

ORIGINAL

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PHILADELPHIA GAS WORKS

DOCKET No. R-00061931

VOLUME IV

Part 1 of 2

FILING REQUIREMENTS

December 2006

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DEC 22 2006

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Philadelphia Gas Works' Base Rate Filing

52 Pa. Code § 53.52

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

§ 53.52. Applicability; public utilities other than canal, turnpike, tunnel, bridge and wharf companies.

(a) Whenever a public utility, other than a canal, turnpike, tunnel, bridge or wharf company files a tariff, revision or supplement effecting changes in the terms and conditions of service rendered or to be rendered, it shall submit to the Commission, with the tariff, revision or supplement, statements showing all of the following:

- (1) The specific reasons for each change.

RESPONSE: PGW is seeking this rate increase to ensure that PGW will have adequate earnings to cover cost increases and margin losses since its last base rate case, to meet its debt service coverage requirements in the short term and to reduce PGW's dependence on borrowed funds while improving short term liquidity over the next 5-6 years. Please see the testimony of PGW witnesses Bogdonavage, Bisgaier, Krellenstein and Hershey for additional information.

- (2) The total number of customers served by the utility.

RESPONSE: Please see the schedules that are attached in the response to § 53.52(b)(3).

- (3) A calculation of the number of customers, by tariff subdivision, whose bills will be affected by the change.

RESPONSE: Please see the schedules that are attached in the response to § 53.52(b)(3).

- (4) The effect of the change on the utility's customers.

RESPONSE: Please see the schedules that are attached in the responses to § 53.52(b)(3) and § 53.52(b)(4).

- (5) The direct or indirect effect of the proposed change on the utility's revenue and expenses.

RESPONSE: Please see the direct testimony of Joseph Bogdonavage (PGW St. 2) and the accompanying Exhibit JRB-1.

- (6) The effect of the change on the service rendered by the utility.

Philadelphia Gas Works' Base Rate Filing

52 Pa. Code § 53.52

RESPONSE: The changes to rates will not have any effect on the service currently rendered by PGW.

(7) A list of factors considered by the utility in its determination to make the change. The list shall include a comprehensive statement about why these factors were chosen and the relative importance of each. This subsection does not apply to a portion of a tariff change seeking a general rate increase as defined in 66 Pa. C.S. § 1308 (relating to voluntary changes in rates).

RESPONSE: Not applicable.

(8) Studies undertaken by the utility in order to draft its proposed change. This paragraph does not apply to a portion of a tariff change seeking a general rate increase as defined in 66 Pa. C.S. § 1308.

RESPONSE: Not applicable.

(9) Customer polls take and other documents which indicate customer acceptance and desire for the proposed change. If the poll or other documents reveal discernible public opposition, an explanation of why the change is in the public interest shall be provided.

RESPONSE: No customer polls or other documentation regarding customer acceptance or desire for the proposed change exists.

(10) Plans the utility has for introducing or implementing the changes with respect to its ratepayers.

RESPONSE: The Company will notify its customers of the proposed increase by means of a billing insert in compliance with the Commissions regulations as codified at 52 Pa.Code § 53.45.

(11) FCC, FERC or Commission orders or rulings applicable to the filing.

RESPONSE: There are not any FERC or Commission rulings directly applicable to this change.

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Philadelphia Gas Works' Base Rate Filing

52 Pa.Code § 53.52

§ 53.52. Applicability; public utilities other than canal, turnpike, tunnel, bridge and wharf companies.

(b) Whenever a public utility other than a canal, turnpike, tunnel, bridge or wharf company files a tariff, revision or supplement which will increase or decrease the bills to its customers, it shall submit in addition to the requirements of subsection (a), to the Commission, with the tariff, revision or supplement, statements showing the following:

- (1) The specific reasons for each increase or decrease.

RESPONSE: PGW is seeking this rate increase to ensure that PGW will have adequate earnings to cover cost increases and margin losses since its last base rate case, to meet its debt service coverage requirements in the short term and to reduce PGW's dependence on borrowed funds while improving short term liquidity over the next 5-6 years.. Please see the testimony of PGW witnesses Bogdonavage, Bisgaier, Krellenstein and Hershey for additional information.

- (2) The operating income statement of the utility for a 12-month period, the end of which may not be more than 120 days prior to the filing. Water and wastewater utilities with annual revenues under \$100,000 and municipal corporations subject to Commission jurisdiction may provide operating income statements for a 12-month period, the end of which may not be more than 180 days prior to the filing.

RESPONSE: Please see attached.

- (3) A calculation of the number of customers, by tariff subdivision, whose bills will be increased.

RESPONSE: Please see attached.

- (4) A calculation of the total increases, in dollars, by tariff subdivision, projected to an annual basis.

RESPONSE: Please see attached.

Philadelphia Gas Works' Base Rate Filing

52 Pa.Code § 53.52

(5) A calculation of the number of customers, by tariff subdivision, whose bills will be decreased.

RESPONSE: Not applicable.

(6) A calculation of the total decreases, in dollars, by tariff subdivision, projected to an annual basis.

RESPONSE: Not applicable.

(c) If a public utility files a tariff, revision or supplement which it is calculated will increase the bills of a customer or a group of customers by an amount, when projected to an annual basis, exceeding 3% of the operating revenues of the utility—subsection (b)(4) divided by the operating revenues of the utility for a 12-month period as defined in subsection (b)(2)—or which it is calculated will increase the bills of 5% or more of the number of customers served by the utility—subsection (b)(3) divided by subsection (a)(2)—it shall submit to the Commission with the tariff, revision or supplement, in addition to the statements required by subsections (a) and (b), all of the following information:

(1) A statement showing the utility's calculation of the rate of return or operating ratio (if the utility qualifies to use an operating ratio under § 53.54 (relating to small water and wastewater utilities)) earned in the 12-month period referred to in subsection (b)(2), and the anticipated rate of return or operating ratio to be earned when the tariff, revision or supplement becomes effective. The rate base used in this calculation shall be supported by summaries of original cost for the rate of return calculation. When an operating ratio is used in this calculation, it shall be supported by studies of *margin above operation and maintenance expense plus depreciation* as referred to in § 53.54(b)(2)(B).

RESPONSE: Not applicable.

(2) A detailed balance sheet of the utility as of the close of the period referred to in subsection (b)(2).

RESPONSE: Please see attached.

Philadelphia Gas Works' Base Rate Filing

52 Pa. Code § 53.52

§ 53.52. Applicability; public utilities other than canal, turnpike, tunnel, bridge and wharf companies.

(d) If a utility renders more than one time of public service, such as electric and gas, information required by §§ 53.51 – 53.53 (relating to information furnished with the filing of rate changes), except subsection (c)(2), relates solely to the kind of service to which the tariff or tariff supplement is applicable. In subsection (c)(2), the book value of the property used in furnishing each type of public service, as well as the depreciation reserve applicable to the property, shall be shown separately.

RESPONSE: Not applicable.

Philadelphia Gas Works' Base Rate Filing

52 Pa.Code § 53.52

(3) A summary, by detailed plant accounts, of the book value of the property of the utility at the date of the balance sheet required by paragraph (2).

RESPONSE: Please see attached.

(4) A statement showing the amount of the depreciation reserve, at the date of the balance sheet required by paragraph (2), applicable to the property, summarized as required by paragraph (3).

RESPONSE: Please see attached.

(5) A statement of operating income, setting forth the operating revenues and expenses by detailed accounts for the 12-month period ending on the date of the balance sheet required by paragraph (2).

RESPONSE: Please see attached.

(6) A brief description of a major change in the operating or financial condition of the utility occurring between the date of the balance sheet required by paragraph (2) and the date of transmittal of the tariff, revision or supplement. As used in this paragraph, a major change is one which materially alters the operating or financial condition of the utility from that reflected in paragraphs (1)—(5).

RESPONSE: There has not been any major change in the operating or financial condition of the utility.

UNAUDITED
PGW
STATEMENT OF INCOME
TWELVE MONTHS ENDED AUGUST 31, 2006 AND 2005 WITH COMPARISONS
(Thousands of Dollars)

Line No.	2005 Actual		2006		Increase/(Decrease) Actual 2006 vs Budget	
			Actual	Budget	Amount	%
		<u>Operating revenues</u>				
1	\$ 114,880	Non-heating	\$ 112,836	\$ 110,823	\$ 2,013	2
2	4,679	Gas transport service	6,459	7,210	(751)	(10)
3	711,794	Heating	809,941	797,812	12,129	2
4	10,895	Appliance & Other Revenues	10,482	10,975	(493)	(4)
5	(803)	Unbilled gas adjustment	3,785	319	3,466	-
6	841,445	Total gas revenues	943,503	927,139	16,364	2
7	21,912	Other operating revenues	13,525	21,793	(8,268)	(38)
8	863,357	Total operating revenues	957,028	948,932	8,096	1
		<u>Operating expenses</u>				
9	509,701	Natural gas	625,076	578,362	46,714	8
10	3	Other raw material	17	5	12	-
11	509,704	SUB-TOTAL FUEL	625,093	578,367	46,726	8
12	353,653	CONTRIBUTION MARGIN	331,935	370,565	(38,630)	(10)
13	18,584	Gas Processing	15,234	15,590	(356)	(2)
14	28,455	Field Services	35,667	30,768	4,899	16
15	15,115	Distribution	15,179	16,130	(951)	(6)
16	10,971	Collection	9,952	10,540	(588)	(6)
17	70,424	Appropriation for uncollectible reserve	40,132	55,132	(15,000)	(27)
18	12,512	Customer Services	11,083	12,918	(1,835)	(14)
19	7,695	Account Management	7,337	7,824	(487)	(6)
20	2,592	Marketing	2,467	3,399	(932)	(27)
21	43,391	Administrative & General	39,897	47,958	(8,061)	(17)
22	33,571	Health Insurance	35,076	36,461	(1,385)	(4)
23	(10,348)	Capitalized Fringe Benefits	(9,797)	(9,714)	(83)	1
24	(6,706)	Capitalized Admin. Charges	(6,779)	(7,142)	363	(5)
25	14,702	Pensions	17,563	15,192	2,371	16
26	6,218	Taxes	6,124	6,296	(172)	(3)
27	1,087	Amortization of restructuring costs	1,087	1,087	-	-
28	-	Environmental	-	-	-	-
29	-	Cost Savings	-	(12,891)	12,891	-
30	248,263	Total operating expenses	220,222	229,548	(9,326)	(4)
31	105,390	Operating Income before depreciation	111,713	141,017	(29,304)	(21)
32	39,547	Depreciation	37,955	40,789	(2,834)	(7)
33	(4,502)	Less depreciation distributed thru clearing accounts	(3,230)	(4,647)	1,417	(30)
34	35,045	Net depreciation	34,725	36,142	(1,417)	(4)
35	793,012	Total operating expenses	880,040	844,057	35,983	4
36	70,345	Operating Income	76,988	104,875	(27,887)	(27)
37	4,778	Interest and other income	8,518	24,635	(16,117)	(65)
38	75,123	Income before interest	85,506	129,510	(44,004)	(34)
		<u>Interest</u>				
39	53,856	Long term debt	51,799	53,589	(1,790)	(3)
40	10,902	Other	14,869	12,031	2,838	24
41	(907)	Allowance for funds used during construction	(981)	(986)	5	(1)
42	63,851	Net interest expense	65,687	64,634	1,053	2
43	11,272	Net income (loss)	19,819	64,876	(45,057)	

The unaudited Fiscal Year 2006 Gas Cost Rate and other surcharges is expected to result in a \$22.5M underrecovery at 8/31/06. The DRAFT financial statements for Fiscal Year 2006 reflect the above adjustment.

53.52(b)(3)
[Exhibit HSG-6S
Page 1 of 2]

5	Test Year 2007			Current PUC Approved Tariff Rates					Amounts in \$000s					
	No. of Customers	No. of Annual Bills	Annual Sales (mcf)	Monthly Cust. Charge	GCR Charge	Univ. Service Charge	Restr. and Cons. Educ. Charge	Delivery Charge	Cust. Charge Revenue	GCR Charge Revenue	Univ. Service Charge Revenue	Restr. and Cons. Educ. Charge Revenue	Delivery Charge Revenue	Total Full Tariff Revenue
6														
7 Non-Heating:														
8 Residential	47,922	575,067	1,387,356	\$12.00	\$10.9709	\$2.5387	\$0.0655	\$4.2124	6,901	15,221	3,522	91	5,844	31,578
9 Residential-Senior	3,322	39,868	74,732	\$12.00	\$10.9709	\$2.5387	\$0.0655	\$4.2124	478	820	190	5	315	1,808
10 Commercial	5,604	67,247	1,705,062	\$18.00	\$10.9709	\$2.5387	\$0.0655	\$4.3056	1,210	18,706	4,329	112	7,341	31,698
11 Industrial	254	3,048	345,261	\$50.00	\$10.9709	\$2.5387	\$0.0655	\$4.3029	152	3,788	877	23	1,486	6,325
12 Municipal/MS	335	4,020	262,687	\$18.00	\$10.9709	\$2.5387	\$0.0655	\$3.1470	72	2,882	667	17	827	4,465
13 NGV	1	12	367	\$35.00	\$10.9709	\$2.5387	\$0.0655		0	4	1	0	0	5
14 Total Non-Heat Firm	57,439	689,262	3,775,465						8,815	41,420	9,585	247	15,813	75,880
15														
16 Heating:														
17 Residential	369,201	4,430,417	32,855,506	\$12.00	\$10.9709	\$2.5387	\$0.0655	\$4.2124	53,165	360,455	83,410	2,152	138,401	637,583
18 Residential-Senior	45,232	542,788	4,151,233	\$12.00	\$10.9709	\$2.5387	\$0.0655	\$4.2124	6,513	45,543	10,539	272	17,487	80,354
19 Commercial	19,431	233,177	8,498,417	\$18.00	\$10.9709	\$2.5387	\$0.0655	\$4.3056	4,197	93,235	21,575	557	36,591	156,155
20 Industrial	606	7,271	734,898	\$50.00	\$10.9709	\$2.5387	\$0.0655	\$4.3029	364	8,063	1,866	48	3,162	13,502
21 Municipal/MS	557	6,882	1,006,599	\$18.00	\$10.9709	\$2.5387	\$0.0655	\$3.1470	120	11,043	2,555	66	3,168	16,953
22 PHA Rate 8	780	9,354	548,297	\$18.00	\$10.9709	\$2.5387	\$0.0655	\$4.2952	168	6,015	1,392	36	2,355	9,967
23 PHA/GS	2,577	30,924	270,534	\$12.00	\$10.9709	\$2.5387	\$0.0655	\$4.2124	371	2,968	687	18	1,140	5,183
24 PHA/GS- Senior	101	1,212	10,840	\$12.00	\$10.9709	\$2.5387	\$0.0655	\$4.2124	15	119	28	1	46	207
25 Total HeatFirm	438,485	5,261,825	48,076,324						64,913	527,441	122,051	3,149	202,348	919,903
26														
27 Total Heating & Non-Heating Firm	495,924	5,951,087	51,851,789						73,728	568,861	131,636	3,396	218,161	995,783
28														
29														
30 Interruptible:														
31 BPS, SMALL	113	1,354	162,977	\$35.00	\$15.6414				47				2,549	2,597
32 BPS, LARGE	162	1,944	1,930,441	\$75.00	\$13.5573				146				26,172	26,317
33 BPS, A/C	8	96	109,062	\$35.00	\$10.1585				3				1,108	1,111
34 LBS-S, INDIRECT	18	220	528,264	\$100.00	\$11.4126				22				6,029	6,051
35 LBS-L, INDIRECT	6	76	374,982	\$175.00	\$10.8689				13				4,076	4,089
36 LBS-L, DIRECT	1	12	20,547	\$175.00	\$10.6121				2				218	220
37 LBS-XL, DIRECT	2	24	2,281	\$250.00	\$10.4980				6				24	30
38 LBS-XL, INDIRECT	4	48	54,119	\$250.00	\$10.8419				12				587	599
39 CO-GEN	3	40	15,833	\$250.00	\$10.2449				10				182	172
40 Total Interruptible	318	3,814	3,198,506						262				40,924	41,186
41 Total PGW	496,242	5,954,901	55,050,295						73,990	568,861	131,636	3,396	259,085	1,036,969
42 GTS / IT Revenue														7,256
43 Rounding difference														(98)
44 Current Tariff Revenue at Full Tariff Rates														1,044,127

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**[Exhibit HSG-6T
Page 2 of 2]**

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PGW
BALANCE SHEETS AUGUST 31, 2006 AND 2005
(Thousands of Dollars)

ASSETS

Line No.		2006	2005
	Utility Plant - At Original Cost		
1	In service	\$ 1,555,669	\$ 1,515,463
2	Under construction	65,122	57,883
3	Total	1,620,791	1,573,346
4	Less accumulated depreciation	(613,143)	(591,624)
5	Utility plant - net	1,007,648	981,722
6	Sinking fund - revenue bonds	94,352	104,530
7	Capital improvement funds	39,636	102,701
8	Restricted investment (City of Philadelphia)	-	-
9	Restricted investment Workers' Compensation	1,637	1,579
	Current Assets		
10	Cash and temporary investments	6,697	15,221
	Accounts receivable		
11	Customers	228,715	273,805
12	Others	1,962	12,522
13	Accrued gas revenues	12,572	8,787
14	Accumulated provisions for uncollectible accounts	(168,889)	(207,480)
15	Accounts receivable - net	74,360	87,634
16	Materials and supplies	149,438	129,984
17	Other current assets and deferred debits	28,319	2,632
18	Total Current Assets	258,814	235,471
19	Unamortized bond issuance cost	42,089	39,094
20	Unamortized loss-reacquired debt	55,859	38,494
21	Other Assets	4,188	6,718
22	Deferred Environmental	4,847	9,513
23	Total Assets	<u>\$ 1,509,070</u>	<u>\$ 1,519,822</u>

PGW
BALANCE SHEETS AUGUST 31, 2006 AND 2005
(Thousands of Dollars)

EQUITY AND LIABILITIES

			2006	2005	Line No.
City equity			\$ 242,465	\$ 222,646	1
Long term debt:					
City of Philadelphia bonds					
Issued	Original amount	Current portion			
1989	132,520	-	5,064	5,064	2
1990	50,421	-	-	-	3
1994	183,880	-	14,800	14,800	4
1998	287,185	12,450	118,315	234,315	5
1999	176,280	10,840	55,675	143,655	6
2001	120,225	965	16,715	115,360	7
2002	125,000	1,285	117,205	118,490	8
2003	186,705	10,715	158,585	169,300	9
2004	207,820	1,790	204,635	206,425	10
2006	313,390	-	313,390	-	11
TECA - 11th "C"			12,609	11,394	12
TECA - 12th "A"		-	-	-	13
Subordinate Lease Obligations			-	-	
1997	23,000	-	-	-	14
Total Issued		38,045	1,016,993	1,018,803	15
Unamortized debt discount/premium		1,546	14,138	12,027	16
Total Long Term Bond Debt		39,591	1,031,131	1,030,830	17
Notes payable (City of Phila.)			45,000	45,000	18
Total Long Term Debt			1,076,131	1,075,830	19
Current Liabilities					
Notes payable			55,000	49,900	20
Accounts payable			40,316	63,918	21
Current portion of long term debt			39,591	42,271	22
Customers' deposits			8,628	6,280	23
Other current liabilities and deferred credits			8,137	18,342	24
Accrued accounts:					
Interest, taxes and wages			13,773	13,452	25
Distribution to the City			3,000	3,000	26
Total Current Liabilities			168,445	197,163	27
Other Liabilities			22,029	24,183	28
Total Equity and Liabilities			\$ 1,509,070	\$ 1,519,822	29

PHILADELPHIA GAS WORKS
UTILITY PLANT IN SERVICE - ACTUAL
AS OF AUGUST 31, 2006

ASSET ACCT	PUC CODE	UTILITY PLANT	ENDING BALANCE 8/31/05	ADDITIONS	ADJUSTMENTS	RETIREMENTS	REVALUATION	RECLASSES	TRANSFERS	ENDING BALANCE 8/31/06
1010	304	Land and Land Rights -	1,452,885.00						-	1,452,885.00
1010	305	Structures & Improvement	12,370,087.72	69,897.65		259,323.00		7,081.00	-	12,187,743.37
1010	306	Boiler Plant Equip.	678,670.21			102,066.00			-	576,604.21
1010	307	Other Power Equip.	230,059.00			955.00			-	229,104.00
1010	311	Liquefied Petroleum Gas	6,118,703.00			1,088,136.00			-	5,030,567.00
1010	317	Purification Equip.	13,120.00						-	13,120.00
1010	318	Residual Refining Equip	8,489.00						-	8,489.00
1010	319	Gas Mixing Equip.	156,557.00						-	156,557.00
1010	320	Other Equip. - Prod.	15,447,775.99	965,410.40		931,041.35		419,596.33	-	15,901,741.37
Total		Production Plant	36,476,348.92	1,035,308.05	-	2,381,521.35	-	426,677.33	-	35,556,810.95
1010	361	Structures & Improvement	6,621,113.18	586,735.98	37,466.01	206,031.00		243,497.80	-	7,282,781.97
1010	362	Gas Holders	34,490,601.92			1,085,701.00		180,022.62	-	33,584,923.54
1010	363	LNG Purification Equip.	635,380.00			396,081.00			-	239,299.00
1010	364	LNG Liquefaction Equip.	8,737,009.71			93,742.00		12,981.26	-	8,656,248.97
1010	365	LNG Vaporization Equip.	11,731,567.38	132,388.53		135,585.00		351,495.67	-	12,079,866.58
1010	366	LNG Compressor Equip.	12,582,327.94	88,672.89		441,415.00		42,587.89	-	12,272,173.72
1010	367	LNG Measuring & Regulat	4,797,776.80	148,444.61		216,958.00		2,119.00	-	4,731,382.41
1010	368	LNG Other Equip. - Stor	11,806,567.37	1,006,191.87		1,068,048.00			-	11,744,711.24
Total		Storage Plant	91,402,344.30	1,962,433.88	37,466.01	3,643,561.00	-	832,704.24	-	90,591,387.43
1010	374	Land and Land Rights -	100,977.00						-	100,977.00
1010	375	Structures & Improvement	2,810,955.00			127,981.00			-	2,682,974.00
1010	376	Mains	451,740,658.76	8,924,632.10		2,888,420.65			-	457,776,870.21
1010	377	Compressor Station Equip.	1,293,002.00			38,307.00			-	1,254,695.00
1010	378	Meas. & Regul. Station	15,432,316.53	455,926.32		1,025,862.64			-	14,862,380.21
1010	380	Services	455,580,465.09	24,152,325.23					-	479,732,790.32
1010	381	Meters	44,353,971.57	2,301,708.33					-	46,655,679.90
1010	382	Meter Installations	92,860,125.91	1,018,590.50					-	93,878,716.41
1010	383	House Regulators	1,592,372.76	99,363.65					-	1,691,736.41
1010	384	House Regulator Install	4,807,974.83	(33,112.89)					-	4,774,861.94
1010	385	Industry Mesa. & Regul.	313,528.00						-	313,528.00
1010	387	Other Equip. - Distr.	4,303,913.51						-	4,303,913.51
Total		Distribution Plant	1,075,190,260.96	36,918,433.24	-	4,080,571.29	-	-	-	1,108,029,122.91
1010	389	Land and Land Rights -	3,712,767.00						-	3,712,767.00
1010	390	Structures & Improvement	44,967,842.13	137,196.03		47,420.00		212,160.90	-	45,289,779.06
1010	391	Office Furniture & Equip.	62,567,535.07	33,698.24		2,645,048.00		34,647.65	-	59,990,832.96
1010	392	Transportation Equip.	21,173,907.07			1,116,872.00		26,275.46	-	20,083,310.53
1010	393	Stores Equip.	517,171.00						-	517,171.00
1010	394	Tools, Shop & Garage Eq	7,408,798.26			16,092.00		52,843.48	-	7,445,549.74
1010	396	Power Operated Equip.	399,414.38			30,693.00			-	368,721.38
1010	397	Communications Equip.	15,233,328.44						-	15,233,328.44
1010	398	Miscellaneous Equip.	2,957,560.79	2,494.35				29,446.50	-	2,989,501.64
Total		General Plant	158,938,324.14	173,388.62	-	3,856,125.00	-	355,373.99	-	155,610,961.75
Account	Totals for 101		1,362,007,276.32	40,080,563.79	37,466.01	13,961,778.64	-	1,614,755.56	-	1,389,788,283.04

PHILADELPHIA GAS WORKS
UTILITY PLANT IN SERVICE - ACTUAL
AS OF AUGUST 31, 2008

ASSET ACCT	PUC CODE	UTILITY PLANT	ENDING BALANCE 8/31/05	ADDITIONS	ADJUSTMENTS	RETIREMENTS	REVALUATION	RECLASSES	TRANSFERS	ENDING BALANCE 8/31/06
1080	305	Structures & Improvement	5,164,884.97		472.03			(7,081.00)	-	5,158,276.00
1060	306	Boiler Plant Equip.	1,970,012.00						-	1,970,012.00
1060	320	Other Equip. - Prod.	4,766,933.60					(419,596.33)	-	4,347,337.27
Total		Production Plant	11,901,830.57	-	472.03	-	-	(426,677.33)	-	11,475,625.27
1060	361	Structures & Improvement	645,583.85					(243,497.80)	-	402,086.05
1060	362	Gas Holders	323,829.41					(180,022.62)	-	143,806.79
1060	363	LNG Purification Equip.	12,170.82						-	12,170.82
1060	364	LNG Liquefaction Equip.	20,934,735.51					(12,981.26)	-	20,921,754.25
1060	365	LNG Vaporization Equip.	779,528.23		(155,832.87)			(351,495.67)	-	272,199.69
1060	366	LNG Compressor Equip.	2,249,195.35					(42,587.89)	-	2,206,607.46
1060	367	LNG Measuring & Regulat	74,406.00					(2,119.00)	-	72,287.00
1060	368	LNG Other Equip. - Stor	1,081,146.40						-	1,081,146.40
Total		Storage Plant	28,100,595.37	-	(155,832.87)	-	-	(832,704.24)	-	25,112,058.26
1060	375	Structures & Improvement	12.00						-	12.00
1060	376	Mains	66,858,352.18	6,218,356.07	(297,896.67)				-	72,779,011.58
1060	378	Meas. & Regul. Station	2,213,972.13		(570,014.39)				-	1,643,957.74
1060	380	Services	2,885,716.61	112,949.97					-	2,998,666.58
1060	381	Meters	337,660.00						-	337,660.00
1060	382	Meter Installations	1,722,680.23						-	1,722,680.23
1060	384	House Regulator Install	502.69						-	502.69
1060	387	Other Equip. - Distr.	1,049,357.53						-	1,049,357.53
Total		Distribution Plant	75,068,253.37	6,331,306.04	(867,711.06)	-	-	-	-	80,531,848.35
1060	390	Structures & Improvement	19,747,677.08					(212,160.90)	-	19,535,516.18
1060	391	Office Furniture & Equi	14,230,682.42	2,139,811.14				(34,647.65)	-	16,335,845.91
1060	392	Transportation Equip.	2,956,324.04	4,300,626.02				(26,275.46)	-	7,230,674.60
1060	393	Stores Equip.	240,221.00						-	240,221.00
1060	394	Tools, Shop & Garage Eq	318,921.23					(52,843.48)	-	266,077.75
1060	396	Power Operated Equip.	50,870.12						-	50,870.12
1060	397	Communications Equip.	1,857,921.81	2,291,169.41					-	4,149,091.22
1060	398	Miscellaneous Equip. -	982,377.75					(29,448.50)	-	952,931.25
Total		General Plant	40,384,995.45	8,731,606.57	-	-	-	(355,373.99)	-	48,761,228.03
Account	Totals for 106		153,455,674.76	15,062,912.81	(1,023,071.90)	-	-	(1,614,755.56)	-	165,880,759.91
Report	Totals:		1,515,462,951.08	55,153,476.40	(985,805.89)	13,961,778.64	-	-	-	1,555,669,042.95
			1,515,463,000.00							1,555,669,000.00
		ROUNDING DIFFERENCE	(48.92)							(42.95)
		ADD 107 CWIP	57,883,000.00							65,122,000.00
		TOTAL 101, 106 & 107	1,573,346,000.00							1,620,791,000.00
		TOTAL ON FINANCIALS	1,573,346,000.00							1,620,791,000.00

**PHILADELPHIA GAS WORKS
DEPRECIATION BY PUC CODE
FOR THE YEAR ENDED AUGUST 31, 2006**

PUC CODE	COST	RESERVE	YTD DEPRECIATION
304	1,452,885.00	-	-
305	17,346,019.37	10,707,211.61	506,761.98
306	2,546,616.21	1,653,114.67	100,055.48
307	229,104.00	168,776.75	6,038.98
311	5,030,567.00	5,030,567.00	-
317	13,120.00	13,120.00	-
318	8,489.00	8,489.00	-
319	156,557.00	95,848.43	2,160.18
320	20,249,078.64	11,627,643.72	685,874.97
361	7,684,868.02	4,736,701.03	180,597.31
362	33,728,730.33	29,747,375.72	838,829.34
363	251,469.62	242,023.37	495.34
364	29,578,003.22	10,564,498.45	818,822.78
365	12,352,066.27	10,016,263.60	264,917.99
366	14,478,781.18	7,093,380.50	269,739.67
367	4,803,669.41	3,110,636.35	124,559.28
368	12,825,857.64	6,508,805.86	317,913.16
374	100,977.00	-	-
375	2,682,986.00	2,276,519.17	30,904.01
376	530,555,881.79	178,564,137.08	8,575,508.30
377	1,254,695.00	1,207,233.60	2,754.58
378	16,506,337.95	8,746,292.88	350,937.41
380	482,731,456.90	187,733,923.80	12,463,102.20
381	46,993,339.90	22,933,591.73	1,351,814.54
382	95,601,396.64	22,777,851.91	2,102,040.95
383	1,691,736.41	896,756.89	34,583.09
384	4,775,364.63	2,981,788.41	106,292.86
385	313,528.00	138,899.50	8,433.46
387	5,353,271.04	2,693,923.93	181,482.17
389	3,712,767.00	-	-
390	64,805,295.24	22,481,021.98	1,283,960.84
391	76,326,678.87	26,045,103.64	2,524,802.27
392	27,313,985.13	18,895,159.54	1,002,100.03
393	757,392.00	405,370.08	20,823.65
394	7,711,627.49	3,401,691.02	286,038.22
396	419,591.50	395,720.79	6,077.01
397	19,382,419.66	6,822,244.56	804,098.41
398	3,942,432.89	2,421,461.60	134,223.73
Grand Total	1,555,669,042.95	613,143,148.17	35,386,744.19
Cost of Removal			2,568,006.00
TOTAL			37,954,750.19

PHILADELPHIA GAS WORKS
STATEMENT OF OPERATING INCOME
TWELVE MONTHS ENDED AUGUST 31, 2006

OPERATING REVENUES		August 31, 2006
SALES OF GAS		
480.0	Residential Sales	\$ (627,979)
481.0	Commercial & Industrial Sales	(233,822)
482.0	Public Authority Sales	(30,911)
483.0	Sales for Resale	(3)
489.3	Gas Transportation Service Sales	(6,459)
495.0	Other Gas Revenues	(33,873)
	Total Gas Revenues	\$ (933,048)
APPLIANCE REVENUE		
903.0	Customer Records & Collection	(2,763)
879.0	Customer Installations	(7,721)
880.0	Other Expenses	2
		\$ (10,482)
OTHER OPERATING		
487.0	Forfeited Discounts	(13,271)
488.0	Miscellaneous Service Revenue	(227)
		\$ (13,498)
	TOTAL OPERATING REVENUE	\$ (957,028)
OPERATING & MAINTENANCE EXPENSES		
700.0 - 708.0	Steam Production	1,396
710.0 - 742.0	Manufactured Gas Production	1,394
800.0 - 813.0	Other Gas Supply	623,498
840.0 - 843.9	Other Storage	12,146
850.0 - 870.0	Transmission	1,197
871.0 - 894.0	Distribution	51,846
901.0 - 905.0	Customer Accounts	67,769
907.0 - 910.0	Customer Service	4,954
920.0 - 931.0	Administrative & General	74,992
	Total O&M Expenses	\$ 839,191
OTHER EXPENSES		
403.0	Depreciation Expenses	34,725
408.1	Taxes Other than Income Taxes	6,124
	Total Depreciation and Taxes	\$ 40,848
	TOTAL OPERATING EXPENSES	\$ 880,040
OTHER INCOME		
417.0	Other Non Operating Income	(58)
418.0	Non Operating Rental Income	(59)
419.0	Interest & Dividend Income	(7,615)
421.0	Miscellaneous Non Operating Income	(1,136)
426.3	Reserved Penalties	105
426.5	Other Deductions	246
	Total Other Income	\$ (8,518)
INTEREST		
427.0	Interest on Long Term Debt	51,799
428.0	Amortization of Debt Discount & Expense	3,722
428.1	Amortization of Loss on Required Debt	5,332
429.0	Amortization of Premium on Debt	(2,057)
431.0	Other Interest Expenses	7,873
432.0	Allowance for Borrowed Funds Used During Construction	(981)
	Total Interest	\$ 65,687
	NET INCOME	\$ (19,819)

Philadelphia Gas Works' Base Rate Filing

I. VALUATION

A. ALL UTILITIES

I.A.1. Provide a corporate history (include the dates of original incorporation, subsequent merges and/or acquisitions). Indicate all counties and cities and other governmental subdivisions to which service is provided (including service areas outside the state), and the total population in the areas served.

RESPONSE: Philadelphia Gas Works is not a separately incorporated entity, rather, it represents an enterprise fund of the City of Philadelphia. As of January 1, 1973, under the terms of a two-year agreement automatically extended for successive two year periods unless cancelled upon 90 days notice by the City, PGW is managed by the Philadelphia Facilities Management Corporation.

Mergers and/or acquisitions: None

Service is provided to Philadelphia County. According to the 2000 U.S. Census, the population of Philadelphia is 1,517,550.

Philadelphia Gas Works' Base Rate Filing

II. RATE OF RETURN

I.A.2—I.A.18

RESPONSE: Not applicable to a municipally-owned, cash flow method company.

I. VALUATION

A. ALL UTILITIES

C. GAS UTILITIES ONLY IN ADDITION TO PROVIDING THE INFORMATION REQUESTED IN "A." HEREINABOVE.

I.C.1. Provide with respect to the scope of operations of the utility, a description of all property, including an explanation of the system's operation, and all plans for any significant future expansion, modification, or other alteration of facilities.

This description should include, but not be limited to the following:

- a. If respondent has various gas service areas, indicate if they are integrated, such that the gas supply is available to all customers.

RESPONSE: PGW does not have various service areas. Philadelphia is the Company's sole service area.

- b. Provide all pertinent data regarding company policy related to the addition of new consumers in the company's service area.

RESPONSE: PGW is permitted to attach new customers under the terms and conditions contained in the Company's tariff, the commissions regulations codified at 52 Pa.Code Ch. 59 and orders of the Commission adopted pursuant thereto.

- c. Explain how respondent obtains its gas supply, as follows:

(i) Explain how respondent stores or manufactures gas; if applicable.

(ii) State whether the company has peak shaving facilities.

(iii) Provide details of coal-gasification programs, if any.

(iv) Describe the potential for emergency purchases of gas.

(v) Provide the amount of gas in MCF supplied by various suppliers in the test year (include a copy of all contracts).

(vi) Provide the amount of gas in MCF supplied from company-owned wells during the test year.

RESPONSE:

(i) & (ii) The company operates a peak shaving facility. The Company's Richmond facility liquefies, vaporizes and stores natural gas and the Passyunk facility vaporizes and stores

Philadelphia Gas Works' Base Rate Filing

I. VALUATION

natural gas. The Company's total liquefied natural gas storage capacity is approximately 4.3 Bcf. PGW does not manufacture gas.

(iii) PGW does not have a coal-gasification program.

(iv) PGW does not anticipate making any emergency purchases of gas.

(v) Below are the amounts of gas in MCF supplied by various suppliers in the test year. Abstracts of PGW's gas supply, transportation and storage contracts were provided in the Company's 2006-2007 1307(f) initial filing in Tab 16, Volume II filed on February 1, 2006. A copy is available upon request.

	MCF
Transco Spot	23,164,198
Transco Supplier # 2	1,770,908
Transco Supplier # 3	894,558
Transco Supplier # 7	7,557,489
Transco Supplier # 8	563,868
Transco Supplier # 10	6,234,083
Transco Supplier # 14	846,250
Tetco Spot	14,071,399
Tetco Supplier # 1	<u>1,163,023</u>
Total Delivered Volumes	56,265,776

(vi) PGW does not own gas wells.

d. Provide plans for future gas supply as follows:

(i) Supply details of anticipated gas supply from respondent's near-term development of gas wells, if any.

(ii) Provide gas supply agreements and well development ventures and identify the parties thereto.

RESPONSE:

(i) PGW does not own nor does it plan to own gas wells.

(ii) See the above response to subsection (c)(v) for the gas supply agreement parties. Abstracts of PGW's gas supply, transportation and storage contracts were provided in the Company's 2006-2007 1307(f) initial filing in Tab 16, Volume II filed on February 1, 2006. A copy is available upon request. PGW is not a party in any well development ventures.

Philadelphia Gas Works' Base Rate Filing

I. VALUATION

- e. Indicate any anticipated curtailments and explain the reasons for the curtailments.

RESPONSE: PGW does not anticipate any curtailments.

- f. Provide current data on any Federal Power Commission action or programs that may affect, or tend to affect, the natural gas supply to the gas utility.

RESPONSE: PGW is not under direct regulation by the FERC; however, it is affected by Federal regulations and actions covering the sources and prices of gas to suppliers providing gas to PGW. PGW actively represents its position as a local distribution company in those proceedings that may have a direct impact on PGW. PGW's activity in those proceedings were provided in the Company's 2006-2007 1307(f) initial filing in Tab 3, Volume I filed on February 1, 2006. A copy is available upon request.

Philadelphia Gas Works' Base Rate Filing

I. VALUATION

A. ALL UTILITIES

I.C.2. Provide an overall system map, including and labeling all measuring and regulating stations, storage facilities, production facilities, transmission and distribution mains, by size, and all interconnections with other utilities and pipelines.

RESPONSE: Following the lead of the industry, as well as federal policy guidelines regarding the security of information relating to energy transmission sites, PGW will no longer provide this data to the general public. However, upon request PGW will provide this information to the Commission and will also provide this information, upon written request, to parties to this proceeding that have legitimate business reasons to view this information.

II. RATE OF RETURN

A. ALL UTILITIES

II.A.1. Provide capitalization and capitalization ratios for the last five-year period and projected through the next two years. (with short-term debt and without short-term debt.) (Company, Parent and System (consolidated)).

II.A.1.a. Provide year-end interest coverages before and after taxes for the last three years and at latest date. (Indenture and SEC Bases.) (Company, Parent and System (consolidated)).

II.A.1.b. Provide year-end preferred stock dividend coverages for last three years and at latest date (Charter and SEC bases).

RESPONSE: Not applicable.

Philadelphia Gas Works' Base Rate Filing

II. RATE OF RETURN

II.A.2. Provide latest quarterly financial report (Company and Parent).

RESPONSE:

PGW's financial report for the three months ended November 30, 2006 is attached.



FINANCIAL REPORT
FOR THE THREE MONTHS ENDED NOVEMBER 30, 2006
UNAUDITED

UNAUDITED
PGW
STATEMENT OF INCOME
MONTH OF NOVEMBER 2006 AND 2005 WITH COMPARISONS
(Thousands of Dollars)

Line No.	2005 Actual		2006		Increase/(Decrease) Actual 2006 vs Budget	
			Actual	Budget	Amount	%
		<u>Operating revenues</u>				
1	\$ 11,066	Non-heating	\$ 8,582	\$ 10,222	\$ (1,640)	(16)
2	412	Gas transport service	736	630	106	17
3	60,981	Heating	57,174	63,159	(5,985)	(9)
4	957	Appliance & Other Revenues	832	941	(109)	(12)
5	22,993	Unbilled gas adjustment	13,223	24,415	(11,192)	(46)
6	96,409	Total gas revenues	80,547	99,367	(18,820)	(19)
7	906	Other operating revenues	496	1,381	(885)	(64)
8	97,315	Total operating revenues	81,043	100,748	(19,705)	(20)
		<u>Operating expenses</u>				
9	66,683	Natural gas	42,622	60,704	(18,082)	(30)
10	-	Other raw material	-	-	-	-
11	66,683	SUB-TOTAL FUEL	42,622	60,704	(18,082)	(30)
12	30,632	CONTRIBUTION MARGIN	38,421	40,043	(1,622)	(4)
13	932	Gas Processing	1,106	1,465	(359)	(25)
14	3,022	Field Services	3,606	2,798	808	29
15	1,351	Distribution	1,233	1,345	(112)	(8)
16	966	Collection	530	734	(204)	(28)
17	3,917	Appropriation for uncollectible reserve	4,681	4,681	-	-
18	994	Customer Services	1,025	1,230	(205)	(17)
19	832	Account Management	596	597	(1)	-
20	217	Marketing	217	238	(21)	(9)
21	3,411	Administrative & General	2,928	4,266	(1,338)	(31)
22	3,049	Health Insurance	3,177	3,269	(92)	(3)
23	(876)	Capitalized Fringe Benefits	(932)	(837)	(95)	11
24	(452)	Capitalized Admin. Charges	(420)	(591)	171	(29)
25	1,354	Pensions	1,731	1,413	318	23
26	504	Taxes	506	560	(54)	(10)
27	91	Amortization of restructuring costs	-	-	-	-
28	-	Environmental	-	-	-	-
29	-	Cost Savings	-	(456)	456	-
30	19,312	Total operating expenses	19,984	20,712	(728)	(4)
31	11,320	Operating Income before depreciation	18,437	19,331	(894)	(5)
32	3,054	Depreciation	3,213	3,451	(238)	(7)
33	(387)	Less depreciation distributed thru clearing accounts	(268)	(268)	-	-
34	2,667	Net depreciation	2,945	3,183	(238)	(7)
35	88,662	Total operating expenses	65,551	84,599	(19,048)	(23)
36	8,653	Operating Income	15,492	16,148	(656)	(4)
37	603	Interest and other income	753	561	192	34
38	9,256	Income before interest	16,245	16,709	(464)	(3)
		<u>Interest</u>				
39	4,481	Long term debt	4,088	4,116	(28)	(1)
40	415	Other	1,314	1,524	(210)	(14)
41	(100)	Allowance for funds used during construction	(87)	(89)	2	(2)
42	4,796	Net interest expense	5,315	5,551	(236)	(4)
43	4,460	Net income (loss)	10,930	11,158	(228)	

UNAUDITED
PGW
STATEMENT OF INCOME
THREE MONTHS ENDED NOVEMBER 30, 2006 AND 2005 WITH COMPARISONS
(Thousands of Dollars)

Line No.	2005 Actual		2006		Increase/(Decrease) Actual 2006 vs Budget	
			Actual	Budget	Amount	%
		<u>Operating revenues</u>				
1	\$ 23,481	Non-heating	\$ 23,340	\$ 22,152	\$1,188	5
2	1,120	Gas transport service	2,060	1,647	413	25
3	113,301	Heating	113,149	114,907	(1,758)	(2)
4	2,944	Appliance & Other Revenues	2,993	2,898	95	3
5	39,000	Unbilled gas adjustment	20,819	37,842	(17,023)	(45)
6	179,846	Total gas revenues	162,361	179,446	(17,085)	(10)
7	3,457	Other operating revenues	1,550	3,790	(2,240)	(59)
8	183,303	Total operating revenues	163,911	183,236	(19,325)	(11)
		<u>Operating expenses</u>				
9	122,858	Natural gas	84,573	105,008	(20,435)	(19)
10	-	Other raw material	-	-	-	-
11	122,858	SUB-TOTAL FUEL	84,573	105,008	(20,435)	(19)
12	60,445	CONTRIBUTION MARGIN	79,338	78,228	1,110	1
13	3,270	Gas Processing	2,958	3,607	(649)	(18)
14	7,551	Field Services	8,390	8,032	358	4
15	3,607	Distribution	3,476	3,827	(351)	(9)
16	2,448	Collection	1,918	2,024	(106)	(5)
17	8,188	Appropriation for uncollectible reserve	8,909	8,909	-	-
18	2,829	Customer Services	2,972	3,534	(562)	(16)
19	1,860	Account Management	1,550	1,899	(349)	(18)
20	625	Marketing	594	730	(136)	(19)
21	9,226	Administrative & General	9,419	12,032	(2,613)	(22)
22	8,679	Health Insurance	9,338	9,809	(471)	(5)
23	(2,452)	Capitalized Fringe Benefits	(2,535)	(2,657)	122	(5)
24	(1,130)	Capitalized Admin. Charges	(1,147)	(1,875)	728	(39)
25	3,582	Pensions	4,175	4,214	(39)	(1)
26	1,566	Taxes	1,603	1,582	21	1
27	272	Amortization of restructuring costs	-	-	-	-
28	-	Environmental	-	-	-	-
29	-	Cost Savings	-	(1,219)	1,219	-
30	50,121	Total operating expenses	51,620	54,448	(2,828)	(5)
31	10,324	Operating income before depreciation	27,718	23,780	3,938	17
32	9,243	Depreciation	9,606	10,353	(747)	(7)
33	(1,162)	Less depreciation distributed thru clearing accounts	(804)	(804)	-	-
34	8,081	Net depreciation	8,802	9,549	(747)	(8)
35	181,060	Total operating expenses	144,995	169,005	(24,010)	(14)
36	2,243	Operating income	18,916	14,231	4,685	33
37	1,853	Interest and other income	2,480	1,597	883	55
38	4,096	Income before interest	21,396	15,828	5,568	35
		<u>Interest</u>				
39	13,443	Long term debt	12,267	12,349	(82)	(1)
40	2,698	Other	3,942	4,573	(631)	(14)
41	(291)	Allowance for funds used during construction	(252)	(284)	32	(11)
42	15,850	Net interest expense	15,957	16,638	(681)	(4)
43	(11,754)	Net income (loss)	5,439	(810)	6,249	

PGW
BALANCE SHEETS NOVEMBER 30, 2006 AND 2005
(Thousands of Dollars)

ASSETS

Line No.		2006	2005
	Utility Plant - At Original Cost		
1	In service	\$ 1,555,669	\$ 1,515,463
2	Under construction	<u>77,655</u>	<u>70,610</u>
3	Total	1,633,324	1,586,073
4	Less accumulated depreciation	<u>(622,120)</u>	<u>(600,233)</u>
5	Utility plant - net	1,011,204	985,840
6	Sinking fund - revenue bonds	94,746	101,939
7	Capital improvement funds	39,907	103,271
8	Restricted investment (City of Philadelphia)	-	-
9	Restricted investment Workers' Compensation	1,664	1,592
	Current Assets		
10	Cash and temporary investments	68,484	31,677
	Accounts receivable		-
11	Customers	219,186	253,840
12	Others	1,355	979
13	Accrued gas revenues	33,391	47,787
14	Accumulated provisions for uncollectible accounts	<u>(152,867)</u>	<u>(196,951)</u>
15	Accounts receivable - net	101,065	105,655
16	Materials and supplies	182,685	186,890
17	Other current assets and deferred debits	<u>38,626</u>	<u>13,089</u>
18	Total Current Assets	390,860	337,311
19	Unamortized bond issuance cost	41,417	38,360
20	Unamortized loss-reacquired debt	54,456	37,348
21	Other Assets	4,189	5,805
22	Deferred Environmental	<u>4,847</u>	<u>-</u>
23	Total Assets	<u>\$ 1,643,290</u>	<u>\$ 1,611,466</u>

PGW
BALANCE SHEETS NOVEMBER 30, 2006 AND 2005
(Thousands of Dollars)

EQUITY AND LIABILITIES

			2006	2005	Line No.
City equity			\$ 243,403	\$ 195,286	1
Long term debt:					
City of Philadelphia bonds					
<u>Issued</u>	<u>Original amount</u>	<u>Current portion</u>			
1989	132,520	-	5,064	5,064	2
1990	50,421	-	-	-	3
1994	183,880	-	14,800	14,800	4
1998	287,185	12,450	118,315	234,315	5
1999	176,280	10,840	55,675	143,655	6
2001	120,225	965	16,715	115,360	7
2002	125,000	1,285	117,205	118,490	8
2003	186,705	10,715	158,585	169,300	9
2004	207,820	1,790	204,635	206,425	10
2006	313,390	-	313,390	-	11
TECA - 11th "C"			12,925	11,689	12
TECA - 12th "A"		-	-	-	13
Subordinate Lease Obligations			-	-	
1997	23,000	-	-	-	14
Total Issued		38,045	1,017,309	1,019,098	15
Unamortized debt discount/premium		1,530	13,764	11,685	16
Total Long Term Bond Debt		39,575	1,031,073	1,030,783	17
Notes payable (City of Phila.)			45,000	45,000	18
Total Long Term Debt			1,076,073	1,075,783	19
Current Liabilities					
Notes payable			149,000	99,200	20
Accounts payable			56,741	120,926	21
Current portion of long term debt			39,575	42,342	22
Customers' deposits			9,534	7,180	23
Other current liabilities and deferred credits			17,196	25,547	24
Accrued accounts:					
Interest, taxes and wages			19,465	23,188	25
Distribution to the City			7,500	7,500	26
Total Current Liabilities			299,011	325,883	27
Other Liabilities			24,803	14,514	28
Total Equity and Liabilities			\$ 1,643,290	\$ 1,611,466	29

Philadelphia Gas Works' Base Rate Filing

II. RATE OF RETURN

II.A.3. Provide latest Stockholder's Report (Company and Parent).

RESPONSE:

PGW does not issue a Stockholder's Report. Attached is Philadelphia Gas Works' audited 2005 financial report.



PHILADELPHIA GAS WORKS

Financial Statements and Supplementary Information

August 31, 2005 and 2004

(With Independent Auditors' Report Thereon)

PHILADELPHIA GAS WORKS

Table of Contents

	Page
Independent Auditors' Report	1
Required Supplementary Information (Unaudited) – Management's Discussion and Analysis, August 31, 2005 and 2004	3
Balance Sheets, August 31, 2005 and 2004	9
Statements of Operations, Years ended August 31, 2005 and 2004	11
Statements of Cash Flows, Years ended August 31, 2005 and 2004	12
Statements of Changes in City Equity, Years ended August 31, 2005 and 2004	13
Notes to Financial Statements	14
Required Supplementary Information (Unaudited) – Schedule of Pension Funding Progress	40
Supplemental Statements of Net Assets (City Format), August 31, 2005 and 2004	41
Supplemental Statements of Activities (City Format), Years ended August 31, 2005 and 2004	42
Supplemental Statements of Revenues, Expenses, and Changes in Fund Net Assets (City Format), Years ended August 31, 2005 and 2004	43
Supplemental Schedule of Interfund Transfers, Year ended August 31, 2005	44



KPMG LLP
1601 Market Street
Philadelphia, PA 19103-2499

Independent Auditors' Report

The Controller of the City of Philadelphia and
Chairman and Members of the
Philadelphia Facilities Management Corporation
Philadelphia, Pennsylvania:

We have audited the accompanying balance sheets of Philadelphia Gas Works (the Company), an enterprise fund of the City of Philadelphia, as of August 31, 2005 and 2004, and the related statements of operations, cash flows, and changes in city equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Philadelphia Gas Works as of August 31, 2005 and 2004, 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 required supplementary information of management's discussion and analysis on pages 3 to 8 and the schedule of pension funding progress on page 40 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 Company's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included on pages 41 to 44 is for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

December 22, 2005

PHILADELPHIA GAS WORKS

Required Supplementary Information (Unaudited)

Management's Discussion and Analysis

August 31, 2005 and 2004

The narrative overview and analysis of the financial statements of Philadelphia Gas Works (PGW) for the years ended August 31, 2005 and 2004 have been prepared by PGW's Management. The information presented here is unaudited and should be read in conjunction with additional information contained in PGW's financial statements.

Financial Highlights

- The FY 2005 heating season reflected a 5.0% warmer-than-normal winter. The 2005 period was 1.0% colder than the prior year; however, firm gas sales declined by 2.4 Bcf. This decrease in gas sales was more than offset by higher commodity prices for natural gas. In addition, the Weather Normalization Adjustment (WNA), which was in effect from October 2004 through May 2005, resulted in heating customers receiving credits totaling \$1.4 million as a result of the temperatures experienced during the period.
- FY 2005 reflected PGW's continued steady improvement in its collection rate from 86.6% in 2003 and 91.4% in FY 2004 to 94.9 % in the current period. This improved liquidity position occurred in spite of the escalating natural gas prices and their impact on customer billings.
- PGW issued \$207.8 million of revenue bonds during FY 2005. The proceeds from the sale of the \$120.0 million Fifth Series A-1 Bonds (1998 Ordinance) and the \$30.0 million Fifth Series A-2 Bonds were utilized to fund PGW's capital expenditure program, while the proceeds from the sale of the \$57.8 million Eighteenth Series Bonds (1975 Ordinance) were utilized to refund existing long-term debt issued under the 1975 General Ordinance.

Overview of the Financial Statements

The discussion and analysis are intended to serve as an introduction and overview of PGW's basic financial statements. PGW's financial statements are comprised of:

Financial Statements provide both long-term and short-term information about PGW's overall financial condition, results of operations, and cash flows.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data presented in PGW's financial statements. The notes can be found immediately following the basic financial statements.

The financial statements report information about PGW as a whole using accounting methods similar to those used by private sector business. The four statements presented are:

The Statement of Operations presents revenue and expenses and their effects on the change in equity during the FY. These changes in equity are recorded as soon as the underlying event giving rise to the change occurs, regardless of when cash is received or paid.

The Balance Sheet includes all of PGW's assets and liabilities, with the difference between the two reported as equity. Over time, increases or decreases in equity are indicators of whether PGW's financial position is improving or deteriorating.

PHILADELPHIA GAS WORKS
Required Supplementary Information (Unaudited)
Management's Discussion and Analysis
August 31, 2005 and 2004

The Statement of Cash Flows provides relevant information about the cash receipts and cash payments of an enterprise during a period and the impact on PGW's financial position.

The Statement of Changes in City Equity provides a rollforward of the equity balance of the City of Philadelphia (the City) based upon the results from the statement of operations.

Statements of Operations

Condensed Statements of Operations
(Thousands of dollars)

	Years ended August 31	
	2005	2004
Total gas revenues	\$ 830,550	783,356
Other revenues	32,807	28,954
Total operating revenues	863,357	812,310
Total operating expenses	793,012	739,151
Operating income	70,345	73,159
Interest and other income	4,778	3,580
Total interest expense	(63,851)	(59,580)
Net income	\$ 11,272	17,159

Operating Revenues

Operating revenues in FY 2005 were \$863.4 million, an increase of \$51.0 million or 6.3% from the 2004 level. This increase was principally due to the higher customer billings reflecting the rise in natural gas costs. The degree days during the 2005 heating season totaled 4,327, an increase of 40 degree days, or 0.9% from the 4,287 degree days experienced in the 2004 heating season. Total sales volumes, including gas transportation deliveries, in 2005 increased by 0.7 Bcf to 69.9 Bcf or 1.0% from the 2004 level of 69.2 Bcf. Firm gas sales of 53.8 Bcf were 2.4 Bcf or 4.3% lower compared to the prior year, while interruptible customer sales increased by 0.4 Bcf compared to the prior period. Gas transportation sales in 2005 increased by 2.7 Bcf to 11.6 Bcf from the 8.9 Bcf level experienced in 2004. The number of customers served by PGW at the end of 2005 decreased by 0.4% from the previous year to approximately 497,000 customers. Commercial accounts were approximately 25,000, a decrease of 1,000. Industrial accounts approximated the prior year's level of 1,000. Residential customers decreased to approximately 471,000 customers, a decrease of 1,000.

Operating Expenses

Total operating and maintenance expenses including fuel costs in FY 2005 were \$793.0 million, an increase of \$53.9 million or 7.3% from the 2004 level. This increase reflects substantially higher natural gas costs and a higher bad debt expense.

PHILADELPHIA GAS WORKS

Required Supplementary Information (Unaudited)

Management's Discussion and Analysis

August 31, 2005 and 2004

Cost of Fuel – The cost of natural gas utilized increased by \$58.8 million or 13.0% to \$509.7 million in 2005 compared with \$450.9 million in 2004. The average commodity price per Mcf increased by nearly \$1.13 or \$77.4 million, while the volume of gas utilized decreased by \$24.3 million, 3.6 Bcf, or 5.3% in 2005 due mainly to the reduced overall sendout requirements. In addition, pipeline supplier refunds in 2005 increased by \$453,000 while demand charges increased by \$6.1 million compared to the 2004 level. Variations in the cost of purchased gas are passed through to customers under the gas cost rate (GCR) provision of PGW's rate schedules. Over-recoveries or under-recoveries of purchased gas costs are subtracted from or added to gas revenues and are included in current assets or liabilities, thereby eliminating the effect that recovery of gas costs would otherwise have on net income.

Other Operating Expenses – Expenditures for street operations, infrastructure improvements, and plant operations were \$62.2 million, down slightly from the prior year total of \$62.6 million, reflecting similar winter weather conditions. In addition, the cost for customer services, collection and account management, marketing, and the administrative area decreased by \$4.3 million or 4.4%. The main reasons for the lower costs reflect reduced amortization of bad debt arrearages and environmental expenses, offset somewhat by higher premiums for (active and retired) employee health insurance coverage. Pension costs in FY 2005 decreased by \$271,000 below the prior year's level, based on the most recent actuarial valuation of the retirement fund. The decrease in pension expense was due primarily to the increase in the Retirement Reserve Fund's contribution to beneficiary payments.

Bad Debt Expense – Bad debt expense in FY 2005 totaled \$70.4 million, a decrease of \$576,000 or 0.8% lower than the 2004 level based on the most recent accounts receivable collectibility evaluation. This expense reflects an additional level of written-off accounts. The accumulated provision for uncollectible accounts at August 2005 reflects a balance of \$207.5 million, compared to the \$230.2 million balance in FY 2004. PGW is committed to continuing its collection efforts in an attempt to reduce outstanding delinquent account balances and to provide assistance to those customers who qualify for low-income grants and payment programs to help those customers maintain their gas service.

Depreciation Expense – Depreciation expense increased by \$679,000 in FY 2005 compared with FY 2004. The composite depreciation rate for FYs 2005 and 2004 was 2.4%. Cost of removal is charged to expense as incurred.

Interest and Other Income – Interest and other income was \$1.2 million greater than the 2004 FY as the result of increased earnings rates and higher restricted fund balances.

Interest Expense – Total interest expense increased by \$4.3 million or 7.2% in FY 2005 compared with FY 2004. Interest on long-term debt was \$3.0 million higher than the 2004 level reflecting the additional interest expense for the full-year effect of the issuance of \$150.0 million of revenue bonds during FY 2005. Other interest costs rose by \$1.3 million or 13.0% reflecting additional costs associated with PGW's commercial paper program and the loss on reacquired debt.

Net Income – The net income for FY 2005 was \$11.3 million compared with \$17.2 million in FY 2004.

PHILADELPHIA GAS WORKS
Required Supplementary Information (Unaudited)
Management's Discussion and Analysis
August 31, 2005 and 2004

Balance Sheets

Condensed Balance Sheets
(Thousands of dollars)

Assets	August 31	
	2005	2004
Utility plant, net	\$ 981,722	950,736
Restricted investment funds	207,231	136,423
Current assets:		
Accounts receivable (net of accumulated provision for uncollectible accounts of \$207,480 and \$230,216 for 2005 and 2004, respectively)	87,634	93,124
Other current assets	147,837	116,150
Total current assets	235,471	209,274
Other assets and deferred debits	95,398	81,748
Total assets	\$ 1,519,822	1,378,181
Equity and Liabilities		
City equity	\$ 222,646	211,374
Total long-term debt	1,075,830	913,514
Current liabilities:		
Note payable	49,900	95,750
Current portion of long-term debt	42,271	41,813
Other current liabilities	104,992	94,143
Total current liabilities	197,163	231,706
Other liabilities and deferred credits	24,183	21,587
Total equity and liabilities	\$ 1,519,822	1,378,181

Assets

Utility Plant – Utility plant, net of depreciation, totaled \$981.7 million in FY 2005, an increase of \$31.0 million or 3.3% above the 2004 balance of \$950.7 million.

Capital Expenditures – Capital expenditures for construction of distribution facilities, purchase of equipment, information technology enhancements, and other general improvements were \$66.0 million in 2005 compared to \$60.7 million in 2004. During 2005, PGW funded \$68.0 million of its capital expenditures through drawdowns from its Capital Improvement Fund. In 2004, PGW funded \$55.6 million of its capital expenditures through drawdowns from its Capital Improvement Fund. The major capital expenditures are associated with PGW's gas supply infrastructure, namely, gas mains and customer service lines.

PHILADELPHIA GAS WORKS
Required Supplementary Information (Unaudited)
Management's Discussion and Analysis
August 31, 2005 and 2004

Restricted Investment Funds – Restricted investment funds increased by \$70.8 million in FY 2005 primarily due to the deposit of funds to the Capital Improvement Fund to support PGW's FY 2005 capital construction program. Interest income on these funds is reflected as an increase and approximated \$3.7 million. A drawdown from the Capital Lease Fund in the amount of \$2.0 million was utilized to offset the final debt service payment of the capital lease that ended in October 2004. Cash and cash equivalents were \$15.2 million, an increase of \$11.6 million from the 2004 level.

Accounts Receivable – Accounts receivable (net) of \$87.6 million decreased by \$5.5 million, or 5.9% from the 2004 level, mainly reflecting the impact of greater write-offs. The accumulated provision for uncollectible accounts totaling \$207.5 million decreased by \$22.7 million to reflect estimated uncollectible amounts in the accounts receivable balance at August 31, 2005.

Materials and Supplies – Materials and supplies of \$130.0 million, which principally include storage gas, maintenance spare parts, and material, increased by \$31.5 million. Gas storage, utilized by PGW's gas supply area, increased by \$32.4 million or 36.5%. The increase in gas storage expense reflects higher natural gas prices and an increased volume of gas in storage.

Other Current Assets and Deferred Debits – Other current assets and deferred debits totaled \$2.6 million, down \$11.4 million, mainly due to the \$7.6 million over-recovery adjustment associated with the 2005 FY GCR.

Other Assets and Deferred Debits – Other assets and deferred debits including unamortized bond issuance costs, unamortized loss on reacquired debt, and a deferred regulatory asset for environmental expenses totaled \$95.4 million, an increase of \$13.7 million from the 2004 level. The major portion of this increase is the bond issuance costs on \$207.8 million of debt issued in FY 2005, offset partially by the loss on reacquired debt, and deferred environmental costs. Furthermore, the 2004 fiscal period was the last year of the amortization of deferred customer arrearages.

Liabilities

Long-Term Debt – Long-term debt, including the current portion, unamortized debt discount and premium, and note payable – City Loan totaled \$1,118.1 million in FY 2005, \$162.8 million higher than the previous year as a result of the issuance of revenue bonds during FY 2005 and the reclassification of the note payable – City Loan from current liabilities as a result of the extension of the repayment date. This represented 83.4% of PGW's total capitalization in FY 2005. The total long-term debt for FY 2004 totaled \$955.3 million, which represented 81.9% of PGW's total capitalization.

Ratios, Coverages, and Ratings – PGW has a mandatory debt service coverage ratio of 1.50 times on 1975 Ordinance Bonds and 1998 Ordinance Bonds. In FY 2005, the debt service coverage was at 3.36 times debt service on the outstanding 1975 Ordinance Bonds and 1.94 times debt service on the Senior 1998 Ordinance Bonds compared to debt service coverage ratios of 2.39 and 1.61 times, respectively, in 2004. PGW's current bond ratings are "Baa2" from Moody's Investors Service, "BBB-" from Standard and Poor's Ratings Service, and "BBB-" from Fitch Ratings.

PHILADELPHIA GAS WORKS

Required Supplementary Information (Unaudited)

Management's Discussion and Analysis

August 31, 2005 and 2004

Short-Term Debt – Due to the highly seasonal nature of PGW's business, short-term debt is used to meet working capital requirements. PGW, pursuant to the provisions of the Note Ordinance, may sell short-term notes in a principal amount which, together with interest, may not exceed \$100.0 million outstanding at any one time. The letter of credit supporting PGW's commercial paper program for FY 2005 fixed the maximum level of outstanding notes at \$100.0 million. These notes are intended to provide additional working capital and are supported by an irrevocable letter of credit and a security interest in PGW's revenues. The notes outstanding at August 31, 2005 had an average weighted interest rate of approximately 2.4% and a remaining time to maturity of two days. The principal amounts outstanding at August 31, 2005 and 2004 were \$49.9 million and \$50.8 million, respectively. Also, the City provided PGW with a \$45.0 million, 0.0% interest loan in FY 2001. The repayment date is August 2008.

Liquidity/Cash Flow – At November 30, 2005, no funds were available from the Commercial Paper Program, and no funds were available from the \$45.0 million City loan. However, PGW had \$99.9 million of bond proceeds available in its Capital Improvement Fund from the October 2004, Fifth Series Bonds issuance to partially fund the FY 2005 capital construction program. These funding sources may be utilized during the fall and early winter period to provide liquidity until billings from the winter heating season are collected.

Accounts Payable – Accounts payable decreased by \$9.1 million or 12.5% compared to last year primarily due to a lower amount of trade payables and payables associated with the purchase of natural gas at August 31, 2005.

Other Liabilities and Deferred Credits – Other liabilities and deferred credits totaling \$24.2 million increased by \$2.6 million in FY 2005. The major reason for this increase is the recording of the environmental liability offset by the termination of the interest swap agreement.

The 2005 FY presented both challenges and successes. PGW's major accomplishment was improving its overall cash collections rate, as a percentage of annual billings, from under 92.0% in 2004 to a level approaching 94.9% in 2005. The City has made a major commitment to PGW by granting back its annual \$18.0 million payment, thereby improving PGW's overall liquidity position. PGW must continue to focus its efforts on becoming a competitive utility in the deregulated marketplace. PGW remains committed to achieving its tradition of providing high-quality service to customers, while continuing as a valuable enterprise of the City.

PHILADELPHIA GAS WORKS

Balance Sheets

August 31, 2005 and 2004

(Thousands of dollars)

Assets	2005	2004
Utility plant, at original cost:		
In service	\$ 1,515,463	1,473,519
Under construction	57,883	43,527
Total	1,573,346	1,517,046
Less accumulated depreciation	591,624	566,310
Utility plant, net	981,722	950,736
Restricted investment funds:		
Sinking fund, revenue bonds	104,530	95,929
Capital improvement fund	102,701	40,494
Total restricted investment funds	207,231	136,423
Current assets:		
Cash and cash equivalents	15,221	3,666
Accounts receivable (net of provision for uncollectible accounts of \$207,480 and \$230,216 for 2005 and 2004, respectively)	87,634	93,124
Gas inventories, materials, and supplies	129,984	98,467
Other current assets and deferred debits	2,632	14,017
Total current assets	235,471	209,274
Unamortized bond issuance costs	39,094	32,718
Unamortized losses on reacquired debt	38,494	39,439
Other assets and deferred debits	17,810	9,591
Total assets	\$ 1,519,822	1,378,181

PHILADELPHIA GAS WORKS

Balance Sheets

August 31, 2005 and 2004

(Thousands of dollars)

Equity and Liabilities	2005	2004
City equity:		
Invested in capital assets, net of related debt	\$ 24,739	35,903
Restricted	104,530	95,929
Unrestricted	93,377	79,542
Total City equity	222,646	211,374
Long-term debt:		
Revenue bonds	1,030,830	913,514
Note payable – City Loan	45,000	—
Total long-term debt	1,075,830	913,514
Current liabilities:		
Note payable	49,900	95,750
Current portion of long-term debt:		
Revenue bonds	42,271	39,866
Subordinated lease obligations	—	1,947
Accounts payable	63,918	73,027
Customer deposits	6,280	1,694
Other current liabilities and deferred credits	18,342	6,729
Accrued accounts:		
Interest, taxes, and wages	13,452	9,693
Distribution to the City	3,000	3,000
Total current liabilities	197,163	231,706
Other liabilities and deferred credits	24,183	21,587
Commitments and contingencies		
Total equity and liabilities	\$ 1,519,822	1,378,181

See accompanying notes to financial statements.

PHILADELPHIA GAS WORKS
Statements of Operations
Years ended August 31, 2005 and 2004
(Thousands of dollars)

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Gas revenues:		
Nonheating	\$ 114,880	99,074
Gas transport service	4,679	2,945
Heating	711,794	679,877
Unbilled gas adjustment	(803)	1,460
Total gas revenues	<u>830,550</u>	<u>783,356</u>
Appliance and other revenues	10,895	10,065
Other operating revenues	21,912	18,889
Total operating revenues	<u>863,357</u>	<u>812,310</u>
Operating expenses:		
Natural gas	509,704	450,868
Gas processing	18,584	17,284
Field services	28,455	29,557
Distribution	15,115	15,778
Collection and account management	18,666	18,226
Provision for uncollectible receivables	70,424	71,000
Customer services	12,512	13,514
Marketing	2,592	2,677
Administrative and general	60,995	64,670
Pensions	14,702	14,973
Taxes	6,218	6,638
Total operating expenses before depreciation	<u>757,967</u>	<u>705,185</u>
Depreciation	39,547	38,868
Less depreciation expense included in operating expenses above	4,502	4,902
Total depreciation	<u>35,045</u>	<u>33,966</u>
Total operating expenses	<u>793,012</u>	<u>739,151</u>
Operating income	70,345	73,159
Interest and other income	4,778	3,580
Income before interest expense	<u>75,123</u>	<u>76,739</u>
Interest expense:		
Long-term debt	53,856	50,837
Other	10,902	9,650
Allowance for funds used during construction	(907)	(907)
Total interest expense	<u>63,851</u>	<u>59,580</u>
Net income	<u>\$ 11,272</u>	<u>\$ 17,159</u>

See accompanying notes to financial statements.

PHILADELPHIA GAS WORKS
Statements of Cash Flows
Years ended August 31, 2005 and 2004
(Thousands of dollars)

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Receipts from customers	\$ 845,900	756,000
Payments to suppliers	(652,060)	(546,987)
Payments to employees	(102,500)	(101,200)
Claims paid	(2,715)	(2,463)
Other receipts	11,700	15,500
Net cash provided by operating activities	<u>100,325</u>	<u>120,850</u>
Cash flows from noncapital financing activities:		
Interest	(6,701)	1,050
Interest payments on notes payable	(2,864)	(2,085)
Net repayments of notes payable	(850)	(23,250)
Distribution to the City of Philadelphia	(18,000)	—
Grant back of distribution from the City of Philadelphia	18,000	—
Net cash used in noncapital financing activities	<u>(10,415)</u>	<u>(24,285)</u>
Cash flows from capital and related financing activities:		
Proceeds from long-term debt issued	155,396	—
Long-term debt premium, discount, issuance, and losses	(9,996)	—
Purchases of capital assets	(66,032)	(60,671)
Principal paid on long-term debt	(38,169)	(41,400)
Interest paid on long-term debt	(53,044)	(52,871)
Capital improvement fund deposits	(129,532)	—
Drawdowns on capital improvement fund	67,325	59,221
Interest income on capital improvement fund	2,806	696
Interest income on sinking fund	585	748
Sinking fund deposits	(8,601)	91
Other investment income	907	907
Net cash used in capital and related financing activities	<u>(78,355)</u>	<u>(93,279)</u>
Net increase in cash and cash equivalents	11,555	3,286
Cash and cash equivalents at the beginning of the year	<u>3,666</u>	<u>380</u>
Cash and cash equivalents at the end of the year	<u>\$ 15,221</u>	<u>3,666</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 70,345	73,159
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	36,953	42,668
Change in assets and liabilities:		
Receivables, net	5,538	(264)
Inventories	(31,516)	(24,438)
Accounts payable	(9,109)	25,538
Other liabilities and deferred credits	26,856	(2,464)
Other assets and deferred debits	1,258	6,651
Net cash provided by operating activities	<u>\$ 100,325</u>	<u>120,850</u>

See accompanying notes to financial statements.

PHILADELPHIA GAS WORKS
Statements of Changes in City Equity
Years ended August 31, 2005 and 2004
(Thousands of dollars)

	<u>2005</u>	<u>2004</u>
Balance, beginning of the year	\$ 211,374	194,215
Net income	11,272	17,159
Distribution to the City of Philadelphia	(18,000)	—
Grant back of distribution from the City of Philadelphia	<u>18,000</u>	<u>—</u>
Balance, end of the year	<u>\$ 222,646</u>	<u>211,374</u>

See accompanying notes to financial statements.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

On August 5, 2004, the Company filed its FY 2005 Operating Budget. The PGC conducted hearings concerning this budget in October 2004. Briefs were filed on October 21, 2004. The Hearing Examiner issued a Recommended Decision on November 10, 2004, providing Operating Budget adjustments for consideration by the Commissioners. The net effect of the recommended adjustments was \$12,782,000 compared to FY 2005 budgeted revenues totaling \$866,794,000 set forth in the original filing. The Company and Public Advocate filed Exceptions to the Recommended Decision on November 24, 2004. The Commission Motion approving the FY 2005 Operating Budget, as revised, was passed on December 14, 2004. The final Order memorializing the PGC's action was entered on December 16, 2004. The approved budget incorporates the Company's proposed operating revenues and expenses with adjustments.

(c) Capital Budget

On March 1, 2005, the Company filed with the PGC its FY 2006 Capital Budget requesting spending authority in the amount of \$65,686,000. This amount was revised to \$65,301,000 by the Company during the proceeding. The PGC conducted hearings concerning this budget in April 2005. Briefs were filed on May 11, 2005. The Hearing Examiner issued a Recommended Decision on May 25, 2005 for consideration by the Commissioners. The Hearing Examiner recommended a downward adjustment in spending authority of approximately \$2,017,000 from the original filing. The Company and Public Advocate filed Exceptions to the Recommended Decision on June 1, 2005. The Commission's Resolution and Order recommending approval of the FY 2006 Capital Budget, as revised, to City Council was passed on June 21, 2005. This recommendation of \$63,669,000 was approved by City Council. Subsequent to this approval, the PGC approved PGW's request to amend the budget in the amount of \$65,835,000. Approval of this amended budget has been forwarded to City Council for final approval.

On April 30, 2004, the Company filed with the PGC its FY 2005 Capital Budget requesting spending authority in the amount of \$59,812,000 (this amount was revised to \$57,815,000 by the Company during the proceeding). The PGC conducted hearings concerning this budget in July 2004. Briefs were filed on July 23, 2004. The Hearing Examiner issued a Recommended Decision on August 13, 2004 for consideration by the Commissioners. The Hearing Examiner recommended a downward adjustment in spending authority of approximately \$1,160,000. The Company and Public Advocate filed Exceptions to the Recommended Decision on August 27, 2004. The PGC's final Order recommending approval of the FY 2005 Capital Budget, as revised, to City Council was passed on September 20, 2004, recommending the approval of program and spending authorization not to exceed \$58,652,000. Thereafter, a budget amendment in the amount of \$5,295,000 was recommended by the PGC for approval of City Council, increasing the FY 2005 Capital Budget to \$63,947,000. City Council approved the FY 2005 Capital Budget on October 28, 2004 and the amendments thereto on June 2, 2005 in the above amounts. The Mayor of the City (the Mayor) signed the Ordinance approving the FY 2005 Capital Budget on November 18, 2004 and the Ordinance approving the amendments thereto on June 15, 2005.

(d) Base Rates

Base rate increases and increases in the GCR (see Gas Cost Rate below) are required to maintain the Company's long-term financial stability. On April 12, 2002, the PUC approved a \$36,000,000 increase in base rates. There have been no increases or decreases in base rates since FY 2002.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(e) Weather Normalization Adjustment Clause

The Weather Normalization Adjustment Clause (WNA) was approved by PUC Order dated August 8, 2002. The purpose of the WNA is to neutralize the impact of weather on the Company's revenues. This allows the Company to achieve the recovery of appropriate costs as authorized by the PUC. The WNA results in neither a rate increase nor a rate decrease. The main benefits of the WNA are the stabilization of cash flow and the reduction of the need for short-term borrowing from year to year. The WNA is applied to customer invoices rendered during the period of October 1 through May 31 of each year for each billing cycle. The WNA had an initial three-year period that expired October 31, 2005. The Company conducted a review of the costs and benefits of the WNA. The Company is currently in the process of presenting its conclusions regarding the WNA to the PUC with a request that the PUC acknowledge that the WNA should continue in place. The WNA will continue in place unless the PUC issues an order directing that it be discontinued. A determination will be made by the PUC at the end of the review as to whether the WNA will continue, continue with modifications, or be eliminated. The Company cannot predict when the PUC will complete its review of the WNA. The Company reserved the right to file a petition seeking extraordinary rate relief in the event of a force majeure, significant regulatory change, or projected material change in the status of the Company's credit arrangements. The adjustment for the years ended August 31, 2005 and 2004 was a \$1,365,000 decrease and \$2,109,000 increase, respectively, in billings.

(f) Gas Cost Rate

The Company's single greatest operating expense is the cost of natural gas. The rate charged to the Company's customers to recover these costs is called the Gas Cost Rate (GCR) factor. The GCR reflects the increases or decreases in natural gas costs and the cost of other raw materials. This GCR mechanism provides the flexibility to rapidly reflect current conditions without the time delay inherent in full base rate alteration. The intent is to achieve an annual balance between the costs incurred for fuel and their pass-through to customers.

At the end of the fiscal year, costs recovered through the GCR are compared to the actual cost of fuel and other specific costs. Customers are then credited or charged for over-recovery or under-recovery of costs. The GCR may be adjusted quarterly or in the subsequent fiscal year to reflect the under-recovery or over-recovery. Changes in the GCR impact the reported amounts of gas revenues and operating expenses, but do not affect operating income or net income.

On November 30, 2005, the Company filed with the PUC its First Quarter FY 2006 GCR Update reflecting no change to the \$12.5632 per Mcf December 1, 2005 GCR.

On August 31, 2005, the Company filed with the PUC its Fourth Quarter FY 2006 GCR Update reflecting an increase in the September 1, 2005 GCR from \$8.9998 per Mcf to \$9.7056 per Mcf. An interim GCR Update filed with the PUC on September 23, 2005 became effective on October 7, 2005 reflecting an increase from \$9.7056 per Mcf to \$12.5632 per Mcf.

On May 31, 2005, the Company filed with the PUC its Third Quarter FY 2005 GCR Update reflecting an increase in the June 1, 2005 GCR from \$8.1122 per Mcf to \$8.9998 per Mcf.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

On February 28, 2005, the Company filed with the PUC its Second Quarter FY 2005 GCR Update reflecting a decrease in the March 1, 2005 GCR from \$9.8857 per MCF to \$8.1122 per Mcf.

On November 29, 2004, the Company filed with the PUC its First Quarter FY 2005 GCR Update reflecting an increase in the December 1, 2004 GCR from \$8.3085 per Mcf to \$9.8857 per Mcf.

On August 30, 2004, the Company filed with the PUC its Fourth Quarter FY 2004 GCR Update reflecting an increase in the September 1, 2004 GCR from \$8.0699 per Mcf to \$8.3085 per Mcf.

On May 28, 2004, the Company filed with the PUC its Third Quarter FY 2004 GCR Update reflecting an increase in the June 1, 2004 GCR from \$7.9254 per Mcf to \$8.0699 per Mcf.

On February 27, 2004, the Company filed with the PUC its Second Quarter FY 2004 GCR Update reflecting an increase in the March 1, 2004 GCR from \$7.6313 per Mcf to \$7.9254 per Mcf.

On November 26, 2003, the Company filed with the PUC its First Quarter FY 2004 GCR Update reflecting a decrease in the December 1, 2003 GCR from \$7.8670 per Mcf to \$7.6313 per Mcf.

On August 29, 2003, the Company filed with the PUC its Fourth Quarter FY 2003 GCR Update reflecting an increase in the September 1, 2003 Restructured GCR from \$5.7687 per Mcf to \$7.8670 per Mcf.

(g) Utility Plant

Utility plant is stated at original cost. The cost of additions, replacements, and betterments of units of property are capitalized and included in the utility plant accounts. The cost of property sold or retired is removed from the utility plant accounts and charged to accumulated depreciation. Normal repairs, maintenance, the cost of minor property items, and expenses associated with retirements are charged to operating expenses as incurred.

In a previous rate order, the PGC disallowed the accrual of the net negative salvage component in depreciation. Cost of removal in the amounts of \$3,643,000 and \$3,261,000 was charged to expense as incurred in FY 2005 and 2004, respectively, and is included in depreciation expense in the statements of operations. Depreciation is calculated on an asset by asset basis on the estimated useful lives of plant and equipment on a straight-line method. The composite rate for FY 2005 and 2004 was 2.4%. The composite rates are supported by a depreciation study of utility plant as of August 31, 2004. The following composite depreciation rates were used for FY 2005:

Production plant	0.97% – 4.75%
Transmission, distribution, and storage	0.83% – 4.12%
General plant	0.38% – 10.84%

Allowance for funds used during construction (AFUDC) is an estimate of the cost of funds used for construction purposes. The AFUDC, as calculated on borrowed funds, reduces interest expense. The AFUDC rate applied to construction work in progress was 5.22% and 5.17% in FY 2005 and 2004, respectively.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

The following is a summary of utility plant activity for the fiscal years ended August 31, 2005 and 2004, respectively (in thousands of dollars):

	August 31, 2005			
	Beginning balance	Additions and transfers	Retirements and transfers	Ending balance
Land	\$ 5,267	—	—	5,267
Distribution and collection systems	1,086,476	40,328	(3,402)	1,123,402
Buildings and equipment	381,776	14,024	(9,006)	386,794
Total utility plant, at historical cost	1,473,519	54,352	(12,408)	1,515,463
Under construction	43,527	68,698	(54,342)	57,883
Less accumulated depreciation for:				
Distribution and collection systems	(489,627)	(24,453) *	3,402	(510,678)
Buildings and equipment	(76,683)	(11,451) *	7,188	(80,946)
Utility plant, net	\$ 950,736	87,146	(56,160)	981,722

	August 31, 2004			
	Beginning balance	Additions and transfers	Retirements and transfers	Ending balance
Land	\$ 5,310	—	(43)	5,267
Distribution and collection systems	1,046,848	48,353	(8,725)	1,086,476
Buildings and equipment	377,465	6,771	(2,460)	381,776
Total utility plant, at historical cost	1,429,623	55,124	(11,228)	1,473,519
Under construction	37,953	60,398	(54,824)	43,527
Less accumulated depreciation for:				
Distribution and collection systems	(472,675)	(23,527) *	6,575	(489,627)
Buildings and equipment	(66,457)	(12,080) *	1,854	(76,683)
Utility plant, net	\$ 928,444	79,915	(57,623)	950,736

* Cost of removal in the amounts of \$3,643 and \$3,261 was charged to expense as incurred in FY 2005 and 2004, respectively, and is not included in accumulated depreciation.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(h) Revenue Recognition

The Company is primarily a natural gas distribution company. Operating revenues include revenues from the sale of natural gas to residential, commercial, and industrial heating and nonheating customers. The Company also provides natural gas transportation service. Appliance and other revenues primarily consist of revenue from the Company's parts and labor repair program. Revenue from this program is recognized on a deferred monthly basis for the life of the individual parts and labor plans. Additional revenue is generated from collection fees and reconnection charges. Other operating revenues primarily consist of finance charges assessed on delinquent accounts.

Operating expenses include the cost of natural gas and the related costs incurred through the processing, distribution, and delivery of natural gas to residential, commercial, and industrial heating and nonheating customers.

The unbilled gas adjustment results because customers' meters are read, and bills are rendered, on a cycle basis rather than all being read at the end of the month. Revenues are recognized as gas is distributed. Estimated revenues from gas distributed and unbilled, less estimated uncollectible amounts, are accrued and included in operating revenues.

As required by GASB Statement No. 34, *Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments*, operating revenues, reported in the statement of revenues, expenses, and changes in net assets, are shown net of discounts.

(i) Customers (unaudited)

The Company's service territory encompasses the City. Of the Company's approximately 497,000 customers at August 31, 2005, nearly 95.0% are residential.

The Company offers a discounted payment plan for current receivables with a possible forgiveness of arrearages in three years. The total number of customers with discounted payment plans as of August 31, 2005 and 2004 was approximately 65,000 and 53,000, respectively.

The Senior Citizen Discount also provides customers with a discounted payment plan. The total number of customers receiving the discount as of August 31, 2005 and 2004 was approximately 56,000 and 62,000, respectively.

(j) Provision for Uncollectible Accounts

The Company estimates its accumulated provision for uncollectible accounts based on financial analysis and a collectibility study performed at least annually at or near the fiscal year-end. The methodology used in performing the collectibility study has been reviewed with the PGC. For FY 2005 and 2004, management has provided an accumulated provision for uncollectible accounts in excess of the collectibility study results based on its analysis of historical aging data. The actual results of the Company's collection efforts could differ significantly from the Company's estimate.

Due to the seasonal nature of the business, the Company has credit balances at fiscal year-end in accounts receivable in the amounts of \$12,920,000 and \$10,675,000 for FY 2005 and 2004, respectively, primarily as a result of prepayment by budget customers.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(k) Gas Inventories, Materials, and Supplies

Gas inventories, materials, and supplies, consisting primarily of fuel stock, gases stored to meet peak demand requirements, and spare parts, are stated at average cost at August 31, 2005 and 2004, as follows (thousands of dollars):

	2005	2004
Gas inventory	\$ 121,266	88,821
Material and supplies	8,718	9,646
Total	\$ 129,984	98,467

(l) Bond Issuance Costs, Debt Discount, and Premium

Discounts or premiums and bond issuance costs arising from the sale of revenue bonds are amortized using the interest method over the term of the particular bond issue.

(m) Losses on Reacquired Debt

Losses on reacquired debt are deferred and amortized, using the interest method, to interest expense over the life of the refunding bond issue as required by the PGC and the GASB.

(n) Pensions

The Company has a noncontributory pension plan (the Pension Plan) covering all employees and providing for retirement payments at age 65 or earlier under various options. These options include a disability pension provision, a preretirement spouse's death benefit, a reduced pension for early retirement, various reduced pension payments for the election of a survivor option, and a provision for retirement after 30 years of service without penalty for reduced age. In accordance with Resolutions of the PGC, Ordinances of City Council, and as prescribed by the City's Director of Finance, the Pension Plan is being funded with contributions by the Company to the Sinking Fund Commission of the City.

On June 26, 2002, the Mayor signed an Ordinance amending and restating retirement benefits for Company employees. The Ordinance restates and replaces various ordinances constituting the Pension Plan since its inception in 1967. The new Ordinance granted the vesting of pension benefits after five years of service replacing the prior provision of a ten-year vesting period. The Company has filed an Application for Determination for Employee Benefit Plan with the Internal Revenue Service. Pursuant to same, the Internal Revenue Service reviewed the Pension Plan and issued a favorable determination letter effective October 21, 2003, subject to the adoption of certain amendments. The required amendments were included in an ordinance passed by City Council in June 2004. Management believes that the Pension Plan is in compliance with all applicable law.

(o) Statements of Cash Flows

For the purpose of reporting cash flows, all nonrestricted highly liquid investments (stated at cost which approximates market) with original maturities of three months or less are considered cash equivalents.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(p) Reserve for Injuries and Damages

The Company is principally insured through insurance carriers; however, the Company is required to cover settlement of claims which are excluded under the provisions of such insurance policies. An estimated liability has been established, in accordance with PGC regulations, for settlements to be paid by the Company in the next fiscal year.

Estimated losses from claims for occurrences not covered by insurance, which will not be paid in the next fiscal year, have been accrued and deferred. Such liabilities have been established based upon Company history and consultation with counsel. Such expenses are expected to be recovered through future rates. Charges against the reserve are made as claims are settled.

(q) Investments

GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, establishes fair value standards for investments held by government entities, except for certain money market investments, as defined, which are recorded at amortized cost. The Company's investments consist of money market investments that have a remaining maturity at time of purchase of one year or less.

(r) Segment Information

All of the Company's assets and operations are employed in only one segment, local transportation and distribution of natural gas in the City.

(s) Estimates

In preparing the financial statements in conformity with accounting principles generally accepted in the United States of America, management uses estimates. The Company has disclosed in the financial statements all estimates where it is reasonably possible that the estimate will change in the near term and the effect of the change could be material to the financial statements.

(t) Presentation

Certain FY 2004 amounts have been reclassified to conform with the FY 2005 presentation.

(2) Ownership and Management

The Company is not a separately incorporated entity, but represents an enterprise fund of the City. As of January 1, 1973, under the terms of a two-year agreement automatically extended for successive two-year periods unless canceled upon 90 days notice by the City, the Company is being managed by the Philadelphia Facilities Management Corporation (PFMC). The agreement, as amended, provides for reimbursement to PFMC of actual costs incurred in managing the Company, not to exceed a total of the prior fiscal year's maximum amount adjusted to reflect the percentage change in the Consumer Price Index for All Urban Consumers (CPI-U) All Items Index, Philadelphia, Pennsylvania, United States Department of Labor, Bureau of Labor Statistics, as most recently published and available to the Director of Finance on March 1 of each such fiscal year. In FY 2005, the applicable maximum amount was calculated to be \$916,000. In FY 2004, the applicable maximum amount was calculated to be \$876,000. The applicable maximum amount in FY 2003 was fixed at \$854,000. The agreement requires the Company to make

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

annual payments of \$18,000,000 to the City. In FY 2004, this payment was not made. In FY 2005, the Company made the annual payment of \$18,000,000 to the City. The City then granted the \$18,000,000 back to the Company.

The Company engages in various other transactions with the City. The Company provides gas service to the City. Operating revenues include \$14,473,000 and \$11,953,000 in FY 2005 and 2004, respectively, relating to sales to the City. Water and sewer services and licenses are purchased from the City. Such purchases totaled \$555,000 and \$784,000 in 2005 and 2004, respectively. Net amounts receivable from the City were \$562,000 and \$355,000 at August 31, 2005 and 2004, respectively.

Certain activities of the PGC are paid for by the Company. Such payments totaled \$909,000 and \$921,000 in FY 2005 and 2004, respectively.

(3) Cash, Cash Equivalents, and Investments

(a) Cash

Cash consists primarily of bank deposits. Bank balances of such deposits at August 31, 2005 and 2004 were \$16,914,000 and \$5,170,000, respectively. Book balances of such deposits at August 31, 2005 and 2004 were \$15,221,000 and \$3,666,000, respectively. Federal depository insurance on these balances at August 31, 2005 and 2004 was \$290,000 and \$162,000, respectively.

(b) Cash Equivalents and Investments

Statutes authorize the Company to invest in obligations of the U.S. Treasury, U.S. government agencies and instrumentalities, and repurchase agreements (collateralized by obligations of the U.S. Treasury and government agencies).

For the Company's cash equivalents, the Company's cash balances fluctuate significantly during the year. Excess cash balances are usually invested in repurchase agreements or money market accounts. The highest balances of repurchase agreements and money market accounts during the fiscal years ended August 31, 2005 and 2004 were \$79,800,000 and \$32,650,000, respectively. Money market accounts with a carrying amount (at market value) of \$14,825,000 and \$3,595,000 at August 31, 2005 and 2004, respectively, could not be classified as to credit risk.

(c) Restricted Investment Funds

The Company's Sinking Fund, Capital Improvement Fund, and City Loan Escrow Account investments, consisting primarily of U.S. Treasury and government agency obligations, are maintained by the City or in the Company's name by its agent. The balance of the Capital Improvement Fund at August 31, 2005 and 2004 was \$102,701,000 and \$40,494,000, respectively. The unexpended Capital Improvement Fund proceeds are restricted to the purchase of utility plant. In FY 2005 and 2004, the Company utilized the Capital Improvement Fund to provide liquidity for the additions to utility plant.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

The following is a schedule that details the Company's investments in the Capital Improvement Fund (thousands of dollars):

<u>Investment type</u>	<u>Fair value</u>	<u>Weighted average maturity (years)</u>	<u>Credit rating</u>	<u>Rating agency</u>
Guaranteed Investment Contract	\$ 77,892	**	*	*
Money market	24,590	N/A	N/A	
Accrued interest	219			
Total fair value of investments	<u>\$ 102,701</u>	N/A		

* The credit rating of this investment is unrated.

** There is a schedule of drawdowns and an expiration date for the GIC of May 15, 2007.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

The following is a schedule that details the Company's investments in the Sinking Fund (thousands of dollars):

Investment type	Fair value	Weighted average maturity (years)	Credit rating	Rating agency
Forward Delivery Agreement	\$ 55,924	15.5000	*	*
U.S. government obligations	18,636	1.8406	Aaa/AAA	Moody's/S&P
U.S. government agencies and Instrumentalities	18,499	1.3495	Aaa/AAA	Moody's/S&P
Corporate obligations	1,040	1.7917	Aaa/AAA	
Corporate obligations	3,138	2.3161	Aa1/AA-	Moody's/S&P
Total corporate obligations	4,178			
State obligations	994	25.2083	AA-	S&P
Guaranteed Investment Contract	6,054	(a)	*	*
Total fair value of investments	104,285			
Money market	231	N/A	N/A	
Accrued interest	14			
Total fair value of investments, including cash deposits	\$ 104,530			
Portfolio weighted modified duration		2.2087		

* The credit rating of this investment is unrated.

(a) There is a schedule of drawdowns and an expiration date for the GIC of September 1, 2006.

GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, establishes fair value standards for investments held by government entities, except for certain money market investments, as defined, which are recorded at amortized cost. The adjustment to market value for the Capital Improvement Fund and the Capital Lease Fund resulted in no gains or losses at August 31, 2005 and 2004. The Funds were held in money market investments and the GIC at August 31, 2005. The adjustment to market value for the Sinking Fund resulted in a loss of \$317,000 and \$136,000 at August 31, 2005 and 2004, respectively.

The Company has established a City Loan Escrow account as a disbursement precondition to the utilization of the funds from the City Loan. The restricted account is interest bearing, the interest on which accrues to the benefit to the City. The Company may only draw on the account after providing

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

details of the projected cash deficit that the draw will be utilized to fund. The Company, on a daily basis, must deposit excess cash into the restricted account. The balance at August 31, 2005 and 2004 was \$0.

(d) Interest Rate Risk

It is the policy of the City to diversify its investment portfolios. Portfolio diversification is employed as a way to control interest rate risk. Investments shall be diversified as to maturities and as to kind of investment to eliminate the risk of loss which might result from overconcentration of assets in a specific maturity, in a specific kind of a security, or from a specific issuer.

(e) Credit Risk

The City has adopted an investment policy relating to the investments of the Company. Per the investment policy, the Company's allowable investments are: (1) bonds or notes of the U.S. government; (2) U.S. Treasury obligations, including STRIPs; receipts indicating an undivided interest in such U.S. Treasury obligations; and stripped coupons held under book-entry with the New York Federal Reserve Bank; (3) U.S. agency obligations rated Aaa/AAA by Moody's Investor Services or Standard & Poor's; (4) collateralized certificates of deposit; (5) bankers acceptances, Eurodollars deposits, and Euro certificates of deposit that are collateralized; (6) commercial paper rated MIG1 or A1+ by Moody's Investor Services and Standard & Poor's, respectively; (7) general obligation bonds of corporations rated AA or better by Moody's Investor Services or Standard & Poor's, with a maturity of two years or less (except the Sinking Fund); (8) collateralized mortgage obligations and pass-through securities rated AA or better by Moody's Investor Services or Standard & Poor's or collateralized with securities that meet the Company's own investment criteria, with a maturity of two years or less (except the Sinking Fund); (9) money market mutual funds, as defined by the Securities and Exchange Commission; (10) repurchase agreements collateralized either through actual delivery of eligible collateral or through segregation of collateral by a depository that is holding the counterparty's securities, provided such collateral meets the Company's own investment criteria; and (11) obligations of the Commonwealth of Pennsylvania (the Commonwealth) or any municipality or other political subdivision of the Commonwealth, registered or otherwise as to principal and interest, with a maturity of two years or less (except the Sinking Fund).

Authorized investments for Sinking Fund Portfolios are dictated by the First Class City Revenue Bond Act and as stated in Bond Counsel opinion, and include any investment vehicle permitted for any state agency.

(f) Custodial Credit Risk

The Company has selected custodian banks that are members of the Federal Reserve System to hold its investments. Delivery of the applicable investment documents (e.g., contracts, securities, and safekeeping receipts) to the Company's custodian is required for all investments. For secured transactions, such as repurchase agreements, either the title to or a perfected security interest in the securities, along with any necessary transfer documents, must be transferred to the custodian. Such transactions will always use delivery versus payment procedures. Safekeeping procedures of the

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

custodian shall be reviewed annually by independent auditors, and a copy of their report shall be supplied to the Company for review.

(g) Concentration of Credit Risk

More than 5% of the Company's investments are in the GIC with Royal Bank of Canada and the Forward Delivery Agreement with FSA Capital Markets Services, LLC. These investments are 40.5% and 27.0%, respectively, of the Company's total investments.

(4) Deferred Costs

In compliance with rate orders issued by the PGC, the cost of projects that produce benefits over an extended period are deferred. Such costs are being amortized to expense over a period matching their useful lives, which range from two to ten years. There were no costs in FY 2005 that were deemed to be deferred. The unamortized costs included in other assets and deferred debits were \$642,000 and \$2,875,000 as of August 31, 2005 and 2004, respectively. The unamortized costs included in other current assets and deferred debits were \$1,550,000 and \$1,908,000 as of August 31, 2005 and 2004, respectively.

As a result of settlements during FY 2005 by PGW's insurance carriers associated with environmental remediation costs, the Company recorded \$11,790,000 in FY 2005. Environmental remediation costs of approximately \$6,303,000 were offset by this insurance settlement. Additional environmental remediation costs of \$9,513,000 were recorded as a deferred cost and a deferred regulatory asset based on an engineering assessment.

(5) Deferred Compensation Plan

The Company offers its employees a deferred compensation plan (the Plan) created in accordance with *Internal Revenue Code* Section 457. The Plan, available to all Company employees with six months of service, permits them to defer a portion of their salary until future years. The Company provides a matching contribution that immediately vests to the employee.

The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency in accordance with the *Internal Revenue Code*.

During the fiscal year ended August 31, 1999, the Plan was amended to comply with *Internal Revenue Code* Section 457, subsection (g) through the creation of a trust in which all assets and income of the Plan are to be held for the exclusive benefit of participants and their beneficiaries. As a result, the Company no longer owns the assets of the Plan nor has a contractual liability to Plan participants.

(6) Notes Payable

Pursuant to the provisions of certain ordinances and resolutions of the City, the Company may sell short-term notes in a principal amount that, together with interest, may not exceed \$100,000,000 outstanding at any one time. These notes are intended to provide additional working capital. They are supported by an irrevocable letter of credit and a subordinated security interest in the Company's revenues. On May 29, 2002, the Mayor signed an Ordinance authorizing the continued issuance and sale by the Company of the short-term notes. The terms of the Ordinance enable the Company to do so through a date no later than the fifth anniversary of the date of the enactment of this Ordinance.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

A new Series D of the tax-exempt commercial paper program was instituted on August 30, 2002 concurrently with the expiration of Series C. The expiration date of the credit agreement was extended to August 15, 2003. The previous credit agreements contained language that granted to the agent bank the option to accelerate the expiration of the credit agreement if the Company's long-term debt were rated below investment grade for a period of six months by at least two rating agencies. The acceleration clause has been removed from the new credit agreement, and notification of this fact has been transmitted to the rating agencies.

A new Series D of the tax-exempt commercial paper program was instituted on August 7, 2003. The expiration date of the credit agreement was extended to August 14, 2004. The credit agreement was further amended and restated as of July 20, 2004. The expiration date of the credit agreement was extended to August 15, 2005. On August 8, 2005, the credit agreement was further amended and restated with an expiration date of May 29, 2007, which is concurrent with the expiration of the General Inventory Receivables Gas Works Revenue Note Ordinance of 1998. Under the new credit agreement, the commitment amount was increased from \$80,000,000 to \$100,000,000.

The notes outstanding at August 31, 2005 had an average weighted interest rate of approximately 2.4% and remaining time to maturity of two days. The principal amount outstanding at August 31, 2005 and 2004 was \$49,900,000 and \$50,750,000, respectively. All of the notes outstanding at August 31, 2005 matured on September 2, 2005, with a portion of the notes being reissued.

On December 22, 2005, the Mayor signed an ordinance authorizing an increase in the authorized amount of short-term notes in a principal amount that, together with interest, may not exceed \$150,000,000 outstanding at any one time. Additionally, the Bill included a provision to extend the authority to issue notes from May 2007 to August 2010.

(7) GCR Tariff Reconciliation

During the fiscal year ended August 31, 2005, the Company's actual gas costs were below its billed gas costs by \$21,369,000. The Company deferred this amount at August 31, 2005. This amount will be included in the First Quarter GCR Filing.

During the fiscal year ended August 31, 2004, the Company's actual gas costs were below its billed gas costs by \$337,000. The Company deferred this amount at August 31, 2004. This amount was included in subsequent GCR Filings.

During the fiscal year ended August 31, 2003, the Company's actual gas costs exceeded its billed gas costs by \$12,303,000. The Company deferred this amount, which is included in other current assets and deferred debits at August 31, 2003. This amount was included in the November 26, 2003 First Quarter GCR Filing.

Natural Gas Pipeline Supplier Refund

The Company received refunds in FY 2005 for the amount of \$592,000 related to Rate Cases. This amount was utilized as a reduction in the cost of gas for reconciliation purposes in the calculation of the GCR for FY 2005.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

The Company received refunds in FY 2004 for the amount of \$143,000 related to Rate Cases. This amount was utilized as a reduction in the cost of gas for reconciliation purposes in the calculation of the GCR for FY 2004.

(8) Long-Term Debt

The following summary of long-term debt consists primarily of bonds issued by the City under agreements whereby the Company must reimburse the City for the principal and interest payments required by the bond ordinances (thousands of dollars):

	August 31, 2005			August 31, 2004		
	Current portion	Long-term	Total	Current portion	Long-term	Total
Revenue bonds	\$ 40,881	1,018,803	1,059,684	39,245	909,627	948,872
Unamortized debt discount	(668)	(8,816)	(9,484)	(698)	(8,894)	(9,592)
Unamortized premium	2,058	20,843	22,901	1,319	12,781	14,100
Total revenue bonds	42,271	1,030,830	1,073,101	39,866	913,514	953,380
Subordinate lease obligations	—	—	—	1,947	—	1,947
Note payable – City Loan	—	45,000	45,000	—	—	—
Total	\$ 42,271	1,075,830	1,118,101	41,813	913,514	955,327

The following is a summary of activity related to revenue bonds, subordinate lease obligations, and certain other liability balances for the fiscal years ended August 31, 2005 and 2004 (thousands of dollars):

	Year ended August 31, 2005				
	Beginning balance	Additions	Reductions	Ending balance	Amounts due within one year
Revenue bonds	\$ 948,872	207,820	(97,008)	1,059,684	40,881
Subordinate lease obligations	1,947	—	(1,947)	—	—
Total bonds and subordinate lease obligations	\$ 950,819	207,820	(98,955)	1,059,684	40,881
Other liabilities:					
Compensated absences	\$ 2,153	60	—	2,213	2,213
Claims and judgments	7,366	3,859	(2,715)	8,510	3,521
Accrued bond interest payable	6,569	9,312	(6,569)	9,312	9,312
Total other liabilities	\$ 16,088	13,231	(9,284)	20,035	15,046

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

Year ended August 31, 2004					
	Beginning balance	Additions	Reductions	Ending balance	Amounts due within one year
Revenue bonds	\$ 988,256	—	(39,384)	948,872	39,245
Subordinate lease obligations	5,692	—	(3,745)	1,947	1,947
Total bonds and subordinate lease obligations	\$ 993,948	—	(43,129)	950,819	41,192
Other liabilities:					
Compensated absences	\$ 2,041	112	—	2,153	2,153
Claims and judgments	8,239	1,590	(2,463)	7,366	3,235
Accrued bond interest payable	6,874	6,569	(6,874)	6,569	6,569
Total other liabilities	\$ 17,154	8,271	(9,337)	16,088	11,957

Principal maturities and scheduled interest payments for revenue bonds are as follows (thousands of dollars):

	Revenue bonds		
	Principal	Interest	Total
Fiscal year ending August 31:			
2006*	\$ 40,881	52,110	92,991
2007	39,425	50,410	89,835
2008	40,055	48,404	88,459
2009	39,735	46,347	86,082
2010	41,280	44,271	85,551
2011-2015*	195,263	194,285	389,548
2016-2020	197,295	143,813	341,108
2021-2025	209,965	90,953	300,918
2026-2030	171,715	39,233	210,948
2031-2035	84,070	7,184	91,254
Total	\$ 1,059,684	717,010	1,776,694

* T.E.C.A. Accretions for the 12 "A" Series for \$224,000 is not included in principal amount in FY 2006. T.E.C.A. Accretions for the 11 "C" Series for \$8,787,000 is not included in principal amount in FY 2011-2015.

(a) Recent Bond Issuances

On May 27, 2004, two bills were introduced into City Council related to the authorization to sell Gas Works Revenue Bonds. The first bill, constituting the Sixth Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1998 (the 1998 Ordinance), authorizes the sale in an aggregate principal amount of up to \$150,000,000 of Fifth Series A Gas Works Revenue Bonds (Fifth Series A Bonds) under the 1998 Ordinance. The Fifth Series A Bonds were issued for the purpose of providing funds for the capital projects of the Company. The first bill also authorizes the

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

sale in an aggregate principal amount of up to \$18,000,000 of Fifth Series B Gas Works Revenue Bonds (Fifth Series B Bonds) under the 1998 Ordinance. The Fifth Series B Bonds may be issued for the purpose of providing funds redeeming or refunding certain outstanding Gas Works Revenue Bonds and related project costs, but as of August 31, 2005, there were no Fifth Series B Bonds issued.

The second bill, constituting the Eighteenth Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1975 (the 1975 Ordinance), authorizes the sale in an aggregate principal amount of up to \$75,000,000 of Gas Works Revenue Bonds under the 1975 Ordinance. The bonds were issued for the purpose of providing funds for the redeeming or refunding on a current basis all or any portion of the outstanding Fifteenth Series Gas Works Revenue Bonds.

City Council approved the bills on June 21, 2004, and the Mayor signed the bills into law on July 1, 2004.

On October 14, 2004, the Company issued \$120,000,000 of new debt for the purpose of providing funds for the financing of the capital projects included in the capital program of the Company. This new debt was issued as the Fifth Series A 1 Bonds under the 1998 Ordinance. The interest rates on the \$70,275,000 of Serial Bonds ranged from 4% to 5.25%. The interest rate on the \$49,725,000 of Term Bonds was 5%. The bonds, consisting of Serial Bonds and Term Bonds, have maturity dates through 2033.

On October 14, 2004, the Company issued \$57,820,000 of new debt for the purpose of redeeming and refunding, on a current basis, a portion of the outstanding Fifteenth Series City of Philadelphia, Pennsylvania, Gas Works Revenue Bonds previously issued under the 1975 Ordinance. The par amount of the Fifteenth Series Bonds being redeemed and refunded was \$58,995,000. This new debt was issued as the Eighteenth Series under the 1975 Ordinance. The interest rates on the \$57,820,000 of Serial Bonds ranged from 3% to 5.25%. The bonds consisting of Serial Bonds have maturity dates through 2021.

On October 19, 2004, the Company issued \$30,000,000 of new debt for the purpose of providing funds for the financing of the capital projects included in the capital program of the Company. This new debt was issued as the Fifth Series A 2 Bonds under the 1998 Ordinance. The interest rates on the \$30,000,000 of Fifth Series A 2 Bonds will initially bear interest at a weekly rate and during such weekly mode interest will be payable on the first business day of each month commencing November 1, 2004. Thereafter, the City may designate a different rate mode for the Fifth Series A 2 Bonds. The bonds have maturity dates through 2034.

Proceeds of all series of revenue bonds were applied to reduce capital improvement loans from the City that had been previously approved by the voters but for which bonds had not been issued, to fund future capital projects by deposits in the Capital Improvement Fund, or to refund bonds previously issued. The serial bonds are not subject to redemption prior to maturity while the term bonds are subject to redemption at the option of the City after a designated date, either in whole or in part, at varying redemption prices. In addition, the term bonds are subject to mandatory redemption after a designated date prior to maturity at a redemption price of 100% of principal amount and accrued interest. Funds deposited in a Sinking Fund may be used for this purpose.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(b) Bond Ordinances

Under the terms of both general ordinances, the City is required to maintain rates to allow the Company to satisfy 1975 and 1998 revenue bond debt coverage ratio requirements. The Company has satisfied the debt coverage requirements in FY 2005 and 2004.

Also provided by both general ordinances is the establishment of a Sinking Fund into which deposits are made sufficient to meet all principal and interest requirements of the bonds as they become due. Both general ordinances also provide that Sinking Fund reserves be maintained as part of the Sinking Fund, which have heretofore initially been funded from the proceeds of each series of bonds in an amount equal to the maximum annual debt service requirement on the bonds of each such series in any fiscal year.

Monies in the Sinking Fund reserves are to be applied to the payment of debt service if, for any reason, other monies in the Sinking Fund should be insufficient.

The revenue bonds are, and will be, equally and ratably collateralized by a security interest in all of the Company's project revenues, as defined in the general ordinances, and monies in the Sinking Fund.

Portions of certain revenue bonds were issued as zero-coupon securities. Interest on these securities is accrued and compounded on the payment dates of the current interest bonds within the issue. The accrued interest is reported as long-term debt.

On December 22, 2005, the Mayor signed an ordinance into law authorizing the City to issue revenue bonds for the purpose of (a) refunding all or a portion of the following Series of Gas Works Revenue Bonds (1998 General Ordinance): First Series B, Second Series A, Third Series, Fourth Series, and Fifth Series; (b) paying the costs of issuing the bonds and making any required deposits to the Sinking Fund Reserve; and (c) paying any other Project Costs, which may include, without limitation, the repayment to any fund of the City or to accounts of the Company of amounts advanced for Project Costs.

(c) Subordinate Lease Obligations

In August 1997, the City entered into a contract with the Philadelphia Municipal Authority (the PMA) to have the PMA provide certain capital equipment to the Company. The equipment value cannot exceed \$32,000,000. The equipment is owned by the PMA and leased to the City for the exclusive use of the Company. On August 22, 1997, the PMA issued \$23,000,000 of revenue bonds with terms to October 1, 2004 to provide funding to purchase the equipment. Payments made by the City under the contract are made solely from the revenues of the Company and are subordinate to certain other payments from the Company's revenues. Accordingly, these assets and corresponding lease obligations are included in the Company's financial statements.

In 2005, ownership of these leased assets was transferred to the Company. The assets were fully depreciated at the date of transfer. The gross amount of assets under such lease obligation was approximately \$17,645,000 at August 31, 2004. The amortization of such assets is included in depreciation expense in the statements of operations. The unexpended balance of the PMA bond

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

proceeds of \$2,005,000 at August 31, 2004 in the Capital Lease Fund was restricted to the purchase of additional utility plant. There was no balance at August 31, 2005.

(d) Interest Swap Agreement

On December 28, 1999, the Company entered into an interest swap agreement with a financial institution. Under the swap agreement, the financial institution had the option, under certain circumstances, to pay the Company a fixed rate of 5.01% on a notional amount of \$103,550,000 (amortizing down to \$14,670,000 on January 3, 2028) and receive a floating rate payment based on the "Municipal Swap Index" plus 0.5%. The financial institution paid the Company \$8,645,000 for this option right in FY 2000. The purpose of the transaction was to provide additional funding for the Company's main and service cast iron replacement program.

The swap agreement was terminated on September 30, 2004 with a termination payment of \$8,014,000 being made on October 4, 2004. The transaction resulted in a net loss of \$890,000 as compared to the unamortized balance of \$7,124,000 in October 2004.

(e) Forward Delivery Agreement and Guaranteed Investment Contracts

On August 23, 2002, the City entered into Guaranteed Investment Contracts (GICs) in connection with a portion of its 1975 and 1998 Ordinance Sinking Fund Reserves for the Company. At settlement, approximately 65% of the Sinking Fund Reserves, from the two ordinances, totaling \$61,396,000 were invested in the GICs. In exchange for this investment, the Company received an up-front payment of \$21,800,000 in lieu of receiving interest payments over the life of the GICs. The Company also paid \$1,650,000 to terminate an existing Forward Delivery Agreement. Of the remaining net proceeds of \$20,150,000, \$8,596,000 and \$11,554,000 were allocated to the 1975 and 1998 Sinking Fund Reserves, respectively. For debt service coverage purposes, the \$20,150,000 was considered "project revenues" in FY 2002. For financial statement purposes, the \$8,596,000 was recorded as revenue in FY 2002 in the category of interest and other income. This amount is nonrefundable and was granted to the Company by the City.

Under the 1998 Ordinance, the Company is entitled to the earnings on the portion of the Sinking Fund allocated to bonds issued under the 1998 Ordinance. Therefore, the \$11,554,000 received under the 1998 ordinance was deferred and is being amortized on a straight-line basis over the life of the agreement, 18-1/2 years. The unamortized balance of the proceeds was \$9,680,000 and \$10,305,000 at August 31, 2005 and 2004, respectively.

(f) Note Payable – City Loan

On November 15, 2000, the Mayor signed an ordinance authorizing the City to advance in whole or in part up to \$45,000,000 to the Company in order to enable the Company to operate through the winter of 2000-2001. The loan is subject to the Company submitting a Five-Year Financial and Management Plan. This plan was accepted by City Council in January 2001. The loan from the City carries no interest. The loan originally had to be repaid in full within 24 months following the first draw under the loan agreement, but no later than January 2003. On May 15, 2002, the Mayor signed an ordinance authorizing the extension of the repayment period of the City loan. The repayment period for the \$45,000,000 temporary advance was extended from a date no later than June 30, 2003

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

to a date no later than August 29, 2006. On December 22, 2005, the Mayor signed an ordinance extending the repayment date of the loan from August 2006 to August 2008. All of the other terms of the loan remain unchanged.

The loan from the City is subordinate to the Company's other repayment obligations on its revenue bonds and commercial paper program. The outstanding balance of the City loan was \$45,000,000 at August 31, 2005 and 2004.

(9) Defeased Debt

Defeased debt of the Company (bonds issued by the Company payable from the proceeds of irrevocably pledged assets) at August 31, 2005 was as follows:

	<u>Latest date maturing to</u>	<u>Interest rate</u>	<u>Bonds outstanding</u>
7th Series	3/15/13	6.00%	\$ 10,675,000
12th Series B	5/15/20	7.00%	54,940,000

The investments held by the trustee and the defeased bonds are not recognized on the Company's balance sheets in accordance with the terms of the Indentures of Defeasance. The investments pledged for the redemption of the defeased debt have maturities and interest payments scheduled to coincide with the trustee cash requirements for debt service.

The assets pledged, primarily noncallable U.S. government securities, had a market value of \$74,473,000 at August 31, 2005, bearing interest on face value from 0% to 5.89%.

(10) Accounting for Pension Costs

(a) Plan Description

The Company sponsors a public employee retirement system (PERS), a single-employer defined-benefit plan to provide pension benefits for all of its employees, whose annual covered payroll (which was substantially equal to total payroll) was \$102,500,000 and \$101,200,000 at August 31, 2005 and 2004, respectively.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

At September 1, 2003, the beginning of the plan year of the last actuarial valuation, the Pension Plan membership consisted of:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving them	2,157
Current employees:	
Vested	1,365
Nonvested	373
Total current employees	1,738
Total membership	3,895

The Pension Plan provides retirement benefits as well as death and disability benefits. Retirement benefits vest after five years of credited service. Employees who retire at or after age 65 are entitled to receive an annual retirement benefit, payable monthly, in an amount equal to the greater of:

- 1.25% of the first \$6,600 of Final Average Earnings plus 1.75% of the excess of Final Average Earnings over \$6,600, times years of credited service, with a maximum of 60% of the highest annual earnings during the last 10 years of credited service, or
- 2% of total earnings received during the period of credited service plus 22.5% of the first \$1,200 annual amount, applicable only to participants who were employees on or prior to March 24, 1967.

Final Average Earnings are the employee's average pay, over the highest five years of the last ten years of credited service. Employees with 15 years of credited service may retire at or after age 55 and receive a reduced retirement benefit. Employees with 30 years of service may retire without penalty for reduced age.

Covered employees are not required to contribute to the Pension Plan. The Company is required by statute to contribute the amounts necessary to finance the Pension Plan. Benefit and contribution provisions are established by City ordinance and may be amended only as allowed by City ordinance.

The City issues a publicly available financial report that includes financial statements and required supplementary information for the Pension Plan. The report may be obtained by writing to the Director of Finance of the City.

(b) Annual Pension Cost, Contributions Required, and Contributions Made

In 2005, contributions of \$14,702,000 consisted of \$7,015,000 normal cost plus \$7,687,000 amortization of the underfunded balance of the plan assets under the pension benefit obligation. In 2004, contributions of \$14,973,000 consisted of \$6,980,000 normal cost plus \$7,993,000 amortization of the underfunded balance of the plan assets under the pension benefit obligation. In 2003, contributions of \$13,013,000 consisted of \$7,411,000 normal cost plus \$5,602,000

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

amortization of the underfunded balance of the plan assets under the pension benefit obligation. In recent years, payments to beneficiaries exceeded the Company's annual required pension contribution.

Withdrawals from pension assets of \$16,502,000 and \$15,754,000 in 2005 and 2004, respectively, were utilized to meet beneficiary payment obligations.

The Company's annual pension cost is equal to its annual required contribution. The annual required contribution for the Plan Year September 1, 2003 through August 31, 2004 was determined based on an actuarial study completed in August 2004 using the projected unit credit method. The annual required contribution for the Plan Year September 1, 2004 through August 31, 2005 was determined based on an actuarial study completed in August 2004, as updated using the projected unit credit method. Significant actuarial assumptions used for the above valuation include a rate of return on the investment of present and future assets of 8.25% per year compounded annually; projected salary increases of 3% of the salary at the beginning of the next three years, then 4.25% of the salary at the beginning of the fourth and subsequent year; and retirements that are assumed to occur prior to age 62, at a rate of 10% at ages 55 to 61 and 100% at age 62. The assumptions did not include postretirement benefit increases.

The actuarial asset value is equal to the value of the fund assets as reported by the City with no adjustments. The unfunded actuarial accrued liability is being amortized over ten years.

The Pension Plan funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate assets to pay benefits when due. Level percentages of payroll employer contribution rates are determined using the Projected Unit Credit actuarial funding method.

(c) Historical Trend Information (unaudited)

Historical trend information reflecting funding progress and contributions made by the Company is presented in the supplemental schedule of pension funding progress (unaudited).

(d) Postemployment Benefit Information

In addition to providing pension benefits, the Company also provides health care and life insurance benefits to Pension Plan beneficiaries and their dependents. Such benefits are funded and expensed on a pay-as-you-go basis. The Company recognizes the cost of providing health care benefits for the 1,958 and 1,981 beneficiaries and their dependents for FY 2005 and 2004, respectively, and the cost of providing such benefits for 1,767 and 1,739 active employees and their dependents for FY 2005 and 2004, respectively, by charging the annual insurance premiums to expense.

Total premiums incurred for health care amounted to \$33,571,000 and \$32,863,000 in 2005 and 2004, respectively, of which approximately 50% represents payments on behalf of retired employees and their dependents. Total premiums for group life insurance were \$2,092,000 and \$2,078,000 in 2005 and 2004, respectively. The amount attributed to retirees was approximately 76% and 77% in FY 2005 and 2004, respectively.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

Also, the Company has entered into several one-year contracts to provide health care for both active and retired employees that are experience rated, and premiums are adjusted annually; in addition, the Company has in place approximately \$164,126,000 of group life insurance coverage for both active and retired employees, which is retrospectively rated on a monthly basis. The Company also has in place approximately \$128,523,000 of accidental death and dismemberment insurance coverage for active employees.

(11) Risk Management

The Company is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. While self-insured for many risks, the Company purchases insurance coverage where appropriate. The Company's property was insured against the risk of loss or damage, without aggregate limits, in the amount of \$250,000,000 per occurrence with a \$100,000 retention (deductible) subject, however, to an annual aggregate limit of \$50,000,000 for earthquake and an annual aggregate limit of \$50,000,000 for flood subject to a \$1,000,000 retention (deductible), generally, and to lower flood limits as to the Richmond plant through the end of October 2001. Because of the dramatic effect of the September 11, 2001 terrorist attacks on the insurance market, the Company was unable to renew the property coverage with the same terms.

Property coverage has been continuously renewed on an annual basis, and the current policies, in effect as of October 31, 2004, still provide a program limit of \$250,000,000 per occurrence with no aggregate limits. However, the \$100,000 retention has been raised to \$500,000 for losses at the Passyunk and Richmond plants. In addition, the annual aggregate limits for earthquake and flood have been reduced to \$50,000,000 with lower limits for flood losses at the Richmond plant. The Company's property insurance includes coverage for damage incurred from a terrorist attack. In addition, the Company maintains boiler and machinery, blanket crime, and other forms of property insurance.

The Company maintains \$210,000,000 in liability (including terrorism) coverage, insuring against the risk of damage or injury to the public with a \$500,000 deductible per occurrence.

In the past, the Company maintained workers' compensation (including terrorism) coverage with a limit of \$35,000,000 each accident or each employee for disease, in excess of a \$500,000 per incident self-insured retention and an additional \$20,000,000 in coverage on a single-occurrence basis for on-duty injuries to employees. In September 2004, the Company was able to purchase statutory workers' compensation (including terrorism) limits and currently maintains a policy with a limit of \$35,000,000 in excess of the Company's self-insured retention of \$500,000 each accident or each employee for disease and a second policy providing statutory limits. This was a change from the period of 2001 through 2004, when the Company's limits were capped at \$55,000,000. For many years prior, the Company had always had statutory limits. None of the Company's losses have been settled with the purchase of annuity contracts.

Since February 28, 2000, the Company has continuously purchased public officials liability (directors and officers liability) coverage with a \$10,000,000 annual aggregate limit and a \$500,000 retention. The current policy was renewed for another one-year term, effective February 28, 2005.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

Claims and settlement activity for occurrences excluded under the provisions of insurance policies for injuries and damages is as follows (thousands of dollars):

	<u>Beginning of year reserve</u>	<u>Current year claims and adjustments</u>	<u>Claims settled</u>	<u>End of year reserve</u>	<u>Current liability amount</u>
Fiscal year ended August 31:					
2004	\$ 8,239	1,590	(2,463)	7,366	3,235
2005	7,366	3,859	(2,715)	8,510	3,521

(12) Commitments and Contingencies

Commitments for major construction and maintenance contracts were approximately \$7,383,481 as of August 31, 2005.

The Company is committed under various noncancelable operating lease agreements to pay minimum annual rentals as follows (thousands of dollars):

Fiscal year ending August 31:	
2006	\$ 580
2007	218

Rent expense for the fiscal years ended August 31, 2005 and 2004 amounted to \$895,000 and \$859,000, respectively.

The Company, in the normal course of conducting business, has entered into long-term contracts for the supply of natural gas and firm transportation and long-term firm gas storage service. The Company's cumulative obligations for demand charges for all of these services are approximately \$5,700,000 per month.

The Company has entered into seasonal contracts with suppliers providing the Company the ability to fix the price of the purchase of natural gas during the period from November 1, 2004 through March 31, 2005.

The Company's operations and facilities are subject to federal, state, and local environmental requirements, including the need to obtain certain permits and approvals. Because these requirements are subject to change, additional or different requirements may be imposed upon the Company in the future. No assurances can be given that the Company would be able to comply with any such changed or new requirements, or that compliance with such requirements would not materially increase the Company's capital or operating costs, or have a material adverse effect on its financial position.

Like many providers of utility services throughout the northeastern United States, the Company has been in operation for more than 100 years, and many of its facilities were built decades ago. As a result of preliminary internal environmental evaluations of its facilities, the Company believes that several of its facilities that had been used in gas manufacturing contain contaminants from those operations or from other sources, and that certain equipment and processes that the Company removed from service years ago may no longer comply with current environmental requirements. In order to address these issues, the Company and the City voluntarily approached the Pennsylvania Department of Environmental Protection (DEP), and proposed to resolve these issues under DEP's Land Recycling Program. The Company intends

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

to reach an agreement with DEP on a comprehensive program pursuant to which the Company will address identified environmental issues.

At this time, the Company is unable to determine the full extent to which it may be necessary to remediate environmental conditions impacting its facilities, or the final costs of any such remedial work. The Company's pending agreement with DEP provides that DEP will cooperate with the Company to develop a schedule for any necessary work. The Company expects that this will allow for the proper allocation resources in a manner calculated to avoid any material adverse effect on the Company's cash flows. Nevertheless, until a definitive schedule is finalized with DEP, it is not possible to determine with quantifiable certainty many of the costs of potential site remediation and whether such costs would have a material adverse effect on the Company's financial position, results of operations, or cash flows.

The Company has received from its engineering firm and forwarded to DEP Phase 1 and 2 site assessments on relevant properties. DEP has approved these final reports, and the Company is moving forward on a series of remedial projects that will meet clean-up standards as set in DEP's Act 2 Program. Preliminary indications are that Company expenditures may be in the range of \$15,000,000 to \$20,000,000 over the next five years. These estimates are subject to substantial revision. The Company has allocated \$15,000,000 for estimated future environmental costs. The Company is also pursuing further recovery for remediation against environmental insurance policies.

The FY 2006 Capital Budget received a positive recommendation from the PGC in the amount of \$64,619,000. This recommendation is being forwarded to City Council for its approval. In this budget, funding is provided to implement an 18-mile Cast Iron Main Replacement Program. The forecasted cost for this program in FY 2006 is \$14,832,000. The total six-year cost of this program is forecasted to be approximately \$92,791,000.

The FY 2006 Capital Budget also includes \$716,000 for the purchase of replacement Automatic Meter Reading (AMR) devices. The total six-year cost to purchase replacement AMR devices is approximately \$25,754,000.

The Company's FY 2005 Capital Budget was originally approved by City Council in the amount of \$58,652,000. Later, a budget amendment in the amount of \$5,295,000 was approved by City Council, increasing the FY-2005 Capital Budget authorization to \$63,947,000. Within this revised approval, funding is provided to continue the implementation of an 18-mile Cast Iron Main Replacement Program. Main replacement cost for this program in FY 2005 is \$14,896,000. The total six-year cost of the Cast Iron Main Replacement Program is forecasted to be approximately \$82,753,000.

The FY 2005 Capital Budget also includes \$726,000 for the purchase of replacement AMR units. The total six-year cost of this program to replace AMR units is approximately \$21,879,000.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

State and Local Sales and Use Tax

On November 7, 2002, the Commonwealth of Pennsylvania Department of Revenue and Bureau of Audits (the Department) filed with the Company an acknowledgement of postaudit conference document (the document). This document pertained to an audit that was performed by the Department for the period from January 1, 1997 through December 31, 1999 related to the accrual and remittance of sales tax on gas sales and purchases of services that are taxable for the Company's customers. The Department concluded in the document that the Company did not properly charge and remit sales and use tax to the Department on various customers throughout the audit period. The total assessment was \$3,853,000 including penalties and interest.

An administrative appeal was filed by the Company with the Department's Board of Appeals (the Board of Appeals) on January 22, 2003. A reduction to the assessment was made by the Board of Appeals. The Company appealed the Board of Appeals' decision to the Board of Finance and Revenue (the BF&R). The BF&R reduced the assessment. As a result, the Company's total assessment, including interest of \$682,000, was lowered to \$2,550,000. The Company has remitted this amount to the Commonwealth. On September 10, 2004, the Company filed with the Commonwealth Court a petition for de novo review of the BF&R's decision and order. Settlement discussions with the Commonwealth regarding the petition are currently active.

The Company is also subject to an audit for the period January 1, 2000 to December 31, 2003. The Company has remitted \$1,500,000 to the Commonwealth for this period. Management does not believe that the ultimate outcome of this situation will be material to the Company's financial statements.

PHILADELPHIA GAS WORKS
Required Supplementary Information (Unaudited)
Schedule of Pension Funding Progress
(Thousands of dollars)

Actuarial valuation date	(a) Actuarial value of assets	(b) Actuarial accrued liability (AAL)	(b)-(a) Unfunded (overfunded) AAL (UAAL (OAAL))	(a/b) Funded ratio	Covered payroll	UAAL (OAAL) as a percent of covered payroll
September 1, 2000	\$ 418,768	385,892	(32,876)	108.52%	\$ 99,306	(33.11)%
September 1, 2001*	391,000	411,025	20,025	95.13%	91,878	21.80%
September 1, 2002**	370,019	424,670	54,651	87.13%	98,300	56.00%
September 1, 2003+	356,000	427,006	71,006	83.37%	101,200	70.16%
September 1, 2004++	366,783	436,255	69,472	84.08%	102,500	67.78%

* The required supplementary information is based on a biennial actuarial valuation of the pension fund for the Plan Year September 1, 2001 through August 31, 2002.

** The required supplementary information is based on a biennial actuarial valuation of the pension fund as updated for the Plan Year September 1, 2002 through August 31, 2003.

+ The required supplementary information is based on a biennial actuarial valuation of the pension fund for the Plan Year September 1, 2003 through August 31, 2004.

++ The required supplementary information is based on a biennial actuarial valuation of the pension fund as updated for the Plan Year September 1, 2004 through August 31, 2005.

See accompanying independent auditors' report.

PHILADELPHIA GAS WORKS
Supplemental Statements of Net Assets (City Format)
August 31, 2005 and 2004
(Thousands of dollars)

	<u>2005</u>	<u>2004</u>
Assets:		
Cash on deposit and on hold	\$ 15,191	3,643
Equity in pooled cash and investments	—	—
Equity in treasurer's account	—	—
Investments	—	—
Internal balances	—	—
Amounts held by fiscal agent	30	23
Notes receivable	164	232
Taxes receivable	—	—
Accounts receivable	294,950	323,108
Allowance for doubtful accounts	(207,480)	(230,216)
Interest and dividends receivable	—	—
Due from other governments	—	—
Restricted assets	207,231	136,423
Inventories	129,984	98,467
Unamortized loss and discount	47,979	49,031
Other assets	59,536	56,326
Property, plant, and equipment	1,573,346	1,517,046
Accumulated depreciation	(591,624)	(566,310)
Total assets	\$ 1,529,307	1,387,773
Liabilities:		
Notes payable	\$ 94,900	95,750
Vouchers and accounts payable	63,918	73,027
Salaries and wages payable	3,860	2,920
Accrued expenses	40,509	13,971
Funds held in escrow	—	—
Due to other governments	—	—
Deferred revenue	20,889	21,304
Current portion of long-term obligations	40,881	41,813
Noncurrent portion of long-term obligations	1,018,803	913,514
Unamortized gain and premium	22,901	14,100
Total liabilities	\$ 1,306,661	1,176,399
Net assets:		
Invested in capital assets, net of related debt	\$ 24,739	35,903
Restricted for:		
Capital projects	—	—
Debt service	104,530	95,929
Community development projects	—	—
Behavioral health programs	—	—
Intergovernmental financing	—	—
Emergency phone system	—	—
Rate stabilization	—	—
Unrestricted	93,377	79,542
Total net assets	\$ 222,646	211,374

See accompanying independent auditors' report.

PHILADELPHIA GAS WORKS
Supplemental Statements of Activities (City Format)
Years ended August 31, 2005 and 2004
(Thousands of dollars)

August 31, 2005					
	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions	Total
Gas services	\$ (761,027) *	841,445	19,755	—	100,173
Interest on debt	(53,856)	—	—	—	(53,856)
Unallocated depreciation	(35,045)	—	—	—	(35,045)
Total	\$ (849,928)	841,445	19,755	—	11,272

* Includes \$4,778 of interest and other income

August 31, 2004					
	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions	Total
Gas services	\$ (710,072) *	793,421	18,613	—	101,962
Interest on debt	(50,837)	—	—	—	(50,837)
Unallocated depreciation	(33,966)	—	—	—	(33,966)
Total	\$ (794,875)	793,421	18,613	—	17,159

* Includes \$3,580 of interest and other income

See accompanying independent auditors' report.

PHILADELPHIA GAS WORKS
Supplemental Schedule of Interfund Transfers
Year ended August 31, 2005
(Thousands of dollars)

Due to the City, September 1, 2004	\$ 3,000
Accrued distributions	18,000
Payments to the City	<u>(18,000)</u>
Due to the City, August 31, 2005	<u>\$ 3,000</u>

See accompanying independent auditors' report.

Philadelphia Gas Works' Base Rate Filing

II. RATE OF RETURN

II.A.4. Provide latest Prospectus (Company and Parent).

RESPONSE:

The latest bond prospectus dated January 20, 2006 is attached.

In the opinion of Co-Bond Counsel, under existing statutes, regulations, rulings and court decisions, interest on the Bonds will not be includible in the gross income of the Holders thereof for federal income tax purposes, on the assumption that the City complies with its covenants relating to certain requirements of the Internal Revenue Code of 1986, as amended, and interest on the Bonds will not be a specific preference item for purposes of computing the federal alternative minimum tax imposed on individuals and corporations. Under the laws of the Commonwealth of Pennsylvania, as enacted and construed on the date hereof, the Bonds are exempt from Pennsylvania personal property taxes, and interest on the Bonds is exempt from Pennsylvania personal income tax and Pennsylvania corporate net income tax. See "TAX MATTERS" herein.

\$313,390,000

CITY OF PHILADELPHIA, PENNSYLVANIA

Gas Works Revenue Bonds

Sixth Series

(1998 General Ordinance)

Dated: Date of Delivery

Due: August 1, 2031

The City of Philadelphia, Pennsylvania Gas Works Revenue Bonds, Sixth Series (1998 General Ordinance) (the "Bonds") are issued pursuant to the Act and the 1998 General Ordinance (as such terms are defined herein). The Bonds are issuable as fully registered bonds in denominations of \$100,000 or any integral multiple of \$5,000 in excess thereof, will initially bear interest at the Weekly Rate, subject to conversion to another Rate Mode, as described herein, and will mature on August 1, 2031. The Bonds, when issued, will be registered in the name of Cede & Co., as registered owner and nominee of The Depository Trust Company ("DTC"), which will act as securities depository for the Bonds. Purchases of the beneficial ownership interests in the Bonds will be made in book-entry only form. Purchasers will not receive certificates representing their ownership interests in the Bonds during the period in which Cede & Co. is the owner of the Bonds, as nominee of DTC. References herein to the bondholders, Holders and registered owners shall mean Cede & Co., as aforesaid, and shall not mean the Beneficial Owners of the Bonds. See "DESCRIPTION OF THE BONDS - Book-Entry Only System."

The principal and redemption price of the Bonds are payable at the corporate trust office of U.S. Bank National Association, as Fiscal Agent and Sinking Fund Depository (the "Fiscal Agent"), in Philadelphia, Pennsylvania, at the times and in the amounts set forth herein. While the Bonds are in the Weekly Mode, interest is payable on the first Business Day of each month commencing on March 1, 2006, by check mailed by the Fiscal Agent to the persons in whose names the Bonds are registered on the Business Day immediately preceding each interest payment date. So long as DTC or its nominee, Cede & Co., is the registered owner of the Bonds, principal of and interest on the Bonds are payable directly to Cede & Co. for redistribution to Participants and in turn to Beneficial Owners as described herein. For so long as any purchaser is the Beneficial Owner of Bonds, such purchaser must maintain an account with a broker or dealer who is, or acts through, a Participant to receive payment of the principal of and interest on such Bonds.

The Bonds are subject to redemption prior to maturity as described herein under the heading "DESCRIPTION OF THE BONDS." The Bonds are also subject to optional and mandatory tender while in the Weekly Mode, as set forth herein.

THE BONDS DO NOT PLEDGE THE CREDIT OR TAXING POWER OF THE CITY OF PHILADELPHIA OR CREATE ANY DEBT OR CHARGE AGAINST THE TAX OR GENERAL REVENUES OF THE CITY OF PHILADELPHIA OR CREATE A LIEN AGAINST ANY CITY PROPERTY OTHER THAN CERTAIN REVENUES AND FUNDS OF THE PHILADELPHIA GAS WORKS REFERRED TO HEREIN.

THE BONDS SHALL BE ISSUED ON A PARITY WITH OTHER SENIOR 1998 ORDINANCE BONDS ISSUED UNDER THE 1998 GENERAL ORDINANCE BUT SHALL BE SUBORDINATED IN RIGHT OF PAYMENT AND SECURITY TO ALL BONDS ISSUED AND OUTSTANDING UNDER THE 1975 GENERAL ORDINANCE (AS DEFINED HEREIN), AS DESCRIBED IN THIS OFFICIAL STATEMENT.

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



While in the Weekly Mode, the purchase price of the Bonds tendered or deemed tendered for purchase and interest due thereon will be secured by a liquidity facility initially provided on a several but not joint basis by

**JPMORGAN CHASE BANK, NATIONAL ASSOCIATION,
THE BANK OF NOVA SCOTIA, ACTING THROUGH ITS NEW YORK AGENCY and
WACHOVIA BANK, NATIONAL ASSOCIATION**

(collectively, the "Banks") in the form of a Standby Bond Purchase Agreement, dated January 26, 2006, by and among JPMorgan Chase Bank, National Association, as Liquidity Agent, the Banks, the City of Philadelphia, Pennsylvania (the "City") and the Fiscal Agent.

The Bonds are being issued for the purpose of providing funds for any or all of the following purposes: (i) the advance refunding of a portion of the outstanding City of Philadelphia, Pennsylvania, Gas Works Revenue Bonds (1998 General Ordinance), Fourth Series, Third Series and Second Series A and all of the outstanding City of Philadelphia, Pennsylvania, Gas Works Revenue Bonds (1998 General Ordinance), First Series B (collectively, the "Refunded Bonds"); (ii) paying the costs of issuing the Bonds and any required deposits to the Sinking Fund Reserve established under the 1998 General Ordinance; and (iii) paying any other Project Costs (as defined in the Act (defined herein)).

THE COVER PAGE CONTAINS CERTAIN INFORMATION FOR QUICK REFERENCE ONLY. IT IS NOT A SUMMARY OF THIS ISSUE. PROSPECTIVE INVESTORS MUST READ THE ENTIRE OFFICIAL STATEMENT TO OBTAIN INFORMATION ESSENTIAL TO MAKING AN INFORMED INVESTMENT DECISION.

The Bonds are offered when, as and if issued and accepted by the Underwriters, subject to the prior sale, withdrawal, or modification of the offer without notice, and subject to the approval as to the legality of the issuance of the Bonds by Blank Rome LLP and Andre C. Dasent, P.C., Co-Bond Counsel, both of Philadelphia, Pennsylvania. Certain legal matters will be passed upon for the Underwriters by Greenberg Traurig, LLP and Law Offices of Denise Joy Smyler, both of Philadelphia, Pennsylvania, Co-Counsel to the Underwriters. Certain legal matters will be passed upon for the City of Philadelphia by the City of Philadelphia Law Department. Certain legal matters will be passed upon for Philadelphia Gas Works by the Office of General Counsel of Philadelphia Gas Works and by Wolf, Block, Schorr and Solis-Cohen LLP, Philadelphia, Pennsylvania. Certain legal matters will be passed upon for the Banks by Greenberg Traurig, LLP, Philadelphia, Pennsylvania, counsel to the Banks, and by Fasken Martineau DuMoulin LLP, Toronto, Canada, foreign counsel to The Bank of Nova Scotia. It is anticipated that the Bonds will be available for delivery through the facilities of DTC in New York, New York on or about January 26, 2006.

JPMorgan

Siebert Brandford Shank & Co., LLC

Wachovia Bank, National Association

Dated: January 20, 2006

THE CITY OF PHILADELPHIA

MAYOR
JOHN F. STREET

MAYOR'S CHIEF OF STAFF
Joyce S. Wilkerson

MAYOR'S CABINET

Vincent J. Jannetti..... Acting Secretary of Financial Oversight/Director of Finance
Romulo L. Díaz, Jr. City Solicitor
Pedro A. Ramos..... Managing Director
George R. Burrell Secretary of External Affairs
Stephanie W. Naidoff City Representative and Director of Commerce
Jacqueline Barnett Secretary of Education
Sylvester M. Johnson Police Commissioner/Secretary of Public Safety
Thomas A. Chapman Acting Secretary of Strategic Planning and Initiatives/City Planning Commissioner
Kevin R. Hanna Secretary of Housing and Neighborhood Preservation
Dianah L. Neff..... Chief Information Officer

CITY CONTROLLER
Alan L. Butkovitz

PHILADELPHIA GAS WORKS

800 W. Montgomery Avenue
Philadelphia, Pennsylvania 19122

Thomas E. Knudsen, President and Chief Executive Officer
Craig E. White, Interim Chief Operating Officer and Senior Vice President
Joseph R. Bogdonavage, Senior Vice President – Finance
Abby L. Pozefsky, Esq., Senior Vice President – Administration and General Counsel
Janice L. Walsh, Senior Vice President – Operations
Albert L. D'Attilio, Vice President – Human Resources
David Griesing, Vice President – Strategic Planning
Raquel N. Guzman, Vice President and Associate General Counsel
Randall J. Gyory, Vice President – Customer Affairs
Michael W. Handwerk, Vice President – Compliance, Technical & Business Transformation Services
Steven P. Hershey, Vice President – Community Initiatives
Thomas L. Kuczynski, Vice President – Information Services & Chief Information Officer
Paul A. Mondimore, Vice President – Field Operations
Douglas A. Moser, Vice President – Gas Management
Jo Ann Muniz, Vice President – Support Services
Joseph A. Smith, Vice President – Marketing
John P. Straub, Vice President – Labor, Safety and Preparedness
Lorraine S. Webb, Vice President – Organizational Development
Joseph F. Golden, Jr., Controller

FINANCIAL ADVISORS

Public Financial Management, Inc.
P.G. Corbin and Company, Inc.

FISCAL AGENT

U.S. Bank National Association

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

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with and as part of their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information. The information and the opinions expressed herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the operations of the Philadelphia Gas Works or the City of Philadelphia since the date hereof, or as to the information under "PGW BUDGET, RATES AND FINANCES – Fiscal Years 2005 and 2006 Operating Budgets," since August 31, 2005.

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

This Official Statement is not to be construed as a contract with the purchasers of the Bonds. All summaries of statutes and documents are made subject to the complete text of such statutes and documents, respectively, and do not purport to be complete statements of any or all of such provisions.

This Official Statement is submitted in connection with the sale of securities referred to herein and may not be reproduced or be used, as a whole or in part, for any other purpose.

The Bonds have not been registered under the Securities Act of 1933, as amended, in reliance upon an exemption contained therein, and have not been registered or qualified under the securities laws of any state.

THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY.

IN CONNECTION WITH THE OFFERING OF THE BONDS, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF SUCH BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME WITHOUT PRIOR NOTICE.

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

Other than with respect to certain information regarding JPMorgan Chase Bank, National Association, The Bank of Nova Scotia, acting through its New York Agency, and Wachovia Bank, National Association (collectively, the "Banks") contained in APPENDIX H — "Certain Information Concerning the Banks" herein, none of the information in this Official Statement has been supplied or verified by the Banks, and the Banks make no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Bonds; or (iii) the tax exempt status of the interest on the Bonds.

If and when included in the Official Statement, the words "expects," "forecasts," "projects," "intends," "anticipates," "estimates," "assumes," and analogous expressions are intended to identify forward-looking statements and any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those that have been projected. Such risks and uncertainties that could affect the revenues and obligations of PGW include, among others, changes in economic conditions, mandates from

conditions and circumstances, many of which are beyond the control of PGW. Such forward-looking statements speak only as of the date of this Official Statement. The City disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein or to reflect any changes in PGW's expressions with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

This Official Statement speaks only as of the date printed on the cover page hereof. The information contained herein is subject to change. The Official Statement will be made available through one or more of the Nationally Recognized Municipal Securities Information Repositories.

TABLE OF CONTENTS

INTRODUCTION.....	1	Bond Anticipation Notes	31
General	1	OTHER OUTSTANDING DEBT OBLIGATIONS	32
The Philadelphia Gas Works	2	Short-Term Borrowings	32
Prior Issues of Gas Works Revenue		City Loan	32
Bonds	2	DEBT SERVICE SCHEDULE FOR ALL	
Authorization to Issue the Bonds	3	OBLIGATIONS	33
The Bonds	3	REMEDIES OF BONDHOLDERS	34
Purpose of the Bonds	4	Limitation on Remedies of Bondholders	34
Security for the Bonds	4	PHILADELPHIA GAS WORKS	35
Bond Insurance	5	General	35
Standby Purchase Agreement	5	PGW Service Area	36
Interest Rate Swap Agreement	5	Management Agreement	36
Independent Consultant's Report	6	Management	37
Independent Consultant's Assumptions		Management and Governance of the Gas	
with Respect to City Payments	7	Works	40
Continuing Disclosure	8	Proposals to Transfer Gas Works	41
Miscellaneous	8	Labor Relations	41
PLAN OF FINANCE AND ESTIMATED SOURCES		Facilities	41
AND USES OF FUNDS	8	Environmental Matters	43
Plan of Finance	8	Gas Supply and Federal Regulation	44
Estimated Sources and Uses of Funds	9	Competition	44
DESCRIPTION OF THE BONDS	9	Insurance	45
General	9	Litigation	45
Book-Entry Only System	10	Effects of the Natural Gas Choice and	
Discontinuation of Book-Entry System	12	Competition Act	45
Optional Redemption	12	Litigation Relating to the Gas Choice Act	47
Mandatory Redemption	12	Senior Citizen Discount Program	47
Selection of Bonds to be Called for		Act 201 – "Responsible Utility Customer	
Redemption	13	Protection Act"	47
Notice of Redemption of Bonds	13	CITY GOVERNMENTAL OVERSIGHT	48
Transfer of Bonds	13	Gas Commission	48
Description of the Bonds in the Weekly		PGW BUDGET, RATES AND FINANCES	48
Mode	13	Budget Approval	48
Bank Bond Rate	17	Rates and Charges	49
Conversion of Bonds to Another Rate		Gas Cost Rate	50
Mode	17	Base Rate Filings	51
SOURCES OF PAYMENT AND SECURITY		Restructuring's Effect on PGW Rates	51
FOR THE BONDS	18	Capital Improvement Program	52
Bond Insurance Policy	18	Other Funding Sources	53
Standby Purchase Agreement	18	Fiscal Year 2006 Operating Budget	53
Pledge of Revenues and Funds	18	Fiscal Year 2005 and 2006 Capital Budget	
Covenant Against Commingling with		and Forecasts	53
Other City Funds	19	Selected Operating Data	54
Priority in Application of Revenues	20	Summary of Statements of Income and	
Rate Covenant and Rate Requirements	22	Expenses	55
Sinking Fund	23	Debt Service Coverage Ratio	56
Sinking Fund Reserve	24	MANAGEMENT'S DISCUSSION AND ANALYSIS	
STANDBY PURCHASE AGREEMENT	25	RESULTS OF OPERATIONS AND FINANCIAL	
General	25	CONDITION	57
Purchase of Tendered Bonds by the Banks	26	Financial Highlights	57
Events of Default and Remedies	26	Overview of the Financial Statements	57
Extension, Reduction, Adjustment or		Statement of Operations	58
Termination of the Standby Purchase		Balance Sheets	60
Agreement	30	Five Year Summary of Gas Sales	62
Substitute Standby Purchase Agreement	30	Natural Gas	63
BOND INSURANCE	30	Accounts Receivable	63
Bond Insurance Policy	30	UNDERWRITING	65
Bond Insurer	30	VERIFICATION OF MATHEMATICAL	
ADDITIONAL BONDS	31	COMPUTATIONS	65
Additional 1975 Ordinance Bonds	31	EXPECTED RATINGS	65

Federal.....	65	CERTAIN RELATIONSHIPS.....	67
Pennsylvania.....	66	NO LITIGATION.....	67
CERTAIN LEGAL MATTERS.....	66	NEGOTIABLE INSTRUMENTS.....	67
FINANCIAL ADVISORS.....	66	CERTAIN REFERENCES.....	67
INDEPENDENT AUDITORS.....	66	CONTINUING DISCLOSURE.....	68
INDEPENDENT CONSULTANT'S REPORT.....	67	ADDITIONAL INFORMATION.....	68

APPENDICES:

A. Financial Statements of PGW for Fiscal Year Ended August 31, 2005 and 2004.....	A-1
B. Independent Consultant's Engineering Report.....	B-1
C. Certain Information Concerning the City of Philadelphia.....	C-1
D. Summaries of the Act and Legislation Authorizing the Issuance of the Bonds.....	D-1
E. Form of Continuing Disclosure Agreement.....	E-1
F. Proposed Form of Opinions of Co-Bond Counsel.....	F-1
G. Specimen Municipal Bond Insurance Policy.....	G-1
H. Certain Information Concerning the Banks.....	H-1
I. Definitions of Certain Terms Pertaining to the Bonds.....	I-1

OFFICIAL STATEMENT

\$313,390,000
CITY OF PHILADELPHIA, PENNSYLVANIA
GAS WORKS REVENUE BONDS,
SIXTH SERIES
(1998 GENERAL ORDINANCE)

INTRODUCTION

General

This Official Statement, including the cover page, table of contents, tables and appendices, sets forth information with respect to the issuance by the City of Philadelphia, Pennsylvania (the "City") of \$313,390,000 aggregate principal amount of its Gas Works Revenue Bonds, Sixth Series (1998 General Ordinance) (the "Bonds"). The Bonds are being issued pursuant to the First Class City Revenue Bond Act of the Commonwealth of Pennsylvania, Act No. 234, approved October 18, 1972, P.L. 955 (the "Act"), and the General Gas Works Revenue Bond Ordinance of 1998, approved on May 30, 1998, Bill No. 980232, as amended and supplemented from time to time (the "1998 General Ordinance") as Senior 1998 Ordinance Bonds, as defined in this Official Statement.

The Bonds shall be issued on a parity with other Senior 1998 Ordinance Bonds issued under the 1998 General Ordinance but shall be subordinated in right of payment and security to all bonds issued and outstanding under the General Gas Works Revenue Bond Ordinance of 1975, approved on May 30, 1975, Bill No. 1871, as amended and supplemented from time to time (the "1975 General Ordinance" and, together with the 1998 General Ordinance, the "General Ordinances"), as described herein. The Bonds shall also be issued on a parity with the obligation of the City to make periodic payments (but not termination payments) due under a Qualified Swap (as defined in the 1998 General Ordinance) being entered into between the City and JPMorgan Chase Bank, National Association (the "Sixth Series Swap Agreement") in connection and concurrently with the issuance of the Bonds, as more fully described below under "INTRODUCTION - Interest Rate Swap Agreement," provided, however, the Qualified Swap Provider shall have no lien on and security interest in the Sinking Fund or the Sinking Fund Reserve. The pledge of Gas Works Revenues (as defined in the 1998 General Ordinance) to secure the Senior 1998 Ordinance Bonds issued under the 1998 General Ordinance (including the Bonds) is at all times subject and subordinate to the pledge of Project Revenues (as defined in the 1975 General Ordinance) under the 1975 General Ordinance securing the 1975 Ordinance Bonds.

The City's fiscal year begins on July 1 and ends on June 30 of the following calendar year. The term "Fiscal Year" when followed by a year and used in connection with the City refers to the fiscal year of the City ending June 30 of that year. For example, "Fiscal Year 2005" when used in connection with the City refers to the fiscal year ending June 30, 2005. The fiscal year of the Philadelphia Gas Works ("PGW" or the "Gas Works") begins on September 1 and ends on August 31 of the following calendar year. The term "Fiscal Year" when followed by a year and used in connection with the Gas Works refers to the fiscal year of the Gas Works ending August 31 of that year. For example, "Fiscal Year 2005" when used in connection with PGW refers to the fiscal year ending August 31, 2005. Certain capitalized terms used in this Official Statement and not otherwise defined are defined in APPENDIX D - "Summaries of the Act and Legislation Authorizing the Issuance of the Bonds."

This introduction is a brief description of certain matters described in this Official Statement and is qualified by reference to the entire Official Statement. Persons considering a purchase of any of the Bonds should read this Official Statement, including the cover page, inside front cover page, table of contents, tables and appendices, in its entirety. The information contained herein is subject to change. All estimates and assumptions of financial and other information are based on information currently available, are believed to be reasonable and are not to be construed as assurances of actual outcomes.

If and when included in the Official Statement, the words "expects," "forecasts," "projects," "intends," "anticipates," "estimates," "assumes," and analogous expressions are intended to identify forward-looking statements and any such statements inherently are subject to a variety of risks and uncertainties that could cause

actual results to differ materially from those that have been projected. Such risks and uncertainties that could affect the revenues and obligations of PGW include, among others, changes in economic conditions, mandates from regulatory authorities, lack of approval, in whole or in part, of requests by PGW from regulatory authorities and conditions and circumstances, many of which are beyond the control of PGW. Such forward-looking statements speak only as of the date of this Official Statement. The City disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein or to reflect any changes in PGW's expressions with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

The Philadelphia Gas Works

The Gas Works presently consists of real and personal property owned by the City and used for the acquisition, manufacture, storage, processing and distribution of natural gas within the City, and all property, books and records employed and maintained in connection with the operation, maintenance and administration thereof. See "PHILADELPHIA GAS WORKS" herein.

PGW serves the entire 129 square mile area contained within the boundaries of the City and is the distributor and principal supplier of gas in the City. PGW has no distribution mains and provides no service to customers outside the City limits. As of August 31, 2005, PGW served approximately 497,000 customers.

The Philadelphia Home Rule Charter provides for a Gas Commission (the "Gas Commission") to be constituted and appointed and to exercise such powers and perform such duties as may from time to time be provided in contracts between the City and the operator of PGW, or, in the absence of a contract, as may be provided by ordinance. For details of the Gas Commission's various responsibilities and oversight of the operations of PGW, see "CITY GOVERNMENTAL OVERSIGHT - Gas Commission" herein.

Since January 1, 1973, PGW has been managed by the Philadelphia Facilities Management Corporation ("PFMC"), a not-for-profit corporation, pursuant to an agreement between the City and PFMC dated December 29, 1972, as amended, authorized by ordinances of City Council (the "Management Agreement"). See "PHILADELPHIA GAS WORKS - Management Agreement."

As of July 1, 2000, rates and charges of PGW are fixed by the Public Utility Commission of the Commonwealth (the "PUC"). The PUC is required, by statute, to follow the same ratemaking methodology and requirements that were applicable to PGW prior to the assumption of jurisdiction by the PUC. See "PHILADELPHIA GAS WORKS - Effects of the Natural Gas Choice and Competition Act" and "PGW BUDGET, RATES AND FINANCES" herein for a further discussion of PGW's budget process and recent rate proceedings.

PGW's Financial Statements for the Fiscal Years ended August 31, 2005 and 2004 (Audited) are presented in APPENDIX A. For certain information regarding the government of and fiscal affairs of the City, see APPENDIX C - "Certain Information Concerning the City of Philadelphia."

Prior Issues of Gas Works Revenue Bonds

Since 1975, the City has issued eighteen (18) separate series of Gas Works Revenue Bonds and one Revenue Bond Anticipation Note (collectively, together with any bonds issued under the 1975 General Ordinance to refund any such bonds, the "1975 Ordinance Bonds"), all pursuant to the Act and the 1975 General Ordinance. As of August 31, 2005, \$326,384,459 aggregate principal amount of 1975 Ordinance Bonds remained outstanding. The prior 1975 Ordinance Bonds were all issued on a parity basis and share equally and ratably in the pledge of revenues provided for in the 1975 General Ordinance. In the 1975 General Ordinance, the City has, for the security and payment of all 1975 Ordinance Bonds issued under the 1975 General Ordinance, granted a security interest in all rents, rates and charges imposed or charged by the City upon the owners or occupants of properties connected to, and upon all users of, gas distributed by the Gas Works and all other revenues derived therefrom (the "Project Revenues," as such term is defined in the 1975 General Ordinance), and all accounts, contract rights and general intangibles related thereto and all proceeds of the foregoing. 1975 Ordinance Bonds are secured solely by moneys derived, directly or indirectly, from PGW's Project Revenues as provided in the Act and the 1975 General

Ordinance, as amended and supplemented. 1975 Ordinance Bonds of all series issued or to be issued are issued on a parity basis and share equally and ratably in the pledge or Project Revenues provided for in the 1975 General Ordinance.

Pursuant to the 1998 General Ordinance, all 1998 Ordinance Bonds (as defined below) are subordinated in right of payment and security to the 1975 Ordinance Bonds. 1998 Ordinance Bonds may be issued as Senior 1998 Ordinance Bonds ("Senior 1998 Ordinance Bonds") or Subordinate 1998 Ordinance Bonds ("Subordinate 1998 Ordinance Bonds"). Senior 1998 Ordinance Bonds are all issued on a parity basis and share equally and ratably in the pledge of revenues provided for in the 1998 General Ordinance. Senior 1998 Ordinance Bonds are subject to the right of payment and security of the 1975 Ordinance Bonds, but are prior in right of payment and security to Subordinate 1998 Ordinance Bonds. Subordinate 1998 Ordinance Bonds are all issued on a parity basis and share equally and ratably in the pledge of revenues provided for in the 1998 General Ordinance, subject to the prior right of payment and security of the 1975 Ordinance Bonds and the Senior 1998 Ordinance Bonds and to payments due to issuers of Credit Facilities related to Senior 1998 Ordinance Bonds. In the 1998 General Ordinance, the City has pledged for the security and payment of all bonds issued under the 1998 General Ordinance a lien on and security interest in all Gas Works Revenues (as defined in the 1998 General Ordinance) all accounts, contract rights and general intangibles representing the Gas Works Revenues and all funds and accounts established under the 1998 General Ordinance. Such lien is subject to the prior pledge and lien on the Project Revenues created by the 1975 General Ordinance for the benefit of the 1975 Ordinance Bonds. Gas Works Revenues and Project Revenues are treated by PGW as the same revenues and include grants from the City, properly authorized, including, if applicable and if so authorized, any grant back to PGW of any portion of PGW's Base Payment to the City. See "SECURITY - Priority in Application of Revenues."

Since 1998, the City has issued five (5) separate series of Gas Works Revenue Bonds (collectively, together with any bonds heretofore or hereafter issued under the 1998 General Ordinance including the Bonds, the "1998 Ordinance Bonds") under the 1998 General Ordinance. As of August 31, 2005, \$719,075,000 aggregate principal amount of Senior 1998 Ordinance Bonds and \$14,225,000 aggregate principal amount of Subordinate 1998 Ordinance Bonds were outstanding under the 1998 General Ordinance. In the 1998 General Ordinance, the City covenanted that it would not issue any additional bonds under the 1975 General Ordinance except to refund outstanding 1975 Ordinance Bonds.

Authorization to Issue the Bonds

The Bonds are being issued as Senior 1998 Ordinance Bonds pursuant to the Act, the 1998 General Ordinance, and the Seventh Supplemental Ordinance to the 1998 General Ordinance duly adopted by City Council of the City of Philadelphia on December 15, 2005, and signed by the Mayor on December 22, 2005, Bill No. 051137 (the "Seventh Supplemental Ordinance") and a determination by the Bond Committee of the City (consisting of the Mayor, the City Controller and the City Solicitor), or a majority of them, dated January 20, 2006, with respect to the Bonds (the "Bond Authorization").

The Bonds

The Bonds will be dated the date of delivery, and will bear interest from such date. The Bonds will initially be outstanding in the Weekly Mode and will bear interest at the Weekly Rate. During the Weekly Mode, interest will be payable on the first Business Day of each month commencing March 1, 2006. The City may designate a different Rate Mode for the Bonds which may be a Term Mode or Fixed Mode. The Bonds, while in the Weekly Mode, will be issued as fully registered bonds and in the aggregate principal amount set forth on the cover page hereof in denominations of \$100,000 or any integral multiple of \$5,000 in excess thereof. The principal and redemption price of the Bonds will be payable at the corporate trust office of U.S. Bank National Association (the "Fiscal Agent") in Philadelphia, Pennsylvania. Interest on the Bonds while in the Weekly Mode, will be paid by check mailed by the Fiscal Agent to the persons in whose names the Bonds are registered on the close of business on the Business Day immediately preceding such Interest Payment Date; except in the case of any default by the City in payment of interest due, shall be payable to the persons in whose names the Bonds are registered on a special record date as determined by the Fiscal Agent. See "DESCRIPTION OF THE BONDS" herein. Registered Owners of at least \$1,000,000 aggregate principal amount of a series of Bonds may elect to receive interest payments by wire transfer

if so requested in a written notice provided to the Fiscal Agent not less than ten (10) days prior to the relevant interest payment date.

Initially the Bonds will be available in book-entry form only. See "DESCRIPTION OF THE BONDS – Book-Entry Only System" herein.

The Bonds are subject to optional redemption and mandatory redemption as described herein. While in the Weekly Mode, the Bonds are subject to optional and mandatory tender as set forth herein. See "DESCRIPTION OF THE BONDS."

Purpose of the Bonds

The Bonds are being issued for the purpose of providing funds for any or all of the following purposes: (i) the advance refunding of a portion of the outstanding City of Philadelphia, Pennsylvania, Gas Works Revenue Bonds (1998 General Ordinance), Fourth Series, Third Series and Second Series A and all of the outstanding City of Philadelphia, Pennsylvania, Gas Works Revenue Bonds (1998 General Ordinance), First Series B (collectively, the "Refunded Bonds"); (ii) paying the costs of issuing the Bonds and any required deposits to the Sinking Fund Reserve established under the 1998 General Ordinance; and (iii) paying any other Project Costs (as defined in the Act).

Security for the Bonds

The Bonds are secured solely and payable solely from the Gas Works Revenues as provided in the Act, the 1998 General Ordinance and the Seventh Supplemental Ordinance. Such pledge of Gas Works Revenues is subject and subordinate to the prior pledge of Project Revenues granted by the 1975 General Ordinance. Neither the general credit nor the taxing power of the City is pledged to any such payment.

The City has pledged and granted a security interest on a pari passu basis in all Gas Works Revenues and the proceeds thereof for security and payment of all 1998 Ordinance Bonds, including the Bonds, and for security and payment of all periodic payments (but not termination payments) due from the City under the Sixth Series Swap Agreement (except that the Sixth Series Swap Agreement shall have no right or claim at any time to amounts on deposit in the Sinking Fund or the Sinking Fund Reserve). The City has covenanted in the Seventh Supplemental Ordinance that, so long as any of the Bonds shall remain outstanding, all pledged Gas Works Revenues shall be deposited and held and disbursed from one or more unsegregated accounts of PGW. Pursuant to the 1998 General Ordinance, all moneys deposited in the 1998 Ordinance Sinking Fund (including the 1998 Ordinance Sinking Fund Reserve), are subject to a security interest in favor of all Holders of 1998 Ordinance Bonds until such moneys are properly disbursed. See "SECURITY – Pledge of Revenues and Funds" and "REMEDIES OF BONDHOLDERS" herein. The pledge of the Gas Works Revenues to secure the Senior 1998 Ordinance Bonds issued under the 1998 General Ordinance (including the Bonds) is at all times subject and subordinate to the pledge of Project Revenues under the 1975 General Ordinance securing the 1975 Ordinance Bonds.

The 1998 General Ordinance requires PGW to comply with a rate covenant which requires the City to impose, charge and collect in each Fiscal Year, rates and charges which, together with all other Gas Works Revenues to be received in such Fiscal Year, shall be sufficient to meet, among other things, debt service coverage requirements as specified in the 1998 General Ordinance (the "1998 Ordinance Rate Covenant"). See "SECURITY – Rate Covenant and Rate Requirements" and APPENDIX D – "Summaries of the Act and Legislation Authorizing the Issuance of the Bonds" herein.

The 1998 General Ordinance permits the issuance of additional bonds which may be Senior 1998 Ordinance Bonds or Subordinate 1998 Ordinance Bonds. See "ADDITIONAL BONDS – Additional 1998 Ordinance Bonds" herein.

The 1998 General Ordinance establishes the 1998 Ordinance Sinking Fund Reserve which is established in the 1998 Ordinance Sinking Fund as a separate account which is held for the benefit of owners of all bonds issued under the 1998 General Ordinance. See "SECURITY – Sinking Fund Reserve" herein.

The City expects that the capital improvements program of PGW will require the issuance of additional bonds in subsequent Fiscal Years. See APPENDIX B – “Independent Consultant’s Engineering Report.”

The 1998 General Ordinance and the Seventh Supplemental Ordinance also permit the City to enter into a Qualified Swap or Exchange Agreement with respect to a series of bonds or a portion thereof. Payments, other than termination payments, due to the issuer of a Qualified Swap related to Senior 1998 Ordinance Bonds are payable on a parity with debt service on Senior 1998 Ordinance Bonds, except that the Qualified Swap shall have no right or claim at any time to amounts on deposit in the Sinking Fund or the Sinking Fund Reserve. On January 20, 2006, the City entered into the Sixth Series Swap Agreement relating to \$313,390,000 notional amount of the Bonds. See “INTRODUCTION – Interest Rate Swap Agreement” herein. There are currently no other Qualified Swaps or Exchange Agreements to which the City is a party under the 1998 General Ordinance.

Bond Insurance

The scheduled payment of principal of and interest on the Bonds when due will be guaranteed under a municipal bond insurance policy to be issued concurrently with the delivery of the Bonds by Financial Security Assurance Inc. (the “Bond Insurer”). See “BOND INSURANCE” herein and APPENDIX G – “Specimen Municipal Bond Insurance Policy.”

Standby Purchase Agreement

While in the Weekly Mode, the purchase price of the Bonds that are tendered or deemed tendered for purchase will be payable, to the extent that remarketing proceeds are not sufficient therefor, from funds made available on a several but not joint basis by the Banks pursuant to the Standby Bond Purchase Agreement, dated January 26, 2006, by and among the City, JPMorgan Chase Bank, National Association, The Bank of Nova Scotia, acting through its New York Agency, and Wachovia Bank, National Association (collectively, the “Banks”), JPMorgan Chase Bank, National Association, as Liquidity Agent, and the Fiscal Agent (the “Standby Purchase Agreement”). Under the Standby Purchase Agreement each Bank is obligated to fund only principal draws of up to each Bank’s pro rata share of the total principal commitment of \$313,390,000 and interest draws on such amount (equal to thirty-four (34) days of interest on such amount at the rate of 10.0% per annum). A failure by a Bank to honor a draw on the Standby Purchase Agreement shall result in a mandatory tender of all outstanding Bonds. See “STANDBY PURCHASE AGREEMENT” and APPENDIX H - “Certain Information Concerning the Banks” below.

Interest Rate Swap Agreement

The City has entered into an interest rate swap pursuant to an agreement (the “Sixth Series Swap Agreement”) with JPMorgan Chase Bank, National Association (the “Swap Provider”) in connection and concurrently with the issuance of the Bonds. The Sixth Series Swap Agreement provides, in general, that the City will pay to the Swap Provider semiannually on each February 1 and August 1 a fixed rate payment of 3.6745% on an initial notional amount equal to \$313,390,000, amortizing in accordance with the principal amortization schedule of the Bonds, as set forth in the Sixth Series Swap Agreement, and that the Swap Provider will pay to the City on the first day of each calendar month a floating rate payment equal to the lesser of the interest rate on the Bonds and the Bond Market Association Municipal Swap Index (the “Swap Index”), on the notional amount from time to time outstanding, to and including August 1, 2011, and thereafter a floating rate payment equal to 70% of one-month LIBOR, on the notional amount from time to time outstanding. The execution and delivery of the Sixth Series Swap Agreement will not alter the City’s obligation to pay the principal of, premium, if any, and interest on the Bonds.

The Sixth Series Swap Agreement constitutes a Qualified Swap under the 1998 General Ordinance and the City’s payment obligations under the Sixth Series Swap Agreement are payable solely from Gas Works Revenues. The City’s scheduled periodic payments due under the Sixth Series Swap Agreement (other than termination payments discussed below) are payable on a parity with the Senior 1998 Ordinance Bonds (except that the Sixth Series Swap Agreement shall have no right or claim at any time to amounts on deposit in the 1998 Ordinance Sinking Fund or the 1998 Ordinance Sinking Fund Reserve. PGW calculates required sinking fund deposits for purposes of compliance with the 1998 General Ordinance Rate Covenant without regard to the effect of the Sixth Series Swap Agreement. See “SECURITY - Pledge of Revenues and Funds” herein.

Under certain circumstances (including certain events of default with respect to the City or the Swap Provider), the Sixth Series Swap Agreement could terminate in whole or in part prior to its stated termination date. Following any such early termination of the Sixth Series Swap Agreement, either the City or the Swap Provider, as applicable, may owe a termination payment to the other, depending upon market conditions. If at the time of an early termination of the Sixth Series Swap Agreement long-term interest rates are significantly lower than they were when the Sixth Series Swap Agreement was executed and delivered, the City could owe a substantial termination payment to the Swap Provider. Any termination payments owed by the City will be subordinate to the City's obligation to make all payments due and owing on Senior 1998 Ordinance Bonds (including the Bonds) and periodic payments due under the Sixth Series Swap Agreement.

The City's payments, including any termination payment due in connection with a termination at the direction of the Bond Insurer but excluding all other termination payments, under the Sixth Series Swap Agreement will be guaranteed by Financial Security under a Swap Insurance Policy. Financial Security will be given certain rights under the Swap Agreement, including rights to consent to the designation of an Early Termination Date upon the occurrence of certain events and the right to designate an Early Termination Date with respect to the City if an event of default under the Swap Agreement occurs with respect to the City as a defaulting party.

Independent Consultant's Report

To establish that Project Revenues and Gas Works Revenues will be sufficient to amortize all bonds outstanding under the 1975 General Ordinance and the 1998 General Ordinance, the Act and the General Ordinances require a finding to be made in the supplemental ordinance authorizing the issuance of a series of bonds that the pledged Project Revenues or Gas Works Revenues (as the case may be) will be sufficient to comply with the corresponding rate covenant and to pay all costs, expenses and payments required to be paid from Project Revenues or Gas Works Revenues (as the case may be) in the order of priority set forth in the respective General Ordinance and to pay any prior or parity charges on such pledged Project Revenues or Gas Works Revenues (as the case may be) and the principal and interest on such series of bonds. The finding is to be based on a report of the chief fiscal officer of the City filed with City Council and supported by appropriate schedules and summaries. As provided by the Act, the report of the chief fiscal officer of the City may be based on a report of an independent engineer employed by the City to evaluate PGW. Black & Veatch Corporation ("Black & Veatch"), a consulting firm independent of the City and PGW, was retained to evaluate PGW. Black & Veatch submitted a report dated December 2, 2005, which is appended hereto as APPENDIX B (the "Independent Consultant's Report" or the "2005 Report"). In its report, Black & Veatch has opined and concluded, based upon its investigation, that:

- PGW is a competently managed and operated gas distribution utility. PGW and its facilities are organized, operated and maintained at a level equal to, or in excess of, regulatory requirements and generally accepted industry practices. PGW's facilities are in good operating condition.
- Based on its evaluation of financial projections covering the period September 1, 2005 through August 31, 2011, and on the basis of actual and estimated future annual financial operations of PGW's facilities and certain assumptions with respect thereto over the amortization period of the Bonds, which Black & Veatch believes to be reasonable, current and future Project Revenues, which are pledged under the 1975 General Ordinance and the 1998 General Ordinance, comply with the requirements of the definition of Project Revenues in Section 2 of the Act, and over the amortization period of the Bonds and the outstanding bonds under the 1975 General Ordinance and the 1998 General Ordinance, such Project Revenues will be adequate to meet all expenses of operation and maintenance, repair and replacement, reserve fund deposits, debt service on the bonds issued under the 1975 General Ordinance and debt service on the bonds issued under the 1998 General Ordinance, as the same shall become due and payable, and the surplus requirements of the rate covenants contained in Section 4.03(b) of the 1975 General Ordinance and Section 4.03(b) of the 1998 General Ordinance.
- The Project Revenues and Gas Works Revenues which are pledged as security for the bonds issued under the 1975 General Ordinance and the 1998 General Ordinance, respectively, are currently and are projected to be sufficient to comply with the Rate Covenants set forth in Section 4.03(b) of the 1975 General Ordinance and Section 4.03(b) of the 1998 General Ordinance.

- The capital improvements proposed during the projection period, September 1, 2005 through August 31, 2011, will, along with continued good operation and maintenance practices, enable PGW to maintain its system in good operating condition. Review of present management practices indicates that good operation and maintenance is likely to continue.
- Contracted PGW gas supplies plus: (a) spot market purchases, and (b) anticipated additional contracted supplies plus supplemental gas capacities, as well as (c) the pipeline transport capacity to move these supplies to PGW, are adequate to meet PGW's projected demand on a day of maximum demand (a "design peak day"), in an hour of maximum demand (a "design peak hour"), and during a year of maximum demand (a "design peak year").
- The following are the significant changes that have occurred since the issuance of Black & Veatch's 2004 Independent Consultant's Engineering Report ("2004 Report"):
 - a. PGW improved its collection factor of less than 87 percent of billed revenues in 2003 to 91.4 percent in 2004 and 94.9 percent in 2005.
 - b. The projections in the 2005 Report are based on analyses prior to the effects of Hurricanes Katrina and Rita. The current gas cost recovery rate, approved on October 7, 2005, reflects the unprecedented commodity price of natural gas resulting from the impact of those hurricanes in the Gulf Coast region.
 - c. All Phase 1 liquefaction facilities are functional and PGW is negotiating terms of final acceptance with the general contractor, Chicago Bridge & Iron.
 - d. On May 16, 2005, a new three-year Collective Bargaining Agreement (the "Collective Bargaining Agreement") began between PGW and Union Local 686 and will expire on May 15, 2008. The Collective Bargaining Agreement includes incremental wage increases of 1 percent in September 2005, 3 percent in September 2006, and 2.5 percent in May 2007.
 - e. PGW's projected capital improvement expenditures for Gas Processing decreased from \$10.6 million in 2004 to \$5.0 million in 2005 and are projected to further decrease to \$2.3 million in 2006. PGW has removed any further investment for Phase 2 LNG facilities from its six-year capital improvement program pending its negotiations with a LNG terminal operator.
 - f. As a result of improved collections, the base rate increase anticipated for 2007 is not expected to be needed prior to fiscal year 2009.

Independent Consultant's Assumptions with Respect to City Payments

The Independent Consultant's Report assumes that: (i) as set forth in the City's Five-Year Plan for Fiscal Years 2006 – 2011, the City will grant back to PGW \$18 million in each of the Fiscal Years 2006 through 2008; and (ii) the City, subject to City Council's approval, will extend the repayment date of its \$45 million loan to PGW from Fiscal Year 2006 to Fiscal Year 2008. As discussed below, subsequent to the delivery of the Independent Consultant's Report, City Council approved the City's extension of the repayment date of the \$45 million loan to Fiscal Year 2008.

The City granted back the \$18 million payment in Fiscal Year 2005, included the grant back of such payment for Fiscal Years 2007 and 2008 in its Five-Year Plan and budgeted for and appropriated the \$18 million grant back for Fiscal Year 2006. However, there is no assurance that such grant backs will actually be included in the City's approved budget and appropriated by the City for Fiscal Years 2007 and 2008.

In its calculation of PGW's projected debt service coverage for Fiscal Years 2006 through 2008 in the Independent Consultant's Report, Black & Veatch includes the City's grant back of the \$18 million payment in such Fiscal Years in "other income." By contrast, in Fiscal Year 2004, the \$18 million payment due from PGW to the City was not paid and not granted back, and accordingly was not included in other income. If the funds granted back to PGW by the City were not included in other income, or if such grant backs are not appropriated by the City in any of Fiscal Years 2005 through 2008, PGW's net revenues available for debt service and debt service coverage ratio set forth in the Independent Consultant's Report would be lower in such Fiscal Years.

On December 15, 2005, City Council passed Bill No. 051136 authorizing the extension of the maturity of the \$45 million loan to Fiscal Year 2008. The Mayor signed the Bill on December 22, 2005.

Continuing Disclosure

The City will enter into a Continuing Disclosure Agreement (the "Continuing Disclosure Agreement") with the Digital Assurance Certification, L.L.C. with respect to the Bonds. See "CONTINUING DISCLOSURE" herein and the form of Continuing Disclosure Agreement attached hereto as APPENDIX E.

Miscellaneous

Any quotation from, and summaries and explanations of, the Constitution and laws of the Commonwealth and ordinances of the City contained herein do not purport to be complete and are qualified in their entirety by reference to the official compilations thereof, and all references to the Bonds are qualified in their entirety by reference to the definitive forms of the Bonds. All capitalized terms used herein, unless otherwise defined herein, shall have the meanings ascribed to them in the Act and the General Ordinances. See "APPENDIX D" herein. Copies of the Act, the General Ordinances and the Seventh Supplemental Ordinance are available from the Office of the Director of Finance, 13th Floor, Municipal Services Building, 1401 John F. Kennedy Boulevard, Philadelphia, Pennsylvania 19102.

PLAN OF FINANCE AND ESTIMATED SOURCES AND USES OF FUNDS

Plan of Finance

The proceeds from the sale of the Bonds will be used for the purpose of providing funds for: (i) advance refunding of the Refunded Bonds, which were issued under the 1998 General Ordinance; (ii) paying the costs of issuing the Bonds and the required deposits to the 1998 Ordinance Sinking Fund Reserve; and (iii) paying any other Project Costs (as defined in the Act).

A portion of the proceeds of the Bonds will be deposited, on the date of delivery of the Bonds, in a refunding escrow account (the "Escrow Account") held by U.S. Bank National Association, as escrow agent. The escrow agent will hold and administer the Escrow Account, and will apply the amounts therein to payment of the principal of and redemption premium, if any, and interest on the Refunded Bonds on certain future redemption dates specified in the Escrow Deposit Agreement relating to the Escrow Account. The Escrow Account is pledged solely for the benefit of the Holders of the Refunded Bonds.

Pursuant to certain provisions of the 1998 General Ordinance and the Seventh Supplemental Ordinance and as a result of the deposit of moneys in the Escrow Account, the Refunded Bonds will be deemed no longer Outstanding and the registered owners of the Refunded Bonds shall have recourse solely and exclusively to the funds so deposited for any claims of whatsoever nature with respect to the Refunded Bonds.

Estimated Sources and Uses of Funds

The sources and uses of funds are estimated to be as follows:

<u>Estimated Sources:</u>	<u>Bonds</u>
Principal Amount	<u>\$313,390,000.00</u>
Total Sources	\$313,390,000.00
<u>Estimated Uses:</u>	
Deposit to Escrow Account	\$298,937,139.38
Costs of Issuance ¹	<u>14,452,860.62</u>
Total Uses	\$313,390,000.00

¹ Includes the fees and expenses of various counsel and the Fiscal Agent, consultant's fees, fees of accountants and verification agents, fees of financial advisors, bank fees, Liquidity Agent's fees, Liquidity Agent's counsel fees, certain Remarketing Agent's fees, rating agency fees, printing and publication costs, bond insurance premium, contingency, Underwriters' discount, and other expenses related to the issuance of the Bonds.

DESCRIPTION OF THE BONDS

General

The Bonds will be dated the date of delivery and will bear interest from such date. The Bonds will be issued initially in the Weekly Mode as bonds that bear interest at the Weekly Rate and during such Weekly Mode, interest will be payable on the first Business Day of each month commencing March 1, 2006. Thereafter, the Bonds may be converted, at the option of the City and subject to certain restrictions, to the Term Mode in whole or a Fixed Mode in whole or in part. There shall not be outstanding at the same time Bonds in the Term Mode and Bonds in the Weekly Mode, but there may be outstanding at the same time Bonds in the Weekly Mode or the Term Mode and Bonds in the Fixed Mode. Generally, the Rate Modes have different operating features, including different demand features, purchase features, redemption provisions, interest rate determination dates, rate change dates and interest payment dates.

If a different Rate Mode is designated for the Bonds, the Fiscal Agent will, not less than thirty (30) days prior to the Conversion Date, or ten (10) days if the Bonds are then in the Weekly Mode, give written notice to the owner of each affected Bond that such Bond will be subject to mandatory purchase on the Conversion Date. See "Description of the Bonds in the Weekly Mode - Tenders of the Bonds - Mandatory Tender for Purchase of Weekly Rate Bonds" herein. The Standby Purchase Agreement shall terminate upon conversion of the Bonds to any Rate Mode other than a Weekly Mode. This Official Statement only describes the terms and provisions applicable to the Bonds while bearing interest at the Weekly Rate. In the event the Bonds are converted to another Rate Mode, a remarketing memorandum or remarketing circular may be distributed describing the terms of the Bonds during the period in which the Bonds are in another Rate Mode.

The Bonds will be issued as fully registered bonds in the aggregate principal amounts set forth on the cover page hereof. While in the Weekly Mode, the Bonds will be issued in denominations of \$100,000 and any integral multiple of \$5,000 in excess thereof. The Bonds, when issued, will be registered in the name of Cede & Co., as nominee for The Depository Trust Company ("DTC"), one bond for each maturity of each series of Bonds. Purchases of beneficial interests in the Bonds will be made in book-entry only form (without certificates) in the denominations of \$100,000 and any integral multiple of \$5,000 in excess hereof.

The principal of, and premium, if any, on the Bonds will be payable at the principal corporate trust office of the Fiscal Agent in Philadelphia, Pennsylvania. Interest on the Bonds, when due, will be paid by check, mailed by the Fiscal Agent to the persons in whose names the Bonds are registered on close of business on the Business Day immediately preceding each Interest Payment Date. So long as a series of Bonds is in book-entry form, the principal

of and interest on such Bonds are payable by check mailed to or by wire transfer of funds to Cede & Co., as nominee for DTC as registered owner thereof for redistribution by DTC to the Direct Participants (as defined herein) and in turn to Indirect Participants or Beneficial Owners as described under "Book-Entry Only System" below. Registered Owners of at least \$1,000,000 aggregate principal amount of a series of Bonds may elect to receive interest payments by wire transfer, provided that notice is provided to the Fiscal Agent not less than ten (10) days prior to the relevant Interest Payment Date. In the event of any default by the City in the payment of interest due on any Interest Payment Date, such defaulted interest shall be payable to the persons in whose names such series of Bonds are registered at the close of business on a special record date which shall be established, with notification to Bondholders as provided in the 1998 General Ordinance.

Book-Entry Only System

The following information concerning DTC and DTC's book-entry only system has been obtained from DTC. The City, the Underwriters and the Fiscal Agent make no representation as to the accuracy of such information.

DTC will act as securities depository for the Bonds. The 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 certificate will be issued for each maturity of each series of the Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

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

Purchases of the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("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 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 the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all 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 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 the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such 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 the Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the 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 registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of a series of 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 Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to an issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal, premium, if any, and interest on the 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 issuer or its agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, the City or its agent, subject to any statutory or regulatory requirements as may be in effect from time to time. Payments of principal, premium, if any, and interest on the Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City or its agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

The City 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 to DTC.

NEITHER THE CITY NOR THE FISCAL AGENT SHALL HAVE ANY RESPONSIBILITY OR OBLIGATION TO ANY DTC PARTICIPANT OR ANY BENEFICIAL OWNER OR ANY OTHER PERSON NOT SHOWN ON THE REGISTRATION BOOKS OF THE FISCAL AGENT AS BEING A BONDHOLDER WITH RESPECT TO EITHER: (1) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DTC PARTICIPANT; (2) THE PAYMENT BY DTC OR ANY DTC PARTICIPANT OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL OR REDEMPTION OR PURCHASE PRICE OF OR INTEREST ON THE BONDS; (3) THE DELIVERY OR THE TIMELINESS OF ANY NOTICE TO ANY BENEFICIAL OWNER WHICH IS REQUIRED OR PERMITTED UNDER THE TERMS OF THE 1998 GENERAL ORDINANCE TO BE GIVEN TO THE OWNER OF THE BONDS; OR (4) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS BONDHOLDER.

Discontinuation of Book-Entry System

The book-entry system described above may be discontinued at any time if either: (a) DTC determines to resign as securities depository for the Bonds; or (b) the City determines that the continuation of the system of book-entry transfers through DTC (or through a successor securities depository) is not in the best interests of the City. In either of such events (unless the City appoints a successor securities depository) the Bonds will be delivered in registered certificate form to such persons and in such maturities and principal amounts as may be designated in writing by DTC, without any liability on the part of the City or the Fiscal Agent for the accuracy of such designation.

Optional Redemption

While the Bonds are in the Weekly Mode, the Bonds may be redeemed by the City, in whole at any time or in part on any Interest Payment Date, prior to maturity at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the date fixed for redemption.

Mandatory Redemption

The Bonds are subject to mandatory redemption prior to maturity, in part, by lot, at the times and in the amounts set forth below at a price equal to 100% of the principal amount of such Bonds being redeemed, plus accrued interest to the date of redemption:

<u>Year</u> <u>(August 1)</u>	<u>Principal</u> <u>Amount</u>	<u>Year</u> <u>(August 1)</u>	<u>Principal</u> <u>Amount</u>
2008	\$ 1,775,000	2020	\$ 16,070,000
2009	1,845,000	2021	17,445,000
2010	1,915,000	2022	18,885,000
2011	1,990,000	2023	20,360,000
2012	2,070,000	2024	21,180,000
2013	5,235,000	2025	22,820,000
2014	9,420,000	2026	23,960,000
2015	12,515,000	2027	26,860,000
2016	11,080,000	2028	27,990,000
2017	12,255,000	2029	13,770,000
2018	13,485,000	2030	7,705,000
2019	14,755,000	2031 ¹	8,005,000

¹ Final Maturity

Selection of Bonds to be Called for Redemption

Except where DTC or its nominee is the registered owner of the Bonds as described above, if less than all of a series of Bonds are to be redeemed, the particular Bonds of a series to be called for redemption shall be selected by lot or by such other method as the Fiscal Agent deems fair and appropriate; provided however that any Bank Bonds (as defined below) shall be redeemed first to the extent redemption moneys are available therefor.

Notice of Redemption of Bonds

Notice of redemption of Bonds shall be made not less than thirty (30) days nor more than (60) days before the date fixed for redemption with respect to the Bonds to the Registered Owners appearing on the Bond Register of the Bonds to be redeemed. Any notice of redemption mailed in accordance with the requirements set forth in the 1998 General Ordinance shall be conclusively presumed to have been duly given, whether or not such notice is actually received by the Bondholders. No defect in the notice with respect to any Bond (whether in the form of notice or the mailing thereof) shall affect the validity of the redemption proceedings for any other Bonds. A notice with respect to an optional redemption of the Bonds may state that it is conditioned upon the deposit of moneys with the Fiscal Agent on or before the date fixed for redemption and in such event, such notice shall be of no effect unless such moneys are deposited. Notice having been so given and provision having been made for redemption from funds on deposit with the Fiscal Agent or Sinking Fund Depositary, all interest on the Bonds called for redemption accruing after the date fixed for redemption shall cease, and the Registered Owners of the Bonds called for redemption shall have no security, benefit or lien under the 1998 General Ordinance or any rights thereunder, except to receive payment of the redemption price.

Transfer of Bonds

Bonds are transferable and exchangeable by the Registered Owners thereof at the designated corporate trust office of the Fiscal Agent in Philadelphia, Pennsylvania in the manner and subject to the limitations contained in the and 1998 General Ordinance and the Seventh Supplemental Ordinance. The Fiscal Agent shall not be required to issue or to register the transfer of or exchange any Bonds (a) during the period fifteen (15) days prior to any interest payment date for such Bonds, or (b) during the period fifteen (15) days prior to any mailing of notice of redemption of such Bonds.

Description of the Bonds in the Weekly Mode

General

While Bonds are outstanding in the Weekly Mode, interest on the Bonds will be payable on the first Business Day of each calendar month and on the maturity date thereof. In addition, interest on each Bond will be payable on each Purchase Date applicable thereto. Interest on the Bonds will accrue from and including the Dated Date thereof until payment of the principal or redemption price thereof shall have been made or provided for in accordance with the Bond Authorization. Interest on the Bonds in the Weekly Mode will be computed on the basis of a year of 365 or 366 days, as appropriate, for the number of days actually elapsed. For definitions of terms relating to the Bonds, see APPENDIX I – "Definitions of Certain Terms Pertaining to the Bonds." The Remarketing Agent for the Bonds will initially be J.P. Morgan Securities Inc., pursuant to the terms of the Remarketing Agreement, dated January 26, 2006, between the City and the Remarketing Agent.

From and after the date upon which any Bond is to be purchased as described below under "DESCRIPTION OF THE BONDS – Description of the Bonds in the Weekly Mode –Tenders of the Bonds – Optional Tender for Purchase of Weekly Rate Bonds," no interest shall accrue on such Bond if sufficient moneys are on deposit with the Fiscal Agent to pay the applicable purchase price thereof.

Determination of Weekly Rate

A Weekly Rate shall be determined for each Weekly Rate Period as described below. The Weekly Rate for each Weekly Rate Period shall be effective from and including the commencement date of such period and shall

remain in effect through and including the last day thereof. The "Weekly Rate Period" means, while the Bonds bear interest at a Weekly Rate, the weekly period which begins on Thursday of each calendar week and ends at the close of business on Wednesday of the immediately following calendar week; except that (i) the first Weekly Rate Period shall commence on the date of issuance of the Bonds (the "Series Issue Date") and end on and include the first Wednesday occurring after the Series Issue Date, (ii) the first Weekly Rate Period following a conversion from a Term Mode to the Weekly Mode shall commence on the Conversion Date and end on and include the first Wednesday occurring after such date, and (iii) in the case of conversion from the Weekly Mode to a Term Mode or the Fixed Mode, the last Weekly Rate Period prior to such conversion shall end on and include the last day immediately preceding the Conversion Date. Each such Weekly Rate shall be determined by the Remarketing Agent on the Weekly Rate Calculation Date (i.e., Wednesday in each calendar week or, if such Wednesday is not a Business Day, the first Business Day preceding such Wednesday) and shall be provided by the Remarketing Agent in writing to the Fiscal Agent and the City by the close of business on the date of determination, except that the Weekly Rate for the first Weekly Rate Period may be determined by the Remarketing Agent on the Series Issue Date or on any Business Day preceding the Series Issue Date. The initial Weekly Rate Period shall commence on the Series Issue Date and shall continue through the next Weekly Rate Calculation Date. Each such Weekly Rate so to be determined shall be the lowest rate of interest which, in the judgment of the Remarketing Agent, would cause the Bonds to have a market value equal to the principal amount thereof, taking into account Prevailing Market Conditions as of the date of determination; provided that:

- if the Remarketing Agent fails for any reason to determine and notify the Fiscal Agent and the City of the Weekly Rate for any Weekly Rate Period, such Weekly Rate shall be the same as the Weekly Rate in effect for the immediately preceding Weekly Rate Period, except that if such failure continues for more than one consecutive Weekly Rate Period, the Weekly Rate thereafter shall be the 30 day tax-exempt commercial paper rate published for that Weekly Rate Period by Munifacts Wire System, Inc. (or a replacement publisher of a tax-exempt commercial paper rate designated in writing by the City to the Fiscal Agent and the Remarketing Agent); representing, as of the publication date, the average of 30-day yield evaluations at par of tax-exempt securities rated by each rating service in its highest commercial paper rating category, provided that if Munifacts Wire System, Inc. or such replacement publisher does not publish such a tax-exempt or taxable commercial paper rate on a day on which a Weekly Rate is to be set, the Weekly Rate shall be 85% of the interest rate for 30-day taxable commercial paper (prime paper placed through dealers) announced on such day by the Federal Reserve Bank of New York;
- in no event shall the Weekly Rate for any Weekly Rate Period exceed 10% per annum; and
- no notice of Weekly Rates will be given to the Owners of the Bonds; however, the Owners may obtain Weekly Rates from the Remarketing Agent.

Tenders of the Bonds

Optional Tender for Purchase of Weekly Rate Bonds

Any Bond bearing interest at the Weekly Rate (or any portion thereof in amounts equal to Authorized Denominations), other than a Bank Bond, will be purchased on a Purchase Date (as hereinafter defined) therefor upon the demand of the Holder thereof, at a purchase price equal to 100% of the principal amount thereof (or of such portions), plus accrued interest, if any, to such Purchase Date, upon written notice to the Fiscal Agent and the Remarketing Agent at their respective offices. Any such notice must state (i) the principal amount of the Bonds to which the notice relates, (ii) that the Holder irrevocably demands purchase of such Bond (or a specified portion thereof in an Authorized Denomination), (iii) the Purchase Date on which such Bond (or specified portion) is to be purchased, (iv) the Owner's taxpayer identification number, and (v) payment instructions with respect to the purchase price.

The Purchase Date shall be the Business Day specified in the notice received by the Fiscal Agent upon which the Holder of such Bond intends to tender such Bond (or any portion thereof in an Authorized Denomination) for purchase, which Business Day shall not be less than seven (7) calendar days after the date such notice is received.

Any Holder of Bonds who has so demanded purchase of such Owner's Bonds is required to deliver such Bonds (properly endorsed for transfer in blank and with all signatures guaranteed to the satisfaction of the Fiscal Agent) to the Fiscal Agent at its Office prior to 11:00 a.m., New York time, on the Purchase Date specified in his or her notice in order to receive payment of the purchase price by 4:30 p.m., New York time on such date.

Each notice of tender automatically constitutes (i) an irrevocable offer to sell the Bond (or portion thereof) to which such notice relates on the Purchase Date at a price equal to the principal of such Bond (or portion thereof) plus any interest thereon accrued and unpaid as of the Purchase Date, (ii) an irrevocable authorization and instruction to the Fiscal Agent to effect transfer of such Bond (or portion thereof) upon payment of such price to the Fiscal Agent on the Purchase Date, (iii) an irrevocable authorization and instruction to the Fiscal Agent to effect the exchange of such Bond in whole or in part for other Bonds in an equal aggregate principal amount so as to facilitate the sale of such Bond (or portion thereof), and (iv) an acknowledgment that such owner will have no further rights with respect to such Bond (or portion thereof) upon payment of the purchase price thereof to the Fiscal Agent on the Purchase Date, except for the right of such owner to receive such purchase price upon surrender of such Bond to the Fiscal Agent endorsed for transfer in blank and with guaranty of signatures satisfactory to the Fiscal Agent, and that after the Purchase Date such owner will hold such Bond as agent for the Fiscal Agent.

Mandatory Tender for Purchase of Weekly Rate Bonds

Each Bond (other than Bonds in the Fixed Mode and other than Bank Bonds) is required to be tendered to the Fiscal Agent for purchase at a purchase price equal to 100% of the principal amount thereof, plus accrued interest, if any, to such Purchase Date on the following dates with respect to such Bond:

- each Conversion Date and each proposed Conversion Date designated by the City for a conversion election which has been rescinded;
- the Interest Payment Date immediately preceding the expiration date of the Standby Purchase Agreement then in effect (or if such Interest Payment Date is not a Business Day, the Business Day next following such Interest Payment Date), but such Interest Payment Date shall be not less than five (5) days prior to the expiration of the Standby Purchase Agreement in the event such Standby Purchase Agreement shall not have been extended effective on or before the 20th day prior to such Interest Payment Date in accordance with the Bond Authorization;
- the date of replacement of the Standby Purchase Agreement with an Alternate Liquidity Facility pursuant to the Bond Authorization;
- the date established by the Fiscal Agent for mandatory tender following receipt by the Fiscal Agent of a Notice of Termination (as defined in the Standby Purchase Agreement) from the Liquidity Agent (or the Banks if there is no Liquidity Agent); and
- in connection with a failure of a Bank to honor a draw under the Standby Purchase Agreement.

THE OWNERS OF BONDS REQUIRED TO BE TENDERED FOR MANDATORY PURCHASE AS DESCRIBED UNDER THIS HEADING MAY NOT ELECT TO RETAIN SUCH BONDS.

On any mandatory tender date, the Owners of Bonds subject to such mandatory purchase who duly tender their Bonds (with any necessary endorsements) to the Fiscal Agent by 11:00 a.m. on such date will be paid a purchase price equal to 100% of the principal amount thereof, plus, unless such mandatory tender date is an Interest Payment Date, accrued interest to the date of purchase.

Notice of Mandatory Tender

In connection with the mandatory tender of Bonds, the Fiscal Agent is required to give notice to the Owners of the Bonds as follows:

Conversion Date. The Fiscal Agent is required to give written notice by first class mail to the Owners of Bonds not later than the 30th day (or the 10th day in the case of Bonds in the Weekly Mode) next preceding the Conversion Date stating (i) that, in the case of conversion to a Term Mode, the current Rate Mode of the Bonds is scheduled to be converted to a Term Mode and the Nominal Term Rate Period of such Term Mode, or in the case of a conversion to the Weekly Mode or Fixed Rate Mode the interest rate on the Bonds is scheduled to be converted to the Weekly Mode or Fixed Mode (as applicable), (ii) the proposed Conversion Date, (iii) that the City on or before the date three (3) days prior to the proposed Conversion Date, may determine not to convert the Bonds, in which case the Bonds shall not be converted to a new Rate Mode but the Owners of the Bonds nevertheless shall be required to tender their Bonds for mandatory purchase in accordance with the Bond Authorization, and (iv) that the Bonds will be subject to mandatory purchase on the Conversion Date, or, if such Conversion Date is not a Business Day, the first Business Day following such Conversion Date, at a purchase price equal to 100% of the principal amount thereof, plus, unless such Conversion Date is an Interest Payment Date, accrued interest to the date of purchase.

Standby Purchase Agreement Expiration. In the event of a mandatory purchase upon expiration of the Standby Purchase Agreement, the Fiscal Agent is required to give written notice by first class mail to the Holders of Bonds no later than the 15th day next preceding the mandatory tender date if the Standby Purchase Agreement will not be extended or replaced, stating that (i) the Fiscal Agent has not received an extension or replacement of the then effective Standby Purchase Agreement in accordance with the requirements of the Bond Authorization, and (ii) the Bonds are required to be purchased by the Fiscal Agent on the mandatory tender date specified in such notice at a purchase price equal to 100% of the principal amount thereof, plus accrued interest, if any, to such Purchase Date.

Standby Purchase Agreement Replacement. If the City has given notice of a replacement Standby Purchase Agreement and has complied with the conditions set forth in the Bond Authorization, the Fiscal Agent is required to give written notice by first class mail to the Holders of the Bonds no later than the 15th day next preceding the mandatory tender date, stating that (i) the Fiscal Agent has received notice of a replacement Standby Purchase Agreement in accordance with the requirements of the Bond Authorization, and (ii) the Bonds are required to be purchased by the Fiscal Agent on the mandatory tender date specified in such notice at a purchase price equal to 100% of the principal amount thereof, plus accrued interest, if any, to such Purchase Date.

Standby Purchase Agreement Termination or Suspension. If the Fiscal Agent receives a Notice of Termination (as such term is defined in the Standby Purchase Agreement) under the Standby Purchase Agreement, the Fiscal Agent shall promptly notify the Holders that such notice has been received and that the Bonds shall be subject to mandatory tender on the date set forth by the Fiscal Agent, which date shall be not more than 20 days following the Fiscal Agent's receipt of the Notice of Termination from the Liquidity Agent (or the Banks if there is no Liquidity Agent).

Failure of Bank to Honor Draw on the Standby Purchase Agreement. In the event that one of the Banks fails to honor a draw under the Standby Purchase Agreement to pay the purchase price of any Bonds that are optionally tendered for purchase, the tendered Bonds shall not be purchased but instead shall be returned to the tendering Bondholders. Immediately thereafter, the Fiscal Agent shall be directed to notify the Holders of all of the Bonds that all of such Bonds are subject to mandatory tender. In the event that a Bank fails to honor a draw to pay the purchase price upon such mandatory tender, the Holders of the Bonds will be paid pro rata from the funds received from the Bank or Banks which honored the draw under the Standby Purchase Agreement and the Bonds that are not so purchased will be returned to the tendering bondholders.

Payment of the Purchase Price of the Bonds is not insured by the Bond Insurance Policy (as defined below).

Bank Bond Rate

When Bonds are purchased by the Banks pursuant to the Standby Purchase Agreement, Bank Bonds shall bear interest at the Bank Bond Rate. Interest on Bank Bonds is payable to the Banks or (if applicable) to any other Bank Bondholder (as such term is defined in the Standby Purchase Agreement), notwithstanding any provisions of the Bond Authorization regarding the Regular Record Date or Special Record Date. Interest accrual at the Bank Bond Rate shall begin on (and shall include) the date such Bond is purchased by the Banks pursuant to the Standby Purchase Agreement and shall end on (but shall not include) the date such Bond is remarketed pursuant to the Bond Authorization or redeemed in accordance with the Standby Purchase Agreement.

Conversion of Bonds to Another Rate Mode

The City shall have the option to convert all of the Bonds from the Weekly Mode to the Term Mode or from the Term Mode to the Weekly Mode, and all or a portion of the Bonds to the Fixed Mode, on any Conversion Date selected by the City; provided that (i) each Conversion Date shall be an Interest Payment Date (except that Bonds in the Weekly Mode may be converted on any Business Day), (ii) Bonds in a Term Mode cannot be converted to another Rate Mode prior to the date on or after which the Bonds may first be redeemed at the option of the City at a redemption price of par or at the end of the Term Rate Period, and (iii) Bonds in the Fixed Mode may not be converted into another Rate Mode. The City may exercise its option to convert the Bonds regardless of the number of times the Bonds have previously been converted pursuant to the exercise of its option to convert. The City shall exercise such option by giving written notice to the Remarketing Agent, the Banks, and the Fiscal Agent stating its election to convert the Rate Mode of the Bonds to another Rate Mode specified in such notice and stating the Conversion Date therefor, not less than forty-five (45) days prior to such Conversion Date (or in the case of Bonds in the Weekly Mode, fifteen (15) days prior to such Conversion Date). In connection with each conversion to a Term Mode, the Nominal Term Rate Period and Semiannual Dates for such Term Rate Period shall be selected by the City and designated in such notice. In the case of a conversion to the Fixed Mode, the City shall select the Semiannual Dates and any bond maturity and mandatory sinking fund redemption schedule to be applicable to the Bonds after such conversion to a Fixed Mode, and such information shall be designated in such notice. If the Bonds are converted to the Fixed Mode in part, the Bonds to be so converted and subject to mandatory tender and purchase shall be determined in accordance with the policies and procedures of DTC.

The exercise of an option to convert the Bonds shall not be effective unless there shall have been delivered to the Fiscal Agent:

- an opinion of nationally recognized bond counsel addressed to the Fiscal Agent, the City, PGW, the Banks and the Remarketing Agent, to the effect that (i) such conversion is authorized or permitted by the Bond Authorization and the Act and (ii) such conversion will not adversely affect the exclusion from gross income of the interest on the Bonds for federal or state income tax purposes, which opinion shall be confirmed by such bond counsel on the Conversion Date;
- in the case of a conversion to a Term Mode, unless the City elects not to provide a Standby Purchase Agreement as permitted by the provisions of the Bond Authorization, an amendment to the Standby Purchase Agreement or a replacement Standby Purchase Agreement, or written evidence satisfactory to the Fiscal Agent that an amendment to the Standby Purchase Agreement or a replacement Standby Purchase Agreement will be delivered to the Fiscal Agent on or before the Conversion Date, which provides for an Expiration Date not earlier than the first to occur of (A) the first anniversary of the Conversion Date or (B) the fifth day following the Term Rate Period End Interest Payment Date of the first Term Rate Period following the Conversion Date;
- in the case of a conversion of the Bonds to the Weekly Mode, an amendment to the Standby Purchase Agreement or a replacement Standby Purchase Agreement which provides for (i) an Expiration Date not earlier than one year (364 days in the case of a conversion to the Weekly Mode) from the Conversion Date and (ii) on and after such

Conversion Date, coverage for thirty (35) days' accrued interest on the Bonds at the maximum annual interest rate of ten percent (10.0%); and

In the case of any conversion of Bonds, the Fiscal Agent shall give notice by first class mail (postage prepaid) to the Holders of the Bonds not less than thirty (30) days (or in the case of a conversion of Bonds in the Weekly Mode, ten (10) days) prior to the proposed Conversion Date, stating (i) that, in the case of a conversion to a Term Mode, the current Rate Mode of the Bonds is scheduled to be converted to a Term Mode and the Nominal Term Rate Period of such Term Mode, or in the case of a conversion to the Weekly Mode, or Fixed Mode, the interest rate on the Bonds is scheduled to be converted to the Weekly Mode or Fixed Mode (as applicable), (ii) the proposed Conversion Date, (iii) that the City, on or before the date three (3) days before the proposed Conversion Date, may determine not to convert the Bonds, in which case the Bonds shall not be converted to a new Rate Mode but the Owners of the Bonds nevertheless shall be required to tender their Bonds for mandatory purchase in accordance with the Bond Authorization, and (iv) that all outstanding Bonds will be subject to a mandatory purchase on the Conversion Date or if such Conversion Date is not a Business Day, the first Business Day following such Conversion Date, at a price of par plus accrued interest.

In the event that the City determines not to convert the Bonds to another Rate Mode or if the conversion fails to be effected for any reason, the Owners of the Bonds nevertheless shall be required to tender their Bonds for mandatory purchase. See "DESCRIPTION OF THE BONDS – Description of the Bonds in the Weekly Mode – Tenders of the Bonds – Mandatory Tender for Purchase of Weekly Rate Bonds" herein.

This Official Statement only describes the terms and provisions applicable to the Bonds while bearing interest at the Weekly Rate. In the event the Bonds are converted to another Rate Mode, a remarketing memorandum or remarketing circular may be distributed describing the terms of the Bonds during the period in which the Bonds are in another Rate Mode.

SOURCES OF PAYMENT AND SECURITY FOR THE BONDS

Bond Insurance Policy

The scheduled payment of principal of and interest on the Bonds when due will be insured by a municipal bond insurance policy or policies (the "Bond Insurance Policy") to be issued by the Bond Insurer simultaneously with the delivery of the Bonds. See "BOND INSURANCE" below. The Bond Insurance Policy does not insure payment of the purchase price of any Bonds.

Standby Purchase Agreement

The City and the Fiscal Agent will enter into the Standby Purchase Agreement with the Banks, whereby, subject to the terms and conditions contained therein, the Banks will agree to purchase any Eligible Bond (as defined therein) that is not remarketed after a tender of such Bond for purchase pursuant to the optional and mandatory tender provisions of the Bond Authorization. See "STANDBY PURCHASE AGREEMENT" below.

Pledge of Revenues and Funds

The Bonds are being issued as Senior 1998 Ordinance Bonds and are secured solely by and payable solely from Gas Works Revenues and the 1998 Ordinance Sinking Fund, including the 1998 Ordinance Sinking Fund Reserve therein, as provided in the Act, the 1998 General Ordinance and the Seventh Supplemental Ordinance. Gas Works Revenues include all operating and nonoperating revenues of the Gas Works derived from its activities and assets involved in the supply, manufacture, storage and distribution of gas, including all rents, rates and charges imposed or charged by the City upon the owners or occupants of properties connected to, and upon all users of, gas distributed by the Gas Works and all other revenues derived therefrom and all other income derived by the City from the Gas Works. Revenues derived from activities unrelated to the supply, manufacture, storage and distribution of gas or assets related thereto shall not be included in Gas Works Revenues, provided that the Gas Works receives fair payment for the use of gas related assets and personnel of the Gas Works used in such activities, which payments shall be included in Gas Works Revenues. At such time as there are no 1975 Ordinance Bonds outstanding, Gas

Works Revenues shall not include any portions of the Gas Works' rents, rates and charges, if any, which are securitized and sold pursuant to the 1998 General Ordinance.

The Act subjects all moneys deposited in the 1998 Ordinance Sinking Fund, including the 1998 Ordinance Sinking Fund Reserve, to a security interest for the 1998 Ordinance Bonds until such moneys are properly disbursed and provides that no bonds issued under the Act shall pledge the credit or taxing power of the City or create any debt or charge against the tax or general revenues of the City or create any lien against any property of the City other than Gas Works Revenues and moneys deposited in the 1998 Ordinance Sinking Fund.

The pledge of the Gas Works Revenues to secure the Senior 1998 Ordinance Bonds issued under the 1998 General Ordinance (including the Bonds) is at all times subject and subordinate to the pledge of Project Revenues under the 1975 General Ordinance securing the 1975 Ordinance Bonds. Gas Works Revenues and Project Revenues are treated by PGW as the same revenues and include grants from the City, properly authorized, including, if applicable and if so authorized, any grant back to PGW of any portion of PGW's Base Payment to the City. See "SECURITY - Priority in Application of Revenues." As of August 31, 2005, \$326,384,459 aggregate principal amount of prior 1975 Ordinance Bonds remained outstanding, \$719,075,000 aggregate principal amount of Senior 1998 Ordinance Bonds and \$14,225,000 of Subordinate 1998 Ordinance Bonds were outstanding under the 1998 General Ordinance.

PGW has sold the right to receive the earnings through the year 2019 on approximately \$53.6 million of deposits (of total deposits of slightly more than \$98.0 million) in the 1975 Ordinance Sinking Fund Reserve and the 1998 Ordinance Sinking Fund Reserve pursuant to two separate investment agreements among FSA Capital Markets Services LLC, the Fiscal Agent and the City (the "Guaranteed Investment Contracts") dated August 23, 2002. PGW's proceeds from the Guaranteed Investment Contracts of approximately \$20.1 million were treated as Project Revenues under the 1975 General Ordinance and Gas Works Revenues under the 1998 General Ordinance in the year received. The portion of such earnings on the 1975 Ordinance Sinking Fund Reserve and the 1998 Ordinance Sinking Fund Reserve which have been sold pursuant to the Guaranteed Investment Contracts no longer belong to PGW and therefore do not constitute Project Revenues or Gas Works Revenues and are not subject to the lien and security interest of the 1975 General Ordinance or the 1998 General Ordinance.

Covenant Against Commingling with Other City Funds

The City has covenanted in the Seventh Supplemental Ordinance that so long as any Bonds remain outstanding, all pledged Gas Works Revenues shall be deposited to the credit of, held in and disbursed from, one or more unsegregated accounts of PGW which shall be separate from and not commingled with the consolidated cash account of the City or any other account of the City not held exclusively for PGW purposes. See "REMEDIES OF BONDHOLDERS."

The proceeds, if any, of the Bonds which remain available for payment of the costs of refunding of the Refunded Bonds or other Project Costs, after payment of the financing costs and the required payment into the 1998 Ordinance Sinking Fund Reserve, will be deposited, held in and disbursed from one or more unsegregated accounts of PGW which shall be separate and apart from and not commingled with the consolidated cash account of the City or any other account of the City not held exclusively for PGW's purposes. However, the effectiveness of the separation of proceeds of the Bonds and revenues from other City accounts may be limited under certain circumstances, including a bankruptcy filing by the City. See "SECURITY" and "REMEDIES OF BONDHOLDERS" herein. Pursuant to the 1998 General Ordinance, all moneys deposited in the Sinking Fund established under the 1998 Ordinance (including the 1998 Ordinance Sinking Fund Reserve), are subject to a security interest in favor of all Holders of the Bonds until such moneys are properly disbursed. See "SECURITY - Pledge of Revenues and Funds" herein.

Priority in Application of Revenues

Project Revenues - 1975 Ordinance Bonds

The 1975 General Ordinance creates a lien on and pledge of all Project Revenues of PGW for the benefit of the Holders of 1975 Ordinance Bonds and creates a priority in application of Project Revenues in each Fiscal Year as follows:

First, to Net Operating Expenses (i.e. Operating Expenses exclusive of City Charges);

Second, to required payments into the 1975 Ordinance Sinking Fund to pay the principal of, and interest on all 1975 Ordinance Bonds and, if required, to accumulate funds in, or to restore any deficiency in, the 1975 Ordinance Sinking Fund Reserve;

Third, to the payment of any general obligation bonds which have been adjudged to be self-liquidating on the basis of expected revenues from PGW¹;

Fourth, to the payment of interest and sinking fund charges of other general obligation debt incurred for PGW¹; and

Fifth, to the payment of City Charges², including any Base Payment due to the City³.

City Charges are the proportionate charges for services performed for the Gas Works by all officers, departments, boards or commissions of the City which are contained in the computation of Operating Expenses of the Gas Works including without limitation, the expenses of the Gas Commission and also means the base payments to the City contained in the agreement between the City and the manager of the Gas Works and all other payments made to the City from Project Revenues. During PGW's Fiscal Years 2001-2005, City Charges exclusive of the \$18,000,000 Base Payment and of rate hearing charges have averaged approximately \$1,815,000 per year.

The 1975 General Ordinance provides that all interest and income earned on moneys held in the 1975 Ordinance Sinking Fund Reserve may, to the extent not required to comply with the requirements of the 1975 General Ordinance relating to the 1975 Ordinance Sinking Fund Reserve, and to the extent not sold pursuant to the Guaranteed Investment Contracts referred to under "SECURITY - Pledge of Revenues and Funds" above, be transferred to the operating funds of PGW to be applied as Project Revenues in accordance with the terms of the 1975 General Ordinance. To the extent that in any Fiscal Year a balance remains in the Project Revenues (after application under the 1975 General Ordinance as modified by the 1998 General Ordinance and the 2005 Note Ordinance), such balance, upon approval of the Gas Commission, may be paid to the City, provided that in a given Fiscal Year such balance does not exceed the amount of the 1975 Ordinance Sinking Fund Reserve earnings transferred to the operating funds of PGW during the same Fiscal Year.

¹ No general obligation debt of the City described in items Third and Fourth above is currently outstanding.

² The City's Five-Year Plan for Fiscal Years 2006 through 2009 reflects that the City will not require the annual \$18 million Base Payment from PGW for Fiscal Year 2004 and, subject to annual appropriation in each applicable Fiscal Year (other than Fiscal Year 2006, for which the \$18 million grant back has been appropriated), intends to grant back the \$18 million Base Payment to PGW in each of the Fiscal Years 2006 through 2009.

³ City Charges include charges for services performed for PGW by various City departments, including the expenses of the Gas Commission. During PGW's Fiscal Years 2001-2005, City Charges (exclusive of the \$18,000,000 Base Payment and of rate hearing charges) have averaged approximately \$1,815,000 per year. City Charges will include repayment of the City Loan. See "OTHER OUTSTANDING DEBT OBLIGATIONS - City Loan" for a discussion of the City Loan.

Gas Works Revenues – 1998 Ordinance Bonds

The 1998 General Ordinance creates a lien on and security interest in all Gas Works Revenues for the benefit of the Holders of the Bonds and creates a priority in application of Gas Works Revenues in each Fiscal Year as follows:

First, to Net Operating Expenses (i.e. Operating Expenses exclusive of City Charges) then payable;

Second, to debt service on the 1975 Ordinance Bonds issued under the 1975 General Ordinance and amounts required to be paid into the Sinking Fund Reserve under the 1975 General Ordinance;

Third, to debt service on Senior 1998 Ordinance Bonds, payments (other than termination payments) due to the issuers of Qualified Swaps and Exchange Agreements related to Senior 1998 Ordinance Bonds and payments due in respect of obligations of the Gas Works to The Philadelphia Municipal Authority existing on the date of adoption of the 1998 General Ordinance (such obligations to The Philadelphia Municipal Authority being referred to herein as the "Prior Obligations");

Fourth, to payments due to issuers of Credit Facilities related to Senior 1998 Ordinance Bonds;

Fifth, to debt service on Subordinate 1998 Ordinance Bonds and payments due in respect of obligations of PGW on a parity with Subordinate 1998 Ordinance Bonds (including notes issued under the City's General Inventory and the 2005 Note Ordinance, as supplemented, or any similar ordinance, and amounts payable to the provider of a Credit Facility in respect of such notes) and payments (other than termination payments) due to the issuers of Qualified Swaps and Exchange Agreements related to Subordinate 1998 Ordinance Bonds;

Sixth, to payments due to issuers of Credit Facilities related to Subordinate 1998 Ordinance Bonds;

Seventh, to required payments of the Rebate Amount to the United States;

Eighth, to replenishment of any deficiency in the Sinking Fund Reserve;

Ninth, to payment of general obligation bonds of the City adjudged to be self-liquidating from Gas Works Revenues¹;

Tenth, to debt service on other general obligation bonds issued for the Gas Works¹; and

Eleventh, to City Charges² and any other proper purpose of the Gas Works (including any termination payments to issuers of Qualified Swaps and Exchange Agreements), except Unrelated Expenses.

Operating Expenses

Operating Expenses are defined in the 1975 General Ordinance and the 1998 General Ordinance as all costs and expenses of the Gas Works necessary and appropriate to operate and maintain the Gas Works in good operable condition during each Fiscal Year, and include, without limitation, the manager's fee, salaries and wages, purchases of service by contract, costs of materials, supplies and expendable equipment, maintenance costs, costs of any property or the replacement thereof or for any work or project, related to the Gas Works, which does not have a

¹ No general obligation debt of the City described in items Ninth and Tenth above is currently outstanding.

² City Charges include charges for services performed for PGW by various City departments, including the expenses of the Gas Commission. During PGW's Fiscal Years 2001-2005, City Charges (exclusive of the \$18,000,000 Base Payment and of rate hearing charges) have averaged approximately \$1,815,000 per year. City Charges will include repayment of the City Loan. See "OTHER OUTSTANDING DEBT OBLIGATIONS – City Loan" for a discussion of the City Loan.

probable useful life of at least five years, pension and welfare plan and workmen's compensation requirements, provision for claims, refunds and uncollectible receivables and for City Charges, all in accordance with generally accepted municipal accounting principles consistently applied, but shall exclude depreciation and interest and sinking fund charges. The 1998 General Ordinance, however, excludes Unrelated Expenses (consisting of those expenses which are unrelated to the supply, manufacture, storage and distribution of gas or assets related thereto) from the definition of Operating Expenses.

Rate Covenant and Rate Requirements

1975 Ordinance Bonds

The 1975 General Ordinance contains the 1975 Ordinance Rate Covenant requiring that, so long as 1975 Ordinance Bonds are outstanding, at a minimum, the City impose, charge and collect in each Fiscal Year, such gas rates and charges as shall, together with all other Project Revenues to be received in such Fiscal Year, equal not less than the greater of (a) the sum of all Net Operating Expenses payable during such Fiscal Year plus (i) 150% of the debt service requirements for such year on all outstanding 1975 Ordinance Bonds and (ii) the amount, if any, required to be paid into the 1975 Sinking Fund Reserve during such year, or (b) the sum of all Net Operating Expenses payable during such Fiscal Year plus (i) the debt service requirements for such year on all outstanding 1975 Ordinance Bonds and all outstanding City general obligation bonds issued for improvements to PGW and (ii) all amounts, if any, required during such year to be paid into the 1975 Sinking Fund Reserve. For a further discussion of the 1975 Rate Covenant and other rate requirements applicable to PGW, see "PGW BUDGET, RATES AND FINANCES – Debt Service Coverage Ratio."

1998 Ordinance Bonds

The 1998 General Ordinance contains a covenant that requires the City, for so long as the 1998 Ordinance Bonds are outstanding, at a minimum, to impose, charge and collect in each Fiscal Year of the Gas Works such gas rates and charges as shall, together with all other Gas Works Revenues to be received in such Fiscal Year, equal not less than the greater of (a) or (b) below:

- (a) The sum of:
 - (i) all Net Operating Expenses payable during such Fiscal Year;
 - (ii) all principal of and interest on 1975 Ordinance Bonds issued and outstanding under the 1975 General Ordinance payable during such Fiscal Year and amounts required to be paid into the Sinking Fund Reserve under the 1975 General Ordinance during such Fiscal Year;
 - (iii) 150% of the amount required to pay Sinking Fund deposits required during such Fiscal Year in respect of all Outstanding Senior 1998 Ordinance Bonds and 100% of the amounts payable in respect of the Prior Obligations during such Fiscal Year;
 - (iv) the amount required to pay Sinking Fund deposits required during such Fiscal Year in respect of all Outstanding Subordinate 1998 Ordinance Bonds and other obligations of the Gas Works on a parity with Subordinate 1998 Ordinance Bonds payable during such Fiscal Year;
 - (v) the amount, if any, required to be paid into the Sinking Fund Reserve during such Fiscal Year;
 - (vi) the Rebate Amount required to be paid to the United States during such Fiscal Year; and
 - (vii) the amounts required to be paid to the issuers of Credit Facilities and the providers of Qualified Swaps and Exchange Agreements during such Fiscal Year; or

(b) The sum of:

- (i) all Net Operating Expenses payable during such Fiscal Year;
- (ii) all principal of and interest on 1975 Ordinance Bonds issued and outstanding under the 1975 General Ordinance payable during such Fiscal Year and amounts required to be paid into the Sinking Fund Reserve under the 1975 General Ordinance during such Fiscal Year;
- (iii) all Sinking Fund deposits required during such Fiscal Year in respect of all Outstanding Bonds and all amounts payable in respect of obligations of the Gas Works which are on a parity with any of the Bonds and in respect of general obligation bonds issued for improvements to the Gas Works and all amounts, if any, required during such Fiscal Year to be paid into the Sinking Fund Reserve;
- (iv) the Rebate Amount required to be paid to the United States during such Fiscal Year; and
- (v) the amounts required to be paid to the issuers of Credit Facilities and the providers of Qualified Swaps and Exchange Agreements during such Fiscal Year.

In calculating PGW's compliance with the rate covenant with respect to 1998 Ordinance Bonds set forth above, required sinking fund deposits are calculated without regard to the effect of any Qualified Swap. For a further discussion of the Rate Covenant and other rate requirements applicable to PGW, see "PGW BUDGET, RATES AND FINANCES - Debt Service Coverage Ratio."

Sinking Fund

1975 Ordinance Sinking Fund

Pursuant to the Act, the 1975 General Ordinance establishes the 1975 Ordinance Sinking Fund for the benefit and security of the Holders of all 1975 Ordinance Bonds to be held separate and apart from all other accounts of the City and directs the Director of Finance to deposit therein from the Project Revenues in each Fiscal Year such amounts as will, together with interest and profits earned and to be earned on investments held therein, be sufficient to accumulate, on or before each interest and principal payment date of the 1975 Ordinance Bonds, the amounts required to pay the principal of and interest on the 1975 Ordinance Bonds then becoming due and payable. It is the current practice of the City to make deposits into the 1975 Ordinance Sinking Fund on or immediately prior to the date on which debt service payments are due. To the extent moneys are on deposit in the 1975 Ordinance Sinking Fund which are not currently required for the payment of debt service, such moneys shall be invested at the direction and under the management of the Director of Finance. The 1975 Ordinance Sinking Fund shall be a consolidated fund for equal and proportionate benefit of the Holders of all 1975 Ordinance Bonds from time to time outstanding under the 1975 General Ordinance and may be invested and reinvested on a consolidated basis. Interest and profit from any such investment shall be added to the 1975 Ordinance Sinking Fund and credited in reduction of or to satisfy required deposits into the 1975 Ordinance Sinking Fund. *The 1975 Ordinance Sinking Fund, including the 1975 Ordinance Sinking Fund Reserve established therein, is established solely for the benefit and security of the Holders of 1975 Ordinance Bonds. Holders of 1998 Ordinance Bonds, including Holders of Bonds, have no claim to amounts in the 1975 Ordinance Sinking Fund.*

1998 Ordinance Sinking Fund

Pursuant to the Act, the 1998 General Ordinance establishes the 1998 Ordinance Sinking Fund for the benefit and security of the Holders of all 1998 Ordinance Bonds to be held in the name of the City separate and apart from all other accounts of the City and directs the Director of Finance to deposit therein from the Gas Works Revenues in each Fiscal Year such amounts as will, together with interest and profits earned and to be earned on investments held therein, be sufficient to accumulate, on or before each interest and principal payment date of the 1998 Ordinance Bonds, the amounts required to pay the principal of and interest on the 1998 Ordinance Bonds then becoming due and payable. It is the current practice of the City to make deposits into the Sinking Fund on or

immediately prior to the date on which debt service payments are due. To the extent moneys are on deposit in the Sinking Fund which are not currently required for the payment of debt service, such moneys shall be invested at the direction and under the management of the Director of Finance of the City. The 1998 Ordinance Sinking Fund shall be a consolidated fund for equal and proportionate benefit of the Holders of all 1998 Ordinance Bonds from time to time Outstanding under the 1998 General Ordinance and may be invested and reinvested on a consolidated basis. The principal of and interest and profits (and losses, if any) realized and investments in the 1998 Ordinance Sinking Fund shall be allocated pro rata among the series of 1998 Ordinance Bonds or the specific 1998 Ordinance Bonds in respect of which such investments were made without distinction or priority. Payments shall be made from the 1998 Ordinance Sinking Fund in the order of priority set forth in the 1998 General Ordinance, except that moneys (and the investments thereof) specifically deposited for the payment of any particular installment of principal, interest (including capitalized interest) or premium in respect of particular 1998 Ordinance Bonds shall be held and applied exclusively to the payment of such particular principal, interest or premium. *The 1998 Ordinance Sinking Fund, including the 1998 Ordinance Sinking Fund Reserve established therein, is established solely for the benefit of the Holders of 1998 Ordinance Bonds, including the Bonds. Holders of 1975 Ordinance Bonds and Qualified Swaps have no claim to amounts in the 1998 Ordinance Sinking Fund.*

Sinking Fund Reserve

1975 Ordinance Sinking Fund Reserve

The 1975 General Ordinance establishes the 1975 Ordinance Sinking Fund Reserve as part of the 1975 Ordinance Sinking Fund. The City is required to deposit in the 1975 Ordinance Sinking Fund Reserve from the proceeds of sale of each series of 1975 Ordinance Bonds an amount equal to the maximum amount required in any Fiscal Year to pay the principal of and interest on the 1975 Ordinance Bonds of such series coming due and payable in that Fiscal Year unless the supplemental ordinance authorizing the series of 1975 Ordinance Bonds authorizes the accumulation from Project Revenues of a reserve of such amount over a period of not more than six Fiscal Years after the issuance and delivery of the 1975 Ordinance Bonds. The money and investments (valued at market) in the 1975 Ordinance Sinking Fund Reserve must be held and maintained, at all times, in an amount equal to the maximum of the principal and interest requirements of all outstanding 1975 Ordinance Bonds in any subsequent Fiscal Year. The City verifies the value of amounts in the 1975 Ordinance Sinking Fund Reserve on a periodic basis. As of December 31, 2005, the value of the funds and investments on deposit in the 1975 Sinking Fund Reserve was required to be at least \$41,948,769, and the amount in the 1975 Ordinance Sinking Fund Reserve met this requirement. If, at any time, the moneys in the 1975 Ordinance Sinking Fund (other than the 1975 Ordinance Sinking Fund Reserve) are insufficient to pay, as and when due, debt service on any 1975 Ordinance Bonds, the 1975 Ordinance Sinking Fund Depositary is required to pay over to the Fiscal Agent, from the 1975 Ordinance Sinking Fund Reserve, the amount of the deficiency. The 1975 Ordinance Sinking Fund and 1975 Ordinance Sinking Fund Reserve are managed by, and invested and reinvested under the direction of, the Director of Finance of the City. The 1975 General Ordinance provides that interest and income earned on moneys held in the 1975 Ordinance Sinking Fund Reserve may be transferred and paid by the Director of Finance to the operating funds of PGW and applied as Project Revenues in the manner described under "SECURITY - Priority in Application of Revenues." *The 1975 Ordinance Sinking Fund Reserve is established solely for the benefit and security of the Holders of 1975 Ordinance Bonds. Holders of 1998 Ordinance Bonds, including the Holders of the Bonds, have no claim to the 1975 Ordinance Sinking Fund Reserve.*

1998 Ordinance Sinking Fund Reserve

The 1998 General Ordinance establishes the 1998 Ordinance Sinking Fund Reserve as part of the 1998 Ordinance Sinking Fund. The City is required to deposit to the credit of the 1998 Ordinance Sinking Fund Reserve from the proceeds of sale of each series of bonds issued under the 1998 General Ordinance an amount equal to the maximum amount required in any Fiscal Year to pay principal of and interest on the 1998 Ordinance Bonds of such series coming due and payable in that Fiscal Year. In lieu of a deposit to the credit of the 1998 Ordinance Sinking Fund Reserve or in substitution for amounts in the 1998 Ordinance Sinking Fund Reserve, the City may provide one or more letters of credit or other Credit Facilities in the same aggregate amount, issued by a provider or providers whose credit facilities are such that bonds secured by such credit facilities are rated in one of the three (3) highest rating categories by Moody's Investors Service, Inc., Fitch Ratings or Standard & Poor's Ratings Service, a Division

of The McGraw-Hill Companies, Inc., all in the manner described under "The 1998 General Ordinance – Sinking Fund and Sinking Fund Reserve" in APPENDIX D. Upon the issuance of the Bonds, the City shall deposit an amount of cash into the 1998 Ordinance Sinking Fund Reserve and/or purchase one or more surety bonds, such that the aggregate of such cash and/or surety bonds shall be equal to the Sinking Fund Reserve Requirement for the Outstanding Bonds under the 1998 Ordinance.

If, at any time, the moneys in the 1998 Ordinance Sinking Fund (other than the 1998 Ordinance Sinking Fund Reserve) are insufficient to pay, as and when due, debt service on any Bond or Bonds secured by the 1998 Ordinance Sinking Fund Reserve, the 1998 Ordinance Sinking Fund Depository is required to pay over to the Fiscal Agent, from the 1998 Ordinance Sinking Fund Reserve, the amount of the deficiency. If by reason of such withdrawal (including draws on any Credit Facilities held to satisfy the Sinking Fund Reserve Requirement) or for any other reason there shall be a deficiency in the 1998 Ordinance Sinking Fund Reserve, the City covenants to restore such deficiency (either by a deposit of funds or the reinstatement of the cash limits of the Credit Facilities) within twelve (12) months. The 1998 Ordinance Sinking Fund Reserve shall be valued by the Sinking Fund Depository promptly after any withdrawal from the 1998 Ordinance Sinking Fund Reserve or any other event indicating a possible deficiency in the 1998 Ordinance Sinking Fund Reserve and on August 31st of each Fiscal Year of PGW. As of December 31, 2005, the value of the funds and investments on deposit in the 1998 Ordinance Sinking Fund Reserve was required to be at least \$55,899,466 and the amount in the 1998 Ordinance Sinking Fund Reserve met this requirement. The 1998 Ordinance Sinking Fund and 1998 Ordinance Sinking Fund Reserve are managed by, and invested and reinvested under the direction of, the Director of Finance of the City. *The 1998 Ordinance Sinking Fund Reserve is established solely for the benefit and security of the Holders of 1998 Ordinance Bonds, including the Bonds. Holders of 1975 Ordinance Bonds and Qualified Swaps have no claim to the 1998 Ordinance Sinking Fund Reserve.*

STANDBY PURCHASE AGREEMENT

General

The purchase price of Bonds which are tendered or deemed tendered for purchase will be payable, to the extent that remarketing proceeds are not sufficient therefor, from funds made available on a several but not joint basis by the Banks pursuant to the Standby Purchase Agreement. The Standby Purchase Agreement will provide liquidity for the purchase of those Bonds which are optionally tendered for purchase or are subject to mandatory purchase but not remarketed by the Remarketing Agent. The Standby Purchase Agreement is scheduled to expire (absent certain events of default described herein) on January 26, 2009. The enforceability of the Standby Purchase Agreement may be limited by the bankruptcy, insolvency or reorganization of the Banks. No assurance can be given that in such event, the obligations of the Banks under the Standby Purchase Agreement would continue.

Under the Standby Purchase Agreement, each Bank is obligated to fund only principal draws of up to each Bank's pro rata share of the total principal commitment of \$313,390,000 and interest draws on such amount (equal to thirty-four (34) days of interest on such amount at a maximum rate of 10.0% per annum). In the event that one of the Banks fails to honor a draw under the Standby Purchase Agreement to pay the purchase price of any Bonds that are optionally tendered for purchase, the tendered Bonds shall not be purchased but instead shall be returned to the tendering bondholders. Immediately thereafter, the Fiscal Agent shall be directed to notify the Holders of all of the Bonds that all of such Bonds are subject to mandatory tender. In the event that a Bank fails to honor a draw to pay the purchase price upon such mandatory tender, the Holders of the Bonds will be paid pro rata from the funds received from the Bank or Banks which honored the draw under the Standby Purchase Agreement and the Bonds that are not so purchased will be returned to the tendering bondholders. Thereafter, the Remarketing Agent will continue to establish the Weekly Rate of interest on such Bonds, taking into account the credit-worthiness of PGW and the fact that the remaining Holders of outstanding Bonds may not have the benefit of the Standby Purchase Agreement. The failure to pay the purchase price of a Bond upon optional or mandatory tender, as a result of a failure of a Bank to honor a draw under the Standby Purchase Agreement, shall not constitute a Default with respect to the Bonds nor shall the City have any obligation to provide funds. The City has agreed to use reasonable efforts to replace a Bank which fails to honor a draw under the Standby Purchase Agreement, unless the Bond Insurer otherwise agrees. *Under certain other circumstances, the City is required to use reasonable efforts to replace the Standby Purchase Agreement. See "STANDBY PURCHASE AGREEMENT – Substitute Standby Purchase Agreement" herein. Accordingly, unless the City either provides a replacement Standby Purchase Agreement or*

converts the Bonds to a Term Mode or a Fixed Mode, the Bonds may remain outstanding in the Weekly Mode until maturity without the benefit of a liquidity facility.

Purchase of Tendered Bonds by the Banks

From time to time during the period prior to the expiration or earlier termination of the Standby Purchase Agreement (the "Purchase Period") the Banks will purchase Bonds in the Weekly Mode that have been tendered for purchase pursuant to the Bond Authorization under an optional tender but not remarketed or which are tendered pursuant to a mandatory tender under the Bond Authorization and in any event upon receipt of an appropriate notice from the Fiscal Agent pursuant to the Bond Authorization and the Standby Purchase Agreement on the date specified for purchase (the "Purchase Date"). See "DESCRIPTION OF THE BONDS - Description of the Bonds in the Weekly Mode - Tenders of the Bonds." The price to be paid by the Banks for such Bonds will be equal to the aggregate principal amount of such Bonds plus, unless such date of purchase is an Interest Payment Date, interest accrued thereon to the date of such purchase calculated at the applicable interest rate for the Bonds. The Banks' commitment with respect to interest shall be equal to thirty-four (34) days' interest on the principal amount of Bonds outstanding (calculated at the maximum interest rate of 10.0% per annum).

UNDER CERTAIN CIRCUMSTANCES DESCRIBED BELOW, THE OBLIGATION OF THE BANKS TO PURCHASE BONDS OPTIONALLY TENDERED BY THE OWNERS THEREOF OR SUBJECT TO MANDATORY PURCHASE MAY BE AUTOMATICALLY TERMINATED OR SUSPENDED WITHOUT PRIOR NOTICE TO ANY PERSON, INCLUDING HOLDERS OF THE BONDS. IN SUCH EVENT, SUFFICIENT FUNDS MAY NOT BE AVAILABLE TO PURCHASE BONDS TENDERED BY THE OWNERS THEREOF OR SUBJECT TO MANDATORY PURCHASE. THE BOND INSURANCE POLICY DOES NOT INSURE PAYMENT OF THE PURCHASE PRICE OF THE BONDS.

Events of Default and Remedies

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

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

"Eligible Bonds" means any Bonds bearing interest at a Weekly Rate other than Bonds owned by, for the account of, or on behalf of the City.

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

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

"Related Documents" means the Standby Purchase Agreement, the 1998 General Ordinance, the Seventh Supplemental Ordinance, the Bond Authorization, the Bonds, the Purchase Contract, the Bond Insurance Policy and

the Remarketing Agreement, as the same may be amended or modified from time to time in accordance with their respective terms and the terms of the Standby Purchase Agreement.

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

(a) (i) Any principal or interest due on any Bond is not paid by the City when due and such principal or interest is not paid by the Bond Insurer when, as, and in the amounts required to be paid pursuant to the terms of the Bond Insurance Policy or (ii) the Bond Insurer defaults in any payment of amounts payable by it when due under any bond insurance policy (other than the Bond Insurance Policy) with respect to publicly-rated debt representing an obligation of the Bond Insurer on a parity with or senior to the Bond Insurer's obligations under the Bond Insurance Policy, and such default continues for a period of seven (7) days (it being understood by the Banks that default, for purposes of this clause (a)(ii) shall not mean a situation whereby the Bond Insurer contests in good faith its liability under the applicable policy or policies in light of the claim or claims made thereunder); or

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

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

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

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

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

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

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

(i) (i) The City's or PGW's commencement of any case, proceeding or other action (A) under any existing or future law of any jurisdiction, domestic or foreign, relating to bankruptcy, insolvency, reorganization or relief of debtors, seeking to have an order for relief entered with respect to it, or seeking to adjudicate it a bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding-up, liquidation, dissolution, composition or other relief with respect to it or its debts, or (B) seeking appointment of a receiver, trustee, custodian or other similar official for it or for all or any substantial part of its assets, or the City's or PGW's making a general assignment for the benefit of its creditors; or (ii) there is commenced against the City or PGW, any case, proceeding or other action of a nature referred to in clause (i) above which (x) results in an order for such relief or in the appointment of a receiver or similar official or (y) remains undismissed, undischarged or unbonded for a period of sixty (60) days; or (iii) there is commenced against the City or PGW, any case, proceeding or other action seeking issuance of a warrant of attachment, execution, distraint or similar process against all or any substantial part of its assets, which results in the entry of an order for any such relief which is not vacated, discharged, or stayed or bonded pending appeal within sixty (60) days from the entry thereof; or (iv) the City or PGW takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the acts set forth in clause (i), (ii) or (iii) above; or (v) the City or PGW is generally not, or is unable to, or so admits in writing its inability to, pay its debts; provided, however, that in regard to any of the foregoing actions by or affecting the City only, such action shall constitute an "Event of Default" under the Standby Purchase Agreement only if it adversely affects the City's ability to perform under the Standby Purchase Agreement or impairs in any way the lien on, or right of payment from, the Gas Works Revenues in favor of the Banks; or

(j) (i) Default by the City in the payment when due (subject to any applicable notice or grace period), whether at stated maturity, required prepayment, demand or otherwise, of any principal of or interest on (howsoever designated) any Indebtedness in excess of \$500,000, whether such Indebtedness now exists or is hereafter created; (ii) an event of default as defined in any mortgage, indenture, instrument or resolution under which there may be issued, or by which there may be secured or evidenced, any Indebtedness for money borrowed of, or guaranteed by, the City in excess of \$500,000, whether such Indebtedness now exists or is hereafter created, occurs and results in the Indebtedness becoming due and payable prior to the stated maturity or due date thereof; or (iii) any event occurs which permits such Indebtedness described in clause (i) or (ii) above in excess of \$500,000 to be so declared due and payable prior to its stated maturity or due date and such event continues unremedied past any period of grace provided for in any mortgage, indenture, instrument or resolution under which such Indebtedness is issued.

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

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

(b) In the case of an Automatic Termination Event (described in paragraphs (a), (c)(ii) and (c)(iii) under "Events of Default" above), the Available Commitment and the obligation of the Banks to advance funds for the purchase of Eligible Bonds will immediately terminate without notice or demand to any Person, and thereafter the Banks will be under no obligation to advance funds for the purchase of Bonds. Promptly after the occurrence of an Automatic Termination Event, the Banks will give written notice of same to the Fiscal Agent, the Bond Insurer, the City, PGW, and the Remarketing Agent; provided, that the Banks will incur no liability or responsibility whatsoever by reason of its failure to give such notice and such failure will in no way affect the termination of the Available Commitment and of its obligation to advance funds for the purchase of Bonds pursuant to the Standby Purchase Agreement.

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

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

bankruptcy, insolvency or similar proceeding with respect to the City or PGW that the Standby Purchase Agreement is not enforceable against the City under applicable bankruptcy, insolvency or similar laws.

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

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

The renewal or extension of the Standby Purchase Agreement is subject to agreement by the Banks and the City. The Banks have no obligation to extend or renew the Standby Purchase Agreement beyond its initial term. The City has the right under certain circumstances to terminate the Standby Purchase Agreement.

Substitute Standby Purchase Agreement

The Bond Authorization provides that, with the approval of the Bond Insurer, a Substitute Standby Purchase Agreement may be substituted for the existing Standby Purchase Agreement. The Bonds are subject to mandatory tender on the Business Day immediately preceding any date proposed by the City for delivery of a Substitute Standby Purchase Agreement. Notice of any such mandatory tender shall be given by the Fiscal Agent by registered or certified mail, mailed to the Holder of each affected Bond not less than 15 days prior to the mandatory tender date. See "DESCRIPTION OF THE BONDS - Description of the Bonds in the Weekly Mode - Tenders of the Bonds."

If at any time the short-term ratings on the Bonds falls below "A-1" (in the case of a rating assigned by S&P) and "VMIG-1" (in the case of a rating assigned by Moody's), the City will, unless otherwise agreed by the Bond Insurer, use reasonable efforts to replace the then effective Standby Purchase Agreement with a Substitute Standby Purchase Agreement approved by the Bond Insurer.

BOND INSURANCE

Bond Insurance Policy

Concurrently with the issuance of the Bonds, the Bond Insurer will issue its Municipal Bond Insurance Policy for the Bonds (the "Bond Insurance Policy"). The Bond Insurance Policy guarantees the scheduled payment of principal of and interest on the Bonds when due as set forth in the form of the Bond Insurance Policy attached as APPENDIX G to this Official Statement.

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

Bond Insurer

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

At September 30, 2005, Financial Security's total policyholders' surplus and contingency reserves were approximately \$2,451,658,000 and its total unearned premium reserve was approximately \$1,773,571,000 in accordance with statutory accounting practices. At September 30, 2005, Financial Security's total shareholders' equity was approximately \$2,867,978,000 and its total net unearned premium reserve was approximately \$1,448,209,000 in accordance with generally accepted accounting principles.

The financial statements of Financial Security included in, or as exhibits to, the Current Report on Form 8K filed on November 22, 2005 by Holdings with the Securities and Exchange Commission are hereby incorporated by reference into this Official Statement. All financial statements of Financial Security included in, or as exhibits to, documents filed by Holdings pursuant to Section 13(a), 13(c), 14 or 15(d) of the Security Exchange Act of 1934 after the date of this Official Statement and before the termination of the offering of the Bonds shall be deemed incorporated by reference into this Official Statement. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc: 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

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

ADDITIONAL BONDS

Additional 1975 Ordinance Bonds

The 1975 General Ordinance permits the issuance of additional 1975 Ordinance Bonds on a parity with other currently outstanding 1975 Ordinance Bonds. The 1998 General Ordinance limits the issuance of additional 1975 Ordinance Bonds, providing that they may only be issued to refund 1975 Ordinance Bonds. In order to issue 1975 Ordinance Bonds to refund prior 1975 Ordinance Bonds, among other requirements, it is necessary that a financial report of the chief fiscal officer of the City be provided which determines that, over the amortization period of the additional 1975 Ordinance Bonds, estimated Project Revenues will be sufficient to meet the 1975 Ordinance Rate Covenant.

Additional 1998 Ordinance Bonds

The 1998 General Ordinance permits the issuance of additional 1998 Ordinance Bonds which may be Senior 1998 Ordinance Bonds, on a parity with outstanding Senior 1998 Ordinance Bonds, including the Bonds, or Subordinate 1998 Ordinance Bonds. All 1998 Ordinance Bonds issued under the 1998 General Ordinance are subordinated to the 1975 Ordinance Bonds. In order to issue additional 1998 Ordinance Bonds, among other requirements, it is necessary that a financial report of the chief fiscal officer of the City be provided which determines that, over the amortization period of the additional 1998 Ordinance Bonds, estimated Gas Works Revenues will be sufficient to meet the 1998 Ordinance Rate Covenant.

Bond Anticipation Notes

The Act authorizes the City to issue revenue bond anticipation notes as well as Gas Works Revenue Bonds. Section 16 of the Act provides that the City may issue its revenue bond anticipation notes which shall be payable by exchange for, or out of the proceeds of the sale of, a designated series of revenue bonds referred to in the bond anticipation notes. The reference to the revenue bonds shall specify a maximum rate of interest to be borne by said bonds and may provide that said bonds shall be offered for sale, but if no proposals shall be received, the sole remedy of the Holders of the revenue bond anticipation notes shall be either to accept the bonds at the specified maximum interest rate, or to extend the maturity of the revenue bond anticipation notes for one or more specified additional periods of not less than six months during which additional offers of the bonds may be made. At the present time, there are no bond anticipation notes outstanding and the City has no present intention to issue revenue bond anticipation notes.

OTHER OUTSTANDING DEBT OBLIGATIONS

Short-Term Borrowings

Gas Works Notes. The City is authorized to issue, from time to time, bonds or notes (collectively, the "Gas Works Notes") pursuant to The City of Philadelphia Municipal Utility Inventory and Receivables Financing Act of the Commonwealth of Pennsylvania (the "Inventory and Receivables Financing Act") and the General Inventory and Receivables Gas Works Revenue Note Ordinance of 2005 (Bill No. 051138, approved December 22, 2005) (the "2005 Note Ordinance"), in amounts, as approved by the Mayor, the City Controller and the City Solicitor or any two of them (the "Committee"), presently in a principal amount not to exceed, in the aggregate, \$150,000,000 at any one time outstanding. Such amount can, in the future, be increased or decreased by action of City Council. The proceeds of the Gas Works Notes may be used to finance or refund the costs of acquisition or funding of Inventory or Receivables (as such terms are defined in the Note Ordinance) of PGW or to refund Gas Works Notes. The Gas Works Notes are junior in priority of payment to the 1975 Ordinance Bonds and the Senior 1998 Ordinance Bonds and are on a parity with Subordinate 1998 Ordinance Bonds and payments due in respect of obligations on a parity with Subordinate 1998 Ordinance Bonds. The 2005 Note Ordinance provides that the stated maturity of Gas Works Notes shall be not later than 270 days from the date of issuance; provided, however, the stated maturity shall be not later than the earlier of 13 months from the date of initial issuance of any installment of any Gas Works Note under the 2005 Note Ordinance or August 31, 2010. As of December 31, 2005, \$99,200,000 in aggregate principal amount of Gas Works Notes issued under the City's commercial paper program for PGW were outstanding. Payment of the principal of and interest on the Gas Works Notes is secured by a letter of credit issued by JPMorgan in the initial stated amount of \$100,000,000 which expires on May 29, 2007. The stated amount of the letter of credit can be increased, at the option of the City, to an amount not to exceed \$150,000,000, and can be decreased, at the option of the City, but to a stated amount not less than Gas Works Notes then outstanding plus interest thereon. See APPENDIX B - "Independent Consultant's Engineering Report - Projected Revenue Requirements" and "Adequacy of Projected Revenues to Meet Projected Revenue Requirements Under Ordinance Requirements."

The 2005 Note Ordinance requires establishment of a sinking fund for the benefit and security of the Holders of each series of the Gas Works Notes. The City covenants to deposit to the credit of the sinking fund for the Gas Works Notes from Gas Works Revenues such amounts as will, together with interest and profits earned and to be earned on investments held therein, be sufficient to pay, on or before each payment date of the Gas Works Notes, the amount required, after taking into account amounts paid from refunding Gas Works Notes and credit support instruments, to pay the Gas Works Notes then becoming due and payable.

Interfund Borrowing. It is PGW's practice to make interfund loans among the various consolidated accounts of PGW for payment, as necessary, of PGW obligations, including debt service on bonds issued under the General Ordinances. PGW anticipates that it will reimburse the project account of the Capital Improvement Fund for the Bonds as revenues are received by the end of each Fiscal Year during which such withdrawals were made.

City Loan

On November 27, 2000, the City and PGW, acting through PFMC, entered into a Loan Agreement pursuant to which the City agreed, subject to certain terms and conditions, to loan \$45,000,000 to PGW (the "City Loan"). The City Loan does not bear interest. Proceeds of the City Loan are deposited to the credit of a segregated account held by PGW and earnings on such account are transferred to the City. The City Loan is unsecured and is subordinated in priority of payment to the 1975 Ordinance Bonds, the Senior 1998 Ordinance Bonds, the Subordinated Bonds and the Gas Works Notes. As of December 31, 2005, the entire loan of \$45 million was outstanding. The City has extended the maturity of the City Loan to Fiscal Year 2008.

DEBT SERVICE SCHEDULE FOR ALL OBLIGATIONS

Debt Service Schedule For All Obligations

Fiscal Year Ending August 31	1975 Ordinance Bonds	1998 Ordinance Bonds			1975 & 1998 Ordinances	
	Existing	Existing	Sixth Series		Total	Combined Total
	Debt Service¹	Debt Service^{1,2}	Principal	Interest³	Debt Service	Debt Service
2006	35,921,288	22,763,711		5,917,695	28,681,406	64,602,694
2007	35,747,550	38,995,146		11,515,516	50,510,662	86,258,212
2008	34,368,038	40,447,378	1,775,000	11,515,516	53,737,893	88,105,931
2009	32,367,575	40,070,960	1,845,000	11,450,293	53,366,253	85,733,828
2010	30,155,000	41,752,373	1,915,000	11,382,499	55,049,871	85,204,871
2011	31,558,500	39,479,743	1,990,000	11,312,132	52,781,874	84,340,374
2012	32,164,344	35,745,235	2,070,000	11,239,009	49,054,244	81,218,588
2013	30,575,281	31,920,388	5,235,000	11,162,947	48,318,335	78,893,616
2014	29,007,088	27,859,644	9,420,000	10,970,587	48,250,231	77,257,318
2015	27,315,763	25,142,231	12,515,000	10,624,449	48,281,681	75,597,443
2016	22,707,538	27,072,788	11,080,000	10,164,586	48,317,373	71,024,911
2017	21,179,625	26,328,775	12,255,000	9,757,451	48,341,226	69,520,851
2018	19,652,938	25,582,469	13,485,000	9,307,141	48,374,610	68,027,547
2019	18,124,369	24,843,331	14,755,000	8,811,635	48,409,966	66,534,335
2020	16,586,088	24,105,406	16,070,000	8,269,462	48,444,869	65,030,956
2021	15,060,781	23,359,263	17,445,000	7,678,970	48,483,233	63,544,014
2022	14,295,088	22,615,625	18,885,000	7,037,954	48,538,579	62,833,666
2023	12,736,538	21,874,625	20,360,000	6,344,024	48,578,649	61,315,187
2024	11,175,963	22,129,000	21,180,000	5,595,896	48,904,896	60,080,859
2025	4,159,000	21,435,125	22,820,000	4,817,637	49,072,762	53,231,762
2026	3,769,500	21,295,125	23,960,000	3,979,116	49,234,241	53,003,741
2027		19,386,375	26,860,000	3,098,706	49,345,081	49,345,081
2028		19,475,750	27,990,000	2,111,735	49,577,485	49,577,485
2029		19,551,250	13,770,000	1,083,243	34,404,493	34,404,493
2030		17,921,375	7,705,000	577,264	26,203,639	26,203,639
2031		17,918,750	8,005,000	294,144	26,217,894	26,217,894
2032		17,915,500			17,915,500	17,915,500
2033		9,519,750			9,519,750	9,519,750
2034		9,519,250			9,519,250	9,519,250
2035		30,552,000			30,552,000	30,552,000
Total	478,627,850	766,578,338	313,390,000	196,019,607	1,275,987,945	1,754,615,795

¹ Outstanding Debt As of January 26, 2006

² Variable rate interest at 3.68% (average rate since 1984)

³ Interest based on fixed rate of Sixth Series Swap

REMEDIES OF BONDHOLDERS

Remedies under the Act and the 1975 General Ordinance available to Holders of the 1975 Ordinance Bonds and remedies under the Act and the 1998 General Ordinance available to Holders of 1998 Ordinance Bonds, including Holders of the Bonds, and to any trustee for Bondholders appointed by the Holders of 25% in principal amount of any series of bonds in default are described in the summaries contained in APPENDIX D hereto. In addition to the remedies described therein, Bondholders or a trustee therefor are entitled under the Pennsylvania Uniform Commercial Code to all remedies of secured parties in respect of the Project Revenues or Gas Works Revenues (as the case may be) and the funds on deposit in the respective Sinking Funds, including the respective Sinking Fund Reserves. The remedies of the Holders of 1998 Ordinance Bonds are subject to the prior lien of the Holders of 1975 Ordinance Bonds on Project Revenues. In addition, the Bond Insurer has been granted certain rights in connection with the insurance of the Bonds that may impact on the rights of the Holders of the Bonds, which rights are set forth in a certain agreement with the City. Reference should be made to such agreement for a further description of such rights. So long as DTC or its nominee is the Registered Owner, the remedies of Beneficial Owners are exercisable by means of written instructions given by them, as transmitted through the respective Participants, to DTC.

Limitation on Remedies of Bondholders

The ultimate enforcement of Bondholders' rights upon any default by the City in the performance of its obligations under the Act, the 1975 General Ordinance, the 1998 General Ordinance, the Seventh Supplemental Ordinance, the Bond Authorization and the Bonds will depend upon the application of remedies provided in the Act, the 1998 General Ordinance, the Seventh Supplemental Ordinance and other applicable laws. Litigation may be necessary to obtain relief in accordance with these remedies. Such litigation may be protracted and costly. Remedies such as mandamus, specific performance or injunctive relief are equitable remedies that are subject to the discretion of the courts.

The following references to the United States Bankruptcy Code (the "Bankruptcy Code") and certain provisions of the Intergovernmental Cooperation Act (hereinafter defined) should not be construed as implying that the City has any expectation or plan to seek to invoke the provisions of such statutes or that if the City were to seek to invoke such provisions, that the consent of the Governor of Pennsylvania (the "Governor") would be obtained. Further, such references are not intended to imply that even if the City were to file for protection under the Bankruptcy Code, any proposed restructuring would include a dilution of the sources of payment of and security for the Bonds. The statutory provisions of the Bankruptcy Code pertaining to the City have not been subject to extensive interpretation by the courts and there can be no assurance that the following discussion accurately reflects the interpretation that a court might make.

Enforcement of Bondholders' rights may be limited by, and is subject to, the provisions of the Bankruptcy Code, as now or hereafter enacted, or to other laws or legal or equitable principles which may affect the enforcement of creditors' rights. The Intergovernmental Cooperation Authority Act for Cities of the First Class (53 P.S. § 12720.101 *et seq.*) (the "Intergovernmental Cooperation Act"), enacted in 1991, prohibits the City from filing a petition for relief under chapter 9 of the Bankruptcy Code as long as the authority created thereunder has outstanding any bonds issued pursuant to the Intergovernmental Cooperation Act or, if no such bonds are outstanding requires approval, in writing, by the Governor of the City's petition and plan following a hearing, prior to a filing under chapter 9 by the City. There are currently bonds outstanding that were issued under the Intergovernmental Cooperation Act, which bonds are scheduled to mature at various dates to and including June 15, 2023, subject to redemption prior to maturity. See "Background - The Pennsylvania Intergovernmental Cooperation Authority" in APPENDIX C. If the City were to obtain authorization from the Governor to file a petition under chapter 9 of the Bankruptcy Code and in fact filed such a petition, the enforcement of Bondholders' rights and remedies might be limited.

The filing of a petition under chapter 9 operates as an automatic stay of the commencement or continuation of any judicial or other proceeding against the debtor or its property. However, a petition filed under chapter 9 does not operate as a stay of application of pledged special revenues to the payment of indebtedness secured by such revenues. Special revenues include receipts derived from the ownership or operation of systems that are used to

provide utility services and the proceeds of borrowings to finance such systems and would include the pledged Project Revenues or Gas Works Revenues (as the case may be). The Bankruptcy Code further provides that special revenues acquired by the debtor after commencement of a chapter 9 case shall remain subject to any lien resulting from any security agreement entered into by the debtor before the commencement. However, the lien on special revenues derived from a system will be subject to the payment of the necessary operating expenses of that system. Therefore, Gas Works Revenues acquired by the City before and after the filing of a chapter 9 petition will remain subject to the lien of the 1998 General Ordinance and the Seventh Supplemental Ordinance in favor of Holders of the Bonds, but will be subject to the payment of PGW's necessary operating expenses as determined by the City (and subject and subordinate to the pledge of Project Revenues under the 1975 General Ordinance Security the 1975 Ordinance Bonds). These operating expense payments could be inconsistent with the requirement in the 1975 General Ordinance with respect to the 1975 Ordinance Bonds, that, under certain circumstances, at least 50% of the Project Revenues be deposited in the 1975 Ordinance Sinking Fund on a daily basis. If the pledged Project Revenues or Gas Works Revenues cannot support both the applicable debt service requirements and operating expenses of PGW, it is possible that payments to Holders of the Bonds may be reduced. The Bankruptcy Code also provides that a transfer of property of a debtor to or for the benefit of a bondholder, on account of such bond, may not be avoided as a preferential transfer.

Unless a debtor consents or the plan proposed under chapter 9 provides, the bankruptcy court may not interfere with any of the property or revenues of a chapter 9 debtor or with such debtor's use or enjoyment of any income-producing property. Accordingly, if the City should decide to use the proceeds of the Bonds or the Gas Works Revenues pledged for the benefit of the Bondholders other than to benefit the Gas Works, it is unclear whether a bankruptcy court would have the power to interfere with that decision. Even if a bankruptcy court had such power, the court, in the exercise of its equitable powers, could refuse to require the City to use the proceeds of the Bonds and the Gas Works Revenues to pay Holders of the Bonds, could permit a subordination of the liens to new bonds if the former were found more than "adequately protected" or could avail itself of a broad range of equitable remedies.

Under the Bankruptcy Code, a debtor may file a plan for the adjustment of its debts which may include provisions modifying or altering the rights of creditors generally, or any class of them, secured or unsecured. The plan, when confirmed by the court, binds all creditors who had notice or knowledge of the case and discharges all claims against the debtor provided for in the plan, unless excepted from discharge by the plan. No plan may be confirmed unless certain conditions are met, among which are that the plan is in the best interests of creditors, is feasible and has been accepted by each class of claims impaired thereunder. Each class of claims has accepted the plan if the votes of at least two-thirds in dollar amount and more than one-half in number of the allowed claims of the class that are voted are cast in favor of the plan. Even if the plan is not so accepted, it may be confirmed if the court finds that the plan is fair and equitable and certain other tests are met. Thus, under the provisions of the Bankruptcy Code, a plan of adjustment could be imposed on the Bondholders that would give them less than their anticipated rate of interest on the Bonds or possibly even less than a full return of their principal and/or extend the time for payment of principal of or interest on the Bonds.

PHILADELPHIA GAS WORKS

General

PGW consists of real and personal property owned by the City and used for the acquisition, manufacture, storage, processing and distribution of natural gas in the City, and all property, books and records employed and maintained in connection with the operation, maintenance and administration of PGW. Included among such assets, in addition to an extensive distribution system, are facilities for the liquefaction, storage and vaporization of natural gas to supplement the natural gas supply from pipeline transmission companies and facilities for storage. Such facilities include two liquefied natural gas ("LNG") plants.

Of total billed gas revenues for the twelve month period ended August 31, 2005, approximately 71% were derived from residential customers, approximately 26% were derived from commercial and industrial customers and approximately 3% were derived from municipal and housing authority customers.

Operating results for PGW and debt service coverage for PGW for the five Fiscal Years ended August 31, 2005 are shown below under the heading "Summary of Statements of Income and Expenses and Debt Service Coverage Ratio." For a further explanation of revenues and expenses, see "PGW BUDGET, RATES AND FINANCES," "MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION" and APPENDIX B. See also the table entitled "Historical Revenues and Debt Service Coverage" below for future debt service payments.

PGW Service Area

PGW, the nation's largest municipally-owned gas utility, purchases, sells and distributes gas within the limits of the City. The City's boundaries enclose an urbanized area of 129 square miles in southeastern Pennsylvania along the Delaware River. Within these boundaries, PGW maintains a distribution system with approximately 3,013 miles of gas mains and approximately 494,349 service lines serving slightly more than a half million customers. The mix of sales to PGW's customers, net of transportation sales, during each of the five Fiscal Years ended August 31 is shown in the following table:

	PERCENT OF GAS SALES FOR THE YEARS ENDED AUGUST 31*				
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Residential	69.3	66.8	69.6	71.0	70.3
Commercial and Industrial	27.8	30.1	27.2	25.9	26.9
Municipal and Housing Authority	<u>2.9</u>	<u>3.1</u>	<u>3.2</u>	<u>3.1</u>	<u>2.8</u>
TOTAL	100	100	100	100	100

*This information was obtained from PGW's historical records.

For a discussion of PGW's sales, see "MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION – Five Year Summary of Gas Sales."

Management Agreement

PFGC has operated PGW pursuant to a Management Agreement since January 1, 1973 (as amended, the "Management Agreement"). Under the Management Agreement, various aspects of PFGC's management of PGW are subject to review and approval by the Gas Commission and, where authorization of City Council is required, recommendation of the City's Director of Finance and/or the Gas Commission. The Gas Commission has various responsibilities for the oversight of the operations of PGW; the City's Director of Finance oversees certain financial practices of PGW; and the City's Law Department is the designated legal advisor to the Gas Commission and PGW. The Law Department has assigned the representation of PGW to the Office of General Counsel of PGW. See "CITY GOVERNMENTAL OVERSIGHT – Gas Commission" and "PGW BUDGET, RATES AND FINANCES" for discussions of the Gas Commission.

The term of the Management Agreement commenced on January 1, 1973 for a period of two years. In the absence of notice of cancellation, the term is automatically extended for additional two year periods. The term is subject to cancellation by the City at any time, or upon the expiration of the two-year period, upon ninety days notice. No cancellation will be effective unless and until approved by resolution or ordinance of City Council.

Management

Under the Management Agreement, PFMC is responsible for providing executive management of PGW. The Management Agreement states that PFMC shall provide a chief executive officer, chief operating officer, chief financial officer and other personnel as deemed appropriate by PFMC. Certain PFMC personnel, including the chief executive officer, chief operating officer and the chief financial officer, provided to PGW are subject to the approval of the Gas Commission. PFMC's officers also serve as officers of PGW.

The following are brief biographical descriptions of the current PFMC/PGW Senior Officers:

Thomas E. Knudsen, President and Chief Executive Officer. Mr. Knudsen joined PGW as Interim Chief Financial Officer in March 2000. He served in that capacity until July 2001 when he was appointed Interim President and Chief Executive Officer. Mr. Knudsen was appointed to his present position by the PFMC in June 2002. Prior to joining PGW, Mr. Knudsen was the founding partner of The Woodside Group, a management consulting firm located in Stamford, Connecticut specializing in utility economics and regulation. For over 25 years, Mr. Knudsen advised industrial, commercial and residential customers and groups, as well as regulatory commissions, regarding appropriate utility operations, budgeting, pricing and rate design issues. Mr. Knudsen's involvement with PGW dates from 1986, having served as a consultant to the Public Advocate in all rate and budget proceedings of PGW before the Gas Commission from 1986 until 2000. His prior experience includes management consulting with Touche Ross & Co., (now Deloitte & Touche), as Assistant to the Finance Administrator of the City of New York and the United States Navy Supply Corp. Mr. Knudsen received his Masters of Business Administration degree in Finance from Columbia University in 1968 and a Bachelor of Arts degree in Economics from Northwestern University in 1964.

Craig E. White, Interim Chief Operating Officer. Mr. White was appointed Interim Chief Operating Officer in July 2001. He is responsible for Field Operations, Customer Service, Sales and Marketing, Legal, Labor - Safety & Preparedness, Organizational Development, Human Resources, Information Services, and Gas Management issues. His previous positions at PGW include: Senior Vice President, Marketing and Supply Services; Vice President, Marketing and New Business Development; Manager, Gas Planning & Federal Regulatory Affairs; Administrator, Federal Regulatory Affairs; Federal Regulatory Specialist; Planning Analyst; Demand Analyst; and Accounting Specialist. Mr. White received his Bachelor of Science degree in Business Administration from Kutztown University in Kutztown, Pennsylvania, and Master of Business Administration degree in Financial Management from Drexel University. Mr. White has been a member of PGW's management team since January 1980. He also serves on the following: American Public Gas Association's Executive Board, North American Energy Standards Board, the American Gas Association's Leadership Council and the Energy Association of Pennsylvania's Executive Gas Committee.

Joseph R. Bogdonavage, Senior Vice President - Finance. Mr. Bogdonavage was appointed Senior Vice President, Finance in November 2000. His responsibilities include the oversight of PGW's Operating & Capital Budget and Procurement functions. Mr. Bogdonavage has over 32 years of diverse experience in the finance area of PGW. He previously held the positions of Director, Budget & Financial Forecasting, Manager, Budget & Financial Forecasting, Supervisor, Budget & Financial Forecasting, Accounting Assistant Supervisor and Budget Analyst. Mr. Bogdonavage is a member of the American Gas Association's Financial and Administrative Committee. Mr. Bogdonavage received his Bachelor of Business Administration in Accounting in 1972 from Temple University.

Abby L. Pozefsky, Esq., Senior Vice President - Administration and General Counsel. Ms. Pozefsky was appointed Senior Vice President and General Counsel in July 1998, and Senior Vice President, Administration and General Counsel in 2005. She manages the departments of Human Resources, Labor, Safety and Preparedness, and Organization Development as well as Legal. Ms. Pozefsky previously held the position of Chief Deputy City Solicitor of Regulatory Affairs for the City of Philadelphia Law Department where she worked for twelve years. Prior to that she held a variety of positions in public and private practice. Ms. Pozefsky received her Bachelor of Arts degree from the University of Pennsylvania cum laude and a Juris Doctor degree from New York University Law School.

Janice L. Walsh, Senior Vice President – Operations. Ms. Walsh was appointed Senior Vice President, Operations in October 2002. She is responsible for PGW's Field Operations (formerly Field Service and Distribution Departments), Support Services (Building Services, Fleet Operations & Materials Management), Operations Compliance & Technical Services (including Environmental & Chemical Services). Ms. Walsh was the Acting Vice President of Operations since October 2001 and previously held many positions at PGW since commencing employment in May 1986 as an Engineering Assistant. Ms. Walsh received her Bachelor of Science degree in Petroleum & Natural Gas Engineering from Pennsylvania State University in 1983 and has previously worked for the Department of the Navy and interned with three major oil companies. Ms. Walsh is a member of the American Gas Association, Association of Energy Engineers, Energy Association of Pennsylvania and American Society of Heating, Refrigerating and Air-Conditioning Engineers.

Albert L. D'Attilio, Vice President, Human Resources. Mr. D'Attilio was appointed Vice President of Human Resources in May 2005. He is responsible for Recruitment, Staffing, Classification, Compensation and Benefits. Mr. D'Attilio previously held the position of Director of Labor Relations, Safety and Security where he was responsible for directing PGW's Labor Relations, Occupational Safety, Employee Medical Services and Security functions for PGW. Prior to coming to PGW in March of 1999 as Director of Labor Relations, Mr. D'Attilio practiced employment and labor law for the City of Philadelphia. He has also served as the Labor Relations Director and Occupational Safety Administrator for the Philadelphia Airport Systems and a Personnel Analyst specializing in selection and employment testing for the City of Philadelphia. Mr. D'Attilio holds Juris Doctor and Bachelors of Arts degrees from Temple University. He earned certification as a Senior Professional in Human Resources from the Society for Human Resources Management in December 2002.

David Griesing, Vice President – Strategic Planning. Mr. Griesing was appointed Vice President, Strategic Planning in October 2001. In this position, he was responsible for filing PGW's comprehensive restructuring plan with the Pennsylvania Public Utilities Commission in July 2002. He is currently implementing PGW's general business planning initiatives and is the business lead on a multi-year project to transform the Company's existing LNG peak shaving facility into an import terminal. Before assuming his current position, Mr. Griesing was PGW's Associate General Counsel, responsible for supervising outside counsel, defending the company in significant litigation matters, and providing guidance to senior management on a range of issues. Prior to joining PGW in September 1998, Mr. Griesing held senior management positions in the areas of operations and strategic planning at companies in the region. He was originally a trial attorney representing investment banking and other business clients in securities, contracts and regulatory matters. In addition to a law degree from the University of Pennsylvania, he has a master's degree from Yale University, and a bachelor degree from Holy Cross.

Raquel N. Guzman, Vice President – Legal and Associate General Counsel. Ms. Guzman was appointed Vice President - Legal in August 2005 and Associate General Counsel in 2003. She, together with the General Counsel and Assistant General Counsel, is responsible for PGW's Legal Department. Prior to joining PGW's legal staff, Ms. Guzman was a Deputy City Solicitor for Regulatory Affairs for the City of Philadelphia and also practiced at a major Philadelphia law firm in its real estate department. She holds a Juris Doctor degree from the University of Pennsylvania Law School and an undergraduate degree from Harvard College.

Randy Gyory, Vice President – Customer Affairs. Mr. Gyory was appointed Vice President of Customer Affairs in 2001. His responsibilities include overseeing the Call Center Operations, Credit and Collections, Regulatory Compliance, Account Management, Bill Processing, Universal Service Programs, Customer Service Center Operations, Billing System operations and support. Prior to his current position, Mr. Gyory managed PGW's Program Management Office and led a team of functional and business analysts in correcting and improving the billing system software issues associated with the transition from their legacy billing system to a client server system. In his twenty-six years of experience at PGW, Mr. Gyory has spent the majority of his career in the Distribution Department where he held several positions in Maintenance, Construction and Engineering. Mr. Gyory received a Bachelor of Science degree in civil engineering from the University of Pittsburgh.

Michael W. Handwerk, Vice President - Compliance, Technical & Business Transformation Services. Mr. Handwerk was appointed Vice President, Compliance, Technical & Business Transformation Services in September, 2005. In this capacity, he is responsible for services to Operations involving regulatory compliance, chemical laboratory analyses and environmental related activities, as well as development and implementation of operational changes and best practices. Mr. Handwerk's previous position was Director, Operations Compliance & Technical

Services. He has been with PGW since 1979. Mr. Handwerk is a member of the American Gas Association's Operations Safety Regulatory Action Committee (OSRAC), Environmental Matters Committee (EM) and Environmental Regulatory Action Committee (ERAC). He is also a member of American Public Gas Association's Operations Committee, as well as Energy Association of Pennsylvania's Gas Transmission and Distribution Committee. Mr. Handwerk has a B.S. degree in Chemistry, a B.A. degree in Corporate Management, and a M.B.A. in Financial Management.

Steven P. Hershey, Vice President – Community Initiatives. Mr. Hershey joined PGW as Vice President, Community Initiatives in January 2004. In his current position, Mr. Hershey's primary responsibility is working with the President and CEO and senior management regarding certain regulatory and stakeholder matters and developing community initiatives to enhance PGW's relationship with various customer organizations. Prior to joining PGW, Mr. Hershey was a partner in the law firm of Eckert, Seamans, Cherin & Mellott, LLC of Philadelphia, Pennsylvania. He represented clients in matters involving energy, telecommunications, and utility policy, implementation of competition, rate setting, conservation, customer service and economics. Prior to becoming a partner at Eckert, Seamans, Cherin & Mellott, LLC, Mr. Hershey was a Supervising Attorney for Community Legal Services of Philadelphia, Pennsylvania. While at CLS, Mr. Hershey served as Lead Attorney for the Public Advocate, representing the interests of residential customers of Philadelphia utilities from 1985 to 1998. Mr. Hershey's involvement with PGW dates back to approximately 1977 when he began representing PGW's residential customers. Mr. Hershey has more than 30 years of experience in private practice, public interest advocacy and legal services.

Thomas L. Kuczynski, Vice President – Information Services & Chief Information Officer. Mr. Kuczynski rejoined PGW in February 2004 as Vice President - Information Services & CIO. He has over 27 years of experience in Information Technology including 18 years of prior experience at PGW. In his present position, Mr. Kuczynski is responsible for all aspects of Information Services including Telecommunications, Technical Services, Information Management and Business Response, Application Development, and Support & Administration. He previously held the position of Director of Technology Strategic Planning for PG&E's National Energy Group ("NEG"). In this role, he was responsible for new technology research and development, strategy and architecture, business continuity planning, disaster recovery and security. Prior to joining NEG, Mr. Kuczynski spent one year at Delmarva Power where he provided IT Strategic Planning Services to the Energy Supply Group. Before Delmarva, Mr. Kuczynski spent 18 years at PGW where he led development efforts for PGW's customer information system, credit and collection, automated meter reading and distribution leak tracking. In 1993 Mr. Kuczynski was recognized by the American Gas Association with the Distribution Achievement Award for his efforts in designing and building PGW's first mobile field service system. Mr. Kuczynski is a graduate of La Salle College in Philadelphia, and the Executive MBA program at University of Maryland University College.

Paul A. Mondimore, Vice President – Field Operations. Mr. Mondimore was appointed Vice President, Field Operations in October 2002. He is responsible for PGW's Distribution and Field Services Departments. He previously held many positions at PGW in the Distribution Department since commencing employment in June 1981 including: Director, Distribution Department, Project Manager, Mobile Dispatch Project, General Supervisor, and Supervisor. Mr. Mondimore received his Bachelor of Science degree in Civil Engineering from Drexel University. He has been a member of the American Gas Association, AGA Best Practices Group and the Energy Association of Pennsylvania.

Douglas A. Moser, Vice President – Gas Management. Mr. Moser was appointed Vice President, Gas Management in October 2002. He is responsible for PGW's Gas Processing, Gas Supply, Gas Control & Transportation, Gas Planning and Engineering Departments. Since commencing employment in September, 1979 at PGW he has held the following positions: Senior Project Manager in the Strategic Planning Department, Manager-Gas Control and Manager-Gas Acquisition in the Gas Supply Department and Engineering Assistant, Production Engineer, Supervisor – Gas Conditioning, and Operations Engineer in the Gas Processing Department. Mr. Moser received his Bachelor of Science degree in Chemical Engineering from Pennsylvania State University and his Master in Business Administration degree from Widener University.

Jo Ann Muniz, Vice President – Support Services. Ms. Muniz was appointed Vice President, Support Services in September 2005. She is responsible for PGW's Facilities, Fleet Operations and Materials Management Departments. Since commencing employment in July 1980 as an Engineering Assistant in Gas Supply, she has held

many positions at PGW including: Fleet Engineer in Fleet Operations, Staff Engineer in the Engineering Department, and Internships in Field Services and Customer Affairs, Co-Project Manager of the Work Management and Mobile Project Team, Project Manager of the Customer Service Training and Process Development, Director Procurement and Contract Services and later became Director, Fleet Operations and Materials Management. She most recently held the position of Director, Support Services. She serves as Chair of the Energy Association of Pennsylvania's Materials and Procurement Management Committee. She holds a B.S. in Mechanical Engineering from Temple University and a M.S. in Electrical Engineering from Pennsylvania State University.

Joseph Smith, Vice President, Marketing & Sales. Mr. Smith was appointed Vice President, Marketing & Sales in May 2005. Mr. Smith oversees the operations of Major Accounts, Sales and Customer Support and Marketing Services. He previously held the position of Director, Major Accounts; Manager, Major Accounts as well as other positions within the Marketing Department. In addition, he has held several positions in PGW's Field Operations. Mr. Smith received his Bachelors Degree in Business Administration in 2004. Mr. Smith has served as the President of the Association of Energy Engineers (AEE), in which he now serves as a Board member. He is currently a member of the American Public Gas Association's Marketing Committee and the American Society of Heating, Refrigeration and Air Conditioning Engineers (ASHRAE).

John P. Straub, Vice President – Labor, Safety and Preparedness. Mr. Straub was appointed Vice President of Labor, Safety and Preparedness in April 2003. He is responsible for matters including Labor Relations, Safety, Security, Medical, Risk Management, Insurance, Workers' Compensation, Policies & Procedures, Business Continuity & Disaster Planning, EAP, Occupational Health & Safety, and also serves as Drug and Alcohol Program Manager. Mr. Straub previously held the position of Vice President – Human Resources Department. Before coming to PGW in January 1999, Mr. Straub headed the Special Litigation Group for the City of Philadelphia's Law Department where he was responsible for the management and supervision of all employment law related matters and litigation involving the City of Philadelphia. Mr. Straub also worked as an Assistant District Attorney for the Philadelphia District Attorney's office. He holds a Juris Doctor degree from Temple University School of Law and is a graduate of Villanova University.

Lorraine S. Webb, Vice President - Organizational Development. Ms. Webb was appointed Vice President of Organizational Development in May 2005. She is responsible for Performance Management, Succession Planning, EEO, Affirmative Action, Training and Development and the Leadership Development program. Ms. Webb previously held the position of Director of Strategic Planning and prior to that Director of Human Resources for PGW. Before joining PGW, Ms. Webb held various positions in the field of human resources. Previous positions included Manager of Human Resources, Affirmative Action Officer for Ciba Geigy (now Novartis), as well as Senior Career Transition Counselor for the Ayers Group of New York. Ms. Webb holds a BA degree from State University of New York-Binghamton. She is a member of SHRM.

Joseph F. Golden, Jr., Controller. Mr. Golden was appointed Controller in March 2001. He is responsible for the treasury, accounting and budget functions. Prior titles held by Mr. Golden at PGW include: Treasurer, Manager - Treasury Department, Senior Staff Accountant, and Staff Accountant. Mr. Golden started his career with PGW in August of 1986. Mr. Golden has prior work experience in public accounting, treasury accounting and cash management, and manufacturing. Mr. Golden holds a Bachelor of Science degree in Accounting from Villanova University, a Master of Business Administration degree from Drexel University, and a Juris Doctor degree, cum laude, from Temple University School of Law.

Management and Governance of the Gas Works

Management. Thomas E. Knudsen was appointed as President and Chief Executive Officer in 2002. PGW's permanent management organization is outlined in the Independent Consultant's Report attached hereto as APPENDIX B. As part of the search process for current management, the City conducted an analysis of the potential benefits of a sale of PGW. The City engaged professional advisors to assist it in this analysis, which included an examination of the options of ownership (which could be either through sale or lease of the PGW assets) by a municipal authority, nonprofit corporation or for-profit entity. This examination was also recommended in the management audit conducted for the PUC pursuant to the Gas Choice Act. Although the City has no current plans to sell PGW, the City continues to consider the potential benefits of a sale or transfer of PGW. The analysis of potential benefits of a sale or transfer of the PGW have been conducted with due regard of the City's covenants in

the 1975 General Ordinance and the 1998 General Ordinance (i) to continuously operate and maintain PGW while any Bonds are outstanding, and (ii) to maintain the tax-exempt status of the Bonds.

Governance. Current governance includes (i) ownership of PGW property and establishment of legislation for the functioning of PGW by the City; (ii) approval by City Council of capital budgets and certain gas supply contracts for PGW; (iii) review and approval by the Gas Commission of personnel provided by PFMC and operating budgets, and recommendation by the Gas Commission to City Council of certain gas supply contracts and capital budgets; and (iv) provisions of executive management functions and directions for operation of PGW facilities by PFMC. PGW personnel are responsible for the day to day management of the construction, operation and maintenance of the gas system. Any changes in governance of PGW must be made pursuant to ordinances adopted by City Council.

Proposals to Transfer Gas Works

It has been suggested in various forums by, among others, members of the Pennsylvania General Assembly, that the assets comprising the Gas Works be transferred to a public authority which would be an instrumentality of the Commonwealth. It has also been suggested by some that the Pennsylvania Public Utility Commission investigate the question of whether such a transfer – in combination with the gas assets currently owned by another Pennsylvania utility – would be desirable. The City has covenanted in the 1998 General Ordinance to continuously operate and maintain the Gas Works as long as any bonds or notes are outstanding under the 1998 General Ordinance. It is the City's position that no transfer of the assets comprising the Gas Works could be effected unless provision is made for payment or defeasance of all outstanding obligations payable from Gas Works Revenues, including the Bonds and the Sixth Series Swap Agreement.

Labor Relations

As of November 2005, PGW employed 1,754 people. Presently, approximately 75 percent of PGW's employees are represented by the Gas Works Employees' Union Local 686 ("Local 686"). Local 686 transferred affiliation from the Service Employees International Union ("SEIU") to the Utility Workers Union of America ("UWUA") in 2003. On May 16, 2005, a new three-year Collective Bargaining Agreement began between PGW and Union Local 686, and will expire on May 15, 2008. The Collective Bargaining Agreement includes incremental wage increases of 1 percent in September 2005, 3 percent in September 2006, and 2.5 percent in May 2007.

Facilities

Gas Facilities. The principal PGW gas facilities include plants for the liquefaction, storage and vaporization of natural gas in the Richmond and Passyunk sections of the City. Located at these plants are two LNG facilities, a deactivated propane/air facility and two gas holders.

Gate Stations. Natural gas is received through nine city gate stations from two pipeline transmission companies, Texas Eastern Transmission Corporation (TETCO) and Transcontinental Gas Pipe Line Corporation (TRANSCO). The facilities at each of the city gate stations perform two basic functions, metering the flow of gas and controlling the pressure delivered to PGW's distribution system. Dispatchers at the gas control center, located at PGW's operating offices at 800 W. Montgomery Avenue, Philadelphia, monitor and control gas flow and pressure from the nine city gate stations to the high pressure distribution system. The gas control dispatchers also provide direction to the production plant operators concerning startup, shutdown and gas flow output from the supplemental facilities. Operations are facilitated through the use of a computer system which includes a backup unit and an auxiliary power supply.

Propane/Air Facilities. The propane/air facility exist at the Passyunk location only and has air compression and propane vaporization capacity to produce 60,000 Dekatherms ("dt") of propane/air mix per day with a liquid propane storage capacity of approximately 662,250 gallons. This facility has been idle since 1994 due to PGW removing this capacity from service. Its use is not anticipated in the current six-year gas supply projection.

Gas Holder Storage Facilities. The Richmond Plant has a low pressure gas holder. The Passyunk holder has been removed from service. The Richmond holder has an operating capacity of 1,000 Mcf. It was installed in the manufactured gas era and is in working order. It is used to enhance operational flexibility of the LNG Plant.

LNG Facilities. There are two LNG facilities, the Richmond Plant and the Passyunk Plant. The smaller LNG storage and vaporization facility at the Passyunk Plant receives its liquefied gas supply from the larger Richmond Plant via cryogenic trailer trucks. The Passyunk LNG facility consists of one LNG storage tank of 3,066,000 gallons gross capacity (i.e., the equivalent of 253,300 thousand cubic feet ("Mcf") of natural gas) and two LNG vaporizers, each having a capacity of 45,000 Mcf per day resulting in 45,000 Mcf per day planned capacity and 45,000 Mcf per day reserve.

The Richmond LNG plant is one of the largest liquefaction facilities in the United States and also includes storage and vaporization facilities. The existing facilities have a liquefaction capability of 23,500 Mcf per day and only liquefy during the non-winter months. The existing liquefaction facilities utilize a modified cascade process installed in the late 1960's. During the summer of 2001, PGW contracted for construction on the first phase (Phase 1) of a new liquefaction facility to be built in two phases utilizing an open expanded loop technology at a contracted price of \$14 million. This technology utilizes energy from the high transmission delivery pressure of the interstate pipeline system throughput to run the turbines, significantly reducing fuel requirements. In addition, these facilities will have the capability to liquefy natural gas year round providing greater operational flexibility. Further, this technology utilizes significantly fewer components than the older facilities and should result in lower operation and maintenance costs.

The new Phase 1 facilities contracted in 2001 had been delayed in commissioning because the new facilities did not meet the required operating capability. However PGW has worked with the general contractor (Chicago Bridge & Iron Company, "CBI") and its subcontractor, the component manufacturer (Air Products & Chemicals Inc.), to correct the problems with the equipment. The facilities are now functional and PGW is negotiating terms of final acceptance with CBI. The tested operating capability of the new facility is in the range of 16,000 to 18,000 Mcf per day, depending on feed gas specifications. The maximum capability of Phase 1 facilities of 18,000 Mcf per day will not be available at all times during the summer months because the demand on the PGW system is not sufficient to create the throughput necessary to run at this capability. PGW's projected capital improvement expenditures for Gas Processing decrease to \$2.3 million in 2006. PGW has removed any further investment for Phase 2 LNG facilities from its six-year capital improvement program pending its negotiations with a LNG terminal operator, as discussed below. Most of the currently budgeted funds will be used to replace equipment at the existing facilities in order to extend the life of the facilities to 2010.

PGW issued a request for proposals ("RFP") in November 2004 to utilize the Richmond LNG facility as a terminal to receive LNG from tanker ships. The layout of the existing facilities and its location near the Delaware River were factors reflected in the original design of the facility anticipating this possibility at some future date. The purpose of the RFP was to find a company that would work in concert with PGW to build and operate the receiving facility. The LNG would then be either stored in the Richmond LNG storage facilities or vaporized and placed into PGW's distribution system or other nearby interstate pipeline systems. As currently planned, this project will not require capital expenditures by PGW and could be a significant ongoing source of revenue.

PGW received proposals in January 2005 and has completed its evaluation of the proposals. PGW is currently negotiating with a developer and hopes to announce the developer in early 2006. If negotiations continue to progress, PGW expects that commissioning of the terminal port would happen no sooner than Fiscal Year 2010. PGW will not continue to undertake this project unless it leads to lower operating costs, lower gas costs, and/or some other form of compensation to PGW. The Independent Consultant's Report does not reflect any impact of this project either in terms of capital improvements, operating costs, cost of gas, or revenues.

The following are some of the benefits that might be realized by PGW:

1. A significant payment by the third party for the rights to use PGW's site and facilities. This enhancement of PGW's commercial revenues is an important supplement to the existing revenue base.

2. The ability of PGW to release upstream interstate pipeline and storage capacity. This release would take the form of PGW retaining ownership of that capacity and selling it on the open market or permanently returning the capacity when PGW's contracts expire. This could result in a significant reduction in PGW's fixed gas supply costs.
3. The significant reduction in PGW's need to liquefy natural gas because PGW would be able to receive LNG from the terminal, the liquefaction facilities could serve as a back-up. This could reduce operating and maintenance costs at the Richmond Plant.
4. By supplying a large volume of natural gas into this region, there is the possibility for a more stable and lower cost for the commodity cost of gas, the single largest component of the overall cost charged to customers.

The vaporization and storage facilities at the Richmond Plant are not affected by the new liquefaction facilities. The storage tanks at the Richmond Plant have a combined gross capacity of 48,970,000 gallons of LNG (4,045,800 Mcf). Regasification of the liquid natural gas is accomplished with six vaporizers having a total output of 411,000 Mcf per day plus 100,000 Mcf per day in reserve. The Richmond Plant also has facilities to receive LNG from and deliver LNG to cryogenic trailer trucks.

Distribution Facilities. The principal gas distribution facilities consist of approximately 3,013 miles of main, 494,349 service lines, 206 regulator stations, approximately 575,500 meters (of which approximately 500,200 are active) and miscellaneous valves, instruments and other appurtenances. PGW operates five different operating pressure systems; each system is connected to the others by control regulators. The high-pressure systems operate at approximately 110, 60 and 35 pounds per square inch gauge (psig); the intermediate pressure system operates at 5 psig; the low-pressure system operates between 6 and 9 inches of water column (approximately 0.25 pounds per square inch). The majority of customers are served from the low-pressure system.

Approximately 55 percent (by length) of the gas mains are cast iron, 33 percent are steel, 5 percent are ductile iron, and 7 percent are plastic. Of the steel mains, approximately 49 percent are wrapped, coated, and cathodically protected. Approximately 45 percent of the service lines are steel (of which 15 percent are protected) and 55 percent are plastic.

Other Facilities. PGW has its executive and operating offices located at 800 West Montgomery Avenue, which is a 150,000 square foot office building constructed in 1988. The former general office building, located at 1800 N. 9th Street, houses administrative operations in addition to distribution and field service dispatch centers, Gas Control dispatching, a customer information center, operating stations, a post office, duplicating center, radio repair shop, training facilities, parking facilities, telecommunication and warehousing, as well as information systems center and a metal fabrication shop. Additional facilities include five district offices, Tioga station for Distribution crews, two LNG plants, and three operating stations for field service crews. There are also five other warehousing facilities, a meter shop, and an automotive maintenance and repair facility. The automotive maintenance and repair facility is responsible for the upkeep of PGW's fleet of approximately 1,000 vehicles and related equipment. PGW also maintains three minor automobile repair facilities, bulk fuel dispensing equipment, and materials and supplies.

Environmental Matters

PGW's operations and facilities are subject to federal, state and local environmental requirements, including the need to obtain certain permits and approvals. Because these requirements are subject to change, additional or different requirements may be imposed upon PGW in the future. No assurances can be given that PGW would be able to comply with any such changed or new requirements, or that compliance with such requirements would not materially increase PGW's capital or operating costs, or have a material adverse effect on Gas Works Revenues.

Like many providers of utility services throughout the northeastern United States, PGW has been in operation for more than 100 years, and many of its facilities were built decades ago. As a result of preliminary internal environmental evaluations of its facilities, PGW believes that several PGW facilities, which had been used

in gas manufacturing, contain contaminants from those operations or from other sources, and that certain equipment and fixtures that PGW removed from service years ago may no longer comply with current environmental requirements. In order to address these issues, PGW and the City voluntarily approached the Pennsylvania Department of Environmental Protection ("PADEP") and proposed to resolve these issues under PADEP's Land Recycling Program.

PGW has determined the extent to which it is necessary to remediate environmental conditions impacting its facilities through environmental site assessment studies that were conducted by Weston Solutions, Inc. ("Weston") on relevant properties in 2003 and 2004. In 2004 PGW received a set of five remedial investigation reports by Weston that were based upon the findings of the environmental site assessment studies. Based on the reports developed by Weston, PGW submitted Notice of Intent to Remediation ("NIR") Forms with copies of the five Weston reports to the PADEP for review at the end of 2004. In early 2005 PGW conducted a series of public meetings to inform the public of PGW's upcoming remediation projects, and also to address any specific concerns raised by local residents regarding PGW's future remediation plans.

PGW has developed a schedule to address and conduct any necessary remedial work for impacted PGW properties over the next five years. PGW expects that this will provide PGW with allocated resources in a manner calculated to avoid any material adverse effect on PGW or on PGW's revenues. Nevertheless, until a definitive schedule is finalized with the PADEP, it is not possible to determine with quantifiable certainty what the costs of any remediation will be and whether such costs would have a material adverse effect on PGW or on PGW's revenues. Preliminary indications are that PGW expenditures may be in the range of \$15 to \$20 million over the next five years. These estimates are subject to substantial revision. PGW has allocated \$15 million for estimated future environmental costs. PGW is pursuing recovery for remediation against environmental insurance policies.

Gas Supply and Federal Regulation

In 1992, the Federal Energy Regulatory Commission ("FERC") issued Order 636 which restructured the interstate pipeline industry to provide non-discriminatory, open-access to all transporters. All interstate pipelines regulated by the FERC were required to exit the gas supply business as a result of Order 636. The interstate pipelines were historically permitted by the FERC to pass through, on a dollar-for-dollar basis, all of their gas supply costs to the pipelines' customers. Therefore, the revenues of the pipelines pledged to their bonds remained unchanged by Order 636 simply because of the historical pass-through nature of the pipelines' gas supply costs.

In the restructured, unbundled marketplace resulting from Order 636, PGW had to contract individually for its gas supply, storage and transportation requirements on the pipelines. PGW now has in place firm year round and seasonal contracts for natural gas supply for its firm requirements. Further, it has contracted for natural gas storage services with four different pipelines operating storage facilities. This permits, among other things, the injection of summer supply and its storage and subsequent withdrawal to meet higher winter demands of its firm heating customers. Finally, it has contracted for firm transportation service with the two directly connected pipelines, as well as with the necessary upstream pipelines feeding these pipelines, to deliver all volumes purchased, together with those volumes withdrawn from storage.

The two interstate pipelines delivering natural gas to PGW have limited delivery capacity and cannot meet PGW's peak-day or winter season requirements. Therefore, PGW owns and operates supplemental LNG facilities to meet incremental demand in excess of flowing gas and underground storage supplies. PGW's supplies of natural gas and LNG are adequate to meet its projected demand under either normal or design (colder than normal) conditions in the future.

Competition

PGW is subject to the Natural Gas Choice and Competition Act No. 1999-21, PL. 122, 66 Pa. C.S. Section 2201 et seq. (the "Gas Choice Act"). Pursuant to the Gas Choice Act, PGW filed for restructuring on July 1, 2002 and PGW customers have the option of choice among natural gas suppliers on and after September 1, 2003. See the section below titled "EFFECTS OF NATURAL CHOICE AND COMPETITION ACT" for a full discussion of the Gas Choice Act's impact on competition. PGW competes to supply natural gas to interruptible customers who are capable of

switching to alternative fuels, including fuel oil, steam, propane and electricity. PGW also competes to supply natural gas to transportation customers who might seek to buy gas from a competitive natural gas supplier and use PGW's distribution system for transportation of that gas. PGW has negotiated contracts with such customers. In addition, PGW's rate schedules offer gas transportation service, on both a firm and interruptible basis, to potential customers. PGW also has Boiler and Power Plant Services ("BPS") and Load Balancing Service ("LBS") interruptible sales rates that permit discounts to compete with alternative fuels, provided that the rate per Mcf is not less than 110% of the avoided gas costs for gas sold under these rate schedules.

Insurance

PGW is exposed to various risks of loss related to: torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. While self-insured for many risks, PGW purchases insurance coverage where appropriate. PGW's property is insured against the risk of loss or damage, without aggregate limits, in the amount of \$250,000,000 per occurrence with a \$100,000 retention (deductible) generally and a \$500,000 retention for losses at the Richmond and Passyunk Plants. There is an annual aggregate limit of \$50,000,000 for earthquake and an annual aggregate limit of \$50,000,000 for flood generally, and lower flood limits as to the Richmond LNG Plant. PGW's property insurance includes coverage for damages incurred from a terrorist attack. In addition, PGW maintains boiler and machinery, blanket crime, and other forms of property insurance.

PGW maintains \$210,000,000 in liability (including terrorism) coverage insuring against the risk of damage or injury to the public with a \$500,000 deductible per occurrence. PFMC and PGW are both insured under the same liability policies insuring against risk of damage or injury to the public. In the instance in which PGW and PFMC have potential liability, PGW will defend against the actions and make settlements on behalf of PGW and PFMC with respect to losses incurred by PGW and PFMC up to \$500,000.

PGW is a qualified self insured in the Commonwealth of Pennsylvania for workers' compensation. In addition, PGW maintains excess workers' compensation liability coverage up to \$35,000,000 with a \$500,000 per occurrence retention. Above that is another layer of coverage for statutory limits which means that regardless of the size of the loss, the policy will pay whatever PGW must pay.

PGW maintains Public Officials (Directors and Officers) liability coverage with a \$10,000,000 annual aggregate limit and a \$500,000 retention.

Litigation

In the ordinary course of their business operations, PGW and/or PFMC are from time to time sued or threatened with litigation. Most frequently such litigation alleges property damage or personal injury to third parties. However, other forms of litigation also arise from time to time. PGW is aware of no litigation pending or threatened in which a final adverse determination, singly or in the aggregate, would have a material adverse effect on PGW's operations or financial condition. PGW believes it has set aside sufficient reserves to meet liabilities arising out of litigation to the extent not covered by insurance. See "PHILADELPHIA GAS WORKS - Litigation Relating to the Gas Choice Act" below.

Effects of the Natural Gas Choice and Competition Act

In June 1999, the Legislature enacted and the Governor approved the Gas Choice Act, which amended the Public Utility Code by providing for the implementation of choice of suppliers of natural gas for all retail customers of gas distribution companies. The Gas Choice Act requires each natural gas utility under Pennsylvania Public Utility Commission ("PUC") jurisdiction (including PGW) to "unbundle" and establish separate charges for natural gas supply services and natural gas distribution services. It provides that each natural gas distribution utility will file a restructuring proceeding with the PUC and, in the context of that proceeding, the utility's tariff has been revised to reflect the unbundling referred to above and to implement customer choice. In addition, the Gas Choice Act provided that PGW is subject to regulation by the PUC effective July 1, 2000, and directed that PGW file for restructuring of the rates. PGW filed for restructuring on July 1, 2002. Most issues related to restructuring

proceeding were resolved by September 1, 2003, and PGW customers have the option of choice among natural gas suppliers effective September 1, 2003 as explained above in the section titled "PHILADELPHIA GAS WORKS - Competition." PGW will continue to be the supplier of last resort for retail customers who do not choose another gas supplier in most instances, unless, upon petition of PGW, the PUC approves an alternative supplier of last resort or, after July 1, 2004, the PUC approves a petition from a party to serve in that capacity for certain groups of customers. As of September 1, 2005, no party has petitioned the PUC to serve as an alternative supplier of last resort.

Notwithstanding the initiation of customer choice in gas suppliers, PGW's gas distribution business remains a regulated monopoly. After the initiation of gas choice, customers may purchase gas from other natural gas suppliers or choose to continue to buy natural gas from PGW. Whomever consumers choose as their supplier, all customers continue to receive their gas through PGW's distribution system of mains and pipes to homes and businesses, and continue to pay a distribution charge to PGW for that service. PGW continues to provide gas to its customers that elect PGW as their supplier and to those who cannot obtain natural gas from an alternate supplier.

The structure of the unbundled services and the rates for each service are set forth in PGW's restructured tariff, which went into effect on September 1, 2003 (the "Restructuring Filing"). These unbundled rates are designed to realize the same level of margin revenues experienced by PGW prior to restructuring.

The Gas Choice Act contains provisions which are designed to (i) preserve the tax-exempt status of bonds or other obligations issued by the City for PGW, including the Bonds and (ii) preserve the ability of the City to comply with its covenants, including the City's covenants with respect to the imposition and collection of rates and charges, to the Holders of such bonds and other obligations, including the Bonds. The Gas Choice Act provides, among other things:

- As of July 1, 2000, PGW is regulated by the PUC and, except as otherwise provided in the Gas Choice Act, the provisions of the Public Utility Code apply to PGW and the PUC sets rates for PGW's customers.
- In setting rates and notwithstanding any other provision of the Public Utility Code, the PUC must permit PGW to impose, charge and collect rates or charges as necessary to permit the City to comply with its covenants to the Holders of any Approved Bonds, as defined in the Gas Choice Act. All bonds issued by the City on behalf of PGW under the Act, including the Bonds, are Approved Bonds.
- The PUC is obligated to use the same rate making methodology and requirements used by PGW until all Approval Bonds are repaid or defeased. The methodology employed by PGW is a "cash flow" method, not a "rate of return" method.
- The PUC is barred from requiring the City or PGW to take any action (or to omit taking any action) under the Public Utility Code if such action or omission would have the effect of causing the interest on any tax exempt bonds issued by the City, including the Bonds, to be includable in the gross income of the Holders of such bonds for federal income tax purposes.
- The PUC must continue the existing senior citizen discount for all individuals who are properly receiving the discount as of September 1, 2003. Although City Council has approved a means-tested senior citizen discount for senior citizens applying for the discount on or after September 1, 2003, the PUC subsequently denied PGW's request to implement the means-tested senior citizens discount. PGW filed an appeal of this issue with the Pennsylvania Commonwealth Court. The appeal is pending.
- Effective June 30, 2000, Gas Commission powers and duties were abrogated to the extent inconsistent with the Gas Choice Act.
- The City cannot be required to take any action under the Public Utility Code if the effect of the action is to cause a variance in the City's financial plan approved by the Pennsylvania Intergovernmental Cooperation Authority.

- The City's executive or legislative powers to "legislate or otherwise determine the powers, functions, budgets, activities and mission of PGW" are not abrogated or limited.

Litigation Relating to the Gas Choice Act

On January 24, 2000, three members of City Council, acting as residents of, and voters in, Philadelphia and as individual members of City Council, and the Chairperson of the Gas Commission (the "Petitioners") filed an action in Commonwealth Court against the Commonwealth of Pennsylvania and the PUC (the "Respondents") seeking to enjoin the implementation of the Gas Choice Act and seeking a declaration that the Gas Choice Act violates the Home Rule Clause of the Pennsylvania Constitution and the Contracts Clauses of both the Pennsylvania and the United States Constitutions. The Commonwealth of Pennsylvania and the PUC filed Preliminary Objections to the Petitioner's action on February 28, 2000. On September 12, 2002, the Preliminary Objections were sustained by the Commonwealth Court and the Petitioners' action was dismissed. The Commonwealth Court's ruling was appealed by the Petitioners on October 11, 2002 to the Pennsylvania Supreme Court. The Pennsylvania Supreme Court remanded the case back to Commonwealth Court on April 15, 2004 based upon a stipulation by the parties that "power over the Philadelphia Gas Works has been transferred to the Pennsylvania Utility Commission" and, as a result of this stipulation, vacated the Commonwealth Court's order granting PUC's Preliminary Objections on the basis that the matter was not ripe. Subsequently, the PUC filed Preliminary Objections requesting the PUC's dismissal from this proceeding. On February 18, 2005, the Preliminary Objections were sustained by the Commonwealth Court, thereby, dismissing the PUC from this action. The Commonwealth of Pennsylvania remains as the sole Respondent. There is no pending briefing schedule in place nor have any arguments been scheduled by the Court.

Senior Citizen Discount Program

PGW offers a senior citizen discount program to residential customers at age 65 or older. Currently, there is no means or income test for eligibility in this program. The discount amounts to approximately 20 percent of the total gas bill for the residence.

On September 30, 2004, the PUC denied PGW's request to continue the senior discount program for post-September 1, 2003 applicants. A request for reconsideration was denied. PGW has filed an appeal to the Commonwealth Court of Pennsylvania, which is pending. There are currently 55,000 "grandfathered participants". All current participants are "grandfathered" into the existing program and will continue to receive the 20 percent discount, unless the program is modified or ended pursuant to an ordinance enacted by the City.

Act 201 - "Responsible Utility Customer Protection Act"

In November 2004, the Pennsylvania Legislature passed and the Governor signed Act 201, entitled the "Responsible Utility Customer Protection Act". PGW may now shut off service to delinquent customers during the winter under certain conditions. To shut off service to non-low-income customers during winter months, PGW is no longer required to first obtain PUC permission. PGW may now require customers whose service has been shut off to pay past due bills arrange for a payment agreement, pay a reconnect fee, and/or pay a deposit before it restores service. The new law also permits PGW to hold any adult living in a home where service has been shut off accountable for all or part of an overdue balance before the adult can obtain service in his or her name.

Act 201 provides a number of other tools to help PGW collect payment. Under Act 201:

1. The time allowed to terminate service following shut-off notification was extended to 60 days.
2. Shut-off with notice is permitted if the customer does not pay a required deposit, does not follow through with payment arrangements or refuses to allow PGW access to its equipment.
3. Shut-off without notice is permitted for theft of service, obtaining service through fraud, tampering with a gas meter or unsafe service conditions.

4. Winter (December 1- March 31) termination is now permitted under specified conditions without PUC prior approval if the customer's household income exceeds 150 percent of the federal poverty level.

CITY GOVERNMENTAL OVERSIGHT

Gas Commission

The Management Agreement provides for a five member Gas Commission consisting of the City Controller, two members appointed by City Council and two members appointed by the Mayor, and vests in the Gas Commission the responsibility for overseeing the operation by PFMC of PGW. The City Controller holds office during his incumbency. The members appointed by the City Council and the Mayor each serve for terms of four years and hold office until their successors are appointed and qualified. The current members of the Gas Commission are listed below:

Marian B. Tasco, Chairwoman. Ms. Tasco currently represents the Ninth District in City Council. Ms. Tasco was appointed to the Gas Commission by City Council on August 2, 1992 and serves until a successor is appointed as chair.

Alan L. Butkovitz. Mr. Butkovitz is the City Controller of the City. Mr. Butkovitz has served as Controller and a member of the Gas Commission since January 2, 2006. Mr. Butkovitz's current term expires on January 3, 2010.

Juan F. Ramos. Mr. Ramos is an at-large member of City Council. Mr. Ramos was appointed to the Gas Commission by City Council on April 12, 2005 and serves until a successor is appointed.

Royal E. Brown. Mr. Brown was appointed to the Gas Commission by then Mayor Edward G. Rendell on August 8, 1996 and serves until a successor is appointed. Mr. Brown is Senior Director, Treasury Services, Independence Blue Cross.

Stephanie L. Franklin-Suber. Ms. Franklin-Suber is a partner in the law firm of Ballard Spahr Andrews and Ingersoll, LLP. She was appointed by Mayor John F. Street and was sworn in as a Commissioner on September 24, 2002. Ms. Franklin-Suber's current term expires September 23, 2006.

The Management Agreement grants the Gas Commission certain specified powers and duties and other powers not specifically granted to PFMC. The powers and duties granted to the Gas Commission include the fixing of PGW rates and charges (now the jurisdiction of the PUC), approval of personnel provided by PFMC, review of gas supply contracts for approval by City Council, approval of changes in tests and standards of gas quality and pressure, approval of PGW's operating budget, review of PGW's capital budgets and recommendations thereon to City Council, approval of certain loans (but not issuance of bonds), access to and review of all books, records and accounts of PGW, prescription of insurance requirements, promulgation of standards for procurement and disposal of material, supplies and services and approval of all real property acquisitions for further approval of City Council.

PGW BUDGET, RATES AND FINANCES

The revenues which PGW uses to pay debt service on its indebtedness and to fund its operations are derived primarily from the sale of gas and related services to its customers. Rate and tariff charges for the sale of gas services are proposed by PGW based on, among other factors, anticipated revenues and expenses, required working capital, required debt service coverage and need for funds for capital expenditures.

Budget Approval

The Management Agreement requires PGW to prepare an annual operating budget and an operating forecast for the three years following the budget year. The operating budget and forecast are subject to the approval of the Gas Commission. PGW also prepares annually a proposed capital budget and a forecast for the five years

following the budget year. The Gas Commission and the Director of Finance of the City review the capital budget and forecast and forward it, together with their recommendations, to City Council for its approval.

The Gas Commission holds public hearings on the budgets at which PGW and other interested parties are permitted to present evidence to support their position. Community Legal Services, Inc. was appointed by the Gas Commission in 1988 to serve as Public Advocate and continues to represent residential customers in budget proceedings. The Gas Commission considers a number of factors before determining whether to accept, modify or reject the budgets proposed by PGW. Based on its findings, the Gas Commission issues an order regarding the operating budget. The capital budget and forecast are reviewed by the Director of Finance of the City and by the Gas Commission, and are forwarded to City Council for approval. The Gas Commission order regarding the operating budget and the City Council ordinance regarding the capital budget may direct PGW to reduce expenses in certain areas or increase spending on certain items or to undertake specific projects. This process remains unchanged after passage of the Gas Choice Act which provides that the City continues to determine PGW's budget function.

Rates and Charges

The rates charged by PGW for providing gas service are subject to various statutory provisions. The 1975 General Ordinance, the 1998 General Ordinance, the 2005 Note Ordinance and the Management Agreement, the complete text of which was authorized by ordinance, each contain a rate covenant. See APPENDIX D for further descriptions of the 1975 General Ordinance and the 1998 General Ordinance. PGW's rates are also subject to regulation under the Public Utility Code by virtue of the Gas Choice Act.

Section 2212(b) of the Public Utility Code transferred rate setting authority for PGW from the Gas Commission to PUC, effective July 1, 2000. Section 2212(e) of the Public Utility Code requires the PUC, notwithstanding any other Public Utility Code provision, to follow the "same ratemaking methodology and requirements" that were applied by the Gas Commission, when determining PGW's revenue requirements and overall rates and charges. The Gas Choice Act requires the PUC to follow that ratemaking methodology until all "approved bonds have been retired, redeemed, advance refunded or otherwise defeased." Approved Bonds are those obligations issued in accordance with the Act or the Inventory and Receivables Financing Act and which were outstanding as of July 1, 2000, or which are issued on or after July 1, 2000, unless City Council declares such bonds not to be "approved." All 1975 Ordinance Bonds and 1998 Ordinance Bonds are Approved Bonds. As discussed below, the PUC, in its September 21, 2001 Order confirmed PGW's ratemaking methodology by stating, "That, in accordance with Section 2212(e) of the Gas Choice Act, we herein set rates for Philadelphia Gas Works in accordance with its previous ratemaking methodology and requirements. In this instance, Philadelphia Gas Works' previous ratemaking methodology, as contained in its Management Agreement and affirmed by the Pennsylvania courts, is the cash flow method."

As acknowledged by the PUC in its September 21, 2001 Order, the specific elements of PGW's "prior ratemaking methodology and requirements" are set forth in the Management Agreement. The Management Agreement directs the Gas Commission to fix rates and charges which, together with Project Revenues, will in each Fiscal Year produce revenues sufficient, at a minimum:

- (a) to pay all the operation and maintenance costs and expenses of PGW, including but not limited to, depreciation, employee retirement costs and a management fee to PFMC equal to the actual costs of PFMC in managing PGW, to pay expenses of the Gas Commission, to pay debt service (including sinking fund deposits) becoming due in such Fiscal Year on debt incurred for PGW and to meet applicable rate covenants and sinking fund reserve requirements;
- (b) to make annual payments to the City in the aggregate principal amount of \$18 million;
- (c) to provide appropriations for debt reduction and capital additions not otherwise provided which are determined by the Gas Commission to be reasonable and which are approved by City Council; and

- (d) to provide reasonable additions to working capital as may be determined by PFMC and approved by the PUC.

The Management Agreement provides that, for purposes of complying with such rate requirements, the amount of operating expenses which do not represent an actual outflow of funds (e.g., depreciation) may be included in determining whether revenues are sufficient to meet other costs, expenses and requirements. Further, Section VII, 1(c) of the Management Agreement obligates rates to be set to comply with the covenants of PGW's bonds and commercial paper program.

Section 2212(e) of the Public Utility Code also states that, notwithstanding any other provision of the Public Utility Code, the PUC is required to set PGW's rates to permit the City to comply with its covenants to the Holders of any Approved Bonds. There are three bond covenants that are relevant with respect to establishing PGW's revenue requirement: a) a covenant that requires PGW to produce net revenues at least equal to 150% of the annual debt service obligation; b) a covenant that requires PGW and its owner, the City of Philadelphia, to charge rates that permit PGW to have sufficient cash to pay all of its third party obligations, including its debt service obligations, during each Fiscal Year in full when they are due; and c) a covenant that requires PGW and the City to continuously maintain and operate PGW's gas works system.

In regulating PGW, the PUC is further required by Section 2212(f) of the Public Utility Code to permit PGW to impose, charge and collect rates and charges as necessary to make its annual payment to its owner, the City of Philadelphia. Additionally, the PUC has stated in its September 21, 2001 Order, "Thus, we conclude that PGW's payment of \$18 million to the City of Philadelphia should be included in its rates requested in this proceeding."

PGW recovers its costs through various mechanisms (discussed below) reflected in its tariff. Changes in the cost of raw materials, primarily natural gas costs, are reflected in rates embodied in a Gas Cost Rate ("GCR"). Discounts provided to low income customers and senior citizens are recovered in a separate Universal Service Charge. The remainder of PGW's costs, including debt service payments, operating expenses (other than costs covered in the GCR) and the annual payment to its owner, the City of Philadelphia, are recovered in PGW's base rates, either through monthly customer charges or volumetric charges.

PGW's base rates are set, in accordance with the Cash Flow method, to enable PGW to recover a normal level of expenses and annual obligations, together with an allowance for cash working capital or liquidity. In PGW's most recent rate proceedings, the PUC authorized rates that produced debt service coverages that complied with PGW's 1998 General Ordinance and 1975 General Ordinance requirements and produced revenues sufficient to provide coverage of all obligations including the Base Payment. Any resulting rate increase is then recovered by increases in the customer or volumetric charges of the various classes of customers taking service from PGW.

Gas Cost Rate

PGW's largest expense item is the cost of the natural gas delivered into its distribution system. Prior to industry restructuring mandated under FERC Order No. 636, the cost of bundled pipeline sales service was reviewed and approved by FERC.

Currently, changes in these costs are recovered on a dollar for dollar basis through the operation of the GCR as authorized by the PUC. PGW's tariff permits PGW to charge annual projected changes in natural gas costs in its GCR factor, after review and approval by the PUC. The GCR is designed to permit PGW, on an annual or quarterly basis, to adjust its gas cost charge to firm sales customers to approximate its actual cost of natural gas. PGW calculates its anticipated annual cost for natural gas and allocates that cost to its customers on a level basis for payment during the Fiscal Year. GCR collections are then matched against actual costs for the year to date, and the GCR is adjusted annually or quarterly if necessary, to credit or charge customers in the upcoming period for overpayment or underpayment of natural gas costs to date.

Base Rate Filings

Permanent Base Rates. Base rates for PGW are established, using the Cash Flow method, to produce a targeted amount of revenue for PGW based on various assumptions, such as normal weather conditions and a projected and normalized level of revenues, expenses, capital expenditures and required working capital. Base rates in effect at any time cannot be modified by PGW except pursuant to a proposed rate filing by PGW for new base rates, and only to the extent such proposed modification is approved by the PUC for implementation on a going forward basis.

Prior to passage of the Gas Choice Act transferring rate setting authority for PGW from the Gas Commission to the PUC, PGW's last base rate increase was approved by the Gas Commission in December 1991 to generate an additional \$15.0 million of annual revenue.

On January 5, 2001, PGW filed a proposal with the PUC to permanently increase its base rates by \$65 million annually. By a PUC order entered on December 6, 2001, PGW was awarded total permanent rate relief of \$33,558,000, including \$11,000,000 of rate relief that the PUC had granted on an interim basis in February 2001.

On February 25, 2002, PGW filed a proposal with the PUC to permanently increase its base rates by an additional \$60 million annually. Additional permanent base rate relief of \$36 million was approved by the PUC on August 8, 2002. This \$36 million of base rate relief had initially been approved by the PUC on an interim basis by order entered April 12, 2002, as part of PGW's request for extraordinary rate relief. As a result, the \$36 million was effective on April 12, 2002. In total, since becoming regulated by the PUC, PGW has been granted \$69.6 million in permanent rate relief since February 2001.

Weather Normalization. Under the Pennsylvania Public Utility Code, when filing for rate relief, PGW's proposed rates must be based upon "normal" weather, which is defined as the average temperature for the past thirty years. During four out of the last five winters, Philadelphia has experienced temperatures that are warmer than the thirty year average. As a result, PGW did not recover the level of margin revenue anticipated in its prior rate relief filings. As part of its February 25, 2002 base rate filing, PGW proposed a Weather Normalization Adjustment (the "Adjustment" or "WNA") and this Adjustment was approved on August 8, 2002 by the PUC. The purpose of the approved WNA is to neutralize the impact of weather on PGW's revenues and enable PGW to achieve the recovery of appropriate costs as authorized by its regulatory body.

With the approval of the WNA, PGW will be able to realize the same level of margin revenues during warmer than normal winters as it would realize during normal winters. Conversely, during colder than normal winters, PGW will be prevented from recovering margin revenues in excess of those anticipated in its most recent rate filing. The WNA was implemented during the winter of 2002-2003. The PUC determined that PGW's WNA would be put in place for an initial three-year period, which expired on October 31, 2005. PGW conducted a review of the costs and benefits of the WNA and determined that although it refunded a net amount of \$8 million to its customers, the program eliminates the risk of underrecovering its approved margin in a warmer than normal season and therefore have proposed to continue the WNA without change. PGW is currently in the process of presenting its conclusions regarding the WNA to the PUC with a request that the PUC acknowledge that the WNA should continue in place. Because PGW's WNA tariff has no sunset provision, the WNA will continue in place unless the PUC issues an order directing that it be discontinued. PGW cannot predict when the PUC will complete its review of PGW's WNA.

Restructuring's Effect on PGW Rates

Consistent with the requirements of the Gas Choice Act, as of September 1, 2003, PGW has provided service pursuant to unbundled tariff terms and conditions of service. The principal changes that occurred were: 1) the rates of all PGW customers are separated into a distribution component and a natural gas commodity component; 2) as of September 1, 2003, all customers have the right to purchase natural gas from an alternative natural gas supplier (provided that alternative natural gas supplier(s) enter the marketplace), but are required to utilize PGW's distribution system to deliver the commodity to the customer's meter; 3) PGW will provide certain services to suppliers, for a tariffed charge, to facilitate the supplier's sale of natural gas to customers and the delivery of gas

supply to PGW's city gate; and 4) PGW is the Supplier of Last Resort for all residential, small commercial and industrial and human needs customers who do not take service from an alternative natural gas supplier.

The rate unbundling and choice options available as of September 1, 2003 were designed by PGW to be revenue neutral such that PGW's earnings levels will not change as a result of restructuring.

PGW was also required as part of its restructuring filing, and has so filed with the PUC, a plan to come into compliance with all applicable PUC rules and regulations (i.e. PGW's Compliance Filing on September 1, 2003). The Gas Choice Act also establishes that any incremental costs that PGW incurs in complying with new regulatory requirements may be recovered in a non-bypassable surcharge to be embedded in PGW's base rates. As of September 1, 2003, PGW charges incremental restructuring costs in a Restructuring Surcharge which is charged to all firm customers on a non-bypassable basis and is reconcilable so as to result in dollar-for-dollar recovery. Additionally, on September 30, 2004, the PUC denied PGW's request to continue the senior discount program for post-September 1, 2003 applicants. A request for reconsideration was denied and PGW has filed an appeal to the Commonwealth Court of Pennsylvania, which is pending. There are currently 55,000 "grandfathered participants". All current participants are "grandfathered" into the existing program and will continue to receive the 20 percent discount unless the program is modified or ended by the enactment of an ordinance by the City.

Capital Improvement Program

Net proceeds of revenue bond sales (other than sales of refunding bonds) are placed into restricted segregated accounts for the Capital Improvement Program and are requisitioned for expenditures as required for the Capital Improvement Program or to reimburse PGW for expenditures made in advance of issuance of bonds. For use of the proceeds of the Bonds, see "PLAN OF FINANCE AND ESTIMATED SOURCES AND USES OF FUNDS." PGW determines its capital improvement requirements from projected customer additions, pipeline gas availability, peak day gas requirements, enforced relocation due to highway and bridge construction and the need to maintain its plant and equipment in a safe, adequate and reliable manner. For further discussion of the Capital Improvement Program, see "FISCAL YEAR 2005 AND 2006 CAPITAL BUDGET AND FORECASTS" below and APPENDIX B - "Independent Consultant's Engineering Report."

The following table represents information regarding actual net capital expenditures for each of the five Fiscal Years 2001-2005:

PHILADELPHIA GAS WORKS CAPITAL EXPENDITURES* (DOLLAR AMOUNTS IN THOUSANDS) (FISCAL YEAR ENDED AUGUST 31)

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Gas Processing	\$14,256	\$10,074	\$4,864	\$10,597	\$5,008
Distribution	34,043	34,478	43,041	40,096	43,572
Field Services	5,080	8,027	5,694	3,266	5,288
Information Technology	1,428	2,804	5,499	3,317	8,026
Other	<u>2,617</u>	<u>2,096</u>	<u>1,793</u>	<u>3,395</u>	<u>5,016</u>
Total ⁽¹⁾	\$57,424	\$57,479	\$60,891	\$ 60,671	\$ 66,910
Capital Fund Drawdowns	<u>55,356</u>	<u>53,778</u>	<u>61,000</u>	<u>55,601</u>	<u>68,000</u>
Other Funding Sources (Uses) for Capital Expenditures	\$2,068	\$3,701	\$(109)	\$ 5,070	\$(1,090)

* This information was obtained from PGW's historical records.

⁽¹⁾ Net of reimbursements, contributions and salvage.

Other Funding Sources

PGW provides for a portion of capital costs to be funded through the use of internally generated funds. Internally generated funds consist of net revenues after payment of City Charges. See "PGW BUDGET, RATES AND FINANCES - Debt Service Coverage Ratio." A decline in net revenues reduces internally generated funds and requires that the shortfall be funded from the issuance of bonds or other indebtedness or the incurrence of capital leases. In Fiscal Years 1999-2005, PGW provided \$9,640,000 of other funding sources of actual capital expenditures.

Fiscal Year 2006 Operating Budget

On June 1, 2005, PGW filed its Fiscal Year 2006 Operating Budget. The PGC conducted hearings concerning this budget in July 2005. Briefs were filed on August 8, 2005. The Hearing Examiner issued a Recommended Decision on August 24, 2005, providing Operating Budget adjustments for consideration by the Commissioners. The net effect of the recommended expense adjustments was approximately \$1,483,000. PGW and Public Advocate filed Exceptions to the Recommended Decision on September 2, 2005. The final Commission Motion approving the Fiscal Year 2006 Operating Budget was passed on December 13, 2005.

Fiscal Year 2005 and 2006 Capital Budget and Forecasts

PGW's Fiscal Year 2005 Capital Budget was originally approved by City Council in the amount of \$58,652,000. Later, a budget amendment in the amount of \$5,295,000 was approved by City Council, increasing the Fiscal Year 2005 Capital Budget authorization to \$63,947,000.

On March 1, 2005, PGW filed with the Philadelphia Gas Commission ("PGC") its Fiscal Year 2006 Capital Budget requesting spending authorization in the amount of \$65,868,000. The PGC's review of the filed budget culminated in deliberations whereby the Gas Commission endorsed a proposed Fiscal Year 2006 Capital Budget in the amount of \$63,669,000. Subsequent to this approval, on June 29, 2005 PGW filed a request for endorsement of two additional projects, increasing the budget by \$950,000. On September 20, 2005 the Commission endorsed this request, increasing the budget to \$64,619,000. The budget was submitted to City Council for approval, which was granted on November 3, 2005. The budget bill was signed by the Mayor on November 17, 2005.

During Fiscal Year 2006, PGW projects net capital expenditures of approximately \$65,751,000, with an additional \$330,086,000 forecasted for the five year forecast period. Approximately 79% of Fiscal Year 2006 capital expenditures are for Distribution, Field Services, and Gas Processing Department projects.

Over the five year forecast period, approximately 88% of PGW's capital expenditures are in Gas Processing, Distribution, and Field Services. These expenditures will support new and replacement main and services and meter and regulator facilities, as well as projects to maintain PGW's gas processing facilities in proper condition.

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Selected Operating Data

The following data is based upon PGW's historical records.

SELECTED OPERATING DATA

	FISCAL YEARS ENDED AUGUST 31				
	2001	2002	2003	2004	2005
Summary of Customers at End of Period					
Residential	485,393	475,649	471,778	471,941	470,758
Industrial and Commercial:					
Firm	26,190	26,033	25,959	26,243	25,990
Interruptible	476	477	480	470	397
Municipal and PHA	2	2	2	2	2
Total Customers	512,061	502,161	498,219	498,656	497,147
Gas Sales By Classification (Mmcf)					
Residential:					
Heating	44,060	34,210	45,345	40,826	39,033
Non-Heating	2,168	1,763	2,109	1,951	1,955
Industrial and Commercial:					
Firm	12,518	9,937	12,428	11,543	11,156
Interruptible	5,988	6,429	6,094	4,103	4,510
Other	145	1,147	2,428	1,796	1,573
Total Gas Sales & Transport	64,879	53,486	68,404	60,219	58,227
Supply & Disposition of Gas (Mmcf)					
Natural Gas Purchased	65,245	61,714	70,518	64,244	65,695
Liquefied Natural Gas	3,612	1,242	3,335	2,609	2,199
Total Gas Supply	68,857	62,956	73,853	66,853	67,894
Deduct:					
Additions to (Withdrawals) from					
Gas Storage	(4,715)	1,211	(2,347)	290	2,457
PGW's Use and Other	8,693	8,259	7,796	6,344	7,210
Total Gas Sales	64,879	53,486	68,404	60,219	58,227
Average Monthly Usage of Residential Customers (Mcf):					
Heating	8.5	6.7	8.9	8.0	7.6
Non-Heating	2.7	2.2	2.8	2.6	2.7
Average Monthly Bill Of Residential Customers:					
Heating	\$95.87	\$72.54	\$100.59	\$104.57	\$110.68
Non-Heating	\$38.15	\$33.07	\$41.72	\$45.00	\$49.09
Degree Days	4,505	3,462	4,794	4,287	4,327
Percentage of Normal (4,555) Degree Days	99%	76%	105%	94%	95%
Maximum 24-Hour Sendout (Mcf)	520,086	459,593	616,928	620,413	591,133
Peak-day Average Temperature (Degrees)	20	27	16	13	15

Summary of Statements of Income and Expenses

Information for each of the Fiscal Years ended August 31 should be read in conjunction with and was derived from the audited financial statements and notes thereto.

	(Dollar Amounts in Thousands)				
	Fiscal Years Ended August 31				
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Operating Revenues					
Residential:					
Heating	\$495,119	\$371,543	\$513,250	\$534,406	\$565,533
Non-Heating	31,084	26,084	31,571	33,159	35,537
Industrial and Commercial:					
Firm	151,624	107,033	146,387	159,977	171,838
Interruptible	40,075	33,819	39,390	32,404	44,678
Gas Transportation	2,354	2,788	2,559	2,945	4,679
Other Gas Revenues (Municipal, Philadelphia Housing Authority ("PHA"), Unbilled Revenues and GCR Adjustment)	(1,331)	20,685	33,378	20,465	8,285
Appliance & Other	12,075	10,276	11,669	10,065	10,895
Total Gas Revenues	<u>\$731,000</u>	<u>\$572,228</u>	<u>\$778,204</u>	<u>\$793,421</u>	<u>\$841,445</u>
Other Operating Revenues	19,046	21,269	18,956	18,889	21,912
Total Operating Revenues	<u>\$750,046</u>	<u>\$593,497</u>	<u>\$797,160</u>	<u>\$812,310</u>	<u>\$863,357</u>
Operating Expenses					
Natural Gas & Raw Material	\$431,327	\$303,807	\$427,436	\$450,868	\$509,704
Gas Processing	13,400	13,912	16,952	17,284	18,584
Field Services	33,202	29,266	29,906	29,557	28,455
Distribution	14,837	13,791	16,804	15,778	15,115
Customer Activities	98,537	81,533	117,016	105,417	104,194
Administrative & General	53,000	58,072	61,186	64,670	60,995
Pensions	2,301	8,496	13,013	14,973	14,702
Taxes, other than income	6,299	6,947	7,941	6,638	6,218
Depreciation	31,840	31,353	31,181	33,966	35,045
Total Operating Expenses	<u>\$684,743</u>	<u>\$547,177</u>	<u>\$721,435</u>	<u>\$739,151</u>	<u>\$793,012</u>
Operating Income	\$65,303	\$46,320	\$75,725	\$73,159	\$70,345
Interest and Other Income	12,343	15,400	3,753	3,580	4,778
Write-Off of SNG Plant	(8,087)	-	-	-	-
Income before Interest Expense	<u>\$69,559</u>	<u>\$61,720</u>	<u>\$79,478</u>	<u>\$76,739</u>	<u>\$75,123</u>
Interest Expense	58,405	58,709	56,728	59,580	63,851
Net Income (Loss) ⁽¹⁾	<u>\$11,154</u>	<u>\$3,011</u>	<u>\$22,750</u>	<u>\$17,159</u>	<u>\$11,272</u>

(1) Net Income (Loss) is before payment of the \$18,000,000 Base Payment portion of City Charges.

Debt Service Coverage Ratio

The annual operating budget approved by the Gas Commission estimates the level of revenues required to reach at least the minimum debt service coverage ratio mandated by the 1975 General Ordinance and the 1998 General Ordinance. The following table presents historical revenue and debt service coverage calculated under the 1975 General Ordinance and the 1998 General Ordinance.

HISTORICAL REVENUES AND DEBT SERVICE COVERAGE (DOLLAR AMOUNTS IN THOUSANDS)

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Operating Revenues	\$750,046	\$593,497	\$797,160	\$812,310	\$863,357
Interest and Other Income	7,838	26,634 ⁽¹⁾	2,808	2,635	22,126
AFUDC (Interest)	588	990	910	907	907
Total Funds	\$758,472	\$621,121	\$800,878	\$815,852	\$886,390
Adjustments	(361)	110	(860)	234	(3,109)
Project Revenues	\$758,111	\$621,231	\$800,018	\$816,086	\$883,281
Operating Expenses	\$684,743	\$547,177	\$721,435	\$739,151	\$793,012
Less:					
Depreciation	35,184	34,959	36,068	38,868	39,547
Other Adjustments	1,196	830	701	478	443
Net Operating Expenses	\$648,363	\$511,388	\$684,666	\$699,805	\$753,022
Funds Available To Cover Debt Service	\$109,748	\$109,843	\$115,352	\$116,281	\$130,259
Debt Service Requirements:					
Revenue Bonds 1975	51,611	55,528	44,063	48,630	38,806
PMA/Capital Leasing	7,977	5,954	3,997	3,997	1,998
Revenue Bonds 1998	29,449	30,926	40,201	39,655	45,999 ⁽²⁾
Subordinate Revenue Bonds 1998	1,990	1,986	1,988	1,988	1,987
Commercial Paper Notes	5,077	3,235	2,316	2,085	2,864
Total Debt Service	\$96,104	\$97,629	\$92,565	\$96,355	\$91,654
Net Funds Available for Other Purposes:	<u>\$13,644</u>	<u>\$12,214</u>	<u>\$22,787</u>	<u>\$19,926</u>	<u>\$38,605</u>
Debt Service Coverage:					
Senior Revenue Bonds 1975	2.13	1.98	2.62	2.39	3.36
Senior Revenue Bonds 1998	1.70	1.56	1.67	1.61	1.94
Subordinate Revenue Bonds 1998	10.41	8.78	13.63	12.07	21.87
Coverage of Debt Service & City Payment	0.95	0.94	1.04	1.01	1.18

⁽¹⁾ Interest and Other Income for Fiscal Year 2002 includes the full \$20.150 million of proceeds from the Forward Delivery Agreement. For financial statement purposes, \$11,544,000 is being amortized over the life of the transaction on a straight line basis.

⁽²⁾ Capitalized Interest of \$2,283,471 excluded from the 1998 Ordinance Coverage Calculation in Fiscal Year 2005.

MANAGEMENT'S DISCUSSION AND ANALYSIS RESULTS OF OPERATIONS AND FINANCIAL CONDITION

The narrative overview and analysis of the financial statements of Philadelphia Gas Works ("PGW") for the Fiscal Years ended August 31, 2005 and 2004 have been prepared by PGW's Management. The information presented here is unaudited and should be read in conjunction with additional information contained in PGW's audited financial statements.

Financial Highlights

- The Fiscal Year 2005 heating season reflected a 5.0% warmer-than-normal winter. The 2005 period was 1.0% colder than the prior year; however, firm gas sales declined by 2.4 Bcf. This decrease in gas sales was more than offset by higher commodity prices for natural gas. In addition, the Weather Normalization Adjustment (WNA), which was in effect from October 2004 through May 2005, resulted in heating customers receiving credits totaling \$1.4 million as a result of the temperatures experienced during the period.
- Fiscal Year 2005 reflected PGW's continued steady improvement in its collection rate from 86.6% in 2003 and 91.4% in Fiscal Year 2004 to 94.9 % in the current period. This improved liquidity position occurred in spite of the escalating natural gas prices and their impact on customer billings.
- PGW issued \$207.8 million of revenue bonds during Fiscal Year 2005. The proceeds from the sale of the \$120.0 million Fifth Series A-1 Bonds (1998 Ordinance) and the \$30.0 million Fifth Series A-2 Bonds were utilized to fund PGW's capital expenditure program, while the proceeds from the sale of the \$57.8 million Eighteenth Series Bonds (1975 Ordinance) were utilized to refund existing long-term debt issued under the 1975 General Ordinance.

Overview of the Financial Statements

The discussion and analysis are intended to serve as an introduction and overview of PGW's basic financial statements. PGW's financial statements are comprised of:

Financial Statements provide both long-term and short-term information about PGW's overall financial condition, results of operations, and cash flows.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data presented in PGW's financial statements. The notes can be found immediately following the basic financial statements.

The financial statements report information about PGW as a whole using accounting methods similar to those used by private sector business. The four statements presented are:

The Statement of Operations presents revenue and expenses and their effects on the change in equity during the Fiscal Year. These changes in equity are recorded as soon as the underlying event giving rise to the change occurs, regardless of when cash is received or paid.

The Balance Sheet includes all of PGW's assets and liabilities, with the difference between the two reported as equity. Over time, increases or decreases in equity are indicators of whether PGW's financial position is improving or deteriorating.

The Statement of Cash Flows provides relevant information about the cash receipts and cash payments of an enterprise during a period and the impact on PGW's financial position.

The Statement of Changes in City Equity provides a rollforward of the equity balance of the City of Philadelphia (the "City") based upon the results from the statement of operations.

Statement of Operations

Condensed Statements of Operations (Thousands of Dollars)

	<u>For the years ended August 31</u>	
	<u>2004</u>	<u>2005</u>
Total gas revenues	\$ 783,356	\$ 830,550
Other revenues	28,954	32,807
Total operating revenues	<u>812,310</u>	<u>863,357</u>
Total operating expenses	<u>739,151</u>	<u>793,012</u>
Operating income	73,159	70,345
Interest and other income	3,580	4,778
Total interest expense	<u>(59,580)</u>	<u>(63,851)</u>
Net income	<u>17,159</u>	<u>11,272</u>

Operating Revenues

Operating revenues in Fiscal Year 2005 were \$863.4 million, an increase of \$51.0 million or 6.3% from the 2004 level. This increase was principally due to the higher customer billings reflecting the rise in natural gas costs. The degree days during the 2005 heating season totaled 4,327, an increase of 40 degree days, or 0.9% from the 4,287 degree days experienced in the 2004 heating season. Total sales volumes, including gas transportation deliveries, in 2005 increased by 0.7 Bcf to 69.9 Bcf or 1.0% from the 2004 level of 69.2 Bcf. Firm gas sales of 53.8 Bcf were 2.4 Bcf or 4.3% lower compared to the prior year, while interruptible customer sales increased by 0.4 Bcf compared to the prior period. Gas transportation sales in 2005 increased by 2.7 Bcf to 11.6 Bcf from the 8.9 Bcf level experienced in 2004. The number of customers served by PGW at the end of 2005 decreased by 0.4% from the previous year to approximately 497,000 customers. Commercial accounts were approximately 25,000, a decrease of 1,000. Industrial accounts approximated the prior year's level of 1,000. Residential customers decreased to approximately 471,000 customers, a decrease of 1,000.

Operating Expenses

Total operating and maintenance expenses including fuel costs in Fiscal Year 2005 were \$793.0 million, an increase of \$53.9 million or 7.3% from the 2004 level. This increase reflects substantially higher natural gas costs and a higher bad debt expense.

Cost of Fuel. The cost of natural gas utilized increased by \$58.8 million or 13.0% to \$509.7 million in 2005 compared with \$450.9 million in 2004. The average commodity price per Mcf increased by nearly \$1.13 or \$77.4 million, while the volume of gas utilized decreased by \$24.3 million, 3.6 Bcf, or 5.3% in 2005 due mainly to the reduced overall sendout requirements. In addition, pipeline supplier refunds in 2005 increased by \$453,000 while demand charges increased by \$6.1 million compared to the 2004 level. Variations in the cost of purchased gas are passed through to customers under the gas cost rate (GCR) provision of PGW's rate schedules. Over-recoveries or under-recoveries of purchased gas costs are subtracted from or added to gas revenues and are included in current assets or liabilities, thereby eliminating the effect that recovery of gas costs would otherwise have on net income.

Other Operating Expense. Expenditures for street operations, infrastructure improvements, and plant operations were \$62.2 million, down slightly from the prior year total of \$62.6 million, reflecting similar winter weather conditions. In addition, the cost for customer services, collection and account management, marketing, and the administrative area

decreased by \$4.3 million or 4.4%. The main reasons for the lower costs reflect reduced amortization of bad debt arrearages and environmental expenses, offset somewhat by higher premiums for (active and retired) employee health insurance coverage. Pension costs in Fiscal Year 2005 decreased by \$271,000 below the prior year's level, based on the most recent actuarial valuation of the retirement fund. The decrease in pension expense was due primarily to the increase in the Retirement Reserve Fund's contribution to beneficiary payments.

Bad Debt Expense. Bad debt expense in Fiscal Year 2005 totaled \$70.4 million, a decrease of \$576,000 or 0.8% lower than the 2004 level based on the most recent accounts receivable collectibility evaluation. This expense reflects an additional level of written-off accounts. The accumulated provision for uncollectible accounts at August 2005 reflects a balance of \$207.5 million, compared to the \$230.2 million balance in Fiscal Year 2004. PGW is committed to continuing its collection efforts in an attempt to reduce outstanding delinquent account balances and to provide assistance to those customers who qualify for low-income grants and payment programs to help those customers maintain their gas service.

Depreciation Expense. Depreciation expense increased by \$679,000 in Fiscal Year 2005 compared with Fiscal Year 2004. The composite depreciation rate for Fiscal Years 2005 and 2004 was 2.4%. Cost of removal is charged to expense as incurred.

Interest and Other Income. Interest and other income was \$1.2 million greater than the 2004 Fiscal Year as the result of increased earnings rates and higher restricted fund balances.

Interest Expense. Total interest expense increased by \$4.3 million or 7.2% in Fiscal Year 2005 compared with Fiscal Year 2004. Interest on long-term debt was \$3.0 million higher than the 2004 level reflecting the additional interest expense for the full-year effect of the issuance of \$150.0 million of revenue bonds during Fiscal Year 2005. Other interest costs rose by \$1.3 million or 13.0% reflecting additional costs associated with PGW's commercial paper program and the loss on reacquired debt.

Net Income. The net income for Fiscal Year 2005 was \$11.3 million compared with \$17.2 million in Fiscal Year 2004.

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Balance Sheets

Condensed Balance Sheets (Thousands of Dollars)

ASSETS	<u>For the years ended August 31</u>	
	<u>2004</u>	<u>2005</u>
Utility plant, net	\$ 950,736	\$ 981,722
Restricted investment funds	136,423	207,231
Current assets:		
Accounts receivable (net of accumulated provision for uncollectible accounts of \$217,480 and \$230,216 for 2005 and 2004, respectively)	93,124	87,634
Other current assets	116,150	147,837
Total current assets	209,274	235,471
Other assets and deferred debits	81,748	95,398
Total assets	<u>\$ 1,378,181</u>	<u>\$ 1,519,822</u>
EQUITY AND LIABILITIES		
City equity	\$211,374	\$222,646
Total long-term debt	913,514	1,075,830
Current liabilities:		
Notes payable	95,750	49,900
Current portion of long-term debt	41,813	42,271
Other current liabilities	94,143	104,992
Total current liabilities	231,706	197,163
Other liabilities and deferred credits	21,587	24,183
Total equity and liabilities	<u>\$ 1,378,181</u>	<u>\$ 1,519,822</u>

Assets

Utility Plant. Utility plant, net of depreciation, totaled \$981.7 million in Fiscal Year 2005, an increase of \$31.0 million or 3.3% above the 2004 balance of \$950.7 million.

Capital Expenditures. Capital expenditures for construction of distribution facilities, purchase of equipment, information technology enhancements, and other general improvements were \$66.0 million in 2005 compared to \$60.7 million in 2004. During 2005, PGW funded \$68.0 million of its capital expenditures through drawdowns from its Capital Improvement Fund. In 2004, PGW funded \$55.6 million of its capital expenditures through drawdowns from its Capital Improvement Fund. The major capital expenditures are associated with PGW's gas supply infrastructure, namely, gas mains and customer service lines.

Restricted Investment Funds. Restricted investment funds increased by \$70.8 million in Fiscal Year 2005 primarily due to the deposit of funds to the Capital Improvement Fund to support PGW's Fiscal Year 2005 capital construction program. Interest income on these funds is reflected as an increase and approximated \$3.7 million. A

drawdown from the Capital Lease Fund in the amount of \$2.0 million was utilized to offset the final debt service payment of the capital lease that ended in October 2004. Cash and cash equivalents were \$15.2 million, an increase of \$11.6 million from the 2004 level.

Accounts Receivable. Accounts receivable (net) of \$87.6 million decreased by \$5.5 million, or 5.9% from the 2004 level, mainly reflecting the impact of greater write-offs. The accumulated provision for uncollectible accounts totaling \$207.5 million decreased by \$22.7 million to reflect estimated uncollectible amounts in the accounts receivable balance at August 31, 2005.

The most recent data available through December 2005 regarding PGW's collection rate shows a decline to just below 91% on a rolling twelve month basis. The decrease from the August 2005 collection rate of 94.9% reflects the substantial rise in customer billings as a result of the significantly higher natural gas prices incurred and the colder than normal temperatures experienced in December 2005. PGW anticipates improvement during the remainder of the winter season and Fiscal Year, as currently through mid January 2006, degree days experienced to date are 11% below the normal level. When this factor is combined with the softening natural gas cash market, which is currently trading around \$9.00 per Mcf, PGW expects to show an improved overall collection rate from that experienced through December 2005.

Materials and Supplies. Materials and supplies of \$130.0 million, which principally include storage gas, maintenance spare parts, and material, increased by \$31.5 million. Gas storage, utilized by PGW's gas supply area, increased by \$32.4 million or 36.5%. The increase in gas storage expense reflects higher natural gas prices and an increased volume of gas in storage.

Other Current Assets and Deferred Debits. Other current assets and deferred debits totaled \$2.6 million, down \$11.4 million, mainly due to the \$7.6 million over-recovery adjustment associated with the 2005 Fiscal Year GCR.

Other Assets and Deferred Debits. Other assets and deferred debits including unamortized bond issuance costs, unamortized loss on reacquired debt, and a deferred regulatory asset for environmental expenses totaled \$95.4 million, an increase of \$13.7 million from the 2004 level. The major portion of this increase is the bond issuance costs on \$207.8 million of debt issued in Fiscal Year 2005, offset partially by the loss on reacquired debt and deferred environmental costs. Furthermore, the 2004 fiscal period was the last year of the amortization of deferred customer arrearages.

Liabilities

Long-Term Debt. Long-term debt, including the current portion, unamortized debt discount and premium, and note payable-City Loan totaled \$1,118.1 million in Fiscal Year 2005, \$162.8 million higher than the previous year as a result of the issuance of revenue bonds during Fiscal Year 2005 and the reclassification of the note payable-City Loan from current liabilities as a result of the extension of the repayment date. This represented 83.4% of PGW's total capitalization in Fiscal Year 2005. The total long-term debt for Fiscal Year 2004 totaled \$955.3 million, which represented 81.9% of PGW's total capitalization.

Ratios, Coverages, and Ratings. PGW has a mandatory debt service coverage ratio of 1.50 times on 1975 Ordinance Bonds and 1998 Ordinance Bonds. In Fiscal Year 2005, the debt service coverage was at 3.36 times debt service on the outstanding 1975 Ordinance Bonds and 1.94 times debt service on the Senior 1998 Ordinance Bonds compared to debt service coverage ratios of 2.39 and 1.61 times, respectively, in 2004. PGW's current bond ratings are "Baa2" from Moody's Investors Service, "BBB-" from Standard and Poor's Ratings Service, and "BBB-" from Fitch Ratings.

Short-Term Debt. Due to the highly seasonal nature of PGW's business, short-term debt is used to meet working capital requirements. PGW, pursuant to the provisions of the 2005 Note Ordinance, may sell short-term notes in a principal amount which, together with interest, may not exceed \$100.0 million outstanding at any one time. The letter of credit supporting PGW's commercial paper program for Fiscal Year 2005 fixed the maximum level of outstanding notes at \$100.0 million. These notes are intended to provide additional working capital and are supported by an irrevocable letter of credit and a security interest in PGW's revenues. The notes outstanding at August 31, 2005 had an average weighted interest rate of approximately 2.4% and a remaining time to maturity of two days. The principal amounts outstanding at August 31, 2005 and 2004 were \$49.9 million and \$50.8 million, respectively. Also, the City provided PGW with a \$45.0 million, 0.0% interest loan in Fiscal Year 2001. The repayment date is August 2008.

Liquidity/Cash Flow. At November 30, 2005, no funds were available from the Commercial Paper Program, and no funds were available from the \$45.0 million City loan. However, PGW had \$100.2 million of bond proceeds available in its Capital Improvement Fund from the October 2004, Fifth Series Bonds issuance to partially fund the Fiscal Year 2005 capital construction program. These funding sources may be utilized during the fall and early winter period to provide liquidity until billings from the winter heating season are collected.

Accounts Payable. Accounts payable decreased by \$9.1 million or 12.5% compared to last year primarily due to a lower amount of trade payables and payables associated with the purchase of natural gas at August 31, 2005.

Other Liabilities and Deferred Credits. Other liabilities and deferred credits totaling \$24.2 million increased by \$2.6 million in Fiscal Year 2005. The major reason for this increase is the recording of the environmental liability offset by the termination of the interest swap agreement.

The 2005 Fiscal Year presented both challenges and successes. PGW's major accomplishment was improving its overall cash collection rate, as a percentage of annual billings, from under 92.0% in 2004 to a level approaching 94.9% in 2005. The City has made a major commitment to PGW by granting back its annual \$18.0 million payment, thereby improving PGW's overall liquidity position. PGW must continue to focus its efforts on becoming a competitive utility in the deregulated marketplace. PGW remains committed to achieving its tradition of providing high-quality service to customers, while continuing as a valuable enterprise of the City.

Five Year Summary of Gas Sales

Total gas sales for PGW are comprised of sales to firm and interruptible customers. Firm customers receive gas service under various schedules which anticipate no interruptions in the delivery of natural gas. Firm service is sold to residential, commercial, and industrial customers, the Philadelphia Housing Authority and the City of Philadelphia depending on the type of service required and represented 92.0% of total gas sales by volume in Fiscal Year 2005. Interruptible sales service is offered to customers under schedules or contracts which anticipate and permit interruptions on short notice, generally in peak-load periods. Interruptible gas service is sold to high volume commercial and industrial customers and represented 8.0% of total gas sales in Fiscal Year 2005. Gas transportation sales service during Fiscal Year 2005 totaled 11.6 Bcf. (See "PGW BUDGET, RATES AND FINANCES – Selected Operating Data" for a five year summary of gas sales).

Gas Sales in Fiscal Year 2001 totaled 64.9 Bcf, an increase of .7 Bcf from the 2000 period. Temperatures during the 2001 Fiscal Year heating season were slightly warmer than normal but cooler than the previous year resulting in 4,505 degree days, a decrease of 50 degree days from normal and an increase of 545 degree days or 13.8% more than experienced in the prior Fiscal Year. Sales to firm customers of 58.9 Bcf were 3.3 Bcf higher than in 2000. Associated interruptible revenues declined by 5% to \$40.1 million.

Gas Sales in Fiscal Year 2002 totaled 53.5 Bcf, a decrease of 11.4 Bcf from the 2001 period. Temperatures during the 2002 Fiscal Year heating season were significantly warmer than normal and warmer than the previous year resulting in 3,462 degree days, a decrease of 1,043 degree days or 23.2% less than experienced in the prior Fiscal Year. Sales to firm customers of 47.1 Bcf were 11.8 Bcf less than in 2001. Associated interruptible revenues fell by 15.6% to \$33.8 million.

Gas Sales in Fiscal Year 2003 totaled 68.1 Bcf, an increase of 14.6 Bcf from the 2002 period. Temperatures during the 2003 Fiscal Year heating season were colder than normal and substantially colder than the previous year resulting in 4,794 degree days, an increase of 1,332 degree days or 38.5% greater than experienced in the prior fiscal period. Sales to firm customers of 62.0 Bcf were 14.9 Bcf more than in the Fiscal Year 2002. Associated interruptible revenues rose by 16.5% to \$39.4 million.

Gas Sales in Fiscal Year 2004 totaled 60.3 Bcf, a decline of 7.8 Bcf from the 2003 period. Temperatures during the 2004 heating season were warmer than normal and significantly warmer than the previous year resulting in 4,287 degree days, a reduction of 507 degree days or 10.6% less than experienced in the prior fiscal period. Sales to firm customers of 56.2 Bcf were 5.8 Bcf less than in the Fiscal Year 2003. Associated interruptible revenues decreased by 17.7% or \$7.0 million to \$32.4 million reflecting a 2.0 Bcf or 32.7% decline in sales.

Gas Sales in Fiscal Year 2005 totaled 58.3 Bcf, a reduction of 2.0 Bcf from the 2004 period. Temperatures during the 2005 heating season were warmer than normal but slightly colder than the prior year resulting in 4,327 degree days, an increase of 40 degree days or 1% greater than experienced in the previous fiscal period. Sales to firm customers of 53.8 Bcf were 2.4 Bcf less than in the Fiscal Year 2004. Associated interruptible revenues rose by 38.0% or \$12.3 million to \$44.7 million reflecting a 0.4 Bcf or 9.9% increase in sales.

Natural Gas

In Fiscal Year 2001, natural gas costs increased by \$165.0 million or nearly 62% over the previous year's level to \$431.3 million. The cost of natural gas rose to \$8.4649 per dth in January 2001 compared to a January 2000 price of \$2.7045 per dth. The cost of higher prices from pipeline suppliers added to the extraordinarily higher cost of natural gas. In addition, increased sendout requirements due to a colder winter heating season further contributed to the added costs, while a higher level of natural gas refunds received from pipeline supplier settlements somewhat lowered natural gas costs.

In Fiscal Year 2002, natural gas expenses decreased by \$127.5 million or 30% from the prior year to a level of \$303.8 million. Sendout requirements were less, reflecting an unprecedented warm winter period compared to Fiscal Year 2001. In addition, a decline in the cost of natural gas cost further contributed to the decreased natural gas expenses. The level of natural gas refunds received from pipeline supplier settlements declined, partially offsetting the above decreases.

In Fiscal Year 2003, natural gas expenses increased by \$123.6 million or 41% from the previous year to a level of \$427.4 million. Sendout requirements were greater, reflecting a colder than normal winter compared to the unprecedented warm Fiscal Year 2002 winter period. In addition, a substantial rise in the cost of natural gas 22.8% or 89.4 cents per Mcf further contributed to the higher expenditures for natural gas. The level of natural gas refunds received from pipeline supplier settlements rose to \$5.7 million, \$5.6 million greater than the prior year, partially offsetting the above increases.

In Fiscal Year 2004, natural gas costs rose by \$23.5 million or 5.5% from the previous year to a level of \$450.9 million. Sendout requirements declined by 7.4 Bcf, reflecting a warmer heating season compared to the much colder Fiscal Year 2003 winter period, resulting in a \$41.4 million decrease compared to the 2003 Fiscal Year. In addition, a significant rise in the cost of natural gas totaling \$57.4 million, 15.7% or 75.5 cents per Mcf more than offset the reduced volume of gas utilized for sendout, while pipeline demand charges rose by \$1.9 million. The level of natural gas refunds received from pipeline supplier settlements declined to \$0.1 million, \$5.6 million less than the prior year.

In Fiscal Year 2005, natural gas costs increased dramatically by \$58.8 million or 13.0% from the prior year to a level of \$509.7 million. Sendout requirements declined by 3.6 Bcf reflecting continued customer conservation. The heating season was slightly colder than the Fiscal Year 2004 period, resulting in a \$24.3 million decrease when compared to the 2004 Fiscal Year. Also, continued escalating prices for natural gas totaling \$77.4 million per Mcf more than offset the lower volume of gas utilized for sendout. Pipeline demand charges increased by \$6.2 million, while the level of natural gas refunds received from pipeline supplier settlements rose by \$0.5 million compared to the Fiscal Year 2004 period.

Accounts Receivable

Accounts receivable (net) of \$87.6 million decreased by \$5.5 million or nearly 6% from the 2004 level, mainly reflecting the higher level of accounts written-off which were \$23.8 million greater than in the prior period. The accumulated provision for uncollectible accounts totaling \$207.5 million declined by nearly \$22.7 million and should be satisfactory to cover uncollectible amounts in the estimated accounts receivable balance at August 31, 2005.

**ACCOUNTS RECEIVABLE, RESERVE FOR BAD DEBT EXPENSE, NET WRITE-OFF EXPENSES,
DELINQUENT CUSTOMERS AND REVENUE STATISTICS
(DOLLAR AMOUNTS IN THOUSANDS)**

	FISCAL YEAR ENDED AUGUST 31				
	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Billed Gas Revenues During the Year	\$741,963	\$557,466	\$755,920	\$786,406	\$846,729
Accounts Receivable	280,406	254,047	321,408	323,340	295,114
Reserve for Bad Debt	(184,324)	(187,461)	(228,548)	(230,216)	(207,480)
Net Accounts Receivable at 8/31	\$96,082	\$66,586	\$92,860	\$93,124	87,634
Reserve for Bad Debt as a Percentage of Accounts Receivable	65.7%	73.8%	71.1%	71.2%	70.3%
Net Write-Offs	\$12,463	\$48,411	\$43,914	\$69,332	\$93,160
Receivable as a Percentage of Billed Gas Revenues	37.8%	45.6%	42.5%	41.1%	34.9%
Bad Debt Expense:	\$67,633	\$51,548	\$85,000	\$71,000	\$70,424
as a Percentage of Billed Gas Revenues	9.1%	9.2%	11.2%	9.0%	8.3%
as a Percentage of Accounts Receivable	24.1%	20.3%	26.4%	22.0%	23.9%
Delinquent Customers at 8/31	160,000	168,136	155,399	167,576	165,479

PGW's most volatile and problematic expense item, outside of natural gas costs is bad debt expense and associated customer accounts receivable balances. Historically, PGW has collected approximately 92% of annual customer billings. PGW's bad debt expense over the past five years has ranged from \$51.5 million in Fiscal Year 2002 to \$85.0 million in Fiscal Year 2003.

The substantial increases over the five year period in bad debt expense and customer accounts receivable balances were primarily due to the flawed implementation of a new Billing, Credit and Collection System ("BCCS") in July 1999. Currently, enhancements and implementation of Act 201 changes to the billing system, still ongoing at this time, have given PGW full functionality to effectively manage its delinquent customer base. These factors combined with escalating natural gas prices led to the significant rise in the number of delinquent customers and the escalating accounts receivable balances in Fiscal Years 2001, 2002 and 2003. PGW, over the five year period ended August 31, 2005, took a charge to earnings of nearly \$345.6 million in aggregate bad debt expense to appropriately provide for uncollectible accounts. PGW anticipates that the Fiscal Year 2005 reserve balance for uncollectible accounts of \$207.5 million will be satisfactory to cover uncollectible amounts in the accounts receivable balance at August 31, 2005.

PGW implemented a Collection Renewal Initiative ("CRI") in early Fiscal Year 2004. The CRI effort covers Customer Service operations involved in the collection of delinquent accounts receivable. The renewal effort is in response to increasing accounts receivable caused by higher natural gas prices during the winter heating seasons. In Fiscal Year 2003, PGW's collection rate declined by 5.4% to 86.6% from the historical level of 92%. Over the past two fiscal periods PGW has increased its collection rate to 91.4 % in 2004 and 94.9% in 2005, respectively. PGW has over 26,000 active payment agreements with delinquent customers as of November 2005. With these collection initiatives in place, PGW believes that the worst of the billing related problems are in the past.

PGW is currently on negative outlook by Standard & Poor's Ratings Service, a Division of The McGraw-Hill Companies, and Fitch Ratings. Moody's Investors Service, Inc. recently raised PGW from negative outlook to stable outlook. PGW is committed to maintaining its overall collection rate above the historical average while at the same time improving its liquidity position.

UNDERWRITING

The Underwriters have jointly and severally agreed pursuant to a purchase contract, subject to certain terms and conditions contained therein, to purchase the Bonds from the City for a purchase price of \$312,440,428.30, which is equal to the par amount of \$313,390,000.00 less the underwriters' discount of \$949,571.70. The Underwriters' obligations pursuant to the purchase contract are subject to certain conditions precedent. The Underwriters are obligated pursuant to the purchase contract to purchase all of the Bonds, if any are purchased.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

The mathematical accuracy of the computation of the adequacy of the proceeds from the sale of the Bonds to pay, when due, the redemption price of the Refunded Bonds on the redemption dates set forth in the Escrow Deposit Agreement together with accrued interest to such date, will be verified by BondResource Partners, LP, Philadelphia, Pennsylvania. The report (the "Verification Report") will be delivered to the City on or before the delivery of the Bonds.

The verification will be solely based upon data, information and documents provided to BondResource Partners, LP by the City, its representatives and the Underwriters. The Verification Report will state that BondResource Partners, LP has no obligation to update the Verification Report because of events occurring, or data or information that comes to its attention, subsequent to the date of Verification Report.

EXPECTED RATINGS

Moody's Investors Service, Inc. ("Moody's"), Standard & Poor's Ratings Service, a Division of The McGraw-Hill Companies ("S&P"), and Fitch Ratings ("Fitch") are expected to assign (a) long term ratings of "Aaa," "AAA" and "AAA", respectively, and (b) short term ratings of "VMIG-1," "A-1+" and "F1+", respectively, to the Bonds, based upon the issuance of the Bond Insurance Policy and the delivery of the Standby Purchase Agreement. The underlying ratings currently assigned to Senior 1998 Ordinance Bonds by Moody's, S&P and Fitch are "Baa2," "BBB-" and "BBB-", respectively, with Moody's indicating a stable outlook and S&P and Fitch indicating a negative outlook. Any explanation of these ratings may only be obtained from the rating agencies. A credit rating is not a recommendation to buy, sell or hold securities. No assurance is given that such ratings will be maintained for any given period of time or that they may not be lowered or withdrawn entirely by the rating agencies if, in their judgment, circumstances so warrant. Any such downward change in or withdrawal of any of such ratings may have an adverse effect on the market price of the Bonds.

TAX MATTERS

Federal

Exclusion of Interest From Gross Income

In the opinion of Co-Bond Counsel, under existing statutes, regulations, rulings and court decisions, interest on the Bonds will not be includible in the gross income of the Holders thereof for federal income tax purposes, on the assumption that the City complies with its covenants relating to certain requirements of the Internal Revenue Code of 1986, as amended ("Code"), and interest on the Bonds will not be a specific preference item for purposes of computing the federal alternative minimum tax imposed on individuals and corporations. However, interest on the Bonds will be taken into account in determining adjusted current earnings for the purpose of computing the federal alternative minimum tax imposed on certain corporations (other than an S corporation, regulated investment company, real estate investment trust or real estate mortgage investment conduit).

In rendering their opinions, Co-Bond Counsel have assumed compliance by the City with the covenants contained in the 1998 General Ordinance and the Tax Compliance Certificate that are intended to comply with the

provisions of the Code relating to actions to be taken by the City in respect of the Bonds after the issuance thereof to the extent necessary to effect or maintain the exclusion from federal gross income of the interest on the Bonds. These covenants relate to, *inter alia*, the use of and investment of proceeds of the Bonds and the rebate to the United States Treasury of specified arbitrage earnings, if any. Failure to comply with such covenants could result in the interest on the Bonds becoming includible in gross income for federal income tax purposes from the date of issuance of the Bonds.

Other Federal Tax Matters

Ownership of the Bonds may result in other federal tax consequences to certain taxpayers, including, without limitation, certain S corporations, foreign corporations with branches in the United States, property and casualty insurance companies, individual recipients of Social Security or Railroad Retirement benefits, and taxpayers, including banks, thrift institutions and other financial institutions subject to Section 265 of the Code and who may be deemed to have incurred or continued indebtedness to purchase or to carry the Bonds. Co-Bond Counsel are not rendering any opinions as to any federal tax matters other than those described under the caption "Exclusion of Interest from Gross Income." Prospective purchasers of the Bonds should consult their independent tax advisors.

Pennsylvania

In the opinion of Co-Bond Counsel, under the laws of the Commonwealth of Pennsylvania as presently enacted and construed, the Bonds are exempt from personal property taxes in Pennsylvania and the interest on the Bonds is exempt from Pennsylvania personal income tax and Pennsylvania corporate net income tax. However, under the laws of the Commonwealth of Pennsylvania, as presently enacted and construed, any profits, gains or income derived from the sale, exchange or other disposition of the Bonds will be subject to Pennsylvania taxes and local taxes within the Commonwealth.

CERTAIN LEGAL MATTERS

All legal matters incident to the authorization, issuance and sale of the Bonds are subject to approval of the legality of the issuance of the Bonds by Blank Rome LLP and Andre C. Dasent, P.C., both of Philadelphia, Pennsylvania, Co-Bond Counsel. The proposed form of such opinions is included herein as APPENDIX F. Certain legal matters will be passed upon for the Underwriters by Greenberg Traurig, LLP and Law Offices of Denise Joy Smyler, Co-Counsel to the Underwriters, both of Philadelphia, Pennsylvania. Certain legal matters will be passed upon for the City by the City of Philadelphia Law Department. Certain legal matters will be passed upon for PGW by the Office of the General Counsel of PGW and by Wolf, Block, Schorr and Solis-Cohen LLP, Philadelphia, Pennsylvania. Certain legal matters will be passed upon for the Banks by Greenberg Traurig, LLP, Philadelphia, Pennsylvania, counsel to the Banks, and by Fasken Martineau DuMoulin LLP, Toronto, Canada, foreign counsel to The Bank of Nova Scotia.

FINANCIAL ADVISORS

Public Financial Management, Inc. and P.G. Corbin and Company, Inc., both of Philadelphia, Pennsylvania, have served as co-financial advisors (the "Financial Advisors") to the City in respect of the sale of the Bonds. The Financial Advisors assisted in the preparation of this Official Statement, and in other matters relating to the planning, structuring and issuance of the Bonds, and have provided other advice. Public Financial Management, Inc. is a financial advisory and consulting organization and is not engaged in the business of underwriting or marketing of municipal securities or any other negotiable instruments. P.G. Corbin and Company, Inc. is a financial advisory and consulting organization and is not engaged in the business of underwriting, marketing or trading of municipal securities or any other negotiable instruments.

INDEPENDENT AUDITORS

The audited financial statements of the Philadelphia Gas Works for the years ended August 31, 2005 and August 31, 2004 and included in Appendix A to this Official Statement have been audited by KPMG LLP, independent auditors, as stated in their report appearing therein.

Any financial information other than in Appendix A to this Official Statement has not been audited by any firm of independent auditors and no opinion on such information is expressed in this Official Statement.

INDEPENDENT CONSULTANT'S REPORT

The report prepared by Black & Veatch Corporation, and contained herein as APPENDIX B, has been included in reliance upon the expertise of that company as an independent consulting firm having broad experience in the design and analysis of the operation of gas works or gas distribution systems of the magnitude and scope of PGW and having skill in assessing assumptions used in the preparation of forecast financial statements of gas works systems.

CERTAIN RELATIONSHIPS

Public Financial Management, Inc., co-financial advisor to the City, acts as a consultant to PGW on certain management and labor relations issues. Blank Rome LLP, Andre C. Desant, P.C. and Law Offices of Denise Joy Smyler provide certain legal services to PGW. Wolf, Block, Schorr and Solis-Cohen LLP is serving as regulatory counsel to PGW and as counsel to the Fiscal Agent in connection with the issuance of the Bonds.

J.P. Morgan Securities Inc. is the lead underwriter and initial Remarketing Agent of the Bonds. JPMorgan Chase Bank, National Association is one of the Banks providing the initial liquidity facility in the form of the Standby Purchase Agreement and will act as the Swap Provider. J.P. Morgan Securities Inc. and JPMorgan Chase Bank, National Association are wholly-owned subsidiaries of JPMorgan Chase & Co. Greenberg Traurig, LLP is acting as counsel to both JPMorgan Chase Bank, National Association and J.P. Morgan Securities Inc.

In January 2005, Black & Veatch acquired Lukens Energy Group ("Lukens") and RJ Rudden Associates ("Rudden"). Both Lukens and Rudden are providing or have provided services for PGW.

NO LITIGATION

To the knowledge of the City of Philadelphia Law Department and, solely with respect to the opinion described in (E) below, based upon certain representations from PGW's General Counsel, after customary inquiry, no litigation is pending against the City before any court, public board or agency, or threatened in writing against the City (A) to restrain or enjoin the issuance, sale, execution or delivery of the Bonds, (B) which contests the validity or enforceability of the Bonds or any proceedings of the City taken with respect to the issuance, sale, execution or delivery thereof, (C) which contests the pledge or application of any moneys or security provided for the payment of the Bonds, (D) challenges the existence or powers of the City or (E) in which a final adverse determination, singly or in the aggregate, would have a material and adverse effect on PGW's operations or financial condition.

Upon delivery of the Bonds, the City Solicitor shall furnish a written confirmation, to the effect, among other things, that, except for litigation which in the opinion of the City Solicitor is without merit, and except as disclosed in the Official Statement, to the knowledge of the Law Department after customary inquiry, no litigation is pending against the City before any court, public board or agency, or threatened in writing against the City (A) to restrain or enjoin the issuance, sale, execution or delivery of the Bonds, (B) which contests the validity or enforceability of the Bonds or any proceedings of the City taken with respect to the issuance, sale, execution or delivery thereof, (C) which contests the pledge or application of any moneys or security provided for the payment of the Bonds, (D) challenges the existence or powers of the City or (E) in which a final adverse determination, singly or in the aggregate, would have a material and adverse effect on PGW's operations or financial condition.

NEGOTIABLE INSTRUMENTS

The Act provides that bonds issued thereunder shall have all the qualities and incidents of securities under the Uniform Commercial Code of the Commonwealth of Pennsylvania and shall be negotiable instruments.

CERTAIN REFERENCES

All summaries of the provisions of the Bonds and the security therefor, the Act, the General Ordinances and the Seventh Supplemental Ordinance set forth herein and in APPENDIX D hereof, and all summaries and references to other materials not purported to be quoted in full are only brief outlines of certain provisions thereof and do not constitute complete statements of such documents or provisions. Reference is made hereby to the complete documents relating to such matters for the complete terms and provisions thereof. So far as statements are made in this Official Statement

involving matters of opinion, whether or not expressly so stated, they are made merely as such and not as representations of fact.

CONTINUING DISCLOSURE

The City will enter into a Continuing Disclosure Agreement with Digital Assurance Certification, L.L.C. with respect to the Bonds, which shall constitute a written undertaking for the benefit of the owners and beneficial owners of the Bonds. The proposed form of Continuing Disclosure Agreement is attached to this Official Statement as APPENDIX E. The City has not contracted with the Underwriters to provide ongoing secondary market disclosure regarding the operations and financial affairs of the City or PGW. As a result of the tender option features of the Bonds, the Bonds are exempt from continuing disclosure requirements of Rule 15c2-12 of the Securities and Exchange Commission.

ADDITIONAL INFORMATION

Upon written request to the office of the Director of Finance and payment of the costs of duplication and mailing, the Annual Report of the City for the fiscal year ended June 30, 2005, and the audited combined financial statements of the City for the fiscal year ended June 30, 2005, will be made available, as well as other pertinent information. Such a request should be addressed to: Office of the Director of Finance, Accounting Bureau, 1330 Municipal Services Building, 1401 John F. Kennedy Boulevard, Philadelphia, Pennsylvania 19102. The City will provide copies of the foregoing documents to one or more nationally recognized municipal securities information depositories. The City will provide financial and other information regarding the Gas Works from time to time to Standard & Poor's Ratings Service, a Division of The McGraw-Hill Companies, Inc., Moody's Investors Service and Fitch Ratings in connection with securities ratings issued by those rating agencies of obligations of PGW. The City intends to continue these practices in future years on an annual basis on behalf of PGW as well as all bonds issued for PGW.

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This Official Statement has been duly executed and delivered by the following officers on behalf of the City of Philadelphia.

CITY OF PHILADELPHIA, PENNSYLVANIA

By: /s/ John F. Street
Honorable John F. Street, Mayor

By: /s/ Alan L. Butkovitz
Honorable Alan L. Butkovitz, City Controller

By: /s/ Romulo L. Diaz, Jr.
Romulo L. Diaz, Jr., City Solicitor

Approved:

By: /s/ Vincent J. Jannetti
Vincent J. Jannetti, Acting Secretary of
Financial Oversight and Acting Director of Finance

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APPENDIX A

**FINANCIAL STATEMENTS OF PGW FOR FISCAL YEARS
ENDED AUGUST 31, 2005 AND 2004**

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PHILADELPHIA GAS WORKS

Financial Statements and Supplementary Information

August 31, 2005 and 2004

(With Independent Auditors' Report Thereon)

PHILADELPHIA GAS WORKS

Table of Contents

	Page
Independent Auditors' Report	1
Required Supplementary Information (Unaudited) – Management's Discussion and Analysis, August 31, 2005 and 2004	3
Balance Sheets, August 31, 2005 and 2004	9
Statements of Operations, Years ended August 31, 2005 and 2004	11
Statements of Cash Flows, Years ended August 31, 2005 and 2004	12
Statements of Changes in City Equity, Years ended August 31, 2005 and 2004	13
Notes to Financial Statements	14
Required Supplementary Information (Unaudited) – Schedule of Pension Funding Progress	40
Supplemental Statements of Net Assets (City Format), August 31, 2005 and 2004	41
Supplemental Statements of Activities (City Format), Years ended August 31, 2005 and 2004	42
Supplemental Statements of Revenues, Expenses, and Changes in Fund Net Assets (City Format), Years ended August 31, 2005 and 2004	43
Supplemental Schedule of Interfund Transfers, Year ended August 31, 2005	44

Independent Auditors' Report

The Controller of the City of Philadelphia and
Chairman and Members of the
Philadelphia Facilities Management Corporation
Philadelphia, Pennsylvania:

We have audited the accompanying balance sheets of Philadelphia Gas Works (the Company), an enterprise fund of the City of Philadelphia, as of August 31, 2005 and 2004, and the related statements of operations, cash flows, and changes in city equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Philadelphia Gas Works as of August 31, 2005 and 2004, 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 required supplementary information of management's discussion and analysis on pages 3 to 8 and the schedule of pension funding progress on page 40 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 Company's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included on pages 41 to 44 is for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

December 22, 2005

PHILADELPHIA GAS WORKS

Required Supplementary Information (Unaudited)

Management's Discussion and Analysis

August 31, 2005 and 2004

The narrative overview and analysis of the financial statements of Philadelphia Gas Works (PGW) for the years ended August 31, 2005 and 2004 have been prepared by PGW's Management. The information presented here is unaudited and should be read in conjunction with additional information contained in PGW's financial statements.

Financial Highlights

- The FY 2005 heating season reflected a 5.0% warmer-than-normal winter. The 2005 period was 1.0% colder than the prior year; however, firm gas sales declined by 2.4 Bcf. This decrease in gas sales was more than offset by higher commodity prices for natural gas. In addition, the Weather Normalization Adjustment (WNA), which was in effect from October 2004 through May 2005, resulted in heating customers receiving credits totaling \$1.4 million as a result of the temperatures experienced during the period.
- FY 2005 reflected PGW's continued steady improvement in its collection rate from 86.6% in 2003 and 91.4% in FY 2004 to 94.9 % in the current period. This improved liquidity position occurred in spite of the escalating natural gas prices and their impact on customer billings.
- PGW issued \$207.8 million of revenue bonds during FY 2005. The proceeds from the sale of the \$120.0 million Fifth Series A-1 Bonds (1998 Ordinance) and the \$30.0 million Fifth Series A-2 Bonds were utilized to fund PGW's capital expenditure program, while the proceeds from the sale of the \$57.8 million Eighteenth Series Bonds (1975 Ordinance) were utilized to refund existing long-term debt issued under the 1975 General Ordinance.

Overview of the Financial Statements

The discussion and analysis are intended to serve as an introduction and overview of PGW's basic financial statements. PGW's financial statements are comprised of:

Financial Statements provide both long-term and short-term information about PGW's overall financial condition, results of operations, and cash flows.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data presented in PGW's financial statements. The notes can be found immediately following the basic financial statements.

The financial statements report information about PGW as a whole using accounting methods similar to those used by private sector business. The four statements presented are:

The Statement of Operations presents revenue and expenses and their effects on the change in equity during the FY. These changes in equity are recorded as soon as the underlying event giving rise to the change occurs, regardless of when cash is received or paid.

The Balance Sheet includes all of PGW's assets and liabilities, with the difference between the two reported as equity. Over time, increases or decreases in equity are indicators of whether PGW's financial position is improving or deteriorating.

PHILADELPHIA GAS WORKS

Required Supplementary Information (Unaudited)

Management's Discussion and Analysis

August 31, 2005 and 2004

The Statement of Cash Flows provides relevant information about the cash receipts and cash payments of an enterprise during a period and the impact on PGW's financial position.

The Statement of Changes in City Equity provides a rollforward of the equity balance of the City of Philadelphia (the City) based upon the results from the statement of operations.

Statements of Operations

Condensed Statements of Operations

(Thousands of dollars)

	Years ended August 31	
	2005	2004
Total gas revenues	\$ 830,550	783,356
Other revenues	32,807	28,954
Total operating revenues	863,357	812,310
Total operating expenses	793,012	739,151
Operating income	70,345	73,159
Interest and other income	4,778	3,580
Total interest expense	(63,851)	(59,580)
Net income	\$ 11,272	17,159

Operating Revenues

Operating revenues in FY 2005 were \$863.4 million, an increase of \$51.0 million or 6.3% from the 2004 level. This increase was principally due to the higher customer billings reflecting the rise in natural gas costs. The degree days during the 2005 heating season totaled 4,327, an increase of 40 degree days, or 0.9% from the 4,287 degree days experienced in the 2004 heating season. Total sales volumes, including gas transportation deliveries, in 2005 increased by 0.7 Bcf to 69.9 Bcf or 1.0% from the 2004 level of 69.2 Bcf. Firm gas sales of 53.8 Bcf were 2.4 Bcf or 4.3% lower compared to the prior year, while interruptible customer sales increased by 0.4 Bcf compared to the prior period. Gas transportation sales in 2005 increased by 2.7 Bcf to 11.6 Bcf from the 8.9 Bcf level experienced in 2004. The number of customers served by PGW at the end of 2005 decreased by 0.4% from the previous year to approximately 497,000 customers. Commercial accounts were approximately 25,000, a decrease of 1,000. Industrial accounts approximated the prior year's level of 1,000. Residential customers decreased to approximately 471,000 customers, a decrease of 1,000.

Operating Expenses

Total operating and maintenance expenses including fuel costs in FY 2005 were \$793.0 million, an increase of \$53.9 million or 7.3% from the 2004 level. This increase reflects substantially higher natural gas costs and a higher bad debt expense.

PHILADELPHIA GAS WORKS

Required Supplementary Information (Unaudited)

Management's Discussion and Analysis

August 31, 2005 and 2004

Cost of Fuel— The cost of natural gas utilized increased by \$58.8 million or 13.0% to \$509.7 million in 2005 compared with \$450.9 million in 2004. The average commodity price per Mcf increased by nearly \$1.13 or \$77.4 million, while the volume of gas utilized decreased by \$24.3 million, 3.6 Bcf, or 5.3% in 2005 due mainly to the reduced overall sendout requirements. In addition, pipeline supplier refunds in 2005 increased by \$453,000 while demand charges increased by \$6.1 million compared to the 2004 level. Variations in the cost of purchased gas are passed through to customers under the gas cost rate (GCR) provision of PGW's rate schedules. Over-recoveries or under-recoveries of purchased gas costs are subtracted from or added to gas revenues and are included in current assets or liabilities, thereby eliminating the effect that recovery of gas costs would otherwise have on net income.

Other Operating Expenses – Expenditures for street operations, infrastructure improvements, and plant operations were \$62.2 million, down slightly from the prior year total of \$62.6 million, reflecting similar winter weather conditions. In addition, the cost for customer services, collection and account management, marketing, and the administrative area decreased by \$4.3 million or 4.4%. The main reasons for the lower costs reflect reduced amortization of bad debt arrearages and environmental expenses, offset somewhat by higher premiums for (active and retired) employee health insurance coverage. Pension costs in FY 2005 decreased by \$271,000 below the prior year's level, based on the most recent actuarial valuation of the retirement fund. The decrease in pension expense was due primarily to the increase in the Retirement Reserve Fund's contribution to beneficiary payments.

Bad Debt Expense – Bad debt expense in FY 2005 totaled \$70.4 million, a decrease of \$576,000 or 0.8% lower than the 2004 level based on the most recent accounts receivable collectibility evaluation. This expense reflects an additional level of written-off accounts. The accumulated provision for uncollectible accounts at August 2005 reflects a balance of \$207.5 million, compared to the \$230.2 million balance in FY 2004. PGW is committed to continuing its collection efforts in an attempt to reduce outstanding delinquent account balances and to provide assistance to those customers who qualify for low-income grants and payment programs to help those customers maintain their gas service.

Depreciation Expense – Depreciation expense increased by \$679,000 in FY 2005 compared with FY 2004. The composite depreciation rate for FYs 2005 and 2004 was 2.4%. Cost of removal is charged to expense as incurred.

Interest and Other Income – Interest and other income was \$1.2 million greater than the 2004 FY as the result of increased earnings rates and higher restricted fund balances.

Interest Expense – Total interest expense increased by \$4.3 million or 7.2% in FY 2005 compared with FY 2004. Interest on long-term debt was \$3.0 million higher than the 2004 level reflecting the additional interest expense for the full-year effect of the issuance of \$150.0 million of revenue bonds during FY 2005. Other interest costs rose by \$1.3 million or 13.0% reflecting additional costs associated with PGW's commercial paper program and the loss on reacquired debt.

Net Income – The net income for FY 2005 was \$11.3 million compared with \$17.2 million in FY 2004.

PHILADELPHIA GAS WORKS

Required Supplementary Information (Unaudited)

Management's Discussion and Analysis

August 31, 2005 and 2004

Balance Sheets

Condensed Balance Sheets
(Thousands of dollars)

Assets	August 31	
	2005	2004
Utility plant, net	\$ 981,722	950,736
Restricted investment funds	207,231	136,423
Current assets:		
Accounts receivable (net of accumulated provision for uncollectible accounts of \$207,480 and \$230,216 for 2005 and 2004, respectively)	87,634	93,124
Other current assets	147,837	116,150
Total current assets	235,471	209,274
Other assets and deferred debits	95,398	81,748
Total assets	\$ 1,519,822	1,378,181
Equity and Liabilities		
City equity	\$ 222,646	211,374
Total long-term debt	1,075,830	913,514
Current liabilities:		
Note payable	49,900	95,750
Current portion of long-term debt	42,271	41,813
Other current liabilities	104,992	94,143
Total current liabilities	197,163	231,706
Other liabilities and deferred credits	24,183	21,587
Total equity and liabilities	\$ 1,519,822	1,378,181

Assets

Utility Plant – Utility plant, net of depreciation, totaled \$981.7 million in FY 2005, an increase of \$31.0 million or 3.3% above the 2004 balance of \$950.7 million.

Capital Expenditures – Capital expenditures for construction of distribution facilities, purchase of equipment, information technology enhancements, and other general improvements were \$66.0 million in 2005 compared to \$60.7 million in 2004. During 2005, PGW funded \$68.0 million of its capital expenditures through drawdowns from its Capital Improvement Fund. In 2004, PGW funded \$55.6 million of its capital expenditures through drawdowns from its Capital Improvement Fund. The major capital expenditures are associated with PGW's gas supply infrastructure, namely, gas mains and customer service lines.

PHILADELPHIA GAS WORKS

Required Supplementary Information (Unaudited)

Management's Discussion and Analysis

August 31, 2005 and 2004

Restricted Investment Funds – Restricted investment funds increased by \$70.8 million in FY 2005 primarily due to the deposit of funds to the Capital Improvement Fund to support PGW's FY 2005 capital construction program. Interest income on these funds is reflected as an increase and approximated \$3.7 million. A drawdown from the Capital Lease Fund in the amount of \$2.0 million was utilized to offset the final debt service payment of the capital lease that ended in October 2004. Cash and cash equivalents were \$15.2 million, an increase of \$11.6 million from the 2004 level.

Accounts Receivable – Accounts receivable (net) of \$87.6 million decreased by \$5.5 million, or 5.9% from the 2004 level, mainly reflecting the impact of greater write-offs. The accumulated provision for uncollectible accounts totaling \$207.5 million decreased by \$22.7 million to reflect estimated uncollectible amounts in the accounts receivable balance at August 31, 2005.

Materials and Supplies – Materials and supplies of \$130.0 million, which principally include storage gas, maintenance spare parts, and material, increased by \$31.5 million. Gas storage, utilized by PGW's gas supply area, increased by \$32.4 million or 36.5%. The increase in gas storage expense reflects higher natural gas prices and an increased volume of gas in storage.

Other Current Assets and Deferred Debits – Other current assets and deferred debits totaled \$2.6 million, down \$11.4 million, mainly due to the \$7.6 million over-recovery adjustment associated with the 2005 FY GCR.

Other Assets and Deferred Debits – Other assets and deferred debits including unamortized bond issuance costs, unamortized loss on reacquired debt, and a deferred regulatory asset for environmental expenses totaled \$95.4 million, an increase of \$13.7 million from the 2004 level. The major portion of this increase is the bond issuance costs on \$207.8 million of debt issued in FY 2005, offset partially by the loss on reacquired debt, and deferred environmental costs. Furthermore, the 2004 fiscal period was the last year of the amortization of deferred customer arrearages.

Liabilities

Long-Term Debt – Long-term debt, including the current portion, unamortized debt discount and premium, and note payable – City Loan totaled \$1,118.1 million in FY 2005, \$162.8 million higher than the previous year as a result of the issuance of revenue bonds during FY 2005 and the reclassification of the note payable – City Loan from current liabilities as a result of the extension of the repayment date. This represented 83.4% of PGW's total capitalization in FY 2005. The total long-term debt for FY 2004 totaled \$955.3 million, which represented 81.9% of PGW's total capitalization.

Ratios, Coverages, and Ratings – PGW has a mandatory debt service coverage ratio of 1.50 times on 1975 Ordinance Bonds and 1998 Ordinance Bonds. In FY 2005, the debt service coverage was at 3.36 times debt service on the outstanding 1975 Ordinance Bonds and 1.94 times debt service on the Senior 1998 Ordinance Bonds compared to debt service coverage ratios of 2.39 and 1.61 times, respectively, in 2004. PGW's current bond ratings are "Baa2" from Moody's Investors Service, "BBB-" from Standard and Poor's Ratings Service, and "BBB-" from Fitch Ratings.

PHILADELPHIA GAS WORKS

Required Supplementary Information (Unaudited)

Management's Discussion and Analysis

August 31, 2005 and 2004

Short-Term Debt – Due to the highly seasonal nature of PGW's business, short-term debt is used to meet working capital requirements. PGW, pursuant to the provisions of the Note Ordinance, may sell short-term notes in a principal amount which, together with interest, may not exceed \$100.0 million outstanding at any one time. The letter of credit supporting PGW's commercial paper program for FY 2005 fixed the maximum level of outstanding notes at \$100.0 million. These notes are intended to provide additional working capital and are supported by an irrevocable letter of credit and a security interest in PGW's revenues. The notes outstanding at August 31, 2005 had an average weighted interest rate of approximately 2.4% and a remaining time to maturity of two days. The principal amounts outstanding at August 31, 2005 and 2004 were \$49.9 million and \$50.8 million, respectively. Also, the City provided PGW with a \$45.0 million, 0.0% interest loan in FY 2001. The repayment date is August 2008.

Liquidity/Cash Flow – At November 30, 2005, no funds were available from the Commercial Paper Program, and no funds were available from the \$45.0 million City loan. However, PGW had \$99.9 million of bond proceeds available in its Capital Improvement Fund from the October 2004, Fifth Series Bonds issuance to partially fund the FY 2005 capital construction program. These funding sources may be utilized during the fall and early winter period to provide liquidity until billings from the winter heating season are collected.

Accounts Payable – Accounts payable decreased by \$9.1 million or 12.5% compared to last year primarily due to a lower amount of trade payables and payables associated with the purchase of natural gas at August 31, 2005.

Other Liabilities and Deferred Credits – Other liabilities and deferred credits totaling \$24.2 million increased by \$2.6 million in FY 2005. The major reason for this increase is the recording of the environmental liability offset by the termination of the interest swap agreement.

The 2005 FY presented both challenges and successes. PGW's major accomplishment was improving its overall cash collections rate, as a percentage of annual billings, from under 92.0% in 2004 to a level approaching 94.9% in 2005. The City has made a major commitment to PGW by granting back its annual \$18.0 million payment, thereby improving PGW's overall liquidity position. PGW must continue to focus its efforts on becoming a competitive utility in the deregulated marketplace. PGW remains committed to achieving its tradition of providing high-quality service to customers, while continuing as a valuable enterprise of the City.

PHILADELPHIA GAS WORKS

Balance Sheets

August 31, 2005 and 2004

(Thousands of dollars)

Assets	2005	2004
Utility plant, at original cost:		
In service	\$ 1,515,463	1,473,519
Under construction	57,883	43,527
Total	1,573,346	1,517,046
Less accumulated depreciation	591,624	566,310
Utility plant, net	981,722	950,736
Restricted investment funds:		
Sinking fund, revenue bonds	104,530	95,929
Capital improvement fund	102,701	40,494
Total restricted investment funds	207,231	136,423
Current assets:		
Cash and cash equivalents	15,221	3,666
Accounts receivable (net of provision for uncollectible accounts of \$207,480 and \$230,216 for 2005 and 2004, respectively)	87,634	93,124
Gas inventories, materials, and supplies	129,984	98,467
Other current assets and deferred debits	2,632	14,017
Total current assets	235,471	209,274
Unamortized bond issuance costs	39,094	32,718
Unamortized losses on reacquired debt	38,494	39,439
Other assets and deferred debits	17,810	9,591
Total assets	\$ 1,519,822	1,378,181

PHILADELPHIA GAS WORKS**Balance Sheets****August 31, 2005 and 2004****(Thousands of dollars)**

Equity and Liabilities	2005	2004
City equity:		
Invested in capital assets, net of related debt	\$ 24,739	35,903
Restricted	104,530	95,929
Unrestricted	93,377	79,542
Total City equity	222,646	211,374
Long-term debt:		
Revenue bonds	1,030,830	913,514
Note payable – City Loan	45,000	—
Total long-term debt	1,075,830	913,514
Current liabilities:		
Note payable	49,900	95,750
Current portion of long-term debt:		
Revenue bonds	42,271	39,866
Subordinated lease obligations	—	1,947
Accounts payable	63,918	73,027
Customer deposits	6,280	1,694
Other current liabilities and deferred credits	18,342	6,729
Accrued accounts:		
Interest, taxes, and wages	13,452	9,693
Distribution to the City	3,000	3,000
Total current liabilities	197,163	231,706
Other liabilities and deferred credits	24,183	21,587
Commitments and contingencies		
Total equity and liabilities	\$ 1,519,822	1,378,181

See accompanying notes to financial statements.

PHILADELPHIA GAS WORKS

Statements of Operations

Years ended August 31, 2005 and 2004

(Thousands of dollars)

	2005	2004
Operating revenues:		
Gas revenues:		
Nonheating	\$ 114,880	99,074
Gas transport service	4,679	2,945
Heating	711,794	679,877
Unbilled gas adjustment	(803)	1,460
Total gas revenues	830,550	783,356
Appliance and other revenues	10,895	10,065
Other operating revenues	21,912	18,889
Total operating revenues	863,357	812,310
Operating expenses:		
Natural gas	509,704	450,868
Gas processing	18,584	17,284
Field services	28,455	29,557
Distribution	15,115	15,778
Collection and account management	18,666	18,226
Provision for uncollectible receivables	70,424	71,000
Customer services	12,512	13,514
Marketing	2,592	2,677
Administrative and general	60,995	64,670
Pensions	14,702	14,973
Taxes	6,218	6,638
Total operating expenses before depreciation	757,967	705,185
Depreciation	39,547	38,868
Less depreciation expense included in operating expenses above	4,502	4,902
Total depreciation	35,045	33,966
Total operating expenses	793,012	739,151
Operating income	70,345	73,159
Interest and other income	4,778	3,580
Income before interest expense	75,123	76,739
Interest expense:		
Long-term debt	53,856	50,837
Other	10,902	9,650
Allowance for funds used during construction	(907)	(907)
Total interest expense	63,851	59,580
Net income	\$ 11,272	17,159

PHILADELPHIA GAS WORKS

Statements of Cash Flows

Years ended August 31, 2005 and 2004

(Thousands of dollars)

	2005	2004
Cash flows from operating activities:		
Receipts from customers	\$ 845,900	756,000
Payments to suppliers	(652,060)	(546,987)
Payments to employees	(102,500)	(101,200)
Claims paid	(2,715)	(2,463)
Other receipts	11,700	15,500
Net cash provided by operating activities	100,325	120,850
Cash flows from noncapital financing activities:		
Interest	(6,701)	1,050
Interest payments on notes payable	(2,864)	(2,085)
Net repayments of notes payable	(850)	(23,250)
Distribution to the City of Philadelphia	(18,000)	—
Grant back of distribution from the City of Philadelphia	18,000	—
Net cash used in noncapital financing activities	(10,415)	(24,285)
Cash flows from capital and related financing activities:		
Proceeds from long-term debt issued	155,396	—
Long-term debt premium, discount, issuance, and losses	(9,996)	—
Purchases of capital assets	(66,032)	(60,671)
Principal paid on long-term debt	(38,169)	(41,400)
Interest paid on long-term debt	(53,044)	(52,871)
Capital improvement fund deposits	(129,532)	—
Drawdowns on capital improvement fund	67,325	59,221
Interest income on capital improvement fund	2,806	696
Interest income on sinking fund	585	748
Sinking fund deposits	(8,601)	91
Other investment income	907	907
Net cash used in capital and related financing activities	(78,355)	(93,279)
Net increase in cash and cash equivalents	11,555	3,286
Cash and cash equivalents at the beginning of the year	3,666	380
Cash and cash equivalents at the end of the year	\$ 15,221	3,666
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 70,345	73,159
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	36,953	42,668
Change in assets and liabilities:		
Receivables, net	5,538	(264)
Inventories	(31,516)	(24,438)
Accounts payable	(9,109)	25,538
Other liabilities and deferred credits	26,856	(2,464)
Other assets and deferred debits	1,258	6,651
Net cash provided by operating activities	\$ 100,325	120,850

See accompanying notes to financial statements

PHILADELPHIA GAS WORKS
Statements of Changes in City Equity
Years ended August 31, 2005 and 2004
(Thousands of dollars)

	<u>2005</u>	<u>2004</u>
Balance, beginning of the year	\$ 211,374	194,215
Net income	11,272	17,159
Distribution to the City of Philadelphia	(18,000)	—
Grant back of distribution from the City of Philadelphia	18,000	—
Balance, end of the year	\$ <u>222,646</u>	<u>211,374</u>

See accompanying notes to financial statements.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(1) Summary of Significant Accounting Policies

The accounting methods employed by the Philadelphia Gas Works (the Company) are prescribed by the City of Philadelphia (the City) and are, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

As described in note 2, the Company is owned by the City and, consequently, follows accounting principles promulgated by the Governmental Accounting Standards Board (GASB) as they apply to proprietary fund type activities. In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Company does not apply accounting standards promulgated by the Financial Accounting Standards Board (FASB) issued after November 30, 1989. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, is applicable to the Company. Under FASB Statement No. 71, certain assets or liabilities may be created by actions of regulatory bodies.

The principal accounting policies within this framework are described as follows:

(a) Regulation

Prior to July 1, 2000, the Company was under the regulatory jurisdiction of the Philadelphia Gas Commission (PGC). The PGC had the authority to set the Company's rates and tariffs. The PGC also approved the Company's annual Operating Budget and reviewed the Company's Capital Budget prior to approval by the City Council of the City (City Council).

Effective July 1, 2000, and pursuant to the passage of the Pennsylvania Natural Gas Choice and Competition Act (the Act), the Company came under the regulatory jurisdiction of the Pennsylvania Public Utility Commission (PUC). Under the PUC's jurisdiction, the Company filed a restructuring plan on July 1, 2002, which among other things, provides for an unbundled tariff permitting customer choice of the commodity supplier by September 1, 2003. Under the Act, the PUC is required to follow the "same ratemaking methodology and requirements" that were previously applicable to the PGC when determining the Company's revenue requirements and approving overall rates and charges. The PGC continues to approve the Company's Operating Budget and review its Capital Budget. The Company's Capital Budget must be approved by City Council.

The Company, as of September 1, 2003, is operating under its Restructuring Compliance Tariff. The Restructuring Compliance Tariff Rates are designed to maintain revenue neutrality and the Tariff Rules and Regulations are designed to comport with the Pennsylvania Public Utility Code.

(b) Operating Budget

On June 1, 2005, the Company filed its FY 2006 Operating Budget. The PGC conducted hearings concerning this budget in July 2005. Briefs were filed on August 8, 2005. The Hearing Examiner issued a Recommended Decision on August 24, 2005, providing Operating Budget adjustments for consideration by the Commissioners. The PGC entered an Order, dated October 31, 2005, approving interim operating spending authority through December 31, 2005. The Commission's Motion giving final approval for the FY 2006 Operating Budget was passed on December 13, 2005. The approved budget incorporates the Company's proposed operating revenues and expenses with net adjustments of \$1,405,000.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

On August 5, 2004, the Company filed its FY 2005 Operating Budget. The PGC conducted hearings concerning this budget in October 2004. Briefs were filed on October 21, 2004. The Hearing Examiner issued a Recommended Decision on November 10, 2004, providing Operating Budget adjustments for consideration by the Commissioners. The net effect of the recommended adjustments was \$12,782,000 compared to FY 2005 budgeted revenues totaling \$866,794,000 set forth in the original filing. The Company and Public Advocate filed Exceptions to the Recommended Decision on November 24, 2004. The Commission Motion approving the FY 2005 Operating Budget, as revised, was passed on December 14, 2004. The final Order memorializing the PGC's action was entered on December 16, 2004. The approved budget incorporates the Company's proposed operating revenues and expenses with adjustments.

(c) Capital Budget

On March 1, 2005, the Company filed with the PGC its FY 2006 Capital Budget requesting spending authority in the amount of \$65,686,000. This amount was revised to \$65,301,000 by the Company during the proceeding. The PGC conducted hearings concerning this budget in April 2005. Briefs were filed on May 11, 2005. The Hearing Examiner issued a Recommended Decision on May 25, 2005 for consideration by the Commissioners. The Hearing Examiner recommended a downward adjustment in spending authority of approximately \$2,017,000 from the original filing. The Company and Public Advocate filed Exceptions to the Recommended Decision on June 1, 2005. The Commission's Resolution and Order recommending approval of the FY 2006 Capital Budget, as revised, to City Council was passed on June 21, 2005. This recommendation of \$63,669,000 was approved by City Council. Subsequent to this approval, the PGC approved PGW's request to amend the budget in the amount of \$65,835,000. Approval of this amended budget has been forwarded to City Council for final approval.

On April 30, 2004, the Company filed with the PGC its FY 2005 Capital Budget requesting spending authority in the amount of \$59,812,000 (this amount was revised to \$57,815,000 by the Company during the proceeding). The PGC conducted hearings concerning this budget in July 2004. Briefs were filed on July 23, 2004. The Hearing Examiner issued a Recommended Decision on August 13, 2004 for consideration by the Commissioners. The Hearing Examiner recommended a downward adjustment in spending authority of approximately \$1,160,000. The Company and Public Advocate filed Exceptions to the Recommended Decision on August 27, 2004. The PGC's final Order recommending approval of the FY 2005 Capital Budget, as revised, to City Council was passed on September 20, 2004, recommending the approval of program and spending authorization not to exceed \$58,652,000. Thereafter, a budget amendment in the amount of \$5,295,000 was recommended by the PGC for approval of City Council, increasing the FY 2005 Capital Budget to \$63,947,000. City Council approved the FY 2005 Capital Budget on October 28, 2004 and the amendments thereto on June 2, 2005 in the above amounts. The Mayor of the City (the Mayor) signed the Ordinance approving the FY 2005 Capital Budget on November 18, 2004 and the Ordinance approving the amendments thereto on June 15, 2005.

(d) Base Rates

Base rate increases and increases in the GCR (see Gas Cost Rate below) are required to maintain the Company's long-term financial stability. On April 12, 2002, the PUC approved a \$36,000,000

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(e) Weather Normalization Adjustment Clause

The Weather Normalization Adjustment Clause (WNA) was approved by PUC Order dated August 8, 2002. The purpose of the WNA is to neutralize the impact of weather on the Company's revenues. This allows the Company to achieve the recovery of appropriate costs as authorized by the PUC. The WNA results in neither a rate increase nor a rate decrease. The main benefits of the WNA are the stabilization of cash flow and the reduction of the need for short-term borrowing from year to year. The WNA is applied to customer invoices rendered during the period of October 1 through May 31 of each year for each billing cycle. The WNA had an initial three-year period that expired October 31, 2005. The Company conducted a review of the costs and benefits of the WNA. The Company is currently in the process of presenting its conclusions regarding the WNA to the PUC with a request that the PUC acknowledge that the WNA should continue in place. The WNA will continue in place unless the PUC issues an order directing that it be discontinued. A determination will be made by the PUC at the end of the review as to whether the WNA will continue, continue with modifications, or be eliminated. The Company cannot predict when the PUC will complete its review of the WNA. The Company reserved the right to file a petition seeking extraordinary rate relief in the event of a force majeure, significant regulatory change, or projected material change in the status of the Company's credit arrangements. The adjustment for the years ended August 31, 2005 and 2004 was a \$1,365,000 decrease and \$2,109,000 increase, respectively, in billings.

(f) Gas Cost Rate

The Company's single greatest operating expense is the cost of natural gas. The rate charged to the Company's customers to recover these costs is called the Gas Cost Rate (GCR) factor. The GCR reflects the increases or decreases in natural gas costs and the cost of other raw materials. This GCR mechanism provides the flexibility to rapidly reflect current conditions without the time delay inherent in full base rate alteration. The intent is to achieve an annual balance between the costs incurred for fuel and their pass-through to customers.

At the end of the fiscal year, costs recovered through the GCR are compared to the actual cost of fuel and other specific costs. Customers are then credited or charged for over-recovery or under-recovery of costs. The GCR may be adjusted quarterly or in the subsequent fiscal year to reflect the under-recovery or over-recovery. Changes in the GCR impact the reported amounts of gas revenues and operating expenses, but do not affect operating income or net income.

On November 30, 2005, the Company filed with the PUC its First Quarter FY 2006 GCR Update reflecting no change to the \$12.5632 per Mcf December 1, 2005 GCR.

On August 31, 2005, the Company filed with the PUC its Fourth Quarter FY 2006 GCR Update reflecting an increase in the September 1, 2005 GCR from \$8.9998 per Mcf to \$9.7056 per Mcf. An interim GCR Update filed with the PUC on September 23, 2005 became effective on October 7, 2005 reflecting an increase from \$9.7056 per Mcf to \$12.5632 per Mcf.

On May 31, 2005, the Company filed with the PUC its Third Quarter FY 2005 GCR Update reflecting an increase in the June 1, 2005 GCR from \$8.1122 per Mcf to \$8.9998 per Mcf.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

On February 28, 2005, the Company filed with the PUC its Second Quarter FY 2005 GCR Update reflecting a decrease in the March 1, 2005 GCR from \$9.8857 per MCF to \$8.1122 per Mcf.

On November 29, 2004, the Company filed with the PUC its First Quarter FY 2005 GCR Update reflecting an increase in the December 1, 2004 GCR from \$8.3085 per Mcf to \$9.8857 per Mcf.

On August 30, 2004, the Company filed with the PUC its Fourth Quarter FY 2004 GCR Update reflecting an increase in the September 1, 2004 GCR from \$8.0699 per Mcf to \$8.3085 per Mcf.

On May 28, 2004, the Company filed with the PUC its Third Quarter FY 2004 GCR Update reflecting an increase in the June 1, 2004 GCR from \$7.9254 per Mcf to \$8.0699 per Mcf.

On February 27, 2004, the Company filed with the PUC its Second Quarter FY 2004 GCR Update reflecting an increase in the March 1, 2004 GCR from \$7.6313 per Mcf to \$7.9254 per Mcf.

On November 26, 2003, the Company filed with the PUC its First Quarter FY 2004 GCR Update reflecting a decrease in the December 1, 2003 GCR from \$7.8670 per Mcf to \$7.6313 per Mcf.

On August 29, 2003, the Company filed with the PUC its Fourth Quarter FY 2003 GCR Update reflecting an increase in the September 1, 2003 Restructured GCR from \$5.7687 per Mcf to \$7.8670 per Mcf.

(g) Utility Plant

Utility plant is stated at original cost. The cost of additions, replacements, and betterments of units of property are capitalized and included in the utility plant accounts. The cost of property sold or retired is removed from the utility plant accounts and charged to accumulated depreciation. Normal repairs, maintenance, the cost of minor property items, and expenses associated with retirements are charged to operating expenses as incurred.

In a previous rate order, the PGC disallowed the accrual of the net negative salvage component in depreciation. Cost of removal in the amounts of \$3,643,000 and \$3,261,000 was charged to expense as incurred in FY 2005 and 2004, respectively, and is included in depreciation expense in the statements of operations. Depreciation is calculated on an asset by asset basis on the estimated useful lives of plant and equipment on a straight-line method. The composite rate for FY 2005 and 2004 was 2.4%. The composite rates are supported by a depreciation study of utility plant as of August 31, 2004. The following composite depreciation rates were used for FY 2005:

Production plant	0.97% – 4.75%
Transmission, distribution, and storage	0.83% – 4.12%
General plant	0.38% – 10.84%

Allowance for funds used during construction (AFUDC) is an estimate of the cost of funds used for construction purposes. The AFUDC, as calculated on borrowed funds, reduces interest expense. The AFUDC rate applied to construction work in progress was 5.22% and 5.17% in FY 2005 and 2004, respectively.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

The following is a summary of utility plant activity for the fiscal years ended August 31, 2005 and 2004, respectively (in thousands of dollars):

August 31, 2005				
	Beginning balance	Additions and transfers	Retirements and transfers	Ending balance
Land	\$ 5,267	—	—	5,267
Distribution and collection systems	1,086,476	40,328	(3,402)	1,123,402
Buildings and equipment	381,776	14,024	(9,006)	386,794
Total utility plant, at historical cost	1,473,519	54,352	(12,408)	1,515,463
Under construction	43,527	68,698	(54,342)	57,883
Less accumulated depreciation for:				
Distribution and collection systems	(489,627)	(24,453) *	3,402	(510,678)
Buildings and equipment	(76,683)	(11,451) *	7,188	(80,946)
Utility plant, net	\$ 950,736	87,146	(56,160)	981,722
August 31, 2004				
	Beginning balance	Additions and transfers	Retirements and transfers	Ending balance
Land	\$ 5,310	—	(43)	5,267
Distribution and collection systems	1,046,848	48,353	(8,725)	1,086,476
Buildings and equipment	377,465	6,771	(2,460)	381,776
Total utility plant, at historical cost	1,429,623	55,124	(11,228)	1,473,519
Under construction	37,953	60,398	(54,824)	43,527
Less accumulated depreciation for:				
Distribution and collection systems	(472,675)	(23,527) *	6,575	(489,627)
Buildings and equipment	(66,457)	(12,080) *	1,854	(76,683)
Utility plant, net	\$ 928,444	79,915	(57,623)	950,736

* Cost of removal in the amounts of \$3,643 and \$3,261 was charged to expense as incurred in FY 2005 and 2004, respectively, and is not included in accumulated depreciation.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(h) Revenue Recognition

The Company is primarily a natural gas distribution company. Operating revenues include revenues from the sale of natural gas to residential, commercial, and industrial heating and nonheating customers. The Company also provides natural gas transportation service. Appliance and other revenues primarily consist of revenue from the Company's parts and labor repair program. Revenue from this program is recognized on a deferred monthly basis for the life of the individual parts and labor plans. Additional revenue is generated from collection fees and reconnection charges. Other operating revenues primarily consist of finance charges assessed on delinquent accounts.

Operating expenses include the cost of natural gas and the related costs incurred through the processing, distribution, and delivery of natural gas to residential, commercial, and industrial heating and nonheating customers.

The unbilled gas adjustment results because customers' meters are read, and bills are rendered, on a cycle basis rather than all being read at the end of the month. Revenues are recognized as gas is distributed. Estimated revenues from gas distributed and unbilled, less estimated uncollectible amounts, are accrued and included in operating revenues.

As required by GASB Statement No. 34, *Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments*, operating revenues, reported in the statement of revenues, expenses, and changes in net assets, are shown net of discounts.

(i) Customers (unaudited)

The Company's service territory encompasses the City. Of the Company's approximately 497,000 customers at August 31, 2005, nearly 95.0% are residential.

The Company offers a discounted payment plan for current receivables with a possible forgiveness of arrearages in three years. The total number of customers with discounted payment plans as of August 31, 2005 and 2004 was approximately 65,000 and 53,000, respectively.

The Senior Citizen Discount also provides customers with a discounted payment plan. The total number of customers receiving the discount as of August 31, 2005 and 2004 was approximately 56,000 and 62,000, respectively.

(j) Provision for Uncollectible Accounts

The Company estimates its accumulated provision for uncollectible accounts based on financial analysis and a collectibility study performed at least annually at or near the fiscal year-end. The methodology used in performing the collectibility study has been reviewed with the PGC. For FY 2005 and 2004, management has provided an accumulated provision for uncollectible accounts in excess of the collectibility study results based on its analysis of historical aging data. The actual results of the Company's collection efforts could differ significantly from the Company's estimate.

Due to the seasonal nature of the business, the Company has credit balances at fiscal year-end in accounts receivable in the amounts of \$12,920,000 and \$10,675,000 for FY 2005 and 2004, respectively primarily as a result of prepayment by budget customers.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(k) Gas Inventories, Materials, and Supplies

Gas inventories, materials, and supplies, consisting primarily of fuel stock, gases stored to meet peak demand requirements, and spare parts, are stated at average cost at August 31, 2005 and 2004, as follows (thousands of dollars):

		2005	2004
Gas inventory	\$	121,266	88,821
Material and supplies		8,718	9,646
Total	\$	129,984	98,467

(l) Bond Issuance Costs, Debt Discount, and Premium

Discounts or premiums and bond issuance costs arising from the sale of revenue bonds are amortized using the interest method over the term of the particular bond issue.

(m) Losses on Recquired Debt

Losses on reacquired debt are deferred and amortized, using the interest method, to interest expense over the life of the refunding bond issue as required by the PGC and the GASB.

(n) Pensions

The Company has a noncontributory pension plan (the Pension Plan) covering all employees and providing for retirement payments at age 65 or earlier under various options. These options include a disability pension provision, a preretirement spouse's death benefit, a reduced pension for early retirement, various reduced pension payments for the election of a survivor option, and a provision for retirement after 30 years of service without penalty for reduced age. In accordance with Resolutions of the PGC, Ordinances of City Council, and as prescribed by the City's Director of Finance, the Pension Plan is being funded with contributions by the Company to the Sinking Fund Commission of the City.

On June 26, 2002, the Mayor signed an Ordinance amending and restating retirement benefits for Company employees. The Ordinance restates and replaces various ordinances constituting the Pension Plan since its inception in 1967. The new Ordinance granted the vesting of pension benefits after five years of service replacing the prior provision of a ten-year vesting period. The Company has filed an Application for Determination for Employee Benefit Plan with the Internal Revenue Service. Pursuant to same, the Internal Revenue Service reviewed the Pension Plan and issued a favorable determination letter effective October 21, 2003, subject to the adoption of certain amendments. The required amendments were included in an ordinance passed by City Council in June 2004. Management believes that the Pension Plan is in compliance with all applicable law.

(o) Statements of Cash Flows

For the purpose of reporting cash flows, all nonrestricted highly liquid investments (stated at cost which approximates market) with original maturities of three months or less are considered cash equivalents.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(p) Reserve for Injuries and Damages

The Company is principally insured through insurance carriers; however, the Company is required to cover settlement of claims which are excluded under the provisions of such insurance policies. An estimated liability has been established, in accordance with PGC regulations, for settlements to be paid by the Company in the next fiscal year.

Estimated losses from claims for occurrences not covered by insurance, which will not be paid in the next fiscal year, have been accrued and deferred. Such liabilities have been established based upon Company history and consultation with counsel. Such expenses are expected to be recovered through future rates. Charges against the reserve are made as claims are settled.

(q) Investments

GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, establishes fair value standards for investments held by government entities, except for certain money market investments, as defined, which are recorded at amortized cost. The Company's investments consist of money market investments that have a remaining maturity at time of purchase of one year or less.

(r) Segment Information

All of the Company's assets and operations are employed in only one segment, local transportation and distribution of natural gas in the City.

(s) Estimates

In preparing the financial statements in conformity with accounting principles generally accepted in the United States of America, management uses estimates. The Company has disclosed in the financial statements all estimates where it is reasonably possible that the estimate will change in the near term and the effect of the change could be material to the financial statements.

(t) Presentation

Certain FY 2004 amounts have been reclassified to conform with the FY 2005 presentation.

(2) Ownership and Management

The Company is not a separately incorporated entity, but represents an enterprise fund of the City. As of January 1, 1973, under the terms of a two-year agreement automatically extended for successive two-year periods unless canceled upon 90 days notice by the City, the Company is being managed by the Philadelphia Facilities Management Corporation (PFMC). The agreement, as amended, provides for reimbursement to PFMC of actual costs incurred in managing the Company, not to exceed a total of the prior fiscal year's maximum amount adjusted to reflect the percentage change in the Consumer Price Index for All Urban Consumers (CPI-U) All Items Index, Philadelphia, Pennsylvania, United States Department of Labor, Bureau of Labor Statistics, as most recently published and available to the Director of Finance on March 1 of each such fiscal year. In FY 2005, the applicable maximum amount was calculated to be \$916,000. In FY 2004, the applicable maximum amount was calculated to be \$876,000. The applicable maximum amount in FY 2003 was fixed at \$854,000. The agreement requires the Company to make

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

annual payments of \$18,000,000 to the City. In FY 2004, this payment was not made. In FY 2005, the Company made the annual payment of \$18,000,000 to the City. The City then granted the \$18,000,000 back to the Company.

The Company engages in various other transactions with the City. The Company provides gas service to the City. Operating revenues include \$14,473,000 and \$11,953,000 in FY 2005 and 2004, respectively, relating to sales to the City. Water and sewer services and licenses are purchased from the City. Such purchases totaled \$555,000 and \$784,000 in 2005 and 2004, respectively. Net amounts receivable from the City were \$562,000 and \$355,000 at August 31, 2005 and 2004, respectively.

Certain activities of the PGC are paid for by the Company. Such payments totaled \$909,000 and \$921,000 in FY 2005 and 2004, respectively.

(3) Cash, Cash Equivalents, and Investments

(a) Cash

Cash consists primarily of bank deposits. Bank balances of such deposits at August 31, 2005 and 2004 were \$16,914,000 and \$5,170,000, respectively. Book balances of such deposits at August 31, 2005 and 2004 were \$15,221,000 and \$3,666,000, respectively. Federal depository insurance on these balances at August 31, 2005 and 2004 was \$290,000 and \$162,000, respectively.

(b) Cash Equivalents and Investments

Statutes authorize the Company to invest in obligations of the U.S. Treasury, U.S. government agencies and instrumentalities, and repurchase agreements (collateralized by obligations of the U.S. Treasury and government agencies).

For the Company's cash equivalents, the Company's cash balances fluctuate significantly during the year. Excess cash balances are usually invested in repurchase agreements or money market accounts. The highest balances of repurchase agreements and money market accounts during the fiscal years ended August 31, 2005 and 2004 were \$79,800,000 and \$32,650,000, respectively. Money market accounts with a carrying amount (at market value) of \$14,825,000 and \$3,595,000 at August 31, 2005 and 2004, respectively, could not be classified as to credit risk.

(c) Restricted Investment Funds

The Company's Sinking Fund, Capital Improvement Fund, and City Loan Escrow Account investments, consisting primarily of U.S. Treasury and government agency obligations, are maintained by the City or in the Company's name by its agent. The balance of the Capital Improvement Fund at August 31, 2005 and 2004 was \$102,701,000 and \$40,494,000, respectively. The unexpended Capital Improvement Fund proceeds are restricted to the purchase of utility plant. In FY 2005 and 2004, the Company utilized the Capital Improvement Fund to provide liquidity for the additions to utility plant.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

The following is a schedule that details the Company's investments in the Capital Improvement Fund (thousands of dollars):

<u>Investment type</u>	<u>Fair value</u>	<u>Weighted average maturity (years)</u>	<u>Credit rating</u>	<u>Rating agency</u>
Guaranteed Investment Contract	\$ 77,892	**	*	*
Money market	24,590	N/A	N/A	
Accrued interest	<u>219</u>			
Total fair value of investments	<u>\$ 102,701</u>	N/A		

* The credit rating of this investment is unrated.

** There is a schedule of drawdowns and an expiration date for the GIC of May 15, 2007.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

The following is a schedule that details the Company's investments in the Sinking Fund (thousands of dollars):

Investment type	Fair value	Weighted average maturity (years)	Credit rating	Rating agency
Forward Delivery Agreement	\$ 55,924	15.5000	*	*
U.S. government obligations	18,636	1.8406	Aaa/AAA	Moody's/S&P
U.S. government agencies and Instrumentalities	18,499	1.3495	Aaa/AAA	Moody's/S&P
Corporate obligations	1,040	1.7917	Aaa/AAA	
Corporate obligations	3,138	2.3161	Aa1/AA-	Moody's/S&P
Total corporate obligations	4,178			
State obligations	994	25.2083	AA-	S&P
Guaranteed Investment Contract	6,054	(a)	*	*
Total fair value of investments	104,285			
Money market	231	N/A	N/A	
Accrued interest	14			
Total fair value of investments, including cash deposits	\$ 104,530			
Portfolio weighted modified duration		2.2087		

* The credit rating of this investment is unrated.

(a) There is a schedule of drawdowns and an expiration date for the GIC of September 1, 2006.

GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, establishes fair value standards for investments held by government entities, except for certain money market investments, as defined, which are recorded at amortized cost. The adjustment to market value for the Capital Improvement Fund and the Capital Lease Fund resulted in no gains or losses at August 31, 2005 and 2004. The Funds were held in money market investments and the GIC at August 31, 2005. The adjustment to market value for the Sinking Fund resulted in a loss of \$317,000 and \$136,000 at August 31, 2005 and 2004, respectively.

The Company has established a City Loan Escrow account as a disbursement precondition to the utilization of the funds from the City Loan. The restricted account is interest bearing, the interest on which accrues to the benefit to the City. The Company may only draw on the account after providing

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

details of the projected cash deficit that the draw will be utilized to fund. The Company, on a daily basis, must deposit excess cash into the restricted account. The balance at August 31, 2005 and 2004 was \$0.

(d) Interest Rate Risk

It is the policy of the City to diversify its investment portfolios. Portfolio diversification is employed as a way to control interest rate risk. Investments shall be diversified as to maturities and as to kind of investment to eliminate the risk of loss which might result from overconcentration of assets in a specific maturity, in a specific kind of a security, or from a specific issuer.

(e) Credit Risk

The City has adopted an investment policy relating to the investments of the Company. Per the investment policy, the Company's allowable investments are: (1) bonds or notes of the U.S. government; (2) U.S. Treasury obligations, including STRIPs; receipts indicating an undivided interest in such U.S. Treasury obligations; and stripped coupons held under book-entry with the New York Federal Reserve Bank; (3) U.S. agency obligations rated Aaa/AAA by Moody's Investor Services or Standard & Poor's; (4) collateralized certificates of deposit; (5) bankers acceptances, Eurodollars deposits, and Euro certificates of deposit that are collateralized; (6) commercial paper rated MIG1 or A1+ by Moody's Investor Services and Standard & Poor's, respectively; (7) general obligation bonds of corporations rated AA or better by Moody's Investor Services or Standard & Poor's, with a maturity of two years or less (except the Sinking Fund); (8) collateralized mortgage obligations and pass-through securities rated AA or better by Moody's Investor Services or Standard & Poor's or collateralized with securities that meet the Company's own investment criteria, with a maturity of two years or less (except the Sinking Fund); (9) money market mutual funds, as defined by the Securities and Exchange Commission; (10) repurchase agreements collateralized either through actual delivery of eligible collateral or through segregation of collateral by a depository that is holding the counterparty's securities, provided such collateral meets the Company's own investment criteria; and (11) obligations of the Commonwealth of Pennsylvania (the Commonwealth) or any municipality or other political subdivision of the Commonwealth, registered or otherwise as to principal and interest, with a maturity of two years or less (except the Sinking Fund).

Authorized investments for Sinking Fund Portfolios are dictated by the First Class City Revenue Bond Act and as stated in Bond Counsel opinion, and include any investment vehicle permitted for any state agency.

(f) Custodial Credit Risk

The Company has selected custodian banks that are members of the Federal Reserve System to hold its investments. Delivery of the applicable investment documents (e.g., contracts, securities, and safekeeping receipts) to the Company's custodian is required for all investments. For secured transactions, such as repurchase agreements, either the title to or a perfected security interest in the securities, along with any necessary transfer documents, must be transferred to the custodian. Such transactions will always use delivery versus payment procedures. Safekeeping procedures of the

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

custodian shall be reviewed annually by independent auditors, and a copy of their report shall be supplied to the Company for review.

(g) Concentration of Credit Risk

More than 5% of the Company's investments are in the GIC with Royal Bank of Canada and the Forward Delivery Agreement with FSA Capital Markets Services, LLC. These investments are 40.5% and 27.0%, respectively, of the Company's total investments.

(4) Deferred Costs

In compliance with rate orders issued by the PGC, the cost of projects that produce benefits over an extended period are deferred. Such costs are being amortized to expense over a period matching their useful lives, which range from two to ten years. There were no costs in FY 2005 that were deemed to be deferred. The unamortized costs included in other assets and deferred debits were \$642,000 and \$2,875,000 as of August 31, 2005 and 2004, respectively. The unamortized costs included in other current assets and deferred debits were \$1,550,000 and \$1,908,000 as of August 31, 2005 and 2004, respectively.

As a result of settlements during FY 2005 by PGW's insurance carriers associated with environmental remediation costs, the Company recorded \$11,790,000 in FY 2005. Environmental remediation costs of approximately \$6,303,000 were offset by this insurance settlement. Additional environmental remediation costs of \$9,513,000 were recorded as a deferred cost and a deferred regulatory asset based on an engineering assessment.

(5) Deferred Compensation Plan

The Company offers its employees a deferred compensation plan (the Plan) created in accordance with *Internal Revenue Code* Section 457. The Plan, available to all Company employees with six months of service, permits them to defer a portion of their salary until future years. The Company provides a matching contribution that immediately vests to the employee.

The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency in accordance with the *Internal Revenue Code*.

During the fiscal year ended August 31, 1999, the Plan was amended to comply with *Internal Revenue Code* Section 457, subsection (g) through the creation of a trust in which all assets and income of the Plan are to be held for the exclusive benefit of participants and their beneficiaries. As a result, the Company no longer owns the assets of the Plan nor has a contractual liability to Plan participants.

(6) Notes Payable

Pursuant to the provisions of certain ordinances and resolutions of the City, the Company may sell short-term notes in a principal amount that, together with interest, may not exceed \$100,000,000 outstanding at any one time. These notes are intended to provide additional working capital. They are supported by an irrevocable letter of credit and a subordinated security interest in the Company's revenues. On May 29, 2002, the Mayor signed an Ordinance authorizing the continued issuance and sale by the Company of the short-term notes. The terms of the Ordinance enable the Company to do so through a date no later than the fifth anniversary of the date of the enactment of this Ordinance.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

A new Series D of the tax-exempt commercial paper program was instituted on August 30, 2002 concurrently with the expiration of Series C. The expiration date of the credit agreement was extended to August 15, 2003. The previous credit agreements contained language that granted to the agent bank the option to accelerate the expiration of the credit agreement if the Company's long-term debt were rated below investment grade for a period of six months by at least two rating agencies. The acceleration clause has been removed from the new credit agreement, and notification of this fact has been transmitted to the rating agencies.

A new Series D of the tax-exempt commercial paper program was instituted on August 7, 2003. The expiration date of the credit agreement was extended to August 14, 2004. The credit agreement was further amended and restated as of July 20, 2004. The expiration date of the credit agreement was extended to August 15, 2005. On August 8, 2005, the credit agreement was further amended and restated with an expiration date of May 29, 2007, which is concurrent with the expiration of the General Inventory Receivables Gas Works Revenue Note Ordinance of 1998. Under the new credit agreement, the commitment amount was increased from \$80,000,000 to \$100,000,000.

The notes outstanding at August 31, 2005 had an average weighted interest rate of approximately 2.4% and remaining time to maturity of two days. The principal amount outstanding at August 31, 2005 and 2004 was \$49,900,000 and \$50,750,000, respectively. All of the notes outstanding at August 31, 2005 matured on September 2, 2005, with a portion of the notes being reissued.

On December 22, 2005, the Mayor signed an ordinance authorizing an increase in the authorized amount of short-term notes in a principal amount that, together with interest, may not exceed \$150,000,000 outstanding at any one time. Additionally, the Bill included a provision to extend the authority to issue notes from May 2007 to August 2010.

(7) GCR Tariff Reconciliation

During the fiscal year ended August 31, 2005, the Company's actual gas costs were below its billed gas costs by \$21,369,000. The Company deferred this amount at August 31, 2005. This amount will be included in the First Quarter GCR Filing.

During the fiscal year ended August 31, 2004, the Company's actual gas costs were below its billed gas costs by \$337,000. The Company deferred this amount at August 31, 2004. This amount was included in subsequent GCR Filings.

During the fiscal year ended August 31, 2003, the Company's actual gas costs exceeded its billed gas costs by \$12,303,000. The Company deferred this amount, which is included in other current assets and deferred debits at August 31, 2003. This amount was included in the November 26, 2003 First Quarter GCR Filing.

Natural Gas Pipeline Supplier Refund

The Company received refunds in FY 2005 for the amount of \$592,000 related to Rate Cases. This amount was utilized as a reduction in the cost of gas for reconciliation purposes in the calculation of the GCR for FY 2005.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

The Company received refunds in FY 2004 for the amount of \$143,000 related to Rate Cases. This amount was utilized as a reduction in the cost of gas for reconciliation purposes in the calculation of the GCR for FY 2004.

(8) Long-Term Debt

The following summary of long-term debt consists primarily of bonds issued by the City under agreements whereby the Company must reimburse the City for the principal and interest payments required by the bond ordinances (thousands of dollars):

	August 31, 2005			August 31, 2004		
	Current portion	Long-term	Total	Current portion	Long-term	Total
Revenue bonds	\$ 40,881	1,018,803	1,059,684	39,245	909,627	948,872
Unamortized debt discount	(668)	(8,816)	(9,484)	(698)	(8,894)	(9,592)
Unamortized premium	2,058	20,843	22,901	1,319	12,781	14,100
Total revenue bonds	42,271	1,030,830	1,073,101	39,866	913,514	953,380
Subordinate lease obligations	—	—	—	1,947	—	1,947
Note payable – City Loan	—	45,000	45,000	—	—	—
Total	\$ 42,271	1,075,830	1,118,101	41,813	913,514	955,327

The following is a summary of activity related to revenue bonds, subordinate lease obligations, and certain other liability balances for the fiscal years ended August 31, 2005 and 2004 (thousands of dollars):

	Year ended August 31, 2005				
	Beginning balance	Additions	Reductions	Ending balance	Amounts due within one year
Revenue bonds	\$ 948,872	207,820	(97,008)	1,059,684	40,881
Subordinate lease obligations	1,947	—	(1,947)	—	—
Total bonds and subordinate lease obligations	\$ 950,819	207,820	(98,955)	1,059,684	40,881
Other liabilities:					
Compensated absences	\$ 2,153	60	—	2,213	2,213
Claims and judgments	7,366	3,859	(2,715)	8,510	3,521
Accrued bond interest payable	6,569	9,312	(6,569)	9,312	9,312
Total other liabilities	\$ 16,088	13,231	(9,284)	20,035	15,046

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

Year ended August 31, 2004					
	Beginning balance	Additions	Reductions	Ending balance	Amounts due within one year
Revenue bonds	\$ 988,256	—	(39,384)	948,872	39,245
Subordinate lease obligations	5,692	—	(3,745)	1,947	1,947
Total bonds and subordinate lease obligations	\$ 993,948	—	(43,129)	950,819	41,192
Other liabilities:					
Compensated absences	\$ 2,041	112	—	2,153	2,153
Claims and judgments	8,239	1,590	(2,463)	7,366	3,235
Accrued bond interest payable	6,874	6,569	(6,874)	6,569	6,569
Total other liabilities	\$ 17,154	8,271	(9,337)	16,088	11,957

Principal maturities and scheduled interest payments for revenue bonds are as follows (thousands of dollars):

	Revenue bonds		
	Principal	Interest	Total
Fiscal year ending August 31:			
2006*	\$ 40,881	52,110	92,991
2007	39,425	50,410	89,835
2008	40,055	48,404	88,459
2009	39,735	46,347	86,082
2010	41,280	44,271	85,551
2011-2015*	195,263	194,285	389,548
2016-2020	197,295	143,813	341,108
2021-2025	209,965	90,953	300,918
2026-2030	171,715	39,233	210,948
2031-2035	84,070	7,184	91,254
Total	\$ 1,059,684	717,010	1,776,694

* T.E.C.A. Accretions for the 12 "A" Series for \$224,000 is not included in principal amount in FY 2006. T.E.C.A. Accretions for the 11 "C" Series for \$8,787,000 is not included in principal amount in FY 2011-2015.

(a) Recent Bond Issuances

On May 27, 2004, two bills were introduced into City Council related to the authorization to sell Gas Works Revenue Bonds. The first bill, constituting the Sixth Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1998 (the 1998 Ordinance), authorizes the sale in an aggregate principal amount of up to \$150,000,000 of Fifth Series A Gas Works Revenue Bonds (Fifth Series A Bonds) under the 1998 Ordinance. The Fifth Series A Bonds were issued for the

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

sale in an aggregate principal amount of up to \$18,000,000 of Fifth Series B Gas Works Revenue Bonds (Fifth Series B Bonds) under the 1998 Ordinance. The Fifth Series B Bonds may be issued for the purpose of providing funds redeeming or refunding certain outstanding Gas Works Revenue Bonds and related project costs, but as of August 31, 2005, there were no Fifth Series B Bonds issued.

The second bill, constituting the Eighteenth Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1975 (the 1975 Ordinance), authorizes the sale in an aggregate principal amount of up to \$75,000,000 of Gas Works Revenue Bonds under the 1975 Ordinance. The bonds were issued for the purpose of providing funds for the redeeming or refunding on a current basis all or any portion of the outstanding Fifteenth Series Gas Works Revenue Bonds.

City Council approved the bills on June 21, 2004, and the Mayor signed the bills into law on July 1, 2004.

On October 14, 2004, the Company issued \$120,000,000 of new debt for the purpose of providing funds for the financing of the capital projects included in the capital program of the Company. This new debt was issued as the Fifth Series A 1 Bonds under the 1998 Ordinance. The interest rates on the \$70,275,000 of Serial Bonds ranged from 4% to 5.25%. The interest rate on the \$49,725,000 of Term Bonds was 5%. The bonds, consisting of Serial Bonds and Term Bonds, have maturity dates through 2033.

On October 14, 2004, the Company issued \$57,820,000 of new debt for the purpose of redeeming and refunding, on a current basis, a portion of the outstanding Fifteenth Series City of Philadelphia, Pennsylvania, Gas Works Revenue Bonds previously issued under the 1975 Ordinance. The par amount of the Fifteenth Series Bonds being redeemed and refunded was \$58,995,000. This new debt was issued as the Eighteenth Series under the 1975 Ordinance. The interest rates on the \$57,820,000 of Serial Bonds ranged from 3% to 5.25%. The bonds consisting of Serial Bonds have maturity dates through 2021.

On October 19, 2004, the Company issued \$30,000,000 of new debt for the purpose of providing funds for the financing of the capital projects included in the capital program of the Company. This new debt was issued as the Fifth Series A 2 Bonds under the 1998 Ordinance. The interest rates on the \$30,000,000 of Fifth Series A 2 Bonds will initially bear interest at a weekly rate and during such weekly mode interest will be payable on the first business day of each month commencing November 1, 2004. Thereafter, the City may designate a different rate mode for the Fifth Series A 2 Bonds. The bonds have maturity dates through 2034.

Proceeds of all series of revenue bonds were applied to reduce capital improvement loans from the City that had been previously approved by the voters but for which bonds had not been issued, to fund future capital projects by deposits in the Capital Improvement Fund, or to refund bonds previously issued. The serial bonds are not subject to redemption prior to maturity while the term bonds are subject to redemption at the option of the City after a designated date, either in whole or in part, at varying redemption prices. In addition, the term bonds are subject to mandatory redemption after a designated date prior to maturity at a redemption price of 100% of principal amount and accrued interest. Funds deposited in a Sinking Fund may be used for this purpose.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

(b) Bond Ordinances

Under the terms of both general ordinances, the City is required to maintain rates to allow the Company to satisfy 1975 and 1998 revenue bond debt coverage ratio requirements. The Company has satisfied the debt coverage requirements in FY 2005 and 2004.

Also provided by both general ordinances is the establishment of a Sinking Fund into which deposits are made sufficient to meet all principal and interest requirements of the bonds as they become due. Both general ordinances also provide that Sinking Fund reserves be maintained as part of the Sinking Fund, which have heretofore initially been funded from the proceeds of each series of bonds in an amount equal to the maximum annual debt service requirement on the bonds of each such series in any fiscal year.

Monies in the Sinking Fund reserves are to be applied to the payment of debt service if, for any reason, other monies in the Sinking Fund should be insufficient.

The revenue bonds are, and will be, equally and ratably collateralized by a security interest in all of the Company's project revenues, as defined in the general ordinances, and monies in the Sinking Fund.

Portions of certain revenue bonds were issued as zero-coupon securities. Interest on these securities is accrued and compounded on the payment dates of the current interest bonds within the issue. The accrued interest is reported as long-term debt.

On December 22, 2005, the Mayor signed an ordinance into law authorizing the City to issue revenue bonds for the purpose of (a) refunding all or a portion of the following Series of Gas Works Revenue Bonds (1998 General Ordinance): First Series B, Second Series A, Third Series, Fourth Series, and Fifth Series; (b) paying the costs of issuing the bonds and making any required deposits to the Sinking Fund Reserve; and (c) paying any other Project Costs, which may include, without limitation, the repayment to any fund of the City or to accounts of the Company of amounts advanced for Project Costs.

(c) Subordinate Lease Obligations

In August 1997, the City entered into a contract with the Philadelphia Municipal Authority (the PMA) to have the PMA provide certain capital equipment to the Company. The equipment value cannot exceed \$32,000,000. The equipment is owned by the PMA and leased to the City for the exclusive use of the Company. On August 22, 1997, the PMA issued \$23,000,000 of revenue bonds with terms to October 1, 2004 to provide funding to purchase the equipment. Payments made by the City under the contract are made solely from the revenues of the Company and are subordinate to certain other payments from the Company's revenues. Accordingly, these assets and corresponding lease obligations are included in the Company's financial statements.

In 2005, ownership of these leased assets was transferred to the Company. The assets were fully depreciated at the date of transfer. The gross amount of assets under such lease obligation was approximately \$17,645,000 at August 31, 2004. The amortization of such assets is included in depreciation expense in the statements of operations. The unexpended balance of the PMA bond

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

proceeds of \$2,005,000 at August 31, 2004 in the Capital Lease Fund was restricted to the purchase of additional utility plant. There was no balance at August 31, 2005.

(d) Interest Swap Agreement

On December 28, 1999, the Company entered into an interest swap agreement with a financial institution. Under the swap agreement, the financial institution had the option, under certain circumstances, to pay the Company a fixed rate of 5.01% on a notional amount of \$103,550,000 (amortizing down to \$14,670,000 on January 3, 2028) and receive a floating rate payment based on the "Municipal Swap Index" plus 0.5%. The financial institution paid the Company \$8,645,000 for this option right in FY 2000. The purpose of the transaction was to provide additional funding for the Company's main and service cast iron replacement program.

The swap agreement was terminated on September 30, 2004 with a termination payment of \$8,014,000 being made on October 4, 2004. The transaction resulted in a net loss of \$890,000 as compared to the unamortized balance of \$7,124,000 in October 2004.

(e) Forward Delivery Agreement and Guaranteed Investment Contracts

On August 23, 2002, the City entered into Guaranteed Investment Contracts (GICs) in connection with a portion of its 1975 and 1998 Ordinance Sinking Fund Reserves for the Company. At settlement, approximately 65% of the Sinking Fund Reserves, from the two ordinances, totaling \$61,396,000 were invested in the GICs. In exchange for this investment, the Company received an up-front payment of \$21,800,000 in lieu of receiving interest payments over the life of the GICs. The Company also paid \$1,650,000 to terminate an existing Forward Delivery Agreement. Of the remaining net proceeds of \$20,150,000, \$8,596,000 and \$11,554,000 were allocated to the 1975 and 1998 Sinking Fund Reserves, respectively. For debt service coverage purposes, the \$20,150,000 was considered "project revenues" in FY 2002. For financial statement purposes, the \$8,596,000 was recorded as revenue in FY 2002 in the category of interest and other income. This amount is nonrefundable and was granted to the Company by the City.

Under the 1998 Ordinance, the Company is entitled to the earnings on the portion of the Sinking Fund allocated to bonds issued under the 1998 Ordinance. Therefore, the \$11,554,000 received under the 1998 ordinance was deferred and is being amortized on a straight-line basis over the life of the agreement, 18-1/2 years. The unamortized balance of the proceeds was \$9,680,000 and \$10,305,000 at August 31, 2005 and 2004, respectively.

(f) Note Payable – City Loan

On November 15, 2000, the Mayor signed an ordinance authorizing the City to advance in whole or in part up to \$45,000,000 to the Company in order to enable the Company to operate through the winter of 2000-2001. The loan is subject to the Company submitting a Five-Year Financial and Management Plan. This plan was accepted by City Council in January 2001. The loan from the City carries no interest. The loan originally had to be repaid in full within 24 months following the first draw under the loan agreement, but no later than January 2003. On May 15, 2002, the Mayor signed an ordinance authorizing the extension of the repayment period of the City loan. The repayment period for the \$45,000,000 temporary advance was extended from a date no later than June 30, 2003

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

to a date no later than August 29, 2006. On December 22, 2005, the Mayor signed an ordinance extending the repayment date of the loan from August 2006 to August 2008. All of the other terms of the loan remain unchanged.

The loan from the City is subordinate to the Company's other repayment obligations on its revenue bonds and commercial paper program. The outstanding balance of the City loan was \$45,000,000 at August 31, 2005 and 2004.

(9) Defeased Debt

Defeased debt of the Company (bonds issued by the Company payable from the proceeds of irrevocably pledged assets) at August 31, 2005 was as follows:

	<u>Latest date maturing to</u>	<u>Interest rate</u>	<u>Bonds outstanding</u>
7th Series	3/15/13	6.00%	\$ 10,675,000
12th Series B	5/15/20	7.00%	54,940,000

The investments held by the trustee and the defeased bonds are not recognized on the Company's balance sheets in accordance with the terms of the Indentures of Defeasance. The investments pledged for the redemption of the defeased debt have maturities and interest payments scheduled to coincide with the trustee cash requirements for debt service.

The assets pledged, primarily noncallable U.S. government securities, had a market value of \$74,473,000 at August 31, 2005, bearing interest on face value from 0% to 5.89%.

(10) Accounting for Pension Costs

(a) Plan Description

The Company sponsors a public employee retirement system (PERS), a single-employer defined-benefit plan to provide pension benefits for all of its employees, whose annual covered payroll (which was substantially equal to total payroll) was \$102,500,000 and \$101,200,000 at August 31, 2005 and 2004, respectively.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

At September 1, 2003, the beginning of the plan year of the last actuarial valuation, the Pension Plan membership consisted of:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving them	2,157
Current employees:	
Vested	1,365
Nonvested	373
Total current employees	1,738
Total membership	3,895

The Pension Plan provides retirement benefits as well as death and disability benefits. Retirement benefits vest after five years of credited service. Employees who retire at or after age 65 are entitled to receive an annual retirement benefit, payable monthly, in an amount equal to the greater of:

- 1.25% of the first \$6,600 of Final Average Earnings plus 1.75% of the excess of Final Average Earnings over \$6,600, times years of credited service, with a maximum of 60% of the highest annual earnings during the last 10 years of credited service, or
- 2% of total earnings received during the period of credited service plus 22.5% of the first \$1,200 annual amount, applicable only to participants who were employees on or prior to March 24, 1967.

Final Average Earnings are the employee's average pay, over the highest five years of the last ten years of credited service. Employees with 15 years of credited service may retire at or after age 55 and receive a reduced retirement benefit. Employees with 30 years of service may retire without penalty for reduced age.

Covered employees are not required to contribute to the Pension Plan. The Company is required by statute to contribute the amounts necessary to finance the Pension Plan. Benefit and contribution provisions are established by City ordinance and may be amended only as allowed by City ordinance.

The City issues a publicly available financial report that includes financial statements and required supplementary information for the Pension Plan. The report may be obtained by writing to the Director of Finance of the City.

(b) Annual Pension Cost, Contributions Required, and Contributions Made

In 2005, contributions of \$14,702,000 consisted of \$7,015,000 normal cost plus \$7,687,000 amortization of the underfunded balance of the plan assets under the pension benefit obligation. In 2004, contributions of \$14,973,000 consisted of \$6,980,000 normal cost plus \$7,993,000 amortization of the underfunded balance of the plan assets under the pension benefit obligation. In 2003, contributions of \$13,013,000 consisted of \$7,411,000 normal cost plus \$5,602,000

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

amortization of the underfunded balance of the plan assets under the pension benefit obligation. In recent years, payments to beneficiaries exceeded the Company's annual required pension contribution.

Withdrawals from pension assets of \$16,502,000 and \$15,754,000 in 2005 and 2004, respectively, were utilized to meet beneficiary payment obligations.

The Company's annual pension cost is equal to its annual required contribution. The annual required contribution for the Plan Year September 1, 2003 through August 31, 2004 was determined based on an actuarial study completed in August 2004 using the projected unit credit method. The annual required contribution for the Plan Year September 1, 2004 through August 31, 2005 was determined based on an actuarial study completed in August 2004, as updated using the projected unit credit method. Significant actuarial assumptions used for the above valuation include a rate of return on the investment of present and future assets of 8.25% per year compounded annually; projected salary increases of 3% of the salary at the beginning of the next three years, then 4.25% of the salary at the beginning of the fourth and subsequent year; and retirements that are assumed to occur prior to age 62, at a rate of 10% at ages 55 to 61 and 100% at age 62. The assumptions did not include postretirement benefit increases.

The actuarial asset value is equal to the value of the fund assets as reported by the City with no adjustments. The unfunded actuarial accrued liability is being amortized over ten years.

The Pension Plan funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate assets to pay benefits when due. Level percentages of payroll employer contribution rates are determined using the Projected Unit Credit actuarial funding method.

(c) *Historical Trend Information (unaudited)*

Historical trend information reflecting funding progress and contributions made by the Company is presented in the supplemental schedule of pension funding progress (unaudited).

(d) *Postemployment Benefit Information*

In addition to providing pension benefits, the Company also provides health care and life insurance benefits to Pension Plan beneficiaries and their dependents. Such benefits are funded and expensed on a pay-as-you-go basis. The Company recognizes the cost of providing health care benefits for the 1,958 and 1,981 beneficiaries and their dependents for FY 2005 and 2004, respectively, and the cost of providing such benefits for 1,767 and 1,739 active employees and their dependents for FY 2005 and 2004, respectively, by charging the annual insurance premiums to expense.

Total premiums incurred for health care amounted to \$33,571,000 and \$32,863,000 in 2005 and 2004, respectively, of which approximately 50% represents payments on behalf of retired employees and their dependents. Total premiums for group life insurance were \$2,092,000 and \$2,078,000 in 2005 and 2004, respectively. The amount attributed to retirees was approximately 76% and 77% in FY 2005 and 2004, respectively.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

Also, the Company has entered into several one-year contracts to provide health care for both active and retired employees that are experience rated, and premiums are adjusted annually; in addition, the Company has in place approximately \$164,126,000 of group life insurance coverage for both active and retired employees, which is retrospectively rated on a monthly basis. The Company also has in place approximately \$128,523,000 of accidental death and dismemberment insurance coverage for active employees.

(11) Risk Management

The Company is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. While self-insured for many risks, the Company purchases insurance coverage where appropriate. The Company's property was insured against the risk of loss or damage, without aggregate limits, in the amount of \$250,000,000 per occurrence with a \$100,000 retention (deductible) subject, however, to an annual aggregate limit of \$50,000,000 for earthquake and an annual aggregate limit of \$50,000,000 for flood subject to a \$1,000,000 retention (deductible), generally; and to lower flood limits as to the Richmond plant through the end of October 2001. Because of the dramatic effect of the September 11, 2001 terrorist attacks on the insurance market, the Company was unable to renew the property coverage with the same terms.

Property coverage has been continuously renewed on an annual basis, and the current policies, in effect as of October 31, 2004, still provide a program limit of \$250,000,000 per occurrence with no aggregate limits. However, the \$100,000 retention has been raised to \$500,000 for losses at the Passyunk and Richmond plants. In addition, the annual aggregate limits for earthquake and flood have been reduced to \$50,000,000 with lower limits for flood losses at the Richmond plant. The Company's property insurance includes coverage for damage incurred from a terrorist attack. In addition, the Company maintains boiler and machinery, blanket crime, and other forms of property insurance.

The Company maintains \$210,000,000 in liability (including terrorism) coverage, insuring against the risk of damage or injury to the public with a \$500,000 deductible per occurrence.

In the past, the Company maintained workers' compensation (including terrorism) coverage with a limit of \$35,000,000 each accident or each employee for disease, in excess of a \$500,000 per incident self-insured retention and an additional \$20,000,000 in coverage on a single-occurrence basis for on-duty injuries to employees. In September 2004, the Company was able to purchase statutory workers' compensation (including terrorism) limits and currently maintains a policy with a limit of \$35,000,000 in excess of the Company's self-insured retention of \$500,000 each accident or each employee for disease and a second policy providing statutory limits. This was a change from the period of 2001 through 2004, when the Company's limits were capped at \$55,000,000. For many years prior, the Company had always had statutory limits. None of the Company's losses have been settled with the purchase of annuity contracts.

Since February 28, 2000, the Company has continuously purchased public officials liability (directors and officers liability) coverage with a \$10,000,000 annual aggregate limit and a \$500,000 retention. The current policy was renewed for another one-year term, effective February 28, 2005.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

Claims and settlement activity for occurrences excluded under the provisions of insurance policies for injuries and damages is as follows (thousands of dollars):

	<u>Beginning of year reserve</u>	<u>Current year claims and adjustments</u>	<u>Claims settled</u>	<u>End of year reserve</u>	<u>Current liability amount</u>
Fiscal year ended August 31:					
2004	\$ 8,239	1,590	(2,463)	7,366	3,235
2005	7,366	3,859	(2,715)	8,510	3,521

(12) Commitments and Contingencies

Commitments for major construction and maintenance contracts were approximately \$7,383,481 as of August 31, 2005.

The Company is committed under various noncancelable operating lease agreements to pay minimum annual rentals as follows (thousands of dollars):

Fiscal year ending August 31:

2006	\$ 580
2007	218

Rent expense for the fiscal years ended August 31, 2005 and 2004 amounted to \$895,000 and \$859,000, respectively.

The Company, in the normal course of conducting business, has entered into long-term contracts for the supply of natural gas and firm transportation and long-term firm gas storage service. The Company's cumulative obligations for demand charges for all of these services are approximately \$5,700,000 per month.

The Company has entered into seasonal contracts with suppliers providing the Company the ability to fix the price of the purchase of natural gas during the period from November 1, 2004 through March 31, 2005.

The Company's operations and facilities are subject to federal, state, and local environmental requirements, including the need to obtain certain permits and approvals. Because these requirements are subject to change, additional or different requirements may be imposed upon the Company in the future. No assurances can be given that the Company would be able to comply with any such changed or new requirements, or that compliance with such requirements would not materially increase the Company's capital or operating costs, or have a material adverse effect on its financial position.

Like many providers of utility services throughout the northeastern United States, the Company has been in operation for more than 100 years, and many of its facilities were built decades ago. As a result of preliminary internal environmental evaluations of its facilities, the Company believes that several of its facilities that had been used in gas manufacturing contain contaminants from those operations or from other sources, and that certain equipment and processes that the Company removed from service years ago may no longer comply with current environmental requirements. In order to address these issues, the Company and the City voluntarily approached the Pennsylvania Department of Environmental Protection

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

to reach an agreement with DEP on a comprehensive program pursuant to which the Company will address identified environmental issues.

At this time, the Company is unable to determine the full extent to which it may be necessary to remediate environmental conditions impacting its facilities, or the final costs of any such remedial work. The Company's pending agreement with DEP provides that DEP will cooperate with the Company to develop a schedule for any necessary work. The Company expects that this will allow for the proper allocation resources in a manner calculated to avoid any material adverse effect on the Company's cash flows. Nevertheless, until a definitive schedule is finalized with DEP, it is not possible to determine with quantifiable certainty many of the costs of potential site remediation and whether such costs would have a material adverse effect on the Company's financial position, results of operations; or cash flows.

The Company has received from its engineering firm and forwarded to DEP Phase 1 and 2 site assessments on relevant properties. DEP has approved these final reports, and the Company is moving forward on a series of remedial projects that will meet clean-up standards as set in DEP's Act 2 Program. Preliminary indications are that Company expenditures may be in the range of \$15,000,000 to \$20,000,000 over the next five years. These estimates are subject to substantial revision. The Company has allocated \$15,000,000 for estimated future environmental costs. The Company is also pursuing further recovery for remediation against environmental insurance policies.

The FY 2006 Capital Budget received a positive recommendation from the PGC in the amount of \$64,619,000. This recommendation is being forwarded to City Council for its approval. In this budget, funding is provided to implement an 18-mile Cast Iron Main Replacement Program. The forecasted cost for this program in FY 2006 is \$14,832,000. The total six-year cost of this program is forecasted to be approximately \$92,791,000.

The FY 2006 Capital Budget also includes \$716,000 for the purchase of replacement Automatic Meter Reading (AMR) devices. The total six-year cost to purchase replacement AMR devices is approximately \$25,754,000.

The Company's FY 2005 Capital Budget was originally approved by City Council in the amount of \$58,652,000. Later, a budget amendment in the amount of \$5,295,000 was approved by City Council, increasing the FY 2005 Capital Budget authorization to \$63,947,000. Within this revised approval, funding is provided to continue the implementation of an 18-mile Cast Iron Main Replacement Program. Main replacement cost for this program in FY 2005 is \$14,896,000. The total six-year cost of the Cast Iron Main Replacement Program is forecasted to be approximately \$82,753,000.

The FY 2005 Capital Budget also includes \$726,000 for the purchase of replacement AMR units. The total six-year cost of this program to replace AMR units is approximately \$21,879,000.

PHILADELPHIA GAS WORKS

Notes to Financial Statements

August 31, 2005 and 2004

State and Local Sales and Use Tax

On November 7, 2002, the Commonwealth of Pennsylvania Department of Revenue and Bureau of Audits (the Department) filed with the Company an acknowledgement of postaudit conference document (the document). This document pertained to an audit that was performed by the Department for the period from January 1, 1997 through December 31, 1999 related to the accrual and remittance of sales tax on gas sales and purchases of services that are taxable for the Company's customers. The Department concluded in the document that the Company did not properly charge and remit sales and use tax to the Department on various customers throughout the audit period. The total assessment was \$3,853,000 including penalties and interest.

An administrative appeal was filed by the Company with the Department's Board of Appeals (the Board of Appeals) on January 22, 2003. A reduction to the assessment was made by the Board of Appeals. The Company appealed the Board of Appeals' decision to the Board of Finance and Revenue (the BF&R). The BF&R reduced the assessment. As a result, the Company's total assessment, including interest of \$682,000, was lowered to \$2,550,000. The Company has remitted this amount to the Commonwealth. On September 10, 2004, the Company filed with the Commonwealth Court a petition for de novo review of the BF&R's decision and order. Settlement discussions with the Commonwealth regarding the petition are currently active.

The Company is also subject to an audit for the period January 1, 2000 to December 31, 2003. The Company has remitted \$1,500,000 to the Commonwealth for this period. Management does not believe that the ultimate outcome of this situation will be material to the Company's financial statements.

PHILADELPHIA GAS WORKS
Required Supplementary Information (Unaudited)
Schedule of Pension Funding Progress
(Thousands of dollars)

Actuarial valuation date	(a) Actuarial value of assets	(b) Actuarial accrued liability (AAL)	(b)-(a) Unfunded (overfunded) AAL (UAAL [OAAL])	(a/b) Funded ratio	Covered payroll	UAAL (OAAL) as a percent of covered payroll
September 1, 2000	\$ 418,768	385,892	(32,876)	108.52%	\$ 99,306	(33.11)%
September 1, 2001*	391,000	411,025	20,025	95.13%	91,878	21.80%
September 1, 2002**	370,019	424,670	54,651	87.13%	98,300	56.00%
September 1, 2003+	356,000	427,006	71,006	83.37%	101,200	70.16%
September 1, 2004++	366,783	436,255	69,472	84.08%	102,500	67.78%

* The required supplementary information is based on a biennial actuarial valuation of the pension fund for the Plan Year September 1, 2001 through August 31, 2002.

** The required supplementary information is based on a biennial actuarial valuation of the pension fund as updated for the Plan Year September 1, 2002 through August 31, 2003.

+ The required supplementary information is based on a biennial actuarial valuation of the pension fund for the Plan Year September 1, 2003 through August 31, 2004.

++ The required supplementary information is based on a biennial actuarial valuation of the pension fund as updated for the Plan Year September 1, 2004 through August 31, 2005.

See accompanying independent auditors' report.

PHILADELPHIA GAS WORKS

Supplemental Statements of Net Assets (City Format)

August 31, 2005 and 2004

(Thousands of dollars)

	2005	2004
Assets:		
Cash on deposit and on hold	\$ 15,191	3,643
Equity in pooled cash and investments	—	—
Equity in treasurer's account	—	—
Investments	—	—
Internal balances	—	—
Amounts held by fiscal agent	30	23
Notes receivable	164	232
Taxes receivable	—	—
Accounts receivable	294,950	323,108
Allowance for doubtful accounts	(207,480)	(230,216)
Interest and dividends receivable	—	—
Due from other governments	—	—
Restricted assets	207,231	136,423
Inventories	129,984	98,467
Unamortized loss and discount	47,979	49,031
Other assets	59,536	56,326
Property, plant, and equipment	1,573,346	1,517,046
Accumulated depreciation	(591,624)	(566,310)
Total assets	\$ 1,529,307	1,387,773
Liabilities:		
Notes payable	\$ 94,900	95,750
Vouchers and accounts payable	63,918	73,027
Salaries and wages payable	3,860	2,920
Accrued expenses	40,509	13,971
Funds held in escrow	—	—
Due to other governments	—	—
Deferred revenue	20,889	21,304
Current portion of long-term obligations	40,881	41,813
Noncurrent portion of long-term obligations	1,018,803	913,514
Unamortized gain and premium	22,901	14,100
Total liabilities	\$ 1,306,661	1,176,399
Net assets:		
Invested in capital assets, net of related debt	\$ 24,739	35,903
Restricted for:		
Capital projects	—	—
Debt service	104,530	95,929
Community development projects	—	—
Behavioral health programs	—	—
Intergovernmental financing	—	—
Emergency phone system	—	—
Rate stabilization	—	—
Unrestricted	93,377	79,542
Total net assets	\$ 222,646	211,374

PHILADELPHIA GAS WORKS

Supplemental Statements of Activities (City Format)

Years ended August 31, 2005 and 2004

(Thousands of dollars)

		August 31, 2005			
	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions	Total
Gas services	\$ (761,027) *	841,445	19,755	—	100,173
Interest on debt	(53,856)	—	—	—	(53,856)
Unallocated depreciation	(35,045)	—	—	—	(35,045)
Total	\$ (849,928)	841,445	19,755	—	11,272

* Includes \$4,778 of interest and other income

		August 31, 2004			
	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions	Total
Gas services	\$ (710,072) *	793,421	18,613	—	101,962
Interest on debt	(50,837)	—	—	—	(50,837)
Unallocated depreciation	(33,966)	—	—	—	(33,966)
Total	\$ (794,875)	793,421	18,613	—	17,159

* Includes \$3,580 of interest and other income

See accompanying independent auditors' report.

PHILADELPHIA GAS WORKS

Supplemental Statements of Revenues, Expenses, and Changes in Fund Net Assets (City Format)

Years ended August 31, 2005 and 2004

(Thousands of dollars)

	2005	2004
Operating revenues:		
Charges for goods and services	\$ 830,550	783,356
Sales of land and improvements	—	—
Rentals and concessions	—	—
Miscellaneous operating revenues	32,807	28,954
Total operating revenues	863,357	812,310
Operating expenses:		
Personal services	71,783	73,383
Purchase of services	78,847	75,203
Material and supplies	4,739	4,105
Employee benefits	13,494	14,943
Indemnities and taxes	—	—
Depreciation and amortization	39,547	38,868
Cost of goods sold	509,704	450,868
Other	—	—
Total operating expenses	718,114	657,370
Operating income	145,243	154,940
Nonoperating revenues (expenses):		
Operating grants	—	—
Passenger facility charges	—	—
Other income	887	1,963
Interest income	3,891	1,617
Debt service – interest	(53,856)	(50,837)
Other expenses	(84,893)	(90,524)
Total nonoperating revenues (expenses)	(133,971)	(137,781)
Income before transfers	11,272	17,159
Transfer in	18,000	—
Transfer out	(18,000)	—
Capital contributions	—	—
Change in net assets	11,272	17,159
Net assets – beginning of period	211,374	194,215
Net assets – end of period	\$ 222,646	211,374

See accompanying independent auditors' report.

PHILADELPHIA GAS WORKS
Supplemental Schedule of Interfund Transfers
Year ended August 31, 2005
(Thousands of dollars)

Due to the City, September 1, 2004	\$ 3,000
Accrued distributions	18,000
Payments to the City	<u>(18,000)</u>
Due to the City, August 31, 2005	<u>\$ 3,000</u>

See accompanying independent auditors' report.

APPENDIX B

INDEPENDENT CONSULTANT'S ENGINEERING REPORT

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**Independent Consultant's
Engineering Report**

**City of Philadelphia, Pennsylvania
Gas Works Revenue Bonds
Consisting of:**

\$ 385,000,000¹

**Gas Works Revenue Bonds
(1998 General Ordinance) Sixth Series**

**Philadelphia Gas Works
Philadelphia, Pennsylvania**



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ENERGY WATER INFORMATION GOVERNMENT

¹ Preliminary, subject to change.

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ENERGY WATER INFORMATION GOVERNMENT

December 2, 2005

Mr. Vincent J. Jannetti
Acting Director of Finance
City of Philadelphia
13th Floor, Municipal Services Building
1401 John F. Kennedy Boulevard
Philadelphia, PA 19102

Dear Sir:

In accordance with our agreement with the Philadelphia Gas Works ("PGW") through the Philadelphia Facilities Management Corporation, the management entity for PGW, we submit herewith our independent consulting engineer's report (the "Report") to be included as an appendix to the official statement or official statements ("Official Statement") prepared by PGW in connection with the City's issuance of \$385,000,000¹ Gas Works Revenue Bonds, Sixth Series (the "Sixth Series Bonds" or the "2006 Bonds"). PGW is refinancing its First Series B Gas Works Revenue Bonds (1998 Ordinance) and all or a portion of its Second Series A, Third Series, Fourth Series, and Fifth Series Gas Works Revenue Bonds (1998 Ordinance) to achieve debt service savings.

You may rely on this submittal in furnishing your report as required by Section 8 of the First Class City Revenue Bond Act, Section 4.03(a) of the General Gas Works Revenue Bond Ordinance of 1998, and Section 4.03(a) of the General Gas Works Revenue Bond Ordinance of 1975. The purpose of this Report is to present the findings of our evaluation of PGW's gas works system (the "System") and to set forth information concerning financial factors relating to the 2006 Bonds. This Report is based on our analysis of the records and capital improvement programs of PGW, discussions with key PGW personnel, physical inspections of predominately above-ground and underground facilities conducted in April 2004 in connection with our 2004 Independent Consultant's Engineering Report ("2004 Report"), and such other investigations as we have deemed necessary.

The evaluation of the System, which includes a discussion of organization, management, and staffing; system service area; supply facilities; distribution facilities; and the Capital Improvement Program (the "CIP") for fiscal years 2006 through 2011, is presented in the first part of the report. The second part of the report contains financial feasibility information including analyses of gas rates and rate methodology; projection of future operation and maintenance expenses; CIP financing plans; projection of revenue requirements as a determinant of future revenues; and assessing the ability of PGW to satisfy the covenants in the City Ordinances authorizing the issuance of the Prior Bonds and the 2006 Bonds. "Prior Bonds" are defined as the outstanding bonds issued under the General Gas Works Revenue Bond Ordinance of 1975 (the "1975 General Ordinance") and the General Gas Works Revenue Bond Ordinance of 1998 (the "1998 General Ordinance"). A listing of our principal assumptions and opinions developed as a result of our studies is presented at the end of the Report.

In conducting our studies, we reviewed the books, records, agreements, capital improvement programs, and customers, sales and financial projections of PGW and investigated such physical properties of PGW as we deemed necessary to express our opinion of PGW's operating results and

¹ Preliminary, subject to change.

projections. While we consider such books, records, documents, and projections to be reliable, Black & Veatch has not verified the accuracy of these documents.

Black & Veatch is one of the oldest, largest and most diversified engineering, procurement, and construction companies in the United States. Black & Veatch operates and maintains a global network of regional, marketing, and project offices. Founded in 1915, Black & Veatch employs over 6,000 people performing financial, economic, and engineering studies and design and construction of facilities for clients in government and industry in the fields of energy, water, wastewater, and telecommunications. Black & Veatch has extensive experience in the design and analysis of the operation and financing of electric, natural gas, water, and wastewater systems serving communities ranging in size from small cities to large metropolitan systems of the magnitude of the System.

In this Report, where standards or requirements are indicated as being applicable, being fulfilled, or to be attained, such standards or requirements are those promulgated by the Pennsylvania Public Utilities Commission (the "PUC") and other Federal, State, and local agencies, in accordance with the provisions of Federal laws and the laws of the Commonwealth of Pennsylvania governing the storage, delivery, and sale of natural gas. Capitalized terms not otherwise defined herein have the same meanings as ascribed to them in the Official Statement. References made herein to specific years are for the fiscal years of PGW ending August 31, unless otherwise noted.

The Report includes our assessment of the condition of PGW's physical plant including PGW's existing storage and distribution facilities, based upon site inspections during April 2004 of certain PGW facilities as deemed appropriate. We also reviewed and evaluated existing and planned natural gas transportation and supply contracts with respect to volumes of natural gas to be delivered. The general physical condition of the System's facilities has been evaluated using three rating categories - good, adequate, and poor - as described below.

- *Good:* The facility is in condition to provide reliable operation in accordance with design parameters and requires only routine maintenance.
- *Adequate:* The facility is operating at or near design levels, however, non-routine renovation, upgrading, and repairs are needed to ensure continued reliable operation. Significant expenditures for these improvements may be required.
- *Poor:* The facility cannot be operated within design parameters. Major renovations are required to restore the facility and assure reliable operation. Major expenditures for these improvements may be required.

The ratings assigned in this Report are the result of physical inspections of individual above-ground facilities and underground facilities at existing sites conducted in April 2004.

An evaluation of a gas storage and distribution system of the magnitude and complexity of PGW's requires an assessment of each of the System's various components. The evaluation described in this Report is based on estimates of the degree of improvement that has been and will be provided by the projects in the current CIP and their impact in meeting service requirements.

The projections set forth in this Report are "forward-looking statements". In formulating these projections, Black & Veatch has made certain assumptions with respect to conditions, events, and circumstances that may occur in the future. The methodologies utilized by Black & Veatch in performing these analyses follow generally accepted practices for such projections. Such assumptions and methodologies are summarized in this Report and are reasonable and appropriate for the purpose for which they are used. While Black & Veatch believes the assumptions are reasonable and the projection methodology valid, actual results may differ materially from those projected, as influenced by conditions, events, and circumstances that may actually occur. Such factors may include PGW's ability to execute the CIP as scheduled and

gas, and adverse legislative, regulatory or legal decisions (including environmental laws and regulations) affecting PGW's ability to operate the System.

Based on these analyses and the assumptions set forth or referred to in this Report, we offer the following opinions to indicate PGW's conformance with specific requirements which must be met for the issuance of the 2006 Bonds as provided in the 1975 and 1998 General Ordinances:

1. PGW is a competently managed and operated gas distribution utility. PGW and the System are organized, operated, and maintained at a level equal to, or in excess of, regulatory requirements and generally accepted industry practices. PGW's facilities are in good operating condition.
2. Based on our evaluation of financial projections covering the period September 1, 2005 through August 31, 2011, and on the basis of actual and estimated future annual financial operations of PGW's facilities and certain assumptions with respect thereto over the amortization period of the 2006 Bonds, which Black & Veatch believes to be reasonable, current and future Project Revenues, which are pledged under the 1975 General Ordinance and the 1998 General Ordinance, comply with the requirements of the definition of Project Revenues in Section 2 of the Act, and over the amortization period of the 2006 Bonds and the Prior Bonds, such Project Revenues will be adequate to meet all expenses of operation and maintenance, repair and replacement, reserve fund deposits, debt service on the Bonds issued under the 1975 General Ordinance and debt service on the Bonds issued under the 1998 General Ordinance, as the same shall become due and payable, and the surplus requirements of the rate covenants contained in Section 4.03(b) of the 1975 General Ordinance and Section 4.03(b) of the 1998 General Ordinance.
3. The Project Revenues and Gas Works Revenues which are pledged as security for the bonds issued under the 1975 General Ordinance and the 1998 General Ordinance, respectively, are currently, and are projected to be, sufficient to comply with the Rate Covenants set forth in Section 4.03(b) of the 1975 General Ordinance and Section 4.03(b) of the 1998 General Ordinance.
4. The capital improvements proposed during the projection period, September 1, 2005 through August 31, 2011, will, along with continued good operation and maintenance practices, enable PGW to maintain the System in good condition. Review of present management practices indicates that good operation and maintenance is likely to continue.
5. Contracted PGW gas supplies plus (a) spot market purchases, (b) anticipated additional contracted supplies plus supplemental gas capacities, as well as, (c) the pipeline transport capacity to move these supplies to PGW, are adequate to meet PGW's projected demand on a day of maximum demand (a "design peak day"), in an hour of maximum demand (a "design peak hour"), and during a year of maximum demand (a "design peak year").
6. The following are the significant changes that have occurred since the issuance of our 2004 Report and are addressed more fully in the text of this Report:
 - a. PGW improved its collection factor of less than 87 percent of billed revenues in 2003 to 91.4 percent in 2004 and 94.9 percent in 2005. (*See Rate and Tariffs – Billing and Collections*).
 - b. The projections in this Report are based on analyses prior to the effects of Hurricanes Katrina and Rita. The current gas cost recovery rate, approved in October 7, 2005

Mr. Vincent J. Jannetti

December 2, 2005

reflects the unprecedented commodity price of natural gas resulting from the impact of those hurricanes in the Gulf Coast region. (*See Post Katrina and Rita Impacts*).

- c. All Phase 1 liquefaction facilities are functional and PGW is negotiating terms of final acceptance with the general contractor, Chicago Bridge & Iron.
- d. On May 16, 2005, a new three-year Collective Bargaining Agreement began between PGW and Union Local 686 and will expire on May 15, 2008. The Agreement includes incremental wage increases of 1 percent in September 2005, 3 percent in September 2006, and 2.5 percent in May 2007.
- e. PGW's projected capital improvement expenditures for Gas Processing decreased from \$10.6 million in 2004 to \$5.0 million in 2005 and are projected to further decrease to \$2.3 million in 2006. PGW has removed any further investment for Phase 2 LNG facilities from its six-year capital improvement program pending its negotiations with a LNG terminal operator.
- f. As a result of improved collections, the base rate increase anticipated for 2007 is not expected to be needed prior to fiscal year 2009.

Very truly yours,

BLACK & VEATCH CORPORATION



Larry W. Loos
Director, Enterprise Management Solutions Division

Enclosure

Contents

	<u>Page</u>
INTRODUCTION	1
PURPOSE	1
SCOPE	1
BLACK & VEATCH QUALIFICATIONS	2
ORGANIZATION AND MANAGEMENT	3
CITY OF PHILADELPHIA	3
PHILADELPHIA GAS WORKS	4
PHILADELPHIA GAS COMMISSION	11
PENNSYLVANIA PUBLIC UTILITY COMMISSION	11
THE PGW GAS SYSTEM	14
POPULATION AND SERVICE AREA	14
SUPPLY FACILITIES	14
<i>City Gate Stations</i>	14
<i>Gas Control Center</i>	14
<i>LNG Facilities</i>	16
<i>Propane/Air Facilities</i>	17
<i>Gas Holder Storage Facilities</i>	17
DISTRIBUTION FACILITIES	17
OTHER FACILITIES	17
CONDITION OF FACILITIES	18
<i>Construction Sites</i>	18
<i>Meter Settings</i>	18
<i>Field and District Offices</i>	18
<i>Personnel</i>	18
<i>Facility Inspections</i>	19
<i>Conclusions</i>	19
PGW GAS SUPPLY	21
SUPPLY SERVICES	21
TRANSPORTATION AND STORAGE SERVICES	21
LNG FACILITIES	23
SUPPLY AND DEMAND BALANCE	23
CAPITAL IMPROVEMENT PROGRAM	27
GAS PROCESSING	30
DISTRIBUTION	30
FIELD SERVICES	30
TRANSPORTATION	31
OTHER DEPARTMENTS	31
RATES AND TARIFFS	32

Contents (continued)

	<u>Page</u>
REGULATION.....	32
EXISTING RATES	33
<i>Firm Service</i>	33
<i>Interruptible Service</i>	36
<i>Transportation Service</i>	36
GAS COST RATE.....	37
POST KATRINA AND RITA IMPACTS.....	38
SURCHARGES	38
WEATHER NORMALIZATION ADJUSTMENT	39
CUSTOMER RESPONSIBILITY PROGRAM	42
CONSERVATION WORKS PROGRAM	43
SENIOR CITIZEN DISCOUNT PROGRAM.....	44
OTHER PROGRAMS AND GRANTS	44
<i>LIHEAP Program</i>	44
<i>Vendor Payment Program</i>	45
<i>Utility Emergency Services Fund</i>	45
<i>Dollar Plus Program</i>	45
<i>Payment Plans</i>	45
BILLING AND COLLECTIONS.....	45
COMPETITION.....	48
FINANCIAL FEASIBILITY FOR THE 2006 BONDS.....	49
PROJECTED REVENUES.....	49
<i>Projected Average Number of Customers</i>	49
<i>Historical and Projected Gas Sales and Throughput</i>	49
<i>Sales and Transportation Revenues</i>	51
<i>Other Operating Revenues</i>	52
<i>Assistance Programs</i>	52
<i>Accounts Receivable</i>	53
CAPITAL IMPROVEMENT PROGRAM FINANCING.....	56
PROJECTED REVENUE REQUIREMENTS.....	57
<i>Gas Costs</i>	57
<i>Operation and Maintenance Expenses</i>	57
<i>Debt Service Requirements</i>	58
<i>Payments to City</i>	58
ADEQUACY OF PROJECTED REVENUES TO MEET PROJECTED REVENUE REQUIREMENTS UNDER ORDINANCE REQUIREMENTS.....	58
ASSUMPTIONS AND OPINIONS.....	65
CONSIDERATIONS AND ASSUMPTIONS.....	65
<i>Revenues</i>	65
<i>Operating Expenses</i>	66
<i>Capital Improvement Program</i>	66

Contents (continued)

	<u>Page</u>
<i>Debt Service and Outstanding Obligations</i>	66
<i>City Payments</i>	66
OPINIONS	66

List of Tables

	<u>Page</u>
TABLE 1 GAS SUPPLY, TRANSPORTATION, AND STORAGE CONTRACTS	22
TABLE 2 PEAK DAY SUPPLY AND DEMAND	24
TABLE 3 ANNUAL SUPPLY AND DEMAND	25
TABLE 4 HISTORICAL AND PROPOSED CAPITAL IMPROVEMENT PROGRAM EXPENDITURES	28
TABLE 5 NEW CAPITAL PROJECTS FOR FY2004	29
TABLE 6 COMPARISON OF EXISTING TARIFF RATES	34
TABLE 7 COMPARISON OF RESIDENTIAL GAS BILLS	36
TABLE 8 PROJECTED AVERAGE NUMBER OF CUSTOMERS	50
TABLE 9 HISTORICAL AND PROJECTED SALES AND THROUGHPUT	52
TABLE 10 HISTORICAL AND PROJECTED REVENUES	53
TABLE 11 HISTORICAL AND BUDGETED ASSISTANCE PROGRAMS	54
TABLE 12 HISTORICAL AND PROJECTED ACCOUNTS RECEIVABLE AND WRITE-OFFS	55
TABLE 13 CAPITAL IMPROVEMENT FUND	56
TABLE 14 HISTORICAL AND PROJECTED OPERATION AND MAINTENANCE EXPENSES	59
TABLE 15 PROJECTED LONG TERM DEBT SERVICE REQUIREMENTS	60
TABLE 16 PROJECTED STATEMENT OF INCOME	62
TABLE 17 PROJECTED STATEMENT OF CASH FLOWS	63
TABLE 18 PROJECTED DEBT SERVICE COVERAGE	64

List of Figures

	<u>Page</u>
FIGURE 1 PHILADELPHIA GAS WORKS ORGANIZATION CHART	7
FIGURE 2 PGW SERVICE AREA	15
FIGURE 3 COMPONENTS OF PGW GAS COST RATE	40
FIGURE 4 COMPONENTS OF PGW SURCHARGES	41

Listing of Acronyms

AFUDC	Allowance for Funds Used During Construction
AMR	Automatic Meter Reading Program
BCCS	Billing Collections and Customer Service
BMA	Bond Market Association
CDS	Comprehensive Delivery Service
CIP	Capital Improvement Program
CNG	Compressed Natural Gas
CRI	Collections Renewal Initiative
CRP	Customer Responsibility Program
CWP	Conservation Works Program
dt or Dth	Dekatherms
FERC	Federal Energy Regulatory Commission
FOI	Field Operations Initiative
FPL	Federal Poverty Level
FT	Firm Transportation
FY	Fiscal year beginning September 1 through August 31
GCR	Gas Cost Rate
GSS	General Storage Service
GTS	Gas Transportation Service
HDD	Heating Degree-Day
IRC	Interruptible Revenue Credit
LIHEAP	Low Income Home Energy Assistance Program
Lukens	Lukens Energy Group
Mcf	Thousand Cubic Feet

Listing of Acronyms (continued)

MEI	Management Efficiency Investigation
NGS	Natural Gas Supplier
PFMC	<i>Philadelphia Facilities Management Corporation</i>
PGC	Philadelphia Gas Commission
PGW	Philadelphia Gas Works
PHA	Philadelphia Housing Authority
PSFT	Peaking Service Firm Transportation
Psig	Pounds per Square Inch Gauge
PUC	Pennsylvania Public Utilities Commission
Rudden	RJ Rudden Associates
SS	Storage Service
UESF	<i>Utility Emergency Services Fund</i>
UWUA	Utility Workers Union of America
WNA	Weather Normalization Adjustment
WSS	Washington Storage Service

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Introduction

The Philadelphia Gas Works ("PGW") is a gas distribution utility owned by the City of Philadelphia, Pennsylvania (the "City"). The utility acquires, stores, and distributes gas to residents and other customers within the City.

Under the terms of certain of the current revenue bond covenants, PGW is obligated to charge and collect rents, rates and charges to maintain net revenues at or above certain specified levels in excess of annual debt service requirements. In addition, prior to the issuance of bonds under the General Gas Works Revenue Bond Ordinance of 1975 ("1975 Ordinance") or the General Gas Works Revenue Bond Ordinance of 1998 ("1998 Ordinance"), a financial report from the City's Chief Fiscal Officer, which may be given in reliance on an engineering report, is required.

Purpose

The purpose of this Independent Consultant's Engineering Report ("Report") is to summarize findings of engineering studies performed by Black & Veatch Corporation ("Black & Veatch") related to the gas system of the Philadelphia Gas Works and to set forth information concerning the financial factors relating to the issuance of the \$385,000,000¹ Gas Works Revenue Bonds, Sixth Series (the "Sixth Series Bonds" or "2006 Bonds"). PGW is refinancing its First Series B Gas Works Revenue Bonds (1998 Ordinance) and all or a portion of its Second Series A, Third Series, Fourth Series, and Fifth Series Gas Works Revenue Bonds (1998 Ordinance) to achieve debt service savings.

Scope

This Report addresses the organization and management, regulation, physical condition, adequacy of system capacity, operation and maintenance practices, and staffing levels of PGW's systems. It provides a review of the proposed capital improvement program ("CIP") for fiscal years 2006 through 2011 and includes the results of engineering studies regarding the financial requirements of the System. Evaluation of the projected financing of future operating and capital improvement needs is based upon a review of historical operating and financial data and projected capital program and operating budget information provided by PGW. Projections of revenues and revenue requirements are presented for the fiscal years 2006 through 2011. The financial feasibility of the issuance of the 2006 Bonds is evaluated recognizing the results of these analyses and PGW's projected compliance with applicable revenue bond covenants.

PGW representatives and others have provided certain historical data and other information presented in this Report. Black & Veatch has not conducted detailed verification tests of this information. As is normal in conducting the analysis and preparing projections, Black & Veatch has made certain assumptions with respect to conditions, events, and circumstances that may occur in the future. The methodologies utilized by Black & Veatch in performing these analyses follow generally accepted practices for such projections. Such assumptions and methodologies are summarized in this Report and are reasonable and appropriate for the purpose for which they are used. While Black & Veatch believes the assumptions are reasonable and the projection methodology valid, actual results may differ materially from those projected, as influenced by conditions, events, and circumstances that may actually occur. Such factors may include PGW's ability to execute the CIP as scheduled and within budget, regional

¹ Preliminary, subject to change.

climate and weather conditions affecting the demand for gas, and adverse legislative, regulatory or legal decisions (including environmental laws and regulations) affecting PGW's ability to operate the System.

Black & Veatch Qualifications

Black & Veatch is one of the largest and most experienced engineering companies in the United States specializing in utility engineering. Our experience includes the planning, design, operation analysis, and construction of gas, electric, water, and wastewater systems. In addition, the firm has extensive experience in assisting utilities with management and financial aspects of their operations. The firm has been engaged in more than 30,000 projects with a range of clients that include utilities owned by municipalities ranging in size from small communities to large metropolitan regions, investor-owned utilities, industrial and commercial businesses, local and state agencies, and the United States Government. In the past five years, Black & Veatch has performed more than 1,000 financial and institutional studies, including engagements for 26 of the 50 largest U.S. cities. Black & Veatch performed the Independent Consultant's Engineering Report ("2001 Report") for PGW's (1998 General Ordinance) Third Series Bonds issued in 2001, the Independent Consultant's Engineering Report ("2002 Report") for PGW's (1998 General Ordinance) Fourth Series issued in 2002, the Gas Works Revenue Refunding Bonds, Seventeenth Series issued in 2003, and the Independent Consultant's Engineering Report ("2004 Report") for PGW's (1998 General Ordinance) Fifth Series A-1 and A-2 issued in 2004. Since 1972, the City of Philadelphia's Water Department has engaged Black & Veatch for various consulting services. These consulting services have included engineering evaluation reports for all Water and Wastewater System Revenue Bonds sold by the City since 1974 and various projects involving the development of water and wastewater rates.

Experienced personnel from Black & Veatch have performed the physical evaluation of PGW's gas supply and distribution systems. In performing our engineering assessment of PGW, Black & Veatch reviewed the current condition and operation and maintenance of the gas supply and distribution systems. We conducted inspections of PGW's major facilities in April 2004, including PGW's nine city gate stations and PGW's two liquefied natural gas facilities. We also interviewed key members of PGW's management team on numerous occasions in April 2004 and November 2005, regarding operations and maintenance issues and practices.

The financial feasibility review has been performed by personnel assigned to the Enterprise Management Solutions Division² of Black & Veatch, which provides services in such areas as utility rates, utility property valuation, depreciation rate studies, financial analysis and planning, non-audit accounting, management and operations analysis, and the preparation of independent engineering reports for official statements.

² In January 2005, Black & Veatch acquired Lukens Energy Group ("Lukens") and RJ Rudden Associates ("Rudden"). Both Lukens and Rudden are providing or have provided services for PGW. We do not believe that any work currently being performed, or performed in the past by either Lukens or Rudden bear on the conclusions and opinions we set forth in this Report. Professionals outside and completely independent of the Lukens and Rudden organizations managed all work performed in connection with the preparation of this Report. Further, no Black & Veatch professional working in conjunction with the preparation of this Report, consulted with any professional assigned to either the Lukens or Rudden organizations concerning any aspect of PGW's operations.

Organization and Management

The Philadelphia Gas Works ("PGW") is owned by the City of Philadelphia and is responsible for the acquisition, storage, and distribution of gas within the limits of the City. As described in greater detail herein (*See The PGW Gas System*), PGW is the largest municipally owned gas utility in the nation.

PGW's operations are managed by the Philadelphia Facilities Management Corporation ("PFMC"), a not-for-profit corporation whose Board is appointed by the Mayor. PFMC's responsibilities are set forth in a Management Agreement between the City and PFMC, which delegates responsibility for PGW's operation to an executive management team provided by PFMC. Under the Management Agreement, those responsibilities that are not specifically granted to PFMC fall under the domain of the Philadelphia Gas Commission ("PGC"), except to the extent preempted by the Pennsylvania Public Utility Commission ("PUC").

Prior to the passage of the Natural Gas Choice and Competition Act ("Gas Choice Act")³, rates charged by PGW were regulated exclusively by the PGC because PGW was not a "public utility" within the meaning of the Pennsylvania Public Utility Code, as it was defined prior to the passage of the Gas Choice Act. On June 22, 1999, the Pennsylvania General Assembly passed the Gas Choice Act which amends the Public Utility Code by providing for the implementation of choice of suppliers of natural gas for retail customers of gas distribution companies. In addition, the Gas Choice Act provides that PGW is subject to regulation by the PUC, effective July 1, 2000, and that choice among natural gas suppliers will be provided to PGW's customers.

On March 31, 2003, the PUC approved PGW's restructuring plan, which among other things, provides for an unbundled tariff permitting customer choice of the commodity supplier. On September 1, 2003, PGW began operating under its Restructuring Compliance Tariff. PGW's Restructuring Compliance Tariff Rates are designed to maintain revenue neutrality and the Tariff Rules and Regulations are designed to comport with the Pennsylvania Public Utility Code.

City of Philadelphia

The City of Philadelphia was founded in 1682 and merged with the County of Philadelphia in 1854. There are two principal governmental entities in Philadelphia: (1) the City, which performs ordinary municipal functions as well as traditional county functions; and (2) the School District, which has boundaries coterminous with the City and has responsibility for all public primary and secondary education. The court system in Philadelphia, consisting of Common Pleas, Municipal, and Traffic Courts, is part of the Commonwealth of Pennsylvania (the "Commonwealth") Judicial System. Although the Commonwealth pays judges and top level administrators, the City pays all other court costs, with partial reimbursement from the Commonwealth.

The City is governed primarily under the Home Rule Charter⁴, which provides for the election, organization, powers, and duties of the legislative branch (the "City Council"); the powers and duties of the executive and administrative branches; and the City's fiscal and budgetary matters, contracts, procurement, property, and records.

³ Act of June 22, 1999, P.L. 122, No. 21, §3 (66 Pa. C.S.A. §2201 et seq.).

⁴ Philadelphia Home Rule Charter, 351 Pa. Code §1.1-100 et seq., adopted pursuant to authorization of the First Class City Home Rule Act approved April 21, 1949, P.L. 665, §1 et seq. (53 P.S. §13101 et seq.).

The School District was established by the Educational Supplement to the City's Home Rule Charter to provide free public education to the City's residents. Under the Home Rule Charter, its board is appointed by the Mayor and must submit a lump sum statement of expenditures to the City annually. Such statement is used by City Council in making its determination to authorize the levy of taxes on behalf of the School District. Since December 22, 2001, the School District has been governed by the School Reform Commission, created under the provisions of the Public School Code of 1949, as amended ("Public School Code"). All of the powers and duties of the Board of Education are vested in the School Reform Commission.

Philadelphia Gas Works

In March 1835 a City ordinance was passed authorizing private ownership and operation of a public gas utility under trustee management. This ordinance also contained an option clause permitting the City to take ownership of the gas utility properties by issuing City bonds to the private stockholders. This option initiating City ownership of gas utility properties to ultimately form PGW was exercised March 1, 1841, and has since been continuously in effect. Manufactured gas production commenced February 8, 1836 and service was inaugurated February 10, 1836 to 46 gas lamps along Second Street.

During its 170 years of existence, the operation and management of PGW has evolved to its present configuration through a variety of arrangements. Initially the private owners managed it. In 1841, a Board of Trustees assumed management of PGW in accordance with an enabling City ordinance. This arrangement continued through April 1887 when the City under the Director of Public Works assumed direct management and operation of PGW. Serious financial and operating problems led to replacement of this arrangement on November 12, 1897. At that time, the City, unable to sell PGW, contracted with the United Gas Improvement Company ("UGI"), now UGI Corporation, for the operation and management of PGW under authority granted by the Home Rule Charter. Operation and management by UGI continued through December 31, 1972.

On December 5, 1972, the City caused the incorporation of the Philadelphia Facilities Management Corporation as a not-for-profit Pennsylvania corporation for the specific purpose of operating PGW. PFMC currently manages PGW in accordance with the original agreement with the City dated December 29, 1972, effective January 1, 1973, as subsequently amended (the "Management Agreement"). The relationship between the City, PGC, PFMC, and PGW as originally detailed in the Management Agreement is summarized below. As described later in this Report, as of July 1, 2000, the Gas Choice Act confers the responsibility of regulating PGW's rates and services to the PUC. (*See Pennsylvania Public Utility Commission and Regulation*).

Organization

City of Philadelphia

The Philadelphia Gas Commission

Function

Owns PGW property and establishes legislation for the functioning of PGW. City Council approves the capital budget.

Responsibilities include: approval of personnel provided by PFMC, review of gas supply contracts for approval by City Council, approval of PGW's operating budget, review of PGW's capital budgets, and regulation of rates⁵.

⁵ As of July 1, 2000, the PUC became responsible for regulating rates pursuant to the Gas Choice Act.

Organization

PFMC

Function

Provides executive management and directs operation of PGW facilities.

PGW

Manages construction, operation and maintenance of the gas system on a day-to-day basis.

The Management Agreement states that for the operation of PGW, the PFMC shall provide:

- A Chief Executive Officer,
- A Chief Operating Officer,
- A Chief Financial Officer, and
- Other personnel as deemed appropriate by PFMC.

All PFMC personnel are subject to the approval of the PGC. The PGC consists of five members: the City Controller, two Mayoral appointees, and two City Council appointees. The PGC has the general responsibility to oversee operation of PGW by PFMC and retains all powers not specifically granted to PFMC. In addition, the Management Agreement specifies certain functions of the PGC, mainly:

- Approval of PFMC personnel,
- Review and make recommendations regarding gas supply contracts for City Council approval,
- Approval of PGW's annual operating budget,
- Review and make recommendations regarding PGW capital budgets for City Council approval,
- Approval of short-term loans,
- Review and approval of all PGW real estate acquisitions, sales, or leases for submittal to City Council for approval by ordinance, and power to establish procurement standards and to fix and regulate rates and charges⁶ for supplying gas to customers other than the City and the Board of Education, which will annually produce revenues sufficient to:
 - Pay all operating and maintenance expenses of PGW and the interest and amortization expense of its debt;
 - Maintain debt coverage ratios;
 - Pay \$18,000,000 to the City each year; and,
 - Provide such other funds as may be approved by the PGC and City Council for debt reduction or capital additions.

In the 1990s, PGW experienced a number of changes in its management organization. PFMC set up an interim management structure for PGW in December 1994 through January 1996 and again in October 1998 through March 2000. In February 2001, the PUC issued an order adopting a settlement with PGW in Docket No. R-00005654 whereby the PUC and the City agreed on a timetable and process to replace its interim management with permanent management. Permanent management was set in place

⁶ Ibid.

with the appointment of Thomas Knudsen as President and CEO in June 2002. Mr. Knudsen's appointment was formally approved by the PGC in December 2002. PGW's permanent management organization is shown in Figure 1. (*See also Rates and Tariffs, Regulation*).

In preparing this Report, Black & Veatch interviewed key PGW officers⁷ and a number of its managers. The interviews were supplemented with reviews of PGW's policies, practices, procedures, and field observations of employees at various facilities performing their daily activities. Based on these interviews, reviews, and observations, it is our opinion that PGW is suitably organized, managed, and operated by qualified personnel.

As of October 2005 PGW employed 1,754 people. Presently, approximately 75 percent of PGW's employees are represented by the Gas Works Employees' Union Local 686 ("Local 686"). Local 686 transferred affiliation from the Service Employees International Union ("SEIU") to the Utility Workers Union of America ("UWUA") in 2003. On May 16, 2005, a new three-year Collective Bargaining Agreement began between PGW and Union Local 686 and will expire on May 15, 2008. The Agreement includes incremental wage increases of 1 percent in September 2005, 3 percent in September 2006, and 2.5 percent in May 2007.

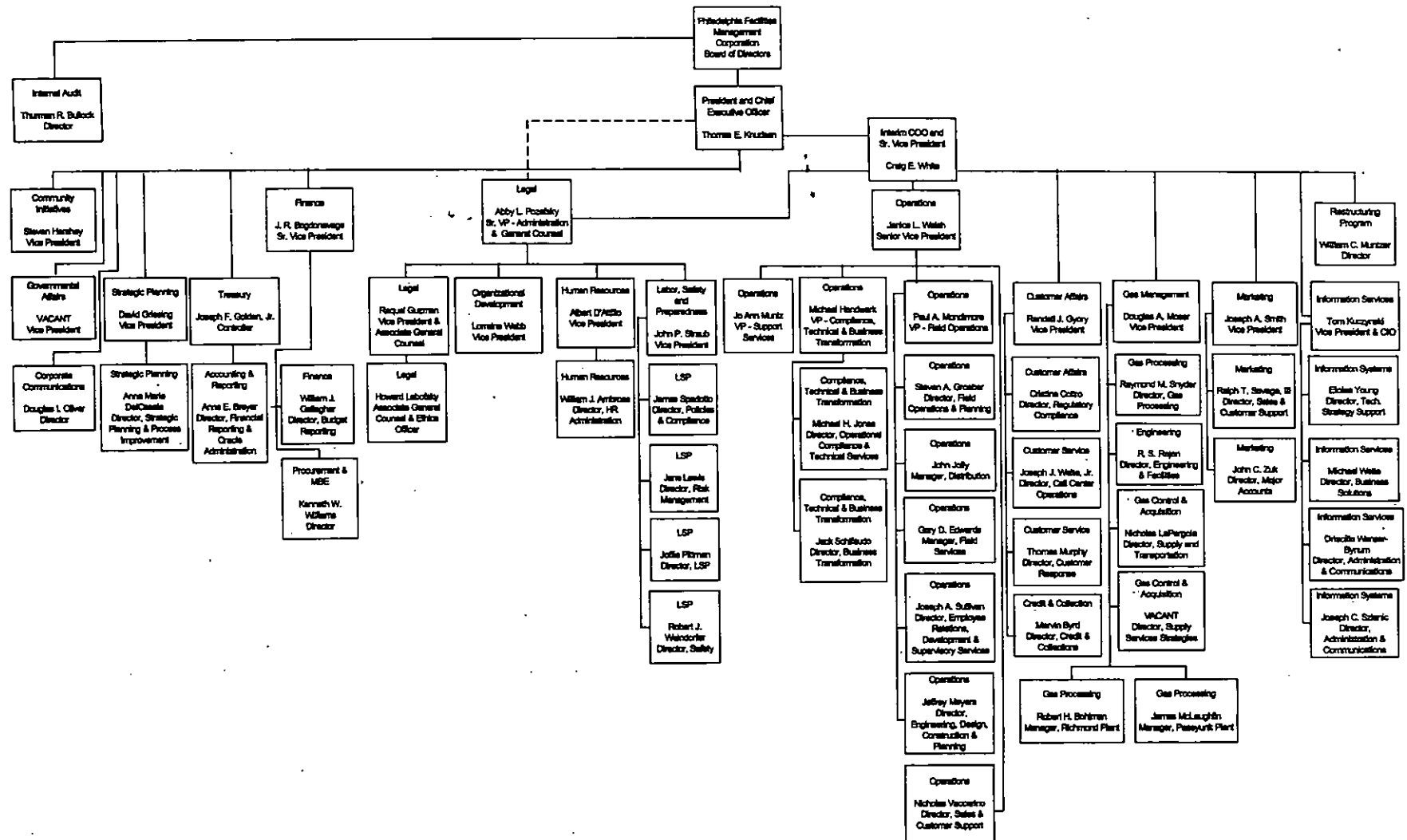
The following are brief biographical descriptions of the current PFMC/PGW Senior Officers:

Thomas E. Knudsen, President and Chief Executive Officer. Mr. Knudsen joined PGW as Interim Chief Financial Officer in March 2000. He served in that capacity until July 2001 when he was appointed Interim President and Chief Executive Officer. Mr. Knudsen was appointed to his present position by the PFMC in June 2002. Prior to joining PGW, Mr. Knudsen was the founding partner of The Woodside Group, a management consulting firm located in Stamford, Connecticut specializing in utility economics and regulation. For over 25 years, Mr. Knudsen advised industrial, commercial and residential customers and groups, as well as regulatory commissions, regarding appropriate utility operations, budgeting, pricing and rate design issues. Mr. Knudsen's involvement with PGW dates from 1986, having served as a consultant to the Public Advocate in all rate and budget proceedings of PGW before the Gas Commission from 1986 until 2000. His prior experience includes management consulting with Touche Ross & Co., (now Deloitte & Touche), as Assistant to the Finance Administrator of the City of New York and the United States Navy Supply Corp. Mr. Knudsen received his Masters of Business Administration degree in Finance from Columbia University in 1968 and a Bachelor of Arts degree in Economics from Northwestern University in 1964.

Craig E. White, Interim Chief Operating Officer. Mr. White was appointed Interim Chief Operating Officer in July 2001. He is responsible for Field Operations, Customer Service, Sales and Marketing, Legal, Labor - Safety & Preparedness, Organizational Development, Human Resources, Information Services, and Gas Management issues. His previous positions at PGW include: Senior Vice President, Marketing and Supply Services; Vice President, Marketing and New Business Development; Manager, Gas Planning & Federal Regulatory Affairs; Administrator, Federal Regulatory Affairs; Federal Regulatory Specialist; Planning Analyst; Demand Analyst; and Accounting Specialist. Mr. White received his Bachelor of Science degree in Business Administration from Kutztown University in Kutztown, Pennsylvania, and Master of Business Administration degree in Financial Management from Drexel University. Mr. White has been a member of PGW's management team since January 1980. He also serves on the following: American Public Gas Association's Executive Board, North American Energy Standards Board, the American Gas Association's Leadership Council and the Energy Association of Pennsylvania's Executive Gas Committee.

⁷ For the purpose of this report, PGW officers and management include individuals provided by PFMC.

Figure 1
Philadelphia Gas Works Organization Chart



Joseph R. Bogdonavage, Senior Vice President – Finance. Mr. Bogdonavage was appointed Senior Vice President, Finance in November 2000. His responsibilities include the oversight of PGW's Operating & Capital Budget and Procurement functions. Mr. Bogdonavage has over 32 years of diverse experience in the finance area of PGW. He previously held the positions of Director, Budget & Financial Forecasting, Manager, Budget & Financial Forecasting, Supervisor, Budget & Financial Forecasting, Accounting Assistant Supervisor and Budget Analyst. Mr. Bogdonavage is a member of the American Gas Association's Financial and Administrative Committee. Mr. Bogdonavage received his Bachelor of Business Administration in Accounting in 1972 from Temple University.

Abby L. Pozefsky, Esq., Senior Vice President - Administration and General Counsel. Ms. Pozefsky was appointed Senior Vice President and General Counsel in July 1998, and Senior Vice President, Administration and General Counsel in 2005. She manages the departments of Human Resources, Labor, Safety and Preparedness, and Organization Development as well as Legal. Ms. Pozefsky previously held the position of Chief Deputy City Solicitor of Regulatory Affairs for the City of Philadelphia Law Department where she worked for twelve years. Prior to that she held a variety of positions in public and private practice. Ms. Pozefsky received her Bachelor of Arts degree from the University of Pennsylvania cum laude and a Juris Doctor degree from New York University Law School.

Janice L. Walsh, Senior Vice President – Operations. Ms. Walsh was appointed Senior Vice President, Operations in October 2002. She is responsible for PGW's Field Operations (formerly Field Service and Distribution Departments), Support Services (Building Services, Fleet Operations & Materials Management), Operations Compliance & Technical Services (including Environmental & Chemical Services). Ms. Walsh was the Acting Vice President of Operations since October 2001 and previously held many positions at PGW since commencing employment in May 1986 as an Engineering Assistant. Ms. Walsh received her Bachelor of Science degree in Petroleum & Natural Gas Engineering from Pennsylvania State University in 1983 and has previously worked for the Department of the Navy and interned with three major oil companies. Ms. Walsh is a member of the American Gas Association, Association of Energy Engineers, Energy Association of Pennsylvania and American Society of Heating, Refrigerating and Air-Conditioning Engineers.

Albert L. D'Attilio, Vice President, Human Resources. Mr. D'Attilio was appointed Vice President of Human Resources in May 2005. He is responsible for Recruitment, Staffing, Classification, Compensation and Benefits. Mr. D'Attilio previously held the position of Director of Labor Relations, Safety and Security where he was responsible for directing PGW's Labor Relations, Occupational Safety, Employee Medical Services and Security functions for PGW. Prior to coming to PGW in March of 1999 as Director of Labor Relations, Mr. D'Attilio practiced employment and labor law for the City of Philadelphia. He has also served as the Labor Relations Director and Occupational Safety Administrator for the Philadelphia Airport Systems and a Personnel Analyst specializing in selection and employment testing for the City of Philadelphia. Mr. D'Attilio holds Juris Doctor and Bachelors of Arts degrees from Temple University. He earned certification as a Senior Professional in Human Resources from the Society for Human Resources Management in December 2002.

David Griesing, Vice President – Strategic Planning. Mr. Griesing was appointed Vice President, Strategic Planning in October 2001. In this position, he was responsible for filing PGW's comprehensive restructuring plan with the Pennsylvania Public Utilities Commission in July 2002. He is currently implementing PGW's general business planning initiatives and is the business lead on a multi-year project to transform the Company's existing LNG peak shaving facility into an import terminal. Before assuming his current position, Mr. Griesing was PGW's Associate General Counsel, responsible for supervising outside counsel, defending the company in significant litigation matters, and providing guidance to senior management on a range of issues. Prior to joining PGW in September 1998, Mr. Griesing held senior management positions in the areas of operations and strategic planning at companies in the region. He was originally a trial attorney representing investment banking and other business

clients in securities, contracts and regulatory matters. In addition to a law degree from the University of Pennsylvania, he has a master's degree from Yale University, and a bachelor degree from Holy Cross.

Raquel N. Guzman, Vice President – Legal and Associate General Counsel. Ms. Guzman was appointed Vice President - Legal in August 2005 and Associate General Counsel in 2003. She, together with the General Counsel and Assistant General Counsel, is responsible for PGW's Legal Department. Prior to joining PGW's legal staff, Ms. Guzman was a Deputy City Solicitor for Regulatory Affairs for the City of Philadelphia and also practiced at a major Philadelphia law firm in its real estate department. She holds a Juris Doctor degree from the University of Pennsylvania Law School and an undergraduate degree from Harvard College.

Randy Gyory, Vice President – Customer Affairs. Mr. Gyory was appointed Vice President of Customer Affairs in 2001. His responsibilities include overseeing the Call Center Operations, Credit and Collections, Regulatory Compliance, Account Management, Bill Processing, Universal Service Programs, Customer Service Center Operations, Billing System operations and support. Prior to his current position, Mr. Gyory managed PGW's Program Management Office and led a team of functional and business analysts in correcting and improving the billing system software issues associated with the transition from their legacy billing system to a client server system. In his twenty-six years of experience at PGW, Mr. Gyory has spent the majority of his career in the Distribution Department where he held several positions in Maintenance, Construction and Engineering. Mr. Gyory received a Bachelor of Science degree in civil engineering from the University of Pittsburgh.

Michael W. Handwerk, Vice President - Compliance, Technical & Business Transformation Services. Mr. Handwerk was appointed Vice President, Compliance, Technical & Business Transformation Services in September, 2005. In this capacity, he is responsible for services to Operations involving regulatory compliance, chemical laboratory analyses and environmental related activities, as well as development and implementation of operational changes and best practices. Mr. Handwerk's previous position was Director, Operations Compliance & Technical Services. He has been with PGW since 1979. Mr. Handwerk is a member of the American Gas Association's Operations Safety Regulatory Action Committee (OSRAC), Environmental Matters Committee (EM) and Environmental Regulatory Action Committee (ERAC). He is also a member of American Public Gas Association's Operations Committee, as well as Energy Association of Pennsylvania's Gas Transmission and Distribution Committee. Mr. Handwerk has a B.S. degree in Chemistry, a B.A. degree in Corporate Management, and a M.B.A. in Financial Management.

Steven P. Hershey, Vice President – Community Initiatives. Mr. Hershey joined PGW as Vice President, Community Initiatives in January 2004. In his current position, Mr. Hershey's primary responsibility is working with the President and CEO and senior management regarding certain regulatory and stakeholder matters and developing community initiatives to enhance PGW's relationship with various customer organizations. Prior to joining PGW, Mr. Hershey was a partner in the law firm of Eckert, Seamans, Cherin & Mellott, LLC of Philadelphia, Pennsylvania. He represented clients in matters involving energy, telecommunications, and utility policy, implementation of competition, rate setting, conservation, customer service and economics. Prior to becoming a partner at Eckert, Seamans, Cherin & Mellott, LLC, Mr. Hershey was a Supervising Attorney for Community Legal Services of Philadelphia, Pennsylvania. While at CLS, Mr. Hershey served as Lead Attorney for the Public Advocate, representing the interests of residential customers of Philadelphia utilities from 1985 to 1998. Mr. Hershey's involvement with PGW dates back to approximately 1977 when he began representing PGW's residential customers. Mr. Hershey has more than 30 years of experience in private practice, public interest advocacy and legal services.

Thomas L. Kuczynski, Vice President – Information Services & Chief Information Officer. Mr. Kuczynski rejoined PGW in February 2004 as Vice President - Information Services & CIO. He has over 27 years of experience in Information Technology including 18 years of prior experience at PGW. In

his present position, Mr. Kuczynski is responsible for all aspects of Information Services including Telecommunications, Technical Services, Information Management and Business Response, Application Development, and Support & Administration. He previously held the position of Director of Technology Strategic Planning for PG&E's National Energy Group ("NEG"). In this role, he was responsible for new technology research and development, strategy and architecture, business continuity planning, disaster recovery and security. Prior to joining NEG, Mr. Kuczynski spent one year at Delmarva Power where he provided IT Strategic Planning Services to the Energy Supply Group. Before Delmarva, Mr. Kuczynski spent 18 years at PGW where he led development efforts for PGW's customer information system, credit and collection, automated meter reading and distribution leak tracking. In 1993 Mr. Kuczynski was recognized by the American Gas Association with the Distribution Achievement Award for his efforts in designing and building PGW's first mobile field service system. Mr. Kuczynski is a graduate of La Salle College in Philadelphia, and the Executive MBA program at University of Maryland University College.

Paul A. Mondimore, Vice President – Field Operations. Mr. Mondimore was appointed Vice President, Field Operations in October 2002. He is responsible for PGW's Distribution and Field Services Departments. He previously held many positions at PGW in the Distribution Department since commencing employment in June 1981 including: Director, Distribution Department, Project Manager, Mobile Dispatch Project, General Supervisor, and Supervisor. Mr. Mondimore received his Bachelor of Science degree in Civil Engineering from Drexel University. He has been a member of the American Gas Association, AGA Best Practices Group and the Energy Association of Pennsylvania.

Douglas A. Moser, Vice President – Gas Management. Mr. Moser was appointed Vice President, Gas Management in October 2002. He is responsible for PGW's Gas Processing, Gas Supply, Gas Control & Transportation, Gas Planning and Engineering Departments. Since commencing employment in September, 1979 at PGW he has held the following positions: Senior Project Manager in the Strategic Planning Department, Manager-Gas Control and Manager-Gas Acquisition in the Gas Supply Department and Engineering Assistant, Production Engineer, Supervisor – Gas Conditioning, and Operations Engineer in the Gas Processing Department. Mr. Moser received his Bachelor of Science degree in Chemical Engineering from Pennsylvania State University and his Master in Business Administration degree from Widener University.

Jo Ann Muniz, Vice President – Support Services. Ms. Muniz was appointed Vice President, Support Services in September 2005. She is responsible for PGW's Facilities, Fleet Operations and Materials Management Departments. Since commencing employment in July 1980 as an Engineering Assistant in Gas Processing, she has held many positions at PGW including: Fleet Engineer in Fleet Operations, Staff Engineer in the Engineering Department, and Internships in Field Services and Customer Affairs, Co-Project Manager of the Work Management and Mobile Project Team, Project Manager of the Customer Service Training and Process Development, Director Procurement and Contract Services and later became Director, Fleet Operations and Materials Management. She most recently held the position of Director, Support Services. She serves as Chair of the Energy Association of Pennsylvania's Materials and Procurement Management Committee. She holds a B.S. in Mechanical Engineering from Temple University and a M.S. in Electrical Engineering from Pennsylvania State University.

Joseph Smith, Vice President, Marketing & Sales. Mr. Smith was appointed Vice President, Marketing & Sales in May 2005. Mr. Smith oversees the operations of Major Accounts, Sales and Customer Support and Marketing Services. He previously held the position of Director, Major Accounts; Manager, Major Accounts as well as other positions within the Marketing Department. In addition, he has held several positions in PGW's Field Operations. Mr. Smith received his Bachelors Degree in Business Administration in 2004. Mr. Smith has served as the President of the Association of Energy Engineers (AEE), in which he now serves as a Board member. He is currently a member of the American Public Gas Association's Marketing Committee and the American Society of Heating, Refrigeration and Air Conditioning Engineers (ASHRAE).

John P. Straub, Vice President – Labor, Safety and Preparedness. Mr. Straub was appointed Vice President of Labor, Safety and Preparedness in April 2003. He is responsible for matters including Labor Relations, Safety, Security, Medical, Risk Management, Insurance, Workers' Compensation, Policies & Procedures, Business Continuity & Disaster Planning, EAP, Occupational Health & Safety, and also serves as Drug and Alcohol Program Manager. Mr. Straub previously held the position of Vice President – Human Resources Department. Before coming to PGW in January 1999, Mr. Straub headed the Special Litigation Group for the City of Philadelphia's Law Department where he was responsible for the management and supervision of all employment law related matters and litigation involving the City of Philadelphia. Mr. Straub also worked as an Assistant District Attorney for the Philadelphia District Attorney's office. He holds a Juris Doctor degree from Temple University School of Law and is a graduate of Villanova University.

Lorraine S. Webb, Vice President - Organizational Development. Ms. Webb was appointed Vice President of Organizational Development in May 2005. She is responsible for Performance Management, Succession Planning, EEO, Affirmative Action, Training and Development and the Leadership Development program. Ms. Webb previously held the position of Director of Strategic Planning and prior to that Director of Human Resources for PGW. Before joining PGW, Ms. Webb held various positions in the field of human resources. Previous positions included Manager of Human Resources, Affirmative Action Officer for Ciba Geigy (now Novartis), as well as Senior Career Transition Counselor for the Ayers Group of New York. Ms Webb holds a BA degree from State University of New York-Binghamton. She is a member of SHRM.

Joseph F. Golden, Jr., Controller. Mr. Golden was appointed Controller in March 2001. He is responsible for the treasury, accounting and budget functions. Prior titles held by Mr. Golden at PGW include: Treasurer, Manager - Treasury Department, Senior Staff Accountant, and Staff Accountant. Mr. Golden started his career with PGW in August of 1986. Mr. Golden has prior work experience in public accounting, treasury accounting and cash management, and manufacturing. Mr. Golden holds a Bachelor of Science degree in Accounting from Villanova University, a Master of Business Administration degree from Drexel University, and a Juris Doctor degree, cum laude, from Temple University School of Law.

Philadelphia Gas Commission

The Philadelphia Home Rule Charter contains provisions for the establishment of the PGC with powers and duties as set forth in ordinances and contracts. The Management Agreement grants PGC certain specified powers and duties and all other powers not specifically granted to PFMC. The powers and duties granted to PGC include the fixing of PGW rates and charges (now the jurisdiction of the PUC), approval of personnel provided by PFMC, review of gas supply contracts for approval by City Council, approval of changes in tests and standards of gas quality and pressure, approval of PGW's operating budget, review of PGW's capital budgets and recommendations thereon to City Council, approval of certain loans (but not the issuance of Bonds), access to and review of all books, records and accounts of PGW, prescription of insurance requirements, promulgation of standards for procurement and disposal of material, supplies and services and approval of all real property acquisitions for further approval of City Council.

Pennsylvania Public Utility Commission

The PUC regulates the rates and supervises the service of Pennsylvania's public utilities, including electricity, water, natural gas, and telephone. Under current law, all rate regulation authority for PGW is held by the PUC, pursuant to the Gas Choice Act. The Gas Choice Act contains provisions which are designed to (i) preserve the tax-exempt status of bonds or other tax-exempt obligations issued by the City for PGW, including the 2006 Bonds, (ii) preserve the ability of the City to comply with its

covenants, including the City's covenants with respect to the imposition and collection of rates and charges to the holders of such bonds and other obligations, including the 2006 Bonds, and (iii) require rates to be set for PGW utilizing the ratemaking methodology and requirements that were applicable to PGW's natural gas distribution operation prior to the assumption of jurisdiction by the PUC. The Gas Choice Act provides, among other things:

- Commencing July 1, 2000, PGW is subject to regulation by the PUC and, except as otherwise provided in the Gas Choice Act, the provisions of the Public Utility Code apply to PGW as if it were a public utility. The PUC, instead of the PGC, sets rates for PGW's customers.
- Notwithstanding customer choice in gas suppliers, PGW's gas distribution business will remain a regulated monopoly.
- In setting rates and notwithstanding any other provision of the Public Utility Code, the PUC must permit the City to impose, charge and collect rates or charges as necessary to permit the City to comply with its covenants to the holders of any approved bonds, as defined in the Gas Choice Act. All bonds issued by the City on behalf of PGW under the Act, including the 2006 Bonds, are approved bonds.
- The PUC is obligated to use PGW's ratemaking methodology and requirements until Approved Bonds are refunded or defeased.
- The PUC is barred from requiring the City or PGW to take any action (or omit taking any actions) under the Public Utility Code if such action or omission would have the effect of causing the interest on any tax exempt bonds issued by the City, including the 2006 Bonds, to be includable in the gross income of the holders of such bonds for Federal income tax purposes.
- On March 31, 2003, the PUC approved PGW's restructuring plan (Docket No. M-00021612), which implements customer choice and permits licensed natural gas suppliers to deliver gas to their customers in Philadelphia using PGW's distribution system.
- On September 1, 2003, PGW began operating under its Restructuring Compliance Tariff.
- The Gas Choice Act permits, but does not require, the PUC to approve a senior citizen discount. On September 30, 2004, the PUC denied PGW's request to continue the senior discount program for post-September 1, 2003 applicants. PGW has filed an appeal to the Commonwealth Court of Pennsylvania, which is pending. (*See Senior Citizen Discount Program*).
- The PUC is required to provide for a management audit of all employees, records, equipment, contracts, assets, liabilities, appropriations, and obligations of PGW prior to the commencement of the restructuring proceeding.⁸ (*See Rates and Tariffs, Regulation*).

⁸ In regard to the Management Audit, PGW submitted its May 18, 2004 Implementation Plan to the PUC. The PUC subsequently made 30 follow-up recommendations for improvement. PGW accepted 24, partially accepted 4, and rejected 2 of the PUC's follow-up recommendations. On June 2, 2005, the PUC released PGW's Implementation Plan and the PUC's Management Efficiency Investigation ("MEI") of PGW to the public. The PUC directed PGW to proceed with the May 18, 2005 Implementation Plan. PGW's implementation actions may be reviewed by the PUC at a later date to determine if PGW has effectively implemented the recommendations.

- Effective June 30, 2000, the provisions of the Home Rule Charter with respect to the powers and duties of the PGC are abrogated to the extent inconsistent with the Gas Choice Act.
- The City cannot be required to take any action under the Public Utility Code if the effect of the action is to cause a variation in the City's financial plan approved by the Pennsylvania Intergovernmental Cooperation Authority.
- The City's executive or legislative powers to "legislate or otherwise determine the powers, functions, budgets, activities and mission of PGW" are not abrogated or limited.

This Report assumes rate regulation will be administered by the PUC to comply with the City's bond covenants, as required by the Gas Choice Act.

The PGW Gas System

Philadelphia Gas Works began gas production in February 1836 and has since continuously provided the City of Philadelphia with service. Today, PGW is the largest municipally owned gas utility in the nation, maintaining a distribution system of approximately 3,013 miles of gas mains and 494,349 service lines. In addition to this extensive distribution system, PGW operates facilities for the liquefaction, storage, and vaporization of natural gas to supplement gas supply taken directly from interstate pipeline and storage companies.

Population and Service Area

PGW Gas System presently serves the limits of the City of Philadelphia with an average customer base of approximately 510,000 accounts. This service area is shown in Figure 2. The service area consists of an urban area of 129 square miles located in southeast Pennsylvania along the Delaware River. Philadelphia is the largest incorporated area within the Delaware Valley region, which consists of Bucks, Chester, Delaware, Montgomery, and Philadelphia counties in Pennsylvania, and Burlington, Camden, Gloucester, and Mercer counties in New Jersey. According to the 2000 United States Census, Philadelphia has a population of approximately 1,500,000 inhabitants, a decrease of about 4 percent since 1990.⁹ With the exception of Philadelphia and Delaware counties, the counties within the Delaware Valley region all reported increases in population over their 1990 census figures.

Supply Facilities

The principal PGW natural gas supply facilities include nine city gate stations owned in large part by the interstate pipeline companies serving PGW and two liquefied natural gas ("LNG") plants, Richmond and Passyunk, owned by the City. The supply facilities also include a gas control center, a deactivated propane/air plant, and two gas holders, one of which has been removed from service.

City Gate Stations

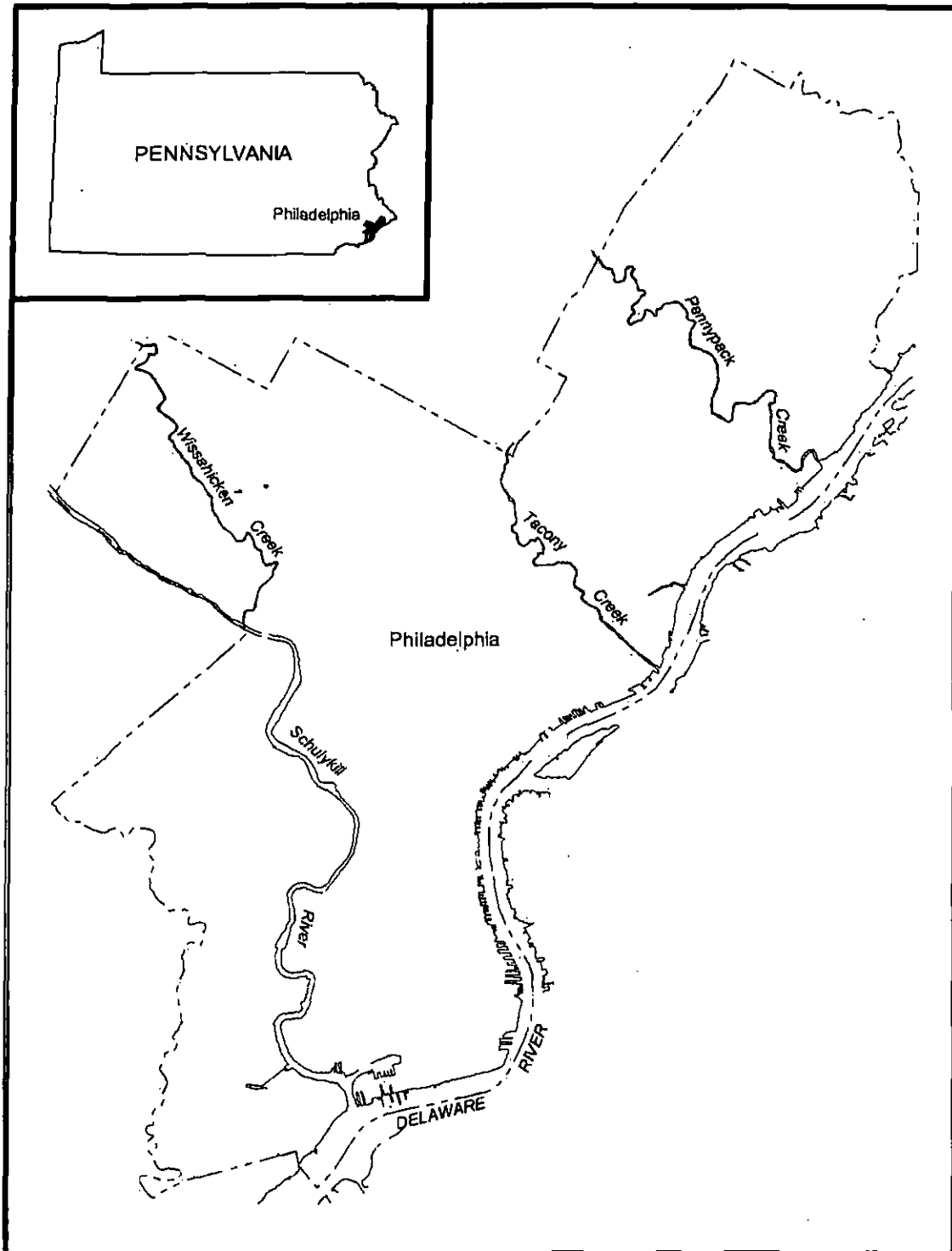
Natural gas is received through nine city gate stations from two pipeline transmission companies – Texas Eastern Transmission Corporation ("Texas Eastern") and Transcontinental Gas Pipe Line Corporation ("Transco"). The two pipeline companies own most of the facilities and land at eight of the nine city gate stations. The pressure delivered to PGW's distribution system is controlled at each of the city gate stations. Eight city gate stations are equipped with gas heaters.

Gas Control Center

The gas control center is located at 800 W. Montgomery Avenue, with a backup at the Richmond Plant. The center monitors and controls gas flow and pressure from the nine city gate stations to the high-pressure distribution system. The gas control dispatchers also provide direction to the LNG production plant operators concerning startup, shutdown and gas flow output from the LNG facilities. Operations are facilitated through the use of a computer system that includes a backup unit and an auxiliary power supply.

⁹ The City of Philadelphia and Philadelphia County are coextensive. *United States Census Bureau, Census 2000 Redistricting Data (P.L. 94-171) Summary File, Table PL1 and 1990 Census.*

Figure 2
Philadelphia Gas Works Service Area



LNG Facilities

There are two LNG facilities – the Passyunk Plant and the Richmond Plant. The smaller LNG storage and vaporization facility at the Passyunk Plant receives its liquefied gas supply from the larger Richmond Plant via cryogenic trailer trucks. The Passyunk LNG facility consists of one LNG storage tank of 3,066,000 gallons gross capacity (i.e., the equivalent of 253,300 thousand cubic feet [“Mcf”] of natural gas) and two LNG vaporizers, each having a capacity of 45,000 Mcf per day resulting in 45,000 Mcf per day planned capacity and 45,000 Mcf per day reserve.

The Richmond LNG plant is one of the largest liquefaction facilities in the United States and also includes storage and vaporization facilities. The existing facilities have a liquefaction capability of 23,500 Mcf per day and only liquefy during the non-winter months. The existing liquefaction facilities utilize a modified cascade process installed in the late 1960’s. During the summer of 2001, PGW contracted for construction on the first phase (Phase 1) of a new liquefaction facility to be built in two phases utilizing an open expanded loop technology at a contracted price of \$14 million. This technology utilizes energy from the high transmission delivery pressure of the interstate pipeline system throughput to run the turbines, significantly reducing fuel requirements. In addition, these facilities will have the capability to liquefy natural gas year round providing greater operational flexibility. Further, this technology utilizes significantly fewer components than the older facilities and should result in lower operation and maintenance costs.

The new Phase 1 facilities contracted in 2001 had been delayed in commissioning because the new facilities did not meet the required operating capability. However PGW has worked with the general contractor (Chicago Bridge & Iron, “CBI”) and its subcontractor, the component manufacturer (Air Products), to correct the problems with the equipment. The facilities are now functional and PGW is negotiating terms of final acceptance with CBI. The tested operating capability of the new facility is in the range of 16,000 to 18,000 Mcf per day, depending on feed gas specifications. The maximum capability of Phase 1 facilities of 18,000 Mcf per day will not be available at all times during the summer months because the demand on the PGW system is not sufficient to create the throughput necessary to run at this capability. PGW’s projected capital improvement expenditures for Gas Processing decreased from \$10.6 million in 2004 to \$5.0 million in 2005 and are projected to further decrease to \$2.3 million in 2006. PGW has removed any further investment for Phase 2 LNG facilities from its six-year capital improvement program pending its negotiations with a LNG terminal operator, as discussed below. Most of the currently budgeted funds will be used to replace equipment at the existing facilities in order to extend the life of the facilities to 2010.

PGW issued a request for proposals (“RFP”) in November 2004 to utilize the Richmond LNG facility as a terminal to receive LNG from tanker ships. The layout of the existing facilities and its location near the Delaware River were factors reflected in the original design of the facility anticipating this possibility at some future date. The purpose of the RFP was to find a company that would work in concert with PGW to build and operate the receiving facility. The LNG would then be either stored in the Richmond LNG storage facilities or vaporized and placed into PGW’s distribution system or other nearby interstate pipeline systems. As currently planned, this project will not require capital expenditures by PGW and could be a significant ongoing source of revenue.

PGW received proposals in January 2005 and has completed its evaluation of the proposals. PGW is currently negotiating with a developer and hopes to announce the developer in early 2006. If negotiations continue to progress, PGW expects that commissioning of the terminal port would happen no sooner than fiscal year 2010. This Report does not reflect any impact of this project either in terms of capital improvements, operating costs, cost of gas, or revenues.

The vaporization and storage facilities at the Richmond Plant are not affected by the new liquefaction facilities. The two storage tanks at the Richmond Plant have a combined gross capacity of 48,970,000 gallons of LNG (4,045,800 Mcf). Regasification of the liquid natural gas is accomplished with six vaporizers having a total output of 411,000 Mcf per day plus 100,000 Mcf per day in reserve. The Richmond Plant also has facilities to receive LNG from and deliver LNG to cryogenic trailer trucks.

Propane/Air Facilities

At the Passyunk location, PGW also has a propane/air plant. The plant has the air compression and propane vaporization capacity to produce 60,000 Dekatherms ("dt") of propane/air mix per day (45,000 dt per day planning basis) and has a liquid propane storage capacity of approximately 662,250 gallons. This facility has been idle since 1994 due to PGW removing this capacity from service. Its use is not anticipated in the current six-year gas supply projection.

Gas Holder Storage Facilities

The Richmond Plant has a low pressure gas holder. The Passyunk holder has been removed from service. The Richmond holder has an operating capacity of 1,000 Mcf. It was installed in the manufactured gas era and is in working order. It is used to enhance operational flexibility of the LNG Plant.

Distribution Facilities

The principal gas distribution facilities consist of approximately 3,013 miles of main, 494,349 service lines, 206 regulator stations, approximately 575,500 meters (of which approximately 500,200 are active) and miscellaneous valves, instruments, and other appurtenances. PGW operates five different operating pressure systems; each system is connected to the other by control regulators. The high-pressure systems operate at approximately 110, 60, and 35 pounds per square inch gauge (psig); the intermediate pressure system operates at 5 psig; and the low-pressure system operates between 6 and 9 inches of water column (approximately 0.25 pounds per square inch). The majority of customers are served from the low-pressure system.

Approximately 55 percent (by length) of the gas mains are cast iron, 33 percent are steel, 5 percent are ductile iron, and 7 percent are plastic. Of the steel mains, approximately 49 percent are wrapped, coated, and cathodically protected. Approximately 45 percent of the service lines are steel (of which 13 percent are protected) and 55 percent are plastic.

Other Facilities

PGW has its executive and operating offices located at 800 West Montgomery Avenue, which is a 150,000 square foot office building constructed in 1988. The former general office building, located at 1800 N. 9th Street, still houses administrative operations, in addition to, distribution and field service dispatch centers, gas control dispatching, a customer information center, operating stations, a post office, duplicating center, radio repair shop, training facilities, parking facilities, telecommunications, and warehousing, as well as information systems center and a metal fabrication shop. Additional facilities include five district offices, Tioga station for distribution crews, two LNG plants, and three operating stations for field service crews. There are also five other warehousing facilities, a meter shop, and an automotive maintenance and repair facility. The automotive maintenance and repair facility is responsible for the upkeep of PGW's fleet of approximately 1,000 vehicles and related equipment. PGW also maintains three minor automobile repair facilities, bulk fuel dispensing equipment, and materials and supplies.

Condition of Facilities

In April 2004, Black & Veatch conducted site inspections of certain PGW facilities as deemed appropriate. During the inspections, Black & Veatch used three evaluation criteria based on observation to evaluate the condition of each facility. These criteria are described below:

- *Good:* The facility is in condition to provide reliable operation in accordance with design parameters and requires only routine maintenance.
- *Adequate:* The facility is operating at or near design levels, however, non-routine renovation, upgrading, and repairs are needed to ensure continued reliable operation. Significant expenditures for these improvements may be required.
- *Poor:* The facility cannot be operated within design parameters. Major renovations are required to restore the facility and assure reliable operation. Major expenditures for these improvements may be required.

Construction Sites

Inspections at construction sites included the observation of crews, vehicles, power-operated equipment, tools, safety procedures for the crew and public, construction standards, and general quality of work performed.

System maps were also examined and compared to existing facilities. This comparison showed the maps to have adequate detail to describe the system at the site. The maps contain the year the line was placed in service, size and material used, operating pressure, location of valves and bends, and where repairs have been performed.

Meter Settings

Meter setting observations include materials and equipment. Observed meter settings conformed to accepted industry standards, accessibility, and safety and security measures.

Field and District Offices

Field and district office sites, including related facilities, such as vehicle and equipment fueling stations, garage and vehicle maintenance supply, structures, driveways, parking, material and equipment storage areas and security features, were observed. Three of the six district offices are leased to PGW. Inspections of these leased sites were focused primarily on materials and equipment typically provided by PGW. In summer of 2002, in an effort to streamline operations, PGW closed two of its district offices, leaving the existing six district offices. The offices were closed to provide better customer service by staffing the remaining offices at a higher level with personnel from the closed offices.

Personnel

During the inspection period, Black & Veatch conducted interviews and was assisted by PGW staff who are experienced, qualified, well trained, and knowledgeable in their assigned tasks. In addition to details of the operations, they were knowledgeable in details of routine and preventative maintenance procedures PGW has in place.

The following is a list of key areas discussed in conducting inspections and in the collection of system data:

Construction	System Losses & Meter Maintenance Programs
Corrosion Engineering	Leak Surveys
Field Offices	Operations
District Offices	SCADA System
Treasury	Meter Settings
District Regulators	City Gates and LNG Plants
Field Services	Accounts Receivable
Gas Supply	

Facility Inspections

The following facilities were inspected in April 2004:

Supply Facilities	Distribution Facilities
Liquefied Natural Gas Facilities	District Regulator
Richmond & Passyunk Plants	3rd & Arch. - Underground Vaults
City Gate Stations	Meter Setting
034	Residential
Ashmead	Low Pressure - new housing area near 800 W. Montgomery Office
Ivy Hill	Intermediate Pressure - new development near Castor Field Office
Penrose	Commercial
Richmond	PGW - CNG facility at Montgomery Field Office
Somerton	Industrial
Whitman	SSA Building, 470 N. 3rd St.
060	
030	Construction Sites
	60th St. between Walnut & Chestnut - Plastic gas main and replacement of service lines.
	Redfield between Arch & Race - Plastic gas main and replacement of service lines.
	100 S. 44th St. - Plastic gas main and replacement of service lines.
Other Facilities	
Field Offices/On-Site Facilities	District Offices
Montgomery	Germantown - Leased
Porter	North - Owned
Tioga	South - Owned
Castor	West - Owned
Belfield	Center City - Leased
SCADA Control Room	Frankford - Leased
PGW - 1800 N. 9th St.	

Conclusions

All observed facilities, vehicles, equipment and warehouse stock appeared to be reasonably maintained and in good operating condition. During the inspections, Black & Veatch identified only minor items not in good operating condition as would be expected during the normal course of operation. These items were either in the process of being repaired or were essentially retired in place. Employees appeared to be knowledgeable of their job requirements and well trained.

PGW's highest operating priority is response to emergencies and the maintenance of a safe gas distribution system. PGW maintains maps and other records of the distribution system in good order and has comprehensive written construction, operating and maintenance standards and procedures. Its personnel appeared well trained in the operation and maintenance of the gas distribution system. PGW is routinely actively involved in entering its facility records (Corrosion, Service and Leak Records) into computer databases, thus facilitating and improving the accuracy of accessing information. PGW has continued to monitor its security measures at its major facilities, including the two LNG facilities, the city

gate stations, and the headquarters building complex, as a result of September 11, 2001 terrorist attacks. PGW has added concrete barriers around critical facilities at Richmond and perimeter fencing around both Passyunk and Richmond Plants.

Based on the physical inspections conducted in April 2004 and interviews conducted at that time and in November 2005, it is our opinion that PGW operates and maintains its system prudently and in accordance with current regulatory standards and generally accepted industry practices. During the course of our investigation leading up to this Report, nothing has come to our attention which affects the conclusions we reached based on our April 2004 physical inspections.

PGW Gas Supply

PGW manages its gas supply through a mix of flowing supplies, off-system underground storage, and City-owned and PGW-operated LNG facilities. PGW utilizes this mix to meet its obligation to serve customers' demand on the coldest day (peak day) as well as customers' annual requirements. PGW's gas distribution facilities are directly connected to Texas Eastern through four city gate stations and to Transco through five city gate stations. All gas purchased by PGW is transported to the city gates through either one of these pipelines. During predominantly off-peak periods, a portion of the purchased gas supply is stored in off-system underground storage facilities connected to these two pipelines or in PGW's LNG facilities. Through the effective use of off-system storage and LNG, PGW is able to more efficiently utilize its transportation contracts with Texas Eastern and Transco.

Supply Services

PGW purchases gas through a combination of term contracts and spot market purchases. Natural gas supplies are purchased under a portfolio approach intended to secure the lowest price consistent with reliability of supply. Consideration is given to maintaining a diversity of sources and types of supply. During the 2006 fiscal year, purchased gas costs are estimated to account for approximately 74 percent of the total gas supply expenses of \$578.4 million and approximately 47 percent of total revenues of \$916 million. The cost of gas-supply is a function of the prices paid and the quantity purchased, both of which are variable. While this price component can be managed by PGW to some extent through the timing of purchases, the prices paid are largely determined in a very competitive and a sometimes volatile marketplace. While the total annual volumes purchased are highly dependent on temperatures during the heating season and are beyond the direct control of PGW, PGW can manage the timing of purchases and hence prices to a limited degree, by utilizing off-system and LNG storage.

Transportation and Storage Services

All of PGW's gas purchases are ultimately transported from the sources of supply to the city gates through either Texas Eastern or Transco facilities. Injections and withdrawals of gas from off-system storage also rely on these two pipelines. Table 1 summarizes the existing transportation agreements between PGW and the two pipelines. As shown in this table, PGW's currently available pipeline capacity is almost equally divided between the two pipelines. Of PGW's total contract pipeline capacity of 446,928 Mcf per day, Texas Eastern accounts for 227,276 Mcf per day, or 51 percent, and Transco accounts for 219,652 Mcf per day, or 49 percent. The initial terms of the major contracts for the Texas Eastern transportation service (CDS and FT) expire prior to the 2006-07 winter period and the initial term of the major contract for the Transco transportation service (FT) expires after the 2007-08 winter period. These contracts will then renew on an automatic year-to-year basis. PGW's current long-term plan assumes that the material contracts may also be renewed as longer term contracts.

Due to the highly seasonal nature of PGW's load (demand), the efficiency of pipeline transportation service can be increased significantly through the use of storage services. During periods when PGW's load is less than contracted transportation service, PGW may utilize the available capacity to deliver gas to off-system storage facilities or liquefy gas and store it in its LNG facilities. The ability to store gas off-system and in LNG facilities provides three significant benefits. First, reduced capacity can be reserved on interstate pipelines to serve higher seasonal loads to the extent that gas can be stored in off-system storage and local LNG facilities. Second, less volumes need to be actually purchased during the generally higher cost winter period to the extent that gas can be purchased during the lower cost non-

winter period, stored and then redelivered from storage during the winter. Third, market area storage provides increased security of supply.

Table 1
Gas Supply, Transportation, and Storage Contracts

Contract	Contract Expiration ^(b)	2006 - 2011			
		Transportation ^(c)		Storage ^(d)	
		dt/day	Mcf/day	dt/day	Mcf/day
Transco					
FT	03/31/08	165,212	160,400		
PSFT	07/31/11	1,967	1,910		
S-2	04/15/07	5,191	5,040	5,191	5,040
GSS	03/31/13	53,871	52,302	53,871	52,302
WSS ^(a)	03/31/07			39,246	38,103
Subtotal		226,241	219,652	98,308	95,445
Texas Eastern					
CDS	10/31/06	75,000	72,816		
FT1 - 800233R	10/31/06	23,822	23,128		
FT1 - 800514R	10/31/07	18,000	17,476		
FT1 - 800515R	10/31/07	18,000	17,476		
Dominion/GSS/FTS7	03/31/08	6,815	6,616	6,815	6,616
Dominion/GSS/FTS8	03/31/08	22,495	21,840	22,495	21,840
Equitable/FTS2	03/31/07	4,998	4,852	4,998	4,852
SS1A		44,118	42,833	44,118	42,833
SS1B		20,847	20,240	20,847	20,240
Subtotal		234,095	227,276	99,273	96,381
Total		460,336	446,928	197,581	191,826

(a) Transportation included in FT.

(b) Contracts are assumed renewed beyond their expiration date.

(c) Reference: SDS 6, Page 4 of 4, In the Matter of Proposed Operating Budget, Supporting Documentation - Gas Costs and Purchasing Plans, Volume 1, June 2005.

(d) Reference: GCR 12, Pages 1-2 of 3, In the Matter of Proposed Operating Budget, Supporting Documentation - Gas Costs and Purchasing Plans, Volume 1, June 2005.

As shown in Table 1, PGW's currently available off-system storage capacity is almost equally divided between facilities connected to Texas Eastern and Transco. Of PGW's total contract storage deliverability of 191,826 Mcf per day, services provided on Texas Eastern account for 96,381 Mcf per day, or 50.2 percent, and Transco accounts for 95,445 Mcf per day, or 49.8 percent. All of this deliverability requires transportation to PGW via the respective transportation services obtained from Texas Eastern and Transco. This storage deliverability is used primarily to reduce contract demand for long haul transportation services and reduce the quantity of gas that needs to be purchased during the typically higher cost winter period to meet winter peak demand.

During the 2006 fiscal year, transportation and storage costs are estimated to account for approximately 26 percent of the total gas supply expenses of \$578.4 million. The prices paid for these services are determined by long-term contracts and tariff rates regulated by the Federal Energy Regulatory Commission ("FERC"). Generally, these components of gas supply cost represent the purchase of capacity, are relatively fixed, and do not vary directly with the volumes of gas purchased.

LNG Facilities

The City owns and PGW operates two LNG facilities, the Richmond Plant and the Passyunk Plant. The LNG facilities are primarily used to minimize pipeline capacity needed to serve peak demand. The LNG facilities displace capacity that would otherwise be needed from flowing gas and off-system storage (i.e. pipeline and storage capacity) to meet peak day demands. The LNG facilities also allow for a nominal reduction in purchases during the higher cost winter period. Based upon current pipeline and storage charges, which have remained relatively constant over the past five years, PGW estimates that utilizing the existing LNG facilities in lieu of additional pipeline and storage capacity saves approximately \$75 million per year.

Gas is liquefied, stored, and vaporized at the Richmond Plant, and stored and vaporized at the Passyunk Plant. Total liquefaction (converting natural gas to liquid state for storage) capacity at the Richmond Plant existing facilities is approximately 35,000 Mcf per day. With the current equipment at the Richmond Plant, liquefaction is limited to the non-winter period and therefore the gas that is liquefied is purchased during the generally lower cost non-winter period. The Richmond Plant can store approximately 49 million gallons of LNG (4.05 million Mcf natural gas equivalent) and the Passyunk Plant can store approximately 3 million gallons of LNG (250,000 Mcf natural gas equivalent). The LNG stored at the Passyunk Plant is liquefied at the Richmond Plant and then transported by cryogenic trailer trucks to the Passyunk Plant. Total vaporization (converting the liquid LNG to gas) capacity at the Richmond Plant is 411,000 Mcf per day and 100,000 Mcf per day in reserve, and the capacity at the Passyunk Plant is 45,000 Mcf per day and 45,000 Mcf per day in reserve. The highest daily vaporization rate from the LNG facilities of approximately 360,000 Mcf occurred at the time of the all time system peak in January 1994.

Supply and Demand Balance

Table 2 summarizes the supply mix that was used to meet historical peak day demand from fiscal years 2000 through 2005, and the supply mix that would enable PGW to meet future demand assuming design conditions over the 2006 through 2011 fiscal years. A design day on PGW's system is based on the highest actual historical peak day experienced by PGW. This occurred on January 19, 1994 with a peak day total demand (sendout) of 752,707 Mcf. The average temperature on that day was 2°F. For design purposes, PGW projects total demand based on a 65 heating degree-day ("HDD") which translates to an average temperature of 0°F. During the past five years, pipeline deliveries (flowing gas plus underground storage) have met between 65 and 97 percent of actual peak day demand. These figures are relatively high due to significantly warmer than normal winters. During the projection period, approximately 55 percent of peak day demand under design conditions would be met from pipeline supply with the remaining 45 percent met from LNG. PGW must maintain these capacity levels because it is considered the supplier of last resort if the customer's supplier is unable to perform. However, PGW will assign proportionate shares of pipeline and LNG capacity and cost to transportation customers. Table 2 shows that PGW has sufficient capacity to meet demand requirements.

Table 3 summarizes the supply mix that is projected to meet annual requirements during normal and design years from 2006 through 2011. PGW defines a normal year as one containing 4,555 HDD. This normal year is based on a 30-year average. PGW defines a design year as one containing 5,280 HDD. A design year is based on the temperatures experienced during the 1977-1978 winter, which was the coldest recorded winter in the last 60 years.

Table 2
Peak Day Supply and Demand

Description	Fiscal Year Ending August 31,											
	Actual						Projected - Design ^(a)					
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Actual^(b)												
Heating Degree-Days	49	45	38	49	52	50						
Demand - Mcf	639,903	520,086	459,593	616,928	620,413	591,133						
Supply - Mcf												
Pipeline/Storage	434,955	397,136	448,432	445,948	434,420	455,735						
LNG	204,948	122,950	11,161	170,980	185,993	135,398						
Total	639,903	520,086	459,593	616,928	620,413	591,133						
Projected - Design												
Heating Degree-Days ^(c)							65	65	65	65	65	65
Demand - Mcf ^(c)							742,300	745,100	747,800	750,600	753,300	756,000
Supply - Mcf												
Pipeline/Storage ^(d)							446,928	446,928	446,928	446,928	446,928	446,928
LNG (net)							295,372	298,172	300,872	303,672	306,372	309,072
Total							742,300	745,100	747,800	750,600	753,300	756,000

(a) Assumes no unbundling of services.

(b) For 2000-2005, SDS 7, In the Matter of Proposed Operating Budget, Supporting Documentation - Gas Costs and Purchasing Plans, Volume 1, June 2005.

(c) SDS 6, Page 3 of 4, In the Matter of Proposed Operating Budget, Supporting Documentation - Gas Costs and Purchasing Plans, Volume 1, June 2005.

(d) SDS 6, Page 4 of 4, In the Matter of Proposed Operating Budget, Supporting Documentation - Gas Costs and Purchasing Plans, Volume 1, June 2005.

Table 3
Annual Supply and Demand

Line							
No.	Description	2006	2007	2008	2009	2010	2011
		dt	dt	dt	dt	dt	dt
Normal Year - 4,555 Heating Degree-days							
Requirements - Sales							
1	Firm Service	62,950,387	63,118,288	63,393,260	63,491,294	63,677,413	63,866,051
2	Boiler and Power Plant Service	2,518,835	2,386,854	2,401,519	2,438,067	2,491,424	2,553,560
3	Load Balancing Service	1,117,015	1,001,036	975,045	966,456	963,691	965,777
4	Cogeneration Service	8,669	7,956	10,874	14,084	17,328	21,294
5	Gas Transportation Service	0	0	0	0	0	0
6	Natural Gas Vehicle Service	0	0	0	0	0	0
7	Trigen	0	0	0	0	0	0
8	Grays Ferry	0	0	0	0	0	0
9	Subtotal Sales	66,594,906	66,514,134	66,780,698	66,909,901	67,149,856	67,406,682
10	Plant Use	1,009,223	1,004,809	844,805	802,574	813,063	859,283
11	Storage Return	17,715,130	17,645,300	16,767,781	14,470,014	14,884,305	15,858,573
12	Liquefaction	2,629,093	2,923,720	1,855,881	1,718,596	1,787,776	1,775,805
13	Total Demand	87,948,352	88,087,963	86,249,165	83,901,085	84,635,000	85,900,343
Supply							
14	Texas Eastern	21,362,668	21,269,624	23,002,856	21,600,021	21,622,351	22,029,951
15	Transco	46,123,458	47,057,980	46,628,010	45,542,231	46,134,715	46,189,432
16	Pipeline Subtotal	67,486,126	68,327,604	69,630,866	67,142,252	67,757,066	68,219,383
17	Texas Eastern	8,718,114	8,732,960	6,436,830	6,221,114	6,269,571	7,081,915
18	Transco	8,856,654	8,881,854	8,290,415	8,819,123	8,820,581	8,823,240
19	Storage Subtotal	17,574,768	17,614,814	14,727,245	15,040,237	15,090,152	15,905,155
20	LNG	2,887,458	2,145,546	1,891,054	1,718,596	1,787,782	1,775,805
21	Total Supply	87,948,352	88,087,964	86,249,165	83,901,085	84,635,000	85,900,343
Design Year - 5,280 Heating Degree-days							
Requirements - Sales							
22	Firm Service	70,420,306	70,601,956	70,894,406	71,005,067	71,206,551	71,411,307
23	Boiler and Power Plant Service	2,820,423	2,669,686	2,684,825	2,725,930	2,785,851	2,855,679
24	Load Balancing Service	634,834	584,455	547,820	538,468	532,219	536,804
25	Cogeneration Service	5,770	5,648	7,551	9,826	12,101	15,042
26	Gas Transportation Service	0	0	0	0	0	0
27	Natural Gas Vehicle Service	0	0	0	0	0	0
28	Trigen	0	0	0	0	0	0
29	Grays Ferry	0	0	0	0	0	0
30	Subtotal Sales	73,881,333	73,861,745	74,134,602	74,279,291	74,536,722	74,818,832
31	Plant Use	979,106	980,466	952,576	947,236	960,464	973,850
32	Storage Return	17,572,436	17,536,747	17,510,801	15,593,147	16,268,245	16,577,596
33	Liquefaction	2,629,093	2,923,720	2,346,326	2,381,499	2,381,493	2,381,499
34	Total Demand	95,061,968	95,302,678	94,944,305	93,201,173	94,146,924	94,751,777
Supply							
35	Texas Eastern	27,924,858	27,937,981	28,039,531	26,495,148	26,766,124	27,124,647
36	Transco	47,104,125	47,283,560	47,292,279	46,437,603	46,960,347	47,033,864
37	Pipeline Subtotal	75,028,983	75,221,541	75,331,810	72,932,751	73,726,471	74,158,511
38	Texas Eastern	7,343,474	7,329,918	7,528,492	7,591,352	7,615,113	7,684,223
39	Transco	8,516,901	8,875,311	8,217,502	8,735,206	8,777,609	8,823,240
40	Storage Subtotal	15,860,375	16,205,229	15,745,994	16,326,558	16,392,722	16,507,463
41	LNG	4,172,610	3,875,908	3,866,501	3,941,864	4,027,731	4,085,803
42	Total Supply	95,061,968	95,302,678	94,944,305	93,201,173	94,146,924	94,751,777

Reference: SDS4A and SDS 4B, In the Matter of Proposed Operating Budget, Supporting Documentation - Gas Costs and Purchasing Plans, Volume 1, June 2005.

Even though 100 percent of PGW's supply is originally transported through one of the two interstate pipelines, the supply components shown in Table 3 are based on the source of gas when ultimately delivered to the end user. As shown, approximately 68 percent of PGW's total gas pipeline supply during a normal year flows through the Transco pipeline system. On a projected normal annual basis, approximately 97 percent of volume is delivered to end users through the interstate pipeline systems (80 percent flowing gas¹⁰ and 20 percent off-system storage), and 3 percent is delivered from the LNG facilities.

¹⁰ Flowing gas represents gas that is purchased at the same time as delivered to customers.

Capital Improvement Program

PGW uses a formal process for evaluating capital needs and funding programs to meet those needs. This annual capital planning process is used to formally review the Capital Improvement Program ("CIP") and incorporates revisions into the five-year capital program projection using certain specified economic parameters to prepare the capital requirement estimates that form the basis for departmental budgets. Department budgets and projections are based on meeting PGW's design hour and design day projections as prepared by the Gas Management Department.¹¹ Under the terms of the Management Agreement, PGW submits the annual CIP to the Director of Finance and the PGC for review, and approval of the current fiscal year budget is then obtained from City Council.

In keeping with PGW's philosophy of maintaining a safe and reliable gas distribution system, all capital projects are assigned a priority. The highest priority projects (Priority 1 and Priority 2) relate to expenditures required for maintaining the safety and reliability of PGW's system. Priority 3 expenditures relate to facility relocations that are based on City, State, or Federal mandated projects. Priority 4 expenditures relate to projects that will result in additional revenues from load growth, and the lowest priority projects (Priority 5) are for those expenditures associated with improving operational efficiencies and/or discretionary items.

Table 4 presents a summary of PGW's historical and forecasted capital improvement program expenditures. Capital expenditures for the major PGW departments are shown in the table. Capital expenditures for all departments other than Gas Processing, Distribution, Field Services, and Transportation, are grouped together under the miscellaneous category "Other Departments".

Proposed capital expenditures over the six-year projection period total \$396 million. For fiscal year 2006, PGW's estimated capital expenditures of \$65.8 million (net of salvage, contributions, and reimbursements) represent a 1.7 percent decrease from the 2005 capital expenditures. The majority of the 2006 capital expenditures, \$43.8 million or 67 percent, is committed to Distribution Department projects. Gas Processing and Transportation Departments have planned expenditures of about \$2.3 million and \$2.8 million, respectively, in fiscal year 2006. Field Services and Other Departments have planned expenditures of about \$6.5 million and \$10.4 million, respectively, in fiscal year 2006. Over the six-year forecasted period, Distribution Department projects have planned expenditures of \$256.3 million, which represents 65 percent of the total capital spending. The majority of the Distribution Department capital projects involve the replacement of gas services and ongoing and required main replacements for intermediate and low-pressure mains of small diameter (8 inches or less).

Based on our inspections of existing facilities in April 2004 and under normal operating conditions, the proposed capital expenditures should be sufficient to maintain the system in good condition.

A listing of projects approved for fiscal year 2006, by major department, is shown in Table 5. This table also shows the priority assigned to each project. In addition to the budgeted \$58.8 million as shown in Table 5 for 2006, PGW anticipated completing \$7.0 million of capital improvements carried over from prior fiscal years.

¹¹ Operating department budgets are based on assessing capital requirements for maintaining a safe and reliable system calculated for a design day of 0°F average temperature, a -5°F design hour, and a normal annual weather pattern resulting in 4,555 annual heating degree-days.

Table 4
Historical and Proposed Capital Improvement Program Expenditures
(Thousands of Dollars)

Category	Fiscal Year Ending August 31, ^(a)												Total
	Actual						Budget	Projected					
	2000	2001	2002	2003	2004	2005 ^(b)	2006 ^(d)	2007	2008	2009	2010	2011	
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	
Gas Processing	926	14,255	10,074	5,613	10,597	5,008	2,278	4,464	4,141	5,466	3,909	3,036	23,294
Distribution	31,183	33,890	34,478	43,786	40,096	43,573	43,754	42,654	41,502	41,812	42,802	43,751	256,275
Field Services	8,097	5,233	8,027	6,550	3,266	5,287	6,481	12,590	12,461	11,983	11,353	10,566	65,434
Transportation	772	683	1,085	1,003	2,649	2,917	2,792	4,104	3,378	4,217	4,296	3,375	22,162
Other Departments ^(c)	7,161	3,363	3,815	3,939	4,063	10,125	10,446	6,428	4,257	2,818	2,212	2,511	28,672
Subtotal	48,139	57,424	57,479	60,891	60,671	66,910	65,751	70,240	65,739	66,296	64,572	63,239	395,837

(a) All figures are net of Salvage, Reimbursements, and Contributions.

(b) Based on unaudited year-end figures.

(c) Includes Approved and Budgeted Program for Building Services, Customer Affairs, and Systems Technology.

(d) Includes carryover of \$7.0 million in capital improvements from fiscal year 2005.

Table 5
New Capital Projects for FY2006
(Thousands of Dollars)

Category	Priority 1 Safety	Priority 2 Reliability	Priority 3 Enforced	Priority 4 New Rev	Priority 5 Efficiency	Total
	\$	\$	\$	\$	\$	\$
Gas Processing						
Install Backup Emergency Generator - M&R	175	0	0	0	0	175
Migrate Rosemount RS3 Control System	300	0	0	0	0	300
P-103 LNG Pump (Phase I) - Richmond Plant	200	0	0	0	0	200
Workforce Management	200	0	0	0	0	200
Boiler Feed Water Pumps - Passyunk Plant	61	0	0	0	0	61
Upgrades & Security Improvements - Building #304039	173	0	0	0	0	173
Miscellaneous Additions	137	0	0	0	0	137
Miscellaneous Replacements	374	0	0	0	0	374
Total Gas Processing	1,620	0	0	0	0	1,620
Distribution						
Prudent Main Replacements	8,701	0	0	0	0	8,701
High Pressure Main Valves Replacements	250	0	0	0	0	250
Joint Clamping and Encapsulation	4,365	0	0	0	0	4,365
Small Service Replacements	17,422	0	0	0	0	17,422
Large Service Replacements	1,107	0	0	0	0	1,107
Small Service Installations	0	0	0	3,256	0	3,256
Large Service Installations	0	0	0	1,279	0	1,279
Customer Metering & Regulator Installation	0	0	0	61	0	61
Replace Pressure Regulating/Corrosion Control Facilities	0	229	0	0	0	229
Purchase Tools, Equipment	0	0	0	0	152	152
Replace Tools, Equipment	0	177	0	0	0	177
Enforced Relocations From City and State Work	0	0	640	0	0	640
Enforced Relocations For System Pressure	0	0	2,420	0	0	2,420
Supply Customers/Installation of Mains Ahead-of-Paving	0	0	0	251	0	251
Local Mains to Supply New Houses/Increased Capacity	0	0	0	2,100	0	2,100
Total Distribution	31,845	406	3,060	6,947	152	42,410
Field Services						
Regulator Purchases	85	0	0	0	0	85
Service Regulators Purchases and Installations	0	0	0	13	0	13
Meter Replacements	2,130	0	0	0	0	2,130
Shop Equipment Replacements	0	0	0	0	50	50
Training Equipment Replacements	0	200	0	0	0	200
Meters Purchases for Automatic Meter Reading	0	0	0	2,091	0	2,091
AMR ERT Devices Purchases and Installations	0	0	0	0	76	76
AMR Replacements	0	0	0	0	600	600
BPS Metscan & LBS Metretek	500	0	0	0	0	500
PUC Meter Testing Program Equipment Purchase	0	0	0	0	36	36
Instrumentation Purchases and Installations	0	0	0	0	300	300
Total Field Services	2,715	200	0	2,104	1,062	6,081
Transportation						
Shop Equipment Additions	0	38	0	0	0	38
Conditional Funding for Vehicle Replacements	0	2,289	0	0	0	2,289
Shop Equipment Replacements	0	46	0	0	0	46
Mobile Equipment Replacements	0	194	0	0	0	194
Mobile Radio Equipment Replacements	0	100	0	0	0	100
Total Transportation	0	2,667	0	0	0	2,667
Other Departments	2,496	2,255	0	0	1,238	5,989
Total FY 2006 Projects	38,676	5,528	3,060	9,051	2,452	58,767
Carryover from Years Prior to FY 2006^(a)	2,433	3,585	0	300	666	6,984
Total FY 2006 Expenditures (Net)	41,109	9,113	3,060	9,351	3,118	65,751

(a) The projects listed in the Table 5 are planned fiscal year 2006 capital improvements. In addition to the budgeted \$58.76 million, PGW will also be completing \$6.98 million of capital improvements carried over from prior years.

Gas Processing

As shown in Table 4, the estimated capital spending for the Gas Processing Department is \$2.3 million in fiscal year 2006. This represents an approximate 55 percent decrease in planned expenditures over fiscal year 2005. Historical expenditures for the Gas Processing Department were largely attributable to the expansion of the open expanded loop facility for Phase 1. PGW has removed any further investment for Phase 2 facilities from its six-year capital improvement program pending negotiations with an LNG terminal operator (*See the PGW Gas System – LNG Facilities*).

Distribution

The ongoing mains replacement capital program follows recommendations made by Navigant Consulting Inc. ("Navigant") in a February 2000 report entitled "Philadelphia Gas Works Mains Replacement Study." The study recommended an 18-mile annual replacement program for cast iron mains, about one percent of current inventory, which was projected by Navigant to eliminate most of PGW's cast iron pipe that had the highest likelihood of cracking and leaking in the next five years. Cast iron pipe was generally used by natural gas utilities many decades ago and was quite common for low-pressure gas mains such as PGW's. While this pipe has performed well, as it ages the pipe is prone to cracking and the joints to separating, thereby resulting in leaks. Over the last 20 years or so, natural gas utilities have been systematically replacing cast iron mains generally with plastic for low-pressure systems and sometimes wrapped and cathodically protected steel for higher pressure systems. A one percent annual replacement program was found by Navigant to be typical for gas distribution utilities, like PGW, with greater than 500 miles of cast iron mains. The Distribution Department has also coordinated its mains replacement with the Billing Department to ensure that as the mains are replaced, shutoff valves are added in areas with significant risk of non-payment.

The estimated capital spending for fiscal year 2006 for the Distribution Department is \$43.8 million, which is about the same level as 2005 capital expenditures. Projected expenditures are based on the 18 miles per year replacement schedule. Planned capital projects for the Distribution Department follow a recurring pattern that generally requires equal capital outlays each year.

The next largest department expenditure relates to the prudent replacement of small diameter (1.25 inches or less) services. This ongoing multi-year project is budgeted at \$17.4 million for fiscal year 2006. These expenditures are scheduled for the renewal of services based on customer complaints, leak surveys, and City and State work.

Field Services

The estimated capital spending for fiscal year 2006 for the Field Services Department is \$6.5 million. Over the past decade, PGW has embarked on an aggressive program to retrofit customer meters with electronic devices to maximize the effectiveness of its automated meter reading system ("AMR"). PGW continues to realize benefits from the implementation of the automated meter reading system, including fewer estimated readings, increased reading accuracy, reduction in meter reading personnel and reduced customer complaints. Increased expenditures beginning in fiscal year 2007 reflect replacement of metering devices in the AMR program. Initially, PGW intended to only replace batteries on the AMR meters; however, PGW has determined that the cost of replacing the entire meter is essentially the same.

Transportation

The Transportation Department estimated capital expenditures are \$2.8 million for fiscal year 2006. The majority of the estimated capital expenditures for this department are associated with mobile equipment replacements (11 percent), and vehicle replacements (89 percent). The remainder of the proposed capital spending for the Transportation Department is distributed between shop equipment additions and replacements.

Transportation Department spending totals for fiscal year 2004 more than doubled that of fiscal year 2003, which reflected PGW's need to begin replacing its aging fleet requirements. In fiscal year 2005, PGW started implementing a phased approach to optimize fleet operations. The Transportation Department budget is projected to increase from \$2.8 million in fiscal year 2006 to \$4.1 million in fiscal year 2007. The majority of the vehicle replacements are targeted to support critical field operations activities.

Other Departments

The "Other Departments" category includes estimated capital expenditures for Building Services, Information Technology, and Customer Affairs. For fiscal year 2006, the combined spending of these departments is \$10.4 million. PGW continues to invest in its Field Operations Initiative ("FOI"), which is the cornerstone of how PGW will comply with PUC requirements, as well as achieves the benefits of integrating PGW's Distribution and Field Services Departments. Once fully implemented, this initiative will support mobile and work management functions, as well as automate the Distribution Department.

Rates and Tariffs

The following sections present a discussion of existing rate programs and some of the ongoing issues facing PGW due to the changes in legislation and regulation and the impact on rates and rate-making methodology.

Regulation

Prior to July 1, 2000, PGW's rates were regulated by the PGC. PGW's last base rate increase under PGC regulation was in December 1991. Commencing on July 1, 2000, PGW became regulated by the PUC. Although the PGC continues to approve PGW's operating budget, which has the effect of setting PGW's revenue requirement, the PUC has the authority to approve the rates charged by PGW.¹²

Since PGW became regulated under the PUC in 2000, PGW has filed for three separate permanent base rate increases totaling \$125 million. The PUC has granted \$69.6 million of this total, or 56 percent. PGW has also interfaced with the PUC on several occasions regarding revisions to its gas cost rate ("GCR"). The PUC has approved all of the GCRs filed by PGW. In our opinion, PGW has requested and received timely changes in its GCR.

In August 2000, PGW filed for interim base rate relief of \$52 million (annually) with the PUC. In its order dated November 22, 2000, the PUC granted \$11 million of this interim increase but attached certain conditions precedent to the increase that were not acceptable to PGW. PGW and the City filed an appeal of the PUC Order with the Commonwealth Court. On February 22, 2001, the PUC issued an order adopting a settlement of the appeal between the PUC Law Bureau, PGW, and the City that included the following:

1. PGW would be allowed to increase rates to provide an additional \$11 million in base rate revenues by August 31, 2001.
2. PGW would be permitted to recover an additional \$7 million through its GCR to account for higher than anticipated bad debt expense. PGW would be allowed to reserve any over collection of GCR up to \$25 million.
3. PGW agreed to implement all of the recommendations of the PUC Management Audit (the "Audit") or explain why it believes it cannot or should not.
4. The PUC is obligated to establish rates that permit PGW to meet all of its Bond Ordinance covenants.
5. The PUC and the City agreed on a timetable and process to replace interim management with permanent management.

The appeal was withdrawn following the February 22, 2001 Order approving the settlement. PGW implemented rates consistent with the order on March 1, 2001.

In regard to the Management Audit, PGW submitted its May 18, 2004 Implementation Plan to the PUC. The PUC subsequently made 30 follow-up recommendations for improvement. PGW accepted 24, partially accepted 4, and rejected 2 of the PUC's follow-up recommendations. On June 2, 2005, the PUC released PGW's Implementation Plan and the PUC's Management Efficiency Investigation ("MEI") of PGW to the public. The PUC directed PGW to proceed with the May 18, 2005 Implementation Plan.

¹² Generally, the PUC is required to rule on application for base rate relief within nine months of the utility's application.

PGW's implementation actions may be reviewed by the PUC at a later date to determine if PGW has effectively implemented the recommendations.

On January 5, 2001, PGW filed for a \$65 million permanent increase in base rates. This was the first permanent base rate filing PGW submitted to the PUC for approval. On October 12, 2001, the PUC granted PGW the authority to raise base rates by \$22.6 million.

On February 25, 2002, PGW filed for a \$60 million increase in base rates and the power to implement a weather normalization clause (Docket No. R-00017034). As part of the request for base rate relief, PGW submitted a petition for Extraordinary Rate Relief seeking to have \$44 million of the total requested \$60 million to be approved as extraordinary rates effective in mid-April 2002 to meet the immediate need to maintain its investment grade rating. The remaining \$16 million was necessary to provide financing to pay down loans, upgrade plant security, and expand gas leak detection capabilities.

On April 11, 2002 the PUC granted PGW a \$36 million extraordinary base rate increase in order for PGW to maintain its overall liquidity and access to capital markets. The increase took effect April 16, 2002. The increase was permanently approved on August 8, 2002. The PUC also permitted PGW to implement its proposed Weather Normalization Adjustment ("WNA") clause. The WNA is discussed more fully in the section on *"Existing Rates – Weather Normalization Adjustment"*.

PGW filed a restructuring plan with the PUC on July 1, 2002, which was approved by the PUC on March 31, 2003. The restructuring plan, among other things, provides for an unbundled tariff permitting customer choice of the commodity supplier by September 1, 2003. PGW's Restructuring Compliance Tariff Rates are designed to maintain revenue neutrality and the Tariff Rules and Regulations are designed to comport with the PUC requirements.

PGW does not expect to seek another permanent base rate increase from the PUC prior to fiscal year 2009.

Existing Rates

The current tariff sets forth the rules and regulations for gas service and the rates PGW is allowed to charge for various types of service. Changes to this tariff must be approved by the PUC. Currently, PGW primarily provides service under three broad classifications: firm, interruptible, and transportation service. Table 6 summarizes PGW's existing rates and applicable surcharges. PGW's rates are presented as unbundled and include a customer charge, distribution charge, and gas cost rate. The distribution charge includes a delivery charge, as well as any applicable surcharges. The GCR is not applicable to certain firm service customers who transport gas through a qualified natural gas supplier ("NGS").

Firm Service

PGW provides firm service under three rate schedules: General Service, Municipal Service, and Philadelphia Housing Authority ("PHA") Service. The vast majority of PGW's customers are served under the General Service Rate. During the 2006 fiscal year, over 99 percent of PGW's customers are estimated to be served under this rate and these customers account for 92 percent of sales volumes (and 76 percent of total throughput). This rate is available to any residential, commercial, or industrial customer. Monthly customer charges differ depending on whether the customer is classified as residential, commercial, or industrial. A different commodity rate applies to residential customers versus commercial and industrial customers. The General Service Rate contains special provisions for separately metered summer air conditioning and compressed natural gas ("CNG") vehicle service. Residential senior citizens may have qualified for a discount under this rate. (*See Senior Citizen Discount Program*). The commodity rate is subject to adjustment under the GCR clause.

Table 6
Comparison of Existing Tariff Rates

Tariff	Effective	Tariff Charges ^(a)
Firm Service		
General Service - Rate GS		
Customer Charge - \$/meter per month		
Residential and Public Housing Customers	10/7/05	12.00
Commercial and Municipal Customers	10/7/05	18.00
Industrial Customers	10/7/05	50.00
Gas Cost Rate (GCR) - \$/Mcf		
Residential and Public Housing Customers	10/7/05	12.5632
Commercial and Municipal Customers	10/7/05	12.5632
Industrial Customers	10/7/05	12.5632
Distribution Charge - \$/Mcf ^(b)		
Delivery Charge		
Residential and Public Housing Customers	10/7/05	4.2124
Commercial and Municipal Customers	10/7/05	4.3056
Industrial Customers	10/7/05	4.3029
Surcharges		
Universal Service and Energy Conservation	10/7/05	2.3723
Restructuring and Consumer Education	9/1/05	0.0771
Total Commodity Charge - \$/Mcf		
Residential and Public Housing Customers		19.2250
Commercial and Municipal Customers		19.3182
Industrial Customers		19.3155
Municipal Service - Rate MS		
Customer Charge - \$/meter per month	10/7/05	18.00
Gas Cost Rate (GCR) - \$/Mcf	10/7/05	12.5632
Distribution Charge - \$/Mcf ^(b)		
Delivery Charge	10/7/05	3.1470
Surcharges		
Universal Service and Energy Conservation	10/7/05	2.3723
Restructuring and Consumer Education	9/1/05	0.0771
Total Commodity Charge - \$/Mcf		18.1596
Philadelphia Housing Authority Service - Rate PHA		
Customer Charge - \$/meter per month	10/7/05	18.00
Gas Cost Rate (GCR) - \$/Mcf	10/7/05	12.5632
Distribution Charge - \$/Mcf ^(b)		
Delivery Charge	10/7/05	4.2952
Surcharges		
Universal Service and Energy Conservation	10/7/05	2.3723
Restructuring and Consumer Education	9/1/05	0.0771
Total Commodity Charge - \$/Mcf		19.3078
Interruptible Service		
Boiler and Power Plant Service-Small Volume - Rate BPS-S		
Customer Charge - \$/meter per month		
Annual consumption less than 10,000 Mcf.	9/1/03	35.00
Annual consumption between 10,000 and 100,000 Mcf, inclusive.	9/1/03	75.00
Annual consumption greater than 100,000 Mcf.	9/1/03	150.00
Commodity Charge ^(c) - \$/Mcf		14.11
Boiler and Power Plant Service - Large Volume - Rate BPS-L		
Customer Charge - \$/meter per month		
Annual consumption less than 10,000 Mcf.	9/1/03	35.00
Annual consumption between 10,000 and 100,000 Mcf, inclusive.	9/1/03	75.00
Annual consumption greater than 100,000 Mcf.	9/1/03	150.00
Commodity Charge ^(c) - \$/Mcf		12.17
Boiler and Power Plant Service - Heavy Oil - Rate BPS-H		
Customer Charge - \$/meter per month		
Annual consumption less than 10,000 Mcf.	9/1/03	35.00
Annual consumption between 10,000 and 100,000 Mcf, inclusive.	9/1/03	75.00
Annual consumption greater than 100,000 Mcf.	9/1/03	150.00
Commodity Charge ^(c) - \$/Mcf		11.17

Table 6 (continued)
Comparison of Existing Tariff Rates

Tariff	Effective	Tariff Charges ^(a)
Interruptible Service (Continued)		
Load Balancing Service - Extra-Large Volume - Rate LBS-XL		
Customer Charge - \$/meter per month	9/1/03	250.00
Commodity Charge ^(c) - \$/Mcf		10.09
Load Balancing Service - Large Volume - Rate LBS-L		
Customer Charge - \$/meter per month	9/1/03	175.00
Commodity Charge ^(c) - \$/Mcf		10.11
Load Balancing Service - Small Volume - Rate LBS-S		
Customer Charge - \$/meter per month	9/1/03	100.00
Commodity Charge ^(c) - \$/Mcf		10.13
Gas Transportation Service - Rate GTS		
Customer Charge - \$/meter per month	9/1/03	250.00
Commodity Charge ^(c) - \$/Mcf		0.4118
Cogeneration Service - Rate CG		
Customer Charge - \$/meter per month	9/1/03	250.00
Commodity Charge ^(c) - \$/Mcf		9.45
Developmental Natural Gas Vehicle Service, Firm Service - Rate NGVS		
Customer Charge - \$/meter per month	9/1/03	35.00
Commodity Charge - \$/Mcf	9/1/03	
For all monthly usage up to 7times the Maximum Daily Quantity (MDQ)		7.12
For additional usage up to the next 7 times the MDQ		4.80
For all additional volumes		4.00
Developmental Natural Gas Vehicle Service, Interruptible Service - Rate NGVS		
Customer Charge - \$/meter per month	9/1/03	35.00
Commodity Charge - \$/Mcf		10.06
Transportation Service		
Daily Balancing Service - Rate DB		
Administrative Charge - \$/supply pool per month	9/1/03	150.00
Plus charges and/or credits related to balancing and Operational Flow Orders (OFOs)		
Interruptible Transportation - Rate IT		
9/1/03		
IT-1 - Available to customers who otherwise do not qualify for rates IT-2 through IT-8.		
IT-2 - Contracts for not less than 2,500 Dth, maintain standby non-natural gas energy.		
IT-3 - Contracts for not less than 5,000 Dth, maintain standby non-natural gas energy.		
IT-4 - Contracts for not less than 5,000 Dth, maintain Standby No. 4 oil.		
IT-5 - Contracts for not less than 5,000 Dth, maintain Standby No. 5 or No. 6 oil.		
IT-6 - Contracts for not less than 80,000 Dth, maintain standby non-natural gas energy.		
IT-7 - Contracts for not less than 350,000 Dth, maintain standby non-natural gas energy.		
IT-8 - Maximum and minimum quantities of gas to be delivered shall be defined.		
Customer Charge - \$/meter location per month		Transportation Charge - \$/Dth delivered
IT-1	75.00	IT-1 3.81 maximum
IT-2	75.00	IT-2 3.58 maximum
IT-3	150.00	IT-3 1.66 maximum
IT-4	150.00	IT-4 1.23 maximum
IT-5	150.00	IT-5 0.81 maximum
IT-6	250.00	IT-6 0.80 maximum
IT-7	250.00	IT-7 0.72 maximum
IT-8	250.00	IT-8 0.73 maximum

(a) Reference: Philadelphia Gas Works, Gas Service Tariff, Pa P.U.C No 2.

(b) Sum of Delivery Charge and Surcharges.

(c) Competitively priced based on cost of alternative fuel. Based on December 2004-November 2005 average.

(d) Commodity charge includes Delivery Charge, Transportation charge, and Standby Service Charge, if applicable.

Source of commodity charge is PGW Gas Sales and Revenue Report - Month Ending August 2005.

(e) Commodity charge based on cost of gas purchased and delivered to PGW gate stations.

Table 7 presents a comparison of a typical peak winter month's residential gas bill for PGW and the other principal gas distribution utilities in Pennsylvania. Based on rates, surcharges, and costs of gas currently in effect, PGW's typical winter residential bill is approximately \$52 higher than the group average of \$344. One of PGW's surcharges, Universal Service and Energy Conservation surcharge, includes the recovery of costs related to the Customer Responsibility Program, the Conservation Works Program, and the Senior Citizen Discount Program. We understand costs of comparable programs at other utilities in Pennsylvania are significantly lower in comparison because the cost of other utilities social programs are not as high as these costs are in Philadelphia. PGW's Universal and Energy Conservation surcharge is currently \$2.3723 per Mcf. For the typical peak winter month's residential bill for 20 Mcf of consumption, the Universal Service Charge amounts to \$47.45 of the \$396.50. Based on the effective date of the changes of gas cost of some of the utilities shown below, the recent spike in gas cost due to the effect of the hurricanes in the Gulf Coast region have not been fully reflected.

Table 7
Comparison of Residential Gas Bills – Pennsylvania Utilities
For Customers Using 20 Mcf per Month

<u>Utility</u>	<u>Gas Cost Effective</u>	<u>Monthly Bill^(a)</u>
Peoples Natural Gas	10/1/2005	298.19
PG Energy	12/1/2005	304.87
PECO Energy	12/1/2005	337.40
National Fuel Gas	11/1/2005	339.99
UGI Corporation	12/1/2005	340.18
Columbia Gas of Pennsylvania	10/1/2005	362.68
Equitable Gas	10/1/2005	372.45
Philadelphia Gas Works	10/7/2005	396.50

(a) Table assumes 1 cubic foot equals 1,000 Btu.

Interruptible Service

PGW provides interruptible service under several rate schedules. Over 99 percent of the interruptible customers take service under the Boiler and Power Plant Service ("BPS") or Load Balancing Service ("LBS"). The BPS rates are set within a range based on the price of No. 2 fuel oil with a ceiling based on the total price (including GCR) for commercial and industrial firm service. The LBS service is priced similarly except that No. 6 fuel oil is used rather than No. 2 fuel oil. Because their service is interruptible, customers taking BPS or LBS service must have an alternate energy source. Under normal operating conditions, interruption may be requested if the temperature is at or below 18 degrees Fahrenheit. Service to these customers is a competitive service. If the price of No. 2 or No. 6 fuel oil is less expensive than the equivalent price that PGW offers in any given month, the customer may choose to switch to alternate fuel rather than burn natural gas.

Transportation Service

PGW currently provides transportation service to 111 customers. Grays Ferry Cogeneration Facility accounts for about 65 percent of the transportation throughput and about 25 percent of the transportation revenue. Service to this customer is provided through essentially dedicated facilities under

a long-term negotiated contract. Under this contract, PGW receives approximately 8 cents per Mcf for each unit transported plus a service charge intended to cover PGW's cost of operating and maintaining the facilities required to serve this customer. The other customers are served under individually negotiated contracts. In some cases, transportation customers also take some service under the sales rate schedule for a portion of their load.

Although PGW has operated under its Restructuring Compliance Tariff with unbundled rates since September 1, 2003, all but a handful of PGW's customers (described in the prior paragraph) continue to take fully bundled service from PGW. A fully bundled service is a service where the customer deals with one provider and pays for all services through a single charge. All of the separate services (gas supply, transportation, storage, and distribution) currently performed by PGW are packaged into one full-service rate.

Under PGW's restructured rates, customers have the option to continue taking the gas supply, transportation, and storage services from PGW or choose a third party supplier to provide these services. Whether the customer decides to have PGW provide these services or a third party, the customer continues to take and pay for distribution service from PGW. Under its current tariff, PGW assigns (with recall rights) portions of its transportation and storage (pipeline and LNG) capacity to the third party supplier such that PGW and customers who take a fully bundled service will not be adversely impacted by having to pay for capacity that would otherwise be stranded by customers who choose a third party supplier. PGW retains ownership to the transportation and storage capacity because PGW continues to be the supplier of last resort. If a third party supplier defaults or is no longer able to meet its commitments, PGW is able to recall the transportation and storage capacity and serve the customers who had opted for service from this third party supplier.

Under the unbundled rates, PGW's contribution margin should not be materially impacted by whether a customer chooses a third party supplier or elects to continue taking the fully bundled service. In effect, the unbundled rates and services will make PGW indifferent as to which service a customer takes. Customers will continue to pay the distribution and customer charges no matter which service is taken, the GCR mechanism will keep PGW whole with regard to gas supply, transportation, and storage costs, and PGW's ability to assign capacity to the third party suppliers will not adversely impact customers who choose to take the fully bundled service.

PGW has experienced a slight increase in number of interruptible customers that have migrated to Gas Transportation Service ("GTS") service from the projection in the 2004 Report. For purposes of this Report, it has been assumed that no firm customers will take transportation service through fiscal year 2011. The only customers that are assumed to take transportation service during the projection period are interruptible customers.

Gas Cost Rate

As previously discussed, all changes in gas supply related costs are passed through to customers through the gas cost rate ("GCR"). The specific components of PGW's current GCR are depicted in Figure 3. PGW's gas supply costs consist of purchased gas costs, transportation costs, and off-system storage costs. This cost is reduced by the cost directly paid by interruptible customers (specifically, load balancing service customers). Sales are made to these interruptible customers based on prices quoted monthly by PGW. The prices quoted are based on the highest prices paid by PGW during the month with some consideration given to the customer's cost of alternative fuel oil. Natural gas service is competing against the price of alternative fuel; however, PGW only incurs gas supply cost attributable to these customers to the extent that sales are made (and gas is purchased to meet load). Total gas supply costs are also adjusted to reflect changes in the inventory cost of off-system and LNG storage and the cost of power

purchased for the LNG facilities. The change in inventory cost is attributable to changes in volume as well as the price paid for the gas put into storage.

These costs are divided by the total sales volumes less the volumes attributable to direct billed interruptible customers to determine the unit cost of fuel, or sales service charge as depicted in Figure 3. Various adjustments are then made to the sales service charge. An additional adjustment is made for the net over or undercollection of natural gas during the previous fiscal year resulting from differences between values used to project the prior year's GCR and those actually experienced. The interest expense or credit on the over or under recovery is also applied to calculate the total adjustment. In addition, a credit for margin realized from interruptible sales ("IRC") is made. Each of these components comprises the GCR. The GCR may be adjusted quarterly.

Prior to the restructuring, PGW recovered certain non-fuel expenses in addition to gas supply costs through the GCR. These included discounts given to low income customers through the Customer Responsibility Program and funds provided to weatherize the homes for low-income customers through the Conservation Works Program. These costs are now recovered through surcharges which are not included as part of the GCR. By recovering these costs through surcharges, customers cannot avoid these costs by not purchasing gas from PGW.

Post Katrina and Rita Impacts

The projections in this Report are based on analyses prior to the effects of Hurricanes Katrina and Rita. The current GCR was approved on October 7, 2005 and reflects the unprecedented commodity price of natural gas resulting from the recent hurricanes in the Gulf Coast region. The commodity charge in PGW's approved GCR is \$12.56 per Mcf, which is an increase from \$9.71 per Mcf in effect prior to these hurricanes. PGW estimates that this increase in the GCR alone will result in an increase of approximately \$150 million in customer obligations for the 2006 winter under normal weather conditions. Based on a forecasted collection factor of 94.5 percent, PGW estimates that its write-offs could increase by about 8 million dollars, however, to offset this impact, the potential exists that additional LIHEAP funding will be realized (*See LIHEAP Program*).

Surcharges

PGW's surcharges include a Restructuring and Consumer Education Surcharge and Universal Service and Energy Conservation Surcharge. These surcharges are depicted in Figure 4. Gas utilities in Pennsylvania can recover the costs of social programs through what are generally referred to as universal service charges. The Universal Service and Energy Conservation Surcharge provides for the recovery of discounts to customers on the Customer Responsibility Program ("CRP"), of discounts to customers receiving the Senior Citizen Discount, of the costs of the Conservation Works Program, and of past due arrearages forgiven to CRP customers entering CRP after September 1, 2003. The Universal Service Charge is applicable to all PGW customers, excluding interruptible customers, who are delivered natural gas through PGW's distribution system. PGW automatically adjusts the surcharge quarterly in connection with its GCR filing.

The Restructuring and Consumer Education Surcharge separately tracks and recovers costs associated with the transition to customer choice and what are generally referred to as PUC Chapter 56 (customer service) and Chapter 59 (safety) costs. The restructuring costs include the recovery of Commission approved costs which the Company has or will incur to meet requirements of the Natural Gas Choice and Competition Act and applicable Commission regulations, orders, and other regulatory requirements. The additional costs associated with Chapter 56 primarily relate to more frequent reading

of indoor meters. The additional costs associated with Chapter 59 primarily relate to more frequent meter testing and indoor leak surveys.

Weather Normalization Adjustment

As part of the settlement in PGW's 2002 rate case in Docket R-00017034, PGW received approval to implement a weather normalization adjustment ("WNA"). This marked the first time that the PUC authorized a WNA for a gas utility under its jurisdiction. The benefit of a WNA is that it essentially removes the single biggest risk to PGW of recovering its approved margin, warmer than normal weather during the winter season. PGW's approved commodity charges (exclusive of cost of gas) are derived using throughput (volumes) that are based on the assumption that weather will be normal. If conditions are warmer than normal, sales decline and in conjunction with that, margin revenues decline. Several warmer than normal winters, including one of the warmest winters in PGW's history, created the circumstances that led to PGW's need to file for extraordinary rate relief in 2002.

The WNA is designed to adjust the customers' bills upwards or downwards to reflect differences between actual heating degree-days and normal heating degree-days. The benefits of a WNA include the following:

- Stabilizes earnings.
- Stabilizes cash flow during the winter heating season.
- Reduces the need to file rate cases, thereby lowering costs.
- Reduces the need for short term financing.
- Stabilizes customers' bills.

Fiscal year 2004 was the second year the WNA was in effect and heating degree-days during the winter period were 20 percent lower than normal (4,287 actual HDD versus 5,280 normal HDD). Therefore, heating customers were billed approximately \$2.1 million as a result of the warmer than normal weather. PGW's WNA applies to customers served under its General Service, Municipal Service, and Philadelphia Housing Authority Service rate schedules and is calculated for each customer bill rendered between October 1 and May 31.

The type of WNA that PGW implemented is referred to as a Type 1 WNA. This type of WNA adjusts the customer's bill to reflect conditions during the billing cycle covering that bill. This contrasts with a Type 2 WNA that is calculated on a seasonal basis. The advantage of the Type 1 WNA is that the calculation of the customers' bills and PGW's revenue recovery are concurrent with the current billing cycle. The adjustment is calculated as the ratio of the normal heating degree-days during the billing cycle divided by the actual heating degree-days during the cycle. For example, assume a residential customer uses 10 Mcf during the period November 16 through December 15, the actual heating degree-days during this period are 750, and the normal heating degree-days during this period are 850. The customer's commodity charge (exclusive of gas cost) would be calculated as 10 Mcf times 850 HDDs divided by 750 HDDs times \$4.2124 per Mcf which equals \$47.74. Without a WNA, the customer's bill would have been \$42.12 (10 Mcf times \$4.2124 per Mcf). The WNA only applies if the actual HDDs deviate by more than 1 percent from the normal HDDs during the billing cycle. Therefore, if the actual HDDs during the cycle in the above example had been within the range of 842 to 859 HDDs, no adjustment would be made to the bill.

Figure 3
Components of PGW Gas Cost Rate

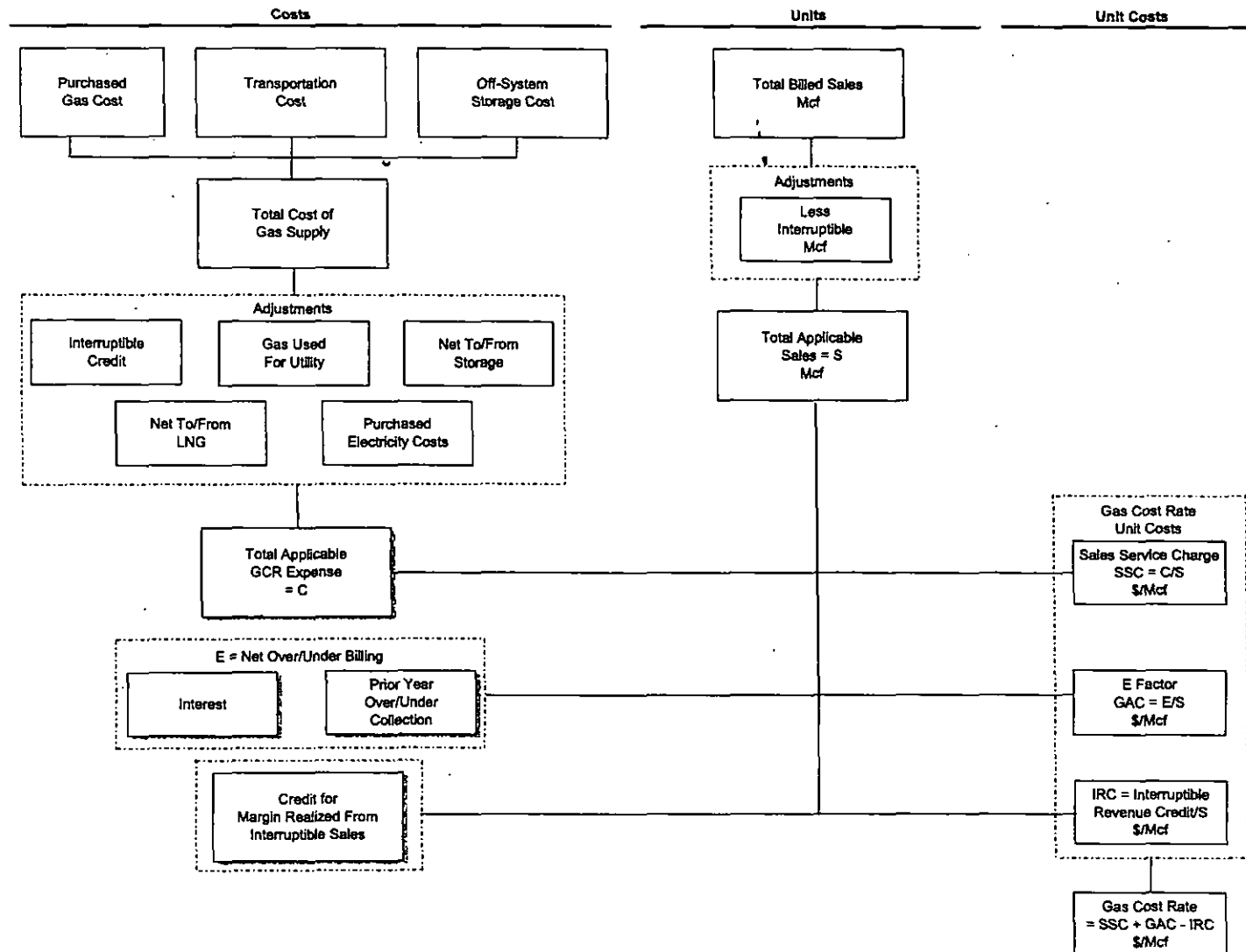
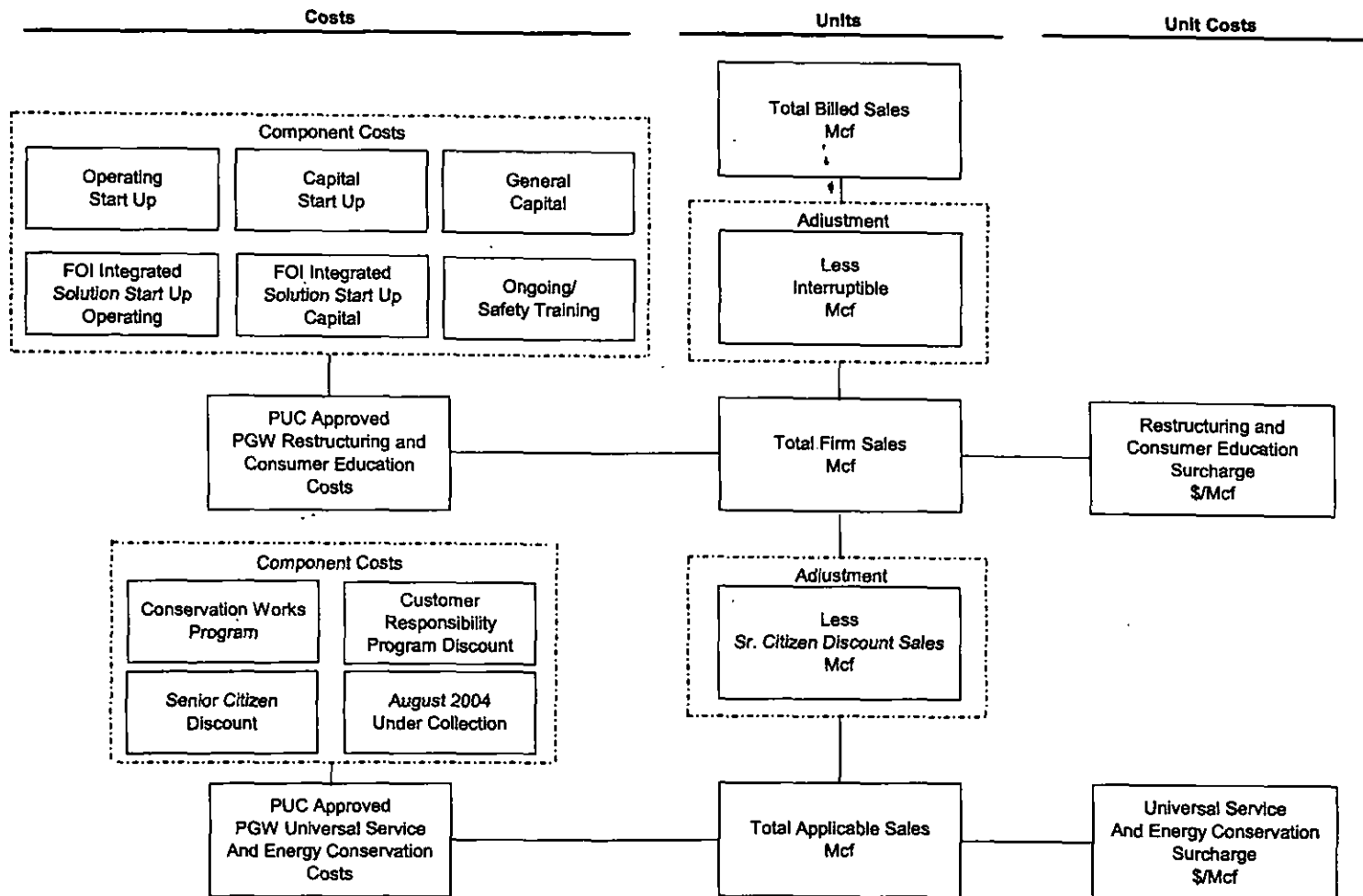


Figure 4
Components of PGW Surcharges



The PUC determined that PGW's WNA would be put in place for an initial three-year period, which expired October 31, 2005. PGW conducted a review of the costs and benefits of the WNA and determined that although it refunded a net amount of \$8 million to its customers, the program eliminates the risk of underrecovering its approved margin in a warmer than normal season and therefore have proposed to continue the WNA without change. PGW is currently in the process of presenting its conclusions regarding the WNA to the PUC with a request that the PUC acknowledge that the WNA should continue in place. Because PGW's WNA tariff has no sunset provision, the WNA will continue in place unless the PUC issues an order directing that it be discontinued. PGW cannot predict when the PUC will complete its review of PGW's WNA

Customer Responsibility Program

In November 1993, the Philadelphia Gas Commission adopted a low-income program known as the Customer Responsibility Program ("CRP"). This program became effective in February 1994. The purpose of CRP is to increase the collection of revenues, provide an affordable payment plan for low-income customers, impress payment responsibility on the customer, reinforce the importance of conservation and increase grant assignment. The goal of the program is to increase cash flow to PGW and decrease accounts receivable.

The CRP is open to any customer who is at or below 150 percent of the Federal poverty level ("FPL"). New CRP customers are asked to pay 5 percent of their arrearage as a down payment, although exceptions are provided if warranted. CRP customers are also required to accept conservation measures offered to them in the Conservation Works Program. CRP customers are required to recertify for the program each year and are considered in default when they are two full payments past due. A formula is developed to forgive past arrearages after successful completion of three years on the program.

In September 2003, the CRP program was changed to conform to requirements of the PUC. This revised program is described below:

Customer Responsibility Program ("CRP") is a customer assistance program that can help low-income residential customers who are at or below 150 percent of the poverty level to better afford their PGW bills and maintain their gas service. Participants receive a discount based on their gross household income. Applicants must apply by showing proof of income and social security cards for everyone in the household. There are three agreement types:

<u>PGW Annual Bill</u>	<u>Household Income</u>
8% of income	0-50% FPL
9% of income	51-100% FPL
10% of income	101-150% FPL

The minimum payment under a CRP agreement is \$18 per month. Customers with pre-program arrears must pay a \$3 monthly co-pay in addition to the CRP budget amount. Participant's responsibilities are to:

- pay CRP bills on time and in full,
- apply for and assign LIHEAP to PGW, if applicable,
- allow an AMR device to be installed,
- accept conservation and weatherization measures, and energy use education, if offered free of charge,
- recertify yearly or when household income and number living in household changes whichever comes first.

Participants are entitled to 1/36 arrearage forgiveness of pre-program arrears each month, if applicable, provided payment is current.

Approximately 65,000 customers or about 13 percent of PGW's total residential customer base are enrolled in the CRP. The main costs associated with the CRP program are the discount or shortfall in revenues and arrearage forgiveness associated with the program.

The CRP revenue shortfall is currently recovered in the Universal Service Surcharge. In the past five fiscal years, these amounts were \$16.1 million in 2002, \$32.9 million in 2003, \$48.5 million in 2004, \$61 million in 2005, and an estimated \$89 million for 2006. The shortfall fluctuation can be primarily attributed to the higher cost of natural gas supply and increased participation levels.

The CRP Arrearage Forgiveness, implemented in June 2002, is designed to forgive arrearage of eligible participants. From June 2002 until August 2003, under the "old" program design, approximately \$23.6 million has been forgiven from CRP customers' arrears. Since September 1, 2003 through fiscal year 2006 under the "new" program, approximately \$17 million has been forgiven.

Conservation Works Program

The Conservation Works Program ("CWP") is designed to provide cost-effective energy savings to PGW's low-income customers who participate in the CRP. The CWP is intended to reduce the overall long-term costs of the CRP.

The CWP began in 1990 and was operated by the Energy Coordinating Agency of Philadelphia ("ECA") for the first years of the program. In September 1996, the program was redesigned, a second weatherization contractor was added, and PGW became the program operator. Both contractors have pursued a lower cost program approach designed to install only the most cost-effective measures. Since redesign, the program has continued with an annual budget of approximately \$2.2 million. About 3,000 homes have been treated annually in recent years.

Generally, CRP customer consumption levels are approximately 30 percent greater than that of the average residential customer. Most CRP customers live in row houses more than 100 years old that are in poor condition. Abandoned and vacant neighboring properties are also factors inducing high-energy usage. Average gas used among Philadelphia's low-income population (qualifying customers) when calculated on a per square foot per degree-day basis is far above national levels.

The basic characteristics of the targeted CWP population are customers with household income at or below 150 percent of the FPL and gas usage levels that are at or above their usage limit.

The goals of the CWP program include:

- Reducing gas usage of low-income households in a cost-effective manner
- Lowering gas bills and improving the payment practices of participating customers

The CWP focuses on this population of low-income customers by addressing the main factors that influence their energy usage, such as, mechanical and structural systems, as well as, behavior issues. The principal program treatments are:

- Energy education and basic health and safety checks have been provided to all houses.
- Set-back thermostats have been installed in about two-thirds of all houses.
- Roof insulation has been installed by subcontractors in about 15 percent of

- Blower-door guided air sealing has been performed in about 25 percent of the houses.

PGW commissioned an independent evaluation of the CWP that was completed in September 2005. Overall, the CWP was found to produce beneficial energy savings for a modest cost. The report recommended that the measures should be applied to a greater proportion of houses.

Senior Citizen Discount Program

PGW offers a senior citizen discount program to residential customers at age 65 or older. Currently, there is no means or income test for eligibility in this program. The discount amounts to approximately 20 percent of the total gas bill for the residence.

On September 30, 2004, the Pennsylvania Public Utility Commission ("PUC") denied PGW's request to continue the senior discount program for post-September 1, 2003 applicants. PGW has filed an appeal of the PUC's order to the Commonwealth Court of Pennsylvania, which is pending. There are currently 58,000 "grandfathered participants". All current participants are "grandfathered" into the existing program and will continue to receive the 20 percent discount.

Other Programs and Grants

In addition to the programs described above, PGW also maintains several other assistance programs that are intended to increase cash flow and reduce accounts receivable.

LIHEAP Program

The Federally funded Low Income Home Energy Assistance Program ("LIHEAP") provides funds to households in order to ensure continued utility service. The City's low-income residential gas consumers may apply for assistance through PGW's neighborhood offices, the Department of Public Welfare, or at one of many other community sites. The LIHEAP program consists of two grant components: "Cash" and CRISIS grants. The main difference between the two grant types is that CRISIS grants are only offered to eligible customers whose utility service is off or in danger of having services terminated. Funds obtained are paid directly to PGW for crediting to the customer's account.

LIHEAP is an important source of low income assistance funding for PGW and has ranged over the last five years from a low of \$13.8 million in 2000 to a high of \$31.0 million in 2001. PGW's share of LIHEAP funds allocated by the Commonwealth of Pennsylvania has ranged from approximately 17 to 22 percent since 2000. These levels have been achieved through a vigorous educational and outreach program by PGW to enroll its low-income residential population.

In 1996, the Commonwealth of Pennsylvania changed the customer eligibility criteria for LIHEAP participation from 150 percent of the FPL to 110 percent of the FPL. Consequently, the number of PGW customers that are eligible for LIHEAP was reduced. In fiscal year 2001, the LIHEAP Cash eligibility criteria increased to 135 percent of the FPL and the CRISIS eligibility was increased to 150 percent of FPL. Funding levels in 2001 were increased substantially due to the high gas supply cost and the cold winter season. In 2002, the eligibility for LIHEAP Cash and CRISIS was reset to 135 percent of the FPL and funding levels were reduced. In 2003, PGW received significant funds from CRISIS grants due to additional emergency funds that were released.

Natural gas price escalation, which began in 2003 and has spiked dramatically since the recent hurricanes in the Gulf Coast region, has led to an increase in LIHEAP authorization by the Federal

government from \$3.1 billion to \$5.1 billion. However, the increased funds have not been appropriated yet and PGW does not anticipate this additional funding will be available for the 2005-06 winter season.

Pennsylvania's Governor has proposed a supplemental LIHEAP state appropriation of \$15 million based on the anticipated impact of commodity price spikes in both natural gas and deliverable fuels. The Governor has indicated to industry representatives that he is also expecting an additional \$75 million in supplemental federal LIHEAP funds. Of the possible \$90 million of added resources, PGW's customers could expect to get its historical 20 percent of the added revenue. In the absence of further Federal funding, the Governor reports he would look to raise the full amount from state sources.

Vendor Payment Program

PGW continues to support a Vendor Payment Program for a group of customers known as Scattered Site Tenants of the PHA. The customers occupy dwellings, usually single family homes, owned by the PHA and for which the Federal Government provides rent subsidies. Under agreement with the PHA and the Scattered Site Tenants, the Federal Government's Department of Housing and Urban Development provides a utility allowance to PHA, on behalf of the tenant. There are basically two groups of PHA tenants: one for which utility payments is received by PGW directly from PHA, and another group that is responsible for paying their own utility bills.

Utility Emergency Services Fund

PGW also participates in the Utility Emergency Services Fund ("UESF"), which is a private fuel fund set up with the assistance of the City of Philadelphia Water Department and PECO Energy. Under this program, customers at or below 175 percent of the FPL may make application for an energy assistance grant (LIHEAP) which together with their own payment, a grant from UESF, and a matching contribution from the utility involved, may enable the customers to zero-out any arrearages they may have. The maximum allowance that a customer may receive is \$500, \$250 from UESF, and a matching grant of \$250 from the utility.

Dollar Plus Program

PGW also continues to support a program called "Dollar Plus" wherein PGW's customers are asked to add \$1.00 or more to their gas bill payments as a donation to the Utility Emergency Services Fund.

Payment Plans

PGW maintains a number of residential customer payment plans that are tailored to the customer's ability to pay in order to allow the customer the opportunity to pay down past arrearages and budget future usage and payments.

Billing and Collections

To strengthen its financial condition, PGW continues to improve its billing and collections programs. The principal components of this effort are improving the functionality of its Billing, Collections, and Customer Service ("BCCS") system that was installed in calendar year 1999; improving customer service in its Customer Service and Credit Collection Call Centers; and implementing its Collections Renewal Initiative ("CRI") in early fiscal year 2004.

The CRI effort covers Customer Service operations involved in the collection of accounts receivable. The renewal effort is in response to increasing account receivables caused by two consecutive cold winters and increasing natural gas prices. The recent impact of the billing and collection programs has shown improving trends in Call Center performance metrics and delinquent account collections. PGW's goal for the CRI program is to make substantial and sustainable improvements in receivable collections. The initial financial objective of the CRI was to collect at least 92 percent of fiscal year billed revenues with continued incremental percentage improvements in successive years.

PGW has systematically improved the functionality of the BCCS. Through an aggressive program to eliminate all residential meters without an automatic meter reading device ("AMR"), PGW reduced its estimated billing rate from 15 percent in fiscal year 2001 to less than 1 percent in fiscal year 2004. This has significantly improved the accuracy of the bills and has led to a reduction in billing accuracy complaints and an improved level of customer service.

Collection Call Center operations were strengthened in June 2003 with the hiring of 30 additional employees including supervisory personnel with call center and collections experience, additional employee training, expanding service hours with a two shift operation weekdays, continuing Saturday operations, and retaining the services of a call center management consultant, Accenture Consulting, in December 2003 to implement additional effectiveness improvements and management reporting systems in the call center.

PGW has been able to effectively implement the collections program because the credit and collection modules in the BCCS are fully functional allowing PGW to effectively move customers through the collections process as their accounts age. PGW can also now automatically assess deposits on customers when they do not pay promptly. PGW provides on-line payments through its website and will allow customers to receive their bill on-line and enroll in a program where payments are automatically deducted from their bank account.

Additional receivable collection efforts include:

- Delinquent Accounts – Delinquent accounts are pursued within PUC collection guidelines. With the CRI, PGW launched "quick hit" initiatives which have resulted in improved collections.
- Slow Paying Accounts – These accounts represent residential accounts that are overdue less than 91 days. Collection evidence suggests that without PGW monitoring or intervention, a large number of these accounts will tend to become non-paying over time. PGW intervention includes increased bill collection efforts coordinated with the Call Center and field operations.
- Payment Agreements – Placing customers on payment arrangements and keeping customers paying is another campaign designed to contact customers when they miss their first payment.
- Commercial Resource Center – These personnel work with PGW's 500 largest customers on billing, metering, and collection problems. A task force concentrates on making dunning calls and field visits for accounts more than 90 days overdue and subject to shutoff.
- Credit Reporting – Improvements to the BCCS have enabled PGW to submit credit reports on all residential customers to consumer credit agencies. Residential customers with delinquent accounts who are seeking consumer loans may be required by those lenders to pay off the PGW account before the new loan is approved.

- Pre-Lien Letter – PGW notifies delinquent customers by letter indicating that a lien will be placed on their property if the PGW account is not paid. The real threat of a property lien appears effective in motivating customers to pay their outstanding PGW accounts.
- Lien/Judgment Program – PGW has worked to realize recoveries as properties are sold. PGW has increased its capability to file up to 750 liens per week.
- Written-Off Accounts - PGW has assigned nearly all of its written-off accounts to outside collection agencies. The incentive scale was recently changed from age of receivable collected to the amount of money collected.
- CRP Accounts – PGW requires CRP customers to remain current in paying their bills in order to remain on the program.
- Telephone Payment – PGW accepts credit card and Intel-A-Check payments for delinquent accounts by telephone.

In addition, on November 30, 2004 the Pennsylvania General Assembly passed and the Governor signed Act 201, entitled the "Responsible Utility Customer Protection Act". Under specified conditions, PGW may now shut off service to delinquent customers during the winter and on Fridays. To shut off service to non-low-income customers during winter months, PGW is no longer required to get PUC permission. PGW may now require higher income customers whose service has been shut off to pay past due bills in full, arrange for a payment agreement, pay a reconnect fee, and/or pay a deposit before it restores service. Lower income customers who have been shut off must agree to repay their arrearage over time. The new law also permits PGW to make any adult living in a home where service has been shut off accountable for all or part of an overdue balance before the adult can obtain service in his or her name.

The Act provides a number of new tools to help PGW collect payment including:

1. An extension of the time allowed to terminate service following shut-off notification to 60 days.
2. Shut-off with notice is permitted if the customer does not pay a required deposit, does not follow through with payment arrangements or refuses to allow PGW access to its equipment.
3. Shut-off without notice permitted for theft of service, obtaining service through fraud, tampering with a gas meter, unsafe service conditions or presenting a fraudulent check to stop termination.
4. Winter (December 1- March 31) termination is now permitted (under specified conditions) without PUC prior approval if the customer's household income exceeds 150 percent of the federal poverty level.

Act 201 has significantly improved PGW's collection capabilities. In addition, PGW has become more aggressive in terminating service for those with the means to pay. For example, PGW has instituted a program where it will isolate service from the street mains when access to the isolation valve is not provided. PGW is also coordinating the installation of replacement mains with its Collections Department such that terminations are completed while the mains are exposed. In addition, street isolation valves are being added when mains are replaced.

Competition

PGW's customer, volume, and revenue mix is heavily weighted towards the residential and smaller commercial markets. PGW currently holds in excess of 85 percent of the home heating market in the City with fuel oil constituting most of the remaining market. This high market share combined with a service territory that is not growing limits PGW's ability to increase its customer base. For residential and small commercial customers, the short run cost of changing energy sources is generally prohibitive without some kind of incentive to switch appliances (rebates or financing of appliances, for example). While not totally immune from competition, the residential and small to medium-sized commercial markets are quite stable. Further, opportunities for PGW to increase market share are limited without investment in marketing or incentive programs.

Generally, competition in the larger commercial and industrial markets is common. PGW's BPS and LBS customers (interruptible sale customers) have the ability to burn alternate fuels (generally fuel oil). If the equivalent price of natural gas is higher than fuel oil, many customers will opt to burn oil. Further, these interruptible customers may be curtailed during peak periods in the winter. While large commercial and industrial loads are an important part of PGW's base, PGW's risk to competition is lower than most natural gas utilities that have a relatively higher industrial load.

Financial Feasibility for the 2006 Bonds

The financial data used in the analyses presented herein were obtained from the historical financial records of PGW, the latest available estimates for fiscal year 2005, PUC GCR filings, and proposed operating and capital budgets for fiscal years 2006 through 2011. PGW's financial statements are audited annually. The most recently available audited financial statement is for fiscal year 2004. According to that audit, PGW's financial statements are maintained in conformity with generally-accepted accounting principles for gas utilities.

Projected Revenues

Operating revenues for PGW consist principally of revenues from the sale of natural gas to residents of the City of Philadelphia. Non-operating revenues include interest income and miscellaneous other revenues from non-operating sources.

Projected Average Number of Customers

Consistent with the trend in a declining population base, the number of customers served by PGW is projected to decline slightly during fiscal years 2006 through 2011. Table 8 summarizes projected average number of customers. Historical average number of customers (for fiscal years 2000 through 2005) has been approximately 510,000. The total average number of customers served is projected to decline from approximately 510,400 in fiscal year 2006 to about 504,718 in fiscal year 2011, a total decline of about 1.1 percent over five years. Most of this decline is in the number of residential customers served. PGW has projected a slowing of its residential customer decline from the 2004 Report due to recent new construction of housing in the City.

Although PGW's rates are now fully unbundled, customers have not migrated from sales to transportation service as projected by PGW in previous years in anticipation of Gas Choice. For purposes of this Report, it has been assumed that no firm customers will take transportation service through fiscal year 2011. The only customers that are assumed to take transportation service during the projection period are interruptible customers. The principal difference between customers taking sales versus transportation service is that PGW does not buy the natural gas commodity for the transportation customers. However, PGW continues to charge for the transportation of gas through its distribution system, through which customers will continue to take service from PGW. This charge for distribution service should not differ appreciably from the charge (less gas cost) that would apply to sales service customers. Therefore, PGW is unlikely to experience a material reduction in contribution margin (gross revenues less cost of gas) due to customers migrating to transportation service. So long as PGW's existing GCR provision remains in effect, the contribution margin will be unaffected as long as the number of customers who opt for other suppliers is relatively modest. While it is difficult to predict with certainty the actual number of customers who will migrate and the timing of such a migration, PGW's projection of interruptible customers transferring to transportation service appears to be reasonable. If the rates for transportation service are properly designed, the net revenues realized by PGW will not be materially sensitive to whether customers take sales or transportation service.

Historical and Projected Gas Sales and Throughput

Historical throughput (sales plus transportation volumes) for the 2000 through 2005 fiscal years and projected throughput for the 2006 through 2011 fiscal years are summarized in Table 9. The throughput volumes for the projected period are based on 4,555 HDD.

Table 8
Projected Average Number of Customers

Line No.	Description	Projected ^(a)					
		2006	2007	2008	2009	2010	2011
1	Total Average Number of Customers	510,400	509,249	508,111	506,975	505,845	504,718
	Gas Customers						
	Non-heating						
	<i>Firm</i>						
2	Residential	57,362	56,501	55,642	54,784	53,928	53,073
3	CRP Residential	2,384	2,384	2,384	2,384	2,385	2,384
4	Commercial	5,682	5,684	5,686	5,687	5,688	5,689
5	Industrial	359	421	486	551	615	679
6	Municipal	343	343	343	343	343	343
7	Housing Authority	0	0	0	0	0	0
8	Total Average Firm Non-heating	66,130	65,333	64,541	63,749	62,959	62,168
	<i>Interruptible</i>						
9	BPS - Small	106	104	106	110	115	120
10	BPS - Large	167	159	158	160	163	167
11	BPS - A/C	8	9	9	9	9	9
12	LBS - L Direct	1	1	1	1	1	1
13	LBS - L Indirect	11	9	9	9	9	9
14	LBS - S Indirect	19	17	17	17	17	17
15	LBS - XL Direct	1	0	0	0	0	0
16	LBS - XL Indirect	3	3	3	3	3	3
17	Cogeneration - Indirect	1	2	3	4	5	6
18	LNG - Direct	0	0	0	0	0	0
19	GTS - Sales	0	0	0	0	0	0
20	NGV Indirect	0	0	0	0	0	0
21	Total Average Interruptible	317	303	305	312	322	332
22	Total Average Non-Heating	66,447	65,636	64,847	64,062	63,281	62,499
	Heating						
23	Residential	358,208	357,501	356,798	356,100	355,409	354,722
24	CRP Residential	60,782	60,783	60,783	60,783	60,783	60,783
25	Commercial	19,603	19,845	20,087	20,327	20,566	20,805
26	Industrial	780	886	995	1,104	1,212	1,320
27	Municipal	571	572	573	574	575	576
28	Housing Authority	3,837	3,831	3,823	3,815	3,807	3,799
29	Total Average Heating	443,781	443,418	443,059	442,702	442,351	442,004
30	Total Average Sales Customers	510,227	509,054	507,905	506,764	505,632	504,503
31	Total Average Transportation Customers^(b)	173	195	206	211	213	215

(a) Projected figures are based on budgeted department figures.

(b) Increase in transportation customers is due to the transfer of interruptible customers to GTS service. No firm customers are assumed to transfer to GTS service.

The decline in total residential throughput is consistent with the projected decline in the average number of residential customers. The projection for residential and commercial throughput generally reflects a constant use per customer.

As with the number of customers projection, interruptible customers are projected to begin migrating from sales to transportation service. Therefore, sales volumes are shown to be slightly reduced during the projected period as interruptible customers opt for transportation service. As stated previously, if transportation rates are designed properly, this migration should not translate into a material reduction in net contribution margin.

Sales and Transportation Revenues

Historical revenues (sales plus transportation service) for the 2000 through 2005 fiscal years and projected revenues for the 2006 through 2011 fiscal years are summarized in Table 10. The revenue figures shown in Table 10 are based on application of PGW's existing rates to the projected number of customers, projected normal sales and transported volumes, and the gas cost assumptions discussed in the "Projected Revenue Requirements – Gas Costs" section of this Report. The revenue projections reflect the same adjustments made to sales and throughput (migration of interruptible customers to transportation). We assume consistent with PGW's existing GCR, that changes in the gas cost recovery portion of revenues will equal changes in gas costs.

In this Report, the revenue projections reflect currently effective rates and a 94.5 percent collection factor on billed revenues. (See Table 12). Based on the assumptions contained in this Report, we find that a \$35 million permanent increase in base rates (or an equivalent combination of permanent revenue enhancements or cost savings) beginning in fiscal year 2009 with additional increments of \$5 million in fiscal years 2010 and 2011, respectively, will likely be necessary. This will produce a level of revenues that will allow PGW to fulfill its goal of not using short-term financing for other than seasonal working capital requirements. In addition, this level of revenue enhancements, cost savings, and/or rate relief will also enable PGW to:

- Establish an adequate level of working capital, and
- Repay the \$45 million City loan by August 2008¹³.

The level of revenues projected for fiscal years 2006 through 2011 is based on normal weather conditions. As discussed in "Rates and Tariffs - Weather Normalization Adjustment", the WNA essentially removes the single biggest risk to PGW of recovering its approved margin during periods of warmer than normal weather during the winter season as long as it remains in effect. PGW is currently in the process of presenting its conclusions regarding the WNA to the PUC with a request that the PUC acknowledge that the WNA should continue in place. Because PGW's WNA tariff has no sunset provision, the WNA will continue in place unless the PUC issues an order directing that it be discontinued. PGW cannot predict when the PUC will complete its review of PGW's WNA clause. We are assuming for the purposes of this Report that the WNA will remain in effect through the projected period.

As with the volume and number of customers projections, as sales volumes and customers migrate to transportation service, so do revenues. As stated previously, if transportation rates are designed properly, this migration should not translate into a material reduction in net contribution margin and hence, net cash flow and income will not be materially affected.

¹³ Assumes the City Council will approve an extension of the current maturity date from August 2006 to August 2008

Other Operating Revenues

Other operating revenues are projected to remain at an annual level of approximately \$32 million throughout fiscal years 2006 through 2011 (Table 16, Line 8). These revenues consist of sales of energy-related appliance services, finance charges realized on overdue accounts, field collection charges, and other miscellaneous sources.

Table 9
Historical and Projected Sales and Throughput

Line No.	Description	Actual ^(a)						Projected					
		2000	2001	2002	2003	2004	2005 ^(b)	2006	2007	2008	2009	2010	2011
		MMcf	MMcf	MMcf	MMcf	MMcf	MMcf	MMcf	MMcf	MMcf	MMcf	MMcf	MMcf
Gas Sales Volumes													
Non-heating													
Firm													
1	Residential	1,940	2,168	1,763	2,109	1,951	1,955	1,742	1,718	1,694	1,669	1,645	1,620
2	CRP Residential	NA	NA	NA	NA	NA	NA	208	208	208	208	208	208
3	Commercial	1,920	2,068	1,714	1,869	1,798	1,754	1,791	1,804	1,817	1,828	1,839	1,851
4	Industrial	456	536	372	429	389	327	444	490	545	600	654	709
5	Municipal	261	270	233	292	269	278	284	285	285	285	285	285
6	Housing Authority	17	(1)	0	0	0	0	0	0	0	0	0	0
7	Total Firm Non-heating	4,594	5,042	4,081	4,698	4,407	4,315	4,469	4,504	4,548	4,589	4,631	4,672
Interruptible													
8	BPS - Small	177	154	169	202	138	205	174	169	174	181	190	199
9	BPS - Large	3,769	2,650	2,820	2,738	2,247	2,795	2,047	1,925	1,933	1,960	2,002	2,052
10	BPS - A/C	0	0	0	0	0	0	109	114	114	113	112	111
11	LBS - L Direct	177	258	224	435	262	97	19	19	19	19	19	19
12	LBS - L Indirect	1,114	796	1,206	1,047	552	391	518	460	443	434	429	426
13	LBS - S Indirect	1,649	1,195	986	1,005	649	787	452	407	400	397	399	403
14	LBS - XL Direct	312	300	268	197	112	11	1	0	0	0	0	0
15	LBS - XL Indirect	1,063	474	490	352	35	62	44	41	41	45	46	47
16	Cogeneration - Indirect	208	125	114	110	98	47	8	7	10	13	16	20
17	LNG - Direct	0	0	0	0	0	0	0	0	0	0	0	0
18	Grays Ferry	0	0	0	0	0	0	0	0	0	0	0	0
19	GTS - Sales	134	48	153	8	10	116	0	0	0	0	0	0
20	NGV Indirect	3	(20)	0	0	0	0	0	0	0	0	0	0
21	Off-System Sales	0	0	0	0	0	0	0	0	0	0	0	0
22	Total Interruptible	8,604	5,980	6,429	6,094	4,103	4,510	3,371	3,141	3,134	3,162	3,212	3,275
23	Total Non-Heating	13,198	11,022	10,510	10,792	8,510	8,825	7,840	7,645	7,682	7,752	7,843	7,947
Heating													
24	Residential	39,048	44,063	34,211	45,345	40,826	39,033	33,640	33,555	33,534	33,376	33,288	33,204
25	CRP Residential	NA	NA	NA	NA	NA	NA	8,048	8,048	8,053	8,048	8,048	8,048
26	Commercial	8,192	8,929	7,113	9,227	8,618	8,363	9,091	9,213	9,339	9,455	9,575	9,694
27	Industrial	844	985	738	903	738	711	944	1,027	1,129	1,230	1,332	1,433
28	Municipal	978	1,108	838	1,191	996	826	1,076	1,078	1,080	1,082	1,083	1,085
29	Housing Authority	871	556	583	681	584	560	853	850	845	840	835	830
30	Total Heating	49,932	55,641	43,482	57,348	51,762	49,493	53,651	53,772	53,981	54,031	54,162	54,295
31	Total Sales Volumes	63,129	66,662	53,992	68,140	60,272	58,318	61,491	61,417	61,663	61,783	62,005	62,242
32	Total Transportation^(c)	14,092	6,845	12,309	10,828	8,946	11,624	13,517	14,022	14,124	14,161	14,159	14,134
33	Total Throughput	77,221	73,507	66,302	78,968	69,218	69,943	75,008	75,439	75,788	75,944	76,164	76,376

(a) PGW historical data. CRP volumes are included in appropriate residential figure.

(b) 2005 figures are based on unaudited year end figures.

(c) Increase in transportation sales is due to the transfer of interruptible customers to GTS service. No firm customers are assumed to transfer to GTS service.

Assistance Programs

Over the past several years, PGW has seen high accounts receivable balances and higher than usual delinquent accounts. As part of PGW's proactive approach to managing this problem, PGW has continued to develop programs targeted at assisting customers with meeting their energy costs. Table 11 details PGW's LIHEAP participation in recent years and provides an estimate for fiscal year 2006. Assistance programs are estimated to contribute \$19.7 million in revenues in fiscal year 2006.

Accounts Receivable

Since PGW has increased its focus on improving its billing and collection practices (*See Billing and Collections*) in the past few years, it has experienced a marked decrease in its accounts receivable in fiscal year 2005. Net accounts receivable decreased \$15.5 million in fiscal year 2005, or 16.6 percent, from fiscal year 2004 level.

Table 10
Historical and Projected Revenues
(Thousands of Dollars)

Line		Actual ^(a)						Projected					
No.	Description	2000	2001	2002	2003	2004	2005 ^(b)	2006	2007	2008	2009	2010	2011
		\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Gas Sales Revenues													
Non-heating													
Firm													
1	Residential	21,039	31,084	26,084	31,571	34,245	37,132	33,956	32,640	30,644	29,189	28,190	27,734
2	CRP Residential	NA	NA	NA	NA	(1,086)	(1,595)	1,796	1,787	1,685	1,670	1,661	1,660
3	Commercial	16,424	25,007	18,441	22,762	25,178	26,980	28,216	27,515	26,023	25,038	24,528	24,613
4	Industrial	4,111	6,144	4,013	5,101	5,338	5,036	6,901	7,386	7,723	8,139	8,657	9,364
5	Municipal	1,978	3,077	2,203	2,975	3,323	3,862	4,037	3,890	3,627	3,449	3,348	3,340
6	Housing Authority	139	(6)	0	0	0	0	0	0	0	0	0	0
7	Total Firm Non-heating	43,690	65,306	50,742	62,409	66,998	71,415	74,906	73,218	69,702	67,485	66,384	66,711
Interruptible													
8	BPS - Small	1,737	1,403	1,335	1,787	1,749	2,705	2,350	2,233	2,198	2,297	2,409	2,523
9	BPS - Large	19,662	18,521	15,200	18,471	18,134	29,289	22,902	20,534	19,322	19,923	20,390	20,895
10	BPS - A/C	0	0	0	0	0	0	887	865	810	770	748	751
11	LBS - L Direct	798	1,863	1,053	2,529	1,866	765	160	150	137	132	130	131
12	LBS - L Indirect	4,944	4,961	6,009	6,360	4,179	3,165	4,539	3,786	3,304	3,084	2,989	2,981
13	LBS - S Indirect	4,358	7,584	5,278	6,309	4,653	6,502	3,984	3,371	3,066	2,977	2,989	3,016
14	LBS - XL Direct	1,334	1,930	1,419	1,294	777	83	9	0	0	0	0	0
15	LBS - XL Indirect	4,578	2,795	2,186	1,860	290	512	400	350	311	327	321	329
16	Cogeneration - Indirect	848	741	577	691	663	371	0	0	0	0	0	0
17	LNG - Direct	0	0	0	0	0	194	73	64	81	100	120	148
18	Grays Ferry	0	0	0	0	0	0	0	0	0	0	0	0
19	GTS - Sales	694	339	756	88	93	1,091	0	0	0	0	0	0
20	NGV Indirect	53	(62)	7	0	0	0	0	0	0	0	0	0
21	Off-System Sales	0	0	0	0	0	0	0	0	0	0	0	0
22	Total Interruptible	42,006	40,075	33,820	39,390	32,404	44,678	35,304	31,353	29,429	29,610	30,096	30,774
23	Subtotal Non-Heating	85,696	105,381	84,561	101,799	99,402	116,093	110,210	104,571	99,131	97,095	96,480	97,485
24	Cost of Gas Increase												
25	Prior Year's Gas Cost Recovery	2,134	(701)	412	546	(328)	(1,212)	613	0	0	0	0	0
26	Total Non-Heating	87,830	104,680	84,973	102,345	99,074	114,880	110,823	104,571	99,131	97,095	96,480	97,485
Heating													
27	Residential	315,227	531,850	371,543	521,275	580,390	626,072	538,918	521,645	492,052	470,974	459,265	458,196
28	CRP Residential	NA	(36,731)	NA	NA	(47,408)	(59,493)	67,169	66,749	62,765	62,112	61,727	61,674
29	Commercial	69,435	108,559	76,577	109,529	118,677	129,073	141,343	138,504	131,690	127,481	125,687	126,988
30	Industrial	7,140	11,913	8,002	10,694	10,188	11,048	14,698	15,494	15,995	16,676	17,584	18,892
31	Municipal	7,459	11,954	7,972	12,041	12,127	12,041	15,112	14,573	13,599	12,948	12,587	12,581
32	Housing Authority	7,275	6,683	6,024	8,052	7,976	8,583	13,377	12,896	12,046	11,455	11,095	11,009
33	Subtotal Heating	406,536	634,228	470,117	661,590	681,950	727,323	790,617	769,861	728,147	701,646	687,945	689,340
34	Cost of Gas Increase												
35	Prior Year's Gas Cost Recovery	28,009	(13,371)	4,292	7,054	(4,182)	(14,164)	7,195	0	0	0	0	0
36	Total Heating	434,544	620,857	474,409	668,644	677,768	713,159	797,812	769,861	728,147	701,646	687,945	689,340
37	Weather Normalization Adjustment	0	0	0	(10,029)	2,109	(1,365)	0	0	0	0	0	0
38	Total Adjusted Heating	434,544	620,857	474,409	658,614	679,877	711,794	797,812	769,861	728,147	701,646	687,945	689,340
39	Total Sales Revenues	522,374	725,537	559,382	760,959	778,951	826,674	908,635	874,432	827,278	798,741	784,425	786,825
40	Total Transportation ^(c)	3,313	2,355	2,788	2,560	2,945	4,679	7,210	7,884	8,047	8,125	8,152	8,152
41	Total Revenues	525,687	727,892	562,170	763,519	781,896	831,353	915,845	882,316	835,325	806,866	792,577	794,977
42	Rate Increase	0	0	0	0	0	0	0	0	0	35,000	40,000	45,000
43	Adjusted Total Revenues	525,687	727,892	562,170	763,519	781,896	831,353	915,845	882,316	835,325	841,866	832,577	839,977

(a) PGW historical data. CRP volumes are included in appropriate residential figure.

(b) 2005 figures are based on unaudited year-end figures.

(c) Increase in transportation revenues is due to the transfer of interruptible customers to GTS service. No firm customers are assumed to transfer to GTS service.

Table 12 summarizes historical and projected accounts receivable and account write-offs. As seen from the table, we assume receivables as a percent of billed gas revenues will remain relatively constant over the projection period at about 30 percent.

The projections in Table 12 are based on analyses prior to the effects of Hurricanes Katrina and Rita. (*See Post Katrina and Rita Impacts*). Realized bad debt expense as a percent of billed gas revenues is projected to range from 5.3 percent to 6.1 percent over the projected period. Table 12 also shows PGW's historical and projected average collection rate. PGW's collection rate is projected to be 94.5 percent. The eight-year historical average collection factor (fiscal years 1998 through 2005) is 92.3 percent.

Table 11
Historical and Budgeted Assistance Programs

Description	Historical												Estimated	
	2000		2001		2002		2003		2004		2005		2006	
	Number	%	Number	%	Number	%	Number	%	Number	%	Number	%	Number	%
Grant Money Available	\$70,744,155		\$140,625,391		\$90,157,655		\$121,518,984		\$108,384,165		\$116,058,846		\$116,000,000	
Cash	\$50,947,594	72.0%	\$76,970,868	54.7%	\$71,832,222	79.7%	\$72,786,033	59.9%	\$78,433,307	72.4%	\$82,414,865	71.0%	\$81,200,000	70.0%
Crisis	\$19,796,561	28.0%	\$63,654,523	45.3%	\$18,325,433	20.3%	\$48,732,951	40.1%	\$29,950,858	27.6%	\$33,643,981	29.0%	\$34,800,000	30.0%
Number of Grants														
State of PA														
Cash	209,923	73.1%	302,241	70.6%	292,107	79.8%	307,344	73.5%	327,279	75.2%	339,898	74.2%	338,920	74.0%
Crisis	77,326	26.9%	125,732	29.4%	73,740	20.2%	110,925	26.5%	107,705	24.8%	118,163	25.8%	119,080	26.0%
Total State of PA	287,249	100.0%	427,973	100.0%	365,847	100.0%	418,269	100.0%	434,984	100.0%	458,061	100.0%	458,000	100.0%
PGW														
Cash	41,085	19.6%	58,730	19.4%	60,159	20.6%	59,718	19.4%	63,064	19.3%	63,333	18.6%	63,333	18.7%
Crisis	16,786	21.7%	28,216	22.4%	10,781	14.6%	17,675	15.9%	9,297	8.6%	10,508	8.9%	10,508	8.8%
Total PGW	57,871	20.1%	86,946	20.3%	70,940	19.4%	77,393	18.5%	72,361	16.6%	73,841	16.1%	73,841	16.1%
CRP vs. Non-CRP														
Cash - CRP	23,622	57.5%	32,500	55.4%	35,494	59.0%	35,234	59.0%	37,208	59.0%	37,366	59.0%	37,366	59.0%
Cash - Non-CRP	17,463	42.5%	26,202	44.6%	24,665	41.0%	24,484	41.0%	25,856	41.0%	25,967	41.0%	25,967	41.0%
Crisis - CRP	12,106	72.1%	15,000	53.2%	7,708	71.5%	12,549	71.0%	6,601	71.0%	7,461	71.0%	7,461	71.0%
Crisis - Non-CRP	4,680	27.9%	13,204	46.8%	3,073	28.5%	5,126	29.0%	2,696	29.0%	3,047	29.0%	3,047	29.0%
Total Funding - Final														
State of PA														
Cash	\$50,947,594		\$76,970,868		\$71,832,222		\$72,840,528		\$78,433,307		\$82,414,865		\$81,200,000	
Crisis	\$19,796,561		\$63,654,523		\$18,325,433		\$48,696,075		\$29,950,858		\$33,643,981		\$34,800,000	
Total State of PA	\$70,744,155		\$140,625,391		\$90,157,655		\$121,536,603		\$108,384,165		\$116,058,846		\$116,000,000	
PGW														
PGW - Cash	\$8,812,733	17.3%	\$12,525,934	16.3%	\$14,517,618	20.2%	\$13,803,219	18.9%	\$16,030,238	20.4%	\$16,636,439	20.2%	\$16,636,439	20.5%
PGW - Crisis	\$4,985,442	25.2%	\$18,540,734	29.1%	\$3,231,170	17.6%	\$8,607,725	17.7%	\$2,631,051	8.8%	\$3,110,380	9.2%	\$3,110,380	8.9%
Total PGW	\$13,798,175	19.5%	\$31,066,668	22.1%	\$17,748,788	19.7%	\$22,410,944	18.4%	\$18,661,289	17.2%	\$19,746,819	17.0%	\$19,746,819	17.0%
Value of Grants, per customer														
State of PA														
Cash	\$243		\$255		\$246		\$237		\$240		\$242		\$240	
Crisis	\$256		\$506		\$249		\$439		\$278		\$285		\$292	
PGW														
Cash	\$215		\$213		\$241		\$231		\$254		\$263		\$263	
Crisis	\$297		\$657		\$299		\$487		\$283		\$296		\$296	

Table 12
Historical and Projected Accounts Receivable and Write-offs

Description	Fiscal Year Ending August 31,													
	Historical					Projected								
	1998	1999	2000 ^(b)	2001	2002	2003	2004	2005 ^(a)	2006	2007	2008	2009	2010	2011
Billed Gas Revenues (\$000) ^(a)	497,985	482,700	495,545	741,964	557,467	755,919	786,406	846,729	908,037	882,316	835,325	841,866	832,577	839,977
Accounts Receivable (\$000)	110,790	107,453	185,421	280,406	254,047	321,408	323,340	295,114	282,542	270,954	258,194	246,796	236,619	228,692
Less: Reserve for Bad Debt	(64,724)	(67,070)	(129,154)	(184,324)	(187,461)	(228,548)	(230,216)	(217,480)	(210,119)	(200,433)	(189,759)	(179,837)	(169,956)	(160,629)
Net Accounts Receivable	46,066	40,383	56,267	96,082	66,586	92,860	93,124	77,634	72,423	70,521	68,435	66,959	66,663	68,063
Bad Debt Reserve/Accounts Receivable	58.4%	62.4%	69.7%	65.7%	73.8%	71.1%	71.2%	73.7%	74.4%	74.0%	73.5%	72.9%	71.8%	70.2%
Net Write-Offs (\$000)	45,873	36,653	19,712	12,463	48,411	43,914	69,332	93,201	65,000	62,500	61,000	58,000	56,000	54,000
Receivable/Billed Gas Revenues	22.2%	22.3%	37.4%	37.8%	45.6%	42.5%	41.1%	34.9%	31.1%	30.7%	30.9%	29.3%	28.4%	27.2%
Bad Debt (\$000)	34,130	39,000	54,642	67,633	51,548	85,000	71,000	80,424	55,132	52,914	50,426	48,203	46,219	44,673
Bad Debt/Billed Gas Revenues	6.9%	8.1%	11.0%	9.1%	9.2%	11.2%	9.0%	9.5%	6.1%	6.0%	6.0%	5.7%	5.6%	5.3%
Bad Debt/Accounts Receivable	30.8%	36.3%	29.5%	24.1%	20.3%	26.4%	22.0%	27.3%	19.5%	19.5%	19.5%	19.5%	19.5%	19.5%
Total Customer Receipts (\$000)	499,900	458,000	475,100	677,400	575,300	690,300	756,000	846,600						
Total Customer Billings (\$000)	510,200	497,500	511,700	769,100	589,600	797,400	827,000	892,450						
Collection Factor	97.98%	92.06%	92.85%	88.08%	97.57%	86.57%	91.41%	94.86%	94.50%	94.50%	94.50%	94.50%	94.50%	94.50%
Eight-Year Average Collection Factor								92.28%						

^(a) Adjusted Total Revenues (Table 10, Line 43) less Prior Year's Gas Cost Recovery (Table 10, Lines 25 and 35)

^(b) For fiscal year 2000, accounts receivable and reserve for bad debt is restated.

^(c) 2005 figures are based on unaudited year end figures.

Capital Improvement Program Financing

The Capital Improvement Program described earlier (*See Capital Improvement Program*) will be financed by PGW through funds currently available for capital projects, revenue bond issues, investment income, and system revenues.

The projected CIP expenditures for the six-year period ending August 31, 2011 are shown on Line 8 of Table 13 and total approximately \$396 million. Within the constraints of the rate covenants and additional bonds tests outlined in the 1975 and 1998 Ordinances, the total par amount of bonds to be issued of approximately \$300 million during the projection period is designed to maximize the capital requirements financed with bond proceeds.

Lines 1 through 7 outline the sources available to meet the CIP financing requirements. Line 1 in fiscal year 2006 shows the net balance available in the Capital Improvement and Capital Leasing Funds as of August 31, 2005, available to fund the CIP. Lines 2 through 5 show the net proceeds from bond sales, Line 6 shows the amount projected to be available from other sources each year from current operating revenues, and Line 7 presents the total funds available. The level of cash financing presented on Line 6 of the table has been modified from PGW's projection based on estimated available cash and maximizing PGW's financial position. Planned fund uses are summarized on Lines 8 and 9 of Table 13.

Table 13
Capital Improvement Fund
(Thousands of Dollars)

Line No.	Description	Fiscal Year Ending August 31,					
		Projected					
		2006	2007	2008	2009	2010	2011
		\$	\$	\$	\$	\$	\$
1	Balance from Previous Year	104,806	33,131	93,529	33,529	106,926	56,926
2	Bond Proceeds @ Par	0	150,000	0	150,000	0	0
3	Less Discount & Issuance Costs	0	(9,982)	0	(9,982)	0	0
4	Less Deposit to Sinking Fund Reserve	0	(11,621)	0	(11,621)	0	0
5	Net Bond Proceeds	0	128,397	0	128,397	0	0
6	Other Sources of Funds ^(a)	0	2,240	5,739	11,296	14,572	18,240
7	Total Sources of Funds	104,806	163,768	99,268	173,222	121,498	75,166
8	Capital Expenditures	65,751	70,240	65,739	66,296	64,572	63,239
9	Capitalized Interest	5,924	0	0	0	0	0
10	Total Uses of Funds	71,675	70,240	65,739	66,296	64,572	63,239
11	Net Balance - End of Year	33,131	93,529	33,529	106,926	56,926	11,927

(a) Includes PGW internally generated funds as well as temporary financing sources.

As presented in Table 13, a total of two bond sales totaling \$300 million¹⁴ are proposed for the six-year projection period. Coupled with a beginning available balance of \$104.8 million and a total of \$52.1 million of other funding sources, sufficient funds will be available for PGW to complete its planned capital improvement program.

Projected Revenue Requirements

PGW's rates are developed to provide sufficient levels of revenue to meet cost of gas, all operation and maintenance expenses of the System, debt service requirements on obligations issued for the System, capital improvement expenditures to be funded from current revenues, and other specific bond ordinance and revenue requirements. This section provides a discussion of the components that make up PGW's revenue requirements.

Gas Costs

Table 14, Line 1 presents PGW's historical and projected natural gas costs. The projections in the Report are based on analyses prior to the effects of Hurricane Katrina (*See Post Katrina and Rita Impacts*). The unit gas costs assumed by PGW and relied upon in this Report are projected to decrease from approximately \$9.41 per Mcf in fiscal year 2006 to \$7.40 per Mcf in fiscal year 2011. PGW gas cost assumptions are based on pricing input from Global Insight and futures prices from the New York Mercantile Exchange. PGW purchases its gas supplies under a portfolio approach as discussed in the "PGW Gas Supply – Supply Services" section of this Report. As a result of the GCR, changes in the cost of gas result in equal changes in revenues. The mechanism by which PGW recovers its gas supply costs is discussed in the "Gas Cost Rate" section of this Report.

Operation and Maintenance Expenses

Table 14 presents PGW's historical and projected operation and maintenance expense. The unaudited expenses for 2005 serve as a base for the projected years.

Variance in the current operations and maintenance projections and the forecast provided in the 2004 Report for fiscal year 2006 are due to the following factors:

- Increased administrative and general costs (\$3 million) due to increased labor costs
- Decreased bad debt expense (\$11 million)
- Decreased environmental expenses (\$1.5 million)
- Lower health insurance costs (\$2.4 million)
- Decrease in number of employees (\$13 million)

As discussed in the *Sales and Transportation Revenues* section of this Report, PGW's collection factor is projected at 94.5 percent of billed revenues through 2006-2011 fiscal years with bad debt expense forecasted to range from \$55.1 million to \$44.7 million. The higher level of bad debt expense for PGW relative to other gas utilities is consistent with the higher level of costs associated with social programs for PGW, colder than normal heating season, and higher gas prices. Pension fund and health insurance costs are based on PGW's fiscal year 2005 operating budget filing and has been updated with the most current information from PGW for the forecast period through fiscal year 2011. The number of employees is projected to decline from 1,767 to 1,670 through the forecast period due to attrition.

¹⁴ Of this \$300 million, the par value of the 2007 Bonds accounts for \$150 million and the par value of additional bonds assumed to be issued in fiscal year 2009 accounts for \$150 million.

Debt Service Requirements

Table 15 presents a summary of the existing and proposed long-term debt service requirements for the six-year projection period. The repayment of the City loan (\$45 million) is assumed to be made in two installments of \$2 million in 2007 and \$43 million in 2008¹⁵. PGW's repayment of the City loan is subordinate to the debt service on any outstanding bonds issued under the General Bond Ordinances.

The proposed 2006 Bonds are assumed to be issued no earlier than January 2006 as variable rate bonds. Concurrent with the issuance of the 2006 Bonds, the City expects to enter into a Qualified Swap Agreement enabling PGW to manage its interest rate costs or risks by synthetically creating a fixed rate of interest with respect to the 2006 Bonds.

The 2006 Bonds are being issued to achieve debt service savings. PGW anticipates realizing the majority of the savings over fiscal years 2006 and 2007. After the issuance of the 2006 Bonds, PGW's aggregate annual debt service after 2007 will be marginally less than prior to the issuance of the 2006 Bonds.

Two future bond issues are projected for December 2006 and December 2008. Debt service on these bonds is based on a 6.50 percent interest rate, 30-year amortization, and level annual debt service payments.

Payments to City -

In accordance with the Management Agreement and the Gas Choice Act, PGW makes an annual base payment of \$18 million to the City. The \$18 million payment for fiscal year 2004 was not paid and may be forgiven. In fiscal year 2005, the \$18 million payment was made and was granted back. In the current fiscal year (2006), the City's budget includes the payment and grant back of the payment. The City's current Five-Year Plan also provides for payment and grant back of the \$18 million for fiscal years 2007 and 2008.

Adequacy of Projected Revenues to Meet Projected Revenue Requirements Under Ordinance Requirements

Table 16 presents a pro forma statement developed from the revenue and expense projections for 2006 through 2011. This table in conjunction with Table 17, which presents a statement of cash flows, provides an indication of the adequacy of PGW's revenues and the financial feasibility of the currently proposed and future anticipated revenue bond sales.

The operating revenue projections presented earlier in Table 10, Line 41 are summarized in Lines 1 through 3 of Table 16. These projected revenues are based on PGW's currently effective rate schedules. Revenues from Other Sales, primarily unbilled gas adjustments, are shown on Lines 4, of Table 16. Since the Gas Choice Act mandates that the PUC approve and the PUC has acknowledged it has to approve PGW rates sufficient to meet PGW's bond covenants, as well as to provide PGW with needed liquidity, we reasonably assume the PUC will approve rate increases required to meet these requirements in a timely manner. Any combination of revenue enhancements, cost savings, and/or a permanent base rate

¹⁵ Assumes the City Council will approve an extension of the current maturity date from August 2006 to August 2008.

Table 14
Historical and Projected Operation and Maintenance Expenses
(Thousands of Dollars)

		Fiscal Year Ending August 31,											
Line		Historical					Projected						
No.	Description	2000	2001	2002	2003	2004	2005 ^(a)	2006	2007	2008	2009	2010	2011
		\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Operating Expenses													
1	Natural Gas	266,350	431,320	303,806	427,433	450,868	509,701	578,362	349,762	501,457	471,216	456,389	460,879
2	Other Raw Materials	4	7	1	3	0	4	5	5	5	5	5	5
3	Subtotal Fuel	266,354	431,327	303,807	427,436	450,868	509,705	578,367	349,767	501,462	471,221	456,394	460,884
4	Gas Processing	14,033	13,400	13,912	16,952	17,284	18,584	15,590	15,570	16,258	16,419	16,699	17,010
5	Field Services	22,720	33,202	29,266	29,906	29,557	28,455	30,972	30,969	31,183	31,711	32,420	33,104
6	Distribution	14,246	14,837	13,791	16,804	15,778	15,115	16,230	16,363	16,515	16,830	17,200	17,623
7	Collection	12,609	11,473	7,808	8,504	10,730	10,971	10,540	10,308	10,340	10,519	10,645	10,852
8	Customer Services	10,759	14,228	13,130	13,704	13,514	12,512	12,918	13,012	13,003	13,208	13,329	13,531
9	Customer Accounting	3,669	1,717	6,232	6,976	7,496	7,695	8,179	8,215	8,239	8,349	8,484	8,678
10	Bad Debt Expense	54,642	67,633	51,548	85,000	71,000	80,424	55,132	52,914	50,426	48,203	46,219	44,673
11	Marketing & Point-of-Sale Expenses	3,041	3,486	2,815	2,832	2,677	2,592	3,699	3,173	3,155	3,152	3,210	3,205
12	Administrative & General	37,676	37,516	37,617	41,118	41,872	44,496	48,340	45,795	46,488	47,326	47,910	48,476
13	Health Insurance	24,241	27,404	29,194	30,259	32,863	33,571	36,563	40,231	43,735	47,549	51,695	56,205
14	Capitalized Fringe Benefits	(4,654)	(5,035)	(5,214)	(8,488)	(9,053)	(10,348)	(9,714)	(9,918)	(9,069)	(9,168)	(9,309)	(9,647)
15	Capitalized Admin. Charges	(4,858)	(7,224)	(6,440)	(5,694)	(6,193)	(6,706)	(7,142)	(7,995)	(7,611)	(7,891)	(7,648)	(7,482)
16	Regulatory Asset Amortization	1,984	(1,508)	2,836	3,750	3,750	0	0	0	0	0	0	0
17	Amortization of Restructuring Costs	965	965	0	0	1,097	1,087	1,087	0	0	0	0	0
18	Year 2000 & Deregulation Amortization	882	882	0	0	0	0	0	0	0	0	0	0
19	Pensions	1,096	2,301	8,496	13,013	14,973	14,702	15,280	15,063	14,599	14,294	13,990	13,676
20	Taxes	6,512	6,299	6,947	7,941	6,638	6,218	6,340	6,446	6,523	6,600	6,679	6,751
21	Environmental Expenses	0	0	79	241	334	0	0	0	335	810	1,235	1,365
22	Cost Savings/Productivity Improvements	0	0	0	0	0	0	(13,082)	0	0	0	0	0
23	Total Other Operating Expenses	199,563	221,576	212,017	262,818	254,317	259,368	230,932	240,146	244,119	247,911	252,758	258,020
24	Total Operating Expenses	465,917	652,903	515,824	690,254	705,185	769,073	809,299	789,913	745,581	719,132	709,152	718,904
25	Depreciation	32,614	32,559	32,654	33,712	35,607	39,547	37,589	38,947	40,288	41,587	42,873	44,131
26	Cost of Removal	2,519	2,625	2,305	2,356	3,261	(b)	3,200	3,200	3,200	3,200	3,200	3,200
27	Less: Clearing Account Depreciation	(4,328)	(3,344)	(3,606)	(4,887)	(4,902)	(4,502)	(4,647)	(4,731)	(4,815)	(4,898)	(4,812)	(4,685)
28	Net Depreciation	30,805	31,840	31,353	31,181	33,966	35,045	36,142	37,416	38,673	39,889	41,261	42,646
29	Total Operating Expense & Dep'n.	496,722	684,743	547,177	721,435	739,151	804,118	845,441	827,329	784,254	759,021	750,413	761,550

(a) 2005 figures are based on unaudited year end figures.

(b) Cost of removal is included with Line 25 (Depreciation) in fiscal year 2005.

Table 15
Projected Long Term Debt Service Requirements
(Thousands of Dollars)

Description	Fiscal Year Ending August 31,					
	Projected					
	2006	2007	2008	2009	2010	2011
	\$	\$	\$	\$	\$	\$
Revenue Bonds under 1975 Ordinance						
Series 11C	0	0	0	0	0	11,830
Series 12A	4,655	0	0	0	0	0
Series 15	777	777	777	777	777	777
Series 16	10,866	10,844	10,817	10,392	930	930
Series 17	21,104	19,552	18,012	16,466	14,934	13,121
Series 18	3,807	4,574	4,762	4,732	13,514	4,900
Total 1975 Ordinance Debt	41,209	35,748	34,368	32,368	30,155	31,559
Revenue Bonds under 1998 Ordinance						
<i>Senior Debt</i>						
First Series A	13,338	17,261	16,527	15,789	15,054	12,779
First Series B	5,190	5,190	5,190	5,190	5,190	5,190
Second Series	7,404	7,405	7,403	7,403	7,402	7,404
Third Series	8,350	8,348	8,351	8,346	8,346	8,346
Fourth Series	8,397	7,295	8,034	8,395	8,398	8,399
Fifth Series	3,000	6,000	6,000	6,000	8,418	8,416
A-2 Fifth Series Variable	552	1,104	1,104	1,104	1,104	1,104
2007 Bonds ^(a)	0	11,621	11,621	11,621	11,621	11,621
2009 Bonds ^(a)	0	0	0	11,621	11,621	11,621
Senior Debt	46,232	64,225	64,230	75,470	77,156	74,882
<i>Subordinate Debt</i>						
First Series C	1,987	1,987	1,986	1,990	1,986	1,988
Total Subordinate Debt	1,987	1,987	1,986	1,990	1,986	1,988
Total 1998 Ordinance Debt	48,218	66,212	66,216	77,460	79,142	76,869
Capital Leases						
\$23M Capital Lease	0	0	0	0	0	0
Capital Leases	0	0	0	0	0	0
Total Long-Term Debt	89,428	101,960	100,584	109,828	109,297	108,428
City Loan^(b)	0	2,000	43,000	0	0	0
Total Long Term Debt Service	89,428	103,960	143,584	109,828	109,297	108,428

(a) Projected debt service.

(b) Assumed debt service schedule.

increase in fiscal years 2006 through 2011 is included on Line 6 (Line 42 on Table 10) and represents, in our opinion, the minimum level of increase needed to:

- Fund a portion of capital expenditures from sources other than bond proceeds,
- Establish an adequate level of working capital,
- Repay the \$45 million City loan by August 2008 instead of August 2006¹⁶, and
- Meet coverage requirements in each fiscal year for which a bond issue is planned.

Other operating revenues presented on Table 16, Line 8 include revenues from sales of energy-related appliance services and field collection charges. Projected Other Income for the System (Table 16, Line 28) includes interest earnings from the different reserve funds.

The projected operation and maintenance expenses shown on Table 16, Lines 10 through 26 are from Table 14. PGW's projected net operating income before interest is summarized on Line 29 of Table 16. Interest expense on existing bonds, proposed bonds, and capital leases is presented on Line 30. Other interest costs including loss from refunded debt and the allowance for funds used during construction ("AFUDC") are shown on Lines 32 and 33. PGW's projected net income is shown on Line 35 of the table and ranges from \$41.8 million to \$66.3 million.

On Table 17, Line 1 presents PGW's cash balance as of September 1 for each fiscal year. From this starting point, the net income line from Table 16 is combined with non-cash adjustments (such as depreciation and amortization) expensed on the Income Statement. External sources of funds are summarized on Lines 8 through 12 and include revenue bond proceeds, drawdowns on the capital improvement fund, capital lease proceeds, and the payment and grant back of the \$18 million for fiscal years 2006 and 2008. The total for all sources of funds is shown on Line 13 of Table 17.

Uses of funds are summarized on Lines 14 through 22 of Table 17. Lines 14 through 16 present the principal payments made on long-term debt, CIP requirements are shown on Line 17 and payments to the City and short-term debt obligations are shown on Lines 18 through 21. Changes in non-cash working capital items, including changes in accounts payable and accounts receivable, are shown in Line 22.

The net increase or decrease in available cash for each fiscal year is shown on Line 24 of Table 17. The ending cash balance for the year, which is the sum of Lines 1 and 24, is shown on Line 25. The ending cash balance for 2006 represents approximately 6 weeks of operations and maintenance expenses (excluding the cost of fuel) and the ending cash balances for fiscal years 2007 through 2011 represent approximately 3 to 6 weeks of operations and maintenance expense (excluding the cost of fuel). These projected year-end cash balances for fiscal years 2006 through 2011 should be sufficient for PGW to accommodate normal fluctuations in expenditures for utility operations.

A detailed calculation of debt service coverage requirements under the 1975 and 1998 General Ordinances is presented in Table 18. Debt service requirements do not include the letter of credit or remarketing fees for the 2006 Bonds. The results presented in the table indicate that provided the assumptions made herein are realized, PGW will meet the requirements of the 1975 and 1998 General Ordinances for all years in the projection period.

¹⁶ Extension of the maturity date requires City Council approval

Table 16
Projected Statement of Income
(Thousands of Dollars)

Line No.	Description	Fiscal Year Ending August 31,					
		2006	2007	2008	2009	2010	2011
		\$	\$	\$	\$	\$	\$
Projected Revenues							
1	Non-Heating	110,823	104,571	99,131	97,095	96,480	97,485
2	Gas Transport Service	7,210	7,884	8,047	8,125	8,152	8,152
3	Heating	797,812	769,861	728,147	701,646	687,945	689,340
4	Other Sales	319	(151)	(527)	(302)	(152)	75
5	Total Gas Revenues - Existing Rates	916,164	882,166	834,797	806,564	792,425	795,052
6	Base Rate Increase	0	0	0	35,000	40,000	45,000
7	Total Gas Revenues	916,164	882,166	834,797	841,564	832,425	840,052
8	Other Operating Revenues	32,768	32,371	31,466	31,012	30,902	31,196
9	Total Operating Revenues	948,932	914,537	866,263	872,576	863,327	871,248
Operating Expenses							
10	Natural Gas	578,362	549,762	501,457	471,216	456,389	460,879
11	Other Raw Materials	5	5	5	5	5	5
12	Total Fuel	578,367	549,767	501,462	471,221	456,394	460,884
13	Gas Processing	15,590	15,570	16,258	16,419	16,699	17,010
14	Field Services	30,972	30,969	31,183	31,711	32,420	33,104
15	Distribution	16,230	16,363	16,515	16,830	17,200	17,623
16	Collection	10,540	10,308	10,340	10,519	10,645	10,852
17	Customer Services	12,918	13,012	13,003	13,208	13,329	13,531
18	Customer Accounting	8,179	8,215	8,239	8,349	8,484	8,678
19	Bad Debt Expense	55,132	52,914	50,426	48,203	46,219	44,673
20	A&G and Other Expenses	81,371	92,795	98,155	102,672	107,762	112,549
21	Total Non-Fuel O&M	230,932	240,146	244,119	247,911	252,758	258,020
22	Depreciation	37,589	38,947	40,288	41,587	42,873	44,131
23	Cost of Removal	3,200	3,200	3,200	3,200	3,200	3,200
24	Less: Clearing Accounts	(4,647)	(4,731)	(4,815)	(4,898)	(4,812)	(4,685)
25	Net Depreciation	36,142	37,416	38,673	39,889	41,261	42,646
26	Total Operating Expenses	845,441	827,329	784,254	759,021	750,413	761,550
27	Net Operating Income	103,492	87,208	82,009	113,555	112,914	109,698
28	Other Income ^(a)	24,614	26,034	26,064	9,505	9,749	7,867
29	Net Income Before Interest Charges	128,106	113,242	108,073	123,060	122,663	117,565
Interest							
30	Long Term Debt	50,712	59,330	57,468	65,340	71,735	60,523
31	Other	7,496	5,855	5,810	6,096	6,021	5,809
32	Loss From Refunded Debt	4,535	4,224	3,874	3,526	3,201	2,864
33	AFUDC	(986)	(1,020)	(900)	(825)	(750)	(675)
34	Total Interest	61,757	68,389	66,252	74,137	80,207	68,521
35	Net Income	66,349	44,852	41,821	48,923	42,456	49,044

(a) Includes the City's grant back of the \$18 million payment in fiscal years 2006 through 2008.

Table 17
Projected Statement of Cash Flows
(Thousands of Dollars)

Line No.	Description	Fiscal Year Ending August 31,					
		2006	2007	2008	2009	2010	2011
		\$	\$	\$	\$	\$	\$
1	Beginning Cash Balance	15,221	25,756	16,517	16,231	18,991	15,888
	Sources of Funds						
	Internal Sources						
2	Net Income	66,349	44,852	41,821	48,923	42,456	49,044
3	Depreciation	37,589	38,947	40,288	41,587	42,873	44,131
4	Amortized Costs ^(a)	6,066	2,326	3,531	2,878	1,304	(322)
5	Earnings on Restricted Funds	69	0	0	0	0	0
6	Increased/(Decreased) Other Liabilities	(1,015)	830	187	1,269	1,064	(8,141)
7	Total Internal Sources	109,058	86,955	85,827	94,657	87,697	84,712
	External Sources						
8	Revenue Bond Proceeds	0	128,396	0	128,396	0	0
9	Capital Improvement Fund Drawdown	65,751	60,396	60,000	55,000	50,000	45,000
10	Capital Lease Proceeds	5,924	0	0	0	0	0
11	Temporary Borrowings	19,900	0	30,000	0	0	0
12	Total External Sources	91,575	188,793	90,000	183,396	50,000	45,000
13	Total Sources of Funds	200,633	275,748	175,827	278,053	137,697	129,712
	Uses of Funds						
14	Debt Reduction on all Bonds	36,651	38,055	38,625	40,106	41,708	35,343
15	PMA Bond Debt Reduction	1,310	1,370	1,430	1,500	1,565	1,640
16	Capital Lease Debt Reduction	0	0	0	0	0	0
17	CIP Requirements	65,751	70,240	65,739	66,296	64,572	63,239
18	Payment to City	18,000	18,000	18,000	18,000	18,000	18,000
19	Deposit to CIP Fund	0	128,396	0	128,396	0	0
20	Repayment of Commercial Paper	40,000	35,000	0	35,000	19,700	0
21	Repayment of City Loan	0	2,000	43,000	0	0	0
22	Change in Non-Cash Working Capital ^(b)	28,386	(8,074)	9,319	(14,006)	(4,745)	(1,843)
23	Total Uses of Funds	190,098	284,987	176,113	275,293	140,800	116,379
24	Increase/(Decrease) in Cash	10,535	(9,239)	(286)	2,760	(3,103)	13,333
25	Ending Cash Balance	25,756	16,517	16,231	18,991	15,888	29,221

(a) Includes amortization on capital leases, bond issuance costs and extraordinary losses.

(b) Includes changes in Accounts Payable, Accounts Receivable, and Materials and Supplies.

Table 18
Projected Debt Service Coverage
(Thousands of Dollars)

Line No.	Description	Fiscal Year Ending August 31,					
		2006	2007	2008	2009	2010	2011
		\$	\$	\$	\$	\$	\$
SOURCES OF FUNDS							
1	Total Gas Revenues	916,164	882,166	834,798	841,564	832,425	840,052
2	Other Operating Revenues	32,768	32,371	31,466	31,012	30,902	31,196
3	Total Operating Revenues	948,932	914,537	866,263	872,576	863,327	871,248
4	Other Income ^(a)	25,669	27,054	26,964	45,330	50,499	53,542
5	Total Sources of Funds	974,601	941,591	893,227	917,906	913,826	924,790
USES OF FUNDS							
6	Fuel Costs	578,367	549,767	501,462	471,221	456,394	460,884
7	Other Operating Costs	267,074	277,562	282,792	287,800	294,019	300,666
8	Total Operating Expenses	845,441	827,329	784,254	759,021	750,413	761,550
9	Less: Non-Cash Expenses	(41,371)	(42,765)	(44,142)	(45,477)	(46,822)	(48,146)
10	Total Uses of Funds	804,070	784,564	740,112	713,544	703,591	713,404
11	Funds Available for Debt Service	170,532	157,027	153,115	204,362	210,235	211,386
12	1975 Ordinance Bonds Debt Service	41,209	35,748	34,368	32,368	30,155	31,559
13	Debt Service Coverage - 1975 Ordinance	4.14	4.39	4.46	6.31	6.97	6.70
14	Net Available after Prior Debt Service	129,322	121,279	118,747	171,994	180,080	179,827
15	Less Capital Lease Costs	0	0	0	0	0	0
16	Net Available after Prior Capital Leases	129,322	121,279	118,747	171,994	180,080	179,827
17	1998 Ordinance Bonds Debt Service	46,232	64,225	64,230	75,470	77,156	74,882
18	Debt Service Coverage - 1998 Ordinance	2.80	1.89	1.85	2.28	2.33	2.40
19	Net Available after Prior Debt Service	83,090	57,054	54,517	96,524	102,924	104,946
20	1998 Ordinance Subordinate Debt	1,987	1,987	1,986	1,990	1,986	1,988
21	Debt Service Coverage on Subordinate Debt	41.82	28.71	27.45	48.50	51.82	52.80
Standard & Poor's Fixed Coverage Charge Calculations							
22	Net Available to Service Aggregate Debt Service ^(b)	165,234	151,678	147,646	163,774	164,674	160,886
23	Aggregate Debt Service ^(c)	89,428	101,960	100,584	109,828	109,297	108,428
24	Fixed Coverage Charge on Long-Term Debt	1.85	1.49	1.47	1.49	1.51	1.48

(a) Includes the City's grant back of the \$18 million payment in fiscal years 2006 through 2008.

(b) S&P's Definition: Net Available for Debt Service = Line 9, Table 16 - Line 33, Table 16 - (Line 26 - Line 25, Table 16) + Line 28, Table 16

(c) Line 12 + Line 17 + Line 20 - Line 15

Assumptions and Opinions

In developing the information which Black & Veatch utilized for preparing the projections presented herein; Black & Veatch relied on PGW's financial planning model and PGW's assumptions contained within that model with several exceptions as noted in this Report. The analyses summarized in this Report are based on assumptions that have been provided by or reviewed by PGW and others and relied on currently available information and present circumstances. Black & Veatch has not conducted detailed verification tests of this information. While we believe that these assumptions are reasonable, actual results may differ from those projected, as influenced by the conditions, events and circumstances that actually occur.

Considerations and Assumptions

The following is a list of critical assumptions used in the development of the projections presented herein:

Revenues

1. As set forth by the PUC in its order dated February 22, 2001, the PUC will comply with its statutory obligations under the Public Utility Code, including the section of the Gas Choice Act (66 Pa C.S.A. §2212(b)) requiring that the PUC, in determining PGW's revenue requirement and approving overall rates and charges, "follow the same rate-making methodology and requirements that were applicable to [PGW] prior to the assumption of jurisdiction by the [PUC]" and permit PGW to "impose, charge or collect rates or charges as necessary to permit...PGW to comply with its covenants to the holders of any approved bonds." "Approved Bonds" include the 2006 Bonds and the commercial paper.
2. The throughput and revenue figures are based on the assumption of normal weather (4,555 HDD per year). To the extent that weather is warmer than normal, the resulting contribution margin will be maintained to the extent that the WNA remains in effect.
3. Projected revenue figures are based on the assumption that PGW will recover, in a timely manner, 100 percent of all gas supply costs and 100 percent of the costs (or discounted revenues) attributed to the Customer Responsibility Program, Customer Works Program, Senior Citizen Discount Program, restructuring transition costs, and costs attributable to PUC mandated programs such as those indicated in Chapters 56 and 59.
4. PGW will realize \$35 million in permanent revenue enhancements, cost savings, or permanent base rate increase on a levelized basis beginning in fiscal year 2009, with additional increments of \$5 million in fiscal years 2010 and 2011, respectively. Thirty-five million dollars in fiscal year 2009 is approximately equal to 4.2 percent of PGW's annual revenues. If the overall revenue enhancements, cost savings, or permanent base rate increase over the 2009 through 2011 period is significantly lower than the level assumed herein, PGW may not be able to fund a portion of capital expenditures from other funding sources, establish an adequate level of working capital, repay

the \$45 million City loan by August 2008, or meet coverage requirements in fiscal year 2009 as assumed in this Report.

5. Rates implemented in fiscal year 2004 to comply with PUC requirements to unbundle rates and permit customer choice are designed such that PGW's contribution margin is not materially impacted regardless of whether a customer purchases gas from PGW or only transports gas on PGW's system. It is further assumed that PGW will be allowed to assign any excess capacity and associated costs that may result from customer choice or collect any transition costs.

Operating Expenses

1. PGW's annual accounts receivable write-offs will range from \$65.0 to \$54.0 million and PGW's collection factor on billed revenues is 94.5 percent during the projected period.
2. PGW will realize approximately \$13 million of cost savings in fiscal year 2006 through productivity improvements and / or other to be determined cost saving measures.

Capital Improvement Program

1. The planned capital improvements are assumed to be sufficient to maintain the System and meet regulatory requirements.
2. Projected levels of cash-financed capital improvements are assumed to comply with PGW's internal policies for financing capital improvements with other funding sources.

Debt Service and Outstanding Obligations

1. City Council will approve PGW's repayment of the short-term loan from the City in the amount of \$45 million by August 2008 instead of August 2006.

City Payments

1. The \$18 million annual payment to the City will be granted back to PGW by the City in fiscal years 2006 through 2008.

Opinions

Based on these analyses and the assumptions set forth or referred to in this Report, we offer the following opinions to indicate PGW's conformance with specific requirements which must be met for the issuance of the 2006 Bonds as provided in the 1975 and 1998 General Ordinances:

1. PGW is a competently managed and operated gas distribution utility. PGW and its facilities are organized, operated, and maintained at a level equal to, or in excess of, regulatory requirements and generally

accepted industry practices. PGW's facilities are in good operating condition.

2. Based on our evaluation of financial projections covering the period September 1, 2006 through August 31, 2011, and on the basis of actual and estimated future annual financial operations of PGW's facilities and certain assumptions with respect thereto over the amortization period of the 2006 Bonds, which Black & Veatch believes to be reasonable, current and future Project Revenues, which are pledged under the 1975 General Ordinance and the 1998 General Ordinance, comply with the requirements of the definition of Project Revenues in Section 2 of the Act, and over the amortization period of the 2006 Bonds and the Prior Bonds, such Project Revenues will be adequate to meet all expenses of operation and maintenance, repair and replacement, reserve fund deposits, debt service on the Bonds issued under the 1975 General Ordinance and debt service on the Bonds issued under the 1998 General Ordinance, as the same shall become due and payable, and the surplus requirements of the rate covenants contained in Section 4.03(b) of the 1975 General Ordinance and Section 4.03(b) of the 1998 General Ordinance.
3. The Project Revenues and Gas Works Revenues which are pledged as security for the bonds issued under the 1975 General Ordinance and the 1998 General Ordinance, respectively, are currently and are projected to be sufficient to comply with the Rate Covenants set forth in Section 4.03(b) of the 1975 General Ordinance and Section 4.03(b) of the 1998 General Ordinance.
4. The capital improvements proposed during the projection period, September 1, 2006 through August 31, 2011, will, along with continued good operation and maintenance practices, enable PGW to maintain its system in good condition. Review of present management practices indicates that good operation and maintenance is likely to continue.
5. Contracted PGW gas supplies plus (a) spot market purchases, (b) anticipated additional contracted supplies plus supplemental gas capacities, as well as, (c) the pipeline transport capacity to move these supplies to PGW, are adequate to meet PGW's projected demand on a day of maximum demand (a "design peak day") in an hour of maximum demand (a "design peak hour"), and during a year of maximum demand (a "design peak year").
6. The following are the significant changes that have occurred since the issuance of our 2004 Report and are addressed more fully in the text of this Report:
 - a. PGW improved its collection factor of less than 87 percent of billed revenues in 2003 to 91.4 percent in 2004 and 94.9 percent in 2005. (*See Rate and Tariffs – Billing and Collections*).

- b. The projections in this Report are based on analyses prior to the effects of Hurricanes Katrina and Rita. The current gas cost recovery rate, approved in October 7, 2005, reflects the unprecedented commodity price of natural gas resulting from the impact of those hurricanes in the Gulf Coast region. (*See Post Katrina and Rita Impacts*).
- c. All Phase 1 liquefaction facilities are functional and PGW is negotiating terms of final acceptance with the general contractor, Chicago Bridge & Iron.
- d. On May 16, 2005, a new three-year Collective Bargaining Agreement began between PGW and Union Local 686 and will expire on May 15, 2008. The Agreement includes incremental wage increases of 1 percent in September 2005, 3 percent in September 2006, and 2.5 percent in May 2007.
- e. PGW's projected capital improvement expenditures for Gas Processing decreased from \$10.6 million in 2004 to \$5.0 million in 2005 and are projected to further decrease to \$2.3 million in 2006. PGW has removed any further investment for Phase 2 LNG facilities from its six-year capital improvement program pending its negotiations with a LNG terminal operator.
- f. As a result of improved collections, the base rate increase anticipated for 2007 is not expected to be needed prior to fiscal year 2009.

APPENDIX C

CERTAIN INFORMATION CONCERNING THE CITY OF PHILADELPHIA

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THE GOVERNMENT OF THE CITY OF PHILADELPHIA

General

The City was incorporated in 1789 by an Act of the Commonwealth of Pennsylvania General Assembly (predecessors of the City under charters granted by William Penn in his capacity as proprietor of the colony of Pennsylvania may date to as early as 1684). In 1854 the General Assembly, by an act commonly referred to as the Consolidation Act, made the City's boundaries coterminous with the boundaries of Philadelphia County (the same boundaries that exist today) (the "County"), abolished all governments within these boundaries other than the City and the County and consolidated the legislative functions of the City and the County. Article 9, Section 13 of the Pennsylvania Constitution abolished all county offices in the City and provides that the City performs all functions of county government and that laws applicable to counties apply to the City.

Since 1952, the City has been governed under a Home Rule Charter authorized by the General Assembly (First Class City Home Rule Act, Act of April 21, 1949, P.L. 665, Section 17) and adopted by the voters of the City. The Home Rule Charter, as amended and supplemented to this date, provides, among other things, for the election, organization, powers and duties of the legislative branch (the "City Council"); the election, organization, powers and duties of the executive and administrative branch; and the basic rules governing the City's fiscal and budgetary matters, contracts, procurement, property and records. The Home Rule Charter, as amended, now also provides for the governance of the School District of Philadelphia (the "School District") as a home rule school district. Certain other constitutional provisions and Commonwealth statutes continue to govern various aspects of the City's affairs, notwithstanding the broad grant of powers of local self-government in relation to municipal functions set forth in the First Class City Home Rule Act.

Under the Home Rule Charter, as now in effect, there are today two principal governmental entities in Philadelphia: (1) the City, which performs ordinary municipal functions as well as traditional county functions; and (2) the School District, which has boundaries coterminous with the City and has responsibility for all public primary and secondary education.

The court system in Philadelphia, consisting of Common Pleas, Municipal and Traffic Courts, is part of the Commonwealth of Pennsylvania judicial system. Although judges are paid by the Commonwealth, most other court costs are paid by the City, with partial reimbursement from the Commonwealth.

Elected and Appointed Officials

The Mayor is elected for a term of four years and is eligible to succeed himself for one term. Each of the seventeen members of the City Council is also elected for a four-year term which runs concurrently with that of the Mayor. There is no limitation on the number of terms that may be served by members of the City Council. Of the members of the City Council, ten are elected from districts and seven are elected at-large, with a minimum of two of the seven representing a party or parties other than the majority party. The District Attorney and the City Controller are elected at the mid-point of the terms of the Mayor and City Council.

The City Controller's responsibilities derive from the Home Rule Charter, various City ordinances and state and federal statutes, and contractual arrangements with auditees. The City Controller must follow GAGAS, Generally Accepted Government Auditing Standards established by the federal Government Accountability Office (formerly known as the General Accounting Office), and GAAS, Generally Accepted Auditing Standards promulgated by the American Institute of Certified Public Accountants. As of December 31, 2005, the Office of the City Controller had 128 employees, including 78 auditors, 28 of whom are certified public accountants.

The City Controller post-audits and reports on the City's combined financial statements, federal assistance received by the City, the performance of City departments and the finances of the School District. The City Controller also conducts a pre-audit program of expenditure documents required to be submitted for approval, such as invoices, payment vouchers, purchase orders and contracts. Documents are selected for audit on a category and

statistical basis. The Pre-Audit Division verifies that expenditures are authorized and accurate in accordance with the Charter and other pertinent legal and contractual requirements before any moneys are paid by the City Treasurer. The Pre-Audit Technical Unit, consisting of auditing and engineering staff, inspects and audits capital project design, construction and related expenditures. Other responsibilities of the City Controller include investigation of allegations of fraud, preparation of economic reports, certification of the City's debt capacity and the capital nature and useful life of the capital projects, and opining to the Pennsylvania Intergovernmental Cooperation Authority on the reasonableness of the assumptions and estimates in the City's five-year financial plans.

The principal officers of the City's government appointed by the Mayor are the Managing Director of the City (the "Managing Director"), the Director of Finance of the City (the "Director of Finance"), who is the chief financial and budget officer and is selected from three names submitted to the Mayor by a Finance Panel, the City Solicitor (the "City Solicitor"), who is head of the Law Department, and the City Representative and Director of Commerce (the "City Representative and Director of Commerce"). These officials, together with the Mayor and the other members of the Mayor's cabinet, constitute the major policy-making group in the City's government.

The Managing Director is responsible for supervising the operating departments and agencies of the City that render the City's various municipal services. The City Solicitor acts as legal advisor to the Mayor, the City Council, and all of the agencies of the City government. The City Solicitor is also responsible for all of the City's contracts and bonds, for assisting City Council, the Mayor, and City agencies in the preparation of ordinances for introduction in City Council, and for the conduct of litigation involving the City. The City Representative and Director of Commerce is charged with the responsibility of giving wide publicity to any items reflecting the activities and accomplishments of the City, its inhabitants, and commerce and industry, and is charged with the responsibility of promoting and developing commerce and industry.

The Director of Finance is responsible for the financial functions of the City including development of the annual operating budget, the capital budget, and capital program; the City's program for temporary and long-term borrowing; supervision of the operating budget's execution, the collection of revenues through the Department of Revenue, purchasing, and some aspects of property management through the Procurement Department; and the oversight of pension administration as Chairperson of the Board of Pensions and Retirement. The Director of Finance is also responsible for the appointment and supervision of the City Treasurer, whose Office serves as the disbursing agent for the distribution of checks and electronic payments from the City Treasury and the management of cash resources.

The City's former Director of Finance, Janice D. Davis, resigned from her position effective August 13, 2004 to become the Chief Financial Officer of the City of Atlanta, Georgia. The City is currently conducting a nationwide search for a new Director of Finance. Currently, the duties of the Director of Finance are being handled by Vincent J. Jannetti, Acting Director of Finance.

The following are brief biographies of Mayor Street, his chief of staff, his cabinet and the City Controller:

John F. Street, Mayor, was sworn in as Philadelphia's 97th mayor on January 3, 2000 and was re-elected to a second 4-year term on November 4, 2003. Elected to Philadelphia City Council in 1979, Mayor Street took his City Council seat in 1980. For nearly 20 years he represented the City's Fifth Councilmanic District, distinguishing himself as a fighter for working people and neighborhoods. He was unanimously elected City Council President in 1992 and again in 1996. Mayor Street received his B.A. from Oakwood College in Huntsville, Alabama, and a J.D. from Temple University Law School.

Joyce S. Wilkerson, Chief of Staff, began practicing law as a legal service attorney first in California and later in Philadelphia. Ms. Wilkerson worked as Housing Counsel at the Philadelphia Redevelopment Authority where she represented the Redevelopment Authority in its capacity as issuer of housing bonds. More recently, Ms. Wilkerson served as Chief Staff Attorney to the City Council of Philadelphia. Ms. Wilkerson has a B.A. degree from the University of Pennsylvania and a J.D. degree from Boalt Hall School of Law at the University of California, Berkeley.

Vincent J. Jannetti, Acting Secretary of Financial Oversight and Director of Finance, was appointed in December 2004. Mr. Jannetti is a life-long Philadelphian and a City employee for over 30 years. Mr. Jannetti was

most recently Deputy Director of Finance for Debt Management as well as Executive Director of the Sinking Fund Commission, responsible for overseeing the issuance of new debt as well as budgeting and payment of debt service on City general obligation bonds and revenue bonds. Mr. Jannetti earned a Bachelor of Science in Business Administration from Villanova University.

Romulo L. Diaz, Jr, was appointed on April 1, 2005 as City Solicitor. The City Solicitor of the City of Philadelphia is the City's chief legal officer, the head of the City's Law Department, and a member of the Mayor's Cabinet. Prior to his appointment, Mr. Diaz was Chair of the Commercial and Regulatory Law Group of the City's Law Department, which he joined in March 2002. Prior thereto, he held numerous legal, management and policy positions at increasing levels of trust and responsibility in the federal government, including assistant administrator for management at the U.S. Environmental Protection Agency, and Deputy Chief of Staff and Counselor to the Secretary of Energy. He received the Secretary of Energy's Gold Award for coordinating the Department of Energy's reform efforts that streamlined the Department's regulations and paperwork burden. He chaired several international groups, including NATO's Petroleum Planning Committee from 1992-1995 during a major realignment of the North Atlantic Alliance. Mr. Diaz received his J.D. from the University of Texas School of Law and B.A. from the University of Texas at Austin. He is licensed to practice in Pennsylvania, New Jersey, the District of Columbia and Texas. He is a Charter Fellow of the Federal Bar Association; Treasurer of the Hispanic Bar Association of Pennsylvania; and a Director of Servicemembers Legal Defense Network and the Pan American Association of Philadelphia.

Pedro A. Ramos, Managing Director, was appointed in April 2005. Prior to his appointment as Managing Director, Mr. Ramos served as City Solicitor from March 2004. Mr. Ramos was a Vice President and the Chief of Staff to University of Pennsylvania President, Dr. Judith Rodin. Mr. Ramos joined the Penn President's Office in January 2002. Mr. Ramos' legal career started at Ballard Spahr Andrews & Ingersoll, LLP, where he worked since his graduation from law school through December 2001, when he left the partnership to work at Penn. His primary area of practice was employee benefits. Mr. Ramos is also a former member and president of the Board of Education of The School District of Philadelphia. Mr. Ramos has served on several boards in the Philadelphia community. Mr. Ramos is a 1992 cum laude graduate of the University of Michigan Law School, a 1987 graduate of the University of Pennsylvania, and a 1983 graduate of Central High School in Philadelphia.

George R. Burrell, Jr., Secretary of External Affairs, was appointed in January 2000. While serving as a member of City Council, Mr. Burrell served as Chair of the Committees on Labor and Civil Service and Licenses and Inspections. In 1974, he began his law practice as a corporate attorney with Ragan Henry, Esquire. He later joined the law firm of Wolf Block Schorr and Solis-Cohen in 1977. In both firms, Mr. Burrell served as Chairman of their Governmental Relations Department. In 1985, before his election as an at-large member of the Philadelphia City Council, he founded Burrell, Waxman, Donaghy, and Lee. Mr. Burrell graduated from the University of Pennsylvania Wharton School in 1969. He received a J.D. from the University of Pennsylvania Law School in 1974.

Stephanie W. Naidoff, the City Representative and Director of Commerce, was appointed on March 8, 2004. Earlier, she was the founding President of the Kimmel Center for the Performing Arts from 1997 to 2001. Before taking on that assignment, she had a long career as an attorney starting out in Federal service with the U.S. Department of Health and Human Services, then as General Counsel to Thomas Jefferson University and then with the law firm of Morgan, Lewis and Bockius. She is a graduate of the University of Pennsylvania Law School in 1966 and Goucher College in 1963.

Jacqueline E. Barnett, Secretary of Education, was appointed in August 2005. Prior to her current appointment Ms. Barnett for four years served as Senior Education Policy Advisor to Congressman Chaka Fattah. In her role she was immersed in the work leading to the creation of the College Opportunity Resources for Education (Core) Philly Scholarship program. Ms. Barnett is a 2001 graduate with honors from NOVA Southeastern University, a 1989 graduate of Fisk University, and a 1984 graduate of the High School for the Creative and Performing Arts in Philadelphia.

Sylvester M. Johnson, Police Commissioner/Secretary of Public Safety. Mr. Johnson is a thirty-six year veteran of the Philadelphia Police Department. Prior to his current appointment, Mr. Johnson was, since April 1998, Deputy Commissioner of Operations under former Police Commissioner John F. Timoney. Mr. Johnson attended Philadelphia Community College, Temple University, the Senior Management Institute for Police at Harvard

University, Pennwalt Corporation's Targeted Management Training, the United States Secret Service Dignitary Protection Training, the Federal Bureau of Investigation's ("FBI") National Academy Class 172, and the FBI National Executive Institute.

Thomas A. Chapman was appointed Acting Secretary for Strategic Planning and Executive Director of the City Planning Commission in July 2005. From 2002 until 2005, he was Director of the Development Planning and Zoning Division. In this capacity, he supervised a professional planning staff involved in development and environmental review on all development proposals throughout the City. This staff also reviews and makes planning recommendations on all applications before the Zoning Board of Adjustment and prepares and provides Planning Commission recommendations on all zoning legislation, property legislation and street ordinances before City Council. He joined the staff of the Philadelphia City Planning Commission in 1978 and over the years has held various staff positions involving development review, subdivision, environmental assessment, and zoning controls and until recently served as the Commission's Director of the Development Planning Division. Mr. Chapman received a Bachelor of Arts degree from La Salle University and a Law degree from Widener University.

Kevin R. Hanna was appointed Secretary of Housing and Neighborhood Preservation by the Mayor in December 2002. Mr. Hanna has more than 20 years' experience in economic development and banking finance. Before joining the City of Philadelphia, he served for five years as the first president of the Atlanta Development Authority (ADA), an independent public authority created by the City of Atlanta to promote the growth of its downtown area and the redevelopment of its surrounding communities. Prior to 1996, Mr. Hanna was vice president, public finance, First Union Capital Markets, Atlanta. Mr. Hanna earned a Bachelor of Science in Economics degree from Davidson (N.C.) College where he is on the Board of Trustees. He received a Master of Business Administration degree with concentration in banking finance from the University of North Carolina at Chapel Hill and was awarded a fellowship by the Consortium for Graduate Studies in Business.

Dianah L. Neff, Chief Information Officer, was appointed in May 2001. Prior to that Ms. Neff served as deputy City Manager and Chief Information Officer for the City of San Diego, California. Before that she served as Chief Information Officer of the City of Bellevue, Washington. Ms. Neff has also served as Director of Information Systems for the County of San Bernadino, California and Director of Information Resources for the City of Palo Alto, California, where she oversaw efforts to make Palo Alto the first city in the nation on the World Wide Web. Prior to her work in government, Ms. Neff had fourteen years' experience in the private sector working for high-tech software and hardware firms in the Silicon Valley. Ms. Neff holds a Bachelor's Degree in marketing and economics from San Jose State University.

Alan L. Butkovitz, City Controller, is serving his first term as Philadelphia's elected City Controller, an office independent of the Mayor. Prior to his election as City Controller, Mr. Butkovitz served 15 years in the Pennsylvania House of Representatives, representing the 174th Legislative District in Northeast Philadelphia where he served on the Veterans Affairs and Urban Affairs Committees as well as committees on Aging and Older Adults, Children and Youth, and Insurance. Mr. Butkovitz was widely praised for leading the bi-partisan investigation into violence in Philadelphia public schools. He authored legislation creating the Office of the Safe Schools Advocate, the first of its kind in the nation. Mr. Butkovitz was born and raised in Philadelphia. He is an attorney and received his Juris Doctor degree from Temple University Law School in 1976 and a Bachelor's degree from Temple University in 1973.

Government Services

Municipal services provided by the City include: police and fire protection; health care; certain welfare programs; construction and maintenance of local streets, highways, and bridges; trash collection and disposal; provision for recreational programs and facilities; maintenance and operation of the water and wastewater systems (the "Water and Wastewater Systems"); the acquisition and maintenance of City real and personal property, including vehicles; maintenance of building codes and regulation of licenses and permits; maintenance of records; collection of taxes and revenues; purchase of supplies and equipment; construction and maintenance of airport facilities; and maintenance of a prison system. The City owns the assets that comprise the Philadelphia Gas Works ("PGW" or the "Gas Works"). PGW serves residential, commercial, and industrial customers in the City. PGW is operated by Philadelphia Facilities Management Corporation ("PFMC"), a non-profit corporation specifically organized to manage and operate the PGW for the benefit of the City.

Local Government Agencies

There are a number of significant governmental authorities and quasi-governmental non-profit corporations that also provide services within the City.

The Southeastern Pennsylvania Transportation Authority ("SEPTA"), which is supported by transit revenues and Federal, Commonwealth, and local funds, is responsible for developing and operating a comprehensive and coordinated public transportation system in the southeastern Pennsylvania region.

The Philadelphia Parking Authority is responsible for the construction and operation of parking facilities in the City and at the Philadelphia International Airport and, by contract with the City, for enforcement of on-street parking regulations.

The Philadelphia Municipal Authority (formerly The Equipment Leasing Authority of Philadelphia) ("PMA") was originally established for the purpose of buying equipment and vehicles to be leased to the City. PMA's powers have been expanded to include, without limitation, the construction and leasing of municipal solid waste disposal facilities, correctional facilities, and other municipal buildings.

The Redevelopment Authority of the City of Philadelphia (the "Redevelopment Authority") and the Philadelphia Housing Authority develop and/or administer low and moderate income rental units and housing in the City. The Redevelopment Authority, supported by Federal funds through the City's Community Development Block Grant Fund and by Commonwealth and local funds, is responsible for the redevelopment of the City's blighted areas.

The Hospitals and Higher Education Facilities Authority of Philadelphia, formerly The Hospitals Authority of Philadelphia (the "Hospitals Authority") assists non-profit hospitals by financing hospital construction projects. The City does not own or operate any hospitals. The powers of the Hospitals Authority have been expanded to permit the financing of construction of buildings and facilities for certain colleges and universities and other health care facilities and nursing homes.

The Philadelphia Industrial Development Corporation ("PIDC") and its affiliate, the Philadelphia Authority for Industrial Development ("PAID"), coordinate the City's efforts to maintain an attractive business environment and to attract new businesses to the City and retain existing ones.

The Pennsylvania Convention Center Authority (the "Convention Center Authority") constructed and maintains, manages, and operates the Pennsylvania Convention Center, which opened on June 25, 1993.

School District

The School District was established by the Educational Supplement to the City's Home Rule Charter to provide free public education to the City's residents. Under the Home Rule Charter, its board is appointed by the Mayor and must submit a lump sum statement of expenditures to the City annually. Such statement is used by City Council in making its determination to authorize the levy of taxes on behalf of the School District. Certain financial information regarding the School District is included in the City's Comprehensive Annual Financial Report. It has no independent taxing powers and may levy only the taxes authorized on its behalf by the City and the Commonwealth. Under the Home Rule Charter, the School District is managed by a nine-member Board of Education appointed by the Mayor from a list supplied by an Educational Nominating Panel that is chosen by the Mayor. In some matters, including the incurrence of short-term and long-term debt, both the City and the School District are governed primarily by the laws of the Commonwealth. The School District is a separate political subdivision of the Commonwealth and the City has no property interest in or claim on any revenues or property of the School District.

The School District was declared distressed by the Secretary of Education of the Commonwealth pursuant to Section 691(c) of the Public School Code of 1949, as amended (the "School Code"), on December 22, 2001. During a period of distress under Section 691(c) of the School Code, all of the powers and duties of the Board of

Education granted under the School Code or any other law are suspended and all of such powers and duties are vested in the School Reform Commission (the "School Reform Commission") provided for under the School Code. The School Reform Commission is responsible for the operation, management and educational program of the School District during such period. It is also responsible for financial matters related to the School District. The School Code provides that the members of the Board of Education continue to serve during the time the School District is governed by the School Reform Commission, and that the establishment of the School Reform Commission shall not interfere with the regular selection of the members of the Board of Education. During the tenure of the School Reform Commission, the Board of Education will perform those duties delegated to it by the School Reform Commission.

PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY

General

The Pennsylvania Intergovernmental Cooperation Authority ("PICA") was created on June 5, 1991 by the Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class (the "PICA Act"). PICA was established to provide financial assistance to cities of the first class. The City is the only city of the first class in the Commonwealth. The PICA Act provides that, upon request by the City to PICA for financial assistance and for so long as any bonds issued by PICA remain outstanding, PICA shall have certain financial and oversight functions. Under the PICA Act, PICA no longer has the authority to issue bonds for new money purposes, but may refund bonds previously issued by it. PICA has the power, in its oversight capacity, to exercise certain advisory and review procedures with respect to the City's financial affairs, including the power to review and approve five-year financial plans prepared at least annually by the City, and to certify non-compliance by the City with the then-existing five-year plan adopted by the City pursuant to the PICA Act. Under the PICA Act, such certification would require the Secretary of the Budget of the Commonwealth to withhold payments due to the City from the Commonwealth or any of its agencies (including, with certain exceptions, all grants, loans, entitlements and payment of the portion of the PICA Tax, hereinafter described, otherwise payable to the City). See "Source of Payment of PICA Bonds" below.

On June 16, 1992, PICA, at the request of the City, issued \$474,555,000 Special Tax Revenue Bonds (City of Philadelphia Funding Program), Series of 1992 (the "1992 PICA Bonds"). The proceeds of the 1992 PICA Bonds were used (i) to make grants to the City to fund the Fiscal Year 1991 General Fund cumulative deficit (\$153.5 million) and the then-projected Fiscal Year 1992 General Fund deficit (\$71.4 million); (ii) to make grants to the City to pay the costs of certain capital projects to be undertaken by the City; and (iii) to make a grant to the City to provide it with financial assistance to enhance productivity in the operation of City government. It had been anticipated that the proceeds of the 1992 PICA Bonds would also be used to fund the City's projected Fiscal Year 1993 General Fund deficit; however, because no deficit occurred, a grant from PICA for this purpose was not required. These proceeds, in the amount equal to \$23.5 million, were instead used to provide funds for other City purposes.

On July 29, 1993, PICA, at the request of the City, issued \$643,430,000 Special Tax Revenue Bonds (City of Philadelphia Funding Program), Series of 1993 (the "1993 PICA Bonds"), the proceeds of which were used to make grants to the City to pay the costs of certain capital projects to be undertaken by the City and to make a grant to the City to provide for the defeasance of certain outstanding general obligation bonds of the City in the aggregate amount of \$336,225,000.

On September 14, 1993, PICA issued \$178,675,000 Special Tax Revenue Refunding Bonds (City of Philadelphia Funding Program), Series of 1993A (the "1993A PICA Bonds"), the proceeds of which were used to advance refund \$136,670,000 principal amount of the 1992 PICA Bonds.

On December 15, 1994, PICA, at the request of the City, issued \$122,020,000 Special Tax Revenue Bonds (City of Philadelphia Funding Program) Series of 1994 (the "1994 PICA Bonds"), the proceeds of which were used to make grants to the City to pay the costs of certain capital projects to be undertaken by the City.

On May 30, 1996, PICA issued \$343,030,000 Special Tax Revenue Refunding Bonds (City of Philadelphia Funding Program), Series of 1996 (the "1996 PICA Bonds"), the proceeds of which were used to advance refund \$304,160,000 principal amount of the 1992 PICA Bonds and \$120,180,000 principal amount of the 1994 PICA Bonds.

On April 15, 1999, PICA issued \$610,005,000 Special Tax Revenue Refunding Bonds (City of Philadelphia Funding Program), Series of 1999, the proceeds of which were used to advance refund \$610,730,000 principal amount of the 1993 PICA Bonds.

On June 16, 2003, PICA issued \$165,550,000 Special Tax Revenue Refunding Bonds (City of Philadelphia Funding Program), Series of 2003, the proceeds of which were used to refund \$163,185,000 principal amount of the 1993A PICA Bonds.

As of the close of business on June 30, 2005, the principal amount of PICA bonds outstanding was \$723,585,000.

Source of Payment of PICA Bonds

The PICA Act authorized the City to impose a tax for the sole and exclusive purposes of PICA. In connection with the adoption of the Fiscal Year 1992 budget and the adoption of the first Five-Year Plan, the City reduced the wage, earnings, and net profits tax on City residents by 1.5% and enacted a 1.5% tax on wages, earnings and net profits of City residents (the "PICA Tax"). Proceeds of the PICA Tax are solely the property of PICA. The PICA Tax, collected by the City's Department of Revenue, is deposited in the "Pennsylvania Intergovernmental Cooperation Authority Tax Fund" (the "PICA Tax Fund") of which the State Treasurer is custodian. The PICA Tax Fund is not subject to appropriation by City Council or the General Assembly of the Commonwealth.

The PICA Act authorizes PICA to pledge the PICA Tax to secure its bonds and prohibits the Commonwealth and the City from repealing the PICA Tax or reducing the rate of the PICA Tax while any bonds secured by the PICA Tax are outstanding.

The PICA Act requires that proceeds of the PICA Tax in excess of amounts required for (i) debt service, (ii) replenishment of any debt service reserve fund for bonds issued by PICA, and (iii) certain PICA operating expenses, be deposited in a trust fund established pursuant to the PICA Act exclusively for the benefit of the City and designated the "City Account." Amounts in the City Account are required to be remitted to the City not less often than monthly, but are subject to withholding if PICA certifies the City's non-compliance with the then-current five-year plan.

The PICA Act establishes a "Bond Payment Account" for PICA as a trust fund for the benefit of PICA bondholders and authorizes the creation of a debt service reserve fund for bonds issued by PICA. Since PICA has issued bonds secured by the PICA Tax, the PICA Act requires that the State Treasurer pay the proceeds of the PICA Tax held in the PICA Tax Fund directly to the Bond Payment Account, the debt service reserve fund created for bonds issued by PICA and the City Account.

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The total amount of PICA Tax remitted to PICA by the State Treasurer for each of the Fiscal Years 1995 through 2006 is set forth below:

<u>Year</u>	<u>Amount</u>
1995	\$ 209.6 million
1996	218.8 million
1997	218.2 million
1998	236.1 million
1999	245.8 million
2000	256.6 million
2001	273.6 million
2002	278.0 million
2003	281.5 million
2004	285.0 million
2005	300.2 million actual
2006	310.7 million (budgeted)

PICA bonds are payable from the PICA revenues, including the PICA Tax, pledged to secure PICA's bonds, the Bond Payment Account and any debt service reserve fund established for such bonds and have no claim on any revenues of the Commonwealth or the City.

Five-Year Plans of the City

One of the conditions precedent to the issuance of bonds by PICA was the development by the City and approval by PICA of a five-year financial plan. The original five-year plan, which covered Fiscal Years 1992 through 1996, was prepared by the Mayor, approved by City Council on April 29, 1992 and by PICA on May 18, 1992. In each subsequent year, the City updated the previous year's five-year plan, each of which was adopted by City Council, signed by the Mayor and approved by PICA. The Thirteenth Five-Year Plan was presented to Council on March 18, 2004, and approved by PICA on July 7, 2004. In the Thirteenth Five-Year Plan, the City projects a balanced budget in each of the five years covered by the plan through a continued strategy based upon implementation of management initiatives, productivity improvements, cost containments, certain workforce restructurings, and revenue enhancements. An amendment to the Thirteenth Five-Year Plan was presented to PICA on November 15, 2004, and was approved by PICA on December 21, 2004.

The Mayor presented the Fourteenth Five-Year Plan to City Council and to PICA on January 25, 2005. City Council approved the Fourteenth Five-Year Plan on June 16, 2005. On June 21, 2005, PICA requested the City to make revisions to the Fourteenth Five Year Plan relating to the City's estimates of certain revenues. The City responded to the PICA requests and submitted a revised Fourteenth Five Year Plan to PICA on July 20, 2005. PICA approved the Plan on July 21, 2005. In the Fourteenth Five-Year Plan, the City projects a balanced budget in each of the five years covered by the plan through a continued strategy based upon implementation of management initiatives, productivity improvements, cost containments, certain workforce restructurings, and revenue enhancements.

CITY FINANCIAL PROCEDURES

Except as otherwise noted, the financial statements, tables, statistics, and other information contained in this Official Statement have been prepared by the Office of the Director of Finance and can be reconciled to the financial statements in the City's Comprehensive Annual Financial Report and Notes therein.

Independent Audit and Opinion of the City Controller

The City Controller has examined and expressed an opinion on the basic financial statements of the City of Philadelphia contained in the City's Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2005 (the "Fiscal Year 2005 Comprehensive Annual Financial Report"). The City Controller has not examined and

expressed an opinion on the financial statements of the Philadelphia Gas Works contained in this Official Statement and has not examined and expressed an opinion on any other financial data contained in this Official Statement. Such financial statements for the Philadelphia Gas Works have been prepared by the Philadelphia Gas Works and approved by the Director of Finance. The City Controller has not participated in the preparation of this Official Statement nor in the preparation of the budget estimates and projections and cash flow statements and forecasts set forth in various tables contained in this Official Statement. Consequently, the City Controller expresses no opinion with respect to any of the data contained in this Official Statement other than what is contained in the Fiscal Year 2005 Comprehensive Annual Financial Report.

Fund Structure

The major operations of the City are conducted through the Principal Operating Funds (Debt Related), which include the General Fund. In addition, the City has three other Principal Operating Funds that are not debt related ("Non-Debt Related Funds"), two of which are financed solely from grants from the Commonwealth and Federal governments. Collectively, the Principal Operating Funds (Debt Related and Non-Debt Related Funds) are referred to herein as the "Principal Operating Funds."

Principal Operating Funds

The Unrestricted Debt Related Funds include the General Fund, the resources of which are available for any City purpose, and the County Liquid Fuels Tax Fund and the Special Gasoline Tax Fund, the resources of which are available only for servicing general obligation debt issued for construction of public roads or streets. The Other Debt Related Funds include the Water Fund and the Aviation Fund, the resources of which are not generally available for City purposes, other than the operations of the City's Water Department and the City's Division of Aviation, respectively.

The Non-Debt Related Funds, the resources of which are not available for other City purposes, include the Grants Revenue Fund, the Community Development Fund, the Hotel Room Rental Tax Fund, the Car Rental Tax Fund and the HealthChoices Behavioral Health Revenues Fund.

Fund Accounting

Funds are groupings of activities that enable the City to maintain control over resources that have been segregated for particular purposes or objectives. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds and fiduciary funds.

Governmental funds. The governmental funds are used to account for the financial activity of the City's basic services, such as: general government; economic and neighborhood development; public health, welfare and safety; cultural and recreational; and streets, highways and sanitation. The fund financial activities focus on a short-term view of the inflows and outflows of spendable resources, as well as on the balances of spendable resources available at the end of the fiscal year. The financial information presented for the governmental funds is useful in evaluating the City's short term financing requirements.

The City maintains twenty individual governmental funds. The City's Comprehensive Annual Financial Report presents data separately for the general fund, grants revenue fund and health-choices behavioral health fund, which are considered to be major funds. Data for the remaining seventeen funds are combined into a single aggregated presentation.

Proprietary funds. The proprietary funds are used to account for the financial activity of the City's operations for which customers are charged a user fee; they provide both a long and short-term view of financial information. The City maintains three enterprise funds that are a type of proprietary funds - airport, water and wastewater operations, and industrial land bank.

Fiduciary funds. The City is the trustee, or fiduciary, for its employees' pension plans. It is also responsible for PGW's employees' retirement reserve assets. Both of these fiduciary activities are reported in the City's

Comprehensive Annual Financial Report as separate financial statements of fiduciary net assets and changes in fiduciary net assets.

Basis of Accounting and Measurement Focus

Governmental funds account for their activities using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures are generally recorded when a liability is incurred, as in the case of full accrual accounting. Debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due; however, those expenditures may be accrued if they are to be liquidated with available resources.

Imposed non-exchange revenues, such as real estate taxes, are recognized when the enforceable legal claim arises and the resources are available. Derived tax revenues, such as wage, business privilege, net profits and earnings taxes, are recognized when the underlying exchange transaction has occurred and the resources are available. Grant revenues are recognized when all the applicable eligibility requirements have been met and the resources are available. All other revenue items are considered to be measurable and available only when cash is received by the City.

Revenue that is considered to be program revenue includes: (1) charges to customers or applicants for goods received, services rendered or privileges provided, (2) operating grants and contributions, and (3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program specific revenues; therefore, all taxes are considered general revenues.

The City's financial statements reflect the following three funds as major Governmental Funds:

The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in other funds.

The HealthChoices Behavioral Health Fund accounts for resources received from the Commonwealth. These resources are restricted to providing managed behavioral health care to Philadelphia residents.

The Grants Revenue Fund accounts for the resources received from various federal, state and private grantor agencies. The resources are restricted to accomplishing the various objectives of the grantor agencies.

The City also reports on Permanent Funds, which are used to account for resources legally held in trust for use by the park and library systems of the City. There are legal restrictions on the resources of the funds that require the principal to remain intact, while only the earnings may be used for the programs.

The City reports on the following Fiduciary Funds:

The Municipal Pension Fund accumulates resources to provide pension benefit payments to qualified employees of the City and certain other quasi-governmental organizations.

The Philadelphia Gas Works Retirement Reserve Fund accounts for contributions made by PGW to provide pension benefit payments to its qualified employees under its noncontributory pension plan.

The City reports the following major Proprietary Funds:

The Water Fund accounts for the activities related to the operation of the City's water delivery and sewage systems.

The Aviation Fund accounts for the activities of the City's airports.

The Industrial Land Bank Fund accounts for the activities of the City's inventory of commercial land sites.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's ongoing operations. The principal operating revenues of the Water Fund are charges for water and sewer service. The principal operating revenue of the Aviation Fund is charges for the use of the airport. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. The principal operating revenues of the Industrial Land Bank Fund come from sales of land sites, while the operating expenses are comprised of land purchases and improvements made thereon. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Legal Compliance

The City's budgetary process accounts for certain transactions on a basis other than generally accepted accounting principles (GAAP). In accordance with the Philadelphia Home Rule Charter, the City has formally established budgetary accounting control for its operating and capital improvement funds.

The operating funds of the City, consisting of the General Fund, seven Special Revenue Funds (County Liquid Fuels Tax, Special Gasoline Tax, HealthChoices Behavioral Health, Hotel Room Rental Tax, Grants Revenue, Community Development and Car Rental Tax Funds) and two Enterprise Funds (Water and Aviation Funds), are subject to annual operating budgets adopted by City Council. Included with the Water Fund is the Water Residual Fund. These budgets appropriate funds for all City departments, boards and commissions by major class of expenditure within each department. Major classes are defined as: personal services; purchase of services; materials and supplies; equipment; contributions, indemnities and taxes; debt service; payments to other funds; and advances and other miscellaneous payments. The appropriation amounts for each fund are supported by revenue estimates and take into account the elimination of accumulated deficits and the re-appropriation of accumulated surpluses to the extent necessary. All transfers between major classes (except for materials and supplies and equipment, which are appropriated together) must have councilmanic approval. Appropriations that are not expended or encumbered at year-end are lapsed.

The City Capital Improvement Fund budget is adopted annually by the City Council. The Capital Improvement budget is appropriated by project for each department. All transfers between projects exceeding twenty percent of each project's original appropriation must be approved by City Council. Any funds that are not committed or expended at year-end are lapsed.

Schedules prepared on the legally enacted basis differ from the generally accepted accounting principles (GAAP) basis in that both expenditures and encumbrances are applied against the current budget, adjustments affecting activity budgeted in prior years are accounted for through fund balance or as reduction of expenditures and certain interfund transfers and reimbursements are budgeted as revenues and expenditures.

Budget Procedure

At least ninety days before the end of the Fiscal Year the operating budget for the next Fiscal Year is prepared by the Mayor and must be submitted to City Council for adoption. The budget, as adopted, must be balanced and provide for discharging any estimated deficit from the current Fiscal Year and make appropriations for all items to be funded with City revenues. The Mayor's budgetary estimates of revenues for the ensuing Fiscal Year and projection of surplus or deficit for the current Fiscal Year may not be altered by City Council. Not later than the passage of the operating budget ordinance, City Council must enact such revenue measures as will, in the opinion of the Mayor, yield sufficient revenues to balance the budget.

At least thirty days before the end of each Fiscal Year, City Council must adopt by ordinance an operating budget and a capital budget for the ensuing Fiscal Year and a capital program for the six ensuing years. Within ten days after the adoption of each of such ordinances and their receipt by the Mayor, the Mayor must act upon such ordinances or the ordinances become effective.

The capital program is prepared annually by the City Planning Commission to present the capital expenditures planned for each of the six ensuing Fiscal Years, including the estimated total cost of each project and the sources of funding (local, state, Federal, and private) estimated to be required to finance each project. The capital program is reviewed by the Mayor and transmitted to City Council for adoption with his recommendation thereon. See Table C-11 for a summary of the City's capital improvement program for the Fiscal Years 2006 through 2011.

The capital budget ordinance, authorizing in detail the capital expenditures to be made or incurred in the ensuing Fiscal Year from funds that City Council appropriates, is adopted by City Council concurrently with the capital program. The capital budget must be in full conformity with that part of the capital program applicable to the Fiscal Year that it covers.

Awards

For the twenty-fourth consecutive year, the Government Finance Officers Association of the United States and Canada (GFOA) awarded its prestigious Certificate of Achievement for Excellence in Financial Reporting to the City for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004. The City received this recognition by publishing a report that was well organized and readable and satisfied both generally accepted accounting principles and applicable legal requirements.

CITY CASH MANAGEMENT AND INVESTMENT POLICIES

Consolidated Cash

The Act of the General Assembly of the Commonwealth of June 25, 1919, P.L. 581, Art. XVII, § 6, gives the City the authority to make temporary inter-fund loans between operating and capital funds.

The Consolidated Cash Account provides for the physical commingling of the cash of all City Funds, except those which, for legal or contractual reasons, cannot be commingled (e.g., the Municipal Pension Fund, sinking funds, certain capital project funds, sinking fund reserves, funds of PGW, the Water Fund, the Aviation Fund and certain other restricted purpose funds). A separate accounting is maintained for the equity of each member fund in the Consolidated Cash Account. The City manages the Consolidated Cash Account pursuant to written procedures adopted by the Office of Director of Finance.

To the extent that any member fund temporarily experiences the equivalent of a cash deficiency, the required advance is made from the Consolidated Cash Account, in the amount necessary to result in a zero balance in the cash equivalent account of the borrowing fund. All subsequent net receipts of a borrowing fund are applied in repayment of the advance.

All advances are made within the budgetary constraints of the borrowing funds. Within the General Fund, this system of inter-fund advances has historically resulted in the temporary use of tax revenues or other operating revenues for capital purposes and the temporary use of capital funds for operating purposes.

Written procedures governing the City's cash management operations require the General Fund-related operating fund to borrow initially from the General Fund-related capital fund, and only to the extent there is a deficiency in such fund may the General Fund-related operating fund borrow money from any other funds in the Consolidated Cash Account.

Investment Practices

Cash balances in each of the City's funds are invested by the City Treasurer's Office through the use of money market mutual funds and professional money managers under contract with the City. The Director of Finance adopted a written Investment Policy (the "Policy") which went into effect in August 1994 and was revised most recently in April 2001.

The Policy delineates the authorized investments as approved by City Council Ordinance and the funds to which the Policy applies. The authorized investments include U.S. Government Securities, U.S. Treasuries, U.S.

Agencies, Certificates of Deposit, Bankers Acceptance Notes, Eurodollar Deposits, Euro Certificates of Deposit, Commercial Paper, Corporate Bonds, Money Market Mutual Funds, Repurchase Agreements and Commonwealth of Pennsylvania securities, all of investment grade rating or better. Each category of instruments, excluding U.S. Government, Treasury and Agency securities which carry no limitation, is limited to investment of no more than 25% of the total portfolio, and no more than 10% of the total portfolio per institutional or corporate issuer. The Policy also restricts investments to those having a maximum maturity of two years. Daily liquidity is maintained through the use of SEC-registered money market mutual funds with the balance of funds invested by money managers in accordance with the Policy.

The Policy provides for an ad hoc Investment Committee consisting of the Director of Finance, the City Treasurer and the Deputy City Treasurer with ex-officio membership of a representative of each of the principal operating and capital funds, i.e., Water Fund, Aviation Fund, Philadelphia Gas Works and Philadelphia Municipal Authority. The Investment Committee meets quarterly with each of the investment managers to review each manager's performance to date and to plan for the next quarter. Investment managers are given any changes in investment instructions at these meetings. All changes in the Policy are approved by the Investment Committee.

The Policy expressly forbids the use of any derivative investment product whose yield or market value does not follow the normal swings in interest rates. Investment in derivatives such as "inverse floaters," leveraged variable rate debt and interest-only or principal-only Collateralized Mortgage Obligations are specifically forbidden. The use of any other derivative investment products is restricted to identified "core cash" in any fund but never to exceed 25% of any fund's balance at the time of purchase. If the market values fall 5% below cost, a written explanation is required from the investment manager outlining the reasons for the decline and outlining the steps, if any, that are needed to correct the situation.

General Fund Cash Flow

Because the receipt of General Fund revenues lags behind expenditures during most of each fiscal year, the City issues notes in anticipation of General Fund revenues and makes borrowings from the Consolidated Cash Account to finance its on-going operations. The City has issued notes in anticipation of the receipt of income by the General Fund in each fiscal year since Fiscal Year 1972. Each issue was repaid when due, prior to the end of the fiscal year.

The timing imbalance referred to above results from a number of factors, principally the following: (1) real property, business privilege tax and certain other taxes are not due until the latter part of the fiscal year; (2) the City makes the majority of the employer's contribution to the Municipal Pension Fund in July of each year; and (3) the City experiences lags in reimbursement from other governmental entities for expenditures initially made by the City in connection with programs funded by other governments.

DISCUSSION OF FINANCIAL OPERATIONS

Fiscal Year 2004 Results

The City ended Fiscal Year 2004 on the legally enacted basis with a fund balance deficit of \$46.8 million. This deficit is largely the result of delayed State reimbursements for child welfare costs under Act 148. Over \$90 million, representing the second and third quarter reimbursements and the fourth quarter advance, was received in September and was not accrued, in accordance with GASB guidelines. Had the funds been received on a timely basis, the FY2004 fund balance would have been \$45.1 million. This would have been a decrease of \$46.2 million from the FY2003 fund balance of \$91.3 million.

Fiscal Year 2005 Results

The City ended Fiscal Year 2005 on the legally enacted basis with a fund balance surplus of \$96.2 million. This surplus is due to strict budget management and improved tax collections. Personnel services were \$14.2 below budget due to a workforce right sizing program and both the Business Privilege Tax and the Realty Transfer Tax significantly exceeded budget projections by \$69.7 million.

Fiscal Year 2006 Budget

The City's Fiscal Year 2006 budget was approved by City Council on June 2, 2005 and signed by the Mayor on June 16, 2005. This budget was prepared by the City in conjunction with the Fourteenth Five-Year Plan. The Fourteenth Five-Year Plan, which covers Fiscal Years 2006-2010, was approved by City Council on June 16, 2005. On June 21, 2005, PICA requested the City to make revisions to the Fourteenth Five Year Plan relating to the City's estimates of certain revenues. The City responded to the PICA requests and submitted a revised Fourteenth Five Year Plan to PICA on July 20, 2005. PICA approved the Plan on July 21, 2005.

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Table C-1
City of Philadelphia General Fund
Summary of Operations (Legal Basis) (Amounts In Millions of USD)

	2001	2002	2003	2004	Audited 2005	Adopted Budget 2006
EVENUES						
Real Property Taxes	363.4	373.6	361.1	377.7	392.7	394.3
Personal Property Taxes	0.8	0.0	0.0	0.0	0.0	0.0
Wage and Earnings Tax	1,047.2 ^(b)	1,006.0	1,013.4	1,049.6	1,073.6	1,086.7
Net Profits Tax	11.8	13.4	11.7	13.0	13.7	13.7
Business Privilege Tax	314.0 ^(b)	295.8	286.1	309.2	379.5	316.2
Sales Tax	111.3	108.1	108.0	108.0	119.9	114.8
Other Taxes ^(a)	130.0 ^(b)	148.2	156.3	202.2	250.9	217.9
Total Taxes	<u>1,977.7</u>	<u>1,945.4</u>	<u>1,936.6</u>	<u>2,059.6</u>	<u>2,230.3</u>	<u>2,143.5</u>
Locally Generated Non-Tax Revenue	204.5	207.1	245.2	207.4	200.9	243.7
Revenue from Other Governments	748.8	687.7	876.6	801.1	1,054.6	1,052.0
Receipts from Other City Funds	24.0	24.7	27.3	24.7	26.3	27.5
Total Revenue	<u>2,955.1</u>	<u>2,866.9</u>	<u>3,085.7</u>	<u>3,092.8</u>	<u>3,512.1</u>	<u>3,466.8</u>
OBLIGATIONS/APPROPRIATIONS						
Personnel Services	1,173.3	1,188.3	1,246.7	1,278.3	1,243.5	1,249.9
Purchase of Services	871.8	920.5	1,007.1	1,050.3	1,090.1	1,154.2
Materials, Supplies and Equipment	84.0	80.0	76.0	70.6	71.5	71.2
Employee Benefits	483.4	485.8	540.6	598.9	704.7	754.5
Indemnities, Contributions and Grants	82.4	123.8	122.9	95.1	113.5	109.3
City Debt Service	88.2	101.8	97.1	93.7	89.7	80.3
Other	72.9	30.2	32.4	32.0	36.7	38.6
Payments to Other City Funds	25.5	50.7	30.4	29.1	36.6	24.3
Total Obligations/Appropriations	<u>2,881.5</u>	<u>2,981.1</u>	<u>3,153.2</u>	<u>3,248.2</u>	<u>3,386.3</u>	<u>3,482.3</u>
Operating Surplus for the Year	73.6	(114.2)	(67.5)	(155.4)	125.8	(15.4)
Net Adjustments – Prior Year	(138.7) ^(c)	23.2	19.8	17.3	17.2	18.0
Funding for Contingencies	0.0	0.0	0.0	0.0	0.0	0.0
Cumulative Fund Balance Prior Year	<u>295.1</u>	<u>230.0</u>	<u>139.0</u>	<u>91.3</u>	<u>(46.8)</u>	<u>26.7</u>
Cumulative Adjusted Year End Fund Balance (Deficit)	<u>230.0</u>	<u>139.0</u>	<u>91.3</u>	<u>(46.8)</u>	<u>96.2</u>	<u>29.2</u>

a) Includes Real Estate Transfer Tax, Parking Tax, Amusement Tax, and Other Taxes.

b) Accounting accrual changes required by GASB #33 resulted in additional one-time tax revenue accruals in Fiscal year 2001. (Wage Tax, \$50.4 million; Business Privilege, \$5.2 million; Other Taxes, \$4.3 million)

c) Reflects GASB #33's impact on prior year accruals.

FIGURES MAY NOT ADD DUE TO ROUNDING.

Table C-2
City of Philadelphia
Principal Operating Funds (Debt Related)
Summary of Operations
(Legal Basis)
(Amounts in Millions of USD)

	2001	2002	2003	2004	Audited 2005	Adopted Budget 2006
REVENUES						
General Fund	2,955.1	2,866.9	3,085.7	3,092.8	3,512.1	3,466.8
Water Fund ^(a)	410.3	404.2	440.8	438.3	451.4	505.9
Aviation Fund ^(b)	180.6	184.2	219.8	241.4	249.0	292.7
Other Operating Funds ^(c)	<u>29.1</u>	<u>35.8</u>	<u>39.2</u>	<u>39.0</u>	<u>38.6</u>	<u>167.3</u>
Total Revenue	<u>3,575.1</u>	<u>3,491.1</u>	<u>3,785.5</u>	<u>3,811.4</u>	<u>4,251.1</u>	<u>4,432.8</u>
OBLIGATIONS/APPROPRIATIONS						
Personnel Services	1,321.4	1,339.1	1,406.0	1,444.7	1,409.0	1,555.0
Purchase of Services	992.2	1,050.3	1,147.4	1,197.0	1,250.0	1,334.4
Materials, Supplies and Equipment	127.1	121.9	120.0	119.2	121.9	132.8
Employee Benefits	538.1	541.8	600.6	662.1	784.9	836.2
Indemnities, Contributions and Taxes	88.1	129.1	128.5	99.7	117.3	119.8
Debt Service ^(d)	296.2	330.7	358.0	344.6	336.8	356.2
Other	72.9	30.3	32.4	32.0	36.7	38.6
Payments to Other City Funds	<u>75.5</u>	<u>97.5</u>	<u>93.9</u>	<u>95.5</u>	<u>97.0</u>	<u>91.0</u>
Total Obligations/Appropriations	<u>3,511.5</u>	<u>3,640.7</u>	<u>3,886.8</u>	<u>3,994.8</u>	<u>4,153.6</u>	<u>4,464.1</u>
Operating Surplus (Deficit) for the Year	63.6	(149.6)	(101.3)	(183.4)	97.5	(31.4)
Net Adjustments Prior Year	(122.8)	43.1	50.2	41.0	45.8	36.1
Funding for Contingencies	0.0	0.0	0.0	0.0	0.0	0.0
Cumulative Fund Balance (Deficit) Prior Year End	<u>330.3</u>	<u>289.6</u>	<u>183.1</u>	<u>132.0</u>	<u>(10.4)</u>	<u>46.7</u>
Cumulative Adjusted Year End Fund Balance (Deficit)	<u>271.1</u>	<u>183.1</u>	<u>132.0</u>	<u>(10.4)</u>	<u>132.9</u>	<u>51.4</u>

- i) Revenues of the Water Fund are not legally available for payment of other obligations of the City until, on an annual basis, all revenue bond debt service requirements and covenants relating to those bonds have been satisfied, and then only to the extent of \$4,994,000 per year, provided certain further conditions are satisfied. From Fiscal Year 1991 to Fiscal Year 2003, the maximum transfer, per administrative agreement, was \$4,138,000. For Fiscal Year 2004, the budgeted transfer was not made. For Fiscal Year 2005, the transferred amount is budgeted at \$4,994,000.
- j) Airport revenues are not available for other City purposes.
- k) Includes County Liquid Fuels Tax Fund, Special Gasoline Tax Fund and Water Residual Fund.
- l) Excludes PICA bonds.

FIGURES MAY NOT ADD DUE TO ROUNDING.

Quarterly Reporting to PICA

On November 16, 1992, the City submitted the first of its quarterly reports to PICA. This reporting is required under the PICA Act so that PICA may determine whether the City is in compliance with the then-current Five-Year Plan. Under the PICA Act, a "variance" is deemed to have occurred as of the end of a reporting period if (i) a net adverse change in the fund balance of a covered fund of more than 1% of the revenues budgeted for such fund for that fiscal year is reasonably projected to occur, such projection to be calculated from the beginning of the fiscal year for the entire fiscal year, or (ii) the actual net cash flows of the City for a covered fund are reasonably projected to be less than 95% of the net cash flows of the City for such covered fund for that fiscal year originally forecast at the time of adoption of the budget, such projection to be calculated from the beginning of the fiscal year for the entire fiscal year. The Mayor is required to provide a report to PICA that describes actual or current estimates of revenues, expenditures, and cash flows by covered funds compared to budgeted revenues, expenditures, and cash flows by covered funds for such previous quarterly or monthly period and for the year-to-date period from the beginning of the then-current fiscal year of the City to the last day of the fiscal quarter or month, as the case may be, just ended. Each such report is required to explain any variance existing as of such last day.

PICA may not take any action with respect to the City for variances if the City (i) within 30 days provides a written explanation of the variance that PICA deems reasonable; (ii) within 45 days proposes remedial action that PICA believes will restore overall compliance with the then-current Five-Year Plan; (iii) provides information in the immediately succeeding quarterly financial report demonstrating to the reasonable satisfaction of PICA that the City is taking remedial action and otherwise complying with the then-current Five-Year Plan; and (iv) submits monthly supplemental reports as required by the PICA Act.

The City submitted its Fourteenth Five Year Plan to PICA on January 25, 2005. The City's most recent quarterly report was submitted to PICA on May 16, 2005. On June 21, 2005, PICA requested the City to make revisions to the Fourteenth Five Year Plan relating to the City's estimates of certain revenues. The City responded to the PICA requests and submitted a revised Fourteenth Five Year Plan to PICA on July 20, 2005. PICA approved the Plan on July 21, 2005.

REVENUES OF THE CITY

General

In 1932, the Pennsylvania General Assembly adopted an act (commonly referred to as the Sterling Act) under which the City was permitted to levy any tax that was not specifically pre-empted by the Commonwealth. Prior to 1939, the City relied heavily upon the real property tax as the mainstay of its revenue system. Acting under the Sterling Act and other legislation, the City has taken various steps over the years to reduce its reliance on real property taxes as a source of income, including: (1) enacting the wage, earnings, and net profits tax in 1939; (2) introducing a sewer service charge to make the sewage treatment system self-sustaining after 1945; (3) requiring under the Home Rule Charter that the water, sewer, and other utility systems be fully self-sustaining; and (4) enacting in 1952 the Mercantile License Tax (a gross receipts tax on business done within the City), which was replaced as of the commencement of Fiscal Year 1985 by the Business Privilege Tax.

Major Revenue Sources of Principal Operating Funds (Debt Related)

The City derives its revenues primarily from various taxes, non-tax revenues, and receipts from other governments. See Table C-3 for revenues by major source for Fiscal Years 1997-2006 and Table C-4 for General Fund tax revenues for Fiscal Years 2001-2006. The following description does not take into account revenues in the Non-Debt Related Funds. The tax rates for Fiscal Years 1995 through 2004 are contained in the Fiscal Year 2004 Comprehensive Annual Financial Report.

Real Property Taxes — A real estate tax on all taxable real property is levied at a rate of 82.64 mills on the assessed value of residential and commercial property located within the City's boundaries. From Fiscal Year 2003 onward, the City's portion of the rate is 34.74 mills and the School District's portion is 47.90 mills.