstate level in the DRBC and the Interstate Environmental Commission and at the municipal level in DEP, the New York City Department of Health and Mental Hygiene (“NYCDOH”), DOB and the Department of Small Business Services and to a limited degree, in municipalities and districts located in eight counties north of the City. Water quality standards are enforced within the watershed areas north of the City through a network of overlapping governmental jurisdictions. Participating in that network, among others, are NYSDEC and NYSDOH, county, municipal and district police, engineers and inspectors; and City personnel from DEP. The various jurisdictions maintain physical security, take water samples, monitor construction activities and wastewater treatment in the watershed, and generally oversee the physical condition of, activity on and the operation of water supply lands and facilities. Portions of the overall legislative and regulatory framework governing the watersheds may be found in the City’s Administrative Code, Health Code and Water Supply Regulations. Regulatory enforcement within City limits is almost exclusively accomplished through City personnel. Provisions incorporating and augmenting the substance of the federal Safe Drinking Water Act (“SDWA”), related regulations and the Sanitary Code, are contained in the Health Code, Water Supply Regulations and the City’s Building and Building Construction Codes. These provisions are enforced by personnel from DEP, NYCDOH and DOB.

Drinking Water Regulations. In January 2006, USEPA issued final versions of two drinking water supply regulations, developed pursuant to the SDWA: the Long Term 2 Surface Water Treatment Rule (“LT2”) and the Stage 2 Disinfection/Disinfectant By-Products Rule (“DBP2”). Compliance with these new regulations may require additional capital expenses, not all of which are currently included in the CIP.

The purpose of LT2 is to reduce the incidence of waterborne disease by mandating certain levels of inactivation and/or the removal of certain microorganisms from water supply systems, including the Catskill and Delaware Systems. DEP anticipates achieving compliance with such levels through the construction and operation of its planned ultraviolet treatment facility (the “UV Facility”). See “— *Watershed Protection/Catskill, Delaware Filtration.*” LT2 also mandates that uncovered finished water storage facilities, which include the Hillview Reservoir, be covered or that water from such facilities be treated. DEP is already a party to an Administrative Order with NYSDOH (“Hillview Administrative Order”) which requires, among other things, that the City install or construct a cover for the Hillview Reservoir. DEP is seeking a variance from the LT2 requirement that Hillview Reservoir be covered as a finished water storage facility, which, if granted, would also exempt DEP from the requirement to cover the reservoir under the Hillview Administrative Order. There can be no assurance that such variance will be obtained. The cost of covering the Hillview Reservoir, is expected to be \$1.6 billion, \$500 million of which is included in the CIP.

The purpose of DBP2 is to reduce the potential health risks associated with disinfection byproducts, which are chemical compounds formed when disinfectants such as chlorine are added to drinking water. Based on preliminary assessments, DEP believes that the mandated level of disinfection byproducts set forth by DBP2 may be exceeded in certain parts of the System. DEP hired a consultant to study the matter and issue a report recommending steps to be taken by DEP. The final report was issued in October 2008.

The report does not suggest switching to chloramination (an alternative form of disinfectant) at this time, but does recommend that DEP leave space available at its facilities to accommodate the use of chloramination in the event that a change in disinfection is necessary in the future. The report also makes certain recommendations regarding DEP's operation of the water supply system, which will improve DEP's ability to achieve compliance with DBP2. There are no significant capital issues related to the recommendations set forth in the report.

Croton Filtration. Because of the quality of the System's water and the long periods of retention in the reservoirs, it has not been necessary to filter water from the System to reduce the bacterial content and the turbidity. The only treatment procedures routinely employed by DEP are screening, detention, disinfection, flouridation, and the addition of caustic soda and phosphoric acid for corrosion control. Additions of copper sulfate for algae control and alum for turbidity control are made only when needed. Historically, this level of treatment proved to be more than sufficient to maintain water quality standards throughout the entire Water System. However, more stringent federal standards for surface water treatment in the 1980s and 1990s led to a 1992 stipulation with NYSDOH, which has been superseded by a 1998 federal court consent decree, as supplemented in 2002 and 2005 (the "Croton Filter Consent Decree"). The Croton Filter Consent Decree mandates the construction of a full scale water treatment facility to filter Croton System water.

After an extensive study, DEP identified the Mosholu Golf Course in the Bronx as its preferred site for the treatment facility and began work at the site in late 2004. The Croton Filter Consent Decree sets forth milestones, including commencement of operations of the facility on October 31, 2011 which, if not met by the City, require the payment of penalties to the State and federal governments. Because of the withdrawal of the low bidder on one of the general construction contracts for the facility, DEP missed several milestones relating to commencement of construction. Those milestones have now been met. It is anticipated that the total cost to complete the Croton filtration plant will be \$563 million, all of which is included in the CIP. Construction of a permanent golf club house, the costs of which are not yet known, but which DEP is mandated to fund, is not fully funded in the CIP. As a result of the delay in commencing the construction of the water treatment facility, DEP may not meet other milestones in the Croton Filter Consent Decree, which could result in the imposition of penalties.

From time to time, the Croton System has failed to meet the water quality standard for haloacetic acids, a disinfection by-product regulated by USEPA. Pursuant to a USEPA Administrative Order issued in June 2003, DEP has evaluated feasible and cost-effective interim measures that could be taken to reduce haloacetic acid levels in Croton water until the Croton filtration plant is completed. It is anticipated that the Croton System will be used only intermittently and for short periods over the next few years. As such, DEP has determined that implementation of such interim measures is not needed at present due to the very limited use of the Croton system.

Watershed Protection/Catskill, Delaware Filtration. Pursuant to the SDWA, USEPA has promulgated nationwide drinking water regulations which specify the maximum level of harmful contaminants allowed in drinking water and which govern the construction, operation, and maintenance of the System. USEPA has also promulgated filtration treatment regulations, known as the federal Surface Water Treatment Rule ("SWTR"), that prescribe guidelines concerning studies to be performed, programs to be implemented, timetables to be met and any other actions necessary to insure compliance with the regulations' terms. Enforcement of SDWA and many of its related regulations was delegated by USEPA to the State. With respect to the Catskill and Delaware systems, the City believes that it will continue to be able to meet the criteria for non-filtered supplies under the SWTR.

On January 21, 1997, the City and the State executed a Memorandum of Agreement with the communities in the Catskill, Delaware and Croton watersheds, USEPA and several environmental groups (the "Watershed Memorandum of Agreement"). The Watershed Memorandum of Agreement supplemented the City's existing watershed protection program with approximately \$400 million in additional funding for economic-environmental partnership programs with upstate communities. As provided under the Watershed Memorandum of Agreement, the State issued a land acquisition permit to the City to

acquire water quality sensitive land in the watershed until January 2012 and approved the City's revised rules and regulations governing certain aspects of land use in the watershed.

Since 1993, USEPA has been issuing filtration avoidance determinations ("FADs") pursuant to which the City is not required to filter water from the Catskill and Delaware Systems. If the City were to have to filter water from the Catskill and Delaware Systems, construction costs to provide for such filtration are estimated to be between \$6 billion and \$8 billion. In July 2007 USEPA issued a new FAD (the "2007 FAD") which supersedes previous determinations and has a term of 10 years, divided into two five-year periods. The 2007 FAD requires the City to take certain actions to protect the Catskill and Delaware water supplies. These actions included the continuation and enhancement of certain environmental and economic partnership programs established under the Watershed Memorandum of Agreement, and the creation of new programs.

Since 1997, the FAD has required that the City solicit property from owners of land in the watershed and actually acquire (with certain limited exceptions) title to or conservation easements on any solicited land if the owner accepts the City's purchase price. The 2007 FAD requires the City to allocate a total of \$300 million for land acquisition during its ten year term, including approximately \$59 million of unspent funds remaining from moneys set aside for land acquisition under the Watershed Memorandum of Agreement and the previous FAD and \$241 million in new funding. In addition, the City is obligated to develop and implement a strategy to augment its land acquisition efforts through increased participation of land trusts and other non-governmental organizations in identifying and helping the City acquire eligible lands. As of January 5, 2009, title to or conservation easements on approximately 93,400 acres of land in the Catskill and Delaware watersheds at a cost of approximately \$306 million have either been acquired or are under contract for acquisition. The current NYSDEC land acquisition permit allowing the City to continue its watershed land acquisition program expires in early 2012. It will be necessary for DEP to obtain a new permit in order to continue acquiring watershed land during the second five years of the 2007 FAD. Under the 2007 FAD DEP must apply for the new permit in early 2010. Other stakeholders will have the opportunity, as part of the permitting process, to oppose the issuance of the permit or to request the inclusion of conditions or limitations on such permit. A failure to obtain such a permit will impact DEP's ability to comply with the 2007 FAD.

The 2007 FAD also calls for the continuation, during its first five years, of many of the City's other successful watershed protection programs that were part of the previous FAD, with additional enhancements to several programs including the Community Wastewater Management Program and the Stream Management Program. Prior to commencement of the second five years of the 2007 FAD, the City will need to reach agreement with USEPA and NYSDOH on which of such programs should be further continued into the second five-year period, whether and how any such programs to be further continued should be modified, and/or whether additional programs are needed to justify continuation of the 2007 FAD into the second five years of its term. To assist in making these decisions and reaching an agreement, DEP will prepare a Revised Long Term Watershed Protection Program, to be submitted to USEPA/NYSDOH by December 15, 2011.

On September 12, 2007, the Coalition of Watershed Towns and three individual towns in the watershed filed a petition for review in the U.S. Court of Appeals for the Second Circuit, challenging the USEPA's issuance of the 2007 FAD. The petitioners claim: first, that based on language in the Watershed Memorandum of Agreement, and correspondence between USEPA and NYSDOH in 1997, primary responsibility for administering the SWTR for the Catskill and Delaware water supplies should have been transferred to NYSDOH in May 2007 and, therefore, USEPA lacked authority in July 2007 to issue the 2007 FAD for Catskill and Delaware systems; and, second, that the Watershed Control Program embodied in the 2007 FAD does not conform to the SWTR requirement that the water supplier demonstrate "through ownership and/or written agreements with landowners within the watershed that it can control all human activities which may have an adverse impact on the microbiological quality of the source water." On December 29, 2008, the Second Circuit denied the petition, finding that petitioners lacked constitutional standing to assert these claims. On January 12, 2009, petitioners filed a petition for rehearing en banc. An adverse determination on the first claim could invalidate the 2007 FAD and require that a new FAD be

issued by NYSDOH. An adverse determination on the second claim could invalidate the 2007 FAD and prevent either USEPA or NYSDOH from issuing a new FAD. USEPA and the other respondents are actively defending the 2007 FAD. See “LITIGATION.”

In recent months, there has been increased interest in natural gas drilling in southeastern New York State, including the watershed. DEP has hired a geological consultant and is monitoring the situation to understand what impact, if any, such exploration may have on the System, including any potential impact on water quality. DEP is working closely with State and federal agencies on this effort, and will endeavor to ensure that any exploration or drilling activities are conducted in an appropriate manner that is protective of the watershed and water quality. NYSDEC has issued a draft scoping document for comment for revisions to generic environmental impact statements relating to natural gas drilling. DEP has provided extensive comments on the draft scope. The comment period has closed. To date, no permits have been filed to drill for natural gas in the watershed.

UV Facility. The UV Facility will provide treatment for Catskill and Delaware water by achieving certain levels of inactivation of cryptosporidium. The 2002 FAD, as initially issued, called for the UV Facility to be operable by September 2009. There have since been a number of delays attributable to design changes and permitting issues. In January 2007, DEP entered into an Administrative Order on Consent (“UV Order”), with USEPA, pursuant to USEPA’s authority under LT2. The UV Order establishes a revised schedule of milestones for the construction of the UV Facility including a final completion date of October 29, 2012. The milestones in the UV Order have been incorporated into the 2007 FAD.

At DEP’s request, USEPA extended the milestone in the UV Order for issuance of a notice to proceed on such contract from October 31 to December 31, 2007. In December 2007, DEP notified USEPA that it would miss the December 31, 2007 milestone for issuance of the notice to proceed. The notice to proceed was issued on January 31, 2008. While the UV Order does not provide for stipulated penalties, DEP can be assessed penalties of up to \$37,500 per day for each missed milestone under the SDWA. Violations of the UV Order could also affect DEP’s standing under the terms of the FAD. The cost to complete the UV Facility is fully funded in the CIP.

USEPA/U.S. Attorney Investigations. In August 2001, pursuant to a plea agreement entered into with the United States Attorney’s Office for the Southern District of New York, DEP pleaded guilty to a criminal violation of both the Clean Water Act and the Toxic Substances Control Act. As a result, DEP has been placed on probation and a court-appointed federal monitor was assigned to oversee DEP’s compliance with the terms of the plea agreement. Among other things, the plea agreement required DEP to establish an agency compliance office, and to develop and implement a compliance program for its water supply operations and its upstate water pollution control plants, intended to detect and prevent violations of environmental, health and safety laws, rules and regulations.

The Clean Water Act violation is based on the discharge of water containing low levels of mercury from a DEP facility in Sullivan County. The Toxic Substances Control Act violation was based on DEP’s use of flow control equipment which contains PCBs in other than a totally enclosed manner at a facility in Westchester County. The conditions which gave rise to the violations have not had any detectable impact on water quality and the City’s water supply has been, and continues to be, safe. The federal government, NYSDOH and DEP have all indicated that the water supply remains safe with respect to mercury, PCBs and lead. DEP has been and continues to be engaged in programs to remediate mercury, PCBs, lead, and other constituents of concern from the affected facilities. DEP’s operation and management of the System have not materially changed as a result of the plea.

On August 14, 2003, the City (along with major portions of the northeastern United States) experienced a massive power blackout. With the loss of electrical power during the blackout, DEP’s North River and Red Hook water pollution control plants were unable to treat wastewater being conveyed to those facilities, resulting in the outflow of untreated wastewater into the waters of New York Harbor. The United States Attorney’s Office for the Southern District of New York conducted an investigation into operations at the two plants in connection with the blackout. On January 13, 2006, DEP entered into an agreement with the United States Attorney’s Office, whereby DEP admitted that it had violated the terms

of probation by failing to properly maintain emergency back-up generators at the Red Hook plant, in violation of its SPDES permit for the plant. It further agreed to an extension of probation for three years, ending February 6, 2009, with a possible further extension until December 31, 2009 upon motion by the United States Attorney's Office. Finally, DEP agreed to expand its environmental, health and safety compliance program to the balance of the agency's operations, and to extend the monitor's oversight to include DEP's in-City wastewater treatment operations. On February 7, 2006, the United States District Court for the Southern District of New York entered an order extending probation and the monitor's oversight, and directing DEP to expand its compliance program, as contemplated by the agreement.

In recognition of progress made by DEP in developing and implementing its compliance program, and based on an agreement reached among DEP, the United States Attorney's Office and the federal monitor, the court issued orders releasing DEP's Bureau of Water and Sewer Operations, Bureau of Water Supply, and DEP's risk management and process safety management programs at the four DEP facilities where drinking water is chlorinated for disinfection, from the monitor's day-to-day supervision.

From time to time, the United States Attorney's Office requests additional information from DEP concerning the System, and issues subpoenas for additional documents. DEP cooperates with the office and provides information and documents in response to such requests and subpoenas.

Tap Water Testing Program. DEP has historically monitored key locations in its distribution system for over 40 individual water quality parameters, including lead. DEP data indicated that lead was absent from or present in very low levels in both the water supply and distribution systems. Beginning in the early 1990s, USEPA and NYSDOH regulations require water suppliers to monitor for lead and copper that may have leached into the water from service lines or interior building plumbing. In compliance with these requirements, DEP began testing tap water for lead and copper. Sample results indicated the presence of lead in some of the tested residential taps, in excess of State lead action levels. To minimize these occurrences, the City began the addition of corrosion control chemicals to the Water System. This addition promotes the formation of a protective coating inside pipes and plumbing, thereby reducing the leaching of metals. The most recent test results for lead in tap water, for 2005, 2006 and 2007, show the City to be in compliance with State action levels for lead in the State Sanitary Code.

The System has six laboratories that monitor water quality, employing approximately 250 microbiologists, engineers, chemists, hydrologists and limnologists. Over 65,000 samples per year are collected and 800,000 analyses are performed annually. Routine checks are made for more than 60 different substances, including heavy metals and trace organics. The monitoring program meets or exceeds federal and State requirements and has the capability to meet potentially more stringent requirements.

Hillview Reservoir. In March 1996, DEP entered into the Hillview Administrative Order with NYSDOH which, as modified in 1997 and 1999, required, among other things, the City to cover the Hillview Reservoir by December 31, 2005 to reduce the possibility of E. coli bacteria entering the Water System.

The City has not commenced construction of a cover for the Hillview Reservoir and therefore did not meet the December 31, 2005 milestone date set out in the Hillview Administrative Order. On February 22, 2008, DEP entered into a revised Hillview Administrative Order which requires the City to cover the Hillview Reservoir by October 31, 2016 while also allowing the City to pursue an evaluation of other strategies to protect the reservoir. Due to a force majeure event, DEP is behind schedule for installing one of the projects required by the Hillview Administrative Order. If NYSDOH does not concur that a force majeure event occurred, DEP may be subject to penalties. DEP has sought a modification of the schedule and relief from the imposition of penalties. Currently, the cost of constructing a concrete cover over the Hillview Reservoir, as DEP originally proposed, is expected to be \$1.6 billion, \$500 million of which is included in the CIP. DEP is continuing to investigate less costly alternatives to a concrete cover, including a floating cover, which would require the consent of NYSDOH. Installation of a floating cover would require additional design work and may cause DEP to miss the October 31, 2016 construction completion date mandated under the Hillview Administrative Order. See “— *Drinking Water Regulations.*”

Consumer Confidence Report. The SDWA requires that utilities prepare and distribute to their consumers a brief annual water quality report, referred to as the Consumer Confidence Report (the “CCR”). The CCR covering calendar year 2007, the most recent such report, demonstrates that the quality of New York City’s drinking water remains high. The CCR notes several exceedences of standards for the naturally-occurring elements iron and manganese, as well as a treatment technique violation, violation of State monitoring requirements in the Groundwater System and PH exceedences in the Catskill/Delaware system. None of these exceedences are considered harmful to public health. DEP issued a public notification about the treatment technique violation and has taken steps to address the cause of the violation.

Delaware System. The conditions under which the System’s Pepacton, Neversink and Cannonsville Reservoirs may be operated are set forth under the terms of a 1954 decree of the Supreme Court of the United States (the “1954 Decree”). It allows the System to divert 800 mgd of water from the Delaware River Basin for use by the Water System. At the same time, an October 2007 agreement with the Delaware River Basin Commission requires the System, under certain circumstances, to release water from the three reservoirs into the tributaries of the Delaware River, when the reservoirs are full. Enforcement of the 1954 Decree is under the jurisdiction of a River Master appointed by the Supreme Court of the United States. The City and State, and the governments of New Jersey, Pennsylvania and Delaware are named parties to the 1954 Decree.

For more information regarding litigation relating to the Water System, see “LITIGATION.”

The Sewer System

The Sewer System is comprised of the sewage collection system and the water pollution control facilities. See “New York City Drainage Areas and Water Pollution Control Plants” map in Appendix G.

Sewage Collection and Treatment

The Sewer System’s plants treat approximately 1,318 mgd of wastewater. The Sewer System is divided into 14 drainage areas corresponding to the 14 water pollution control plants and includes over 6,600 miles of sewer pipes of varying size which are classified as one of three types: sanitary, storm or combined. Sanitary sewers accommodate household and industrial waste. Storm sewers carry rainwater and surface water runoff. Combined sewers carry both types of waste. Approximately 70% of the City’s sewers are of the combined type. In addition to the sewage pipes, the Sewer System includes catch basins and seepage basins to prevent flooding and sewer backups.

The Sewer System is comprised of a number of sewer facilities built to varying standards. Different materials and methods of construction were used resulting in different life cycles. Approximately 4,000 miles or two-thirds of the City’s sewer pipe is made of vitreous clay. Significant mileage of sewer pipe is composed of other building materials including cement, reinforced concrete, iron and brick. Some pipe in the collection system was installed before 1870, and approximately 15% of all sewer pipe in the collection system is over 100 years old.

The facilities related to the treatment of sewage include water pollution control plants, two combined sewer overflow retention facilities, wastewater pump stations, laboratories, sludge dewatering facilities and inner-harbor vessels which transport sludge between facilities. Sludge is a by-product of the sewage treatment process. Sludge that is treated through the sewage treatment process (or “biosolids”) is acceptable for land-based beneficial use either directly or after additional provisions such as composting, lime stabilization or thermal pelletization.

Issues of both water supply volume and consequent sewage treatment volume are raised from time to time in connection with the System. Measures to increase the supply of water available to the System and to increase the sewage treatment capacity of the various water pollution control plants in the System are either being constructed under the CIP or are under continuing review for feasibility and cost effectiveness. DEP has been addressing both the issues of supply and treatment capacity by promoting conservation, through voluntary changes in user behavior, through education and the imposition of use charges based on metered

water usage, leak detection and repair, and increased use of newly designed low-flow water use fixtures such as toilets.

The Sewer System's water pollution control pump stations convey wastewater to the water pollution control plants. When gravity flow becomes uneconomical or not feasible for engineering reasons, pump stations lift the flow so that it can again flow by gravity. In some locations, pump stations utilize pressure piping called force mains to direct the flow of wastewater to the plants. The CIP includes an ongoing program to reconstruct and refurbish pump stations.

Sewer regulators and tide gates control flow in the System. Recent inspections of the regulator system have found it to be structurally adequate, but many portions are in need of mechanical reconstruction. A detailed evaluation of the regulator and tide gate system has been completed and funds have been provided in the CIP for mechanical refurbishment of these facilities.

During periods of heavy rainfall a combination of stormwater and sewage bypasses treatment and is released into the City's waterways via combined sewer overflows. The combined sewer overflow abatement program provides for studies, design and construction of facilities to address this issue.

DEP has awarded contracts for the beneficial use of 100% of its biosolids which commenced in July 1998. These current contracts include: thermally drying the biosolids into fertilizer pellets at a facility located in the Bronx; composting in Pennsylvania; direct land application in Colorado and Virginia; and lime stabilization in Colorado.

Governmental Regulation

Under the Clean Water Act, USEPA oversees compliance with federal environmental laws, regulations and guidelines concerning sewage. Included in that regulatory framework is the National Pollutant Discharge Elimination System Permit Program and the issuance of water pollution control plant operating permits. As authorized by the Clean Water Act, administration of the permit program has been delegated to the State.

Full Secondary Treatment Requirements/Newton Creek. Thirteen of the System's 14 in-City water pollution control plants have been upgraded to meet the full secondary treatment requirements of the Clean Water Act. The remaining plant, Newtown Creek, is in the process of being upgraded to meet secondary treatment requirements and to improve plant operations. All of this work is being undertaken pursuant to the terms of a State court consent judgment (the "Newtown Creek Consent Judgment"), agreed to by NYSDEC and DEP, which required that the plant meet secondary treatment levels by December 31, 2007 and that all other construction-related activities specified in the consent judgment be completed by July 4, 2013. DEP has determined that the amount of time required to take certain plant facilities out of service, upgrade them, and return them to service is in excess of prior estimates. As a result, DEP has advised NYSDEC that it will likely not be able to comply with the July 4, 2013 milestone for completion of construction. NYSDEC has requested that DEP investigate the possibility of accelerating the work. In response, DEP has proposed certain measures which DEP believes will shorten the overall time period for completion of construction. DEP has requested that NYSDEC approve such measures and grant relief from the December 31, 2007 milestone by approving interim discharge limits for the plant and extending the date for attainment of secondary treatment until construction is completed. On November 7, 2006, a court-appointed referee issued a recommendation that the Newtown Creek Consent Judgment be modified to extend interim discharge limits at the plant and the milestone for attainment of secondary treatment to December 31, 2008. The referee also recommended that the City be required to determine if the overall construction schedule at the plant could be accelerated. In addition, on January 23, 2007, NYSDEC issued a notice of violation ("NOV") to DEP, seeking penalties for certain past construction milestones under the Newtown Creek Consent Judgment which NYSDEC alleges have been missed through January 22, 2007. On August 24, 2007, NYSDEC filed a judgment in New York State Supreme Court for approximately \$30 million in penalties with respect to such past missed construction milestones. In addition, NYSDEC issued a further NOV for additional accrued penalties in respect of such past missed construction milestones, in the amount of \$20,683,000 for the period from January 23, 2007 to August 27, 2007. After

extensive negotiations, NYSDEC has agreed to a revised schedule for attainment of secondary treatment and for completion of all construction at the Newtown Creek WPCP. NYSDEC has also agreed to a resolution of their pending claims for stipulated penalties for missed milestone dates. This resolution will be contained in a modification of the Newtown Creek Consent Judgment; approval of this settlement requires approval of the Comptroller of the City of New York. The key elements of the resolution are: placement of \$29 million in escrow, which can be recovered if DEP meets certain future milestone dates; establishment of a \$10 million fund for environmental benefits projects; the conducting of environmental audits of DEP's in-City wastewater treatment plants and four combined sewer overflow ("CSO") facilities, under an agreement that requires DEP to remedy any legal deficiencies uncovered during the audits but shields DEP from penalties for any such deficiencies; and the continued implementation of improvements to DEP's business practices related to certain elements of its capital construction program. The current estimated cost to complete the work at Newtown Creek is \$1.5 billion, all of which is reflected in the CIP. For additional information on the Newtown Creek Consent Judgment, see "LITIGATION."

Combined Sewer Overflows. The System is also required to develop programs to reduce pollution from combined sewer overflows and to eliminate excess infiltration and inflow into the Sewer System from ground and storm water. In June 1992, DEP entered into a consent order with the State (the "CSO Consent Order") establishing various deadlines through 2006 for the construction of nine combined sewer overflow projects, which may include storage tanks. The CSO Consent Order was modified in January 2005. This modification imposed penalties for missed deadlines and established revised milestones for those projects which suffered delays. Certain of these milestones extend beyond the end of the CIP. The estimated remaining cost of complying with the CSO Consent Order, through the end of the CIP, as revised, is \$1.8 billion, all of which is currently included in the CIP. Consistent with USEPA guidelines, the City is exploring alternative approaches to combined sewer overflow problems that focus on cost-effective means of protecting water quality. In January and February 2007, NYSDEC issued NOV's for two missed milestones, which are subject to stipulated penalties under the CSO Consent Order. DEP and NYSDEC executed a consent order modification effective April 14, 2008 settling the two NOV's, along with other issues under the CSO Consent Order and other outstanding obligations for a \$1 million penalty and \$4 million in environmental benefit projects to be proposed by DEP. In November 2007, NYSDEC issued an NOV alleging three separate violations of a permit related to work on combined sewer overflows. Such permit violations may be subject to civil penalties. DEP is continuing to negotiate with NYSDEC to resolve the NOV. In July 2008, NYSDEC issued an NOV disputing DEP's certification of construction completion for the Flushing CSO facility as required under the CSO Consent Order. DEP disputes the merits of the NOV. NYSDEC and DEP are in discussions concerning resolving the NOV. The potential penalty is \$10,355,000.

DEP's SPDES permits for the City's 14 in-City water pollution control plants require those plants to be capable of accepting and treating two times dry weather flow. DEP has met this requirement at 12 plants. Design work has begun for the necessary upgrades at the Tallman Island plant and construction is expected to be completed in fiscal year 2015, the full cost of which is included in the CIP. DEP believes that the Rockaway plant currently meets the two times dry weather flow requirement and is monitoring the performance of the plant in order to gather data for submission to NYSDEC. In 2002, NYSDEC proposed modifications of the existing SPDES permits for the 14 in-City water pollution control plants operated and maintained by DEP. The proposed modifications included certain provisions relating to the control of CSOs. NYSDEC has issued draft SPDES permits which are acceptable to DEP. However, these permits have been challenged by several environmental groups. Such challenge could result in additional permit provisions relating to the control of CSOs and/or a request to modify the terms of the revised CSO Consent Order.

In December 2007, NYSDEC issued an NOV alleging that DEP was not in compliance with certain requirements related to CSOs as set forth in DEP's SPDES permits. DEP has disputed these claims. In August 2008, NYSDEC served DEP with a draft of a new Consent Order (the "CSO SPDES Consent Order") seeking to resolve the NOV's. Negotiations concerning the NOV and the CSO SPDES Consent

Order are ongoing. DEP's potential liability is difficult to estimate; to date NYSDEC has not made a specific penalty demand.

SPDES/Water Pollution Control Plants

On May 1, 2007 NYSDEC issued a notice of violation related to the SPDES permit for the Spring Creek Auxiliary Water Pollution Control Plant, alleging excessive infiltration/inflow entering the facility dating to June 2006. DEP responded to the notice of violation and believes NYSDEC is satisfied with its response. SPDES permit violations are subject to penalties up to \$37,500 per day.

The System also includes eight City-owned upstate water pollution control plants to prevent untreated sewage from being released into the watersheds. To enhance watershed protection, DEP completed upgrades to seven of these facilities. The CIP includes funds to upgrade the eighth facility.

Harbor and Waterway Protection. According to the most recent Harbor Survey issued by DEP, the water quality in New York Harbor and surrounding rivers continues to show long-term overall improvement. The Harbor Survey is an ongoing monitoring effort of the City's waterways that has been done since 1909. The Survey monitors over a dozen water quality parameters at 37 sampling stations within New York Harbor and its tributaries. A key parameter of the overall health of aquatic systems is dissolved oxygen ("DO"). The Harbor Survey has found DO levels in most parts of the harbor at historic highs, although river-bottom DOs are periodically below acceptable concentrations. Many local waterways, which were unfishable just 20 years ago, now meet the coliform bathing standards. These water quality improvements are primarily a response to: continued water pollution control plant construction and upgrades; abatement and surveillance of illegal discharges; and increased capture of wet-weather flows.

In April 2004, the City health code for bathing beaches began utilizing a standard based on enterococcus, rather than coliform, which is regarded as a more precise indicator of water quality. DEP's Harbor Survey has begun a monitoring program for enterococcus and has been assisting the NYCDOH in its beach assessments.

The Long Island Sound Study ("LISS"), which began in 1985, is a joint federal-state-local (the states being New York and Connecticut) program to identify the Long Island Sound's major environmental problems and develop a plan to manage those problems. USEPA is the lead federal agency involved in LISS. Hypoxia, or low levels of dissolved oxygen, has emerged as the issue of greatest concern in Long Island Sound. Hypoxia is the result of a chemical chain reaction that begins with high levels of nutrients, largely nitrogen. In addition to natural sources, other nutrient sources include effluent from water pollution control plants, stormwater run-off carrying lawn and agricultural fertilizer, organic materials, and air-deposited nitrate substances. In 2001, the LISS resulted in the issuance and approval of a Total Maximum Daily Load ("TMDL") for nitrogen in Long Island Sound. The TMDL, as approved, would require point source dischargers into Long Island Sound, such as the operators of water pollution control plants, to reduce their nitrogen discharges in three phases over a period of fifteen years. In 2006, the City entered into a State Court Consent Judgment with NYSDEC (the "Nitrogen Consent Judgment") which requires DEP to upgrade five water pollution control plants, four of which discharge into the Upper East River and one of which discharges into Jamaica Bay, in order to reduce nitrogen discharges and comply with draft SPDES nitrogen limits by January 1, 2017. The Nitrogen Consent Judgment also required DEP to pay a \$2.7 million penalty to the State Marine Resources Account and \$5.3 million for projects to benefit waters in and around the City. The Nitrogen Consent Judgment also establishes less stringent nitrogen limits during construction of the modified facility plan than those set out in the draft SPDES permits. Contracts related to Phase 1 of the facilities plan pursuant to the Nitrogen Consent Judgment have been let, all of which are fully funded. DEP is mandated to submit a draft of Phase 2 of the facilities plan by December 2009. The costs related to Phase 2 of the plan have not yet been determined. DEP has missed certain consent judgment milestones, and is projected to miss additional future milestones. These milestones are subject to maximum stipulated penalties of up to \$15,000 per day under the Nitrogen Consent Judgment. The draft SPDES permit nitrogen levels have been challenged by several environmental groups. Such challenge could result in additional

permit provisions relating to the control of nitrogen at certain plants and/or a request to modify the terms of the Nitrogen Consent Judgment.

For more information on litigation relating to the Sewer System, see “LITIGATION.”

ECONOMIC AND DEMOGRAPHIC INFORMATION

This section presents information regarding certain economic and demographic information about the City. All information is presented on a calendar year basis unless otherwise indicated. The data set forth are the latest available. Sources of information are indicated in the text or immediately following the tables. Although the Authority considers the sources to be reliable, the Authority has made no independent verification of the information provided by non-city sources and does not warrant its accuracy.

New York City Economy

The City has a highly diversified economic base, with a substantial volume of business activity in the service, wholesale and retail trade and manufacturing industries, and is the location of many securities, banking, law, accounting, new media and advertising firms.

The City is a major seaport and focal point for international business. Many of the major corporations headquartered in the City are multinational in scope and have extensive foreign operations. Numerous foreign-owned companies in the United States are also headquartered in the City. These firms, which have increased substantially in number over the past decade, are found in all sectors of the City’s economy, but are concentrated in trade, professional and business services, tourism and finance. The City is the location of the headquarters of the United Nations, and several affiliated organizations maintain their principal offices in the City. A large diplomatic community exists in the City to staff the United Nations and the foreign consulates.

Economic activity in the City has experienced periods of growth and recession and can be expected to experience periods of growth and recession in the future. The City experienced a recession in the early 1970s through the middle of that decade, followed by a period of expansion in the late 1970s through the late 1980s. The City fell into recession again in the early 1990s which was followed by an expansion that lasted until 2001. The economic slowdown that began in 2001 as a result of the September 11 attack, a national economic recession, and a downturn in the securities industry came to an end in 2003. Wall Street activity, tourism and the real estate market drove a broad-based economic recovery through 2007. The Mayor’s most recent financial plan for the City’s fiscal years 2009 through 2012 (the “Financial Plan”) assumes that the decrease in economic activity which began in the second half of 2007 will persist through the beginning of 2010. The Financial Plan also assumes private sector job losses of 147,000 and a contraction of total wage earnings of 7.6% in calendar year 2009. As a result of the City’s weakening economy the Financial Plan projects City budget gaps of \$2.3 billion, \$5.2 billion and \$5.1 billion in fiscal years 2010 through 2012, respectively. However, economic forecasts at the national and local levels released since the date of the Financial Plan indicate that economic conditions have continued to deteriorate. It is expected that this will have a negative impact on City revenues, which will be reflected in the Financial Plan modification to be released in late January.

Personal Income

Total personal income for City residents, unadjusted for the effects of inflation and the differential in living costs, increased from 1996 to 2006 (the most recent year for which City personal income data are available). From 1996 to 2006, personal income in the City averaged 5.1% growth compared to 5.4% for the nation. After increasing by 7.9% in 2005, total personal income has increased by 8.4% in 2006. The following table sets forth information regarding personal income in the City from 1996 to 2006.

Personal Income(1)

| <u>Year</u> | <u>Total City (\$ billions)</u> | <u>Per Capita City</u> | <u>Per Capita U.S.</u> | <u>Per Capita City as a Percent of U.S.</u> |
|-------------|---------------------------------|------------------------|------------------------|---|
| 1996 | \$234.1 | \$30,407 | \$24,175 | 125.8% |
| 1997 | 245.5 | 31,579 | 25,334 | 124.6 |
| 1998 | 262.0 | 33,341 | 26,883 | 124.0 |
| 1999 | 275.4 | 34,658 | 27,939 | 124.0 |
| 2000 | 296.0 | 36,914 | 29,845 | 123.7 |
| 2001 | 302.7 | 37,508 | 30,574 | 122.7 |
| 2002 | 299.8 | 37,046 | 30,821 | 120.2 |
| 2003 | 306.1 | 37,590 | 31,504 | 119.3 |
| 2004 | 327.8 | 40,055 | 33,123 | 120.9 |
| 2005 | 353.6 | 43,047 | 34,757 | 123.9 |
| 2006 | 383.1 | 46,434 | 36,714 | 126.5 |

Sources: U.S. Department of Commerce, Bureau of Economic Analysis and the Bureau of the Census.

(1) In current dollars. Personal Income is based on the place of residence and is measured from income which includes wages and salaries, supplements to wages and salaries, proprietors' income, personal dividend income, personal interest income, rental income of persons and transfer payments.

Employment Trends

The City is a leading center for the banking and securities industry, life insurance, communications, fashion design and retail fields. From 1989 to 1992, the City lost approximately 9% of its employment base. From 1992 through 2000, the City experienced significant private sector job growth with the addition of approximately 452,700 new private sector jobs (an average growth rate of approximately 2%). Between 2000 and 2003 the City lost 174,300 private sector jobs. From 2003 to 2007, the City fully recovered those jobs adding a total of 211,200 jobs. As of December 2008, total employment in the City was 3,773,100 compared to 3,826,700 in December 2007, a decrease of approximately 1.4%.

The table below shows the distribution of employment from 1997 to 2007.

Employment Distribution

| | Average Annual Employment (In thousands) | | | | | | | | | | |
|--|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | <u>1997</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> |
| Goods Producing Sectors | | | | | | | | | | | |
| Construction | 93 | 101 | 112 | 121 | 122 | 116 | 113 | 112 | 113 | 118 | 127 |
| Manufacturing | 201 | 196 | 187 | 177 | 156 | 139 | 127 | 121 | 114 | 106 | 101 |
| Service Producing Sectors | | | | | | | | | | | |
| Trade Transportation and Utilities | 537 | 542 | 556 | 570 | 557 | 536 | 534 | 539 | 547 | 558 | 571 |
| Information | 163 | 166 | 173 | 187 | 200 | 177 | 164 | 160 | 163 | 165 | 166 |
| Financial Activities | 468 | 477 | 481 | 489 | 474 | 445 | 434 | 435 | 445 | 458 | 468 |
| Professional and Business Services | 494 | 525 | 553 | 587 | 582 | 550 | 537 | 541 | 555 | 571 | 591 |
| Education and Health Services | 576 | 589 | 604 | 615 | 627 | 646 | 658 | 665 | 679 | 695 | 707 |
| Leisure and Hospitality | 228 | 236 | 244 | 257 | 260 | 255 | 260 | 270 | 277 | 285 | 297 |
| Other Services | 129 | 134 | 142 | 147 | 149 | 150 | 149 | 151 | 153 | 154 | 158 |
| Total Private | 2,889 | 2,966 | 3,052 | 3,149 | 3,127 | 3,015 | 2,975 | 2,995 | 3,047 | 3,111 | 3,186 |
| Government | 550 | 560 | 567 | 569 | 562 | 566 | 557 | 554 | 556 | 555 | 559 |
| Total | 3,440 | 3,527 | 3,619 | 3,718 | 3,689 | 3,581 | 3,531 | 3,549 | 3,602 | 3,666 | 3,745 |

Note: Totals may not add due to rounding.

Source: U.S. Department of Labor, Bureau of Labor Statistics. Data are presented using the North American Industry Classification System ("NAICS").

Sectoral Distribution of Employment and Earnings

In 2006, the City's service producing sectors provided approximately 2.9 million jobs and accounted for approximately 79% of total employment. Figures on the sectoral distribution of employment in the City from 1980 to 2000 reflect a significant shift to the service producing sectors and a shrinking manufacturing base relative to the nation.

The structural shift to the service producing sectors affects the total earnings as well as the average wage per employee because employee compensation in certain of those sectors, such as financial activities and professional and business services, tends to be considerably higher than in most other sectors. Moreover, average wage rates in these sectors are significantly higher in the City than in the nation. In the City in 2006, the employment share for the financial activities and professional and business services sectors was approximately 28% while the earnings share for that same sector was approximately 50%. In the nation, those same service producing sectors accounted for only approximately 19% of employment and 26% of earnings in 2006. Due to the earnings distribution in the City, sudden or large shocks in the financial markets may have a disproportionately adverse effect on the City relative to the nation.

The City's and the nation's employment and earnings by sector for 2006 are set forth in the following table.

Sectoral Distribution of Employment and Earnings in 2006(1)

| | Employment | | Earnings(2) | |
|---|------------|-------------|-------------|-------------|
| | NYC | U.S. | NYC | U.S. |
| Goods Producing Sectors | | | | |
| Mining | 0.0% | 0.5% | 0.2% | 1.3% |
| Construction | 3.2 | 5.7 | 2.8 | 6.5 |
| Manufacturing | <u>2.9</u> | <u>10.4</u> | <u>2.3</u> | <u>12.5</u> |
| Total Goods Producing | 6.1 | 16.6 | 5.3 | 20.3 |
| Service Producing Sectors | | | | |
| Trade, Transportation and Utilities | 15.2 | 19.3 | 8.5 | 16.0 |
| Information | 4.5 | 2.2 | 7.6 | 3.6 |
| Financial Activities | 12.5 | 6.1 | 30.8 | 10.2 |
| Professional and Business Services | 15.6 | 12.9 | 19.4 | 15.6 |
| Education and Health Services | 18.9 | 13.1 | 10.1 | 10.7 |
| Leisure & Hospitality | 7.8 | 9.6 | 3.8 | 3.8 |
| Other Services | <u>4.2</u> | <u>4.0</u> | <u>2.4</u> | <u>2.9</u> |
| Total Service Producing | 78.7 | 67.3 | 82.7 | 62.8 |
| Total Private Sector | 84.9 | 83.9 | 89.6 | 83.4 |
| Government(3) | 15.1 | 16.1 | 10.4 | 16.6 |

Note: Data may not add due to rounding or restrictions on reporting earnings data. Data are presented using NAICS.

Sources: The two primary sources are the U.S. Department of Labor, Bureau of Labor Statistics and the U.S. Department of Commerce, Bureau of Economic Analysis.

- (1) The sectoral distributions are obtained by dividing each industry's employment or earnings by total non-agricultural employment or earnings.
- (2) Includes the sum of wage and salary disbursements, other labor income and proprietor's income. The latest information available is 2006 data.
- (3) Excludes military establishments.

The comparison of employment and earnings in 1980 and 2000 set forth below is presented using the industry classification system which was in use until the adoption of NAICS in the late 1990s. Though

NAICS has been implemented for most government industry statistical reporting, most historical earnings data have not been converted. Furthermore, it is not possible to compare data from the two classification systems except in the general categorization of government, private and total employment. The table below reflects the overall increase in the service producing sectors and the declining manufacturing base in the City from 1980 to 2000.

The City’s and the nation’s employment and earnings by industry are set forth in the following table.

Sectoral Distribution of Employment and Earnings(1)

| Sector | Employment | | | | Earnings(2) | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | 1980 | | 2000 | | 1980 | | 2000 | |
| | NYC | U.S. | NYC | U.S. | NYC | U.S. | NYC | U.S. |
| Private Sector: | | | | | | | | |
| Non-Manufacturing: | | | | | | | | |
| Services | 27.0% | 19.8% | 39.1% | 30.7% | 26.0% | 18.4% | 30.2% | 28.7% |
| Wholesale and Retail Trade | 18.6 | 22.5 | 16.8 | 23.0 | 15.1 | 16.6 | 9.3 | 14.9 |
| Finance, Insurance and Real Estate | 13.6 | 5.7 | 13.2 | 5.7 | 17.6 | 5.9 | 35.5 | 10.0 |
| Transportation and Public Utilities | 7.8 | 5.7 | 5.7 | 5.3 | 10.1 | 7.6 | 5.2 | 6.8 |
| Contract Construction | 2.3 | 4.8 | 3.3 | 5.1 | 2.6 | 6.3 | 2.9 | 5.9 |
| Mining | <u>0.0</u> | <u>1.1</u> | <u>0.0</u> | <u>0.4</u> | <u>0.4</u> | <u>2.1</u> | <u>0.1</u> | <u>1.0</u> |
| Total Non-Manufacturing | 69.3 | 59.6 | 78.1 | 70.3 | 71.8 | 56.9 | 83.2 | 67.3 |
| Manufacturing: | | | | | | | | |
| Durable | 4.4 | 13.4 | 1.6 | 8.4 | 3.7 | 15.9 | 1.3 | 10.5 |
| Non-Durable | <u>10.6</u> | <u>9.0</u> | <u>4.9</u> | <u>5.6</u> | <u>9.5</u> | <u>8.9</u> | <u>4.8</u> | <u>6.1</u> |
| Total Manufacturing | <u>15.0</u> | <u>22.4</u> | <u>6.5</u> | <u>14.0</u> | <u>13.2</u> | <u>24.8</u> | <u>6.1</u> | <u>16.6</u> |
| Total Private Sector | 84.3 | 82.0 | 84.7 | 84.3 | 85.2 | 82.1 | 89.8 | 84.6 |
| Government(3) | 15.7 | 18.0 | 15.3 | 15.7 | 14.8 | 17.9 | 10.3 | 15.4 |

Totals may not add due to rounding. Data are presented using the Standard Industrial Classification System.

Sources: The two primary sources of employment and earnings information are U.S. Department of Labor, Bureau of Labor Statistics, and U.S. Department of Commerce, Bureau of Economic Analysis.

- (1) The sectoral distributions are obtained by dividing each industry’s employment or earnings by total non-agricultural employment or earnings.
- (2) Includes the sum of wage and salary disbursements, other labor income, and proprietors’ income. The latest information available for the City is 2000 data.
- (3) Excludes military establishments.

Population

The City has been the most populous city in the United States since 1790. The City’s population is almost as large as the combined population of Los Angeles, Chicago and Houston, the three next most populous cities in the nation.

The following table provides information concerning the City’s population.

Population

| <u>Year</u> | <u>Population Total</u> |
|----------------|-------------------------|
| 1970 | 7,895,563 |
| 1980 | 7,071,639 |
| 1990 | 7,322,564 |
| 2000 | 8,008,278 |

Note: Figures do not include an undetermined number of undocumented aliens.
 Source: U.S. Department of Commerce, Bureau of the Census.

LITIGATION

There is no action, suit, proceeding or investigation, at law or in equity, before or by any court, public board or body pending or, to the best knowledge of the Authority, threatened against or affecting the Authority to restrain or enjoin the issuance, sale or delivery of the Fiscal 2009 EE Bonds, or in any way contesting or affecting the validity of the Fiscal 2009 EE Bonds, or any proceedings of the Authority, the Board or the City taken with respect to the issuance or sale of the Fiscal 2009 EE Bonds, or with respect to the First Resolution, the Second Resolution or the pledge or application of any money or security provided for the payment of the Fiscal 2009 EE Bonds, or the existence or powers of the Authority or the Board.

Pursuant to the Lease and the Agreement, the City has agreed, subject to certain conditions, to indemnify the Authority and the Board against any and all liability in connection with any act done or omitted in the exercise of their powers which is taken or omitted in good faith in pursuance of their purposes under the Act. The City, however, is entitled to reimbursement by the Board for the amount of any judgment or settlement paid by the City (and not otherwise reimbursed from any other source) arising out of a tort or contract claim to the extent that the City’s liability therefor is related to the operation, maintenance and improvement of the System provided, however, that the Board is not required to reimburse the City in any one year for tort claims in excess of 5% of the Revenues of the Board for such Fiscal Year.

There are numerous claims seeking damages and injunctive and other relief against the City related to the System. Except as noted below, these claims represent routine litigation incidental to the performance of the City’s governmental functions in connection with the operation, maintenance and improvement of the System. In Fiscal Years 2003 through 2007, respectively, the City paid \$15.1, \$279, \$6.1, \$8.2 and \$31.2 million in satisfaction of tort claims relating to the operation of the System. Contract claims on water supply, sewer and water pollution control projects arise in varying amounts based on alleged change orders and related matters. While most seek under \$10 million in damages, one action seeks damages of approximately \$18 million, a second seeks damages of over \$26 million, and a third seeks damages of approximately \$47 million. While the probable outcome of these actions cannot be determined at this time, contract claims are expected to be funded through the CIP, which may be revised from time to time to accommodate such claims as well as other changes therein. The ultimate outcome of the proceedings described below is not currently predictable, and unfavorable determinations therein could result in substantial expenditures.

As a result of federal litigation resulting in a determination that a SPDES permit is required for water transfers such as the City’s transfer of water through the Shandaken Tunnel, DEP applied for and obtained a SPDES permit for the Shandaken Tunnel. The SPDES permit issued by NYSDEC requires, among other things, that DEP submit a report for approval indicating what short-term and long-term structural measures it intends to undertake to achieve compliance with the permit’s temperature and turbidity limits. DEP submitted its report in December 2006, which analyzed several alternatives including construction of a multiple level intake (with an estimated cost of between \$74 million and \$360 million depending on location), and modification of existing operations at the Schoharie Reservoir (from which water is diverted

into the Shandaken Tunnel), using a highly sophisticated water quality simulation tool (with an estimated cost of \$6.2 million). The report recommended that DEP implement the latter alternative.

On September 22, 2006, the plaintiffs in the federal litigation commenced a proceeding against NYSDEC and DEP under Article 78 of the Civil Practice Law and Rules, in State Supreme Court in Ulster County, seeking to overturn the SPDES permit issued by NYSDEC on September 1, 2006. After the matter was briefed and argued, but before a decision was issued, USEPA adopted the Water Transfers Rule, which clarifies that, contrary to the holdings in the federal litigation describe above, water transfers such as the Shandaken Tunnel are not subject to the Clean Water Act NPDES program. On July 25, 2008, the City filed a motion, based on the new rule, for leave to amend its answer to include both an additional defense against petitioners' challenges to the content of the permit, and also a cross-claim against NYSDEC requesting that the court void the permit entirely. On August 5, 2008, before that motion was fully briefed or decided, the court issued a decision essentially granting the underlying Article 78 petition, finding that the "exemptions" in the permit are not authorized under the Clean Water Act and directing the City to apply for variances. The court allowed the current permit to remain in effect during that regulatory process. Because, however, the City believes, based on the Water Transfers Rule, that the Clean Water Act NPDES program does not apply to the Shandaken Tunnel at all, the City will appeal, arguing that the City should not be required to submit to NYSDEC jurisdiction for variance proceedings unless, at a minimum, an appellate court determines that NYSDEC in fact has jurisdiction. For additional information on SPDES permits, see "THE SYSTEM — The Water System — Governmental Regulation — SPDES/Shandaken Tunnel."

A complaint representing approximately 178 plaintiffs has been filed against the City due to flooding allegedly caused by the City's operation of the Neversink Dam in April 2005. The complaint seeks compensation of approximately \$9 million associated with alleged property damage. In April 2007, the plaintiffs filed an amended complaint in the United States District Court for the Southern District of New York. The amended complaint adds claims under the Endangered Species Act and the Clean Water Act. The City is vigorously defending all these claims.

On August 24, 2007, NYSDEC filed a judgment in New York State Supreme Court for approximately \$30 million in penalties with respect to allegedly having missed construction milestones, through January 22, 2007, under the Newtown Creek Consent Judgment. In addition, NYSDEC issued a NOV for additional penalties accrued through August 27, 2007 in the amount of approximately \$20,683,000. NYSDEC and DEP have agreed to a resolution of this matter to be contained in a modification to the Newtown Creek Consent Judgment and subject to the approval of the Comptroller of the City. For additional information on the Newtown Creek Consent Judgment, see "THE SYSTEM — The Sewer System — Governmental Regulation — Full Secondary Treatment Requirements/Newtown Creek."

On September 12, 2007, the Coalition of Watershed Towns and three individual towns in the watershed filed a petition for review in the Federal Circuit Court of Appeals for the Second Circuit, challenging the USEPA's issuance of the 2007 FAD on both procedural and substantive grounds. On December 29, 2008, the Second Circuit denied the petition, finding that petitioners lacked constitutional standing to assert these claims. On January 12, 2009, petitioners filed a petition for rehearing en banc. An adverse determination on the procedural claim could invalidate the 2007 FAD and require that a new FAD be issued by NYSDOH. An adverse determination on the substantive claim could invalidate the 2007 FAD and prevent either USEPA or NYSDOH from issuing a new FAD. The same petitioners also filed a proceeding in State Court against the City and the State challenging the environmental review of the 2007 FAD. That litigation has been suspended pending settlement discussion. See "THE SYSTEM — The Water System — Governmental Regulation — Watershed Protection/Catskill, Delaware Filtration."

On July 18, 2007 a Con Edison steam main located at Lexington Avenue and 41st Street in Manhattan ruptured resulting in one death, dozens of personal injuries, and substantial property damage. The City was served with 350 notices of claim. About 72 lawsuits have been commenced and the City is a defendant, or a third-party defendant, in each. The other defendants are Con Edison, owner and operator of the steam system, and Team Industrial Services, a company hired by Con Edison to seal leaks in the main. Con Edison's investigation concluded that a sudden pressure surge known as a "waterhammer" caused the rupture, and two "steam traps" designed to drain water were clogged with an epoxy sealant injected by

Team Industrial Services. Con Edison also claims the excessive water, or condensate, formed inside the main because it was submerged in cool water. The allegation against the City is that defective DEP infrastructure leaked water on the main. If plaintiffs and/or Con Edison prevail the City could incur substantial damages. The City denies the allegations and will vigorously contest liability.

On July 9, 2008 Mothers on the Move and other named plaintiffs filed a lawsuit in the Bronx County Supreme Court alleging that the Hunts Point Water Pollution Control Plant and the New York Organic Fertilizer Company (“NYOFCo.”) sludge facility, which are less than one half mile from each other, are generating odors which impair air quality and quality of life and constitute a health hazard and both a private and public nuisance. Plaintiffs seek a determination from the court that the facilities are a private and public nuisance, and an order directing the City and NYOFCo. to investigate and abate or eliminate the odors. If plaintiffs were ultimately to prevail, the City could incur substantial costs in connection with such abatement or elimination.

APPROVAL OF LEGAL PROCEEDINGS

The issuance of the Fiscal 2009 EE Bonds is subject to the approval of legality by Orrick, Herrington & Sutcliffe LLP, New York, New York, Bond Counsel. Certain legal matters will be passed upon for the City and the Board by the City’s Corporation Counsel. Certain legal matters will be passed upon for the Underwriters by Nixon Peabody LLP, New York, New York.

FINANCIAL ADVISORS

Lamont Financial Services Corporation and Ramirez & Co., Inc. have served as financial advisors to the Authority with respect to the sale of the Fiscal 2009 EE Bonds.

FURTHER INFORMATION

The references herein to and summaries of federal, State and local laws, including but not limited to the Code, the Constitution and laws of the State, the Act, the 1905 Act, the Clean Water Act, the SDWA, the Ban Act, the MPRSA, and documents, agreements and court decisions, including but not limited to the Lease, the Agreement, the First Resolution and the Second Resolution are summaries of certain provisions thereof. Such summaries do not purport to be complete and are qualified in their entirety by reference to such acts, laws, documents, agreements or decisions. Copies of the Lease, the Agreement, the First Resolution and the Second Resolution are available for inspection during normal business hours at the office of the Authority.

Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. Neither this Official Statement nor any statement which may have been made orally or in writing shall be construed as a contract or as a part of a contract with the original purchasers or any holders of the Fiscal 2009 EE Bonds.

CONTINUING DISCLOSURE UNDER SEC RULE 15c2-12

To the extent that Rule 15c2-12 (the “Rule”) of the Securities and Exchange Commission (“SEC”) under the Securities and Exchange Act of 1934, as amended (the “1934 Act”), requires the respective Underwriters to determine, as a condition to purchasing the Fiscal 2009 EE Bonds, that the Authority will covenant to the effect of the provisions here summarized (the “Undertaking”), and the Rule as so applied is authorized by a federal law that as so construed is within the powers of Congress, the Authority agrees with the record and beneficial owners from time to time of the Fiscal 2009 EE Bonds (“Bondholders”) that it will:

- (1) within 240 days after the end of each Fiscal Year, deliver to each nationally recognized municipal securities information repository and to any New York State information depository, core financial information and operating data for the prior Fiscal Year, including (i) the System’s audited financial statements, prepared in accordance with generally accepted accounting principles in effect

from time to time, and (ii) material historical financial and operating data concerning the System and the Revenues of the System generally of the type included in this Official Statement under the captions “CAPITAL IMPROVEMENT AND FINANCING PROGRAM,” “FINANCIAL OPERATIONS,” “RATES AND BILLING” and “THE SYSTEM;”

(2) provide in a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to any New York State information depository, notice of any of the following events with respect to the Fiscal 2009 EE Bonds, if material:

- (a) principal and interest payment delinquencies;
- (b) non-payment related defaults;
- (c) in the case of credit enhancement that is provided in connection with the issuance of the Fiscal 2009 EE Bonds, unscheduled draws on such credit enhancement reflecting financial difficulties and substitution of credit providers, or their failure to perform;
- (d) unscheduled draws on debt service reserves reflecting financial difficulties;
- (e) adverse opinions or events affecting the exclusion from gross income for federal income tax purposes of interest on the Fiscal 2009 EE Bonds;
- (f) modifications to rights of security holders;
- (g) bond calls;
- (h) defeasances;
- (i) release, substitution, or sale of property securing repayment of the securities;
- (j) rating changes; and

(3) provide in a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to any New York State information depository, notice of any failure by the Authority to comply with clause (1), above.

The Authority expects to provide the information described in clause (1) above by delivering its first bond official statement that includes its financial statements for the preceding fiscal year.

Currently, there is no New York State information depository and the nationally recognized municipal securities information repositories are: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; Standard & Poor’s Securities Evaluations, Inc., 55 Water Street, 45th Floor, New York, New York 10041; Interactive Data Pricing and Reference Data, Inc., 100 William Street, 15th Floor, New York, NY 10038, Attn: NRMSIR and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

No Bondholder may institute any suit, action or proceeding at law or in equity (“Proceeding”) for the enforcement of the Undertaking or for any remedy for breach thereof, unless such Bondholder has filed with the Authority evidence of ownership and a written notice of and request to cure such breach, and the Authority has not complied within a reasonable time; provided, however, that any Proceeding challenging the adequacy of any information provided pursuant to paragraphs (1) and (2) above may be brought only by the Trustee for the holders of a majority in aggregate principal amount of the Fiscal 2009 EE Bonds affected thereby which at the time are Outstanding. All Proceedings may be instituted only as specified herein, in the federal or State courts located in the Borough of Manhattan, State and City of New York, and for the equal benefit of all holders of the Outstanding Bonds benefited by the same or a substantially similar covenant. No remedy may be sought or granted other than specific performance of the covenant at issue.

Any amendment to the Undertaking will take effect only if:

- (a) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Authority or the Board, or type of business conducted; the Undertaking, as amended, would have complied with the requirements of the Rule at the time of sale of the Fiscal 2009 EE Bonds to the Underwriters of such bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and the amendment does not materially impair the interests of Bondholders,

as determined by parties unaffiliated with the Authority (such as, but without limitation, the Authority's financial advisor or bond counsel) and the annual financial information containing (if applicable) the amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the "impact" (as that word is used in the letter from the staff of the SEC to the National Association of Bond Lawyers dated June 23, 1995) of the change in the type of operating data or financial information being provided; or

(b) all or any part of the Rule, as interpreted by the staff of the SEC at the date of the Undertaking, ceases to be in effect for any reason, and the Authority elects that the Undertaking will be deemed terminated or amended (as the case may be) accordingly.

For purposes of the Undertaking, a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares investment power which includes the power to dispose, or to direct the disposition of, such security, subject to certain exceptions, as set forth in the Undertaking. Any assertion of beneficial ownership must be filed, with full documentary support, as part of the written request to the Authority described above.

INVESTMENTS

The Authority invests moneys available in the Debt Service Fund, the Debt Service Reserve Fund, the Construction Fund and the Revenue Fund. Investments are made pursuant to restrictions contained in the Resolutions and the Authority's Investment Guidelines as adopted and modified from time to time by the Authority's Board of Directors. In conjunction with the annual audit of the financial statements of the System, the independent auditors are required to provide to the Authority's Board of Directors an Investment Compliance letter confirming compliance with both the Authority's Investment Guidelines and with Investment Guidelines of Public Authorities of the State Comptroller of New York. Annual valuation of all funds is at the lower of amortized cost or market value. For other investment restrictions, see "APPENDIX C — GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS." The Authority's primary objective in investment of its available funds is preservation of principal. The Authority is not legally authorized to enter into reverse repurchase agreements. The Authority does not make leveraged investments.

RATINGS

Standard & Poor's Rating Services has rated the Fiscal 2009 EE Bonds "AA+," Moody's Investors Service, Inc. has rated the Fiscal 2009 EE Bonds "Aa3" and Fitch, Inc. has rated the Fiscal 2009 EE Bonds "AA."

Such ratings reflect only the views of the respective rating agencies, from which an explanation of the significance of such ratings may be obtained. There is no assurance that any rating will continue for any given period of time or that any or all will not be revised downward or withdrawn entirely. Any such downward revision or withdrawal could have an adverse effect on the market price of the Fiscal 2009 EE Bonds.

VERIFICATION OF MATHEMATICAL CALCULATIONS

Causey Demgen & Moore Inc., independent certified public accountants, have verified the accuracy of the arithmetical and mathematical computations concerning the adequacy of the amounts and escrow securities, including investment earnings thereon, and uninvested cash, if any, in the Escrow Account together with other funds available or scheduled to be available for such purposes to meet the anticipated redemption schedule and redemption price, and interest on the Refunded Bonds. Such verification of the arithmetical accuracy of the mathematical computations is based upon information and assumptions supplied by the Authority.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Fiscal 2009 EE Bonds from the Authority at an aggregate price which is \$3,699,454.36 less than the initial offering price thereof. The obligations of the Underwriters are subject to certain conditions precedent, and the Underwriters will be obligated to purchase all of the Fiscal 2009 EE Bonds if any of the Fiscal 2009 EE Bonds are purchased. The Fiscal 2009 EE Bonds may be offered and sold to certain dealers (including dealers depositing the Fiscal 2009 EE Bonds into investment trusts) and others at prices lower than such public offering price and such public offering price may be changed, from time to time, by the Underwriters. The Underwriters have designated Siebert Brandford Shank & Co., LLC as their Representative.

J.P. Morgan Securities Inc., one of the underwriters of the Fiscal 2009 EE Bonds, has entered into an agreement (the "Distribution Agreement") with UBS Financial Services Inc. for the retail distribution of certain municipal securities offerings, including the Fiscal 2009 EE Bonds at the original issue prices. Pursuant to the Distribution Agreement, J.P. Morgan Securities Inc. will share a portion of its underwriting compensation with respect to the Fiscal 2009 EE Bonds with UBS Financial Services Inc.

LEGALITY FOR INVESTMENT AND DEPOSIT

Under the Act, the Fiscal 2009 EE Bonds are securities in which all public officials and bodies of the State and all municipalities, all insurance companies and associations and other persons carrying on an insurance business, all banks, bankers, trust companies, savings banks and savings associations, including savings and loan associations, investment companies and other persons carrying on a banking business, and administrators, guardians, executors, trustees and other fiduciaries and all others persons whatsoever, who are now and may hereafter be authorized to invest in the Fiscal 2009 EE Bonds or obligations of the State, may properly and legally invest funds including capital in their control or belonging to them in such Fiscal 2009 EE Bonds. The Act further provides that the Fiscal 2009 EE Bonds are securities which may be deposited with and may be received by all public officers and bodies of the State and all municipalities for any purposes for which the deposit of bonds or other obligations of the State is or may hereafter be authorized.

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS

The financial statements of the System as of and for the years ended June 30, 2008 and June 30, 2007 (the "Audited System Financial Statements") included in Appendix D to this Official Statement have been audited by Deloitte & Touche LLP, independent certified public accountants, as stated in their report appearing therein. Deloitte & Touche LLP, the Authority's independent auditor has not reviewed, commented on or approved, and is not associated with, this Official Statement. The report of Deloitte & Touche LLP relating to the Authority's financial statements for the fiscal years ended June 30, 2008 and 2007, which is a matter of public record, is included in this Official Statement. However, Deloitte & Touche LLP has not performed any procedures on any financial statements or other financial information of the Authority, including without limitation any of the information contained in this Official Statement, since the date of such report and has not been asked to consent to the inclusion of its report in this Official Statement.

ENGINEERING FEASIBILITY REPORT AND FORECASTED CASH FLOWS

Certain information contained in this Official Statement under the captions "CAPITAL IMPROVEMENT AND FINANCING PROGRAM — Capital Improvement Program," "THE SYSTEM — The Water System," "THE SYSTEM — The Sewer System" has been reviewed and independently evaluated by Metcalf & Eddy which has provided the opinion letter set forth in Appendix A confirming such information. Metcalf & Eddy also serves as a consulting engineer to DEP on capital projects relating to the System. As a result of occasional, routine litigation initiated by third parties arising from such projects, Metcalf & Eddy and the City have from time to time been either co-parties or adverse parties in such litigation.

Certain financial forecasts contained in this Official Statement in the tables titled “Sources and Uses of Capital Funds” and “Future Debt Service Requirements” under the caption “CAPITAL IMPROVEMENT AND FINANCING PROGRAM” and “Projected Operating and Maintenance Expenses,” “Projected Revenues,” and “Forecasted Cash Flows” under the caption “FINANCIAL OPERATIONS” have been examined by Amawalk Consulting, to the extent and for the periods indicated in those tables. The conclusions of Amawalk Consulting with respect to the reasonableness of the forecasts are set forth in an opinion letter attached hereto as Appendix B. The President of Amawalk Consulting has provided consulting services including feasibility studies, rate studies and organizational analysis to numerous clients in the water and wastewater industry including the City of New York Water and Sewer System, the Boston Water and Sewer Commission and the Shanghai, PRC Water and Sewer.

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP (“Bond Counsel”), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Fiscal 2009 EE Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the “Code”). Bond Counsel is of the further opinion that interest on the Fiscal 2009 EE Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel is also of the opinion that interest on the Fiscal 2009 EE Bonds is exempt from personal income taxes imposed by the State of New York and any political subdivision thereof (including The City of New York). A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix E hereto.

To the extent the issue price of any maturity of the Fiscal 2009 EE Bonds is less than the amount to be paid at maturity of such Fiscal 2009 EE Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Fiscal 2009 EE Bonds), the difference constitutes “original issue discount,” the accrual of which, to the extent properly allocable to each Beneficial Owner thereof, is treated as interest on the Fiscal 2009 EE Bonds which is excluded from gross income for federal income tax purposes. For this purpose, the issue price of a particular maturity of the Fiscal 2009 EE Bonds is the first price at which a substantial amount of such maturity of the Fiscal 2009 EE Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the Fiscal 2009 EE Bonds accrues daily over the term to maturity of such Fiscal 2009 EE Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Fiscal 2009 EE Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Fiscal 2009 EE Bonds. Beneficial Owners of the Fiscal 2009 EE Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Fiscal 2009 EE Bonds with original issue discount, including the treatment of Beneficial Owners who do not purchase such Fiscal 2009 EE Bonds in the original offering to the public at the first price at which a substantial amount of such Fiscal 2009 EE Bonds is sold to the public.

Fiscal 2009 EE Bonds purchased, whether at original issuance or otherwise, for an amount higher than their principal amount payable at maturity (or, in some cases, at their earlier call date) (“Premium Bonds”) will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of bonds, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner’s basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Fiscal 2009 EE Bonds.

The Authority has made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the Fiscal 2009 EE Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the Fiscal 2009 EE Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the Fiscal 2009 EE Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. 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), or any other matters coming to Bond Counsel's attention after the date of issuance of the Fiscal 2009 EE Bonds may adversely affect the value of, or the tax status of interest on, the Fiscal 2009 EE Bonds. Accordingly, the opinion of Bond Counsel is not intended to, and may not, be relied upon in connection with any such actions, events or matters.

Although Bond Counsel is of the opinion that interest on the Fiscal 2009 EE Bonds is excluded from gross income for federal income tax purposes and is exempt from personal income taxes imposed by the State of New York and any political subdivision thereof (including The City of New York), the ownership or disposition of, or the accrual or receipt of interest on, the Fiscal 2009 EE Bonds may otherwise affect a Beneficial Owner's federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the Beneficial Owner or the Beneficial Owner's other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

Future legislative proposals, if enacted into law, clarification of the Code or court decisions may cause interest on the Fiscal 2009 EE Bonds to be subject, directly or indirectly, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent Beneficial Owners from realizing the full current benefit of the tax status of such interest. The introduction or enactment of any such future legislative proposals, clarification of the Code or court decisions may also affect the market price for, or marketability of, the Fiscal 2009 EE Bonds. Prospective purchasers of the Fiscal 2009 EE Bonds should consult their own tax advisors regarding any pending or proposed federal or state tax legislation, regulations or litigation, as to which Bond Counsel expresses no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel's judgment as to the proper treatment of the Fiscal 2009 EE Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the Authority, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The Authority has covenanted, however, to comply with the requirements of the Code.

Bond Counsel's engagement with respect to the Fiscal 2009 EE Bonds ends with the issuance of the Fiscal 2009 EE Bonds, and, unless separately engaged, Bond Counsel is not obligated to defend the Authority or the Beneficial Owners regarding the tax-exempt status of the Fiscal 2009 EE Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the Authority and its appointed counsel, including the Beneficial Owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions with which the Authority legitimately disagrees, may not be practicable. Any action of the IRS, including but not limited to selection of the Fiscal 2009 EE Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the Fiscal 2009 EE Bonds, and may cause the Authority or the Beneficial Owners to incur significant expense.

CERTAIN LEGAL OPINIONS

At the request of the Authority, Bond Counsel reviewed issues related to the effects on the Board and the Authority of a case under Title 11 of the United States Bankruptcy Code (the "Bankruptcy Code") in which the City is a debtor. Specifically, Bond Counsel considered whether a court, exercising reasonable judgment after

full consideration of all relevant factors, would (i) hold that the Revenues derived from operation of the System would be property of the bankruptcy estate of the City, (ii) hold that the rights of the Board to the Revenues and the interest of the Authority in the Revenues would be subject to a stay, by operation of Section 922(a) of the Bankruptcy Code or (iii) order the substantive consolidation of the assets of either or both the Board and the Authority with those of the City. Based upon its review of the Act, the Lease, the Agreement, the First Resolution, the Second Resolution and such other matters of law and fact as it considered relevant, and recognizing that there is no definitive judicial authority confirming the correctness of its analysis, Bond Counsel has rendered to the Authority its opinion, subject to all the facts, assumptions and qualifications set forth therein, that under the Bankruptcy Code a court, in the circumstances described above, (i) would not hold that the Revenues would be property of the City or that the Board's right to and the Authority's interest in the Revenues would be subject to a stay by operation of Section 922(a) of the Bankruptcy Code, and (ii) would not order the substantive consolidation of the assets and liabilities of either the Board or the Authority with those of the City. This opinion will be based on an analysis of existing laws, regulations, rulings and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point.

Bond Counsel is also of the opinion that, subject to all the facts, assumptions and qualifications set forth therein, in a case under the Bankruptcy Code in which the City is a debtor (i) should the City elect to assume the Lease, the Lease would continue pursuant to its terms and (ii) should the City elect to reject the Lease, the Board may elect to retain its rights under the Lease and remain in possession and enjoy the use of the System and the right to the Revenues derived therefrom for the unexpired balance of the term of the Lease.

The Bankruptcy Code provides that in order for a municipality to be a Chapter 9 debtor it must be specifically authorized by State law to be a debtor under Chapter 9 of the Bankruptcy Code. Bond Counsel is of the opinion, subject to all the facts, assumptions and qualifications set forth therein, that under the Bankruptcy Code neither the Authority nor the Board could properly be a debtor in a voluntary or involuntary case under the Bankruptcy Code.

Bond Counsel has not rendered an opinion, however, as to any preliminary or temporary stay, injunction or order which a bankruptcy court might issue pursuant to its powers under *11 U.S.C. §§ 105 or 362* to preserve the status quo pending consideration of the substantive legal issues discussed above. Moreover, the opinions expressed above have inherent limitations because of the pervasive equity powers of bankruptcy courts as they relate to the business and creditor relationships leading up to the bankruptcy as well as generally the overriding goal of reorganization to which other legal rights and policies may be subordinated, the potential relevance to the exercise of judicial discretion of future-arising facts and circumstances, and the nature of the bankruptcy process; and are based on an analysis of existing laws, regulations, rulings and court decisions. Such opinions may be adversely affected by actions taken or events occurring, including a change in law, regulation or ruling (or in the application or official interpretation of any law, regulation or ruling) after the date of this Official Statement. Bond Counsel has not undertaken to determine, or to inform any person, whether such actions are taken or such events occur and has no obligation to update this section in light of such actions or events.

NEW YORK CITY MUNICIPAL WATER
FINANCE AUTHORITY

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APPENDIX A

LETTER OF METCALF & EDDY OF NEW YORK, INC., CONSULTING ENGINEERS

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**LETTER OF
METCALF & EDDY OF NEW YORK, INC.,
CONSULTING ENGINEERS**

January 23, 2009

Mr. Thomas G. Paolicelli
Executive Director
New York City Municipal Water Finance Authority

Subject: New York City Municipal Water Finance Authority
Water and Sewer System Second General Resolution Revenue Bonds,
Fiscal 2009 Series EE

Dear Mr. Paolicelli:

We hereby submit the opinion of Metcalf & Eddy of New York, Inc. (“Metcalf & Eddy”) on the Engineering Feasibility of the Water and Sewer System serving The City of New York (the “City”). Capitalized terms used herein and not otherwise defined have the meanings ascribed to such terms in the Official Statement.

Based on the information set forth in this Official Statement, our experience and our analyses during the preparation of the 1983 feasibility study, the methodology described below and subject to the reliances and assumptions made throughout this letter, Metcalf & Eddy concludes that overall the water and sewer system (the “System”) serving the City continues to be operated in a professional and prudent manner. Further, Metcalf & Eddy is of the opinion that:

- The condition of the System continues to receive the highest rating of our three rating categories (adequate).
- The expense allocations for Fiscal Year 2009 are adequate for the continued reliable operation of the System.
- The Capital Improvement Program (the “CIP”) is responsive to the long-term operating requirements of the service area.
- Staffing levels of the System are adequate for proper operation and maintenance.

Metcalf & Eddy hereby consents to the inclusion of those opinions and conclusions attributed to it in the Official Statement.

Purpose and Scope

This letter has been prepared to document the results of analyses carried out during the period of August 1983 to the present by personnel of Metcalf & Eddy in connection with the issuance by the New York City Municipal Water Finance Authority (the “Authority”) of the Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 2009 Series EE. Certain studies and analyses were performed in anticipation of the creation of the Authority and were used in developing the information in the Official Statement under the captions: “CAPITAL IMPROVEMENT AND FINANCING PROGRAM — Capital Improvement Program,” “THE SYSTEM — The Water System” and “THE SYSTEM — The Sewer System.” The following sets forth a brief outline of the major tasks addressed:

- An overview of the System’s service area and major facilities, including a general assessment of the capacity and condition of existing water, wastewater and drainage facilities and a review of recently completed improvements.
- An analysis of the CIP for the period 2009-2019 and the funding needed to carry out the CIP and ongoing capital contracts commenced prior to the CIP.
- An analysis of the management of the System and its current and anticipated operating programs.

Since 1983 Metcalf & Eddy has provided engineering services related to the City's Water and Wastewater Operations Evaluation Study. During this period Metcalf & Eddy has performed an evaluation of the condition of the System, independently reviewed the capital plans for water and wastewater programs, and jointly with the rate consultant reviewed the operating programs of the New York City Department of Environmental Protection ("DEP"). Ten topics were addressed in this effort as listed below.

- Present Condition of Physical Facilities
- Remaining Useful Life of Facilities
- Reliability of Utility Systems
- Operation and Maintenance Programs
- Current Utility Use
- Maximum Existing Capacity
- Needs for Routine Maintenance, Upgrading and Expansion
- Evaluation of the Impact of Legal Mandates
- Overview of Present Capital Improvement Program
- Safety Practices and Potential for Catastrophe

Methodology

Interviews with staff members of the Authority and the City were conducted, current engineering and financial reports, System operating data and other documents were reviewed and major facilities were inspected. Audited financial statements of the City and data supplied by the Authority were also reviewed to identify historical costs and revenues. The evaluation of current needs and future conditions was made by analyzing historical data, assessing the effectiveness of current City maintenance programs, reviewing the plans of key outside agencies, and taking into account current trends and the anticipated impact of the CIP.

The physical condition of the facilities was rated by Metcalf & Eddy. A uniform rating system, standard among engineering firms providing similar services, was established consisting of three rating categories — adequate, marginal, and inadequate as described below:

- Adequate: Shows no signs of deterioration, meets design intent, and requires only routine maintenance to meet or exceed expected useful life.
- Marginal: Facility is functional but does not meet design intent, and requires non-routine maintenance or capital replacement to restore to adequate condition.
- Inadequate: Facility does not provide functional operation, and requires major reconstruction to restore to adequate condition.

The Consulting Engineer

Metcalf & Eddy has served the City as consulting engineers for over 90 years in capacities dealing with water supply, water distribution, sewage collection, and wastewater treatment. Metcalf & Eddy is one of the largest consulting engineering firms and is recognized in the United States and internationally as a leader in services to the water and wastewater industry.

We have no responsibility to update this letter or the information provided in the Official Statement for the captioned sections described above for events and circumstances occurring after the date of this letter.

Very truly yours,



William P. Pfrang, P.E.
Director of Engineering
Metcalf & Eddy of New York, Inc.

APPENDIX B

**LETTER OF AMAWALK CONSULTING GROUP LLC,
RATE CONSULTANTS**

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Amawalk Consulting Group LLC

26 BROADWAY, SUITE 761, NEW YORK, NY 10004 • TEL: 212.361.0050 • FAX: 212.361.0055

January 23, 2009

Mr. Thomas G. Paolicelli
Executive Director
New York City Municipal Water Finance Authority

Subject: New York City Municipal Water Finance Authority
Water and Sewer System Second General Resolution Revenue Bonds,
Fiscal 2009 Series EE

Dear Mr. Paolicelli:

The purpose of this letter is to summarize the conclusions of the independent analysis of the financial forecast of the Authority (the “Forecasted Cash Flows”) for Fiscal Years 2009 through 2014 (the “Reporting Period”) prepared by the Amawalk Consulting Group LLC in connection with the issuance by the New York City Municipal Water Finance Authority (the “Authority”) of the Authority’s \$645,455,000 Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 2009 Series EE (the “Fiscal 2009 EE Bonds”). Proceeds from the Fiscal 2009 EE Bonds are expected to be used (i) to pay principal and interest on certain of the Authority’s Outstanding Water and Sewer System Revenue Bonds, (ii) to pay costs of improvements to the System and (iii) to pay certain costs of issuance. In conducting the analysis, the Amawalk Consulting Group LLC has prepared the following tables which are included in this Official Statement under the headings “Capital Improvement and Financing Program” and “Financial Operations.”

- Sources and Uses of Capital Funds
- Future Debt Service Requirements
- Projected Revenues
- Projected System Expense
- Forecasted Cash Flows

The forecast includes provisions for the financing of improvements to the City of New York (the “City”) Water and Sewer System (the “System”) as reflected in the Capital Improvement Program (the “CIP”) for the Reporting Period. The Forecasted Cash Flows set forth the ability of the System to meet the operating costs, working capital needs and other financial requirements of the System, including the debt service requirements associated with the Outstanding Bonds issued under the Authority’s General Bond Resolution (the “First Resolution”) and obligations issued under the Authority’s Second General Resolution (the “Second Resolution”) and additional Bonds and Second Resolution Bonds whose issuance by the Authority during the five years ending June 30, 2014 is anticipated.

Revenues pledged to secure the Authority’s Bonds are to be derived from the following sources: (i) all Revenues, (ii) all moneys or securities in any of the Funds and Accounts, and (iii) all other monies and securities to be received, held or set aside by the Authority or by any Fiduciary pursuant to the First Resolution. The term “Revenues,” as defined by the First Resolution, includes, but is not limited to, all rents, fees, charges and other income and receipts derived by the New York City Water Board (the “Board”) from users of the System, and certain investment proceeds received by the Board.

Moneys pledged to secure bonds issued under the Second Resolution are to be derived from: (i) all available amounts on deposit in the Subordinated Indebtedness Fund established under the First Resolution and

(ii) all moneys or securities in any of the funds and accounts established under the Second Resolution, except the Arbitrage Rebate Fund and the Debt Service Reserve Fund.

The Forecasted Cash Flows summarize the anticipated financial operations of the Authority for the Reporting Period. The Authority's books, records, financial reports, and statistical data have been reviewed to the extent practicable, and other investigations and analyses were conducted as deemed necessary to assemble and analyze the forecast of revenues, revenue requirements, and debt service coverage for the Reporting Period. Various financial tests and analyses have been performed to support the findings and conclusions presented herein. The Authority's fiscal year ends on June 30, and all references in the Official Statement to a fiscal year ("Fiscal Year") relate to the 12 month period ending June 30 of the year shown.

Proposed improvements and additions to the System under the CIP for the Reporting Period were independently evaluated and confirmed by Metcalf & Eddy of New York, Inc. ("Metcalf & Eddy"). The forecasted cash flows rely upon the conclusions of Metcalf & Eddy regarding the capital and operating expenditures that are necessary during the Reporting Period to maintain the System in good working order.

Based on the studies performed, the Amawalk Consulting Group LLC offers the following opinions and conclusions:

1. Revenues (including projected revenue increases resulting from anticipated future rate increases to be implemented by the Board), as set forth in the Forecasted Cash Flows, are currently and will be sufficient to meet the following requirements during the Reporting Period:

a. One hundred and fifteen percent (115%) of the principal of and interest on all Bonds issued under the First Resolution, as the same shall become due and payable, for which such Revenues are pledged;

b. One hundred percent (100%) of the principal of and interest on all bonds issued under the Second Resolution and other subordinate obligations payable from Revenues;

c. One hundred percent (100%) of all expenses of operation, maintenance and repair of the System;

d. One hundred percent (100%) of other Required Deposits as required by the First Resolution. In addition, revenues are adequate to make all payments to the City.

2. In the analysis of the forecast of future operations summarized in this Official Statement, the Amawalk Consulting Group LLC has reviewed certain assumptions with respect to conditions, events and circumstances which may occur in the future. These assumptions are reasonable and attainable, although actual results may differ from those forecast as influenced by the conditions, events and circumstances which actually occur.

3. The water and wastewater rates, fees and charges of the Board, including projected increases, are reasonable and compare favorably to the rates and charges of other major cities.

The opportunity to be of service to the Authority in this important matter is greatly appreciated.

Very truly yours,



Edward J. Markus
Amawalk Consulting Group LLC

APPENDIX C

GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS

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GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS

GLOSSARY

Set forth below are definitions of certain terms contained in the Agreement, the Lease, the First Resolution and not otherwise defined in this Official Statement.

Adjusted Aggregate Debt Service: For any Fiscal Year and as of any date of calculation is the sum of the Adjusted Debt Service for all Series of Bonds Outstanding during such Fiscal Year.

Adjusted Debt Service: For any Fiscal Year, as of any date of calculation and with respect to any Series of Bonds, is the Debt Service for such Fiscal Year for such Series except that, if any Refundable Principal Installment of such Series of Bonds is included in Debt Service for such Fiscal Year, Adjusted Debt Service shall mean Debt Service determined as if each such Refundable Principal Installment had been payable over a period extending from the due date of such Refundable Principal Installment through the last date on which such Series of Bonds could have been stated to mature under the Act as in effect on the date of issuance of such Series, in installments which would have required equal annual payments of Principal Installments and interest over such period. Interest deemed payable in any Fiscal Year after the actual due date of any Refundable Principal Installment of any Series of Bonds shall be calculated at the actual interest cost payable on the Bonds of such Series (using the actuarial method of calculation).

Aggregate Debt Service: For any Fiscal Year, as of any date of calculation, the sum of the Debt Service for all Bonds Outstanding during such Fiscal Year.

Authority Expenses: All reasonable or necessary current expenses of the Authority, including all salaries, administrative, general, commercial, engineering, advertising, public notice, auditing and legal expenses, insurance and surety bond premiums, fees paid to banks, insurance companies or other financial institutions for the issuance of Credit Facilities, consultants' fees and charges, payment to pension, retirement, health and hospitalization funds, costs of public hearings, ordinary and current rentals of equipment and other property, lease payments for real property or interests therein, expenses, liabilities and compensation of any Fiduciary and all other expenses necessary, incidental or convenient for the efficient operation of the Authority. Bond Counsel has determined that payments made under an Interest Rate Exchange Agreement are deemed Authority Expenses if the Interest Rate Exchange Agreement relates to First Resolution Bonds.

Authorized Newspaper: The Bond Buyer or any other newspaper of general circulation printed in the English language and customarily published at least once a day for at least five days (other than legal holidays) in each calendar week in the Borough of Manhattan, City and State of New York, designated by the Authority.

Authorized Representative: In the case of both the Authority and the Board, their respective Chairman or Executive Director, or such other person or persons so designated by resolution of the Authority or the Board, as the case may be, and in the case of the City, the Mayor, unless a different City official is designated to perform the act or sign the document in question.

Bond or Bonds: For purposes of the Agreement and the First Resolution (and as used in this Official Statement unless the context otherwise requires), the bonds, notes or other evidences of indebtedness issued by the Authority under and pursuant to the Act and the First Resolution, including Parity Bond Anticipation Notes and Parity Reimbursement Obligations; but shall not mean Subordinated Indebtedness or other Bond Anticipation Notes or Reimbursement Obligations; and for purposes of the Lease, means any bonds, notes or other evidences of indebtedness for borrowed money issued by the Authority.

Bond Counsel's Opinion: An opinion signed by an attorney or firm of attorneys of nationally recognized standing in the field of law relating to revenue bonds of municipalities and public agencies, selected by the Authority and satisfactory to the Trustee.

Bond Payment Date: June 15 and December 15 of each year; provided, however, that if any such day is not a Business Day, then the Bond Payment Date shall be the next succeeding Business Day.

Business Day: Any day which is not a Saturday, Sunday or a day on which the New York Stock Exchange, banking institutions chartered by the State or the United States of America or the Note Trustee are legally authorized to close in the City.

Cash Flow Requirement: For each Fiscal Year and as of any date of certification, the amount, certified by the Authority to the Trustee and the Board equal to the difference between (A) the sum of (i) the estimated Aggregate Debt Service for such Fiscal Year, (ii) the Projected Debt Service for such Fiscal Year, (iii) the estimated Authority Expenses for such Fiscal Year, and (iv) the other Required Deposits estimated for such Fiscal Year and (B) (i) if the certification is made prior to the commencement of the Fiscal Year, the amount anticipated by the Authority as of such date of certification to be held by the Trustee, as of the first day of such Fiscal Year, in the Revenue Fund and (ii) if the certification is made after the commencement of such Fiscal Year, the amount which had been anticipated pursuant to (B) (i) above.

Consulting Engineer: Metcalf & Eddy of New York, Inc. or such other independent engineer or engineering firm of recognized standing selected by the Authority and satisfactory to the Board.

Corporation: The New York State Environmental Facilities Corporation and any successor entity which may succeed to its rights and duties respecting the State Revolving Fund.

Cost or Costs of a Water Project: The cost of construction, as such term is defined in the Act, including, without limiting the generality of the foregoing, the erection, alteration, improvement, increase, enlargement or rehabilitation of the System or a Water Project, the inspection and supervision thereof, the engineering, architectural, legal, fiscal, economic and environmental investigations and studies, designs, surveys, plans, specifications, procedures and other actions incidental thereto; the cost of the acquisition of all Property; the cost of demolishing, removing or relocating any buildings or structures on lands so acquired (including the cost of acquiring any lands to which such buildings or structures may be moved or relocated); the cost of all systems, facilities, machinery, appurtenances, equipment, financing charges and interest prior to, during and after construction (if not paid or provided for from revenues or other sources); the cost of engineering and architectural surveys, plans and specifications; the cost of consultants' and legal services; the cost of lease guarantee or bond insurance; other expenses necessary, reasonably related or incidental to the construction of such Water Project and the financing of the construction thereof, including the cost of Credit Facilities, the amounts authorized in the First Resolution to be paid into any reserve or other special fund from the proceeds of Bonds and the financing or the placing of any Water Project in operation, including reimbursement to any governmental entity or any other person for expenditures that would be Costs of such Water Project and all claims arising from any of the foregoing.

Counterparty: An entity whose senior long term debt obligations, or whose obligations under an Interest Rate Exchange Agreement are guaranteed by a financial institution whose senior long term debt obligations, have a rating (at the time the subject Interest Rate Exchange Agreement is entered into) of Aa or better by Moody's Investors Service and CC or better by Standard & Poor's Ratings Services.

Credit Facility: A letter of credit, revolving credit agreement, standby purchase agreement, surety bond, insurance policy or similar obligation, arrangement or instrument issued by a bank, insurance company or other financial institution which provides for payment of all or a portion of the Principal Installments or interest due on any Series of Bonds or provides funds for the purchase of such Bonds or portions thereof.

Debt Service: For any Fiscal Year or part thereof, as of any date of calculation and with respect to any Series, means an amount equal to the sum of (a) interest payable during such Fiscal Year or part thereof on Bonds of such Series, except to the extent that such interest is to be paid from amounts representing Capitalized Interest and (b) the Principal Installments of the Bonds of such Series payable during such Fiscal Year or part thereof. Such interest and Principal Installments for such Series shall be calculated on the assumption that (x) no Bonds of such Series Outstanding at the date of calculation will cease to be Outstanding except by reason of the payment thereof upon stated maturity or upon mandatory redemption

by application of Sinking Fund Installments and (y) Variable Rate Bonds will bear interest at the greater of (A) the rate or rates which were assumed by the Authority in the Authority Budget for such Fiscal Year to be borne by Variable Rate Bonds during such Fiscal Year or (B) the actual rate or rates borne during such Fiscal Year on Variable Rate Bonds Outstanding during the 12 calendar months preceding the date of calculation.

Debt Service Reserve Requirement: As of any date of calculation, and for any Fiscal Year, shall mean the amount equal to the maximum Adjusted Aggregate Debt Service in the current or any future Fiscal Year on all Bonds Outstanding; provided, however, that, if (i) the payment of the Principal Installments of or interest on any Series of Bonds or portion thereof is secured by a Special Credit Facility, (ii) the payment of the Tender Option Price of any Option Bond of a Series is secured by a Special Credit Facility or (iii) the Authority has determined in a Supplemental Resolution authorizing the issuance of a Series of Bonds that such Series of Bonds will not be secured by the Common Account in the Debt Service Reserve Fund, the Supplemental Resolution authorizing such Series may specify the Debt Service Reserve Requirement, if any, for the Bonds of such Series.

DEC: The New York State Department of Environmental Conservation and any successor entity which may succeed to its rights and duties respecting the State Revolving Fund.

Defeasance Obligations: (A) any non-callable bonds or other obligations which as to principal and interest constitute direct obligations of, or are guaranteed by the United States of America, including obligations of any agency thereof or corporation which has been or may hereafter be created pursuant to an Act of Congress as an agency or instrumentality of the United States of America to the extent unconditionally guaranteed by the United States of America or (B) any other non-callable receipt, certificate or other evidence of an ownership interest in obligations or in specified portions thereof (which may consist of specified portions of the interest thereon) of the character described in subclause (A); provided, however, that, when used in connection with any Bond authorized to be issued by a Supplemental Resolution adopted on or after June 1, 2001, such term also means: (C) a non-callable obligation of the United States of America which has been stripped by the United States Department of Treasury itself or by any Federal Reserve Bank (not including “CATS,” “TIGRS” and “TRS” unless the Authority obtains Rating Confirmation with respect to the Bonds to be defeased); (D) the interest component of REFCORP bonds for which separate payment of principal and interest is made by request of the Federal Reserve Bank of New York in book-entry form; (E) an obligation of any state or territory of the United States of America, any political subdivision of any state or territory of the United States of America, or any agency, authority, public benefit corporation or instrumentality of such state, territory or political subdivision (i) the interest on which is excludable from gross income under Section 103 of the Code, (ii) that, at the time an investment therein is made or such obligation is deposited in any fund or account established pursuant to the First Resolution, is rated in the highest rating category of the Rating Agencies, (iii) that is not subject to redemption prior to maturity other than at the option of the holder thereof or either (1) has irrevocably been called for redemption or (2) as to which irrevocable instructions have been given to call such obligation on a stated future date and (iv) the timely payment of the principal or redemption price thereof and interest thereon is fully secured by a fund consisting only of cash or obligations described in clauses (A), (B), (C), (D), (E) or (F), which fund may be applied only to the payment of principal, interest and redemption premium, if any, on the obligation secured thereby; and (F) a non-callable note, bond, debenture, mortgage or other evidence of indebtedness that, at the time acquired, is (i) issued or guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Student Loan Marketing Association, the Federal Farm Credit System or any other instrumentality of the United States of America and (ii) rated in the highest rating category of the Rating Agencies; provided, further, that the term “Defeasance Obligations” shall not mean any interest in a unit investment trust or a mutual fund.

Financial Guaranties: One or more of the following: (i) irrevocable, unconditional and unexpired letters of credit issued by banking institutions the senior long-term debt obligations of which (or the holding company of any such banking institution) have (at the time of issue of such letter of credit) a rating of Aa2 or better by Moody’s Investors Service and CC or better by Standard & Poor’s Ratings Services; or (ii) an

irrevocable and unconditional policy or policies of insurance in full force and effect issued by municipal bond insurers the obligations insured by which are eligible for a rating of Aa or better by Moody's Investors Service and CC or better by Standard & Poor's Ratings Services; in each case providing for the payment of sums for the payment of Principal Installments of an interest on Bonds in the manner provided in the First Resolution; and providing further that any Financial Guaranty of the type described in (i) above must be drawn upon, on a date which is at least thirty (30) days prior to the expiration date of such Financial Guaranty, in an amount equal to the deficiency which would exist if the Financial Guaranty expired, unless a substitute Financial Guaranty is acquired prior to such expiration date as provided in a related Supplemental Resolution.

Fiscal Year: The twelve-month period commencing on July 1 of each year; provided, however, that the Authority, the Board and the City may agree on a different twelve-month period as the Fiscal Year and in such event the dates set forth in the Agreement, the Lease and the First Resolution shall be adjusted accordingly.

Government Obligation: A direct obligation of the United States of America, an obligation the principal of, and interest on which are guaranteed as to full and timely payment by the United States of America, an obligation (other than an obligation subject to variation in principal repayment) to which the full faith and credit of the United States of America are pledged, an obligation of a federal agency guaranteed as to full and timely payment by the United States of America and approved by the Authority, and a certificate or other instrument which evidences the ownership of, or the right to receive all or a portion of the payment of, the principal of or interest on, direct obligations of the United States of America.

Interest Rate Exchange Agreement: Any financial arrangement (i) that is entered into by the Authority with an entity that is a Counterparty at the time the arrangement is entered into; (ii) which provides that the Authority shall pay to such entity an amount based on the principal amount of a Series of Bonds, and that such entity shall pay to the Authority an amount based on the principal amount of such Series of Bonds, in each case computed in accordance with a formula set forth in such agreement, or that one shall pay to the other any net amount due under such arrangement; (iii) which has been designated in writing to the Trustee by an Authorized Representative of the Authority as an Interest Rate Exchange Agreement with respect to a Series of Bonds and (iv) which, in the opinion of Bond Counsel, will not adversely affect the exclusion of interest on Bonds from gross income for the purposes of federal income taxation.

Investment Securities shall mean and include any of the following securities, if and to the extent the same are at the time legal investments by the Authority of the funds to be invested therein and conform to the policies set forth in any investment guidelines adopted by the Authority and in effect at the time of the making of such investment:

(i) direct obligations of, or obligations guaranteed as to principal and interest by, the State or direct obligations of any agency or public authority thereof, provided such obligations are rated, at the time of purchase, in one of the two highest rating categories by each Rating Agency then maintaining a rating on Outstanding Bonds;

(ii) (A) any bonds or other obligations which as to principal and interest constitute direct obligations of, or are guaranteed by the United States of America, including obligations of any agency thereof or corporation which has been or may hereafter be created pursuant to an Act of Congress as an agency or instrumentality of the United States of America to the extent unconditionally guaranteed by the United States of America or (B) any other receipt, certificate or other evidence of an ownership interest in obligations or in specified portions thereof (which may consist of specified portions of the interest thereon) of the character described in subclause (A) of this clause (ii);

(iii) obligations of any agency, subdivision, department, division or instrumentality of the United States of America; or obligations fully guaranteed as to interest and principal by any agency, subdivision, department, division or instrumentality of the United States of America;

(iv) banker's acceptances or certificates of deposit issued by a commercial bank (A) whose long-term debt obligations are rated by each Rating Agency then maintaining a rating on the Outstanding Bonds at least equal to the rating on Outstanding Bonds that are not insured or otherwise secured by a Credit Facility or a Special Credit Facility, (B) that has its principal place of business within the State and (C) that has capital and surplus of more than \$100,000,000;

(v) corporate securities, including commercial paper and fixed income obligations, which are, at the time of purchase, rated by each Rating Agency then maintaining a rating on Outstanding Bonds in its highest rating category for comparable types of obligations;

(vi) repurchase agreements collateralized by securities described in clauses (ii) or (iii) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated "investment grade" by each Rating Agency then maintaining a rating on Outstanding Bonds, provided that (1) a specific written repurchase agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is (a) a Federal Reserve Bank, or (b) 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 \$25 million, 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, (3) the repurchase agreement has a term of thirty days or less, or the Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five business days of such valuation, (4) the fair market value of the collateral securities in relation to the amount of the repurchase obligation, including principal and interest, is equal to at least 102% and (5) the repurchase agreement meets the guidelines then applicable to such investments of each Rating Agency then maintaining a rating on Outstanding Bonds;

(vii) investment agreements or guaranteed investment contracts with any financial institution whose senior long term debt obligations, or whose obligations under such an investment agreement or guaranteed investment contract, are guaranteed by a financial institution whose senior long term debt obligations, have a rating (at the time such agreement or contract is entered into) in one of the two highest rating categories for comparable types of obligations by each Rating Agency then maintaining a rating on the Bonds;

(viii) money market funds rated in the highest rating category for comparable types of obligations by each Rating Agency then maintaining a rating on the Bonds; and

(ix) municipal obligations, the payment of principal and redemption price, if any, and interest on which is irrevocably secured by obligations of the type referred to in clauses (i), (ii) or (iii) above and which obligations have been deposited in an escrow arrangement which is irrevocably pledged to the payment of such municipal obligations and which municipal obligations are rated in the highest rating category for comparable types of obligations by each Rating Agency then maintaining a rating on the Bonds.

Leased Property: The real and personal property and other rights therein leased by the City to the Board pursuant to Article II of the Lease.

Local Water Fund: The special trust fund by that name established by the Act in the custody of the Board into which all Revenues are required to be deposited promptly upon receipt thereof by the Board.

Minimum Monthly Balance: For each Series of Bonds Outstanding, the monthly amount calculated in accordance with Section 4.3(a) of the Agreement. See "Summary of Certain Documents — Summary of the Agreement — Minimum Monthly Balance" in this Appendix C.

O&M Reserve Fund Requirement: For each Fiscal Year, the amount equal to one-sixth (1/6) of the Operating Expenses as set forth in the Annual Budget.

Operating Expenses: All reasonable or necessary current expenses of maintaining, repairing, operating and managing the System net of governmental operating aid, including: all salaries; administrative, general, commercial, architectural, engineering, advertising, public notice, auditing, billing, collection, enforcement and legal expenses; insurance and surety bond premiums; consultants' fees; payments to pension, retirement, health and hospitalization funds; taxes; payments in lieu of taxes; costs of public hearings; ordinary and current rentals of equipment or other property; hydrant rentals; lease payments for real property or interests therein (excluding certain amounts paid by the Board to the City pursuant to the Lease); depository expenses; reasonable reserves for maintenance and repair and all other expenses necessary, incidental or convenient for the efficient operation of the System; but only to the extent properly attributable to the Board or the System and payable by the Board to the City pursuant to the Lease and, except for certain administrative expenses of the Board, payable by the Board to the City pursuant to the Lease.

Option Bonds: Bonds which by their terms may be tendered by and at the option of the owner thereof for payment by the Authority prior to the stated maturity thereof, or the maturates of which may be extended by and at the option of the owner thereof.

Outstanding: As of any date, all Bonds therefore or thereupon being authenticated and delivered under the First Resolution except:

(a) any Bonds canceled by the Trustee at or prior to such date;

(b) any Bond (or portion thereof) for the payment or redemption of which there shall be set aside and held in trust under the First Resolution either:

(i) moneys in an amount sufficient to pay when due the Principal Installments or Redemption Price thereof, together with all accrued interest,

(ii) Defeasance Obligations in such principal amounts, of such maturities, bearing such interest and otherwise having such terms and qualifications, as are necessary to provide moneys (whether as principal or interest) in an amount sufficient to pay when due the Principal Installments or Redemption Price thereof, together with all accrued interest, or

(iii) any combination of (i) and (ii) above,

and, if such Bond or portion thereof is to be redeemed, for which notice of redemption has been given as provided in Article VI of the First Resolution or provision satisfactory to the Trustee has been made for the giving of such notice;

(c) any Bond in lieu of or in substitution for which other Bonds have been authenticated and delivered; and

(d) any Bond deemed to have been paid as provided in Section 1201(b) of the First Resolution.

Parity Bond Anticipation Notes: Bond Anticipation Notes the interest on which is payable from and secured by a pledge of, and a lien on, a parity with all other Bonds.

Permitted Encumbrances: When used with reference to the System, (i) any and all liens, encumbrances, security interests or other defects in or clouds on title existing on the Effective Date, (ii) the Lease, (iii) easements, rights of way and exceptions which do not materially impair the operation or maintenance of the Leased Property or the Revenues therefrom, (iv) mechanics', materialmen's, warehousemen's and other similar liens, as permitted by law and liens for taxes at the time not delinquent or being contested and (v) agreements for the sale and leaseback of elements of the System.

Principal Installment: As of any date of calculation and with respect to any Series, so long as any Bonds thereof are Outstanding, (i) the principal amount of Bonds (including (x) any amount designated in, or determined pursuant to, the applicable Supplemental Resolution, as the "principal amount" with respect to any Bonds which do not pay full current interest for all or any part of their term) (y) the Tender Option Price of any Option Bonds which may be tendered for purchase or payment prior to the stated maturity

thereof in accordance with the terms of the Supplemental Resolution authorizing such Option Bonds, unless such amount is secured by a Credit Facility which is not in default and (z) the principal amount of any Parity Reimbursement Obligations of such Series due (or so tendered for payment) on a certain future date for which no Sinking Fund Installments have been established, or (ii) the unsatisfied balance of any Sinking Fund Installments due on a certain future date for Bonds of such Series, or (iii) if such future dates coincide as to different Bonds of such Series, the sum of such principal amount of Bonds and of such unsatisfied balance of Sinking Fund Installments due on such future date. "Principal Installment" does not include the principal of Parity Bond Anticipation Notes.

Project Financing Agreement: Any Project Financing Agreement to be entered into among the Authority, the City, DEC and the Corporation pursuant to the State Revolving Fund Act.

Projected Debt Service: For any Fiscal Year or part thereof means, as of any date of calculation and with respect to any Projected Series of Bonds, an amount, certified by the Authority to the Trustee and the Board, as provided in the Agreement, equal to the Debt Service estimated by the Authority to be payable during such Fiscal Year on such Projected Series.

Projected Series of Bonds: Any Series of Bonds described in an Authority Budget as anticipated to be issued in the Fiscal Year to which such Authority Budget relates.

Rate Consultant: The independent accountant or firm of independent accountants, or a management consultant or firm of management consultants, or independent engineer or firm of independent engineers, having, in any case, a recognized standing in the field of water and sewer system consulting selected by the Authority and satisfactory to the Board. The Rate Consultant may be the same firm as the Consulting Engineer.

Rating Agencies: Moody's Investors Service and Standard & Poor's Ratings Services and their respective successors and assigns.

Rating Confirmation: A written confirmation of each Rating Agency to the effect that the rating assigned to each of the Bonds rated by such Rating Agency will remain unchanged and will not be withdrawn, suspended or reduced as a consequence of some act or occurrence.

Redemption Price: When used with respect to a Bond or portion thereof, the principal amount thereof plus the applicable premium, if any, payable upon either optional or mandatory redemption thereof pursuant to the First Resolution.

Refundable Principal Installment: Any Principal Installment for any Series of Bonds which the Authority intends to pay with moneys which are not Revenues, provided that such intent shall have been expressed in the Supplemental Resolution authorizing such Series of Bonds and provided further that such Principal Installment shall be a Refundable Principal Installment only through the date of the Authority Budget adopted during the Fiscal Year immediately preceding the Fiscal Year in which such Principal Installment comes due unless the Authority has delivered to the Trustee a certificate of an Authorized Representative that it has made provision for the payment of such Principal Installment from a source other than Revenues.

Refunding Bond: Any Bond authenticated and delivered on original issuance pursuant to Section 206 or Section 207 of the First Resolution for the purpose of refunding any Outstanding Bonds or thereafter authenticated and delivered in lieu of or substitution for such Bond pursuant to the First Resolution.

Reimbursement Obligation: The obligation of the Authority described in the First Resolution to directly reimburse the issuer of a Credit Facility for amounts paid by such issuer thereunder, whether or not such obligation to so reimburse is evidenced by a promissory note or other similar instrument.

Required Deposits: For any Fiscal Year, amounts, if any, payable into the Authority Expense Fund, the Debt Service Reserve Fund and the Subordinated Indebtedness Fund but only to the extent such payments are required to be made from Revenues pursuant to the First Resolution.

Revenues shall mean (a) all the rents, fees, charges, payments and other income and receipts derived by the Board from users of the System, together with all operating aid therefor from any governmental entity, federal, State or local, to the Board, (b) investment proceeds and proceeds of insurance received by the Board (other than the proceeds of insurance with respect to the damage or destruction of all or any portion of the System), (c) Subsidy Payments derived by the Authority, (d) amounts derived by the Authority from a Counterparty pursuant to an Interest Rate Exchange Agreement, and (e) investment proceeds derived from amounts on deposit in the Funds and Accounts established hereunder that are deposited or retained in the Revenue Fund or the Local Water Fund, and but shall not include (w) amounts required to be refunded because of billing or payment errors, (x) any amount attributable to any of the foregoing sources described in clause (a) which (i) is expressly excluded by the Agreement or the Lease, or (ii) is derived from a use of the System not directly related to the supply, treatment and distribution of water to the consumers thereof or the collection, disposal or treatment of sewage, (y) any amount from any governmental entity, federal, State or local, in aid of or for or with respect to the Costs of Water Projects, other than Subsidy Payments, or (z)(i) fines (excluding interest on late payments which shall constitute Revenues), (ii) amounts from the use of water to generate electricity, (iii) amounts from the State as a result of mandatory water discharges from reservoirs or (iv) amounts from the granting of easements, licenses, rights-of-way or other interests in the real property constituting a part of the System.

Special Credit Facility: With respect to any Series of Bonds or portion thereof, a Credit Facility (a) which provides funds for (i) the direct payment of the Principal Installments of and interest on such Bonds when due or (ii) the payment of the Principal Installments of and interest on such Bonds in the event amounts otherwise pledged to the payment thereof are not available when due or (iii) the payment of the Tender Option Price of any Option Bond which may be tendered to the Authority for purchase or payment in accordance with the Supplemental Resolution authorizing such Option Bond (in any case, regardless of whether such Credit Facility provides funds for any other purpose) and (b) which (i) requires the Authority to directly reimburse the issuer of such Credit Facility for amounts paid thereunder and (ii) provides that such obligation is a Parity Reimbursement Obligation.

State: The State of New York.

State Revolving Fund: The New York State Water Pollution Control Revolving Fund established pursuant to the State Revolving Fund Act.

State Revolving Fund Act: Chapter 565 of the laws of New York of 1989, as amended.

Subordinated Indebtedness: Any bond, note or other evidence issued by the Authority in furtherance of its corporate purposes under the Act and payable from the subordinated Indebtedness Fund.

Subsidy Payments shall mean amounts payable to the Authority from any governmental entity, federal, State or local, in connection with Bonds of the Authority.

Supplemental Resolution: A resolution of the Authority authorizing the issuance of a Series of Bonds or otherwise amending or supplementing the Resolution.

System: The Water System and the Sewerage System, collectively, as such terms are defined in the Act.

Tender Option Price: With respect to any Option Bond tendered for purchase or payment, an amount equal to the principal amount thereof plus interest accrued and unpaid thereon from the immediately preceding Bond Payment Date to the date of such tender.

Trustee: The trustee appointed by the Authority pursuant to the First Resolution, and any successors thereto.

Variable Rate Bond: As of any date of determination, any Bond on which the interest rate borne thereby may vary during any part of its remaining term.

Water Project: Any sewerage facility, water facility or water and sewerage facility, as the case may be, including the planning, development, financing or construction thereof.

Summary of Certain Documents

The following are brief summaries of certain provisions of the Agreement, the Lease, the First Resolution and the Second Resolution. These summaries do not purport to be complete and are subject in all respects to the provisions of, and are qualified in their entirety by, reference to the respective documents to which they relate.

Summary of the Agreement

Financing of Water Projects. The Authority agrees to use its best efforts to finance all or a part of the Cost of all Water Projects described in Appendix A to the Agreement. In consideration for the Authority's issuance of the Bonds, the Board gives, grants, conveys and transfers to the Authority all of its right, title and interest in the Revenues, including without limitation, all of its rights to collect and receive said Revenues subject only to provisions of the Act, the Agreement and the First Resolution permitting the application of said Revenues to the purposes therein set forth. The Board itself incurs no indebtedness under the terms of the Agreement, Lease, First Resolution or any other document executed in connection therewith. (*Sections 2.1, 2.2 and 2.4*)

Transfer of Funds. The Authority shall deposit the proceeds of each Series of Bonds with the Trustee in accordance with the provisions of the First Resolution and the Supplemental Resolution authorizing such Series; provided, however, that the portion of the proceeds designated to pay the Costs of any Water Project shall be held only in the Construction Fund established pursuant to the First Resolution.

The Authority shall authorize payment of such Costs in the manner set forth in the First Resolution once evidence thereof is provided in a Certificate signed by an Authorized Representative of the Board or City, as the case may be. Neither the Authority nor the Trustee shall be required to provide funds to pay the Costs of Water Projects from any source other than the Construction Fund, and neither the Authority nor the Trustee shall pay to the City from such Fund any amount in excess of that set aside for the purposes thereof, or for the Projects listed in Appendix A to the Agreement. (*Sections 3.1 and 3.2*)

Local Water Fund. The Board shall deposit all Revenues, as promptly as practicable after receipt, into the Local Water Fund. There shall also be deposited in the Local Water Fund all amounts received by the Board from the Trustee pursuant to the First Resolution. (*Section 4.1*)

Establishment of Certain Funds and Application of Revenues in Local Water Fund. The Board shall establish two special funds (in addition to the Local Water Fund) to be held by the Board at a Depository: the Board Expense Fund and the Operation and Maintenance Reserve Fund, with the General Account therein. The Board shall hold such funds as trust funds and the amounts on deposit shall only be applied for the purposes provided in the Agreement.

Beginning on the first day of each month in each Fiscal Year, the Board is required to apply the Revenues in the Local Water Fund, *first*, to the Trustee for deposit in the Revenue Fund until the amount on deposit in the Revenue Fund equals the Minimum Monthly Balance for such month and the Trustee shall have received the amounts, if any, required to be deposited in the Authority Expense Fund, the Debt Service Reserve Fund and the Subordinated Indebtedness Fund for such month. Thereafter, in such month from the balance remaining in the Local Water Fund, the Board is required, after making provision for Board Expenses, to pay to the City $\frac{1}{12}$ th of the operating expenses for such Fiscal Year. After making such payments, any amounts remaining in the Local Water Fund in each month are applied daily (i) to satisfy the Cash Flow Requirement (if the required payments to the City for Operating Expenses have been made), (ii) to satisfy required payments to the City for Operating Expenses (if the Cash Flow Requirement has been satisfied) or (iii) proportionately, to the Trustee for deposit in the Revenue Fund and to the City for the payment of Operating Expenses, until the total of all amounts deposited in the Revenue Fund during such Fiscal Year equals the Cash Flow Requirement and all Operating Expenses required to be paid shall have been paid. Thereafter, as long as the amount on deposit in the Revenue Fund in each month is equal to the Minimum Monthly Balance and the Cash Flow Requirement continues to be met, all such amounts in the Local Water Fund shall be paid as follows: *first*, to the Authority until the total of the amounts so paid equals

the principal of and interest on any bonds, notes or other obligations of the Authority (other than Bonds, Bond Anticipation Notes, and Subordinated Indebtedness) payable within the then current Fiscal Year, together with all other amounts necessary to make the required deposits to the reserve and other funds and amounts established for such bonds, notes or other obligations; *second*, to the City until the amounts so paid are equal to the rental payment for such Fiscal Year and the unsatisfied balance, if any, of the rental payment for any prior Fiscal Year; and, *third*, to the Operation and Maintenance Reserve Fund, until the amount therein on deposit is equal to the O&M Reserve Requirement for such Fiscal Year. Any amounts remaining in the Local Water Fund on the last day of each Fiscal Year shall be paid to the General Account in the Operation and Maintenance Reserve Fund. (*Section 4.2*)

Minimum Monthly Balance. The Minimum Monthly Balance shall be calculated as of the first day of the month and shall be equal to the sum of:

(i) For each Series of Bonds which is Outstanding during the current Fiscal Year, an amount equal to the product obtained by multiplying (a) the difference between (1) the amount of interest due or projected to be due on the next succeeding Bond Payment Date for such Series and (2) the amount, if any, held in the applicable subaccount for such Series in the Capitalized Interest Account in the Debt Service Fund by (b) a fraction, the numerator of which is the number of full months since the end of the month preceding the last Bond Payment Date for such Series (or, with respect to the first Bond Payment Date for such Series, the number of full months since the last day of the month preceding the date of issuance of such Series) and the denominator of which is the number of months between Bond Payment Dates minus one (or, with respect to the first Bond Payment Date for a Series, the number of months between the last day of the month preceding the date of issuance of such Series and the first Bond Payment Date minus one); provided, however, that if this formula would produce (A) a fraction greater than one, then the fraction shall be equal to one, or (B) a denominator less than one, then the fraction shall be equal to one; plus

(ii) For each Series of Bonds which is Outstanding during the current Fiscal Year, an amount equal to the Principal Installment due or projected to be due on the next succeeding Bond Payment Date for such Series which falls within twelve months or less on which a Principal Installment is due, multiplied by a fraction, the numerator of which is the number of full months since the last day of the month preceding the last Bond Payment Date on which a Principal Installment was due (or, with respect to the first such Bond Payment Date, twelve minus the number of full months to the first Bond Payment Date on which a Principal Installment is due), and the denominator of which is eleven; provided, however, that if this formula would produce a fraction greater than one, then the fraction shall be equal to one. (*Section 4.3*)

Deposits to Operation and Maintenance Reserve Fund. There shall be deposited to the Operation and Maintenance Reserve Fund in each Fiscal Year from the sources described below the amount required, if any, so that the amounts on deposit therein satisfy the O&M Reserve Fund Requirement for the ensuing Fiscal Year.

Deposits to the Operation and Maintenance Reserve Fund may be made from the proceeds of the sale of Bonds of the Authority, from the Local Water Fund, or from any other moneys lawfully available therefor, subject to the following limitations:

(i) The maximum deposit to the Operation and Maintenance Reserve Fund from the proceeds of Bonds of the Authority, as of any time of calculation, may not exceed the O&M Reserve Fund Requirement then in effect, reduced by the cumulative sum of prior deposits thereto from proceeds of Bonds of the Authority.

(ii) Deposits to the Operation and Maintenance Reserve Fund from the Local Water Fund shall be subject to the priorities established in Section 4.2 of the Agreement.

(iii) If there shall be a deficit in the Operation and Maintenance Reserve Fund on May 1 of any Fiscal Year, and if as of such May 1 the Board does not project that available Revenues will at least equal the O&M Reserve Requirement for such Fiscal Year by June 30 of such Fiscal Year, then the

Board shall include in its Annual Budget for the ensuing Fiscal Year an amount sufficient, together with other amounts available therefor, to at least equal the O&M Reserve Fund Requirement for the ensuing Fiscal Year.

If on July 1 of any Fiscal Year the amount on deposit in the Operation and Maintenance Reserve Fund is less than the O&M Reserve Fund Requirement, such deficit shall (subject to paragraph (i) above) be made up from the proceeds of the sale of Bonds issued during such Fiscal Year; provided, however, if, prior to May 1 of such Fiscal Year such deficit has not been made up from Bond proceeds, the Board shall include the amount of such deficit in its Annual Budget for the ensuing Fiscal Year and the amounts necessary to restore such deficit shall be deposited in the Operation and Maintenance Reserve Fund.

Amounts required to be deposited in the General Account shall be held separate and apart from other amounts held in the Operation and Maintenance Reserve Fund and applied as described below. (*Section 4.4*)

Application of Moneys in the Operation and Maintenance Reserve Fund. If on the first day of any month the Board has not paid to the City an amount equal to the product of (i) the amount required to be paid for Operating Expenses pursuant to Section 8.1 of the Lease, multiplied by (ii) a fraction the numerator of which is the number of months which have commenced during such Fiscal Year, and the denominator of which is 12, the Board shall withdraw from the Operation and Maintenance Reserve Fund and pay to the City, on demand, an amount equal to $\frac{1}{2}$ of the amount so required to be paid pursuant to Section 8.1 of the Lease, or the entire balance in such Fund if less than sufficient. Amounts on deposit in the General Account may be applied (i) to purposes provided for in Section 4.2, (ii) to the payment of Bonds in accordance with Article XII of the First Resolution or (iii) to the Costs of Water Projects, but shall be retained therein to the extent required by the Annual Budget. (*Section 4.5*)

Application of Moneys in Board Expense Fund. Amounts on deposit in the Board Expense Fund shall be applied by the Board solely for the purposes of paying expenses of the Board, in accordance with the Annual Budget. (*Section 4.6*)

Application of Revenues After Default. The Board has covenanted that if an “event of default” (as defined in the First Resolution) shall occur, the Board shall pay or cause to be paid to the Trustee, upon its request, all moneys and securities then held by the Board in the Local Water Fund and thereafter the Revenues as promptly as practicable after receipt. (*Section 4.7*)

Amounts Remaining. Any amounts received or held by the Authority or the Trustee pursuant to the First Resolution, any similar document or the Agreement after all Bonds and other evidences of indebtedness have been paid in full or are no longer Outstanding and after payment of all other obligations and expenses of the Authority, or provision for payment thereof has been made, shall be paid to the City.

Any payments by the City to the Water Board pursuant to Section 1045-h(3) of the Act shall be confined to consideration for the sale of goods or the rendering of services by the Water Board to the City pursuant to the Lease or the Agreement as contemplated by the Act. (*Section 4.8*)

Rate Covenant. The Board has covenanted and agreed to establish, fix and revise fees, rates or other charges for the use of or services furnished by the System which, together with any other available funds, are adequate to provide for (i) the timely payment of the Principal Installments of and interest on all Bonds and the principal of and interest on any other indebtedness of the Authority payable from Revenues, (ii) the proper operation and maintenance of the System, (iii) all other payments required for the System not otherwise provided for and (iv) all other payments required pursuant to the Agreement and the Lease. Without intending to limit the generality of the foregoing, the Board has also covenanted to establish and collect rates, fees and charges sufficient in each Fiscal Year so that Revenues collected in such Fiscal Year will be at least equal to the sum of (i) 115% of estimated Aggregate Debt Service and Projected Debt Service payable in such Fiscal Year (excluding any Refundable Principal Installment if payable from funds held in trust therefor and assuming with respect to Variable Rate Bonds that the effective rate of interest is that which the Authority determines so long as such rate is not less than the rate such Bonds bear at the time Aggregate Debt Service is determined), (ii) 100% of the Operating Expenses and Authority Expenses

payable in such Fiscal Year and (iii) 100% of the amount necessary to pay the other Required Deposits for such Fiscal Year. However, a failure to generate such Revenues does not constitute an “event of default” if the Board takes timely action to correct any such deficit. The Board shall review, at least annually, such rates, fees and charges to determine whether such rates, fees and charges are, or will be, sufficient to meet the requirements thereof and shall promptly take action to cure or avoid any deficiency. Except to the extent required by Section 1045-j of the Act, as in effect on July 24, 1984, with regard to the requirement that tax exempt organizations be charged for service provided by the System or by existing agreements (including any successor agreements with Jamaica Water), the Board will not furnish or supply any product, use or service of the System free of charge or at a nominal charge. (*Section 6.1*)

Consulting Engineer and Rate Consultant. The Authority shall employ a Consulting Engineer and a Rate Consultant whose duties, respectively, shall be to make any certificates and perform any other acts required or permitted of the Consulting Engineer and the Rate Consultant under the Agreement and the First Resolution. If so determined by the Authority, the same person or firm may perform the duties and functions of the Consulting Engineer and the Rate Consultant.

In each Fiscal Year, the Consulting Engineer and the Rate Consultant shall make an examination of, and shall report to the Authority, the Board, the City and the Trustee, on the properties and operations of the System. The report of the Rate Consultant shall set forth among other findings, the Rate Consultant’s recommendation as to any necessary or advisable revisions of rates, fees and charges for the ensuing Fiscal Year and such other advice and recommendation as it may deem desirable. The Consulting Engineer’s report shall set forth its findings as to whether the System has been maintained in good repair and sound operating condition, and its estimate of the amount, if any, required to be expended to place such properties in such condition and the details of such expenditures and the approximate time required therefor. The City covenants that if any such report of the Consulting Engineer shall set forth that the properties of the System have not been maintained in good repair and sound operating condition, it will promptly restore the properties to good repair and sound operating condition with all expedition practicable. (*Section 6.2*)

Covenant to Operate and Maintain System. The City has covenanted that it shall, at all times:

(a) in accordance with the advice and recommendations of the Consulting Engineer, operate the System properly and in a sound and economical manner and maintain, preserve, and keep the same preserved and kept with the appurtenances and every part and parcel thereof, in good repair, working order and condition, and from time to time make, or cause to be made, all necessary and proper repairs, replacements and renewals so that at all times the operation of the System may be properly and advantageously conducted, regardless of any failure on the part of the Board to make the payments to the City required by Section 8.1 of the Lease; provided, however, that nothing contained in the Agreement shall require the City to operate, maintain, preserve, repair, replace, renew or reconstruct any part of the System if there shall be filed with the Board, the Authority and the Trustee (i) a certificate of the Commissioner acting as the Authorized Representative of the City stating that in the opinion of the City abandonment of operation of such part of the System will not adversely affect the operation of the System or the amount of Revenues derived therefrom and is not prejudicial to the interests of the Board, the Authority or the Bondholders and (ii) a Certificate of the Consulting Engineer concurring with such statement;

(b) enforce the rules and regulations governing the operation, use and services of the System established from time to time by the Board or the City;

(c) observe and perform all of the terms and conditions contained in the Act, and comply with all valid acts, rules, regulations, orders and directions of any legislative, executive, administrative or judicial body having competent jurisdiction of the City or the System; provided, however, that the failure of the City to comply with the covenant contained in this subsection (c) for any period shall not constitute a default on its part so long as the City (i) is taking reasonable and timely steps to permit compliance and (ii) the City shall have delivered to the Board and to the Authority a Certificate of the Consulting Engineer which (1) sets forth in reasonable detail the facts and circumstances attendant to such non-compliance, (2) sets forth the steps being taken by the City to permit compliance, (3) sets

forth the estimated date on which the City will be in compliance and (4) states that in the opinion of the Consulting Engineer such non-compliance during the period described will not adversely affect the operation of the System or the amount of Revenues to be derived therefrom; and

(d) not create or suffer to be created any lien or charge upon the System or any part thereof except for Permitted Encumbrances. (*Section 6.3*)

Annual Budget. On May 1 of each year (or on such later date as the Authority, the Board and the City may agree) the Authority shall deliver to the Board a certified copy of the Authority Budget for the ensuing Fiscal Year showing the Cash Flow Requirement for such Fiscal Year. Based upon the information contained in (a) the Authority Budget, (b) the City's certification pursuant to Section 8.3 of the Lease and (c) the Certificate of the Consulting Engineer delivered to the Board pursuant to Section 8.3 of the Lease (collectively, the "Budget Documents"), the Board shall prepare the Annual Budget for the ensuing Fiscal Year. In addition to the information contained in the Budget Documents the Board shall also make provision in the Annual Budget for Board Expenses for the ensuing Fiscal Year, for the amount, if any, required to be deposited in the Operation and Maintenance Reserve Fund in accordance with Section 4.4 of the Agreement, and for the application of the amounts in the General Account therein. Thereafter, but in no event later than 15 days after the date of publication of the Executive Budget of the City, the Board shall adopt such Annual Budget. Promptly after adoption of the Annual Budget, and in no event later than June 10 (or such other date as the Authority, the Board and the City may agree) of each year, the Board shall establish the rates, fees and charges for the use of the System for the ensuing Fiscal Year. The Board may from time to time, either before or after commencement of the Fiscal Year to which it relates, amend the Annual Budget, but (except for its own expenses) only in accordance with and after receipt of amended Budget Documents. If as of the first day of any Fiscal Year an Annual Budget has not been adopted, the Annual Budget for the immediately preceding Fiscal Year shall be the Annual Budget for such Fiscal Year until a new Annual Budget is adopted. (*Section 6.4*)

Tax Exemption. The City, the Authority and the Board have covenanted that so long as any Bonds shall be Outstanding, no one will take any action, nor fail to take any action, which, if taken or not taken, as the case may be, would adversely affect the tax-exempt status of the interest payable on the Bonds then Outstanding, the interest on which is excluded from gross income under the Internal Revenue Code of 1986. (*Section 6.5(b)*)

Discontinuance of Service. The Board has covenanted to enforce or cause the City to enforce the rules and regulations providing for discontinuance of, or disconnection from, the supply of water or the provision of sewer service, or both, as the case may be, for non-payment of fees, rents, rates or other charges imposed by the Board, provided that such discontinuance or disconnection shall not be carried out except in the manner and upon the notice as is required of a waterworks corporation pursuant to Sections 89(b)(3)(a)-(c) and 116 of the Public Service Law of the State. (*Section 6.7*)

Covenant of City as to Rates and Charges. The City has covenanted that, upon the issuance of the Bonds by the Authority, the City will not thereafter levy user fees, rents and other charges with respect to the System until all Bonds are paid or are no longer Outstanding pursuant to the terms of the First Resolution; provided, however, that the City may levy *ad valorem* taxes to pay the costs and expenses of the System or to pay the principal of and interest on any general obligation bonds of the City issued to finance the System or any part thereof. (*Section 6.9*)

Books and Records. Each of the Authority and the Board shall keep or cause to be kept proper books of record and account in which complete and correct entries shall be made of all transactions relating to their corporate purposes under the Act. In accordance with Section 1045-y of the Act, the Authority and the Board shall annually submit to the Mayor, the Comptroller and the Director of Management and Budget of the City a detailed report concerning their activities for the Fiscal Year. In addition, the Authority and the Board shall submit to the Mayor, the Comptroller and the Director of Management and Budget of the City audited annual financial statements of the Authority and the Board together with a report thereon of an accountant satisfactory to the Board. (*Section 6.11*)

Liens. Until the Bonds or other evidences of indebtedness issued by the Authority for its purposes under the Act have been paid in full or provision has been made therefor in accordance with the First Resolution or similar document, the Agreement provides that the Board shall not create, and, to the extent it has the power to do so, shall not permit to be created, any lien upon or pledge of the Revenues except the lien and pledge thereon created by the Act. *(Section 6.12)*

Security Interests. Except to the extent provided in the Act, neither the Board nor the Authority may grant any Bondholder any security interest in any of the assets or Properties of the Board. *(Section 6.13)*

Financing through State Revolving Fund. In connection with the financing of Water Projects by the Authority with funds provided from the State Revolving Fund, the City may enter into a Project Financing Agreement or Agreements among DEC, the Corporation and the Authority and make in any such agreement certain representations, warranties, covenants and agreements. *(Section 6.16)*

Agreement of the State. Under the provisions of the Agreement, the parties pledge and agree, for and on behalf of the State as provided in the Act, that the State will not alter or limit the rights vested by the Act in the Authority or the Board to fulfill the terms of any agreement made with or for the benefit of the Bondholders, or in any way impair the rights and remedies of Bondholders, until the Bonds, together with the interest thereon, interest on any unpaid installment of interest, and all costs and expenses incurred in any action or proceeding by or on behalf of such holders, are fully met and discharged. *(Section 7.1)*

Events of Default and Remedies. An “event of default” or a “default” means any one of the following events: (i) failure by the Board to pay the Authority those amounts required under the Agreement; (ii) failure of the City or the Board to observe any covenant, term or condition of the Agreement (other than the payments the Board shall make to the Authority) and such failure shall have continued for a period of sixty (60) days after written notice, specifying such failure and requesting that it be remedied, is given to the City or the Board, or both, by the Authority unless the Authority shall agree in writing to extend such time prior to its expiration, provided such extension shall not be unreasonably withheld if the City or the Board has instituted and is diligently pursuing corrective action which cannot be completed within the applicable period; (iii) the Authority shall file a petition, or otherwise seek relief, under any federal or State bankruptcy or similar law; and (iv) the terms, conditions and security provided under the Agreement and the First Resolution or the respective provisions of the Act pursuant to which the First Resolution has been adopted or the Bonds have been issued or entered into (including, without limitation, the provisions under which the lien upon the Revenues has been created pursuant to the Agreement and the First Resolution and the provisions establishing the powers and obligations of the Board and the relationship of the Authority to the Board and the City) shall be materially and adversely limited, altered or impaired by any legislative action or any final judgment. *(Section 8.1)*

Whenever an event of default shall have occurred and be continuing, the Authority and the Trustee may take whatever legal action may appear necessary or desirable to: (i) collect the payments then due and as they thereafter become due and (ii) so long as any Bonds are Outstanding, enforce performance and observance of any obligation or covenant of the City or the Board under the Agreement. In addition, if the Board defaults in making the payments to the Authority required under the Agreement as a result of its failure to impose sufficient fees, rates, rents or other charges, the Authority may petition for the appointment of a receiver to administer the affairs of the Board in order to achieve Revenues sufficient to make such payments by establishing fees, rates, rents or other charges at least sufficient therefor. The remedies conferred upon or reserved to the Authority in respect of any event of default are not exclusive of other available remedies, but shall be in addition to every other remedy given under the Agreement or existing at law or in equity or by statute. *(Sections 8.2 and 8.3)*

Termination. The Agreement shall terminate and the covenants and other obligations contained therein shall be discharged and satisfied, when (i) payment of all indebtedness of the Authority has been made or provided for in accordance with the First Resolution or similar document securing such indebtedness and (ii) either all payments required thereunder have been made in full, or provision for such payments satisfactory to the Authority has been made, or the City pays or assumes all liabilities, obligations, duties, rights and powers of the Authority under the Agreement. *(Section 9.1)*

Amendments. The parties to the Agreement may enter into any amendment, change or modification of the Agreement (if in writing, signed by each of the parties and consented to in writing by the Trustee if required by the First Resolution) including, without limitation, amendments to Appendix A to the Agreement; provided that the parties shall enter into no such amendment, change or modification which materially adversely affects the rights of the holders of any Bonds by modifying or revoking certain enumerated provisions of the Agreement without first complying with the applicable provisions of the First Resolution. *(Section 10.1)*

Conflicts. The Agreement provides that its provisions shall not change or in any manner alter the terms of the First Resolution, or the security, rights or remedies of the Trustee or the Bondholders. In the event any provision of the Agreement conflicts at any time, or in any manner, with the provisions of the First Resolution or any Bond, the provisions of the First Resolution or Bond shall be controlling and conflicting provisions of the Agreement shall be disregarded. *(Section 12.1)*

Summary of the Lease

Term of Lease and Demise of Leased Property. The City has leased the Leased Property to the Board for the term of the Lease (the "Lease Term"). The Lease Term commenced on the Effective Date (July 1, 1985) and continues until the later of the 40th anniversary of the Effective Date or the date on which all bonds, notes or other obligations of the Authority are paid in full or provision for such payment is made pursuant to the resolution, trust indenture or other instrument under which such bonds, notes or other obligations are issued. During the Lease Term the Board may use the Leased Property only for its corporate purposes and upon the terms and conditions contained in the Lease.

The Leased Property includes (whether now in use or hereafter acquired, and whether or not located within the boundaries of the City) all of the City's right, title and interest in: (i) the City's sewerage system, including but not limited to all plants, structures, equipment and other real and personal property or rights therein acquired, rehabilitated or constructed (including all work in progress as soon as commenced) and used or to be used for the purpose of collecting, treating, pumping, neutralizing, storing and disposing of sewage, including, but not limited to, main, collecting, outlet or other sewers, pumping stations, ground-water recharge basins, backflow prevention devices, sludge dewatering facilities, vessels, barges, clarifiers, filters and phosphorous removal equipment, vehicles and other property used in connection with the sewer system; (ii) the City's water system, including but not limited to all plants, structures and other real and personal property or rights therein, acquired, rehabilitated or constructed (including all work in progress as soon as commenced) and used or to be used for the purpose of supplying, distributing, accumulating or treating water, including, but not limited to, reservoirs, basins, dams, canals, aqueducts, pipelines, mains, pumping stations, water distribution systems, intake systems, water-works, sources of water supply, purification or filtration plants, water meters and rights of flowage or diversion, vehicles and other property used in connection with the water system; and (iii) any other materials, supplies, plans and property contained in the above-mentioned plants and structures incidental to, or necessary or useful and convenient for, the operation of such facilities; provided, however, that the Leased Property shall not include the City's right, title and interest in the following: (i) any property or rights of the City the conveyance of which pursuant to the Lease would cause a reversion to or in favor of, or permit a reentry by or in favor of, any third party; (ii) all mines and minerals whatsoever (but not including surface or subsurface waters) now or hereafter found and discovered, crops and timber, on or under the lands to be conveyed pursuant to the Lease; with power and authority for the City to perform certain mineral extraction and agricultural/timber activities; provided, however, that the City shall not undertake any such activities which interfere with the operation, maintenance or collection of Revenues of the System. *(Section 2.1)*

Right of City to Enter Leased Property. The City retains the right to enter upon any portion of the Leased Property, to use any property not constituting a part thereof which is located in, across or upon the Leased Property or for any purpose unless, in the reasonable judgment of the Board, such entry or use would adversely affect the collection of Revenues. *(Section 2.2)*

Substitution of Board for City. Where necessary or desirable and to the extent permitted by law, the City and the Board agree to use their best efforts to substitute the Board for the City with respect to any application or proceedings filed or commenced in relation to the Leased Property with the various State and federal regulatory bodies having jurisdiction. *(Section 2.5)*

Indemnification. The City agrees, to the extent permitted by law and subject to certain conditions, to hold the Board harmless from any and all liability, loss or damage from or in connection with any act the Board does or omits in the exercise of its powers if taken or omitted in good faith and in pursuance of its corporate purposes. *(Sections 3.1, 3.2 and 7.2)*

Operation and Maintenance of the Leased Property. The City shall administer and operate the Leased Property, maintain the Leased Property in good and safe order and condition and make all repairs therein. The City's duty to "maintain" and "repair" shall include all necessary repairs, replacements, renewals, alterations and additions, whether structural, non-structural, ordinary or extraordinary and its duty to "administer" shall include, without limitation, the enforcement of regulations of the Board and the City relating to the use of the System. However, the Lease shall not impose any obligation or liability upon the City for the administration, operation, maintenance and repair of the System not previously imposed upon it in connection with its prior operation and maintenance of the System. Both the Board and the City shall use all reasonable care to prevent the occurrence of waste, damage or injury to the Leased Property. The System shall be used and operated and maintained in accordance with all applicable laws, rules and regulations. *(Sections 4.1, 4.2 and 4.3)*

Construction and Acquisition. The Board authorizes the City to perform the construction and effectuation of any Water Project specified in the Agreement and the City may incur Costs in connection therewith. The City may acquire all real and personal property, or any interest therein, necessary or useful for the construction or effectuation of a Water Project; provided that all such property or interest acquired by the City through the exercise of the power of eminent domain shall be taken in the name of the City. *(Sections 5.1, 5.2 and 5.3)*

Billing and the Levy of Water and Sewer Charges. The City has agreed to provide billing services to the Board. Such services include but are not limited to: (i) notification to users of the System of the water and sewer charges levied by the Board, (ii) collection of such charges (including the City's use of its power of enforcement and collection of unpaid taxes under the laws of the State to enforce and collect any delinquent water and sewer charges from the persons and property liable therefor) and (iii) maintenance of the books, records and accounts of the billing systems. *(Sections 6.1 and 6.2)*

Late Payments. All late payments of water and sewer charges are the property of the Board and shall be collected by the City on behalf of the Board. Notwithstanding the foregoing, the Board has assigned to the City all of its rights and interest in and to all outstanding charges levied and uncollected on all properties at the time title thereto is vested in the City pursuant to *in rem* proceedings in consideration for the City's payment to the Board, in each Fiscal Year after the Effective Date, of an amount equal to 2% of such outstanding charges (unless, during the Lease Term, the City and the Board mutually agree on a different procedure for allocating such outstanding charges). *(Section 6.3)*

Discontinuance of Billing Services. If either the City or the Board no longer desires that the City provide the Board with billing services, the party desiring termination shall give written notice of such fact to the other party at least two years prior to the termination. Notwithstanding such termination of billing services, Section 6.2 of the Lease shall remain in full force and effect. *(Section 6.4)*

Legal Services. The Board has hired the City's Law Department to provide it with legal services. However, the Board may hire a different attorney or firm of attorneys to provide it with legal services. If the Board retains counsel to defend a claim against it without the prior approval of the Corporation Counsel of the City (which approval shall not be unreasonably withheld), the Board shall not be entitled to the indemnification from the City provided in Article III of the Lease with respect to such claim, unless the City elects in writing to provide such indemnification. *(Sections 7.1 and 7.2)*

Payments of Costs by the Board. The Board has agreed to pay to the City amounts sufficient to: (i) pay the cost of administration, maintenance, repair and operation of the Leased Property, including overhead costs incurred by the City attributable to the Leased Property (but less the amount of any governmental operating aid received or receivable within the current Fiscal Year with respect to the System), the cost of materials and supplies, and the amount of any judgment or settlement paid by the City arising out of a tort claim (but only if the costs of such claim are not otherwise reimbursed, the City's liability for such claim is related to Construction of a Water Project or operation or maintenance of the System and the costs of such claims do not exceed for any Fiscal Year 5% of the aggregate revenues shown on the Board's last year-end audited financial statements); (ii) reimburse the City for capital Costs incurred by the City in the Construction of Water Projects (if requested by the City and not otherwise reimbursed) including, without limitation, the payment of any judgment or settlement arising out of a contract claim related to the Construction of any Water Project; (iii) pay the cost of billing and collection services provided by the City; (iv) pay the cost of legal services provided by the City; and (v) reimburse the City for the compensation, or the costs of the services, of any City officers and employees provided on a full-time or part-time basis to the Board. (*Section 8.1*)

Base Rental Payments. In addition, the Board shall pay the City a rental payment for the System, but only to the extent requested by the City, and not to exceed the greater of (i) the principal and interest payable on general obligation bonds issued by the City for water and sewer purposes and certified by the City to be paid within such Fiscal Year, or (ii) 15% of the amount of principal and interest payable on the Bonds of the Authority and certified by the Authority to be paid within such Fiscal Year. (*Section 8.2*)

Method of Payment. The City shall certify within five business days after publication of the City's Executive Budget for the ensuing Fiscal Year the (i) amount which the City reasonably anticipates it will expend in connection with the costs described in Section 8.2 of the Lease and (ii) the amount of the payments described in Section 8.1 of the Lease; provided that, prior to the Board's payment to the City the Board shall have received, in addition to such certification by the City, a certificate of the Consulting Engineer to the effect that such amounts certified by the City for such payments and costs are reasonable and appropriate. Upon the Board's payment of all such amounts so certified or requested and any other payments required under the Act, or, after provisions for their payment have been made, the Board shall pay to the City, as Additional Rent in each Fiscal Year, any surplus of funds received. (*Section 8.3*)

Disposition of Property. The Board agrees that it will not sell, lease, sublease, assign, transfer, encumber (other than Permitted Encumbrances) or otherwise dispose of any part of the Leased Property, or any other real property or personal property which may be acquired by the Board, or its interest in the Lease, without the prior written approval of the City.

The City will not sell, transfer or otherwise dispose of real property or personal property included in the Leased Property without the Board's written consent. In the case of personal property, the value of which is less than \$1 million per unit (or of greater value if the Board designates), the Board will adopt rules and procedures for the expedited disposition thereof. Upon the City's request to dispose of any real property or personal property valued in excess of \$1 million, the Board will give such consent only upon receipt of a certificate signed by the Consulting Engineer to the effect that such real or personal property may be disposed of without materially adversely affecting the Revenues of the System or impairing the ability of the Board to make any payments required by the Lease or the Agreement or any other agreement to which it may be a party or be bound. The City may also, with the prior written consent of the Board, grant interests in the Leased Property which, in the reasonable judgment of the Board, do not interfere with the operation and maintenance of the System and the collection of the Revenues from the System. (*Section 11.1*)

Encumbrances. The Board may not encumber the Leased Property without the prior written approval of the City. The City may grant temporary licenses for use of the Leased Property which do not interfere with the operation and maintenance of the System or the collection of Revenues therefrom. (*Section 11.3*)

Summary of the First Resolution

Terms used in this Summary of the First Resolution shall have the meanings ascribed thereto in “APPENDIX C – GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS – Glossary.”

Pledge of Revenues and Funds. The Authority pledges for the payment of the Principal Installments or Redemption Price of and any interest on the Bonds, in accordance with their terms and the provisions of the First Resolution: (i) all Revenues, (ii) all moneys or securities in any of the Funds and Accounts created under the First Resolution, except that moneys or securities on deposit in a Special Account are pledged only to the Series of Bonds to which such Account relates and moneys or securities on deposit in the Common Account are pledged only to the Bonds for which a Special Account has not been established pursuant to the First Resolution, and (iii) all other moneys and securities to be received, held or set aside by the Authority or by any Fiduciary pursuant to the First Resolution; subject only to the provisions of the First Resolution and the Agreement permitting the application of such amounts for or to the purposes and on the terms and conditions therein set forth. It is the intention of the Authority that, to the fullest extent permitted by law, such pledge shall be valid and binding from the time when it is made; that the Revenues, moneys, securities and other funds so pledged, and then or thereafter received by the Authority, shall immediately be subject to the lien of such pledge; and that the obligation to perform the contractual provisions therein contained shall have priority over any or all other obligations and liabilities of the Authority and shall be valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the Authority, irrespective of whether such parties have notice thereof.

As further security for the payment of the Bonds, the Authority, under the First Resolution, assigns, transfers and pledges to the Trustee all of its rights and interests under and pursuant to the Agreement (excluding rights to notice and other procedural rights, its right to indemnification and rights and interests not material to Bondholders), including, without limiting the generality of the foregoing, the present and continuing right: (i) to claim, collect or receive from the Board, all Revenues thereunder, (ii) to bring actions and proceedings thereunder for enforcement of such right of collection, and (iii) to do any and all things which the Authority is or may become entitled to do under the Agreement; provided that such assignment shall not impair or diminish any obligation of the Authority under the Agreement.

The Bonds are special obligations of the Authority payable solely from the Revenues and other amounts described in the First Resolution and do not and will not constitute an indebtedness of the State, the City or the Board and neither the State, the City nor the Board shall be in any way liable thereon. *(Sections 203 and 501)*

Establishment of Funds and Accounts. The First Resolution establishes the following Funds:

- (1) Construction Fund;
- (2) Revenue Fund;
- (3) Debt Service Fund;
- (4) Authority Expense Fund;
- (5) Debt Service Reserve Fund;
- (6) Subordinated Indebtedness Fund;
- (7) Surplus Fund; and
- (8) Arbitrage Rebate Fund.

The First Resolution establishes in the Debt Service Reserve Fund a separate account known as the “Common Account”, and provides that any Supplemental Resolution which authorizes a Special Credit Facility may establish one or more “Special Accounts” in the Debt Service Reserve Fund. The First Resolution also establishes in the Debt Service Reserve Fund a separate account to be known as the “Capitalized Interest Account”.

The Trustee shall hold all of the Funds and Accounts, except the Authority Expense Fund, which shall be held by the Authority.

The Trustee is directed to make withdrawals and transfers from the Funds and Accounts established by the First Resolution in order to comply with any agreement entered into upon or after the date of issuance of the Authority's Fiscal 1987 Series C Bonds providing for the rebate of certain arbitrage earnings to the United States. (*Section 502*)

Construction Fund. The Authority shall deposit from time to time in the Construction Fund the net proceeds from the sale of each Series of Bonds and make the deposits in the Funds and Accounts required by the applicable Supplemental Resolutions. The Authority shall also deposit from time to time in the Construction Fund any other amounts required to be deposited therein pursuant to the First Resolution or the Agreement, including amounts received by the Authority for or in connection with the System and determined by the Authority to be deposited therein. Any proceeds of insurance maintained by the Board or the City against physical loss of or damage to the System, or of contractors' performance bonds pertaining to the construction of the System, shall also be paid into the Construction Fund.

Except as otherwise provided, amounts in the Construction Fund may only be expended to pay Costs of Water Projects (including Costs of Issuance). The Trustee shall make payments from the Construction Fund, except as otherwise provided, only upon receipt of a Disbursement Request signed by an Authorized Representative of the Authority.

To the extent that other moneys are not available therefor in any other Fund or Account, amounts in the Construction Fund shall be applied to the payment of principal of and interest on Bonds when due. (*Section 503*)

Allocation of Revenues — Revenue Fund. The Authority shall cause all Revenues received from the Board pursuant to the Agreement or otherwise to be paid to the Trustee and deposited promptly upon receipt in the Revenue Fund. There shall also be deposited in the Revenue Fund all other amounts required by the First Resolution or the Agreement to be so deposited. (*Section 504*)

Payments Into Certain Funds. From the Revenues in the Revenue Fund, the Trustee shall make, as soon as practicable in each month, the following deposits in the following order:

(i) to the Debt Service Fund all such amounts until the amount therein on deposit in such month equals the Minimum Monthly Balance for such month for all Series of Bonds Outstanding;

(ii) from the balance, if any, remaining in such month after making the deposits required in (i) above, to the Authority Expense Fund the entire balance until the total on deposit therein in such month is equal to the product obtained by multiplying (A) the sum of the Authority Expenses for the then current Fiscal Year plus (if included in the Authority Budget for the then current Fiscal Year) an amount (the "Reserve for Expenses") equal to one-sixth ($\frac{1}{6}$ th) of such Authority Expenses by (B) a fraction, the numerator of which is 12 minus the number of full months, excluding the month of calculation, remaining in the Fiscal Year, and the denominator of which is 12;

(iii) from the balance, if any, remaining after making the deposits required in (i) and (ii) above, *first*, to the Common Account in the Debt Service Reserve Fund, the amount, if any, necessary to make the total on deposit in the Common Account equal to the Debt Service Reserve Requirement for the Bonds to which such Common Account relates or, if less than sufficient, the entire balance and, *second*, to each Special Account until the amount therein on deposit equals the Debt Service Reserve Requirement for the Bonds to which each Special Account relates; *provided, however*, if the balance remaining is less than sufficient to credit in full each Special Account, credit shall be made pro rata among all Special Accounts in the same ratio as the Debt Service Reserve Requirement related to such Special Account bears to the sum of the Debt Service Reserve Requirements for all of the Bonds related to the Special Accounts; and

(iv) from the balance, if any, remaining after making the deposits required in (i), (ii) and (iii) above, to the Subordinated Indebtedness Fund the amount required to be deposited in accordance with the Authority Budget, or the entire balance, if less than sufficient.

Beginning with the first day of each Fiscal Year, the Trustee shall calculate the amounts deposited in the Revenue Fund on a daily basis until the total of all amounts deposited therein during such Fiscal Year is at least equal to the Cash Flow Requirement. On such date, if any, the Trustee is directed to give the notice to the Authority and the Board provided in Section 4.3(b) of the Agreement. Thereafter, during each Fiscal Year, no further Revenues shall be paid to the Trustee pursuant to paragraph Fourth of Section 4.2(c) of the Agreement so long as the Cash Flow Requirement, as the same may be revised from time to time, continues to be met. (*Section 505*)

Debt Service Fund. The Trustee shall, for each Series of Bonds Outstanding, pay from the Debt Service Fund the amounts due on each Bond Payment Date for the payment of the Principal Installments, if any, and from the moneys in the Debt Service Fund, including moneys in the Capitalized Interest Account in such Fund, interest on the Outstanding Bonds and on the redemption date or date of purchase, the amounts required for the payment of accrued interest on Bonds to be redeemed or purchased on such date unless the payment of such accrued interest shall be otherwise provided.

The Trustee may, and if so directed by an Authorized Representative of the Authority shall, prior to the forty-fifth day preceding the due date of each Sinking Fund Installment, apply the amounts accumulated in the Debt Service Fund for such Sinking Fund Installment, together with any interest on the Bonds for which such Sinking Fund Installment was established: (i) to the purchase of Bonds of like Series and maturity at prices (including any brokerage and other charges) not exceeding the Redemption Price payable for such Bonds when such Bonds are redeemable with such Sinking Fund Installment plus unpaid interest accrued or (ii) to the redemption of such Bonds, if redeemable by their terms, at or below said Redemption Price. Upon such purchase or redemption of any Bond, the Trustee shall then credit an amount equal to the principal of the Bond so purchased or redeemed toward the next Sinking Fund Installments thereafter to become due and the amount of any excess over the amount of such Sinking Fund Installment shall be credited against future Sinking Fund Installments in direct chronological order.

In any event, the Trustee shall, as soon as practicable after the forty-fifth day preceding the due date of any such Sinking Fund Installment, call for redemption a sufficient amount of Bonds of like Series and maturity to complete the retirement of the principal amount specified for such Sinking Fund Installment of such Bonds whether or not it then has moneys in the Debt Service Fund to pay the applicable Redemption Price thereof on the redemption date. The Trustee shall apply to the redemption of the Bonds on each such redemption date the amount required for the redemption of such Bonds. (*Sections 506 and 514*)

Authority Expense Fund. The Authority shall apply amounts credited to the Authority Expense Fund to the payment of Authority Expenses. Any moneys in the Authority Expense Fund which the Authority determines are in excess of that needed to meet the sum of the unpaid Authority Expenses for such Fiscal Year plus (if such amount was included in the Authority Budget for such Fiscal Year) the Reserve for Expenses, shall be applied toward any deficiencies in the following Funds and Accounts in the order stated: the Debt Service Fund, Debt Service Reserve Fund and Subordinated Indebtedness Fund. Any remaining amounts shall be credited to the Revenue Fund. (*Section 507*)

Debt Service Reserve Fund. The First Resolution establishes a Debt Service Reserve Fund and a Common Account therein. In addition, the First Resolution provides that any Supplemental Resolution which provides for a Special Credit Facility to secure the principal, interest or Tender Option Price of any Bonds may establish one or more "Special Accounts" in the Debt Service Reserve Fund. From the proceeds of each Series of Bonds there shall be deposited in the Debt Service Reserve Fund the amount, if any, necessary to make the amount on deposit therein equal to the Debt Service Reserve Requirement, after giving effect to the issuance of such Bonds; and all such amounts will be credited to the Common Account, unless a Supplemental Resolution requires a deposit in a Special Account. Amounts on deposit in the Common Account will be applied, to the extent necessary, to pay the Principal Installments of and interest on the Bonds; *provided, however*, that the amounts in the Common Account may not be applied to pay the

Principal Installments or Tender Option Price of or interest on Bonds for which such payments are secured by a Special Credit Facility, if the Supplemental Resolution authorizing such Bonds has established a Special Account. Likewise, amounts in any Special Account may not be applied to pay the Principal Installments of or interest on any Bond for which such payments may be made from the Common Account. Amounts on deposit in each of the Accounts in the Debt Service Reserve Fund shall be applied, to the extent other funds are not available in the Surplus Fund, the Subordinated Indebtedness Fund and the Authority Expense Fund, to pay the Principal Installments of, and interest on the Bonds to which such Account relates when due. Amounts so applied shall be derived first from cash or Investment Securities on deposit, and second from draws and demands on Financial Guaranties.

If, as of June 30 of each year, the amount in any Account in the Debt Service Reserve Fund exceeds the applicable Debt Service Reserve Requirement after giving effect to any Financial Guaranty deposited in such Fund, the Trustee shall, on the first business day of the following Fiscal Year, withdraw from such Account the amount of any excess therein over the applicable Debt Service Reserve Requirement as of the date of such withdrawal for deposit into (i) the Arbitrage Rebate Fund, the amount estimated by the Authority to be required by the Code to be rebated to the Department of the Treasury, (ii) the Surplus Fund, the amount required to be deposited therein in accordance with the Authority Budget, and (iii) the Revenue Fund, the amount of any excess then remaining in the Debt Service Reserve Fund over the applicable Debt Service Reserve Fund Requirement.

Whenever the amount (exclusive of Financial Guaranties) in all of the Accounts in the Debt Service Reserve Fund, together with the amount in the Debt Service Fund, is sufficient to pay all Outstanding Bonds in accordance with their respective terms, the funds on deposit in the Debt Service Reserve Fund shall be transferred to the Debt Service Fund and applied to the redemption or payment at maturity of all Bonds Outstanding.

In lieu of the required deposits and transfers to the Debt Service Reserve Fund, the Authority may cause to be deposited into the Debt Service Reserve Fund Financial Guaranties in an amount equal to the difference between the Debt Service Reserve Requirement and the sums, if any, then on deposit in the Debt Service Reserve Fund or being deposited in the Debt Service Reserve Fund concurrently with such Financial Guaranties. The Financial Guaranties shall be payable (upon the giving of notice as required thereunder) on any date on which moneys will be required to be withdrawn from the Debt Service Reserve Account and applied to the payment of a Principal Installment of or interest on any Bonds and such withdrawal cannot be met by amounts on deposit in the Debt Service Reserve Fund. If a disbursement is made pursuant to Financial Guaranties, the Authority shall be obligated either (i) to reinstate the maximum limits of such Financial Guaranties or (ii) to deposit into the Debt Service Reserve Fund, funds in the amount of the disbursement made under such Financial Guaranties, or a combination of such alternatives, as shall provide that the amount in the Debt Service Reserve Fund equals the Debt Service Reserve Requirement.

In the event of the refunding of any Bonds, the Trustee shall, upon the written direction of the Authority, withdraw from the Debt Service Reserve Fund all or any portion of amounts accumulated therein with respect to the Bonds being refunded and deposit such amounts as provided in such written direction; provided that such withdrawal shall not be made unless (a) immediately thereafter the Bonds being refunded shall be deemed to have been paid pursuant to Section 1201 of the First Resolution, and (b) the amount remaining in the Debt Service Reserve Fund after such withdrawal shall not be less than the Debt Service Reserve Requirement. (*Section 508*)

Subordinated Indebtedness Fund. The Trustee shall apply amounts on deposit in the Subordinated Indebtedness Fund solely to the maintenance of reserves for, or the payment of, Subordinated Indebtedness (or as otherwise provided by the resolution of the Authority authorizing each issue of Subordinated Indebtedness). The Trustee shall withdraw from the Subordinated Indebtedness Fund any amount necessary to render the balances in the Debt Service Fund or Debt Service Reserve Fund sufficient to meet the requirements of such Funds. (*Section 509*)

Surplus Fund. The Trustee shall, on each Bond Payment Date, apply moneys credited to the Surplus Fund in the following amounts: (i) to the Debt Service Fund the amount, if any, necessary (or all the moneys in the Surplus Fund if less than the amount necessary) to make up any deficiency in the amount required to be on deposit in such Fund and (ii) to the Debt Service Reserve Fund the amount, if any, necessary (or all the moneys in the Surplus Fund if less than the amount necessary) to make up any deficiency in the amount required to be on deposit in any Account in such Fund. Such transfer shall be made notwithstanding any other provisions of the First Resolution requiring deposits in such Funds. Amounts on deposit in the Surplus Fund on the last day of a Fiscal Year shall be withdrawn from such Fund and transferred to the Board for deposit in the Local Water Fund. *(Section 510)*

Arbitrage Rebate Fund. Amounts on deposit in the Arbitrage Rebate Fund shall be applied by the Trustee to make payments to the Department of the Treasury of the United States of America. Notwithstanding the foregoing, the Trustee shall apply moneys credited to the Arbitrage Rebate Fund in the following amounts: (i) to the Debt Service Fund the amount, if any, necessary (or all the moneys in the Arbitrage Rebate Fund if less than the amount necessary) to make up any deficiency in the amount required to be on deposit in the Debt Service Fund and (ii) to the Debt Service Reserve Fund the amount, if any, necessary (or all the moneys in the Arbitrage Rebate Fund if less than the amount necessary) to make up any deficiency in the amount required to be on deposit in any Account in the Debt Service Reserve Fund.

Amounts on deposit in the Arbitrage Rebate Fund in excess of the amount required to be maintained therein for the purposes of such Fund may be transferred and paid by the Trustee to the Surplus Fund. *(Section 510-a)*

Subordinated Indebtedness. The Authority may issue Subordinated Indebtedness payable out of and secured by a pledge of and lien on amounts in the Subordinated Indebtedness Fund available for such payment. Such Subordinated Indebtedness, however, shall be issued only for the purposes set forth in the First Resolution and shall be secured by a pledge subordinate in all respects to the pledge created by the First Resolution as security for the Bonds. *(Section 511)*

Depositaries. All moneys or securities held by the Trustee shall constitute trust funds and the Trustee may and shall, if directed by the Authority, deposit such moneys or securities with one or more Depositaries. All moneys or securities held by the Authority in the Authority Expense Fund shall be deposited with one or more Depositaries. All moneys or securities deposited under the provisions of the First Resolution with the Trustee or any Depositary shall be held in trust and applied only in accordance with the provisions of the First Resolution, and each of the Funds established by the First Resolution shall be a trust fund for the purposes thereof.

Each Depositary holding moneys or securities in trust for the Trustee shall be a bank or trust company organized under the laws of the State or a national banking association (having its principal office within the State), having capital stock, surplus and undivided earnings aggregating at least \$100,000,000 and willing and able to accept the office on reasonable and customary terms and authorized by law to act in accordance with the provisions of the First Resolution. *(Section 512)*

Investment of Certain Funds. Moneys held in the Debt Service Fund, the Debt Service Reserve Fund and the Subordinated Indebtedness Fund (subject to the terms of any resolutions or other instruments securing any issue of Subordinated Indebtedness) shall be invested and reinvested to the fullest practicable extent in Investment Securities which mature not later than such times as shall be necessary to provide moneys when needed to make payments required from such Funds; provided that in the case of the Debt Service Reserve Fund maturation may not occur later than fifteen years from the date of such investment, and in the case of the Debt Service Fund, investments shall be of the type described in clauses (ii), (iii) and (vi), and in the case of the Debt Service Reserve Fund, clauses (ii) and (iii), of the definition of "Investment Securities" (in either case, to the fullest extent practicable). Moneys in the Authority Expense Fund, the Revenue Fund, the Construction Fund, the Arbitrage Rebate Fund and the Surplus Fund may be invested in Investment Securities which mature no later than such times as shall be necessary to provide moneys when needed to make payments from such Funds. The Trustee shall make all investments in accordance with written instructions from any Authorized Representative of the Authority. Moneys in any Fund or

Account may be combined with moneys in any other Fund or Account for the purpose of making such investments in Investment Securities.

Interest (net of that which represents a return of accrued interest paid in connection with the purchase of any investment) earned on any moneys or investments in such Funds and Accounts, other than the Construction Fund, the Arbitrage Rebate Fund and the Debt Service Reserve Fund, shall be paid into the Revenue Fund as and when received. Interest (net of that which represents a return of accrued interest paid in connection with the purchase of any investment) earned on any moneys or investments in (i) the Debt Service Reserve Fund shall be paid into the Arbitrage Rebate Fund or the Surplus Fund, (ii) the Construction Fund shall be paid to the Board for deposit in the Local Water Fund quarterly, on the 15th day of each July, October, January and April of each Fiscal Year upon receipt of a written request and a certificate of the Authority relating to the satisfaction of the Cash Flow Requirement and (iii) the Arbitrage Rebate Fund shall remain in such fund.

All Investment Securities acquired with moneys in any Fund or Account, including any Fund or Account held by the Authority, shall be held by the Trustee in pledge or by a Depository as agent in pledge in favor of the Trustee. (*Section 514*)

Additional Bonds. The Authority may issue Bonds from time to time without limitation as to amount except as provided in the First Resolution or as specified by law to generate funds sufficient to meet the Costs of Water Projects, to make deposits in the Funds and Accounts or to refund Outstanding Bonds, Bond Anticipation Notes, Subordinated Indebtedness or outstanding bonds of the City issued to pay the capital costs of the System. All Bonds shall be issued subject to the terms, conditions and limitations established in the First Resolution and in one or more Series as therein provided.

Bonds shall be authenticated and delivered only upon the Trustee's receipt of, among other items:

(a) a certified copy of the Supplemental Resolution authorizing such Series;

(b) (i) in the case of the initial Series of Bonds, an executed copy of the Agreement and the Lease; and (ii) in the case of any subsequent Series of Bonds, an executed copy of any amendment or supplement to the Agreement or the Lease not theretofore delivered to the Trustee;

(c) except in the case of Series of Bonds issued prior to July 1, 1986 and any Series of Refunding Bonds issued pursuant to Section 207 of the First Resolution, a certificate of an Authorized Representative of the Authority setting forth (i) the Revenues for either of the last two full Fiscal Years immediately preceding the Fiscal Year in which such Bonds are to be issued and (ii) the Aggregate Debt Service during such Fiscal Year for which Revenues are set forth pursuant to clause (i) above (excluding from Aggregate Debt Service any Principal Installment or portion thereof which was paid from sources other than Revenues) and (iii) the sum of the Operating Expenses and the Required Deposits for such period, and showing that the amount set forth in (i) is at least equal to the sum of (x) an amount equal to 115% of the amount set forth in (ii) and (y) an amount equal to 100% of the amount set forth in (iii);

(d) except in the case of the initial Series of Bonds under the First Resolution and any Series of Refunding Bonds issued pursuant to Section 207 of the First Resolution, a certificate of the Consulting Engineer setting forth the projected Operating Expenses for each of the five Fiscal Years following the Issuance of such Series of Bonds (plus the Fiscal Year in which such Bonds are issued);

(e) except in the case of the initial Series of Bonds under the First Resolution and any Series of Refunding Bonds issued pursuant to Section 207, a certificate, signed by an Authorized Representative of the Authority setting forth the estimated Required Deposits for each of the five Fiscal Years following the issuance of such Series of Bonds (plus the Fiscal Year in which such Bonds are issued); and

(f) except in the case of the initial Series of Bonds under the First Resolution and any Series of Refunding Bonds issued pursuant to Section 207, a certificate of the Rate Consultant (i) setting forth the estimated Revenues for each of the five Fiscal Years following the issuance of such Series of Bonds

(plus the Fiscal Year in which such Bonds are issued) after giving effect to any increases or decreases in rates, fees and charges projected for such Fiscal Years and (ii) showing for each such Fiscal Year that the estimated Revenues for such Fiscal Year will be at least equal to the sum of (A) 115% of the maximum estimated Adjusted Aggregate Debt Service on all Bonds then Outstanding including the Bonds to be issued, and (B) 100% of the sum of the projected Operating Expenses and Required Deposits, as shown on the Certificate of the Consulting Engineer delivered pursuant to paragraph (e) above and the Certificate of the Authority delivered pursuant to paragraph (f) above, respectively. *(Sections 204 and 206)*

Refunding Bonds. One or more Series of Refunding Bonds may be issued pursuant to Section 207 of the First Resolution at any time to refund any Outstanding Bonds provided that (i) estimated average annual Debt Service on such Series of Refunding Bonds shall not exceed the average annual Debt Service on the Bonds to be refunded and (ii) the maximum Debt Service in any Fiscal Year on such Series of Refunding Bonds shall not exceed the maximum Debt Service in any Fiscal Year on the Bonds to be refunded, all as shown in a Certificate signed by an Authorized Representative of the Authority and delivered to the Trustee prior to the authentication and delivery of such Series of Refunding Bonds. Refunding Bonds shall be issued in a principal amount sufficient, together with other moneys available therefor, to accomplish such refunding and to make the deposits in the Funds and Accounts required by the provisions of the Supplemental Resolution authorizing such Bonds. *(Section 207)*

Bond Anticipation Notes. Whenever the Authority shall authorize the issuance of a Series of Bonds, the Authority may, by resolution, authorize the issuance of notes (and renewals thereof) in anticipation of such Series of Bonds. The principal of and interest on such notes and renewals thereof shall be payable from the proceeds of such notes or from the proceeds of the sale of the Series of Bonds in anticipation of which such notes are issued. The proceeds of such Bonds may be pledged for the payment of the principal of and interest on such notes and any such pledge shall have a priority over any other pledge of such proceeds created by the First Resolution. The Authority may also pledge the Revenues to the payment of the interest on, and subject to Section 707 of the First Resolution, the principal of such notes. A copy of the First Resolution of the Authority authorizing such notes, certified by an Authorized Representative of the Authority, shall be delivered to the Trustee following its adoption, together with such other information concerning such notes as the Trustee may reasonably request. *(Section 208)*

Credit Facilities. In connection with the issuance of any Series of Bonds, the Authority may obtain or cause to be obtained one or more Credit Facilities providing for payment of all or a portion of the Principal Installments, or Redemption Price or interest due or to become due on such Bonds, providing for the purchase of such Bonds by the issuer of such Credit Facility or providing funds for the purchase of such Bonds by the Authority.

The Authority may secure such Credit Facility by an agreement providing for the purchase of the Series of Bonds secured thereby with such adjustments to the rate of interest, method of determining interest, maturity or redemption provisions as specified by the Authority in the applicable Supplemental Resolution. The Authority may also in an agreement with the issuer of such Credit Facility agree to directly reimburse such issuer for amounts paid under the terms of such Credit Facility, together with interest thereon (the "Reimbursement Obligation"); *provided, however*, that no Reimbursement Obligation shall be created until amounts are paid under such Credit Facility. Any such Reimbursement Obligation (a "Parity Reimbursement Obligation") may be secured by a pledge of, and a lien on Revenues on a parity with the lien created by Section 501 of the First Resolution. Upon the payment of amounts under the Credit Facility which payment results in the Parity Reimbursement Obligation becoming due and payable, such Parity Reimbursement Obligation shall be deemed to be part of the Series of Bonds to which the Credit Facility which gave rise to such Parity Reimbursement Obligation relates.

Any such Credit Facility shall be for the benefit of and secure such Series of Bonds or portion thereof, as specified in the applicable Supplemental Resolution. *(Section 209)*

Indebtedness and Liens. The First Resolution provides that the Authority shall not issue any bonds, or other evidences of indebtedness, other than the Bonds, Bond Anticipation Notes, Subordinated

Indebtedness and Parity Reimbursement Obligations, secured by a pledge of or other lien on the Revenues and shall not create or cause to be created any lien on such Revenues or on any amounts held by any Fiduciary, under the First Resolution; however, the Authority may: (i) issue notes payable from the proceeds of Bonds or other obligations for the corporate purposes of the Authority payable or secured by Revenues derived on and after such date as the pledge of the Revenues provided in the First Resolution is discharged and satisfied and (ii) issue bonds or other obligations for the corporate purposes of the Authority payable out of or secured by the pledge of amounts in the Local Water Fund after satisfaction of the Cash Flow Requirement for the then current Fiscal Year, and which recite on their face that such pledge of said amounts is and shall be in all respects subordinate to the provisions of the lien and pledge created by the First Resolution. (*Section 707*)

Agreement of the State. In accordance with Section 1045-t of the Act, the Authority agrees, for and on behalf of the State, that the State will not alter or limit the rights vested by the Act in the Authority or the Board to fulfill the terms of any agreement made with or for the benefit of the Bondholders, or in any way impair the rights and remedies of Bondholders, until the Bonds, together with the interest thereon, with interest on any unpaid installment of interest, and all costs and expenses in connection with any action or proceeding by or on behalf of such holders, are fully met and discharged. (*Section 711*)

Authority Budget. The Authority shall, on or before May 1, in each Fiscal Year, adopt and file with the Trustee, the Board and the City, a certified copy of the Authority Budget showing the estimated Cash Flow Requirement and the components thereof (on a monthly basis) for the ensuing Fiscal Year, together with any other information required to be set forth therein by the First Resolution or the Agreement. Such Authority Budget may set forth such additional information as the Authority may determine or as the Board or the City may request. If for any reason the Authority shall not have adopted the Authority Budget before such May 1, the Authority Budget for the then current Fiscal Year shall be deemed to be the Authority Budget for the ensuing Fiscal Year until a new Authority Budget is adopted. The Authority may at any time adopt an amended Authority Budget for the then current or ensuing Fiscal Year, but no such amended Authority Budget shall supersede any prior Budget until the Authority shall have filed with the Trustee, the Board and the City a copy of such amended Authority Budget. Each month the Authority shall recalculate the Cash Flow Requirement. (*Sections 712 and 713*)

Enforcement and Amendment of Agreement and Lease. The Authority shall enforce or cause to be enforced the provisions of the Agreement and the Lease and duly perform its covenants and agreements under the Agreement. The Authority will not consent or agree to or permit any rescission of or amendment to or otherwise take any action under or in connection with the Agreement or the Lease except in accordance with Article X of the Agreement of the First Resolution. (*Section 714*)

Supplemental Resolutions. The First Resolution permits the modification or amendment of the rights and obligations of the Authority and of the holders of the Bonds thereunder by a Supplemental Resolution, with the written consent of the holders of two-thirds of the principal amount of: (i) the Bonds then Outstanding and (ii) in case less than all of the several Series of Bonds then Outstanding are affected by the modification or amendment, of the Bonds of the Series so affected and then Outstanding; however, if such modification or amendment will, by its terms, not take effect so long as any Bonds of any specified like Series and maturity remain Outstanding, the consent of the holders of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of modification; provided no such modification or amendment shall change the terms of redemption, maturity of principal, installment of interest, or reduce the principal amount, Redemption Price, or rate of interest without the consent of the holder of the affected Bond, or reduce the percentages of consents required to effect any future modification or amendment.

The Authority may adopt (without the consent of any holders of the Bonds) supplemental resolutions to authorize additional Bonds; to add to the restrictions contained in the First Resolution upon the issuance of additional indebtedness; to add to the covenants of the Authority contained in, or surrender any rights reserved to or conferred upon it by, the First Resolution; to confirm any pledge under the First Resolution of Revenues or other moneys; to preserve the federal tax exemption of interest on the Bonds; or otherwise to

modify any of the provisions of the First Resolution (but no such other modification may be effective while any of the Bonds of any Series theretofore issued are Outstanding); or to cure any ambiguity, supply any omission or to correct any defect in the First Resolution or to insert such provisions clarifying matters or questions arising under the First Resolution as are necessary or desirable, and are not contrary to or inconsistent with the First Resolution as theretofore in effect or to provide for additional duties of the Trustee (provided that the Trustee shall consent thereto). (*Arts. VIII and IX*)

Defaults and Remedies. The First Resolution provides that if one or more of the following Events of Default shall occur, namely: (i) a default in the payment of the principal or Redemption Price of any Bond; (ii) a default in payment of any installment of interest on any Bond; (iii) a default by the Authority in the performance or observance of any other of its covenants, agreements or conditions in the First Resolution for a period of 45 days after written notice thereof; (iv) a default under the Agreement or the Lease by the Board or the City for a period of 45 days after written notice thereof; or (v) a filing of a petition for relief under any federal or State bankruptcy or similar law by the Authority; then, upon the happening and continuance of any Event of Default, the Trustee may, and upon the written request of the holders of not less than a majority in principal amount of the Bonds Outstanding the Trustee shall, declare the principal and accrued interest on all the Bonds then Outstanding, due and payable immediately subject, however, to rescission of such declaration and annulment of the default upon the remedying thereof.

The Authority covenants that upon the occurrence of an Event of Default, the books of record and account of the Authority shall at all times be subject to the inspection and use of the Trustee and of its agents and attorneys and that, upon demand of the Trustee, the Authority will account, as if it were the trustee of an express trust, for all Revenues and other moneys, securities and funds pledged or held under the First Resolution for such period as shall be stated in such demand.

Upon default, the Trustee may proceed to protect and enforce its rights and the rights of the holders of the Bonds under the First Resolution forthwith by a suit or suits in equity or at law, whether for the specific performance of any covenant therein contained, or in aid of the execution of any power therein granted, or for an accounting against the Authority as if the Authority were the trustee of an express trust, or in the enforcement of any other legal or equitable right as the Trustee, being advised by counsel, shall deem most effectual to enforce any of its rights or to perform any of its duties under the First Resolution. During the continuance of an Event of Default, Revenues shall be applied first, to the reasonable and proper charges and expenses of the Trustee; then (unless the principal of all of the Bonds shall have been declared payable) to the payment of all unpaid interest ratably, and then to unpaid principal or Redemption Price, ratably; and if all of the principal of the Bonds shall be due and payable, to the payment of unpaid principal and interest, without preference or priority of interest over principal, principal over interest or of any Bond or installment over any other Bond or installment, without any discrimination or preference. No Bondholder has any right to institute suit to enforce any provision of the First Resolution or the execution of any trust thereunder or for any remedy thereunder, unless the Trustee has been requested by the holders of at least a majority in principal amount of the Bonds to take such action and has been offered adequate security and indemnity and has failed to commence such suit in the manner provided in the First Resolution. The right to appoint a statutory trustee under Section 1045-p of the Act is expressly abrogated. (*Art. X*)

Defeasance of Bonds Other than Variable Rate or Option Bonds. Any Outstanding Bond shall prior to the maturity or redemption date thereof be deemed to have been paid and shall cease to be entitled to any lien, benefit or security under the First Resolution if (i) in the case of any Bonds to be redeemed prior to their maturity, the Authority shall have given to the Trustee irrevocable instructions accepted in writing by the Trustee to publish on such date the notice of redemption therefor (other than Bonds purchased by the Trustee prior to the publication of the notice of redemption), (ii) there shall have been deposited with the Trustee either moneys in an amount sufficient, or Defeasance Obligations the principal of and/or the interest on which, when due, without reinvestment, will, as verified by the report of a firm of nationally recognized independent certified public accountants, provide moneys which, together with the moneys deposited shall be sufficient, to pay when due the principal or Redemption Price (if applicable) and interest due and to become due on said Bonds and (iii) in the event said Bonds are not by their terms subject to redemption within the next succeeding 60 days, the Authority shall have given the Trustee irrevocable

instructions to publish, as soon as practicable, a notice to the holders of such Bonds that the deposit required above has been made with the Trustee and that said Bonds are deemed paid in accordance with the First Resolution and stating such maturity or redemption date upon which moneys are to be available to pay the principal or Redemption Price, if applicable, on such Bonds (other than Bonds purchased by the Trustee prior to the publication of the notice of redemption); provided that any notice published for Bonds constituting less than all of the Outstanding Bonds of any maturity within a Series shall specify the letter and number or other distinguishing mark of each such Bond. The Trustee shall, to the extent necessary, apply moneys to the retirement of said Bonds in amounts equal to the unsatisfied balances of any Sinking Fund Installments thereto.

The Trustee shall, if so directed by the Authority prior to the maturity date of Bonds deemed to have been paid which are not to be redeemed prior to their maturity date or prior to the publication of the above notice of redemption for Bonds deemed paid and to be redeemed, apply moneys deposited with the Trustee in respect of such Bonds and redeem or sell Defeasance Obligations so deposited with the Trustee and purchase such Bonds and the Trustee shall immediately thereafter cancel all such Bonds so purchased; *provided, however*, that the moneys and Defeasance Obligations remaining on deposit with the Trustee after the purchase and cancellation of such Bonds shall be sufficient to pay when due the Principal Installment or Redemption Price, if applicable, and interest due or to become due on all Bonds. (*Section 1201*)

Defeasance of Variable Rate Bonds. The Resolution provides that for the purposes of determining whether Variable Rate Bonds shall be deemed to have been paid prior to the maturity or redemption date thereof, by the deposit of moneys, or Defeasance Obligations and moneys (if any), the interest due on such Bonds shall be calculated at the maximum rate permitted; *provided, however*, that if, as a result of such Bonds having borne interest at less than the maximum rate for any period, the total amount of moneys and Investment Securities on deposit with the Trustee for the payment of interest on such Bonds exceeds the total amount required to be deposited with the Trustee, the Trustee shall, if requested by the Authority, pay the amount in excess to the Authority free and clear of any lien or pledge securing the Bonds or otherwise existing under the First Resolution. (*Section 1201*)

Defeasance of Option Bonds. Under the First Resolution, Option Bonds shall be deemed paid in accordance with the First Resolution only if, in addition to satisfying several of the requirements applicable to other than Variable Rate or Option Bonds, there shall have been deposited with the Trustee moneys in an amount which shall be sufficient to pay the maximum amount of principal of and premium due, if any, and interest on such Bonds which could become payable to the holders of such Bonds upon the exercise of any options provided to the holders of such Bonds; *provided, however*, that if the options originally exercisable by the holder of an Option Bond are no longer exercisable, such Bond shall not be considered an Option Bond. (*Section 1201*)

Summary of the Second Resolution

Terms used in this Summary of the Second Resolution shall have the meanings ascribed thereto in "APPENDIX C – GLOSSARY AND SUMMARY OF CERTAIN DOCUMENTS – Glossary – Definition of Certain Terms Used in Second Resolution."

Pledge of Revenues and Funds. The Authority pledges for the payment of the Bonds in accordance with their terms and the provisions of the Second Resolution, subject only to the provisions of the Second Resolution, the First Resolution, the Act and the Agreement permitting the application thereof for or to the purposes and on the terms and conditions of the Second Resolution and therein set forth: (i) all moneys or securities in any of the Funds and Accounts, other than the Arbitrage Rebate Fund, (ii) all Other Moneys, (iii) in moneys or securities on deposit in the FGR Subordinated Indebtedness Fund, except that moneys or securities on deposit in a Special Account are pledged only to the Series of Bonds to which such Account relates and moneys or securities on deposit in the Common Account are pledged only to the Bonds for which a Special Account has not been established pursuant to the Second Resolution, (iv) all other moneys and securities to be received, held or set aside by the Authority or by any Fiduciary pursuant to the Second

Resolution and (v) from and after the time that the pledge of Revenues made in the First Resolution shall be discharged and satisfied in accordance with the First Resolution, all Revenues; *provided, however*, that such pledge shall be in all respects subordinate to the provisions of the First Resolution and the lien and pledge created by the First Resolution. This pledge shall, to the fullest extent permitted by law, be valid and binding from the time when it is made and the Revenues, moneys, securities and other funds so pledged and then or thereafter received by the Authority shall immediately be subject to the lien of such pledge and the obligation to perform the contractual provisions contained in the Second Resolution and shall be valid and binding as against all parties having claims of any kind in tort contract or otherwise against the Authority, irrespective of whether such parties have notice thereof.

The Act provides that (i) the pledges made by the Second Resolution are valid, binding and perfected from the time when they are made and property so pledged shall immediately be subject to the lien of such pledges without any physical delivery thereof or further act, (ii) the lien of such pledges shall be valid, binding and perfected as against all parties having claims of any kind in tort, contract or otherwise against the Authority irrespective of whether such parties have notice thereof and (iii) no instrument by which such pledges are created nor any financing statement need be recorded or filed. Accordingly, no financial statements have been or will be filed. Based upon the foregoing, the Authority represents that under the laws of the State (i) the Second Resolution creates valid and binding pledges in favor of the holders from time to time of the Bonds, enforceable in accordance with the terms set forth in the Second Resolution, (ii) the pledges made by the Second Resolution and each pledge made to secure obligations of the Authority which, by the terms set forth in the Second Resolution, are prior to or of equal rank with such pledge are and shall be prior to any judicial lien hereafter imposed on the property pledged by the Second Resolution to enforce a judgment against the Authority on a simple contract and (iii) no instrument by which such pledges are created nor any financing statement need be recorded or filed in order to establish or maintain such priority. The Authority further represents that the Authority has not heretofore made a pledge of, granted a lien on or security interest in, or made an assignment or sale of the Revenues or any other property pledged by the Second Resolution that is prior to or of equal rank with the pledge made by the Second Resolution and neither the Revenues nor any other property pledged by the Second Resolution have been described in any financing statement. Except as expressly permitted by the Second Resolution, the Authority shall not hereafter make or suffer to exist any pledge or assignment of, lien on or security interest in the Revenues or other property pledged by the Second Resolution that is prior to or of equal rank with the pledge made by the Second Resolution, or file any financing statement describing any such pledge, assignment, lien or security interest, except in connection with pledges, assignments, liens or security interests expressly permitted by the Second Resolution.

As further security for the payment of the principal or Redemption Price of and interest on the Bonds, the Authority assigns, transfers and pledges to the Trustee all of its rights and interests under and pursuant to the Agreement (excluding rights to notice and other procedural rights, its rights to indemnification and rights and interests not material to Bondholders), including, without limiting the generality of the foregoing, the present and continuing right (i) to make claim for, collect or cause to be collected, receive or cause to be received, from the Board all Revenues thereunder, (ii) to bring actions and proceedings thereunder for the enforcement thereof, and (iii) to do any and all things which the Authority is or may become entitled to do under the Agreement; *provided, however* that such assignment, transfer and pledge are and shall be in all respects subject and subordinate to the assignment, transfer and pledge made by the First Resolution; *provided, further*, that the assignment made by the Second Resolution shall not impair or diminish any obligation of the Authority under the Agreement.

The Bonds are special obligations of the Authority payable solely from the special funds provided for such payment pursuant to the Act, the First Resolution and the Second Resolution and do not and will not constitute an indebtedness of the State, the City or the Board and neither the State, the City nor the Board shall be in any way liable thereon. (*Sections 203 and 501*)

Establishment of Funds and Accounts. The Second Resolution establishes the following Funds:

- (1) Construction Fund;

- (2) Revenue Fund;
- (3) Debt Service Fund;
- (4) Authority Expense Fund;
- (5) Debt Service Reserve Fund;
- (6) Subordinated Indebtedness Fund;
- (7) Arbitrage Rebate Fund; and
- (8) Surplus Fund.

The Second Resolution establishes in the Debt Service Reserve Fund a separate account known as the “Common Account”; and provides that any Supplemental Resolution which authorizes a (i) Special Credit Facility to secure the payment of the Principal Installments of and interest on the Bonds authorized thereby, (ii) which provides for a Special Credit Facility to secure the payment of the Tender Option Price of any Option Bonds authorized thereby, or (iii) wherein the Authority has determined that the Series of Bonds authorized thereby will not be secured by the Common Account in the Debt Service Reserve Fund, may establish one or more Special Accounts in the Debt Service Reserve Fund. The Second Resolution also establishes in the Debt Service Fund a separate account to be known as the “Capitalized Interest Account”

The Trustee shall hold all of the Funds and Accounts.

The Trustee is directed to make withdrawals and transfers from the Funds and Accounts established by the Second Resolution in order to rebate certain arbitrage earnings to the United States. (*Section 502*)

Construction Fund. From and after the date on which no First Resolution Bonds are Outstanding, the Authority shall deposit from time to time in the Construction Fund the net proceeds from the sale of each Series of Bonds and make the deposits in the Funds and Accounts required by the applicable Supplemental Resolutions. The Authority shall also deposit from time to time in the Construction Fund any other amounts required to be deposited therein pursuant to the Second Resolution or the Agreement, including amounts received by the Authority for or in connection with the System and determined by the Authority to be deposited therein. In addition, all moneys on deposit in the Construction Account shall be deposited in the Construction Fund as soon as practicable after the date on which there are no First Resolution Bonds Outstanding. From and after the date on which no First Resolution Bonds are Outstanding and proceeds of insurance maintained by the Board or the City against physical loss of or damage to the System, or of contractors’ performance bonds pertaining to the construction of the System, shall also be paid into the Construction Fund.

Except as otherwise provided, amounts in the Construction Fund, and subject to the provisions of the First Resolution, the Construction Account may only be expended to pay Costs of Water Projects (including Costs of Issuance). The Trustee shall, subject to certain exceptions contained in the First Resolution and the Second Resolution, make payments from the Construction Fund, except as otherwise provided, only upon receipt of a Disbursement Request signed by an Authorized Representative of the Authority.

To the extent that other moneys are not available therefor in any other Fund or Account, amounts in the Construction Fund and Construction Account shall be applied to the payment of principal of and interest on Bonds and of the interest on Parity Bond Anticipation Notes when due. The Authority will cause moneys in the Construction Account to be transferred to the Debt Service Fund at such time and in such amount as may be required for such purpose. (*Section 504*)

Allocation of Revenues – Revenue Fund. The Authority shall cause all Other Moneys and, from and after the date on which no First Resolution Bonds are Outstanding, all Revenues received from the Board pursuant to the Agreement to be paid to the Trustee and deposited promptly upon receipt in the Revenue Fund. There shall also be deposited in the Revenue Fund all other amounts required by the Second Resolution or the Agreement to be so deposited.

In addition to the payments to be made from the Subordinated Indebtedness Fund, as soon as practicable in each month the amount in the Subordinated Indebtedness Fund (other than in the Construction Account) shall be transferred to the Revenue Fund until the amount on deposit therein is equal to the sum of:

(i) together with the amount in the Debt Service Fund, the Monthly Balance for such month and the amount necessary to pay the purchase price or Redemption Price of Bonds purchased or called for redemption; plus

(ii) the amount, if any, necessary to make the total on deposit in the Debt Service Reserve Fund and credited to the Common Account equal to the Debt Service Reserve Requirement for the Bonds to which such Common Account relates, and to make the total on deposit in each Special Account equal to the Debt Service Reserve Requirement for the Bonds to which each such Special Account relates; plus

(iii) the amount, if any, then required to be in the Subordinated Indebtedness Fund. *(Section 505)*

Payments Into Certain Funds. From the Revenues in the Revenue Fund, the Trustee shall make, as soon practicable in each month, the following deposits in the following order:

(i) to the Debt Service Fund, all such amounts until the total on deposit therein equals the sum of (A) the Monthly Balance for such month for all Series of Bonds Outstanding and (B) the amount necessary to pay the purchase price or Redemption Price of Bonds purchased or called for redemption;

(ii) if no First Resolution Bonds are then Outstanding, from the balance, if any, remaining in such month after making the deposits required by paragraph (i) to the Authority Expense Fund the entire balance until the total on deposit therein in such month is equal to the product obtained by multiplying (A) the sum of (i) the Authority Expenses for the then current Fiscal Year as set forth in the Authority Budget, plus (ii) if included in the Authority Budget for the then current Fiscal Year, an amount (“the Reserve for Expenses”) equal to one-sixth of such Authority Expenses by (B) a fraction, the numerator of which is twelve (12) minus the number of full months (excluding the month of calculation) remaining in the Fiscal Year and the denominator of which is twelve (12);

(iii) from the balance, if any remaining after making the deposits required by paragraphs (i) and (ii), to the Debt Service Reserve Fund, first, to the credit of the Common Account therein the amount, if any, necessary to make the total on deposit in such Fund and credited to the Common Account equal to the Debt Service Reserve Requirement for the Bonds to which such Common Account relates, or, the entire balance if less than sufficient and, then, from the balance of such deposit, if any, remaining after crediting the Common Account as aforesaid, to the credit of each Special Account an amount equal to the Debt Service Reserve Requirement for the Bonds to which each such Special Account relates; *provided, however*, that if the balance remaining is less than sufficient to credit in full each Special Account, credit shall be made pro rata among all Special Accounts in the same ratio as the Debt Service Reserve Requirement related to each Special Account bears to the sum of the Debt Service Reserve Requirements for all the Bonds related to Special Accounts:

(iv) from the balance, if any, remaining after making the deposits required by paragraphs (i), (ii) and (iii) to the Arbitrage Rebate Fund, the amount, if any, equal to the earnings in investments in the Debt Service Reserve Fund which were transferred to the Revenue Fund in the preceding month; and

(v) from the balance, if any, remaining after making the deposits required by paragraphs (i), (ii), (iii) and (iv) and if no First Resolution Bonds are then Outstanding, to the Subordinated Indebtedness Fund the amount required to be deposited in such Fund for such month in accordance with the Authority Budget to the entire balance if less than sufficient.

Beginning with the first day of each Fiscal Year, the Authority shall cause to be calculated the amounts deposited in the Revenue Fund on a daily basis until it is determined that the total of all amounts deposited therein during such Fiscal Year is at least equal to the SGR Cash Flow Requirement. Thereafter, during

such Fiscal Year, no further amounts on deposit in the FGR Subordinated Indebtedness Fund shall be required to be deposited in the Revenue Fund; *provided, however*, if the Authority shall thereafter certify an amended Authority Budget for such Fiscal Year showing an SGR Cash Flow Requirement in excess of the SGR Cash Flow Requirement last certified for such Fiscal Year, calculation of the amounts deposited in the Revenue Fund on a daily basis shall be resumed until it is determined that the total of all amounts deposited therein during such Fiscal Year is at least equal to the SGR Cash Flow Requirement, as amended. Thereafter, during such Fiscal Year, no further amounts on deposit in the FGR Subordinated Indebtedness Fund shall be required to be deposited in the Revenue Fund, unless the Authority thereafter, in such Fiscal Year, again certifies an amended Authority Budget showing an SGR Cash Flow Requirement in excess of the SGR Cash Flow Requirement theretofore certified in such Fiscal Year. (*Section 506*)

Debt Service Fund. The Trustee shall for the Outstanding Bonds of a Series, Parity Bond Anticipation Notes and Parity Reimbursement Obligations, pay (i) on each Bond Payment Date, (1) from the moneys on deposit in the Debt Service Fund the amounts required for the payment of the Principal Installments, if any, due on such Bond Payment Date and (2) from the moneys on deposit in the Debt Service Fund, including the moneys credited to the subaccount, if any, established for such Series in the Capitalized Interest Account in such Fund, the interest due on such Bond Payment Date, (ii) on any redemption date or date of purchase, the amounts required for the payment of accrued interest on Bonds to be redeemed or purchased on such date unless the payment of such accrued interest shall be otherwise provided and (iii) on each Bond Payment Date for Parity Bond Anticipation Notes, the interest due thereon on such Bond Payment Date, including from moneys credited to the sub-account, if any, established for such Parity Bond Anticipation Notes in the Capitalized Interest.

The Trustee may, and if so directed by an Authorized Representative of the Authority shall, prior to the forty-fifth day preceding the due date of each Sinking Fund Installment, apply the amounts accumulated in the Debt Service Fund for such Sinking Fund Installment, together with any interest on the Bonds for which such Sinking Fund Installment was established: (i) to the purchase of Bonds of like Series and maturity at prices (including any brokerage and other charges) not exceeding the Redemption Price payable for such Bonds when such Bonds are redeemable with such Sinking Fund Installment plus unpaid interest accrued or (ii) to the redemption of such Bonds, if redeemable by their terms, at or below said Redemption Price. Upon such purchase or redemption of any Bond, the Trustee shall then credit an amount equal to the principal of the Bond so purchased or redeemed toward the next Sinking Fund Installments thereafter to become due and the amount of any excess over the amount of such Sinking Fund Installment shall be credited against future Sinking Fund Installments in direct chronological order.

In any event, the Trustee shall, as soon as practicable after the forty-fifth day preceding the due date of any such Sinking Fund Installment, call for redemption a sufficient amount of Bonds of like Series and maturity to complete the retirement of the principal amount specified for such Sinking Fund Installment of such Bonds whether or not it then has moneys in the Debt Service Fund to pay the applicable Redemption Price thereof on redemption date. The Trustee shall apply to the redemption of the Bonds on each such redemption date the amount required for the redemption of such Bonds.

In the event of the refunding of any Bonds, the Trustee shall, upon the written direction of the Authority, withdraw from the Debt Service Fund and the Capitalized Interest Account related to the Bonds to be refunded all or any portion of amounts accumulated therein with respect to the Bonds to be refunded and deposit such amounts as provided in such written direction; *provided, however*, that such withdrawal shall not be made unless (i) immediately thereafter the Bonds being refunded shall be deemed to have been paid, and (ii) after giving effect to any amounts being simultaneously deposited therein the amount remaining in the Debt Service Fund after such withdrawal shall not be less than the Monthly Balance at the date of such withdrawal with respect to Bonds then Outstanding, after the Bonds to be refunded have been deemed paid. (*Section 507*)

Authority Expense Fund. The Authority shall apply amounts credited to the Authority Expense Fund to the payment of Authority Expenses. Any moneys in the Authority Expense Fund which the Authority determines are in excess of that needed to meet the sum of the unpaid Authority Expenses for

such Fiscal Year plus (if such amount was included in the Authority Budget for such Fiscal Year) the Reserve for Expenses shall be applied toward any deficiencies in the following Funds and Accounts in the order stated: the Debt Service Fund, Debt Service Reserve Fund and Subordinated Indebtedness Fund. Any remaining amounts shall be credited to the Revenue Fund. (*Section 508*)

Debt Service Reserve Fund. The Second Resolution establishes a Debt Service Reserve Fund and a Common Account therein. In addition, the Second Resolution provides that any Supplemental Resolution which provides (i) for a Special Credit Facility to secure the payment of the Principal Installments of and interest on the Bonds authorized thereby, (ii) which provides for a Special Credit Facility to secure the payment of the Tender Option Price of any option Bonds authorized thereby, or (iii) wherein the Authority has determined that the Series of Bonds authorized thereby will not be secured by the Common Account in the Debt Service Reserve Fund, may establish one or more Special Accounts in the Debt Service Reserve Fund. From the proceeds of each Series of Bonds there shall be deposited in the Debt Service Reserve Fund the amount, if any, necessary to make the amount on deposit therein equal to the Debt Service Reserve Requirement, after giving effect to the issuance of such Bonds; and all such amounts will be credited to the Common Account, unless a Supplemental Resolution requires a deposit in a Special Account.

Amounts on deposit in the Common Account will be applied, to the extent necessary, to pay the Principal Installments of and interest on the Bonds; *provided, however*, that the amounts in the Common Account may not be applied to pay the Principal Installments of and interest on, or Tender Option Price of or interest on, Bonds for which such payments are secured by a Special Credit Facility, or to pay Principal Installments of and interest on Bonds that the Authority has determined will not be secured by amounts in the Common Account; these Bonds will be secured by amounts, if any, on deposit in the Special Account. Likewise, amounts in any Special Account may not be applied to pay the Principal Installments of or interest on any Bond for which such payments may be made from the Common Account. Amounts on deposit in each of the Accounts in the Debt Service Reserve Fund shall be applied, to the extent other funds are not available pursuant to the Second Resolution to pay the Principal Installments of, and interest on the Bonds to which such Account relates when due. Amounts so applied shall be derived first from cash or Investment Securities on deposit, and then from draws and demands on Financial Guaranties; *provided, however*, that if more than one Financial Guaranty is held in an Account at the time moneys are to be withdrawn therefrom the Trustee shall obtain payment under each such Financial Guaranty pro rata based upon the respective amounts then available to be paid thereunder.

If, as of June 30 of each year, the amount in any Account in the Debt Service Reserve Fund exceeds the applicable Debt Service Reserve Requirement after giving effect to any Financial Guaranty deposited in such Fund, the Trustee shall, on the first business day of the following Fiscal Year, withdraw from such Account the amount of any excess therein over the applicable Debt Service Reserve Requirement as of the date of such withdrawal for deposit into (i) the Arbitrage Rebate Fund, the amount estimated by the Authority to be required by the Code to be rebated to the Department of the Treasury, and (ii) the Reserve Fund, the amount of any excess then remaining in the Debt Service Reserve Fund over the applicable Debt Service Reserve Requirement. If, as of February 1 of each year the amount in any Account in the Debt Service Reserve Fund is less than the applicable Debt Service Reserve Requirement and, to the extent that such deficiency has not been made up by May 1 of such year by either (i) deposits pursuant to Sections 506, 511 or 512 of the Second Resolution or (ii) an increase in the market value of the securities therein or (iii) a combination of (i) and (ii), the Authority shall, in its Authority Budget for the ensuing Fiscal Year, include the amount necessary to make up such deficiency as a Required Deposit.

Whenever the amount (exclusive of Financial Guaranties) in all of the Accounts in the Debt Service Reserve Fund, together with the amount in the Debt Service Fund, is sufficient to pay all Outstanding Bonds in accordance with their respective terms, the funds on deposit in the Debt Service Reserve Fund shall be transferred to the Debt Service Fund and applied to the redemption or payment at maturity of all Bonds Outstanding.

In lieu of or in substitution for moneys or Investment Securities otherwise required to be deposited in the Common Account of the Debt Service Reserve Fund, the Authority may deposit or cause to be

deposited with the Trustee a Financial Guaranty for the benefit of the Holders of the Bonds for all or any part of the Debt Service Reserve Requirement; *provided, however*, (i) that any such surety bond or insurance policy shall be issued by an insurance company or association duly authorized to do business in the State and either (A) the claims paying ability of which is rated the highest rating accorded by a nationally recognized rating agency, or (B) obligations insured by a surety bond or an insurance policy issued by such company or association and rated at the time such surety bond or insurance policy is delivered, without regard to qualification of such rating by symbols such as “+” or “-” or numerical notation, in the highest rating category by each Rating Agency or, if Outstanding Bonds are not rated by both Rating Agencies, by whichever Rating Agency that then rates Outstanding Bonds and (ii) that any such letter of credit shall be issued by a bank, a trust company, a national banking association, a corporation subject to registration with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956 or any success or provision of law, a federal branch pursuant to the International Banking Act of 1978 or any successor provision of law or a domestic branch or agency of a foreign bank which branch or agency is duly licensed or authorized to do business under the laws of any state or territory of the United States of America, the unsecured or uncollateralized long term debt obligations of which, or long term obligations secured or supported by a letter of credit issued by such person, are rated at the time such letter of credit is delivered, without regard to qualification of such rating by symbols such as “+,” or “-” or numerical notation, in at least the second highest rating category by each Rating Agency or, if Outstanding Bonds are not rated by both Rating Agencies, by whichever Rating Agency that then rates Outstanding Bonds.

In addition to the conditions and requirements set forth above, no Financial Guaranty shall be deposited in full or partial satisfaction of the Debt Service Reserve Requirement unless the Trustee shall have received prior to such deposit (i) an opinion of counsel to the effect that such Financial Guaranty has been duly authorized, executed and delivered by the Financial Guaranty Provider thereof and is valid, binding and enforceable in accordance with its terms, (ii) in the event such Financial Guaranty Provider is not a domestic entity, an opinion of foreign counsel in form and substance satisfactory to the Trustee and (iii) in the event such Financial Guaranty is a letter of credit, an opinion of counsel acceptable to the Trustee and to each Financial Guaranty Provider substantially to the effect that payments under such letter of credit will not constitute avoidable preferences under Section 547 of the United States Bankruptcy Code in a case commenced by or against the Authority thereunder or under any applicable provisions of the Debtor and Creditor Law of the State.

Notwithstanding the foregoing, if at any time after a Financial Guaranty has been deposited with the Trustee the ratings on any Outstanding Bonds are less than in the second highest rating category by each Rating Agency, without regard to qualification of such rating by symbols such as “+” or “-” or numerical notation, and the unsecured or uncollateralized long term debt of the Financial Guaranty Provider or the long term debt obligations secured or supported by a surety bond, insurance policy or letter of credit of a Financial Guaranty Provider is reduced below the third highest rating category by each Rating Agency, without regard to qualification of such rating by symbols such as “+” or “-” or numerical notation, the Authority shall either (i) replace or cause to be replaced said Financial Guaranty with another Financial Guaranty which satisfies the requirements of the two preceding paragraphs or (ii) deposit or cause to be deposited in the Debt Service Reserve Fund an amount of moneys equal to the value of the Financial Guaranty of such Financial Guaranty Provider, such deposits to be, as nearly as practicable, in ten equal semi-annual installments commencing on the earlier of the December 15 or June 15 next succeeding the reduction in said ratings.

Each Financial Guaranty shall be payable (upon the giving of such notice as may be required thereby) on any date on which moneys are required to be withdrawn from the Debt Service Reserve Fund and such withdrawal cannot be made without drawing upon such letter of credit or obtaining payment under such surety bond or insurance policy.

For the purposes of the above provisions under the heading “Debt Service Reserve Fund”, and the provisions under the heading “Investment of Certain Funds” below, in computing the amount on deposit in the Debt Service Reserve Fund, a letter of credit, a surety bond or an insurance policy shall be valued at the

amount available to be drawn or payable thereunder on the date of computation: *provided, however*, that, if the unsecured or uncollateralized long term debt of the Financial Guaranty Provider thereof, or the long term debt obligations secured or supported by a surety bond, insurance policy or letter of credit of said Financial Guaranty Provider has been reduced below the ratings required by the third paragraph under the heading “Debt Service Reserve Fund;” said Financial Guaranty shall be valued at the lesser of (i) the amount available to be paid thereunder on the date of calculation and (ii) the difference between the amount available to be paid thereunder on the date of issue thereof and an amount equal to a fraction of such available amount the numerator of which is the aggregate number of December 15th’s and June 15th’s which has elapsed since such ratings were reduced and the denominator of which is ten.

With respect to any demand for payment under any Financial Guaranty, the Trustee shall make such demand for payment in accordance with the terms of such Financial Guaranty in a timely manner to assure the availability of moneys on the Bond Payment Date for which such moneys are required.

In the event of the refunding of any Bonds, the Trustee shall, upon the written direction of the Authority, withdraw from the Debt Service Reserve Fund all or any portion of amounts accumulated therein with respect to the Bonds being refunded and deposit such amounts as provided in such written direction; provided that such withdrawal shall not be made unless (a) immediately thereafter the Bonds being refunded shall be deemed to have been paid pursuant to Section 1201 of the Second Resolution, and (b) the amount remaining in the Debt Service Reserve Fund after such withdrawal shall not be less than the Debt Service Reserve Requirement. (*Section 509*)

Subordinated Indebtedness Fund. The Trustee shall apply amounts on deposit in the Subordinated Indebtedness Fund solely to the maintenance of reserves for, or the payment of, Subordinated Indebtedness (or as otherwise provided by the resolution of the Authority authorizing each issue of Subordinated Indebtedness). The Trustee shall withdraw from the Subordinated Indebtedness Fund any amount necessary to render the balances in the Debt Service Fund or Debt Service Reserve Fund sufficient to meet the requirements of such Funds. (*Section 510*)

Arbitrage Rebate Fund. Amounts on deposit in the Arbitrage Rebate Fund shall be applied by the Trustee to make payments to the Department of the Treasury of the United States of America. Notwithstanding the foregoing, the Trustee shall apply moneys credited to the Arbitrage Rebate Fund in the following amounts: (i) to the Debt Service Fund the amount, if any, necessary (or all the moneys in the Arbitrage Rebate Fund if less than the amount necessary) to make up any deficiency in the amount required to be on deposit in the Debt Service Fund and (ii) to the Debt Service Reserve Fund the amount, if any, necessary (or all the moneys in the Arbitrage Rebate Fund if less than the amount necessary) to make up any deficiency in the amount required to be on deposit in any Account in the Debt Service Reserve Fund.

Amounts on deposit in the Arbitrage Rebate Fund in excess of the amount required to be maintained therein or the purposes of such Fund may be transferred and paid by the Trustee to the Revenue Fund. (*Section 511*)

Surplus Fund. The Trustee shall, on each Bond Payment Date, apply moneys credited to the Surplus Fund in the following amounts: (i) to the Debt Service Fund the amount, if any, necessary (or all the moneys in the Surplus Fund if less than the amount necessary) to make up any deficiency in the amount required to be on deposit in such Fund and (ii) to the Debt Service Reserve Fund the amount, if any, necessary (or all the moneys in the Surplus Fund if less than the amount necessary) to make up any deficiency in the amount required to be on deposit in any Account in such Fund. Such transfer shall be made notwithstanding any other provisions of the Second Resolution requiring deposits in such Funds. Amounts on deposit in the Surplus Fund on the last day of a Fiscal Year shall be withdrawn from such Fund and transferred to the Board for deposit in the Local Water Fund. (*Section 512*)

Depositaries. All moneys or securities held by the Trustee under the provisions of the Second Resolution shall constitute trust funds and the Trustee may, and shall, if directed in writing by an Authorized Representative of the Authority deposit such moneys or securities with one or more Depositaries in trust for the Trustee. All moneys or securities deposited under the provisions of the Second Resolution with the

Trustee or any Depository shall be held in trust and applied only in accordance with the provisions of the Second Resolution and the applicable provisions of the First Resolution, and each of the Funds and the Accounts shall be a trust fund for the purposes thereof. The Authority and the Trustee shall instruct each Depository that any moneys or securities credited to a Fund or an Account under the Second Resolution which are deposited with such Depository shall be identified to be part of such Fund or Account and subject to the pledge in favor of the Trustee created under the Second Resolution. Prior to the first deposit of any moneys or securities with each Depository, the Authority and the Trustee shall obtain from such Depository its agreement to serve as agent of the Trustee in holding such moneys or securities in pledge in favor of the Trustee and the contract or other written instrument between the Authority and such Depository governing the establishment and operation of such account shall provide the moneys or securities from time to time deposited with such Depository shall be held by such Depository as such agent in pledge in favor of the Trustee; *provided, however*, that, except as otherwise expressly provided in the Second Resolution, the Authority shall be permitted at any time to make withdrawals from and write checks or other drafts against any account held by the Authority and established with such Depository and apply the same for the purposes specified in the Second Resolution and, subject to Section 515 of the Second Resolution, the Authority shall be permitted to invest amounts in any such account in Investment Securities.

Each Depository holding moneys or securities in trust for the Trustee shall be a bank or trust company organized under the laws of the State or a national banking association (having its principal office within the State), having capital stock, surplus and undivided earnings aggregating at least \$100,000,000 (or such greater amount as set forth in a Supplemental Resolution) and willing and able to accept the office on reasonable and customary terms and authorized by law to act in accordance with the provisions of the Second Resolution. (*Section 513*)

Investment of Certain Funds. Moneys held in the Debt Service Fund, the Debt Service Reserve Fund and the Subordinated Indebtedness Fund (subject to the terms of any resolutions or other instrument securing any issue of Subordinated Indebtedness) shall be invested and reinvested to the fullest practical extent in Investment Securities which mature not later than such times as shall be necessary to provide moneys when needed to make payments required from such Funds; provided that in the case of the Debt Service Fund, investments shall be of the type described in clauses (ii), (iii) or (iv) of the definition of "Investment Securities." Moneys in the Authority Expense Fund, the Revenue Fund, the Construction Fund, the Arbitrage Rebate Fund and the Surplus Fund may be invested and reinvested in Investment Securities which mature later than such times as shall be necessary to provide moneys when needed to make payments from such Funds. The Trustee shall make all investments in accordance with the direction of an Authorized Representative of the Authority, given either in writing, which may be sent by electronic transmission of a facsimile, or by telephonic communication subsequently confirmed in writing. Moneys in any Fund or Account may be combined with moneys in any other Fund or Account for the purpose of making such investments in Investment Securities.

Interest (net of that which represents a return of accrued interest paid in connection with the purchase of any investment) and other investment earnings on any moneys or investments in the Funds and Accounts, other than the Construction Fund, the Debt Service Reserve Fund and the Arbitrage Rebate Fund, shall be paid into the Revenue Fund as and when received. Interest (net of that which represents a return of accrued interest paid connection with the purchase of any investment) and other investment earnings on any moneys or investments in (i) the Debt Service Reserve Fund shall be paid into the Arbitrage Rebate Fund, the Surplus Fund or the Revenue Fund; (ii) the Arbitrage Rebate Fund shall remain in such Fund; and (iii) the Construction Fund shall be paid quarterly, on the fifteenth day of each July, October, January and April of each Fiscal Year, to the Board deposit in the Local Water Fund; *provided, however*, that no such payment shall be made unless the Trustee shall receive (A) the written direction of an Authorized Representative of the Authority to make such payment and (B) a Certificate of an Authorized Representative of the Authority stating that, as of the date thereof, there has been deposited in the Revenue Fund during such Fiscal Year an amount equal to the Cash Flow Requirement.

All Investment Securities acquired with moneys in any Fund or Account shall be held by the Trustee in pledge or by a Depository as agent in pledge in favor of the Trustee. (*Section 515*)

Additional Bonds. In order to provide sufficient funds for the Costs of Water Projects or for the purpose refunding any Bonds, First Resolution Bonds or any other bonds, notes or other obligations issued either by the Authority or the City to pay the capital costs of the System, Bonds of the Authority are authorized to be issued from time to time without limitations as to amount except as provided in the Second Resolution or as may be limited by law and such Bonds shall be issued subject to the terms, conditions and limitations established in the Second Resolution and in one or more Series as therein provided.

Bonds shall be authenticated and delivered only upon the Trustee's receipt of, among other items:

(a) a Bond Counsel's Opinion as to validity and certain other matters required by the Second Resolution;

(b) a certified copy of the Supplemental Resolution authorizing such Series;

(c) an executed copy of an amendment or supplement to the Agreement or the Lease not theretofore delivered to the Trustee;

(d) except in the case of any Series of Refunding Bonds issued pursuant to Section 207 of the Second Resolution, a Certificate of an Authorized Representative of the Authority setting forth (i) the Revenues for either of the last two full Fiscal Years immediately preceding the Fiscal Year in which such bonds are to be issued and (ii) the Aggregate Debt Service on First Resolution Bonds, Outstanding Bonds, Parity Bond Anticipation Notes and Parity Reimbursement Obligations during such Fiscal Year for which Revenues are set forth pursuant to clause (i), excluding from Aggregate Debt Service the amount thereof which was paid from sources other than Revenues, and (iii) the sum of the Operating Expenses and the Required Deposits for such Fiscal Year (exclusive of Required Deposits for the payment of Outstanding Bonds, Parity Bond Anticipation Notes and Parity Reimbursement Obligations), and showing that the amount set forth in (i) is at least equal to the sum of (x) 110% of the amount set forth in (ii) and (y) 100% of the amount set forth in (iii);

(e) except in the case of Refunding Bonds issued pursuant to Section 207 of the Second Resolution, a Certificate of each of the respective Authorized Representatives of the Authority, the Board and City, each dated as of the date of such delivery, stating that (i) the Authority is not in default in the performance of any of the covenants, conditions, agreements or provisions contained in the Second Resolution, (ii) the Board is not in default in the performance of any of the covenants, conditions, agreements or provisions contained in the Agreement or the Lease and (iii) the City is not in default in the performance of any of the covenants, conditions, agreements or provisions contained in the Agreement or the Lease;

(f) a Certificate signed by an Authorized Representative of the Authority setting forth the Cash Flow Requirement as of such date; and

(g) in the case of any Series for which Capitalized Interest has been provided by the Supplemental Resolution authorizing such Series, (i) the written direction of an Authorized Representative of the Authority to establish the sub-account for such Series in the Capitalized Interest Account in the Debt Service Fund and (ii) the amount of the proceeds of such Series to be deposited in the Subordinated Indebtedness Fund for payment to such sub-account. (*Sections 204 and 206*)

Refunding Bonds. One or more Series of Refunding Bonds may be issued pursuant to Section 207 of the Second Resolution at any time to refund any Outstanding Bonds only upon the Trustee's receipt of, among other things, a Certificate signed by an Authorized Representative of the Authority stating that (a) the average annual Debt Service on the Refunding Bonds of such Series does not exceed the average annual Debt Service on the Bonds to be refunded and (b) the maximum Debt Service in any Fiscal Year on the Refunding Bonds of such Series shall not exceed the maximum Debt Service in any Fiscal Year on the Bonds to be refunded. (*Section 207*)

Bond Anticipation Notes. The Authority may, by resolution, authorize the issuance of notes (and renewals thereof in anticipation of the issuance of a Series of Bonds. The principal of and interest on such notes and renewals thereof shall be payable from the proceeds of such notes or from the proceeds of the sale

of the Series of Bonds issued to provide for the payment of such notes. The proceeds of such Bonds may be pledged for the payment of the principal of and interest on such notes and any such pledge shall have a priority over any other pledge of such proceeds created by the Second Resolution. The Authority may also pledge (i) the Funds and Accounts, other than the Arbitrage Rebate Fund, and (ii) the Revenues to the payment of the interest on, and subject to Section 706 of the Second Resolution, the principal of such notes. A copy of the Second Resolution of the Authority authorizing such notes, certified by an Authorized Representative of the Authority, shall be delivered to the Trustee following its adoption, together with such other information concerning such notes as the Trustee may reasonably request. (*Section 208*)

Credit Facilities and Interest Rate Exchange Agreements. In connection with the issuance of any Series of Bonds or Parity Bond Anticipation Notes, the Authority may obtain or cause to be obtained one or more Credit Facilities providing for payment of all or a portion of the Principal Installments, Redemption Price or interest due or to become due on such Bonds or the principal or interest due or to become due on such Parity Bond Anticipation Notes, providing for the purchase of such Bonds by the issuer of such Credit Facility or Revolving funds for the purchase of such Bonds by the Authority. In connection therewith the Authority may enter into such agreements with the issuer of such Credit Facility providing for, among other things: (i) reimbursement of the issuer of the Credit Facility for amounts paid under the terms thereof; *provided, however*, that no obligation to reimburse such issuer shall be created, for purposes of the Second Resolution, until amounts are paid under such Credit Facility; (ii) the payment of fees and expenses to such issuer for the issuance of such Credit Facility; (iii) the terms and conditions of such Credit Facility and the Series of Bonds or the Parity Bond Anticipation Notes affected thereby; and (iv) the security, if any, to be provided for the issuance of such Credit Facility. The Authority may secure such Credit Facility by an agreement providing for the purchase of the Series of Bonds secured thereby with such adjustments to the rate of interest, method of determining interest, maturity, or redemption provisions as specified by the Authority in the applicable Supplemental Resolution. Any such Credit Facility shall be for the benefit of and secure such Series of Bonds or portion thereof as specified in the applicable Supplemental Resolution.

In connection with the Bonds of any Series or Parity Bond Anticipation Notes, the Authority may enter into one or more Interest Rate Exchange Agreements providing for, inter alia: (i) the payment of fees, expenses and other amounts to the Counterparty; (ii) the terms and conditions of such Interest Rate Exchange Agreements; (iii) the Bonds of the Series or Parity Bond Anticipation Notes to which such Interest Rate Exchange Agreement relate; and (iv) the security, if any, to be provided by the Authority or the Counterparty for performance of their respective obligations under the Interest Rate Exchange Agreement.

The Authority may also in an agreement with the issuer of a Credit Facility agree to reimburse such issuer directly for amounts paid under the terms of such Credit Facility, together with accrued interest thereon; *provided, however*, that no obligation to reimburse an issuer of a Credit Facility shall be created, for purposes of the Second Resolution, until amounts are paid under such Credit Facility. Such payments to reimburse the issuer of a Credit Facility and the obligations of the Authority to make payments to a Counterparty, are referred to in the Second Resolution as a “Reimbursement Obligation.” Any Reimbursement Obligation (a “Parity Reimbursement Obligation”) may be secured by a pledge of and a lien on, the Revenues, Other Moneys, the Funds and Accounts (other than the Arbitrage Rebate Fund) and amounts in the FGR Subordinated Indebtedness Fund on a parity with the lien created thereon by Section 501 of the Second Resolution; *provided, however*, that with respect to Parity Bond Anticipation Notes, such pledge and lien may secure only the Authority’s Reimbursement Obligation incurred on account of amounts advanced for the payment of the interest on such Parity Bond Anticipation Notes unless the principal amount of such Reimbursement Obligation which was advanced on account of the principal of such Parity Bond Anticipation Notes is payable to the provider of the Credit Facility in substantially equal installments payable over not less than eight calendar quarters. Any such Parity Reimbursement Obligation shall be deemed to be a part of the Series or Parity Bond Anticipation Notes to which the Credit Facility or Interest Rate Exchange Agreement, as the case may be, which gave rise to such Parity Reimbursement Obligation relates. (*Section 209*)

Indebtedness and Liens. The Second Resolution provides that the Authority shall not issue any bonds, notes, or other evidences of indebtedness or otherwise incur any indebtedness, other than the First General Resolution Bonds, Bonds, Parity Bond Anticipation Notes or Parity Reimbursement Obligations,

secured by a pledge of or other lien or charge on the Revenues or any of the assets pledged which is prior to or of equal rank or priority with the pledge made and shall not create or cause to be created any lien or charge on the Revenues or on any of the assets pledged which is prior to or of equal rank or priority with the pledge made; *provided, however*, that, with respect to Bond Anticipation Notes, such lien or pledge shall secure payment of the interest thereon, unless the principal thereof shall be secured by a lien on the Revenues as hereinafter provided in this paragraph. This paragraph shall not prevent the Authority from issuing bonds, other notes or other obligations for the corporate purposes of the Authority payable out of, or secured by a pledge of, Revenues to be derived on and after such date as the pledge of the Revenues provided in the Second Resolution shall be discharged and satisfied as provided in Section 1201 of the Second Resolution, or from issuing bonds or notes or other obligations for the corporate purposes of the Authority which are payable out of or secured by the pledge of amounts available therefor in the Local Water Fund after satisfaction, in each Fiscal Year, of the Cash Flow Requirement for such Fiscal Year and which recite on their face that such pledge of said amounts is and shall be in all respects subordinate to the provisions of the Second Resolution and the lien and pledge created by the Second Resolution.

The Authority will not issue any bonds, notes or other evidences of indebtedness or otherwise incur any indebtedness, other than Bonds or First Resolution Bonds, payable from, or secured by a pledge of or other lien or charge on the Construction Account of the FGR Subordinated Indebtedness Fund. (*Section 706*)

Agreement of the State. In accordance with Section 1045-t of the Act, the Authority agrees, for and on behalf of the State, that the State will not alter or limit the rights vested by the Act in the Authority or the Board to shall the terms of any agreement made with or for the benefit of the Bondholders, or in any way impair the right, and remedies of Bondholders, until the Bonds, together with the interest thereon, with interest on any unpaid installment of interest, and all costs and expenses in connection with any action or proceeding by or on behalf of such holders, are fully met and discharged. (*Section 709*)

Authority Budget. The Authority shall, on or before May 1, in each Fiscal Year, adopt and file with the Trustee, the Board and the City, a copy of the Authority Budget, duly certified by an Authorized Representative of the Authority, showing the estimated Cash Flow Requirement (including the amount of each item constituting a component thereof, on a monthly basis) for the ensuing Fiscal Year, together with the estimated Revenues, other than Revenues to be received from the Board pursuant to the Agreement, expected to be received by the Authority in the ensuing Fiscal Year, and any other information required to be set forth therein by the Second Resolution or the Agreement. Such Authority Budget may set forth such additional information as the Authority may determine or as the Board or the City may request.

If for any reason the Authority shall not have adopted the Authority Budget before May 1, the Authority Budget for the then current Fiscal Year shall be deemed to be the Authority Budget for the ensuing Fiscal Year until new Authority Budget is adopted.

The Authority may at any time adopt an amended Authority Budget for the then current or ensuing Fiscal Year, but no such amended Authority Budget shall supersede any prior Budget until the Authority shall have filed with the Trustee, the Board and the City a copy of such amended Authority Budget. (*Section 710*)

Cash Flow Requirement. On the first day of each month after the adoption of the Authority Budget for any Fiscal Year, the Authority shall recalculate the Cash Flow Requirement for such Fiscal Year. If any such recalculation results in the determination of a Cash Flow Requirement in excess of the Cash Flow Requirement set forth in the then current Authority Budget, the Authority shall adopt and file an amended Authority Budget in accordance with Section 711(c) of the Second Resolution.

At any time on or after May 1 of a Fiscal Year, but not later than June 15 of such Fiscal Year, the Authority shall recalculate the Cash Flow Requirement for such Fiscal Year and include therein, in addition to all other amounts required by the Second Resolution or by the Agreement or First Resolution to be included therein, an amount equal to the lesser of (i) the amount estimated to be in the Local Water Fund on June 30 of such Fiscal Year after the Board has made the payments and deposits required by paragraphs FIRST through SEVENTH of Section 4.2(c) of the Agreement and (ii) an amount equal to the difference between (x) the Aggregate Debt Service on Bonds, Parity Bond Anticipation Notes and Parity

Reimbursement Obligations payable during the next succeeding Fiscal Year, less (y) the Other Moneys projected to be received during such next succeeding Fiscal Year. Upon such recalculation the Authority shall adopt and file an amended Authority Budget in accordance with Section 711(c) of the Second Resolution.

If a Financial Guaranty is to expire or terminate during a Fiscal Year and as a result thereof the amount in the Debt Service Reserve Fund would be less than the Debt Service Reserve Requirement, the Authority shall include in the Authority Budget and the Cash Flow Requirement for such Fiscal Year and for each of the four Fiscal Years next succeeding such Fiscal Year an amount equal to twenty percent (20%) of the deficit in the Debt Service Reserve Fund created by such expiration or termination, unless prior to adoption of the Authority Budget for any such Fiscal Year the Authority has obtained an extension of or substitute for such Financial Guaranty or a commitment for the issuance of such extension or substitute. (*Section 711*)

Enforcement and Amendment of Agreement and Lease. The Authority shall enforce or cause to be enforced the provisions of the Agreement and the Lease and duly perform its covenants and agreements under the Agreement. The Authority will not consent or agree to or permit any rescission of or amendment to or otherwise take any action under or in connection with the Agreement or the Lease except in accordance with Article X or the Agreement and Section 714 of the Second Resolution. (*Section 713*)

Amendments to First Resolution, Agreement and Lease. Except as otherwise provided in the Second Resolution, the First Resolution, the Agreement or the Lease may not be amended, changed, modified or terminated, nor may any provision thereof be waived, without the consent of the Holders of Outstanding Bonds as provided in the Second Resolution, if such amendment, change, modification, termination or waiver:

(i) amends subsection (c)(ii), (c)(iii), (g), (h), (i), (j), (k) or (l) of Section 206 of the First Resolution:

(ii) amends Section 207 or Section 209 of the First Resolution in any manner which would permit First Resolution Bonds or Parity Reimbursement Obligations to be issued or incurred which, except for such amendment, could not be issued or incurred; or

(iii) amends Article V of the First Resolution in any manner which reduces the amount or delays the time at which moneys are to be deposited in the FGR Subordinated Indebtedness Fund or modifies the order in which payments to the FGR Subordinated Indebtedness Fund are to be made or the purposes for which moneys in the FGR Subordinated Indebtedness Fund may be applied; or

(iv) modifies the events which constitute “Events of Default” under Section 1001 of the First Resolution, or

(v) amends the First Resolution, the Agreement or the Lease in any manner which would indirectly modify the provisions of any of the Sections of the First Resolution referred to in clauses (i), (ii), (iii) or (iv) of Section 714(a) of the Second Resolution in a manner proscribed thereby; or

(vi) adversely affects the interest of the Holders of Outstanding Bonds in any material respect.

No such amendment, change, modification, termination or waiver shall take effect unless the prior written consent of (a) the Holders of at least a majority in principal amount of the Bonds then Outstanding, or (b) in case less than all of the several Series of Bonds then Outstanding are affected by the amendment, change, modification, termination or waiver, the Holders of not less than a majority in principal amount of the Bonds of the Series so affected and then Outstanding; *provided, however*, that if such amendment, change modification, termination or waiver will, by its terms, not take effect so long as any Bonds of any specified Series and maturity remain Outstanding, the consent of the Holders of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under the provisions contained under this “Amendments to First Resolution and Agreement.”

Notwithstanding the provisions of the preceding paragraph, the amendments to the First Resolution made be the resolution of the Authority entitled “Twenty-second Supplemental Resolution to the Water and Sewer System General Revenue Bond Resolution adopted November 14, 1985,” which resolution was adopted by the Authority on November 10, 1993, and any amendments to the Agreement necessary or appropriate to implement or conform the provisions of the Agreement to the First Resolution as so amended may take effect without the prior written consent of Holders of any of the Bonds.

For the purposes of the provisions under this heading “Amendments to First Resolution, Agreement and Lease” the purchasers of the Bonds of a Series, whether purchasing as underwriters, for resale or otherwise, upon such purchase from the Authority, may consent to an amendment, change, modification, termination or waiver permitted by the paragraphs under this heading “Amendments to First Resolution, Agreement and Lease” with the same effect as a consent given by the Holder of such Bonds.

For the purposes of the provisions under this heading, “Amendments to First Resolution, Agreement and Lease,” Series shall be deemed to be adversely affected by an amendment, change, modification or alteration of the First Resolution or the Agreement if the same adversely affects or diminishes the rights of the Holders of the Bonds of such Series in any material respect. The Trustee may in its discretion determine whether or not, in accordance with the foregoing provisions, Bonds of any particular Series would be adversely affected in any material respect by any amendment, change, modification or alteration, and any such determination shall be binding and conclusive on the Authority and all Holders of Bonds.

For the purposes of the provisions under this heading “Amendments to First Resolution, Agreement and Lease,” the Trustee shall be entitled to rely upon an opinion of counsel, which counsel shall be satisfactory to the Trustee with respect to whether any amendment, change, modification or alteration adversely affects the interests of any Holders of Bonds then Outstanding in any material respect. (*Section 714*)

Supplemental Resolutions. The Second Resolution permits the modification or amendment of the rights and obligations of the Authority and of the holders of the Bonds thereunder by a Supplemental Resolution, with the written consent of the holders of a majority of the principal amount of: (i) the Bonds then Outstanding and (ii) in case less than all of the several Series of Bonds then Outstanding are affected by the modification or amendment, of the Bonds of the Series so affected and then Outstanding; however, if such modification or amendment will, by its terms, not take effect so long as any Bonds of any specified like Series and maturity remain Outstanding, the consent of the holders of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of modification: provided no such modification or amendment shall change the terms of redemption, maturity of principal, installment of interest, or reduce the principal amount, Redemption Price, or rate of interest without the consent of the holder of the affected Bond, or reduce the percentages of consents required to effect any future modification or amendment.

The Authority may adopt (without the consent of any holders of the Bonds) supplemental resolutions to authorize additional Bonds; to add to the restrictions contained in the Second Resolution upon the issuance of additional indebtedness; to add to the covenants of the Authority contained in, or surrender any rights reserved to or conferred upon it by, the Second Resolution; to confirm any pledge under the Second Resolution of Revenues or other moneys; to preserve the federal tax exemption of interest on the Bonds; or otherwise to modify any of the provisions of the Second Resolution (but no such other modification may be effective while any of the Bonds of any Series theretofore issued are Outstanding); or to cure any ambiguity, supply any omission or to correct any defect in the Second Resolution or to insert such provisions clarifying matters or questions arising under the Second Resolution as are necessary or desirable, and are not contrary to or inconsistent with the Second Resolution as theretofore in effect; or to modify any provision of the Second Resolution or of any previously adopted Supplemental Resolution in any respect, provided that such modification shall not adversely affect the interests of the Bondholders in any material respect: or to provide for additional duties of the Trustee (provided that the Trustee shall consent thereto).

For the purposes of Article IX of the Second Resolution, the purchasers of the Bonds of a Series, whether purchasing as underwriters, for resale or otherwise, upon such purchase from the Authority, may

consent to a modification or amendment permitted by Sections 803 or 902 of the Second Resolution in the manner provided in the Second Resolution, except that no proof of ownership shall be required, and with the same effect as a consent given by the Holder of such Bonds; *provided, however*, that, if such consent is given by a purchaser who is purchasing as an underwriter or for resale, the nature of the modification or amendment and the provisions for the purchaser consenting thereto shall be described in the official statement, prospectus, offering memorandum or other offering document prepared in connection with the primary offering of the Bonds of such Series by the Authority. (*Arts. VIII and IX*)

Defaults and Remedies. The Second Resolution provides that if one or more of the following Events of Default shall occur, namely: (i) a default in the payment of the principal or Redemption Price of any Bond; (ii) a default in payment of any installment of interest on any Bond; (iii) a default by the Authority in the performance or observance of any other of its covenants, agreements or conditions in the Second Resolution for a period of 45 days after written notice thereof; (iv) a default under the Agreement or the Lease by the Board or the City for a period of 45 days after written notice thereof; (v) a filing of a petition for relief under any federal or State bankruptcy or similar law by the Authority; or (vi) a default by the Authority on any indebtedness payable out of the FGR Subordinated Indebtedness Fund has occurred as a result of which the principal thereof has been declared to be immediately due and payable, which declaration has not been annulled; then, upon the happening and continuance of any Event of Default, the Trustee, if no First Resolution Bonds are then Outstanding under the First Resolution or if the principal of all First Resolution Bonds then Outstanding has been declared to be due and payable immediately pursuant to Section 803 of the First Resolution, may, and upon the written request of the holders of not less than a majority in principal amount of the Bonds Outstanding the Trustee shall, declare the principal and accrued interest on all the Bonds then Outstanding, due and payable immediately subject, however, to rescission of such declaration and annulment of the default upon be remedying thereof.

The Authority covenants that upon the occurrence of an Event of Default, the books of record and account of the Authority shall at all times be subject to the inspection and use of the Trustee and of its agents and attorneys and that, upon demand of the Trustee, the Authority will account, as if it were the trustee of an express trust, for all Revenues and other moneys, securities and funds pledged or held under the Second Resolution for such period as shall be stated in such demand.

Upon default, the Trustee may proceed to protect and enforce its rights and the rights of the holders of the Bonds under the Second Resolution forthwith by a suit or suits in equity or at law, whether for the specific performance of any covenant therein contained, or in aid of the execution of any power therein granted, or for an accounting against the Authority as if the Authority were the trustee of an express trust, or in the enforcement of any other legal or equitable right as the Trustee, being advised by counsel, shall deem most effectual to enforce any of its rights or to perform any of its duties under the Second Resolution. During the continuance of an Event of Default, Revenues shall be applied first, to the reasonable and proper charges and expenses of the Trustee; then (unless the principal thereof shall have been declared payable) to the payment of all unpaid interest ratably, and then to unpaid principal or Redemption Price of any Bond or Parity Reimbursement Obligations, ratably; if the principal of all of the Bonds shall be due and payable, to the payment of the principal and interest then due and unpaid upon the Bonds and Parity Reimbursement Obligations and of the interest then due and unpaid on Parity Bond Anticipation Notes without preference or priority of principal over interest or of interest over principal, or of any installment of interest over any other installment of interest, or of any Bond, Parity Reimbursement Obligation or Parity Bond Anticipation Note over any other Bond, Parity Reimbursement Obligation or Parity Bond Anticipation Note, ratably, according to the amounts due respectively for principal and interest, to the persons entitled thereto without any discrimination or preference. No Bondholder has any right to institute a suit to enforce any provision of the Second Resolution or the execution of any trust thereunder or for any remedy thereunder, unless the Trustee has been requested by the holders of at least a majority in principal amount of the Bonds then Outstanding to take such action and has been offered adequate security and indemnity and has failed to commence such suit in the manner provided in the Second Resolution. The right to appoint a statutory trustee under Section 1045-p of the Act is expressly abrogated. (*Art. X*)

Defeasance of Bonds Other than Variable Rate or Option Bonds. Any Outstanding Bond shall prior to the maturity or redemption date thereof be deemed to have been paid and shall cease to be entitled to any lien, benefit or security under the Second Resolution if (i) in the case of any Bonds to be redeemed prior to their maturity, the Authority shall have given to the Trustee irrevocable instructions accepted in writing by the Trustee to publish on such date the notice of redemption therefor (other than Bonds purchased by the Trustee prior to the publication of the notice of redemption), (ii) there shall have been deposited with the Trustee either moneys in an amount sufficient, or Defeasance Obligations the principal of and the interest on which, when due, without reinvestment, will, as verified by the report of a firm of nationally recognized independent certified public accountants,⁽¹⁾ provide moneys which, together with the moneys deposited shall be sufficient, to pay when due the principal or Redemption Price (if applicable) and interest due and to become due on said Bonds and (iii) in the event said Bonds are not by their terms subject to redemption within the next succeeding 60 days, the Authority shall have given the Trustee irrevocable instructions to publish, as soon as practicable, a notice to the holders of such Bonds that the deposit required above has been made with the Trustee and that said Bonds are deemed paid in accordance with the Second Resolution and stating such maturity or redemption date upon which moneys are to be available to pay the principal or Redemption Price, if applicable, on such Bonds (other than Bonds purchased by the Trustee prior to the publication of the notice of redemption); provided that any notice published for Bonds constituting less than all of the Outstanding Bonds of any maturity within a Series shall specify the letter and number or other distinguishing mark of each such Bond. The Trustee shall, to the extent necessary, apply moneys to the retirement of said Bonds in amounts equal to the unsatisfied balances of any Sinking Fund Installments thereto.

The Trustee shall, if so directed by the Authority prior to the maturity date of Bonds deemed to have been paid which are not to be redeemed prior to their maturity date or prior to the publication of the above notice of redemption for Bonds deemed paid and to be redeemed, apply moneys deposited with the Trustee in respect of such Bonds and redeem or sell Defeasance Obligations so deposited with the Trustee and purchase such Bonds and the Trustee shall immediately thereafter cancel all such Bonds so purchased; *provided, however,* that the moneys and Defeasance Obligations remaining on deposit with the Trustee after the purchase and cancellation of such Bonds shall be sufficient to pay when due the Principal Installment or Redemption Price, if applicable, and interest due or to become due on all Bonds. (*Section 1201*)

Defeasance of Variable Rate Bonds. The Second Resolution provides that for the purposes of determining whether Variable Rate Bonds shall be deemed to have been paid prior to the maturity or redemption date thereof, by the deposit of moneys, or Defeasance Obligations and moneys (if any), the interest due on such Bonds shall be calculated at the maximum rate permitted; *provided, however,* that if, as a result of such Bonds having borne interest at less than the maximum rate for any' period, the total amount of moneys and Investment Securities on deposit with the Trustee for the payment of interest on such Bonds exceeds the total amount required to be deposited with the Trustee, the Trustee shall, if requested by the Authority, pay the amount in excess to the Authority free and clear of any lien or pledge securing the Bonds or otherwise existing under the Second Resolution. (*Section 1201*)

Defeasance of Option Bonds. Under the Second Resolution, Option Bonds shall be deemed paid in accordance with the Second Resolution only if, in addition to satisfying several of the requirements applicable to Bonds other than Variable Rate or Option Bonds, there shall have been deposited with the Trustee moneys in an amount which shall be sufficient to pay the maximum amount of principal of and premium due, if any; and interest on such Bonds which could become payable to the holders of such Bonds upon the exercise of any options provided to the holders of such Bonds; *provided, however,* that if the options originally exercisable by the holder of an Option Bond are no longer exercisable, such Bond shall not be considered an Option Bond. (*Section 1201*)

⁽¹⁾ Supplemental Resolution No. 58 provides that the verification report may be prepared by a firm of nationally recognized verification agents rather than a firm of nationally independent certified public accountants.

APPENDIX D

FINANCIAL STATEMENTS

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NEW YORK CITY WATER AND SEWER SYSTEM

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INDEPENDENT AUDITORS' REPORT

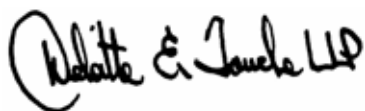
To the Audit Committees of
New York City Municipal Water Finance Authority
and the New York City Water Board:

We have audited the accompanying combining balance sheets of the business-type activities of the New York City Municipal Water Finance Authority and the New York City Water Board, which collectively comprise the New York City Water and Sewer System (the "System"), a component unit of the City of New York, New York, as of June 30, 2008, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the System for the year ended June 30, 2007 were audited by other auditors whose report, dated October 30, 2007, expressed an unqualified opinion on those statements. As discussed in Note 13, the System has restated its 2007 financial statements, including beginning balances, during the current year to adjust capital assets in conformity with accounting principles generally accepted in the United States of America. The other auditors reported on the 2007 financial statements before the restatement.

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

In our opinion, such 2008 financial statements present fairly, in all material respects, the respective financial position of the business-type activities of the New York City Municipal Water Finance Authority and the New York City Water Board of the System as of June 30, 2008, and the respective changes their net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis (MD&A) on pages 2-9 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the System's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information, and we do not express an opinion on it.



October 10, 2008

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT DISCUSSION AND ANALYSIS

Overview of the Financial Statements

The following is an overview of the financial activities of the New York City Water and Sewer System (the “System”) for the fiscal years ended June 30, 2008 and 2007. The System is a joint operation consisting of two legally separate and independent entities, the New York City Municipal Water Finance Authority (the “Authority”) and the New York City Water Board (the “Board”).

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

The 2007 financial statements have been restated, from the amounts previously reported, to reflect adjustments to utility plant in service and utility plant construction. These adjustments are described further in footnote 13 to the financial statements.

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

Financial Analysis and Results of Operations

The following summarizes the activities of the System for the years 2008, 2007 and 2006 (in thousands):

| | 2008 | 2007 | 2006 | Variance | |
|---|--------------|--------------|--------------|--------------|----------------|
| | | | | 2008 v 2007 | 2007 v 2006 |
| REVENUES: | | | | | |
| Water supply and distribution | \$ 784,856 | \$ 796,404 | \$ 735,200 | \$ (11,548) | \$ 61,204 |
| Sewer collection and treatment | 1,220,653 | 1,238,612 | 1,143,424 | (17,959) | 95,188 |
| Other operating revenues | 97,778 | 98,061 | 100,306 | (283) | (2,245) |
| Total operating revenues | 2,103,287 | 2,133,077 | 1,978,930 | (29,790) | 154,147 |
| Subsidy income | 104,234 | 90,601 | 88,447 | 13,633 | 2,154 |
| Investment income — net | 108,892 | 98,132 | 105,239 | 10,760 | (7,107) |
| Total revenues | 2,316,413 | 2,321,810 | 2,172,616 | (5,397) | 149,194 |
| EXPENSES: | | | | | |
| Operations and maintenance | 1,320,439 | 1,147,157 | 1,056,379 | 173,282 | 90,778 |
| Bad debt expense | - | 226,028 | 87,222 | (226,028) | 138,806 |
| Administration and general | 44,027 | 35,493 | 26,727 | 8,534 | 8,766 |
| Depreciation and amortization | 646,377 | 579,860 | 500,161 | 66,517 | 79,699 |
| Capital distribution | 24,619 | 33,133 | - | (8,514) | 33,133 |
| Loss on retirement of fixed assets | 14,598 | 23,257 | 7,046 | (8,659) | 16,211 |
| Interest expense | 834,085 | 771,656 | 731,563 | 62,429 | 40,093 |
| Total expenses | 2,884,145 | 2,816,584 | 2,409,098 | 67,561 | 407,486 |
| Net loss before capital contributions (distributions) | (567,732) | (494,774) | (236,482) | (72,958) | (258,292) |
| CAPITAL CONTRIBUTIONS | 7,340 | 12,357 | (19,241) | (5,017) | 31,598 |
| CHANGE IN NET ASSETS | (560,392) | (482,417) | (255,723) | (77,975) | (226,694) |
| NET ASSETS — Beginning | 1,726,283 | 2,899,381 | 3,155,104 | (1,173,098) | (255,723) |
| Prior period adjustment | - | (690,681) | - | 690,681 | (690,681) |
| NET ASSETS — Ending | \$ 1,165,891 | \$ 1,726,283 | \$ 2,899,381 | \$ (560,392) | \$ (1,173,098) |

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

Operating Revenue

2008–2007

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

2007–2006

Total operating revenues increased by 7.8%, principally from a rate increase of 9.4%.

The following summarizes other operating revenues (in thousands):

| | 2008 | 2007 | 2006 | Variance | |
|---------------------------------|-----------------|-----------------|------------------|-----------------|------------------|
| | | | | 2008 v 2007 | 2007 v 2006 |
| Upstate water fees | \$45,978 | \$42,197 | \$ 42,693 | \$ 3,781 | \$ (496) |
| Late payment fees | 24,261 | 43,286 | 45,519 | (19,025) | (2,233) |
| Residual interest in sold liens | 16,896 | - | - | 16,896 | - |
| Connection fees and permits | <u>10,643</u> | <u>12,578</u> | <u>12,094</u> | <u>(1,935)</u> | <u>484</u> |
| Total other operating revenues | <u>\$97,778</u> | <u>\$98,061</u> | <u>\$100,306</u> | <u>\$ (283)</u> | <u>\$(2,245)</u> |

2008–2007

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

The System implemented GASB 48 in fiscal year 2008, which resulted in the recording of a miscellaneous revenue and an asset, residual interest in sold liens, of \$16.9 million. This represents the estimated amount, as of June 30, 2008, to be received by the Board for tax liens secured by water and sewer rents and surcharges which have been sold by the City to one or more trusts, if and when liens held by the trusts generate cash flows to the trusts above the amounts needed by the trusts to pay their bondholders and satisfy reserve requirements.

2007–2006

Other operating revenues have remained relatively level for 2007.

Investment Income

2008–2007

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

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

Investment Income (continued)

2007-2006

Investment income decreased by \$7 million or 7%, primarily due to reduced average balances in escrow balances, less unrealized gains on investments and swap payments.

Operating Expenses

2008-2007

Total operation and maintenance expenses increased by \$173 million or 15%. Judgments and claims increased by \$37 million primarily due to a pending judgment for missing construction deadlines pursuant to a consent agreement. Also fringe benefits increased by \$37 million reflecting the increased cost of employee benefits for City workers which is a component of the operations and maintenance cost paid by the System.

Bad debt expense decreased by \$226 million or 100% as a result of increased collection and enforcement efforts.

2007-2006

Total operation and maintenance expense increased by \$91 million or 9%. Key components of the changes are the rental payment to the City increased by \$13 million; judgments and claims increased by \$23 million. All other operations and maintenance costs increased by \$47 million or 6%.

Bad debt expense increased by \$139 million. The System had not collected current and past-due receivables.

Non-operating Expenses

2008-2007

Interest expense increased by \$62.4 million or 13% due to an increase in bonds outstanding of \$1.9 billion or 11.3%.

2007-2006

Interest expense increased by \$40 million or 5%. Total debt of the System had increased by \$1.9 billion or 12%.

In 2007, the System granted back to the City land that had been purchased with bond proceeds. The total grant was \$33 million.

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

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

| | 2008 | 2007 | 2006 | Variance | |
|--|---------------------|---------------------|---------------------|---------------------|--------------------|
| | | | | 2008 v 2007 | 2007 v 2006 |
| CURRENT ASSETS | \$ 2,091,480 | \$ 2,075,754 | \$ 1,954,277 | \$ 15,726 | \$ 121,477 |
| RESIDUAL INTEREST IN SOLD LIENS | 16,896 | - | - | 16,896 | - |
| DEFERRED BOND AND FINANCING EXPENSE | 137,508 | 134,673 | 130,728 | 2,835 | 3,945 |
| CAPITAL ASSETS | <u>19,347,150</u> | <u>17,745,015</u> | <u>17,155,603</u> | <u>1,602,135</u> | <u>589,412</u> |
| TOTAL ASSETS | <u>\$21,593,034</u> | <u>\$19,955,442</u> | <u>\$19,240,608</u> | <u>\$ 1,637,592</u> | <u>\$ 714,834</u> |
| LONG-TERM LIABILITIES | \$18,668,133 | \$16,691,440 | \$15,306,834 | 1,976,693 | \$1,384,606 |
| CURRENT LIABILITIES | <u>1,759,010</u> | <u>1,537,719</u> | <u>1,034,393</u> | <u>221,291</u> | <u>503,326</u> |
| Total liabilities | <u>20,427,143</u> | <u>18,229,159</u> | <u>16,341,227</u> | <u>2,197,984</u> | <u>1,887,932</u> |
| NET ASSETS: | | | | | |
| Invested in capital assets — net of related debt | 1,737,181 | 2,056,879 | 2,556,766 | (319,698) | (499,887) |
| Restricted for debt service | 209,130 | 161,661 | 171,859 | 47,469 | (10,198) |
| Restricted for operations and maintenance | 200,438 | 175,161 | 157,806 | 25,277 | 17,355 |
| Unrestricted (deficit) | <u>(980,858)</u> | <u>(667,418)</u> | <u>12,950</u> | <u>(313,440)</u> | <u>(680,368)</u> |
| Total net assets | <u>1,165,891</u> | <u>1,726,283</u> | <u>2,899,381</u> | <u>(560,392)</u> | <u>(1,173,098)</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$21,593,034</u> | <u>\$19,955,442</u> | <u>\$19,240,608</u> | <u>\$ 1,637,592</u> | <u>\$ 714,834</u> |

2008–2007

Current assets have remained level.

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

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

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

2007–2006

Current assets increased by \$122 million or 6%. This increase was due to construction funds on deposit at June 30, 2007.

Total liabilities have increased by \$1.9 billion, which was due to the increase in bonds payable.

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

Capital Assets

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

| | 2008 | 2007 | 2006 | Variance | |
|--|--------------|--------------|--------------|--------------|--------------|
| | | | | 2008 v 2007 | 2007 v 2006 |
| Utility plant under construction | \$ 4,011,216 | \$ 4,338,126 | \$ 4,546,209 | \$ (326,910) | \$ (208,083) |
| Buildings | 23,493 | 23,493 | 22,266 | - | 1,227 |
| Equipment | 953,311 | 629,384 | 472,034 | 323,927 | 157,350 |
| Water supply and wastewater treatment systems | 13,629,051 | 11,865,211 | 10,886,477 | 1,763,840 | 978,734 |
| Water distribution and sewage collection systems | 8,408,040 | 8,014,647 | 7,844,126 | 393,393 | 170,521 |
| Total utility plant in service | 23,013,895 | 20,532,735 | 19,224,903 | 2,481,160 | 1,307,832 |
| Less accumulated depreciation | 7,677,961 | 7,125,846 | 6,615,509 | 552,115 | 510,337 |
| Total — net utility plant in service | 15,335,934 | 13,406,889 | 12,609,394 | 1,929,045 | 797,495 |
| Total capital assets | \$19,347,150 | \$17,745,015 | \$17,155,603 | \$1,602,135 | \$ 589,412 |

The net increase in the System's capital assets during fiscal year 2008 was \$ 1.602 billion or 9%. Net capital asset additions for 2008 were \$2.154 billion.

The net increase in the System's capital assets during fiscal year 2007 was \$589 million or 3%. Net capital asset additions for 2007 were \$1.099 billion offset by adjustments of prior period of \$690.7 million.

Debt Administration

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

At June 30, 2008, the total outstanding debt of the System was \$20.0 billion, of which \$800 million was commercial paper. The remaining \$19.2 billion consisted of variable and fixed-rate bonds and notes maturing in varying installments through 2039. The total outstanding long-term debt at June 30, 2008 was as follows (in thousands):

| Issue Date | |
|----------------------|---------------------|
| 2008 | \$ 3,273,085 |
| 2007 | 2,193,644 |
| 2006 | 2,561,612 |
| 2005 | 2,770,436 |
| 2004 | 1,651,520 |
| 2003 and prior | 6,768,640 |
| Total long-term debt | <u>\$19,218,937</u> |

In the summary above, bonds retired through refundings in 2008 are removed from the year in which the refunded bonds were issued and the refunding bonds are included in the 2008 amount.

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

In fiscal year 2008, the Authority issued \$2.78 billion of water and sewer revenue bonds directly to the public, including \$1.03 billion of refunding bonds and \$1.75 billion of new money bonds. The Authority also issued \$495.6 million of Clean Water and Drinking Water State Revolving Fund (“SRF”) bonds to EFC, of which \$399.7 million were issued for new money purposes and \$95.9 million were issued for refunding purposes. The new money bond proceeds were used to finance capital improvements to New York City’s water and sewer system as well as to provide long-term financing of commercial paper notes which had previously financed capital improvements to the system.

On September 17, 2007, the Authority converted from a variable rate mode to an auction rate mode a combined par of \$683.7 million of its Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 1993 Series C, Fiscal 1994 Series C, Fiscal 1994 Series G and Fiscal 1995 Series A. These four series of bonds were insured by Financial Guaranty Insurance Company at the time of their initial offering. Each of the converted series of bonds except the Fiscal 1993 Series C were broken into two sub-series.

On October 10, 2007, the Authority closed its first new money offering of fiscal year 2008. The Authority issued \$400 million of tax-exempt, fixed rate Fiscal 2008 Series AA bonds under the Authority’s second general resolution and the issue included term bonds maturing in 2027, 2033, 2037 and 2039. Bond proceeds were used to defease the Authority’s commercial paper Series 5 and Series 7 notes and to pay the costs of issuance of the bonds. A portion of the Fiscal 2008 Series AA bonds are insured by Financial Guaranty Insurance Company.

On October 24, 2007, the Authority issued \$753.2 million of tax-exempt adjustable rate second general resolution bonds, including \$401 million of Fiscal 2008 Series BB variable rate demand bonds and \$352.2 million of Fiscal 2008 Series CC auction rate bonds. Of the total variable-rate demand bonds issued, \$250 million were offered in the daily reset mode and \$151 million in the weekly reset mode. Additionally, the variable-rate demand bonds were issued in five subseries (BB-1 through BB-5) with five different remarketing agents chosen to remarket these bonds. However, currently only four banks remarket these bonds. Proceeds of the Fiscal 2008 Series BB bonds were used to defease the Authority’s commercial paper Series 1 and Series 6 notes. The Fiscal 2008 Series CC bonds, issued in four subseries (CC-1 through CC-4), refunded the Authority’s Fiscal 1998 Series A and Series C bonds and are insured by MBIA Inc. A portion of the proceeds from both series were also used to pay the costs of issuance.

On December 11, 2007, the Authority sold \$446.2 million of tax-exempt, fixed rate, first resolution Fiscal 2008 Series A bonds. The bonds included a single term bond maturing in 2038. Proceeds from this offering were used to defease the Authority’s commercial paper Series 1 and Series 6 notes and a portion of its Series 7 notes. Additionally, proceeds were applied to fund a portion of the debt service reserve fund and to pay costs of issuance.

In December 2007, constrained liquidity in the auction rate market, precipitated by credit rating downgrades of several financial guarantors led to a substantial rise in interest rates for the Authority’s auction rate securities. In response, on March 19, 2008, the Authority issued \$535 million of first resolution Adjustable Rate Fiscal 2008 Series B bonds and \$144.9 million of first resolution, fixed-rate Fiscal 2008 Series C bonds to refund its four series of bonds converted into the auction rate mode on September 17, 2007. The variable rate demand bonds were issued in four subseries (subseries B-1, B-2, B-3 and B-4) with four different remarketing agents chosen to remarket these bonds. Additionally, \$300 million of the variable rate demand bonds were offered in the weekly reset mode and \$235 million were offered in the daily reset mode.

NEW YORK CITY WATER AND SEWER SYSTEM

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

On May 22, 2008, the Authority issued Second General Resolution Fiscal 2008 Series 1 and Series 2 bonds to EFC in the respective par amounts of \$270.9 million and \$224.7 million. The Fiscal Series 1 bonds included \$95.9 million issued to refund a portion of the Authority's Fiscal 1998 Series 6 and a portion of its Fiscal 1999 Series 2 bonds. Proceeds of the new money portion of the Fiscal 2008 Series 1 and Fiscal 2008 Series 2 bonds were used to defease the Authority's commercial paper Series 7 notes and a portion of the Authority's Series 5 notes. Proceeds were also used to pay the costs of issuance of the bonds.

On June 5, 2008, NYW issued \$504.9 million of Second General Resolution Fiscal 2008 Series DD bonds. The bonds included term bonds maturing in 2031, 2032, 2037, 2038 and 2039. Proceeds from the Fiscal 2008 Series DD bonds were used to defease the Authority's commercial paper Series 1 notes, to finance capital improvements to the water and sewer system and to pay the costs of issuance of the bonds. A portion of the Fiscal 2008 Series DD bonds are insured by Financial Security Assurance, Inc.

The credit markets in the United States are experiencing a period of volatility and instability. Certain adjustable rate debt instruments issued by the Authority contain provisions that allow holders of the instruments to put the instruments back to the Authority. The Authority relies on its remarketing agents to remarket this debt and should the agent be unable to remarket this debt, the Authority has in place liquidity facilities from banks to support this debt. The Authority has on occasion drawn on its liquidity facilities because of recent unsuccessful remarketing of its debt.

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

Economic Factors and Next Year's Rates

Rates are adopted each year by the Board in May for the following fiscal year. A rate increase of 11.5% for fiscal 2008 became effective July 1, 2007 based on projected revenues and costs.

Request for Information

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

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING BALANCE SHEET

JUNE 30, 2008

(In thousands)

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

See notes to combining financial statements.

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING BALANCE SHEET

JUNE 30, 2008

(In thousands)

| | New York City | | Eliminations | Total |
|--|----------------------|-----------------------------------|------------------------|----------------------|
| | Water Board | Municipal Water Finance Authority | | |
| LIABILITIES AND NET ASSETS | | | | |
| LONG-TERM LIABILITIES: | | | | |
| Bonds and notes payable — less current portion | \$ - | \$ 18,983,922 | \$ - | \$ 18,983,922 |
| Net discount on bonds and notes payable | - | 26,377 | - | 26,377 |
| Deferred bond refunding costs | - | (342,166) | - | (342,166) |
| Revenue requirements payable to the Authority | <u>10,880,165</u> | <u>-</u> | <u>(10,880,165)</u> | <u>-</u> |
| Total long-term liabilities | <u>10,880,165</u> | <u>18,668,133</u> | <u>(10,880,165)</u> | <u>18,668,133</u> |
| CURRENT LIABILITIES: | | | | |
| Accounts payable and accrued expenses | 79,032 | 34,457 | - | 113,489 |
| Revenues received in advance | 74,676 | - | - | 74,676 |
| Commercial paper payable | - | 800,000 | - | 800,000 |
| Current portion of bonds and notes payable | - | 235,015 | - | 235,015 |
| Payable to the City of New York | - | 518,467 | - | 518,467 |
| Refunds payable to customers | <u>17,363</u> | <u>-</u> | <u>-</u> | <u>17,363</u> |
| Total current liabilities | <u>171,071</u> | <u>1,587,939</u> | <u>-</u> | <u>1,759,010</u> |
| Total liabilities | <u>11,051,236</u> | <u>20,256,072</u> | <u>(10,880,165)</u> | <u>20,427,143</u> |
| NET ASSETS: | | | | |
| Invested in capital assets — net of related debt | 19,347,150 | (17,609,969) | - | 1,737,181 |
| Restricted for debt service | - | 209,130 | - | 209,130 |
| Restricted for operations and maintenance | 200,438 | - | - | 200,438 |
| Unrestricted (deficit) | <u>(10,623,218)</u> | <u>9,642,360</u> | <u>-</u> | <u>(980,858)</u> |
| Total net assets | <u>8,924,370</u> | <u>(7,758,479)</u> | <u>-</u> | <u>1,165,891</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$ 19,975,606</u> | <u>\$ 12,497,593</u> | <u>\$ (10,880,165)</u> | <u>\$ 21,593,034</u> |

See notes to combining financial statements.

(Concluded)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING BALANCE SHEET

JUNE 30, 2007

(In thousands)

| | New York City | | Eliminations | Total |
|---|----------------------|-----------------------------------|-----------------------|----------------------|
| | Water Board | Municipal Water Finance Authority | | |
| ASSETS | | | | |
| CURRENT ASSETS: | | | | |
| Cash and cash equivalents | \$ 104,932 | \$ 1,070,154 | - | \$ 1,175,086 |
| Investments | 83,406 | 350,944 | - | 434,350 |
| Accrued interest receivable | 145 | 2,969 | - | 3,114 |
| Accounts receivable: | | | | |
| Billed — less allowance for uncollectible water and sewer receivables of \$ 213,840 | 278,176 | - | - | 278,176 |
| Unbilled | 169,310 | - | - | 169,310 |
| Receivable from the City of New York | 15,718 | - | - | 15,718 |
| Other | - | - | - | - |
| Total current assets | <u>651,687</u> | <u>1,424,067</u> | <u>-</u> | <u>2,075,754</u> |
| UTILITY PLANT IN SERVICE — Less accumulated depreciation of \$7,125,846 | 13,406,889 | - | - | 13,406,889 |
| UTILITY PLANT CONSTRUCTION | <u>4,338,126</u> | <u>-</u> | <u>-</u> | <u>4,338,126</u> |
| | 17,745,015 | - | - | 17,745,015 |
| REVENUE REQUIREMENT TO BE BILLED BY AND RECEIVED FROM THE BOARD | - | 9,479,193 | (9,479,193) | - |
| LONG-TERM DEFERRED BOND AND FINANCING EXPENSES | <u>-</u> | <u>134,673</u> | <u>-</u> | <u>134,673</u> |
| Total non current assets | <u>17,745,015</u> | <u>9,613,866</u> | <u>(9,479,193)</u> | <u>17,879,688</u> |
| TOTAL ASSETS | <u>\$ 18,396,702</u> | <u>\$ 11,037,933</u> | <u>\$ (9,479,193)</u> | <u>\$ 19,955,442</u> |

See notes to combining financial statements.

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING BALANCE SHEET

JUNE 30, 2007

(In thousands)

| | New York City | | Eliminations | Total |
|--|----------------------|-----------------------------------|-----------------------|----------------------|
| | Water Board | Municipal Water Finance Authority | | |
| LIABILITIES AND NET ASSETS | | | | |
| LONG-TERM LIABILITIES: | | | | |
| Bonds and notes payable — less current portion | \$ - | \$ 17,060,213 | \$ - | \$ 17,060,213 |
| Net discount on bonds and notes payable | - | (13,838) | - | (13,838) |
| Deferred bond refunding costs | - | (354,935) | - | (354,935) |
| Revenue requirements payable to the Authority | 9,479,193 | - | (9,479,193) | - |
| Total long-term liabilities | 9,479,193 | 16,691,440 | (9,479,193) | 16,691,440 |
| CURRENT LIABILITIES: | | | | |
| Accounts payable and accrued expenses | 34,110 | 43,397 | - | 77,507 |
| Revenues received in advance | 73,727 | - | - | 73,727 |
| Commerical paper payable | - | 800,000 | - | 800,000 |
| Current portion of bonds and notes payable | - | 210,971 | - | 210,971 |
| Payable to the City of New York | - | 361,860 | - | 361,860 |
| Refunds payable to customers | 13,654 | - | - | 13,654 |
| Total current liabilities | 121,491 | 1,416,228 | - | 1,537,719 |
| Total liabilities | 9,600,684 | 18,107,668 | (9,479,193) | 18,229,159 |
| NET ASSETS: | | | | |
| Invested in capital assets — net of related debt | 17,745,015 | (15,688,136) | - | 2,056,879 |
| Restricted for debt service | - | 161,661 | - | 161,661 |
| Restricted for operations and maintenance | 175,161 | - | - | 175,161 |
| Unrestricted (deficit) | (9,124,158) | 8,456,740 | - | (667,418) |
| Total net assets | 8,796,018 | (7,069,735) | - | 1,726,283 |
| TOTAL LIABILITES AND NET ASSETS | \$ 18,396,702 | \$ 11,037,933 | \$ (9,479,193) | \$ 19,955,442 |

See notes to combining financial statements.

(Concluded)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2008

(In thousands)

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

See notes to combining financial statements.

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2007

(In thousands)

| | New York City | | Total |
|--|---------------------|-----------------------------------|---------------------|
| | Water Board | Municipal Water Finance Authority | |
| OPERATING REVENUES: | | | |
| Water supply and distribution | \$ 796,404 | \$ - | \$ 796,404 |
| Sewer collection and treatment | 1,238,612 | - | 1,238,612 |
| Other operating revenues | 98,061 | - | 98,061 |
| Total operating revenues | <u>2,133,077</u> | <u>-</u> | <u>2,133,077</u> |
| OPERATING EXPENSES: | | | |
| Operation and maintenance | 1,147,157 | - | 1,147,157 |
| Bad debt expense | 226,028 | - | 226,028 |
| Administration and general | 16,996 | 18,497 | 35,493 |
| Total operating expenses | <u>1,390,181</u> | <u>18,497</u> | <u>1,408,678</u> |
| DEPRECIATION AND AMORTIZATION | <u>535,530</u> | <u>44,330</u> | <u>579,860</u> |
| OPERATING INCOME | 207,366 | (62,827) | 144,539 |
| NONOPERATING REVENUE (EXPENSES): | | | |
| Interest expense | - | (771,656) | (771,656) |
| Loss on retirement of fixed assets | (23,257) | - | (23,257) |
| Subsidy income | - | 90,601 | 90,601 |
| Capital distribution | (33,133) | - | (33,133) |
| Investment income | 4,380 | 93,752 | 98,132 |
| NET INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS | 155,356 | (650,130) | (494,774) |
| CAPITAL CONTRIBUTIONS | <u>12,357</u> | <u>-</u> | <u>12,357</u> |
| CHANGE IN NET ASSETS | 167,713 | (650,130) | (482,417) |
| NET ASSETS — Beginning of year | 9,318,986 | (6,419,605) | 2,899,381 |
| Prior period adjustment | <u>(690,681)</u> | <u>-</u> | <u>(690,681)</u> |
| NET ASSETS — End of year | <u>\$ 8,796,018</u> | <u>\$ (7,069,735)</u> | <u>\$ 1,726,283</u> |

See notes to combining financial statements.

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF CASH FLOWS YEAR ENDED JUNE 30, 2008 (In thousands)

| | <u>New York City</u> | | Total |
|---|--------------------------|-----------------------------------|----------------------------|
| | Water Board | Municipal Water Finance Authority | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Receipts from customers | \$ 2,166,236 | \$ - | \$ 2,166,236 |
| Payments for operations and maintenance | (1,209,396) | - | (1,209,396) |
| Payments for administration | (28,429) | (21,799) | (50,228) |
| Net cash provided by (used in) operating activities | <u>928,411</u> | <u>(21,799)</u> | <u>906,612</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES: | | | |
| Proceeds from issuing bonds, notes and other borrowings — net of issuance costs | - | 5,328,296 | 5,328,296 |
| Acquisition and construction of capital assets | - | (2,149,092) | (2,149,092) |
| Payments by the Board to the Authority | (904,726) | 904,726 | - |
| Repayments of bonds, notes and other borrowings | - | (3,381,124) | (3,381,124) |
| Interest paid on bonds, notes and other borrowings | - | (726,864) | (726,864) |
| Net cash used in capital and related financing activities | <u>(904,726)</u> | <u>(24,058)</u> | <u>(928,785)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Proceeds from sales and maturities of investments | 83,405 | 17,746 | 101,151 |
| Purchases of investments | (89,241) | - | (89,241) |
| Interest on investments | 3,203 | 81,375 | 84,578 |
| Net cash (used in) provided by investing activities | <u>(2,633)</u> | <u>99,121</u> | <u>96,488</u> |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | 21,052 | 53,263 | 74,315 |
| CASH AND CASH EQUIVALENTS — Beginning of year | <u>104,932</u> | <u>1,070,154</u> | <u>1,175,086</u> |
| CASH AND CASH EQUIVALENTS — End of year | <u>\$ 125,984</u> | <u>\$ 1,123,417</u> | <u>\$ 1,249,401</u> |

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2008

(In thousands)

| | <u>New York City</u> | | Total |
|---|----------------------|-----------------------------------|-------------------|
| | Water Board | Municipal Water Finance Authority | |
| RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | | |
| Operating income | \$ 156,060 | \$ (63,616) | \$ 92,444 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 604,437 | 41,940 | 646,377 |
| Operations and maintenance expense paid for with bond proceeds | 67,249 | - | 67,249 |
| Changes in net assets and liabilities: | | | |
| Receivables — net | 75,189 | - | 75,189 |
| Receivable from the City | (7,207) | - | (7,207) |
| Residual interest in sold liens | (16,896) | - | (16,896) |
| Accounts payable | 44,922 | (123) | 44,799 |
| Revenues received in advance | 948 | - | 948 |
| Refunds payable | 3,709 | - | 3,709 |
| | <u>928,411</u> | <u>(21,799)</u> | <u>906,612</u> |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | <u>\$ 928,411</u> | <u>\$ (21,799)</u> | <u>\$ 906,612</u> |

The following are the noncash capital and related financing activities:

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

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

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

See notes to combining financial statements.

(Concluded)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2007

(In thousands)

| | <u>New York City</u> | | Total |
|---|----------------------|-----------------------------------|---------------------|
| | Water Board | Municipal Water Finance Authority | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Receipts from customers | \$ 1,917,152 | \$ - | \$ 1,917,152 |
| Payments for operations and maintenance | (1,071,086) | - | (1,071,086) |
| Payments for administration | <u>(10,291)</u> | <u>(19,204)</u> | <u>(29,495)</u> |
| Net cash provided by (used in) operating activities | <u>835,775</u> | <u>(19,204)</u> | <u>816,571</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES: | | | |
| Proceeds from issuing bonds, notes and other borrowings — net of issuance costs | - | 4,103,578 | 4,103,578 |
| Acquisition and construction of capital assets | (20,000) | (1,865,902) | (1,885,902) |
| Payments by the Board to the Authority | (798,763) | 798,763 | - |
| Repayments of bonds, notes and other borrowings | - | (2,329,510) | (2,329,510) |
| Interest paid on bonds, notes and other borrowings | <u>-</u> | <u>(671,831)</u> | <u>(671,831)</u> |
| Net cash used in capital and related financing activities | <u>(818,763)</u> | <u>35,098</u> | <u>(783,665)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Proceeds from sales and maturities of investments | 78,655 | 147,644 | 226,299 |
| Purchases of investments | (83,303) | (66,303) | (149,606) |
| Interest on investments | <u>4,845</u> | <u>93,683</u> | <u>98,528</u> |
| Net cash provided by investing activities | <u>197</u> | <u>175,024</u> | <u>175,221</u> |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | 17,209 | 190,918 | 208,127 |
| CASH AND CASH EQUIVALENTS — Beginning of year | <u>87,723</u> | <u>879,236</u> | <u>966,959</u> |
| CASH AND CASH EQUIVALENTS — End of year | <u>\$ 104,932</u> | <u>\$ 1,070,154</u> | <u>\$ 1,175,086</u> |

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2007

(In thousands)

| | <u>New York City</u> | | Total |
|---|----------------------|-----------------------------------|-------------------|
| | Water Board | Municipal Water Finance Authority | |
| RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | | |
| Operating income | \$ 207,366 | \$ (62,827) | \$ 144,539 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 535,530 | 44,330 | 579,860 |
| Bad debt expense | 226,028 | - | 226,028 |
| Operations and maintenance expense paid for with bond proceeds | 61,983 | - | 61,983 |
| Changes in net assets and liabilities: | | | |
| Receivables — net | (210,020) | - | (210,020) |
| Receivable from the City | (7,212) | - | (7,212) |
| Other | - | (1,284) | (1,284) |
| Accounts payable and accrued expenses | 28,008 | 577 | 28,585 |
| Revenues received in advance | (4,753) | - | (4,753) |
| Refunds payable to customers | (1,155) | - | (1,155) |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | <u>\$ 835,775</u> | <u>\$ (19,204)</u> | <u>\$ 816,571</u> |

The following are the noncash capital and related financing activities:

Interest expense includes the amortization of premium and discount in the amount of (\$3,106) in 2007.

Capital expenditures in the amount of \$361,860 had been incurred but not paid at June 30, 2007.

The Board received capital assets of \$12,357 in 2007, which represented capital contributed by the City.

See notes to combining financial statements.

(Concluded)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

1. ORGANIZATION

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the System have been prepared on the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. Private sector standards of accounting and financial reporting issued by the Financial Accounting Standards Board (“FASB”) prior to December 1, 1989 are followed by the System to the extent that those

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

standards do not conflict with or contradict guidance of GASB. GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Government Entities that Use Proprietary Fund Accounting*, provides the option to follow subsequent FASB standards, subject to the same limitation. The System has elected to follow GASB pronouncements exclusively after that date. Other significant accounting policies are:

Investments and Cash Equivalents — Investments and cash equivalents consist principally of securities of the United States and its agencies, certificates of deposit, guaranteed investment contracts, and repurchase agreements. Investments with maturity periods of greater than one year are carried at market value. Investments with maturities less than one year are carried at cost which approximates fair value. For purposes of the statements of cash flows, the System generally considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

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

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

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

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

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

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

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

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

Newly Adopted Standards and Standards Issued But Not Yet Effective — In September 2006 GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. The Statement established criteria to ascertain whether certain transactions should be regarded as sales or collateralized borrowings, and provides guidance for the reporting and disclosures required when governmental entities have such transactions. The System implemented GASB 48 in fiscal year 2008, which resulted in the recording of a residual interest in sold liens of \$16.9 million as of June 30, 2008. This represents the estimated amount to be received by the Board for tax liens secured by water and sewer rents and surcharges which have been sold by the City to one or more trusts, if and when liens held by the trusts generate cash flows to the trusts above the amounts needed by the trusts to pay their bondholders and satisfy reserve requirements.

In November 2006 GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. The Statement established accounting and financial reporting standards for obligations to address current or potential detrimental effects of existing pollution. GASB 49 is effective for financial statements for periods beginning after December 15, 2007, and thus will be implemented by the System for its fiscal year 2009. The System has not completed the process of evaluating the impact of GASB 49 on its financial statements.

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

In June 2007 GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that intangible assets generally be classified as capital assets and established guidance pertaining to the recognition, valuation and amortization of such assets. GASB 51

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

is effective for financial statements for periods beginning after June 15, 2009. The System had not completed the process of evaluating the impact of GASB 51 on its financial statements.

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

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

3. UTILITY PLANT

The following is a summary of utility plant activity for the fiscal years ended June 30, 2008 and 2007 as adjusted as per Footnote 13 (in thousands):

| | Balance at June 30, 2006 | Additions | Deletions | Balance at June 30, 2007 | Additions | Deletions | Balance at June 30, 2008 |
|--|-----------------------------|-------------|-------------|-----------------------------|-------------|-------------|-----------------------------|
| Nondepreciable assets: | | | | | | | |
| Utility construction | \$ 4,546,209 | \$1,933,996 | \$2,142,079 | \$ 4,338,126 | \$2,313,039 | \$2,639,949 | \$ 4,011,216 |
| Land | | | | | | | |
| Depreciable assets: | | | | | | | |
| Buildings | 22,266 | 1,227 | - | 23,493 | - | - | 23,493 |
| Equipment | 472,034 | 162,341 | 4,991 | 629,384 | 326,405 | 2,478 | 953,311 |
| Water supply and wastewater treatment systems | 10,886,477 | 1,241,396 | 262,662 | 11,865,211 | 1,787,249 | 23,409 | 13,629,051 |
| Water distribution and sewage collection systems | 7,844,126 | 213,980 | 43,459 | 8,014,647 | 434,426 | 41,033 | 8,408,040 |
| | 23,771,112 | 3,552,940 | 2,453,191 | 24,870,861 | 4,861,119 | 2,706,869 | 27,025,111 |
| Less accumulated depreciation | 6,615,509 | 535,530 | 25,193 | 7,125,846 | 604,437 | 52,322 | 7,677,961 |
| Total utility plant | \$17,155,603 | \$3,017,410 | \$2,427,998 | \$17,745,015 | \$4,256,682 | \$2,654,547 | \$19,347,150 |

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

4. INVESTMENTS AND CASH DEPOSITS

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

Cash Deposits — The System follows the New York City Banking Commission designations for the System's bank depositories. The Commission consists of the Comptroller, the Mayor, and the Finance Commissioner of the City and uses independent bank rating agencies in part to assess the financial soundness of each bank, and the banking relationships are under constant operational and credit reviews. Each bank in which the System's cash is deposited is required to have its principal office in New York State and have capital stock, surplus, and undivided earnings aggregating at least \$100 million. The System had \$200 thousand on deposit at June 30, 2007 and 2006, which was covered by Federal depository insurance and the remaining balance was uncollateralized.

At June 30, 2008 and 2007, the carrying amounts of bank deposits were \$16.0 million and \$20.7 million, respectively, and the bank balances were \$17.8 million and \$21.9 million, respectively.

The System had the following investments and maturities (in thousands):

| Investment Type | 2008 | 2007 | Investment Maturity |
|---------------------------------|--------------------|--------------------|-----------------------|
| Certificate of Deposit | \$ - | \$ 104 | Greater than one year |
| U.S. Government securities | 1,368,217 | 1,232,617 | Less than one year |
| New York State securities | 78,465 | 77,474 | Greater than one year |
| Repurchase agreements | 3,000 | 70,345 | Less than one year |
| Guaranteed investment contracts | 215,480 | 211,315 | Greater than one year |
| FPA Market Adjustment | 15,090 | - | Greater than one year |
| | <u>\$1,680,252</u> | <u>\$1,591,855</u> | |

All of the System's investments in U.S. agencies carry the explicit guarantee of the U.S. Government. At June 30, 2008 and 2007, the System's investment in New York State securities was rated AAA by Standard & Poor's and Aaa by Moody's investment services. The System's investments in guaranteed investment contracts are not rated.

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The System's investments, other than repurchase agreements, are not

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

4. INVESTMENTS AND CASH DEPOSITS (CONTINUED)

collateralized. All investments and collateral are held in the Authority's name by the trustee or in the Board's name by the agent.

5. LEASE AGREEMENT

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

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

In addition to the payments described above, the Board pays rent to the City in each fiscal year in an amount not to exceed the greater of (a) the principal and interest payable on general obligation bonds issued by the City for water and sewer purposes certified by the City to be paid within such fiscal year or (b) 15% of principal and interest payable on the bonds of the Authority to be paid within such fiscal year. A summary of operation and maintenance expenses for the years ended June 30, 2008 and 2007 is as follows (in thousands):

| | 2008 | 2007 |
|-------------------------------------|---------------------|---------------------|
| Water transmission and distribution | \$ 381,011 | \$ 339,854 |
| Sewer collection systems | 458,021 | 413,837 |
| City agency support cost | 58,692 | 57,304 |
| Fringe benefits | 147,593 | 110,687 |
| Payments for watershed improvements | 67,249 | 61,983 |
| Judgments and claims | 68,088 | 31,232 |
| | <u>1,180,654</u> | <u>1,014,897</u> |
| Rental payments to the City | <u>139,785</u> | <u>132,260</u> |
| | <u>\$ 1,320,439</u> | <u>\$ 1,147,157</u> |

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

6. PAYABLE TO AND RECEIVABLE FROM THE CITY

As of June 30, 2008 and 2007, all utility construction recorded by the System, which has not been reimbursed to the City has been recorded as a payable to the City, net of the amount of any State or Federal capital grants received by the City.

As of June 30, 2008 and 2007, the System had a net payable of \$495.5 million and \$346.1 million, respectively, from the City for payments of utility construction and for overpayment of operations and maintenance expense.

7. SHORT-TERM LIABILITIES

In fiscal years 2008 and 2007, the changes in short-term liabilities were as follows (in thousands):

| | Balance at June 30, 2006 | Additions | Deletions | Balance at June 30, 2007 | Additions | Deletions | Balance at June 30, 2008 |
|----------------------|--------------------------------|--------------|--------------|--------------------------------|--------------|--------------|--------------------------------|
| Commercial paper (1) | \$ 351,000 | \$ 2,059,000 | \$ 1,610,000 | \$ 800,000 | \$ 2,040,000 | \$ 2,040,000 | \$ 800,000 |

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

Commercial paper activity comprises the following for the year ended June 30, 2008 (in thousands):

| | Balance at June 30, 2007 | Issued | Retired | Balance at June 30, 2008 |
|---|--------------------------------|---------------------|---------------------|--------------------------------|
| Commercial Paper Series 1 — Variable Rate, Short-term Rolling Maturity Backed by Letter of Credit | \$ 200,000 | \$ 600,000 | \$ 600,000 | \$ 200,000 |
| Commercial Paper Series 5 — Variable Rate, Short-term Rolling Maturity Backed by Line of Credit | 200,000 | 400,000 | 400,000 | 200,000 |
| Commercial Paper Series 6 — Variable Rate, Short-term Rolling Maturity Backed by Line of Credit | 200,000 | 600,000 | 600,000 | 200,000 |
| Commercial Paper Series 7 — Variable Rate, Short-term Rolling Maturity | <u>200,000</u> | <u>440,000</u> | <u>440,000</u> | <u>200,000</u> |
| Total commercial paper payable | <u>\$ 800,000</u> | <u>\$ 2,040,000</u> | <u>\$ 2,040,000</u> | <u>\$ 800,000</u> |

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

8. LONG-TERM LIABILITIES

In fiscal years 2008 and 2007, the changes in long-term liabilities were as follows (in thousands):

| Bonds Payable | Balance at June 30, 2006 | Additions | Deletions | Balance at June 30, 2007 | Additions | Deletions | Balance at June 30, 2008 |
|-------------------------------|--------------------------------|--------------------|------------------|--------------------------------|--------------------|--------------------|--------------------------------|
| First resolution | \$10,894,553 | \$ 587,975 | \$549,068 | \$10,933,460 | \$1,126,190 | \$1,067,753 | \$10,991,897 |
| Second resolution | <u>5,039,798</u> | <u>1,633,132</u> | <u>335,206</u> | <u>6,337,724</u> | <u>2,153,715</u> | <u>264,399</u> | <u>8,227,040</u> |
| Total bonds payable | <u>15,934,351</u> | <u>2,221,107</u> | <u>884,274</u> | <u>17,271,184</u> | <u>3,279,905</u> | <u>1,332,152</u> | <u>19,218,937</u> |
| Due within one year | <u>(210,971)</u> | | | | | | <u>(235,015)</u> |
| Less discounts (net) | 42,007 | (15,838) | 12,331 | 13,838 | (31,934) | 8,281 | (26,377) |
| Less deferred refunding costs | <u>370,449</u> | <u>21,575</u> | <u>37,089</u> | <u>354,935</u> | <u>17,791</u> | <u>30,559</u> | <u>342,166</u> |
| Total long-term liabilities | <u>\$15,310,924</u> | <u>\$2,215,370</u> | <u>\$834,854</u> | <u>\$16,902,411</u> | <u>\$3,294,048</u> | <u>\$1,293,312</u> | <u>\$18,668,133</u> |

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

During 2008 and 2007, the Authority issued \$448.1 million and \$586.8 million, respectively, of bonds to refund \$436.7 million and \$683.5 million, respectively, of outstanding bonds. These refundings resulted in an accounting loss of \$17.8 million and \$21.6 million, respectively. The Authority in effect reduced its aggregate debt service by \$18.0 and \$17.3 million, respectively, and obtained an economic benefit of \$14.5 million and \$46.3 million, respectively.

In addition, in 2008, the Authority issued \$679.9 million of bonds to refund \$683.7 million of auction rate bonds.

The Authority has defeased cumulatively \$ 10.763 and \$9.740 billion of outstanding bonds as of June 30, 2008 and 2007, respectively, by placing proceeds of refunding bonds issued in an irrevocable escrow account to provide for all future debt service payments on defeased bonds. Proceeds were used to purchase U.S. Government securities that were placed in the irrevocable escrow account. Accordingly, the escrow account assets and liabilities for the defeased bonds are not included in the Authority's financial statements.

As of June 30, 2008 and 2007, \$8.157 billion and \$8.081 billion of the defeased bonds, respectively, had been retired from the assets of the escrow accounts.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

8. LONG-TERM LIABILITIES (continued)

Debt service requirements to maturity including amounts relating to commercial paper at June 30, 2008 are as follows (in thousands):

| June 30 | Principal ⁽¹⁾ | Interest ⁽²⁾ | Total |
|-----------|--------------------------|-------------------------|----------------------|
| 2009 | \$ 1,035,015 | \$ 733,763 | \$ 1,768,778 |
| 2010 | 262,945 | 721,623 | 984,568 |
| 2011 | 348,684 | 711,800 | 1,060,484 |
| 2012 | 336,954 | 700,878 | 1,037,832 |
| 2013 | 329,623 | 685,742 | 1,015,365 |
| 2014–2018 | 2,327,036 | 3,252,161 | 5,579,197 |
| 2019–2023 | 2,714,260 | 2,856,645 | 5,570,905 |
| 2024–2028 | 3,077,275 | 2,382,834 | 5,460,109 |
| 2029–2033 | 3,950,065 | 1,701,988 | 5,652,053 |
| 2034–2038 | 4,671,225 | 875,356 | 5,546,581 |
| 2039–2043 | 965,855 | 46,089 | 1,011,944 |
| | <u>\$ 20,018,937</u> | <u>\$ 14,668,879</u> | <u>\$ 34,687,816</u> |

(1) Includes \$800 million of commercial paper due in 2009.

(2) Includes interest for variable rate bonds estimated at 2.0%, which is the rate at the end of the fiscal year. Variable rate bonds are sold daily or weekly and interest rates are determined by the market on the day sold.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

8. LONG-TERM LIABILITIES (continued)

Bonds, notes payable, and commercial paper comprise the following for the year ended June 30, 2007 (in thousands):

| | Balance at June 30, 2007 | Issued | Retired/ defeased | Balance at June 30, 2008 |
|--|-----------------------------|--------|----------------------|-----------------------------|
| 1991 Fiscal Series B - 6.00% to 7.25% Serial and Term Bonds maturing in varying installments through 2012 | \$ 7,665 | \$ - | \$ 2,315 | \$ 5,350 |
| 1992 Fiscal Series B - 6.66% to 6.86% Serial and Term Bonds maturing in varying installments through 2014 | 8,620 | | 2,428 | 6,192 |
| 1993 Fiscal Series A - 5.875% to 6.0% Serial, Term, and Capital Appreciation Bonds maturing in varying installments through 2013 | 70,360 | | 20,375 | 49,985 |
| 1993 Fiscal Series C - Adjustable Rate Term Bonds maturing 2022 | 100,000 | | 100,000 | - |
| 1994 Fiscal Series C - Adjustable Rate Term Bonds maturing in 2023 | 200,000 | | 200,000 | - |
| 1994 Fiscal Series G - Adjustable, Auction and Leveraged Reverse Rate Bonds maturing in varying installments through 2024 | 185,000 | | 185,000 | - |
| 1994 Fiscal Series 1 - 3.00% to 6.00% Serial Bonds maturing in varying installments through 2013 | 31,180 | | 340 | 30,840 |
| 1995 Fiscal Series A - Adjustable Rate Term Bonds maturing in varying installments through 2025 | 198,700 | | 198,700 | - |
| 1995 Fiscal Series 1 - 5.25% to 6.875% Serial Bonds maturing in varying installments through 2016 | 23,910 | | 2,750 | 21,160 |
| 1997 Fiscal Series A - 4.85% to 6.0% Serial Bonds maturing in varying installments through 2026 | 25,000 | | | 25,000 |
| 1998 Fiscal Series A - 4.80% to 5.125% Serial Bonds maturing in varying installments through 2022 | 256,315 | | 256,315 | - |
| 1998 Fiscal Series C - 4.30% to 5.125% Serial Bonds maturing in varying installments through 2021 | 83,975 | | 83,975 | - |
| 1998 Fiscal Series D - 4.25% to 5.00% Serial and Capital Appreciation Bonds maturing in varying installments through 2025 | 355,220 | | 4,255 | 350,965 |
| 1998 Fiscal Series 1 - 4.00% to 5.35% Serial Bonds maturing in varying installments through 2017 | 28,350 | | 2,195 | 26,155 |
| 1998 Fiscal Series 3 - 4.30% to 6.00% Serial Bonds maturing in varying installments through 2016 | 120,135 | | | 120,135 |
| 1998 Fiscal Series 4 - 3.60% to 5.20% Serial Bonds maturing in varying installments through 2018 | 9,620 | | 770 | 8,850 |
| 1998 Fiscal Series 6 - 4.827% to 5.125% Serial Bonds maturing in varying installments through 2019 | 12,779 | | 12,779 | - |
| 1999 Fiscal Series A - 4.75% to 5.00% Serial Bonds maturing in varying installments through 2031 | 301,470 | | | 301,470 |
| 1999 Fiscal Series B - 4.0% to 5.25% Serial, Term and Capital Appreciation Bonds maturing in varying installments through 2020 | 171,910 | | | 171,910 |
| 1999 Fiscal Series 2 - 4.00% to 5.25% Serial Bonds maturing in varying installments through 2020 | 89,649 | | 89,649 | - |
| 2000 Fiscal Series B - 6.00% to 6.10% Serial Bonds maturing in varying installments through 2033 | 131,865 | | | 131,865 |

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

8. LONG-TERM LIABILITIES (continued)

| | Balance at June 30, 2007 | Issued | Retired/ defeased | Balance at June 30, 2008 |
|---|-----------------------------|--------|----------------------|-----------------------------|
| 2000 Fiscal Series C - Adjustable Rate Term Bonds maturing in 2033 | \$ 107,500 | \$ - | \$ - | \$ 107,500 |
| 2000 Fiscal Series 2 - 3.80% to 5.96% Serial Bonds maturing in varying installments through 2019 | 9,050 | | 555 | 8,495 |
| 2001 Fiscal Series B - 4.5% to 5.125% Serial and Term Bonds maturing in varying installments through 2031 | 67,225 | | | 67,225 |
| 2001 Fiscal Series C - 5.125% Term Bonds maturing in varying installments through 2033 | 112,040 | | | 112,040 |
| 2001 Fiscal Series D - 4.5% to 5.5% Serial and Capital Appreciation Bonds maturing in varying installments through 2025 | 232,940 | | | 232,940 |
| 2001 Fiscal Series E - 4.5% to 5.25% Serial and Term Bonds maturing in varying installments through 2031 | 86,105 | | | 86,105 |
| 2001 Fiscal Series F - Adjustable Rate Bonds maturing in varying installments through 2033 | 184,130 | | | 184,130 |
| 2002 Fiscal Series A - 5.00% to 5.75% Serial and Term Bonds maturing in varying installments through 2033 | 116,305 | | | 116,305 |
| 2002 Fiscal Series B - 3.625% to 5.00% Serial and Term Bonds maturing in varying installments through 2026 | 171,220 | | 245 | 170,975 |
| 2002 Fiscal Series C - 4.1% to 5.125% Serial and Term Bonds maturing in varying installments through 2032 | 46,580 | | | 46,580 |
| 2002 Fiscal Series D - 3.0% to 4.90% Serial and Term Bonds maturing in varying installments through 2020 | 41,495 | | 90 | 41,405 |
| 2002 Fiscal Series E - 3.4% to 5.0% Serial and Term Bonds maturing in varying installments through 2026 | 213,745 | | 110 | 213,635 |
| 2002 Fiscal Series F - 3.6% to 5.0% Serial and Term Bonds maturing in varying installments through 2029 | 105,635 | | 155 | 105,480 |
| 2002 Fiscal Series G - 5.00% to 5.125% Term Bonds maturing in varying installments through 2034 | 216,375 | | | 216,375 |
| 2002 Fiscal Series 1 - 4.82% to 5.25% Serial Bonds maturing in varying installments through 2031 | 174,953 | | 5,786 | 169,167 |
| 2002 Fiscal Series 2 - 4.22% to 5.00% Serial Bonds maturing in varying installments through 2031 | 59,334 | | 2,566 | 56,768 |
| 2002 Fiscal Series 3 - 4.65% to 5.00% Serial Bonds maturing in varying installments through 2031 | 449,036 | | 15,348 | 433,688 |
| 2002 Fiscal Series 4 - 5.13% to 6.74% Serial Bonds maturing in varying installments through 2023 | 192,529 | | 8,735 | 183,794 |
| 2002 Fiscal Series 5 - 3.82% to 5.21% Serial Bonds maturing in varying installments through 2031 | 158,448 | | 5,513 | 152,935 |
| 2002 Fiscal Series 6 - 3.82% to 5.21% Serial Bonds maturing in varying installments through 2019 | 76,448 | | 5,097 | 71,351 |
| 2002 Fiscal Series 7 - 7.4% to 7.5% Serial Bonds maturing in varying installments through 2012 | 4,435 | | 1,335 | 3,100 |
| 2003 Fiscal Series A - 4.0% to 6.0% Serial, Term and Muni-CP1 Bonds maturing in varying installments through 2034 | 685,845 | | 4,200 | 681,645 |

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

8. LONG-TERM LIABILITIES (continued)

| | Balance at June 30, 2007 | Issued | Retired/ defeased | Balance at June 30, 2008 |
|--|-----------------------------|--------|----------------------|-----------------------------|
| 2003 Fiscal Series C Adjustable Rate Bonds maturing in 2018 | \$ 300,300 | \$ - | \$ - | \$ 300,300 |
| 2003 Fiscal Series D - 2.0% to 5.25% Serial and Term Bonds maturing in varying installments through 2017 | 214,525 | | | 214,525 |
| 2003 Fiscal Series E - 5% Term Bonds maturing in 2034 and 2038 | 367,265 | | | 367,265 |
| 2003 Fiscal Series F - Adjustable Rate Bonds maturing in 2035 | 201,655 | | | 201,655 |
| 2003 Fiscal Series 1 - 4.23% to 4.375% Serial Bonds maturing in varying installments through 2032 | 132,686 | | 4,846 | 127,840 |
| 2003 Fiscal Series 2 - 5.27% Serial Bonds maturing in varying installments through 2028 | 550,074 | | 11,934 | 538,140 |
| 2003 Fiscal Series 3 - 5.15% Serial Bonds maturing in varying installments through 2025 | 19,130 | | 720 | 18,410 |
| 2003 Fiscal Series 4 - 5.18% Serial Bonds maturing in varying installments through 2025 | 30,435 | | 1,150 | 29,285 |
| 2003 Fiscal Series 5 - 4.23% to 4.45% Serial Bonds maturing in varying installments through 2032 | 268,902 | | 9,196 | 259,706 |
| 2004 Fiscal Series A - 5.0% Term Bonds maturing in 2027 and 2035 | 217,000 | | | 217,000 |
| 2004 Fiscal Series B - 2.00% - 5.00% Serial and Term Bonds maturing in varying installments through 2023 | 336,720 | | | 336,720 |
| 2004 Fiscal Series C - 2.00% - 5.00% Serial and Term Bonds maturing in varying installments through 2035 | 595,170 | | 585 | 594,585 |
| 2004 Fiscal Series 1 - 4.12% - 4.45% Serial Bonds maturing in varying installments through 2033 | 278,855 | | 9,136 | 269,719 |
| 2004 Fiscal Series 2 - 4.46% Serial Bonds maturing in varying installments through 2026 | 241,350 | | 7,854 | 233,496 |
| 2005 Fiscal Series A - 5.00% Serial Bonds maturing in varying installments through 2039 | 150,000 | | | 150,000 |
| 2005 Fiscal Series B - 2.125% - 5.00% Serial Bonds maturing in varying installments through 2036 | 919,960 | | 1,070 | 918,890 |
| 2005 Fiscal Series C - 3.00% - 5.00% Serial Bonds maturing in varying installments through 2036 | 575,005 | | 750 | 574,255 |
| 2005 Series D - 5.00% Serial Bonds maturing in varying installments through 2039 | 559,205 | | | 559,205 |
| 2005 Fiscal Series 1 - 3.95% - 5.00% Bonds maturing in varying installments through 2034 | 217,163 | | 6,789 | 210,374 |
| 2005 Fiscal Series 2 - 2.567% - 5.00% Bonds maturing in varying installments through 2026 | 369,623 | | 11,911 | 357,712 |
| 2006 Series A - 3.50% - 5.00% Serial Bonds maturing in varying installments through 2039 | 518,890 | | 365 | 518,525 |
| 2006 Series B - 5.00% Term Bonds maturing in 2036 | 150,000 | | | 150,000 |
| 2006 Series C - 4.50% - 4.75% Term Bonds maturing in 2033 | 350,345 | | | 350,345 |

(Continued)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

| | Balance at June 30, 2007 | Issued | Retired/ defeased | Balance at June 30, 2008 |
|--|-----------------------------|------------------|----------------------|-----------------------------|
| 2006 Fiscal Series D - 4.5% - 5.00% Serial Bonds maturing in varying installments through 2038 | \$ 406,205 | \$ - | \$ - | \$ 406,205 |
| 2006 Fiscal Series AA - Adjustable rate bonds maturing in varying installments through 2032 | 400,000 | | | 400,000 |
| 2006 Fiscal Series BB - 3.25% - 5.00% Serial Bonds maturing in varying installments through 2016 | 90,000 | | 10,000 | 80,000 |
| 2006 Fiscal Series 1 - Adjustable rate bonds maturing in varying installments through 2036 | 220,261 | | 6,803 | 213,458 |
| 2006 Fiscal Series 2 - Adjustable rate bonds maturing in varying installments through 2036 | 199,013 | | 4,223 | 194,790 |
| 2006 Fiscal Series 3 - Adjustable rate bonds maturing in varying installments through 2036 | 253,478 | | 5,190 | 248,288 |
| 2007 Fiscal Series A - 4.25% - 4.75% Serial Bonds maturing in varying installments through 2039 | 587,975 | | | 587,975 |
| 2007 Fiscal Series AA - 4.50% - 5.00% Serial Bonds maturing in varying installments through 2037 | 199,910 | | | 199,910 |
| 2007 Fiscal Series BB - 3.75% - 5.00% Serial Bonds maturing in varying installments through 2021 | 131,745 | | | 131,745 |
| 2007 Fiscal Series CC - Adjustable rate bonds maturing in varying installments through 2038 | 210,500 | | | 210,500 |
| 2007 Fiscal Series DD - 4.75% - 5.00% Serial Bonds maturing in varying installments through 2039 | 395,000 | | | 395,000 |
| 2007 Fiscal Series 1 - 4.35% - 4.40% Serial Bonds maturing in varying installments through 2036 | 226,534 | | 3,882 | 222,652 |
| 2007 Fiscal Series 2 - 4.45% - 4.50% Serial Bonds maturing in varying installments through 2036 | 288,272 | | 4,815 | 283,457 |
| 2007 Fiscal Series 3 - 4.90% Serial Bonds maturing in varying installments through 2024 | 174,937 | | 12,532 | 162,405 |
| 2008 Fiscal Series A - 5.00% Serial Bonds maturing in varying installments through 2038 | | 446,245 | | 446,245 |
| 2008 Fiscal Series B - 1.97% Serial Bonds maturing in varying installments through 2025 | | 535,000 | | 535,000 |
| 2008 Fiscal Series C - 3.00% - 5.25% Serial Bonds maturing in varying installments through 2021 | | 144,945 | 6,820 | 138,125 |
| 2008 Fiscal Series AA - 4.50% - 5.00% Serial Bonds maturing in varying installments through 2039 | | 400,000 | | 400,000 |
| 2008 Fiscal Series BB - 1.97% Serial Bonds maturing in varying installments through 2 | | 401,000 | | 401,000 |
| 2008 Fiscal Series CC - 1.97% Serial Bonds maturing in varying installments through 2022 | | 352,200 | | 352,200 |
| 2008 Fiscal Series DD - 4.50% - 5.00% Serial Bonds maturing in varying installments through 2039 | | 504,905 | | 504,905 |
| 2008 Fiscal Series 1 - 3.69% - 4.64% Serial Bonds maturing in varying installments through 2037 | | 270,907 | | 270,907 |
| 2008 Fiscal Series 2 - 4.67% - 4.73% Serial Bonds maturing in varying installments through 2037 | | 224,703 | | 224,703 |
| Total bonds payable | 17,271,184 | <u>3,279,905</u> | <u>1,332,152</u> | 19,218,937 |
| Current portion of bonds and notes payable | 210,971 | | | <u>235,015</u> |
| Bonds and notes payable — less current portion | <u>\$ 17,060,213</u> | | | <u>\$ 18,983,922</u> |

(Concluded)

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

8. LONG-TERM LIABILITIES (continued)

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

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

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

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

The appropriate measurement of these risks at the reporting date is the fair value of the swap. The fair value of the swaps at June 30, 2008 and 2007 was approximately \$7.7 million and \$3.1 million in favor of the counterparty, respectively.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

9. RESTRICTED ASSETS

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

| | 2008 | 2007 |
|---|--------------------|--------------------|
| The Board: | | |
| Operation and maintenance reserve account | \$ 200,428 | \$ 175,151 |
| Operation and maintenance reserve general account | <u>10</u> | <u>10</u> |
| | <u>200,438</u> | <u>175,161</u> |
| The Authority: | | |
| Revenue fund | 209,130 | 161,863 |
| Debt service reserve fund | 836,028 | 801,226 |
| Debt service fund | 7,766 | |
| Construction fund | 247,730 | 259,708 |
| Arbitrage fund | | 6,519 |
| Escrow fund | <u>179,243</u> | <u>194,713</u> |
| | <u>1,479,897</u> | <u>1,424,029</u> |
| | <u>\$1,680,335</u> | <u>\$1,599,190</u> |

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

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

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

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

10. COMMITMENTS AND CONTINGENCIES

Construction — The System has contractual commitments of approximately \$7.8 billion and \$7 billion at June 30, 2008 and 2007, respectively, for water and sewer projects.

Risk financing activities — The System is self insured and carries no commercial or insurance policies other than Directors and Officers insurance for the Water Authority. Any claims made against the System are resolved through the City's legal support and the amounts of the maximum liability for such judgments are described in (c) below. The System is subject to claims for construction delays, property damage, personal injury and judgments related to delays in construction deadlines under consent agreements.

Claims and Litigation — In accordance with the Lease, the Board is required to reimburse the City for any judgment or settlement paid by the City arising out of a tort claim to the extent that the City's liability is related to capital improvements and the operation or maintenance of the System. However, in no event shall the payment made to the City, in any fiscal year, exceed an amount equal to 5% of the aggregate revenues shown on the prior year's audited financial statements of the System. In addition, the System is required to reimburse the City, to the extent requested by the City, for the payment of any judgment or settlement arising out of a contract claim with respect to the construction of capital improvements. In addition, the City has agreed, subject to certain conditions, to indemnify the Authority, the Board and their staffs against any and all liability in connection with any act done or omitted in the exercise of their powers which is taken or omitted in good faith in pursuance of their purposes under the Act. Currently, the City is a defendant in a significant number of lawsuits pertaining to the System. The litigation includes, but is not limited to, actions commenced and claims asserted against the City arising out of alleged torts, alleged breaches of contract, condemnation proceedings and other alleged violations of law. As of June 30, 2008, the potential future liability attributable to the System for claims outstanding against the City was estimated to be \$256.2 million. This amount is included in the estimated liability for unsettled claims, which is reported in the City's balance sheet. The potential future liability is the City's best estimate based on available information. The estimate may be revised as further information is obtained and as pending cases are litigated.

Arbitrage Rebate — To maintain the exemption from Federal income tax of interest on bonds issued subsequent to January 1, 1986, the System will fund amounts required to be rebated to the Federal Government pursuant to Section 148 of the Internal Revenue Code of 1986, as amended (the "Code"). The Code requires the payment to the United States Treasury of the excess of the amount earned on all nonpurpose obligations over the amount that would have been earned if the gross proceeds of the issue were invested at a rate equal to the yield on the issue, together with any earnings attributable to such excess. Construction funds, debt service funds or any other funds or accounts funded with proceeds of such bonds, including earnings, or pledged to or expected to be used to pay interest on such bonds are subject to this requirement. Payment is to be made after the end of the fifth bond year and after every fifth bond year thereafter, and within 60 days after retirement of the bonds. During 2008 and 2007, the System paid \$7.160 million and \$2.458 million, respectively, in rebates. At June 30, 2008 and 2007, the Authority had a liability of \$2.805 million and \$6.733 million, respectively.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

11. PENSION PLANS

During 2008, the System was billed and contributed \$24 thousand for four employees who participate in the defined benefit pension plan. All other personnel are employees of the City and are covered under the City's pension plan. The System pays the costs of the City employees' pension through an allocation of fringe benefit costs, which are included principally within operations and maintenance expenses in the accompanying financial statements.

12. OTHER POST-EMPLOYMENT BENEFITS

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

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

Funding Policy — The Authority is not required to provide funding for OPEB, other than the pay-as-you-go amount necessary to provide current benefits to retirees and eligible beneficiaries/dependents. For the fiscal years ended June 30, 2008 and 2007, the Authority had two retirees, and thus made a contribution of \$994. Members are not required to contribute, although retirees may elect basic health insurance programs and/or optional coverage that requires contributions.

Annual OPEB Cost and Net OPEB Obligation — The Authority's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer ("ARC"), an amount that was actuarially determined in accordance with the parameters of GASB Statement No. 45. The frozen entry age cost method was used in the actuarial valuation prepared as of June 30, 2007, which was the basis for the 2008 ARC calculation.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

12. OTHER POST-EMPLOYMENT BENEFITS (continued)

The following table shows the elements of the Authority's annual OPEB cost for the years, the amounts actually contributed, and changes in the Authority's net OPEB obligation for the years ended June 30, 2008:

| | |
|--|-------------------|
| Annual required contribution | \$ 317,054 |
| Interest on net OPEB obligations | 9,176 |
| Adjustment to annual required contribution | <u>(238,574)</u> |
| Annual OPEB cost | 87,656 |
| Payments | (994) |
| Net OPEB obligation — beginning of year | <u>229,398</u> |
| Net OPEB obligation — end of year | <u>\$ 316,060</u> |

The Authority's annual OPEB cost, the percentage of annual OPEB cost contributed, and the net OPEB obligation for the fiscal years ended June 30, 2008, June 30, 2007 and June 30, 2006 were as follows:

| Fiscal Years Ended | Annual OPEB cost | Percentage of Annual OPEB Cost Contributed | Net OPEB obligation |
|-----------------------|---------------------|--|---------------------------|
| June 30, 2008 | \$ 87,656 | 0 % | \$ 316,060 |
| June 30, 2007 | (168,010) | 0 | 229,398 |
| June 30, 2006 | 398,010 | 0 | 398,010 |

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

Funded Status and Funding Progress — As of June 30, 2007, the most recent actuarial valuation date, the cost was 0.0% funded. The actuarial accrued liability for benefits was \$242 thousand, and the actuarial value of assets was \$0, resulting in an unfunded actuarial accrued liability ("UAAL") of \$242 thousand. The covered payroll (annual payroll of active employees covered by the Plan) was \$486 thousand, and the ratio of the UAAL to the covered payroll was 50%.

Actuarial Methods and Assumptions — Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future, such as assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the Plan and the annual required contributions of the Authority are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. Projections of benefits for financial reporting purposes are based on

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

12. OTHER POST-EMPLOYMENT BENEFITS (continued)

the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and employees to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

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

Required Supplementary Information (unaudited)

Schedule of Funding Progress

| Valuation Date | Value of Assets | (AAL) — Entry Age | AAL (UAAL) | Funded Ratio | Covered Payroll | of Covered Payroll |
|----------------|-----------------|-------------------|------------|--------------|-----------------|--------------------|
| June 30, 2007 | 0 | \$ 242,193 | \$ 242,193 | 0 | \$ 486,052 | 50 % |
| June 30, 2006 | 0 | 172,974 | 172,974 | 0 | 306,155 | 56 |
| June 30, 2005 | 0 | 308,348 | 308,348 | 0 | 1,041,223 | 29 |

13. PRIOR PERIOD ADJUSTMENTS

The 2007 financial statements have been restated, from the amounts previously reported, to reflect adjustments to utility plant in service and utility plant construction. Certain amounts previously reported as in utility plant construction were placed into service in prior years and should have been reclassified to utility plant in service and depreciated accordingly. In addition, certain amounts included in utility plant construction should have been expensed in prior fiscal years. The effects of these adjustments to the 2007 financial statements are as follows: Utility plant in service, net of accumulated depreciation, was reduced by \$262.6 million. Utility plant construction was reduced by \$428.0 million. Net assets at the beginning of the year were reduced by \$690.7 million.

14. SUBSEQUENT EVENTS

On July 23, 2008 the Authority issued fiscal 2009 Series AA Second Resolution Bonds in the aggregate amount of \$334.1 million to refund outstanding bonds and to pay certain costs of issuance.

On August 7, 2008, the Authority issued fiscal 2009 Series BB Second Resolution Bonds in the aggregate amount of \$200.9 million to refund outstanding commercial paper notes and to pay for certain costs of issuance.

NEW YORK CITY WATER AND SEWER SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007 (CONTINUED)

14. SUBSEQUENT EVENTS (continued)

On August 7, 2008, the Authority issued fiscal 2009 Series CC Second Resolution Bonds in the aggregate amount of \$150.1 million to refund outstanding commercial paper notes and to pay for certain costs of issuance.

As of June 30, 2008, Authority was a party to five debt service reserve fund forward purchase agreements with Lehman Brothers Special Financing, Inc. ("LBSF"). The Bank of New York Mellon is holding U.S government obligations, which were delivered by LBSF pursuant to the agreement, in the Authority's debt service reserve fund accounts. A portion of the securities mature February 1, 2009 in an amount at least equal to the notional amount of the agreement and a portion of the securities mature June 30, 2009 in an amount at least equal to 7 months of interest at the contract rate.

Pursuant to our agreements, LBSF is in default as a result of the filing of a bankruptcy petition by Lehman Brothers Holdings, Inc., the guarantor of LBSF. Consequently, the Authority terminated its agreements with LBSF on September 23, 2008. Since the contract rate for these agreements is higher than the current estimated market rate the Authority would receive if it were to enter into similar investment agreements, LBSF is obligated under the agreements to pay NYW an amount such that NYW would maintain the economic equivalent of the LBSF agreements. However, the actual amount received and the timing of such payments is uncertain and the Authority may realize less interest earnings than it would have earned if the LBSF agreements were to continue through the termination dates.

The Authority will reinvest its debt service reserve fund proceeds from the maturing securities described above in accordance with its bond resolution and investment guidelines. Termination of these agreements will not have a significant impact on the System.

The credit markets in the United States are experiencing a period of volatility and instability. Certain adjustable rate debt instruments issued by the Authority contain provisions that allow holders of the instruments to put the instruments back to the Authority. The Authority relies on its remarketing agents to remarket this debt and should the agent be unable to remarket this debt, the Authority has in place liquidity facilities from banks to support this debt. The Authority has on occasion drawn on its liquidity facilities because of recent unsuccessful remarketing of its debt.

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APPENDIX E

FORM OF OPINION OF BOND COUNSEL

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**FORM OF OPINION OF BOND COUNSEL
(Fiscal 2009 Series EE Bonds)**

January , 2009

New York City Municipal
Water Finance Authority

**New York City Municipal Water Finance Authority
Water and Sewer System Second General Resolution Revenue Bonds,
Fiscal 2009 Series EE
(Final Opinion)**

Ladies and Gentlemen:

We have acted as bond counsel in connection with the issuance by the New York City Municipal Water Finance Authority (the "Authority"), a body corporate and politic constituting a public benefit corporation of the State of New York (the "State"), created and existing under and pursuant to the Constitution and statutes of the State, including the Act (defined below), of \$645,455,000 aggregate principal amount of Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 2009 Series EE (the "2009 Series EE Bonds"), issued under and pursuant to the New York City Municipal Water Finance Authority Act, being Title 2-A of Article 5 of the Public Authorities Law of the State, as amended (which, together with Section 1046 of the Public Authorities Law of the State, is herein referred to as the "Act") and a resolution of the Authority adopted March 30, 1994 entitled "Water and Sewer System Second General Revenue Bond Resolution," as amended and supplemented to the date hereof (the "Second Resolution"), including by a resolution adopted January 21, 2009 entitled "Supplemental Resolution No. 58 Authorizing the Issuance of up to \$725,000,000 Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 2009 Series EE" ("Supplemental Resolution No. 58") authorizing the 2009 Series EE Bonds. The 2009 Series EE Bonds are part of an issue of bonds of the Authority (the "Bonds") which the Authority has created under the terms of the Second Resolution and is authorized to issue from time to time for the purposes authorized by the Act and the Second Resolution, as then in effect, and without limitation as to amount except as provided in the Second Resolution or as may be limited by law. The 2009 Series EE Bonds are being issued for the purposes of the Second Resolution. Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Second Resolution.

Pursuant to the Act, the New York City Water Board (the "Board"), a public benefit corporation of the State, created and existing under the laws of the State, and The City of New York (the "City"), a municipal corporation of the State, have entered into a lease agreement, dated as of July 1, 1985, as amended (the "Lease"), whereby the Board has leased the New York City Water and Sewer System from the City for a term ending on the date on which all bonds, notes or other obligations of the Authority have been paid in full or provision for such payment shall have been made in accordance with the instruments under which they were issued. Pursuant to the Act, the Authority, the Board and the City have entered into a financing agreement, dated July 1, 1985, as amended (the "Financing Agreement"), related to, among other things, the financing Water Projects.

In such connection, we have reviewed the Second Resolution, Supplemental Resolution No. 58, the Authority's Water and Sewer System General Revenue Bond Resolution, adopted November 14, 1985 (the "First Resolution"), the Lease, the Financing Agreement and the Tax Certificate of the Authority (the "Tax Certificate"), opinion of Corporation Counsel of The City of New York, certificates of the Authority, the Trustee and others, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be

affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof, and we disclaim any obligation to update this letter. Accordingly, this opinion is not intended to, and may not, be relied upon in connection with any such actions, events or matters. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the Authority. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinions, referred to in the third paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Second Resolution, Supplemental Resolution No. 58, the First Resolution, the Lease, the Financing Agreement and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the 2009 Series EE Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the 2009 Series EE Bonds, the Second Resolution, Supplemental Resolution No. 58, the First Resolution, the Lease, the Financing Agreement and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles and to the exercise of judicial discretion in appropriate cases. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum, choice of venue, waiver or severability provisions contained in the foregoing documents, nor do we express any opinion with respect to the state or quality of title to or interest in any of the real or personal property described in or as subject to the lien of the Second Resolution, Supplemental Resolution No. 58, the First Resolution, the Lease or the Financing Agreement, or the accuracy or sufficiency of the description contained therein of, or the remedies available to enforce liens on, any such property. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the 2009 Series EE Bonds and express no opinion with respect thereto herein.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof we are of the following opinions:

1. The Authority is a body corporate and politic constituting a public benefit corporation of the State, duly created and existing under the laws of the State with the right and lawful authority and power to enter into the Financing Agreement, to adopt the Second Resolution and Supplemental Resolution No. 58 and to issue the 2009 Series EE Bonds.

2. The Second Resolution and Supplemental Resolution No. 58 have been duly and lawfully adopted by the Authority, are in full force and effect and are the legal, valid and binding agreements of the Authority enforceable in accordance with their terms. The Second Resolution and Supplemental Resolution No. 58 create the valid, binding and perfected pledges they purport to create of the Revenues and any moneys or securities on deposit in the Funds and Accounts created thereby for the repayment of the Bonds, subject only to the provisions of the Second Resolution, Supplemental Resolution No. 58 and the Financing Agreement permitting the application thereof for or to the purposes and on the terms and conditions permitted thereby, including the making of any required payments to the United States with respect to arbitrage earnings.

3. The 2009 Series EE Bonds have been duly and validly authorized and issued. The 2009 Series EE Bonds are valid and binding special obligations of the Authority payable as provided in the Second Resolution, are enforceable in accordance with their terms and the terms of the Second Resolution and are entitled, together with all other Bonds issued under the Second Resolution to the benefits of the Second Resolution and the Act.

4. The 2009 Series EE Bonds are payable solely from the Revenues and other amounts pledged to such payment under the Second Resolution. The 2009 Series EE Bonds are not a debt of the State, the City

or the Board and neither the State, the City, the Board nor any other political subdivision of the State is liable thereon.

5. The Lease and the Financing Agreement have been duly authorized, executed and delivered by the respective parties thereto and constitute valid and binding obligations of such parties, enforceable in accordance with their terms.

6. The Revenues derived from the operation of the System are the property of the Board. The Financing Agreement validly transfers the right, title and interest of the Board in the Revenues to the Authority to the extent and as provided in the Financing Agreement, subject only to the provisions of the Act, the Financing Agreement and the Second Resolution permitting the application thereof for or to the purposes, and on the terms and conditions, therein set forth.

7. By virtue of the Act, the Authority has a valid, binding and perfected statutory lien upon the Revenues to be paid by the Board to the Authority pursuant to the Financing Agreement and such lien constitutes a first priority security interest therein.

8. Interest on the 2009 Series EE Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986. Interest on the 2009 Series EE Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Interest on the 2009 Series EE Bonds is exempt from personal income taxes imposed by the State of New York and any political subdivision thereof (including The City of New York). We express no opinion regarding other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the 2009 Series EE Bonds.

In rendering the opinions set forth in paragraphs 5 and 6 above, we wish to advise you that we have, with your consent, relied upon the opinion of Corporation Counsel of The City of New York dated the date hereof and addressed to you as to the validity, binding effect and enforceability of the Lease and the Financing Agreement with respect to the Board and the City. In rendering the priority of lien opinion set forth in paragraph 7 above, we have (i) relied upon a certification by the Board that it has not made or granted a pledge of or security interest in the Revenues to any person other than the Authority and that it has not taken any action which could result in the imposition by operation of law of any lien, charge or encumbrance upon the Revenues, and (ii) assumed, without making any independent investigation, that (1) no lien, charge or encumbrance upon the Revenues has been imposed or exists by operation of law that is prior to the lien in favor of the Authority and (2) no facts or circumstances have occurred or exist which could result in the imposition by operation of law of any lien, charge or encumbrance upon the Revenues that is prior to the lien in favor of the Authority.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

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APPENDIX F

BOOK-ENTRY-ONLY FORM

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BOOK-ENTRY-ONLY FORM

The Depository Trust Company (“DTC”), New York, NY, will act as securities depository for the Fiscal 2009 EE Bonds. The Fiscal 2009 EE Bonds 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 bond certificate will be issued for each maturity of the Fiscal 2009 EE Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC, in the aggregate principal amount of the Fiscal 2009 EE Bonds, 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 New York Banking Law, 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 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC’s participants (the “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 is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. 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 (the “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 or www.dtc.org.

Purchases of Fiscal 2009 EE Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Fiscal 2009 EE Bonds on DTC’s records. The ownership interest of each actual purchaser of each Fiscal 2009 EE Bonds (“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 Fiscal 2009 EE Bonds 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 Fiscal 2009 EE Bonds, except in the event that use of the book-entry system for the Fiscal 2009 EE Bonds is discontinued.

To facilitate subsequent transfers, all Fiscal 2009 EE Bonds 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 Fiscal 2009 EE Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of any Fiscal 2009 EE Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts the Fiscal 2009 EE Bonds 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 by DTC 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 Fiscal 2009 EE Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Fiscal 2009 EE Bonds, such as redemptions, tenders, defaults and proposed amendments to the bond documents. For example, Beneficial Owners of Fiscal 2009 EE Bonds may wish to ascertain that the nominee holding the Fiscal 2009 EE Bonds 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 Bond Registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Fiscal 2009 EE Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Fiscal 2009 EE Bonds unless authorized by a Direct Participant in accordance with DTC's MMI 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 Fiscal 2009 EE Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Fiscal 2009 EE 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 Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the Authority or Trustee, on the 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, the Trustee, or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, premium, if any, and interest on the Fiscal 2009 EE Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Trustee, 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 depository with respect to the Fiscal 2009 EE Bonds at any time by giving reasonable notice to the Authority or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, bond certificates are required to be printed and delivered.

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

Unless otherwise noted, the information contained in the preceding paragraphs of this subsection "Book-Entry-Only System" has been extracted from information given by DTC. Neither the Authority, the Trustee nor the Underwriters makes any representation as to the completeness or the accuracy of such information or as to the absence of material adverse changes in such information subsequent to the date hereto.

NEITHER THE AUTHORITY NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATIONS TO SUCH DTC PARTICIPANTS, INDIRECT PARTICIPANTS, OR THE PERSONS FOR WHOM THEY ACT AS NOMINEES WITH RESPECT TO THE PAYMENTS TO OR THE PROVIDING OF NOTICE FOR SUCH DTC PARTICIPANTS, INDIRECT PARTICIPANTS, OR THE BENEFICIAL OWNERS.

TABLE OF REFUNDED BONDS

The Authority expects to refund its Outstanding Water and Sewer System Revenue Bonds, specified below by providing for the payment of the principal of and interest on such Bonds on March 16, 2009. The refunding is contingent upon delivery of the Fiscal 2009 EE Bonds.

| <u>Series</u> | <u>Maturity Date</u> | <u>Principal Amount Outstanding</u> | <u>Principal Amount to be Refunded</u> | <u>Redemption Price</u> | <u>CUSIP Number</u> |
|------------------------|----------------------|-------------------------------------|--|-------------------------|---------------------|
| Fiscal 2003 Series C-1 | 6/15/18 | \$100,100,000 | \$100,100,000 | 100% | 64970KVY0 |
| Fiscal 2003 Series C-2 | 6/15/18 | 100,100,000 | 100,100,000 | 100 | 64970KVZ7 |

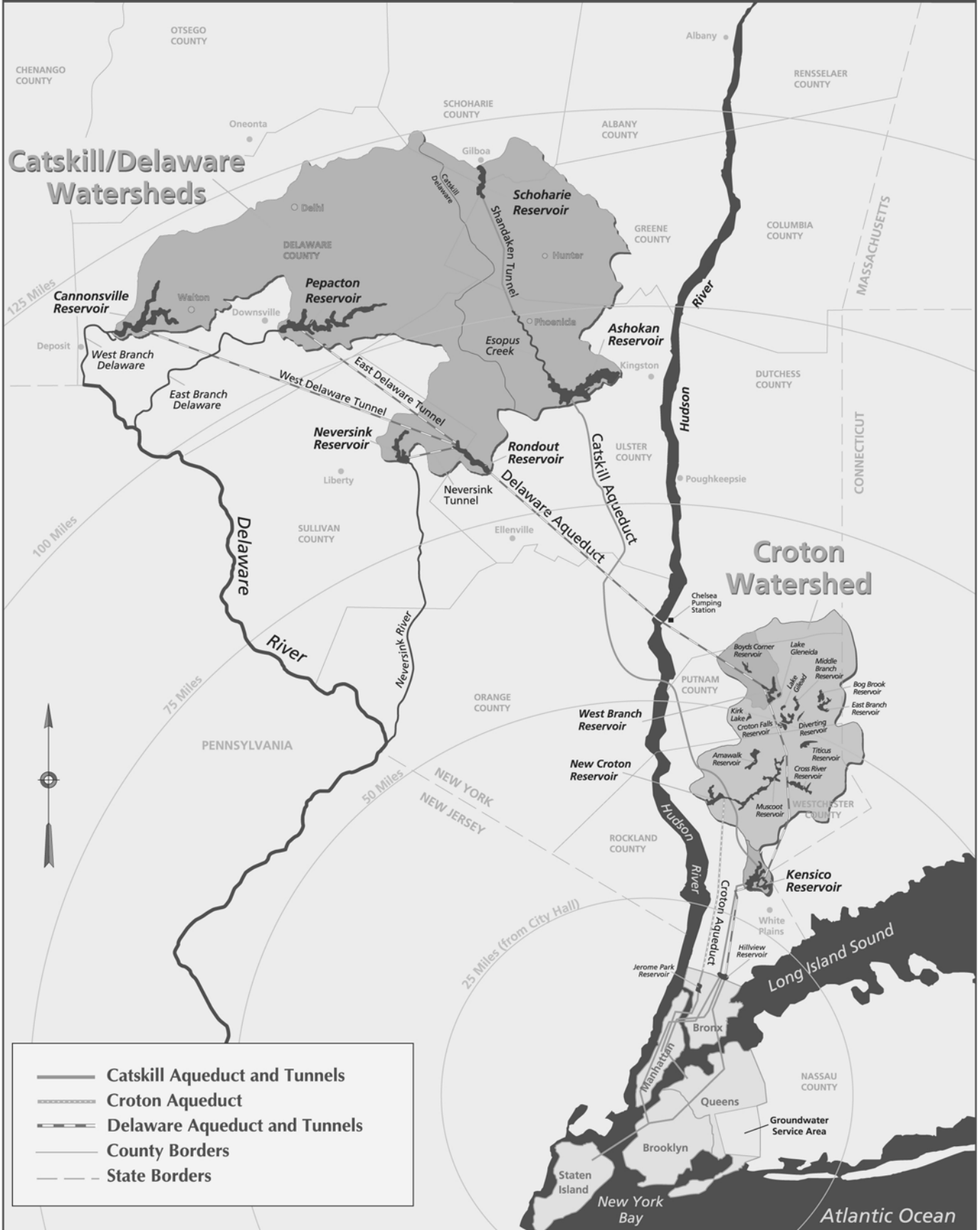
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APPENDIX H

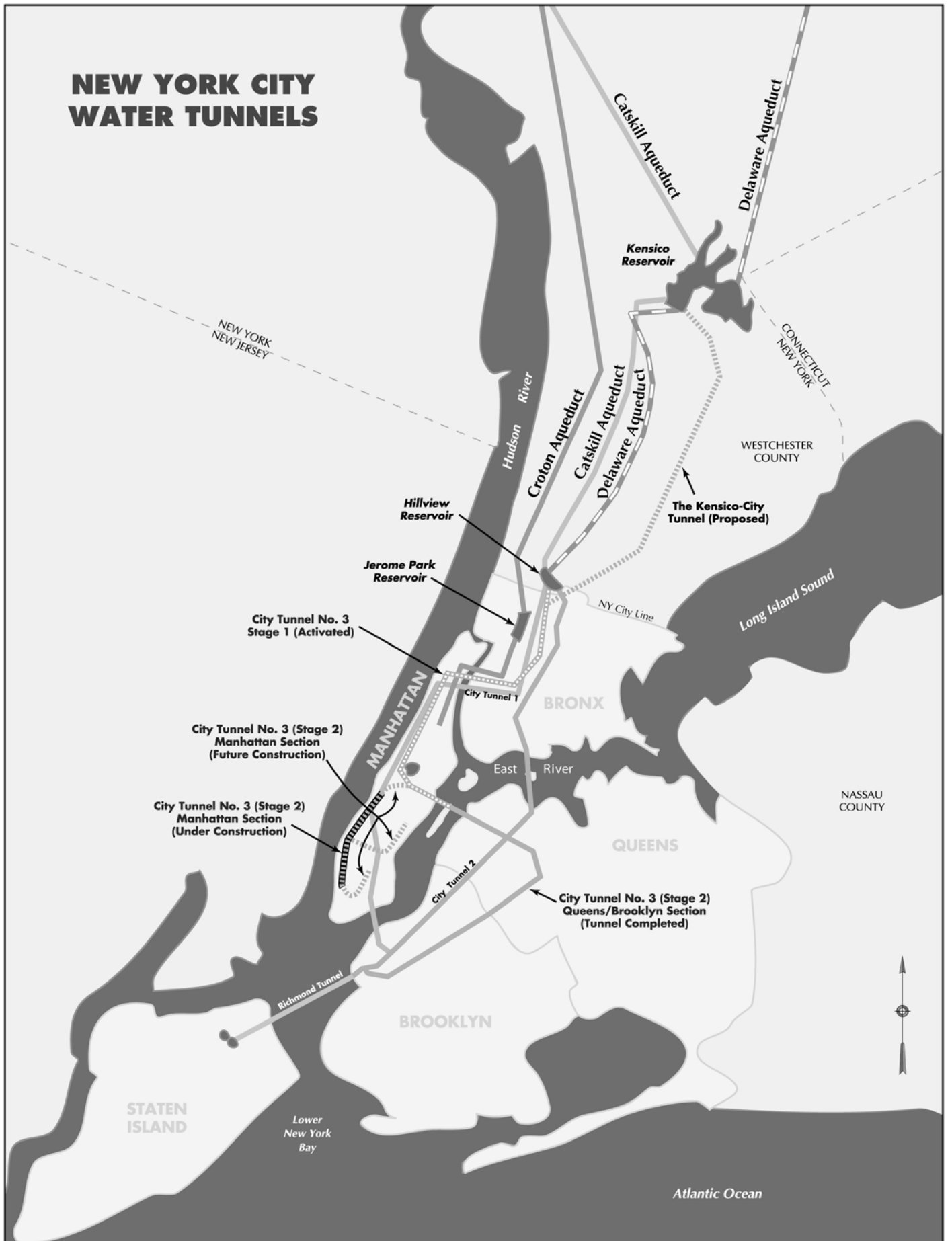
SYSTEM MAPS

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New York City Water Supply System



NEW YORK CITY WATER TUNNELS



New York City Drainage Areas and Water Pollution Control Plants

| Plant Location | Capacity (MGD) |
|-----------------|----------------|
| North River | 170 |
| Wards Island | 250 |
| Hunts Point | 200 |
| Newtown Creek | 310 |
| Red Hook | 60 |
| 26th Ward | 85 |
| Owls Head | 120 |
| Coney Island | 100 |
| Bowery Bay | 150 |
| Tallmans Island | 80 |
| Jamaica | 100 |
| Rockaway | 45 |
| Port Richmond | 60 |
| Oakwood Beach | 40 |

○ Indicates Plant Location in Drainage Area

