

# ***City of Chicago, Illinois*** ***Sewer Fund***

*Basic Financial Statements as of and for the  
Years Ended December 31, 2006 and 2005,  
Required Supplementary Information, Statistical Data,  
and Independent Auditors' Report*

# CITY OF CHICAGO, ILLINOIS SEWER FUND

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## INDEPENDENT AUDITORS' REPORT

The Honorable Richard M. Daley, Mayor,  
and Members of the City Council  
City of Chicago, Illinois

We have audited the accompanying basic financial statements of the Sewer Fund (Sewer Fund) of the City of Chicago, Illinois (City) as of December 31, 2006 and 2005, and for the years then ended, as listed in the foregoing table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

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

As discussed in Note 1 to the financial statements, the basic financial statements referred to above present only the Sewer Fund and are not intended to present the financial position of the City, and the results of its operations and the cash flows of its proprietary fund types, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, such basic financial statements present fairly, in all material respects, the financial position of the Sewer Fund, as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis as listed in the foregoing table of contents is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. The Management's Discussion and Analysis is the responsibility of the City's management. We have applied certain limited procedures that consisted principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. However, we did not audit the information and we express no opinion or any other form of assurance on it.

The statistical data, as listed in the foregoing table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. Such statistical data has not been subjected to auditing procedures and, accordingly, we do not express an opinion or any other form of assurance on it.

*Deloitte + Touche LLP*

June 27, 2007

# CITY OF CHICAGO, ILLINOIS

## SEWER FUND

### MANAGEMENT'S DISCUSSION AND ANALYSIS

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The following discussion and analysis of City of Chicago, Illinois, Sewer Fund financial performance provides an introduction and overview of the Sewer Fund's basic financial activities for the fiscal year ended December 31, 2006. Please read this discussion in conjunction with the Sewer Fund's basic financial statements and the notes to basic financial statements following this section.

#### FINANCIAL HIGHLIGHTS

##### 2006

- Operating revenues for 2006 decreased by \$7.1 million compared to prior-year operating revenues. This decrease of 4.9% is primarily due to a reduction in sewer service revenues as a result in a reduction in water usage.
- Operating expenses before depreciation and amortization decreased for 2006 by \$4.8 million compared to 2005. This decrease of 5.4% is primarily due to a decrease in personnel costs and a decrease in expenses related to engineering and general fund reimbursements.
- The Sewer Fund's total net assets for 2006 increased by \$7.1 million or 1.6% compared to 2005.
- The Sewer Fund's total assets were greater than total liabilities by \$462.0 million (net assets) at December 31, 2006. Total net assets comprise \$415.8 million of investment in capital assets, net of related debt; \$49.8 million of unrestricted net assets which may be used for ongoing operations; and a deficit of \$3.5 million of restricted net assets which are restricted for specific purposes.
- Capital asset additions for 2006 were \$45.3 million, principally due to completion of sewer construction and rehabilitation projects.

##### 2005

- Operating revenues for 2005 decreased by \$1.5 million compared to prior-year operating revenues. This decrease of 1.0% is primarily due to a reduction in sewer service revenues from suburban customers.
- Operating expenses before depreciation and amortization increased for 2005 by \$3.1 million compared to 2004. This increase of 3.6% is primarily due to an increase in personnel costs and an increase in expenses related to repairs and general fund reimbursements.
- The Sewer Fund's total net assets for 2005 increased by \$11.6 million (2.6%) compared to 2004.
- The Sewer Fund's total assets were greater than total liabilities by \$454.9 million (net assets) at December 31, 2005. Total net assets comprise \$411 million of investment in capital assets, net of related debt; \$43.6 million of unrestricted net assets which may be used for ongoing operations; and \$0.3 million of restricted net assets which are restricted for specific purposes.

- Capital asset additions for 2005 were \$48.4 million, principally due to completion of sewer construction and rehabilitation projects.

## **OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the Sewer Fund's basic financial statements. The Sewer Fund's basic financial statements comprise the Financial Statements and the Notes to Financial Statements. In addition to the basic financial statements, this report also presents Statistical Data after the Notes to Basic Financial Statements.

The Statements of Net Assets present all of the Sewer Fund's assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by private-sector companies. The difference between assets and liabilities is reported as net assets. The increase or decrease in net assets may serve as an indicator, over time, whether the Sewer Fund's financial position is improving or deteriorating. However, the consideration of other nonfinancial factors may be necessary in the assessment of overall financial position and health of the Sewer Fund.

The Statements of Revenues, Expenses and Changes in Net Assets present all current fiscal year revenues and expenses, regardless of when cash is received or paid, and the ensuing change in net assets.

The Statements of Cash Flows report how cash and cash equivalents were provided and used by the Sewer Fund's operating, capital financing, and investing activities. These statements are prepared on a cash basis and present the cash, received and disbursed, the net increase or decrease in cash and cash equivalents for the year, and the cash and cash equivalents balance at year-end.

The Notes to Basic Financial Statements are an integral part of the basic financial statements; accordingly, such disclosures are essential to a full understanding of the information provided in the financial statements. The Notes to Basic Financial Statements begin on page 15.

In addition to the basic financial statements, this report includes Statistical Data. The Statistical Data section presents unaudited debt service coverage calculations and includes certain unaudited information related to the Sewer Fund's historical financial and nonfinancial operating results and capital activities.

## FINANCIAL ANALYSIS

At December 31, 2006, the Sewer Fund's financial position continues to be strong with total assets of \$1,287 million, total liabilities of \$825 million, and net assets of \$462 million. A comparative condensed summary of the Sewer Fund's net assets at December 31, 2006, 2005, and 2004, is as follows:

(In thousands of dollars)	Net Assets		
	2006	2005	2004
Current assets	\$ 66,117	\$ 80,083	\$ 60,299
Restricted and other assets	169,119	132,865	168,649
Capital assets — net	<u>1,051,333</u>	<u>1,023,727</u>	<u>990,501</u>
Total assets	<u>1,286,569</u>	<u>1,236,675</u>	<u>1,219,449</u>
Current liabilities	37,456	47,245	36,629
Long-term and restricted liabilities	<u>787,074</u>	<u>734,517</u>	<u>739,489</u>
Total liabilities	<u>824,530</u>	<u>781,762</u>	<u>776,118</u>
Net assets:			
Invested in capital — net of related debt	417,998	411,008	407,523
Restricted for capital projects	751	297	12,450
Unrestricted	<u>43,290</u>	<u>43,608</u>	<u>23,358</u>
Total net assets	<u>\$ 462,039</u>	<u>\$ 454,913</u>	<u>\$ 443,331</u>

### 2006

Current assets decreased by \$14.0 million (17.4%) due to a decrease in amounts due from other City funds and a decrease in investments on hand at year-end. Restricted and other assets increased by \$36.3 million (27.3%) and capital assets — net increased by \$27.6 million (2.7%) due principally to capital activities for sewer construction and rehabilitation projects.

The decrease in current liabilities of \$9.8 million (20.7%) is primarily related to the decrease in accounts payable and accrued liabilities. Long-term and restricted liabilities increased by \$52.6 million (7.2%) due to an increase in long-term debt.

Net assets may serve, over a period of time, as a useful indicator of the Sewer Fund's financial position. As of December 31, 2006, total net assets were \$462.0 million, an increase of \$7.1 million (1.6%) from 2005. Overall, the change in net assets is due to income.

### 2005

Current assets increased by \$19.8 million (32.8%) due to an increase in amounts due from other City funds and an increase in cash, cash equivalents, and investments on hand at year-end. Restricted and other assets decreased by \$35.8 million (21.2%) and capital assets — net increased by \$33.2 million (3.4%) due principally to capital activities for sewer construction and rehabilitation projects.

The increase in current liabilities of \$10.6 million (29.0%) is primarily related to the increase in accounts payable and accrued liabilities. Long-term and restricted liabilities decreased by \$5 million (0.7%) due to a reduction in long-term debt.

Net assets may serve, over a period of time, as a useful indicator of the Sewer Fund's financial position. As of December 31, 2005, total net assets were \$454.9 million, an increase of \$11.6 million (2.6%) from 2004. Overall, the increase is due to cash on hand at year-end and increase in amounts due from Water Fund to Sewer Fund.

The primary sources of the Sewer Fund's operating revenues are sewer service revenues which are derived from 83% of water billings. These revenues fund all Sewer Fund operating expenses, fund deposits, and debt service requirements. A comparative condensed summary of the Sewer Fund's revenues, expenses, and changes in net assets for the years ended December 31, 2006, 2005, and 2004 is as follows:

(In thousands of dollars)	<u>Revenues, Expenses, and Changes in Net Assets</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Revenues:			
Operating revenues			
Sewer service	\$ 134,323	\$ 141,314	\$ 142,680
Other operating revenues	<u>2,114</u>	<u>2,208</u>	<u>2,308</u>
Total operating revenues	136,437	143,522	144,988
Nonoperating revenues	1,160	787	697
Capital grants	<u>          </u>	<u>          </u>	<u>1,242</u>
Total revenues and grants	<u>137,597</u>	<u>144,309</u>	<u>146,927</u>
Expenses:			
Operating expenses	84,015	88,811	85,720
Depreciation and amortization	19,330	18,683	18,394
Nonoperating expenses	<u>27,126</u>	<u>25,233</u>	<u>31,057</u>
Total expenses	<u>130,471</u>	<u>132,727</u>	<u>135,171</u>
Change in net assets	7,126	11,582	11,756
Net assets — beginning of year	<u>454,913</u>	<u>443,331</u>	<u>431,575</u>
Net assets — end of year	<u>\$ 462,039</u>	<u>\$ 454,913</u>	<u>\$ 443,331</u>

## 2006

Sewer service revenues for the years 2006 and 2005 were \$134.3 million and \$141.3 million, respectively. Other revenue which consists primarily of inspection fees and house drain fees for the years ended 2006 and 2005 were \$2.1 million and \$2.2 million, respectively. The decrease in 2006 sewer service revenues of \$7.0 million (4.9%) is primarily due to a reduction in sewer service revenues as a result of a reduction in water usage.

Nonoperating revenues increased by \$.4 million as a result of an increase in interest income. The increase in nonoperating expenses is primarily due to an increase in interest expense as a result of a smaller portion of interest being capitalized in 2006 than in 2005.



## 2005

Sewer service revenues for the years 2005 and 2004 were \$141.3 million and \$142.7 million, respectively. Other revenue which consists primarily of inspection fees and house drain fees for the years ended 2005 and 2004 were \$2.2 million and \$2.3 million, respectively. The decrease in 2005 sewer service of \$1.4 million (1%) is primarily due to a reduction in sewer service revenues from suburban customers.

Nonoperating revenues increased by \$.2 million as a result of an increase in interest income. The decrease in nonoperating expenses is primarily due to a decrease in interest expense as a result of a larger portion of interest being capitalized in 2005 than in 2004.

A comparative summary of the Sewer Fund's operating expenses, as classified in the basic financial statements, for the years ended December 31, 2006, 2005, and 2004 is as follows:

(In thousands of dollars)	Operating Expenses		
	2006	2005	2004
Repairs	\$ 34,770	\$ 33,981	\$ 31,023
General Fund reimbursements	22,569	26,823	25,272
Maintenance	18,964	18,966	19,315
Engineering	1,213	3,587	4,505
Administrative and general	6,499	5,454	5,605
Operating expenses before depreciation and amortization	84,015	88,811	85,720
Depreciation and amortization	19,330	18,683	18,394
Total operating expenses	<u>\$ 103,345</u>	<u>\$ 107,494</u>	<u>\$ 104,114</u>

## 2006

Overall, operating expenses before depreciation and amortization decreased by \$4.8 million (5.4%) in 2006 primarily due to decreases in personnel costs and expenses related to engineering. Depreciation and amortization increased slightly due to an increase in capital assets.

## 2005

Overall, operating expenses before depreciation and amortization increased by \$3.1 million (3.6%) in 2005 primarily due to increases in personnel costs and expenses related to repairs. Depreciation and amortization increased slightly due to an increase in capital assets.

A comparative summary of the Sewer Fund's cash flows for the years ended December 31, 2006, 2005, and 2004, is as follows:

(In thousands of dollars)	Cash Flows		
	2006	2005	2004
Cash from activities:			
Operating	\$ 49,416	\$ 48,477	\$ 49,114
Capital and related financing	(27,057)	(82,137)	(4,572)
Investing	<u>(16,792)</u>	<u>30,188</u>	<u>(64,662)</u>
Net change in cash and cash equivalents	5,567	(3,472)	(20,120)
Cash and cash equivalents:			
Beginning of the year	<u>68,242</u>	<u>71,714</u>	<u>91,834</u>
End of the year	<u>\$ 73,809</u>	<u>\$ 68,242</u>	<u>\$ 71,714</u>

## 2006

As of December 31, 2006, the Sewer Fund's cash and cash equivalents of \$73.8 million increased by \$5.6 million compared to \$68.2 million at December 31, 2005, primarily due to proceeds from issuance of new debt and related financing activities, offset by positive cash flows from operating and investing activities used in 2006. Total cash and cash equivalents at December 31, 2006, comprise unrestricted and restricted cash and cash equivalents of \$7.5 million and \$66.3 million, respectively.

## 2005

As of December 31, 2005, the Sewer Fund's cash and cash equivalents of \$68.2 million decreased by \$3.5 million compared to \$71.7 million at December 31, 2004, due to the use of cash flows for capital and related financing activities, \$82.1 million offset by positive cash flows from operating and investing activities, \$48.5 million and \$30.2 million, respectively. Total cash and cash equivalents at December 31, 2005 comprise unrestricted and restricted cash and cash equivalents of \$12.9 million and \$55.3 million, respectively.

## CAPITAL ASSET AND DEBT ADMINISTRATION

### 2006

At the end of 2006 and 2005, the Sewer Fund had net utility plant of \$1,051.3 million and \$1,023.7 million, respectively. During 2006, the Sewer Fund had capital additions of \$45.3 million, and completed projects totaling \$8.5 million were transferred from construction in progress to applicable facilities and structures capital accounts.

## 2005

At the end of 2005 and 2004, the Sewer Fund had net utility plant of \$1,023.7 million and \$990.5 million, respectively. During 2005, the Sewer had capital additions of \$48.4 million, and completed projects totaling \$5.1 million were transferred from construction in progress to applicable facilities and structures capital accounts. Additionally, \$1.0 million of furniture and equipment with accumulated depreciation of \$0.8 million was retired resulting in a loss on disposal of \$0.2 million.

The Sewer Fund's net utility plant at December 31, 2006, 2005, and 2004, are summarized as follows:

(In thousands of dollars)	Net Utility Plant at Year-End		
	2006	2005	2004
Utility plant not depreciated:			
Land and land rights	\$ 560	\$ 560	\$ 560
Construction in progress	9,817	8,474	5,092
Total utility plant not depreciated	10,377	9,034	5,652
Utility plant being depreciated:			
Facilities and structures	1,317,639	1,272,677	1,225,718
Furniture and equipment	27,349	27,078	26,630
Total utility plant being depreciated	1,344,988	1,299,755	1,252,348
Less accumulated depreciation:			
Facilities and structures	(287,338)	(270,107)	(253,509)
Furniture and equipment	(16,694)	(14,955)	(13,990)
Total accumulated depreciation	(304,032)	(285,062)	(267,499)
Total utility plan being depreciated — net	1,040,956	1,014,693	984,849
Total utility plant — net	\$1,051,333	\$1,023,727	\$ 990,501

The Sewer Fund's capital activities are funded through Sewer revenue bonds and Sewer revenues. Additional information on the Sewer Fund's capital assets is presented in Note 5 of the notes to basic financial statements on page 27 of this report.

The Sewer Fund's outstanding debt at December 31, 2006, 2005, and 2004, is summarized as follows:

(In thousands of dollars)	Long-Term Outstanding Debt at Year-End		
	2006	2005	2004
Revenue bonds	\$ 790,038	\$ 747,463	\$ 757,793
Add accretion of Series 1998			
Capital Appreciation Bonds	20,499	17,648	14,942
Less unamortized deferred loss on bond refunding	(49,464)	(46,456)	(48,260)
Unamortized net bond discount/premium	16,981	4,730	4,775
Total outstanding debt — net	\$ 778,054	\$ 723,385	\$ 729,250

The Sewer Fund's revenue bonds at December 31, 2006, have underlying credit ratings with each of the three major rating agencies as follows:

	<b>Moody's Investor Services</b>	<b>Standard &amp; Poor's</b>	<b>Fitch Ratings</b>
Senior Lien Wastewater Revenue Bonds	N/A	N/A	N/A
Junior Lien Wastewater Revenue Bonds	A2	A	AA-

At December 31, 2006, the Sewer Fund was in compliance with the debt covenants as stated in the Master Trust Indentures. Details regarding the Sewer Fund's long-term debt begin on page 22 in the notes to the basic financial statements. Unaudited statistical data on the Sewer Fund's debt service coverage begins on page 32 of this report.

### **REQUESTS FOR INFORMATION**

This financial report is designed to provide the reader with a general overview of the Sewer Fund's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the City of Chicago Comptroller's Office.

**CITY OF CHICAGO, ILLINOIS  
SEWER FUND**

**STATEMENTS OF NET ASSETS  
AS OF DECEMBER 31, 2006 AND 2005  
(In thousands of dollars)**

<b>ASSETS</b>	<b>2006</b>	<b>2005</b>	<b>LIABILITIES AND NET ASSETS</b>	<b>2006</b>	<b>2005</b>
<b>CURRENT ASSETS:</b>			<b>CURRENT LIABILITIES:</b>		
Cash and cash equivalents (Note 2)	\$ 7,475	\$ 12,918	Accounts payable	\$ 9,483	\$ 16,312
Investments	1,564	4,212	Due to other City of Chicago funds	1,839	1,077
Accounts receivable — net of allowance for doubtful accounts of approximately \$2.5 in 2006 and 2005	31,339	29,417	Deferred revenue	8,180	8,567
Due from other City of Chicago funds	23,872	31,825	Accrued liabilities	<u>17,954</u>	<u>21,289</u>
Inventories	<u>1,867</u>	<u>1,711</u>			
Total current assets	<u>66,117</u>	<u>80,083</u>	Total current liabilities	<u>37,456</u>	<u>47,245</u>
<b>NONCURRENT ASSETS:</b>			<b>NONCURRENT LIABILITIES:</b>		
Restricted assets (Notes 2 and 3):			Liabilities payable from restricted assets:		
Cash and cash equivalents	66,334	55,324	Current portion of revenue bonds payable (Note 4)	19,510	15,500
Investments	94,547	69,765	Accrued interest payable	<u>9,020</u>	<u>11,132</u>
Interest receivable	<u>751</u>	<u>911</u>			
Total restricted assets	<u>161,632</u>	<u>126,000</u>	Total liabilities payable from restricted assets	28,530	26,632
<b>OTHER ASSETS</b>	<u>7,487</u>	<u>6,865</u>	<b>REVENUE BONDS PAYABLE (Note 4) — Net of discount and deferred loss on bond refunding</b>	<u>758,544</u>	<u>707,885</u>
<b>UTILITY PLANT (Note 5):</b>			Total noncurrent liabilities	<u>787,074</u>	<u>734,517</u>
Land and land rights	560	560	Total liabilities	<u>824,530</u>	<u>781,762</u>
Facilities and structures	1,317,639	1,272,677	<b>NET ASSETS:</b>		
Furniture and equipment	27,349	27,078	Invested in capital assets — net of related debt	417,998	411,008
Construction in progress	<u>9,817</u>	<u>8,474</u>	Restricted for capital projects	751	297
Total utility plant	1,355,365	1,308,789	Unrestricted net assets	<u>43,290</u>	<u>43,608</u>
Less accumulated depreciation	<u>304,032</u>	<u>285,062</u>	Total net assets	462,039	454,913
Utility plant — net	<u>1,051,333</u>	<u>1,023,727</u>			
Total noncurrent assets	<u>1,220,452</u>	<u>1,156,592</u>			
<b>TOTAL</b>	<u>\$1,286,569</u>	<u>\$1,236,675</u>	<b>TOTAL</b>	<u>\$1,286,569</u>	<u>\$1,236,675</u>

See notes to basic financial statements.

**CITY OF CHICAGO, ILLINOIS  
SEWER FUND**

**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005  
(In thousands of dollars)**

	<b>2006</b>	<b>2005</b>
OPERATING REVENUES:		
Sewer service	\$ 134,323	\$ 141,314
Other	<u>2,114</u>	<u>2,208</u>
Total operating revenues	<u>136,437</u>	<u>143,522</u>
OPERATING EXPENSES:		
Repairs	34,770	33,981
General Fund reimbursements	22,569	26,823
Maintenance	18,964	18,966
Engineering	1,213	3,587
Administrative and general	<u>6,499</u>	<u>5,454</u>
Total operating expenses before depreciation and amortization	84,015	88,811
Depreciation and amortization	<u>19,330</u>	<u>18,683</u>
Total operating expenses	<u>103,345</u>	<u>107,494</u>
OPERATING INCOME	<u>33,092</u>	<u>36,028</u>
NONOPERATING REVENUE (EXPENSES):		
Interest income	1,063	802
Interest expense	(27,126)	(25,233)
Other	<u>97</u>	<u>(15)</u>
Total nonoperating expenses	<u>(25,966)</u>	<u>(24,446)</u>
CHANGE IN NET ASSETS	7,126	11,582
TOTAL NET ASSETS — Beginning of year	<u>454,913</u>	<u>443,331</u>
TOTAL NET ASSETS — End of year	<u>\$ 462,039</u>	<u>\$ 454,913</u>

See notes to basic financial statements.

**CITY OF CHICAGO, ILLINOIS  
SEWER FUND**

**STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005  
(In thousands of dollars)**

	<b>2006</b>	<b>2005</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Received from customers	\$ 134,128	\$ 143,988
Transactions with other City funds — net	(14,652)	(43,336)
Payments to vendors	(29,923)	(13,663)
Payments to employees	<u>(40,137)</u>	<u>(38,512)</u>
Net cash provided by operating activities	<u>49,416</u>	<u>48,477</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Acquisition and construction of capital assets	(41,033)	(38,928)
Proceeds from sale of capital assets	97	192
Proceeds from issuance of bonds	165,486	
Payment of refunded bonds	(98,945)	
Interest paid on revenue bonds	(35,351)	(33,071)
Payment of bond issuance and discount costs	(1,811)	
Principal paid on bonds	<u>(15,500)</u>	<u>(10,330)</u>
Net cash used in capital and related financing activities	<u>(27,057)</u>	<u>(82,137)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Sales and purchases of investments — net	(22,134)	27,703
Investment interest	<u>5,342</u>	<u>2,485</u>
Net cash (used in) provided by investing activities	<u>(16,792)</u>	<u>30,188</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>5,567</b>	<b>(3,472)</b>
<b>CASH AND CASH EQUIVALENTS — Beginning of year</b>	<b><u>68,242</u></b>	<b><u>71,714</u></b>
<b>CASH AND CASH EQUIVALENTS — End of year</b>	<b><u>\$ 73,809</u></b>	<b><u>\$ 68,242</u></b>
<b>RECONCILIATION TO CASH AND CASH EQUIVALENTS REPORTED ON THE STATEMENTS OF NET ASSETS:</b>		
Unrestricted	\$ 7,475	\$ 12,918
Restricted	<u>66,334</u>	<u>55,324</u>
<b>TOTAL</b>	<b><u>\$ 73,809</u></b>	<b><u>\$ 68,242</u></b>

(Continued)

**CITY OF CHICAGO, ILLINOIS  
SEWER FUND**

**STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005  
(In thousands of dollars)**

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	<b>2006</b>	<b>2005</b>
RECONCILIATION OF OPERATING INCOME TO CASH FLOWS FROM OPERATING ACTIVITIES:		
Operating income	\$ 33,092	\$ 36,028
Adjustments to reconcile:		
Depreciation and amortization	19,330	18,683
Changes in assets and liabilities:		
Decrease (increase) in due from other City funds	7,953	(15,539)
Increase in accounts receivable	(1,922)	(43)
(Increase) decrease in inventories	(156)	70
(Decrease) increase in accrued liabilities	(3,335)	3,505
(Decrease) increase in accounts payable and due to other City funds	(5,159)	5,266
(Decrease) increase in deferred revenue	<u>(387)</u>	<u>507</u>
 CASH FLOWS FROM OPERATING ACTIVITIES	 <u>\$ 49,416</u>	 <u>\$ 48,477</u>

SUPPLEMENTAL DISCLOSURE OF NONCASH ITEMS —  
Property additions in 2006 and 2005 of \$5,208 and  
\$6,116, respectively, are included in accounts payable.

See notes to basic financial statements.

(Concluded)



# CITY OF CHICAGO, ILLINOIS

## SEWER FUND

### NOTES TO BASIC FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005 (In thousands of dollars)

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#### 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Organization** — The Sewer Fund collects and transmits wastewater to the treatment facilities of the Metropolitan Water Reclamation District of Greater Chicago. The Sewer Fund is included in the City of Chicago, Illinois' (City) reporting entity as an Enterprise Fund.

**Basis of Accounting** — The accounting policies of the Sewer Fund are based upon accounting principles generally accepted in the United States of America as prescribed by the Government Accounting Standards Board (GASB). For the year ended December 31, 2006, the Sewer Fund adopted GASB Statement No. 44, *Economic condition reporting: The Statistical section*, and GASB Statement No. 47, *Accounting for Termination Benefits*. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The accounts of the Sewer Fund are reported using the flow of economic resources measurement focus.

The Sewer Fund uses the accrual basis of accounting under which revenues are recognized when earned and expenses are recognized when the liability is incurred. Enterprise funds may elect to apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, provided that such standards are not in conflict with standards issued by the GASB. The Sewer Fund has elected not to apply FASB pronouncements issued after November 30, 1989.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources, as they are needed.

**Annual Appropriated Budget** — The Sewer Fund has a legally adopted annual budget which is not required to be reported.

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

**Cash, Cash Equivalents, and Investments** — Cash, cash equivalents, and investments generally are held with the City Treasurer as required by the Municipal Code of Chicago (Code). Interest earned on pooled investments is allocated to participating funds based upon their average combined cash and investment balances. Due to contractual agreements or legal restrictions, the cash and investments of certain funds are segregated, and earn and receive interest directly.

The Code permits deposits only to City Council-approved depositories which must be regularly organized state or national banks and federal and state savings and loan associations, located within the City, whose deposits are federally insured.

Investments authorized by the Code include interest-bearing general obligations of the City, State of Illinois (State), and the U.S. Government; U.S. Treasury bills and other non-interest-bearing general obligations of the U.S. Government purchased in the open market below face value; domestic money market funds regulated by and in good standing with the Securities and Exchange Commission; and tax anticipation warrants issued by the City. The City is prohibited by ordinance from investing in derivatives, as defined, without City Council approval.

The Sewer Fund values its investments at fair value or amortized cost as applicable. U.S. Government securities purchased at a price other than par with a maturity of less than one year are reported at amortized cost.

Repurchase agreements can be purchased only from banks and certain other institutions authorized to do business in the State. The City Treasurer requires that securities pledged to secure these agreements have a market value equal to the cost of the repurchase agreement plus accrued interest.

Investments, generally, may not have a maturity in excess of one year from the date of purchase. Certain other investment balances are held in accordance with the specific provisions of applicable bond ordinances.

Cash equivalents include certificates of deposit and other investments with maturities of three months or less when purchased.

**Accounts Receivable** — Sewer Fund accounts receivable result from billings and collections for sewer services processed by the Department of Water Management. Management has provided an allowance for amounts recorded at year-end which may be uncollectible.

**Transactions With the City** — The City's General Fund provides services to all other funds. The amounts allocated to other funds for these services are treated as operating expenses by the Sewer Fund and consist mainly of employee benefits, self-insured risks, and administrative expenses.

**Inventories** — Inventories, comprised mainly of materials and supplies, are stated at cost, determined principally on the first-in, first-out method.

**Utility Plant** — Utility plant is recorded at cost or, for donated assets, at fair value at the date of acquisition. Utility plant is defined by the Sewer Fund as assets with an initial cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost if purchased or estimated historical cost if constructed. Depreciation is provided using the straight-line method and begins in the year following the year of acquisition or completion. Estimated useful lives are as follows:

Facilities and structures	75 years
Furniture and equipment	5–20 years
Sewer rehabilitation	50 years

Costs of repairs and maintenance that do not significantly extend the useful life of assets are charged to operations.

**Net Assets** — Net assets comprise the net earnings from operating and nonoperating revenues, expenses and capital grants. Net assets are displayed in three components—invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. Invested in capital assets, net of related debt consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt net of

debt service reserve and unspent bond proceeds. Restricted net assets consist of net assets for which constraints are placed thereon by external parties (such as lenders and grantors) and laws, regulations, and enabling legislation. Unrestricted net assets consist of all other net assets not categorized as either of the above.

**Employee Benefits** — Employee benefits are granted for vacation and sick leave, workers' compensation, and health care. Unused vacation leave is accrued and may be carried over for one year. Sick leave is accumulated at the rate of one day for each month worked, up to a maximum of 200 days. Severance of employment terminates all rights to receive compensation for any unused sick leave. Sick leave pay is not accrued. Employee benefit claims outstanding, including claims incurred but not reported, are estimated and recorded as liabilities.

Employees are eligible to defer a portion of their salaries until future years under the City's deferred compensation plan created in accordance with Internal Revenue Code Section 457. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. The plan is administered by third-party administrators who maintain the investment portfolio. The plan's assets have been placed in trust accounts with the plan administrators for the exclusive benefit of participants and their beneficiaries and are not considered assets of the City.

The City is subject to the State Unemployment Compensation Act and has elected the reimbursing employer option for providing unemployment insurance benefits for eligible former employees. Under this option, the City reimburses the State for claims paid by the State.

**Bond Issuance Costs, Bond Discounts, and Refunding Transactions** — Bond issuance costs and bond discounts are deferred and amortized over the term of the related debt, except in the case of refunding debt transactions where the amortization period is over the term of the refunding or refunded debt, whichever is shorter.

**Swaps** — The Sewer Fund enters into interest rate swap agreements to modify interest rates on outstanding debt. Other than the net interest expenditures resulting from these arrangements, no amounts are recorded in the financial statements. All interest rate swaps are approved by the City Council.

**Capitalized Interest** — Interest expense and interest income earned on construction bond proceeds are capitalized during construction of those capital projects paid for from the bond proceeds and are being amortized over the depreciable life of the related assets on a straight-line basis.

**Capital Grants** — Capital grants are reported as revenue rather than as additions to fund equity on the Statements of Revenues, Expenses, and Changes in Net Assets.

**Revenue Recognition** — Sewer service revenue is billed as a percentage of the City water billings and is recorded as revenue when the water is consumed by the customers. Of the accounts receivable balances, \$12.6 million and \$13.4 million represent revenue recognized on sewer service which had not yet been billed to customers at December 31, 2006 and 2005, respectively. Deferred revenue represents amounts billed to nonmetered customers prior to usage.

**Revenues and Expenses** — The Sewer Fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Sewer Fund's principal ongoing operations. The principal operating revenues of the Sewer Fund are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on

capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

## 2. RESTRICTED AND UNRESTRICTED CASH, CASH EQUIVALENTS, AND INVESTMENTS

**Investments** — As of December 31, 2006, the Sewer Fund had the following investments (dollars in thousands):

Investment Type	Investment Maturities (In Years)				Fair Value
	Less Than 1	1-5	6-10	More Than 10	
<b>Sewer Funds</b>					
U.S. Agencies	\$ 66,702	\$ 46,925	\$	\$	\$ 113,627
Certificates of Deposits and Other Short-term	<u>46,489</u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>46,489</u>
Subtotal	<u>\$ 113,191</u>	<u>\$ 46,925</u>	<u>\$</u>	<u>\$</u>	160,116
Share of City's pooled funds					<u>4,271</u>
Total					<u>\$ 164,387</u>

As of December 31, 2005, the Sewer Fund had the following investments (dollars in thousands):

Investment Type	Investment Maturities (In Years)				Fair Value
	Less Than 1	1-5	6-10	More Than 10	
<b>Sewer Funds</b>					
U.S. Agencies	\$ 22,401	\$ 57,819	\$	\$	\$ 80,220
Certificates of Deposits and Other Short-term	<u>51,148</u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>51,148</u>
Subtotal	<u>\$ 73,549</u>	<u>\$ 57,819</u>	<u>\$</u>	<u>\$</u>	131,368
Share of City's pooled funds					<u>6,339</u>
Total					<u>\$ 137,707</u>

**Interest Rate Risk** — As a means of limiting its exposure to fair value losses arising from rising interest rates, the City's investment policy requires that investments generally may not have a maturity date in excess of two years from the date of purchase. Certain other investments are held in accordance with the specific provisions of applicable ordinances.

**Credit Risk** — The Code limits investments in commercial paper to banks whose senior obligations are rated in the top two rating categories by at least two national rating agencies and who are required to maintain such rating during the term of such investment. The Code also limits investments to domestic money market mutual funds regulated by, and in good standing with, the Securities and Exchange Commission. Certificates of Deposit are also limited by the Code to national banks which provide collateral of at least 110% by marketable U.S. government securities marked to market at least monthly; or secured by a corporate surety bond issued by an insurance company licensed to do business in Illinois and having a claims-paying rating in the top rating category, as rated by a nationally recognized

statistical rating organization maintaining such rating during the term of such investment. The following schedule summarizes the Sewer Fund's exposure to credit risk (dollars in thousands):

Quality Rating	2006	2005
Aaa/AAA	\$ 160,116	\$ 106,915
Not Rated		<u>24,453</u>
Total	<u>\$ 160,116</u>	<u>\$ 131,368</u>

The Sewer Fund participates in the City's pooled cash and investments account, which includes amounts from other City funds and is maintained by the City Treasurer. Individual cash or investments are not specifically identifiable to any participant in the pool. The Treasurer's pooled fund is included in the City's Comprehensive Annual Financial Report.

***Custodial Credit Risk — Cash and Certificates of Deposit*** — This is the risk that in the event of a bank failure, the City's deposits may not be returned. The City's Investment Policy states that in order to protect the City public fund deposits, depository institutions are to maintain collateral pledges on City deposits during the term of the deposit of at least 110% of marketable U.S. Government, or approved securities or surety bonds, issued by top-rated insurers. Collateral is required as security whenever deposits exceed the insured limits of the FDIC. Cash and certificates of deposit with the City's various municipal depositories were \$214.9 million and \$255.5 million at December 31, 2006 and 2005, respectively, and the related bank balances (including certificates of deposit) were \$248.4 million and \$169.6 million at December 31, 2006 and 2005, respectively. Of the bank balance, \$247.6 million and \$168.4 million or 99.7% and 99.3% at December 31, 2006 and 2005, respectively, were either insured or collateralized with securities held by City agents in the City's name. The remainder was uninsured and uncollateralized.

The following schedule summarizes the investments reported in the basic financial statements as of December 31, 2006 (dollars in thousands):

	2006	2005
Per Note 2:		
Investments — Sewer Fund	\$ 160,116	\$ 131,368
Investments — City Treasurer Pooled Fund	<u>4,271</u>	<u>6,339</u>
	<u>\$ 164,387</u>	<u>\$ 137,707</u>
Per Financial Statements:		
Restricted Investments	\$ 94,547	\$ 69,765
Unrestricted Investments	1,564	4,212
Investments included as cash and cash equivalents on the Statements of Net Assets	<u>68,276</u>	<u>63,730</u>
	<u>\$ 164,387</u>	<u>\$ 137,707</u>

### 3. RESTRICTED ASSETS AND ACCOUNTS

The ordinances authorizing the issuance of outstanding Wastewater Transmission Revenue Bonds provide for the creation of separate accounts into which net revenues, as defined, or proceeds are to be credited, are as follows:

#### ***Wastewater Revenue Bonds, Series 1995 and 1994 and Refunding Bonds Series 1993 (Senior Lien Bonds)***

*Bond Principal and Interest Account* — No later than ten days prior to each principal or interest payment date, an amount to pay principal; premium, if any; and interest becoming due, whether upon maturity, redemption, or otherwise.

*Debt Service Reserve Account* — For each series, an amount equal to the least of (i) the maximum annual debt service requirement; (ii) 10% of the original principal amount less original issue discount; or (iii) 125% of the average annual debt service requirement. The required balance in this account was met by the purchase of surety bonds.

*Rebate Account* — Under the Tax Reform Act of 1986 (Act), the City has entered into an arbitrage agreement under which the City will comply with certain requirements of the Act to maintain the tax-exempt status of the bonds. The Rebate account has been established to account for any liability resulting from the Act.

*Construction Account* — Proceeds of the Series 1995 and 1994 Bonds were deposited in this account for the purpose of paying construction costs of projects as defined in the ordinance.

#### ***Wastewater Revenue Bonds, Series 2004, 2001, 2000, 1998, and Refunding Series 2004 (Second Lien Bonds) and Refunding Series 2006 (Second Lien Bonds)***

*Bond Principal and Interest Account* — No later than the business day immediately preceding January 1 and July 1, an amount to pay principal; redemption premium, if any; and interest on the bonds. The City is also required to make deposits in the second lien bonds account to meet other payment obligations under the indenture authorizing Second Lien Parity Bonds.

*Debt Service Reserve Account* — For each series, an amount equal to the least of: (i) the highest future debt service requirement; (ii) 10% of the original principal amount less original issue discount; or (iii) 125% of the average annual debt service requirement. The required balance in this account was met by the purchase of a surety bond.

*Rebate Account* — Amounts required to make rebate payments, if any, to the United States of America related to the Second Lien Bonds regarding matters described previously for the Senior Lien Bonds.

*Construction Account* — Proceeds of the Second Lien Bonds were deposited in this account for the purpose of paying construction cost of projects as defined in the ordinance.

*Sewer Rate Stabilization Account* — Any net revenues remaining after providing sufficient funds for all required deposits in the bond accounts may be transferred to the Sewer Rate Stabilization Account upon the direction of the City to be used for any lawful purpose of the Sewer Fund.

For accounts established by ordinances with balances, the amounts at December 31, 2006 and 2005, are as follows (In thousands of dollars):

	<b>2006</b>	<b>2005</b>
Construction	\$ 117,722	\$ 87,828
Bond principal and interest	28,530	26,632
Sewer rate stabilization	<u>14,629</u>	<u>10,629</u>
Total	<u>\$ 160,881</u>	<u>\$ 125,089</u>

At December 31, 2006 and 2005, the Sewer Fund was in compliance with the above terms of the ordinances.

#### 4. LONG-TERM DEBT

At December 31, 2006 and 2005, long-term debt consisted of the following (In thousands of dollars):

	2006	2005
\$232,880 Series 1993 Wastewater Transmission Revenue Bonds Refunding issued March 1, 1993, due through 2013; interest at 5.125% to 6.5%	\$ 82,790	\$ 91,945
\$62,260 Series 1994 Wastewater Transmission Revenue Bonds issued July 1, 1994, due through 2024; interest at 4.85% to 6.375%		935
\$107,970 Series 1995 Wastewater Transmission Revenue Bonds issued December 1, 1995, due through 2025; interest at 3.9% to 5.125%	95	33,120
\$109,998 Series 1998 A and B Wastewater Transmission Revenue Bonds issued March 18, 1998, due through 2030; interest at 4.0% to 5.25%	66,723	105,778
\$115,000 Series 2000 Wastewater Transmission Revenue Bonds issued February 24, 2000, due through 2030; interest at 5.0% to 6.0%	9,705	13,510
\$114,585 Series 2001A Wastewater Transmission Revenue Bonds issued December 6, 2001, due through 2036; interest at 3.5% to 5.5%	8,820	35,095
\$73,100 Series 2001 Wastewater Transmission Revenue Bonds issued December 6, 2001, due through 2011; interest at 4.0% to 5.5%	72,720	72,925
\$394,155 Series 2004 A and B Wastewater Transmission Revenue Bonds issued July 29, 2004, due through 2039; Series A — variable floating interest rate (4.0% at December 31, 2006) Series B — interest at 3.0% to 5.25%	394,155	394,155
\$155,030 Series 2006 A & B Wastewater Transmission Revenue Bonds issued November 1, 2006 due through 2039; Series A — interest at 4.0% to 5.0% Series B — interest at 4.0% to 5.0%	155,030	
	<hr/>	<hr/>
	790,038	747,463
Add accretion of Series 1998 Capital Appreciation Bonds	20,499	17,648
Add unamortized net bond discount/premium	16,981	4,730
Less current portion (payable from restricted assets)	(19,510)	(15,500)
Less unamortized deferred loss on bond refunding	<u>(49,464)</u>	<u>(46,456)</u>
Long-term portion — net	<u>\$ 758,544</u>	<u>\$ 707,885</u>



During the years ended December 31, 2006 and 2005, long-term debt changed as follows (In thousands of dollars):

	<b>Balance January 1, 2006</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance December 31, 2006</b>	<b>Due Within One Year</b>
Revenue bonds	\$747,463	\$155,030	\$(112,455)	\$790,038	\$19,510
Accretion of Series 1998 Capital Appreciation Bonds	17,648	2,851		20,499	
Unamortized net discount/premium	4,730	10,455	1,796	16,981	
Deferred loss on bond refunding	<u>(46,456)</u>	<u>(5,326)</u>	<u>2,318</u>	<u>(49,464)</u>	
Total revenue bonds	<u>\$723,385</u>	<u>\$163,010</u>	<u>\$(108,341)</u>	<u>\$778,054</u>	<u>\$19,510</u>

  

	<b>Balance January 1, 2005</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance December 31, 2005</b>	<b>Due Within One Year</b>
Revenue bonds	\$757,793	\$	\$(10,330)	\$747,463	\$15,500
Accretion of Series 1998 Capital Appreciation Bonds	14,942	2,706		17,648	
Unamortized net discount/premium	4,775		(45)	4,730	
Deferred loss on bond refunding	<u>(48,260)</u>		<u>1,804</u>	<u>(46,456)</u>	
Total revenue bonds	<u>\$729,250</u>	<u>\$ 2,706</u>	<u>\$(8,571)</u>	<u>\$723,385</u>	<u>\$15,500</u>

Interest expense capitalized for 2006 and 2005 totaled \$10.7 million and \$13.2 million, respectively. Interest income capitalized for 2006 and 2005 totaled \$6.6 million and \$11.6 million, respectively.

Interest expense includes amortization of the loss on bond refunding for 2006 and 2005 of \$1.8 million and \$1.8 million; amortization of net bond discount/premium of \$127 thousand and \$45 thousand; and accretion of Series 1998 Capital Appreciation Bonds of \$2.9 million and \$2.7 million, respectively.

As defined in the ordinances, net revenues are pledged for the payment of principal and interest on the bonds. The ordinances require that net revenues available for bonds equal 115% of the senior lien debt service requirement and that net revenues available for bonds equal the sum of 100% of the aggregate annual senior lien debt service requirement and 100% of the aggregate annual second lien debt service requirement. The above requirements were met for 2006 and 2005.

**Rate Increases** — Sewer service rates are set by ordinance. The sewer service charge is established in an amount designed to pay the costs of Sewer Fund operations and capital improvements, including any related debt service. During 2006 and 2005, the charge for sewer service was an amount equal to 83%, of the gross amount charged for water service, whether such water service is metered or nonmetered. The rate charged for water was \$9.95 per 1,000 cubic feet effective January 1, 2005. There was no rate increase in 2006.

**Issuance of Debt** — Second Lien Wastewater Transmission Revenue Bonds, Series 2006A and B (\$155.0 million) were sold at a premium in November 2006. The bonds have interest rates ranging from 4.0 percent to 5.0 percent and maturity dates from January 1, 2007 to January 1, 2036. Net proceeds of \$163.7 million will be used to finance certain capital improvements and extensions to the Sewer System (\$62.7 million) and to advance refund certain maturities of wastewater transmission bonds outstanding (\$101.0 million). The advance refunding of the bonds decreased the Sewer fund's total debt service payments by \$5.2 million and resulted in an economic gain (difference between the present values of the debt service on the old and new debt) of \$4.9 million.

Following is a schedule of debt service requirements to maturity (In thousands of dollars):

Years Ending December 31	Principal	Interest	Total Debt Service
2007	\$ 19,510	\$ 14,338	\$ 33,848
2008	15,620	33,638	49,258
2009	21,145	32,741	53,886
2010	22,260	31,662	53,922
2011	23,405	30,528	53,933
2012–2016	136,530	133,571	270,101
2017–2021	156,280	114,231	270,511
2022–2026	154,564	116,898	271,462
2027–2031	117,539	78,383	195,922
2032–2036	88,845	17,918	106,763
2037–2039	<u>34,340</u>	<u>2,706</u>	<u>37,046</u>
Total	<u>\$ 790,038</u>	<u>\$ 606,614</u>	<u>\$ 1,396,652</u>

**Pay-Fixed, Receive-Variable Interest Rate Swaps** — In order to protect against the potential of rising interest rates, the Sewer Fund entered into three separate pay-fixed, receive-variable interest rate swaps.

**Terms, Fair Values, and Credit Risk** — The terms, including the fair value and credit ratings of the outstanding swaps as of December 31, 2006, are as follows. The notional amounts of the swaps match the principal amounts of the associated debt. The Sewer Fund’s swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled or anticipated reductions in the associated “bonds payable” category. Under the swap, the Sewer fund pays the counterparty a fixed payment and receives a variable payment computed according to the London Interbank Offered Rate (LIBOR) and/or The Bond Market Association Municipal Swap Index (BMA).

Associated Bond Issue	Notional Amounts	Effective Date	Fixed Rate Paid	Variable Rate Received	Fair Value	Termi- nation Date	party Credit Rating
Wastewater Transmission	\$232,560	07/29/2004	3.886%	BMA*	\$(10,787)	11/1/2039	A1/A+
Variable Rate Revenue Bonds	49,835	07/29/2004	3.886%	BMA*	(2,139)	11/1/2039	Aa1/AA+
(Series 2004)	<u>49,835</u>	07/29/2004	3.886%	BMA*	<u>(2,496)</u>	11/1/2039	Aa2/AAA
	<u>\$332,230</u>				<u>\$(15,422)</u>		

\*If LIBOR < 3%, then BMA is Floating Leg Rate. If LIBOR > 3%, then LIBOR is Floating Leg Rate.

**Fair Value** — As of December 31, 2006, the swaps had a negative fair value of \$15.4 million. As per industry convention, the fair values of the Sewer Fund’s outstanding swaps were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the forward rates implied by the yield curve correctly anticipate future spot rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap. Because interest rates declined subsequent to the date of execution, the Sewer Fund’s swaps had negative values.

**Credit Risk** — The Sewer Fund is exposed to credit risk (counterparty risk) through the counterparties with which it enters into agreements. If minimum credit rating requirements are not maintained, the counterparty is required to post collateral to a third party. This protects the Sewer Fund by mitigating the credit risk, and therefore the ability to pay a termination payment, inherent in a swap. Collateral on all swaps is to be in the form of cash or Eligible Collateral held by a third-party custodian. Upon credit events, the swaps also allow transfers, credit support, and termination if the counterparty is unable to meet the said credit requirements.

**Basis Risk** — Basis risk refers to the mismatch between the variable rate payments received on a swap contract and the interest payment actually owed on the bonds. The two significant components driving this risk are credit and BMA ratios. Credit may create basis risk because the Sewer Fund’s bonds may trade differently than the swap index as a result of a credit change in the Sewer Fund. BMA ratios (or spreads) may create basis risk if BMA swaps of the Sewer Fund’s bonds trade higher than the BMA received on the swap. This can occur due to many factors, including, without limitation, changes in marginal tax rates, tax-exempt status of bonds, and supply and demand for variable rate bonds. The Sewer Fund is exposed to basis risk on the swaps if the rate paid on the bonds is higher than the rate received. The Sewer Fund is liable for the difference. The difference would need to be available on the debt service payment date and would add additional underlying cost to the transaction.

**Tax Risk** — The swap exposes the Sewer Fund to tax risk or a permanent mismatch (shortfall) between the floating rate received on the swap and the variable rate paid on the underlying variable-rate bonds due to tax law changes such that the federal or state tax exception of municipal debt is eliminated or its value reduced. There have been no tax law changes since the execution of this swap agreement.

**Termination Risk** — The swap has the risk that it could be terminated as a result of certain events including a ratings downgrade for the issuer or swap counterparty, covenant violation, bankruptcy, payment default, or other defined events of default. Termination of a swap may result in a payment made by the issuer or to the issuer depending upon the market at the time of termination.

**Swap Payments and Associated Debt** — As of December 31, 2006, debt service requirements for the Sewer Fund’s outstanding variable-rate debt and net swap payments, assuming current interest rates remain the same, for their term are as follows (In thousands of dollars):

Years Ending December 31	Variable-Rate Bonds		Interest Rate	Total
	Principal	Interest	Swaps, Net	
2007	\$	\$ 13,289	\$ (379)	\$ 12,910
2008		13,289	(379)	12,910
2009		13,289	(379)	12,910
2010		13,289	(379)	12,910
2011		13,289	(379)	12,910
2012–2016	16,980	66,446	(1,894)	81,532
2017–2021	83,135	56,361	(1,606)	137,890
2022–2026	88,375	37,929	(1,081)	125,223
2027–2031	50,920	25,224	(719)	75,425
2032–2036	69,465	12,836	(365)	81,936
2037–2039	23,355	1,411	(40)	24,726
Total	<u>\$ 332,230</u>	<u>\$ 266,652</u>	<u>\$ (7,600)</u>	<u>\$ 591,282</u>

**Defeased Bonds** — Defeased bonds have been removed from the balance sheet because related assets have been placed in irrevocable trusts that, together with interest earned thereon, will provide amounts sufficient for payment of all principal and interest. Defeased bonds at December 31, 2006, not including principal payments due January 1, 2007, are as follows (In thousands of dollars):

	<b>Amount Defeased</b>	<b>Outstanding</b>
Wastewater Transmission Revenue Bonds, Series 1995	\$ 31,980	\$ 31,980
Wastewater Transmission Revenue Bonds, Series 1997	57,365	53,415
Wastewater Transmission Revenue Bonds, Series 1998 B *	38,340	38,340
Wastewater Transmission Revenue Bonds, Series 2000	98,405	94,970
Wastewater Transmission Revenue Bonds, Series 2001	101,650	100,235

\* bond is partially defeased as of 12/31/06

## 5. UTILITY PLANT

During the years ended December 31, 2006 and 2005, utility plant changed as follows:

(In thousands of dollars)	Balance January 1, 2006	Additions	Disposals and Transfers	Balance December 31, 2006
Utility plant not depreciated:				
Land and land rights	\$ 560	\$	\$	\$ 560
Construction in progress	<u>8,474</u>	<u>9,817</u>	<u>(8,474)</u>	<u>9,817</u>
Total utility plant not depreciated	<u>9,034</u>	<u>9,817</u>	<u>(8,474)</u>	<u>10,377</u>
Utility plant being depreciated:				
Facilities and structures	1,272,677	44,962		1,317,639
Furniture and equipment	<u>27,078</u>	<u>376</u>	<u>(105)</u>	<u>27,349</u>
Total utility plant being depreciated	<u>1,299,755</u>	<u>45,338</u>	<u>(105)</u>	<u>1,344,988</u>
Less accumulated depreciation:				
Facilities and structures	(270,107)	(17,231)		(287,338)
Furniture and equipment	<u>(14,955)</u>	<u>(1,844)</u>	<u>105</u>	<u>(16,694)</u>
Total accumulated depreciation	<u>(285,062)</u>	<u>(19,075)</u>	<u>105</u>	<u>(304,032)</u>
Total utility plant being depreciated — net	<u>1,014,693</u>	<u>26,263</u>	<u>—</u>	<u>1,040,956</u>
Total utility plant — net	<u>\$ 1,023,727</u>	<u>\$ 36,080</u>	<u>\$ (8,474)</u>	<u>\$ 1,051,333</u>
	Balance January 1, 2005	Additions	Disposals and Transfers	Balance December 31, 2005
Utility plant not depreciated:				
Land and land rights	\$ 560	\$	\$	\$ 560
Construction in progress	<u>5,092</u>	<u>8,474</u>	<u>(5,092)</u>	<u>8,474</u>
Total utility plant not depreciated	<u>5,652</u>	<u>8,474</u>	<u>(5,092)</u>	<u>9,034</u>
Utility plant being depreciated:				
Facilities and structures	1,225,718	46,959		1,272,677
Furniture and equipment	<u>26,630</u>	<u>1,483</u>	<u>(1,035)</u>	<u>27,078</u>
Total utility plant being depreciated	<u>1,252,348</u>	<u>48,442</u>	<u>(1,035)</u>	<u>1,299,755</u>
Less accumulated depreciation:				
Facilities and structures	(253,509)	(16,598)		(270,107)
Furniture and equipment	<u>(13,990)</u>	<u>(1,794)</u>	<u>829</u>	<u>(14,955)</u>
Total accumulated depreciation	<u>(267,499)</u>	<u>(18,392)</u>	<u>829</u>	<u>(285,062)</u>
Total utility plant being depreciated — net	<u>984,849</u>	<u>30,050</u>	<u>(206)</u>	<u>1,014,693</u>
Total utility plant — net	<u>\$ 990,501</u>	<u>\$ 38,524</u>	<u>\$ (5,298)</u>	<u>\$ 1,023,727</u>

## 6. PENSION PLANS

Eligible Sewer Fund employees participate in one of two of the City's single-employer defined benefit pension plans. These plans are the Municipal Employees' and the Laborers' and Retirement Board Employees' Annuity and Benefit Funds. These plans are administered by individual retirement boards represented by elected and appointed officials. Each plan issues publicly available financial statements for each of the pension plans, which may be obtained at the respective fund's office.

The funds provide retirement, death, and disability benefits as established by state law. Benefits generally vest after 20 years of credited service. Employees who retire at or after age 55 with at least 10 years of credited service qualify to receive a money purchase annuity and those with more than 20 years of credited service qualify to receive a minimum formula annuity. The annuity is computed by multiplying the final average salary by a minimum of 2.4% per year of credited service. The final average salary is the employee's highest average annual salary for any four consecutive years within the last 10 years of credited service.

Participating employees contribute 8.5% of their salary to these funds as required by state law. By law, the City's contributions are based on the amounts contributed by the employees. Financing of the City's contribution is through a separate property tax levy and the personal property replacement tax. The Sewer Fund reimburses the City's General Fund for the estimated pension cost applicable to the covered payroll of Sewer Fund employees. These reimbursements, recorded as expenses of the Sewer Fund, were \$3.3 million in 2006, \$3.2 million in 2005 and \$4.0 million in 2004. The annual pension costs are determined using the entry age normal actuarial cost method and the level dollar amortization method.

The funding policy mandated by state law requires City contributions at statutorily, not actuarially, determined rates. The rates are expressed as multiples of employee contributions. These contributions equal employee contributions made in the calendar year two years prior multiplied by the statutory rates. The statutory rates in effect for the City's contributions made during the years ended December 31, 2006, 2005, and 2004 were 1.25 for the Municipal Employees' and 1.00 for the Laborers' and Retirement Board Employees' Annuity and Benefit Funds, respectively. The City has made the required contributions under state law.

The following table as of December 31, 2006, assists users in assessing each fund's progress in accumulating sufficient assets to pay benefits when due. The three-year historical information for each annuity and benefit fund is as follows:

(in thousands of dollars)	Annual Pension Cost	Percent of Annual Pension Cost Contributed	Required Contribution	Percent of Required Contributions Made	Net Pension Assets
Municipal Employees'					
2004	\$197,393	78.0 %	\$ 198,199	77.7 %	\$ 299,415
2005	284,587	54.4	285,291	54.5	169,895
2006	325,514	48.3	325,914	48.3	1,442
Laborers'					
2004	7,860	2.6	8,513	2.4	270,223
2005	12,139	0.3	12,774	0.3	258,125
2006	20,536	0.5	21,142	0.6	237,696

The pension benefits information pertaining expressly to Sewer Fund employees is not available. Accordingly, no amounts have been recorded in the accompanying financial statements for the net pension assets of these plans.

In addition to providing pension benefits, the City, under state law, provides certain health benefits to employees who retire from the City based upon their participation in the City's pension plans. Substantially all employees who qualify as Municipal Employees' or Laborers' pension plan participants older than age 55 with at least 20 years of service may become eligible for postemployment benefits if they eventually become annuitants. Health benefits include basic benefits for annuitants and supplemental benefits for Medicare-eligible annuitants. Currently, the City does not segregate benefit payments to annuitants by fund. The cost of health benefits is recognized as claims are reported and funded on a pay-as-you-go basis. The total cost to the City for providing health benefits to approximately 24,374 and 24,507 annuitants and their dependents was approximately \$79.3 million and \$78.3 million in 2006 and 2005, respectively.

All annuitants who retired prior to July 1 2005, received a 55% subsidy from the City and annuitants who retired on or after July 1, 2005, received a 50, 45, 40, or 0% subsidy from the City based on the annuitant's length of actual employment with the City for the gross cost of retiree health care under a court approved settlement agreement. The pension funds contributed \$55 for each Medicare-eligible annuitant and \$85 for each non-Medicare-eligible annuitant to their gross cost. The annuitants contributed a total of approximately \$51.1 million in 2006 to the gross cost of their retiree health care pursuant to premium amounts set forth in the above-referenced settlement agreement

## 7. RELATED-PARTY TRANSACTIONS

Included in operating expenses are reimbursements to the General Fund of the City and certain other funds for services provided by other City departments, employee fringe benefits, and certain payments made on behalf of the Sewer Fund. Such reimbursements amounted to \$27.1 million and \$26.8 million in 2006 and 2005, respectively.

## 8. COMMITMENTS AND CONTINGENCIES

The Sewer Fund has certain contingent liabilities resulting from litigation, claims, or commitments incident to the ordinary course of business. Management expects that final resolution of these contingencies will not have a material adverse affect on the financial position or results of operations of the Sewer Fund.

The Sewer Fund provides workers' compensation benefits and employee health benefits under self-insurance programs administered by the City. Such claims outstanding, including claims incurred but not reported, are estimated and recorded as liabilities in the financial statements.

Uninsured claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate for claims that have been incurred but not reported. Changes in the claims liability amount for the years ended December 31, 2006 and 2005, are as follows:

<b>(In thousands of dollars)</b>	<b>2006</b>	<b>2005</b>
Balance — January 1	\$ 13,876	\$ 13,879
Claims incurred on current and prior year events	8,870	8,516
Claims paid on current and prior year events	<u>(8,428)</u>	<u>(8,519)</u>
Balance — December 31	<u>\$ 14,318</u>	<u>\$ 13,876</u>

The City purchases annuity contracts from commercial insurers to satisfy certain liabilities; accordingly, no liability is reported for those claims. Property and casualty risks for the Sewer Fund are transferred to commercial insurers. Claims have not exceeded the purchased insurance coverage in the past three years.

At December 31, 2006 and 2005, the Sewer Fund entered into contracts for approximately \$17.7 million and \$16.6 million, respectively, for construction projects.

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**CITY OF CHICAGO, ILLINOIS  
SEWER FUND**

**STATISTICAL DATA  
HISTORICAL FINANCIAL OPERATIONS  
TEN YEARS ENDED DECEMBER 31, 2006  
(In thousands of dollars) (Unaudited)**

	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
OPERATING REVENUES	<u>\$ 124,590</u>	<u>\$ 128,779</u>	<u>\$ 127,349</u>	<u>\$ 137,342</u>	<u>\$ 144,224</u>	<u>\$ 141,330</u>	<u>\$ 142,373</u>	<u>\$ 144,988</u>	<u>\$ 143,522</u>	<u>\$ 136,437</u>
OPERATING EXPENSES:										
Repairs	36,182	35,068	41,145	35,970	38,814	39,079	35,196	31,023	33,981	34,770
Maintenance	15,854	18,007	20,999	21,777	22,253	22,499	23,772	19,315	18,966	18,964
Administrative and general	7,039	8,840	8,658	7,869	7,548	6,068	4,551	5,605	5,454	6,499
General Fund reimbursements	28,003	25,219	24,514	24,670	26,275	26,299	25,779	25,272	26,823	22,569
Engineering	<u>5,546</u>	<u>5,338</u>	<u>6,124</u>	<u>5,985</u>	<u>6,736</u>	<u>6,464</u>	<u>6,461</u>	<u>4,505</u>	<u>3,587</u>	<u>1,213</u>
Total operating expenses	92,624	92,472	101,440	96,271	101,626	100,409	95,759	85,720	88,811	84,015
NONOPERATING REVENUES	<u>621</u>	<u>883</u>	<u>923</u>	<u>1,712</u>	<u>878</u>	<u>355</u>	<u>276</u>	<u>140</u>	<u>802</u>	<u>1,063</u>
NET REVENUES — As defined	<u>\$ 32,587</u>	<u>\$ 37,190</u>	<u>\$ 26,832</u>	<u>\$ 42,783</u>	<u>\$ 43,476</u>	<u>\$ 41,276</u>	<u>\$ 46,890</u>	<u>\$ 59,408</u>	<u>\$ 55,513</u>	<u>\$ 53,485</u>

Source: City of Chicago Comptroller's Office.

# CITY OF CHICAGO, ILLINOIS SEWER FUND

## STATISTICAL DATA REVENUE BOND COVERAGE TEN YEARS ENDED DECEMBER 31, 2006 (In thousands of dollars) (Unaudited)

<b>PRIOR BONDS COVERAGE CALCULATION</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
Net revenues, as defined	\$32,587	\$37,190	\$26,832	\$42,783	\$43,476	\$41,276	\$46,890	\$59,408	\$55,513	\$53,485
Prior bond debt service requirement (1)	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>
Prior bond debt service coverage	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>
<b>COMBINED PRIOR BONDS, SENIOR LIEN, AND SECOND LIEN DEBT SERVICE CALCULATION</b>										
Net revenues, as defined	\$32,587	\$37,190	\$26,832	\$42,783	\$43,476	\$41,276	\$46,890	\$59,408	\$55,513	\$53,485
Deposits to prior lien accounts										
Transfer to (from) Sewer Rate Stabilization Account	<u>1,000</u>	<u>5,000</u>	<u>(5,814)</u>				<u>(1,050)</u>	<u>2,500</u>		<u>4,000</u>
Net revenues available for bonds	<u>31,587</u>	<u>32,190</u>	<u>32,646</u>	<u>42,783</u>	<u>43,476</u>	<u>41,276</u>	<u>47,940</u>	<u>56,908</u>	<u>55,513</u>	<u>49,485</u>
Prior lien debt service requirement										
Adjusted net revenues available for bonds	<u>\$31,587</u>	<u>\$32,190</u>	<u>\$32,646</u>	<u>\$42,783</u>	<u>\$43,476</u>	<u>\$41,276</u>	<u>\$47,940</u>	<u>\$56,908</u>	<u>\$55,513</u>	<u>\$49,485</u>
Debt service requirement:										
Senior lien bonds	<u>\$26,924</u>	<u>\$26,009</u>	<u>\$25,588</u>	<u>\$25,581</u>	<u>\$25,581</u>	<u>\$25,577</u>	<u>\$25,579</u>	<u>\$25,576</u>	<u>\$18,523</u>	<u>\$19,010</u>
Combined prior and senior lien debt service requirement	<u>\$26,924</u>	<u>\$26,009</u>	<u>\$25,588</u>	<u>\$25,581</u>	<u>\$25,581</u>	<u>\$25,577</u>	<u>\$25,579</u>	<u>\$25,576</u>	<u>\$18,523</u>	<u>\$19,010</u>
Combined prior and senior lien debt service coverage (1.15 required)	<u>1.17</u>	<u>1.24</u>	<u>1.28</u>	<u>1.67</u>	<u>1.70</u>	<u>1.61</u>	<u>1.87</u>	<u>2.23</u>	<u>3.00</u>	<u>2.60</u>
Debt service requirement:										
1997 second lien bonds		\$ 2,297	\$ 4,194	\$ 4,193	\$ 4,195	\$ 4,194	\$ 4,195	\$ 4,193		
1998 second lien bonds		547	2,864	2,861	2,862	2,862	2,861	2,863	\$ 2,879	\$ 2,861
2000 second lien bonds				2,788	8,165	1,264	4,155	4,155	743	2,643
2001 second lien bonds						2,276	4,037	4,045	4,079	4,190
2001A second lien bonds						3,337	7,108	7,107	1,792	3,244
2004A and B second lien bonds								4,393	6,698	16,048
2006A and B second lien bonds										
Combined second lien debt service requirement		<u>2,844</u>	<u>7,058</u>	<u>9,842</u>	<u>15,222</u>	<u>13,933</u>	<u>22,356</u>	<u>26,756</u>	<u>16,191</u>	<u>28,986</u>
Total combined prior, senior, and second lien debt service requirement		<u>\$28,853</u>	<u>\$32,646</u>	<u>\$35,423</u>	<u>\$40,803</u>	<u>\$39,510</u>	<u>\$47,935</u>	<u>\$52,332</u>	<u>\$34,714</u>	<u>\$47,996</u>
Combined prior, senior, and second lien debt service coverage (1.0 required)		<u>1.12</u>	<u>1.00</u>	<u>1.21</u>	<u>1.07</u>	<u>1.04</u>	<u>1.00</u>	<u>1.09</u>	<u>1.60</u>	<u>1.03</u>
Sewer Rate Stabilization Account year-end balance	<u>\$ 9,993</u>	<u>\$14,993</u>	<u>\$ 9,179</u>	<u>\$ 9,179</u>	<u>\$ 9,179</u>	<u>\$ 9,179</u>	<u>\$ 8,129</u>	<u>\$10,629</u>	<u>\$10,629</u>	<u>\$14,629</u>

(1) Prior bonds were refunded in December 1995  
Source: City of Chicago Comptroller's Office.

# CITY OF CHICAGO, ILLINOIS SEWER FUND

## STATISTICAL DATA POPULATION OF SERVICE AREA LAST FIVE CENSUS PERIODS (Unaudited)

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<b>Year</b>	<b>Population</b>
1960	3,550,404
1970	3,369,357
1980	3,005,072
1990	2,783,726
2000	2,896,016

Source: U.S. Department of Commerce — Census Bureau.

**CITY OF CHICAGO, ILLINOIS  
SEWER FUND**

**STATISTICAL DATA  
CAPITAL IMPROVEMENT PROGRAM  
2007-2011  
(Unaudited)  
(In thousands of dollars)**

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<b>Year</b>	<b>Amount</b>
2007	\$ 47,793
2008	40,756
2009	65,538
2010	66,948
2011	<u>65,180</u>
Total	<u>\$ 286,215</u>

Note: The information presented in the table above reflects the Sewer Fund's expected allocation of resources to various projects, but does not necessarily represent an expectation of actual cash expenditures for these projects.

Source: City of Chicago Department of Water Management.

**CITY OF CHICAGO, ILLINOIS  
SEWER FUND**

**STATISTICAL DATA  
RECENT SEWER SERVICE RATES  
(Unaudited)**

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Effective Date	Gross Water Rate Per 1,000 Cubic Feet	Sewer Rate	
		Percent of Water Bill	Per 1,000 Cubic Feet
January 1, 1997	\$ 7.87	81 %	\$ 6.37
January 1, 1998	8.02	81	6.50
January 1, 2000	8.34	83	6.92
January 1, 2001	8.67	83	7.20
January 1, 2002	9.02	83	7.49
January 1, 2003	9.38	83	7.79
January 1, 2004	9.66	83	8.02
January 1, 2005	9.95	83	8.26
January 1, 2006	9.95	83	8.26

Source: City of Chicago Department of Water Management.

**CITY OF CHICAGO, ILLINOIS  
SEWER FUND**

**STATISTICAL DATA  
SEWER SYSTEM ACCOUNTS  
TEN YEARS ENDED DECEMBER 31, 2006  
(Unaudited)**

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Year Ended December 31	Water Accounts			Exempt	Sewer Accounts
	Non- metered	Metered	Total		
1997	332,279	159,309	491,588	69,102	422,486
1998	331,554	160,520	492,074	68,623	423,451
1999	329,756	159,353	489,109	66,811	422,298
2000	328,327	160,895	489,222	67,464	421,758
2001	327,276	163,051	490,327	69,994	420,333
2002	326,778	164,067	490,845	80,615	410,230
2003	325,789	165,440	491,229	55,064	436,165
2004	324,689	167,545	492,234	54,809	437,425
2005	323,740	169,664	493,404	55,797	437,607
2006	322,193	171,861	494,054	58,599	435,455

Source: City of Chicago Department of Water Management.