SUFFOLK COUNTY WATER AUTHORITY

2002 Annual Report

ensuring the safety and security of drinking water we supply to...

over 1.2 million Suffolk County residents

Revenues
(dollars in millions)

Expenses
(dollars in millions)

Miles of Main
(miles in thousands)

Financial Highlights

	2002	1993	10-Year Growth	Percent Change
Customers	358,118	308,352	60,399	20%
Miles of Main	5,433	4,564	869	19%
Fire Hydrants	33,351	28,181	5,170	18%
Water Pumped (Billion Gallons)	67.6	46.5	22	49%
Employees	610	586	24	4%
Gross Revenues	$ 128,195,000	$ 72,577,000	$ 55,618,000	77%
Expenses	64,842,000	46,330,000	18,512,000	40%
Water Plant at Cost	1,029,304,000	593,436,000	435,868,000	73%
Bonded Indebtedness	489,200,000	274,325,000	214,875,000	78%
Total Cumulative Earnings	270,765,000	133,349,000	137,416,000	103%

2001–2002 Highlights

	May 31, 2002	May 31, 2001
Total Revenues	$ 128,195,000	$122,950,000
Operating and Maintenance Expense	64,842,000	62,211,000
Interest on Bonds and Notes	21,196,000	22,098,000
Depreciation	18,265,000	17,188,000
Revenues Invested in Facilities before Extraordinary Loss	23,892,000	21,453,000
Extraordinary Loss	4,368,000	0
Revenues Invested in Facilities	19,524,000	21,453,000
Total Water Plant at Cost	1,029,304,000	972,571,000
Net Additions to Water Plant	56,733,000	53,617,000
Customers (Active Service)	358,118	352,763
Miles of Main in Service	5,433	5,269
Fire Hydrants in Service	33,351	32,829
Water Production (Billion Gallons)	67.6	63.8

Authority Profile

The SCWA is a self-supporting, public benefit corporation operating by virtue of the Public Authorities Law of the State of New York. It is without taxing power and operates as a business enterprise. The Authority is neither an agency of New York State nor Suffolk County Government.

The majority of the revenue the Authority receives is that obtained from the sale of water to its customers. The Authority is non-profit; all revenue received must be used for operating expenses, construction costs, and for paying outstanding debts.

The Suffolk County Water Authority is the largest groundwater supplier in the nation and has been operating for 51 years. Currently, the SCWA serves more than one million Suffolk County residents. The Authority is operated solely for the benefit of the customers it serves.

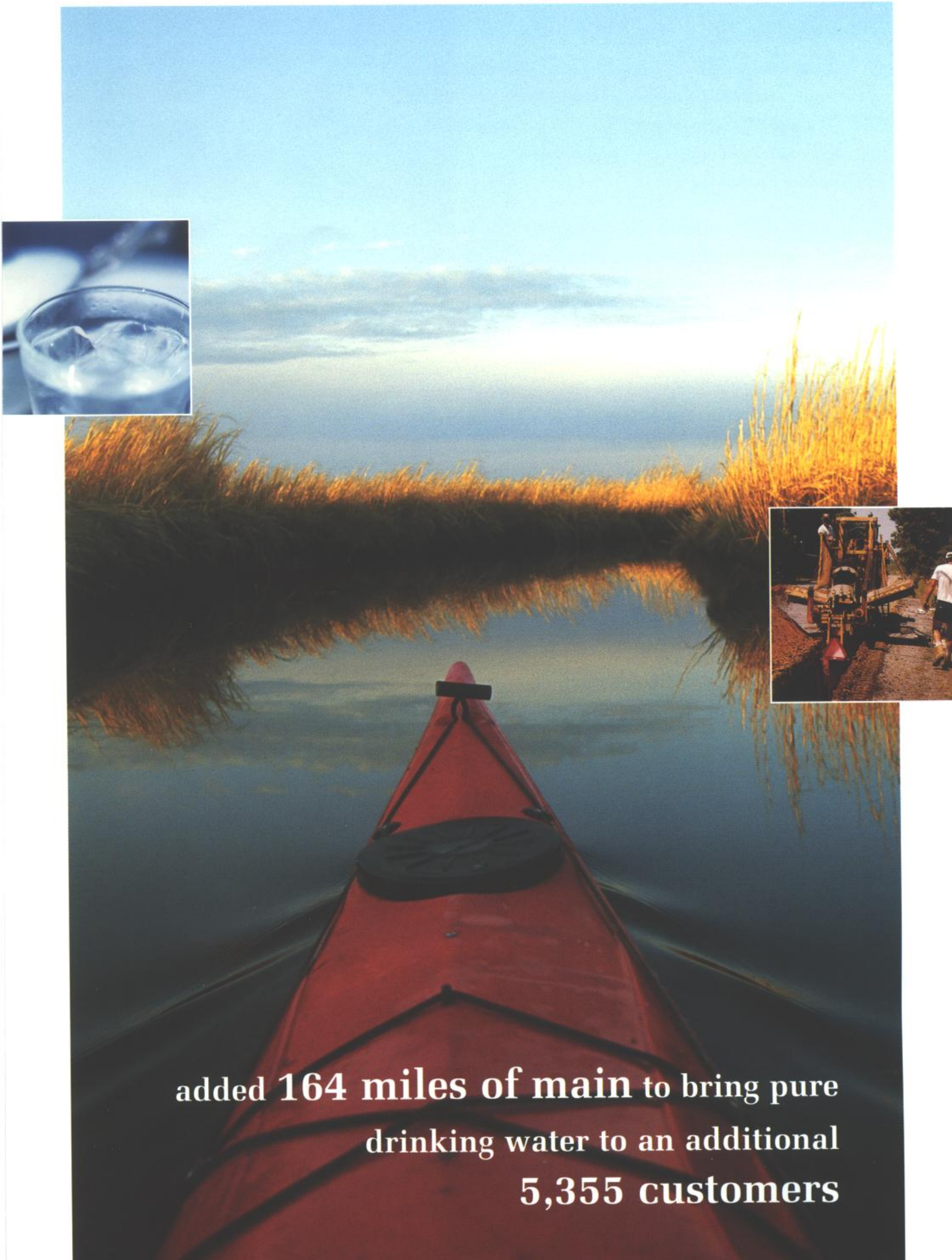
Our efforts remained focused, as they always have, on providing our customers with a pure, safe and reliable supply of drinking water.

Chairman's Message:

The year 2001 was an extraordinary year that tested the resolve of the Authority, the people of New York, and of our nation. The Authority faced new challenges that heretofore were only discussed in theoretical terms. Amid the upheaval caused by the terrorist attacks of September 11, 2001 and thereafter, our employees, like all Americans, rose to meet the challenges before them. Our efforts remained focused, as they always have, on providing our customers with a pure, safe and reliable supply of drinking water. System security and asset protection moved to the highest level of importance. Fortunately, our past seven years' work in system control and monitoring through our Supervisory Control and Data Acquisition System (SCADA) enabled us to provide the level of security being called for by the industry and law enforcement agencies. Upholding their reputation for responding best to the toughest situations, our staff reacted with the highest levels of professionalism, dedication, and self-sacrifice to ensure the safety and security of the drinking water we supply to over 1.2 million Suffolk County residents. The Board and I are extremely proud of their efforts immediately following the attacks and thereafter.

While many of our activities centered on the events of September 11, 2001 and its aftermath, the day-to-day operations of the Water Authority continued, and marked advances were made on many fronts. While the financial markets continued to weaken, we were able to maintain our strong financial standing through prudent fiscal management policies. Revenues before interest and depreciation and amortization expense were 2.24 times the debt service requirement and the Authority maintained its excellent AA rating, the highest category bond rating of any revenue Authority in New York State.

During the fiscal year, we defeased $72 million in outstanding bonds to reduce higher interest rate debt. We continue to actively use short-term variable rate bond anticipation notes to take advantage of current low interest rate markets to finance construction, which annually approximates $50 million. We are currently favoring long-term capital improvements financed through the New York State Environmental



added 164 miles of main to bring pure drinking water to an additional 5,355 customers

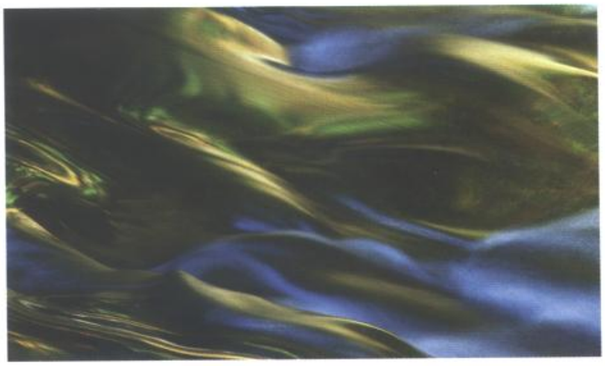
Our staff reacted with the **highest levels of professionalism, dedication and self sacrifice** to ensure the safety and security of our drinking water.

Suffolk County Water Authority staff member

Facilities Corporation, which is subsidized by the New York State Water Revolving Fund. This combination of funding, in addition to normal revenue inflows, made it possible last year to add 164 miles of main, 522 fire hydrants, and most importantly, bring pure drinking water to an additional 5,355 customers. Our conservative fiscal policies, hiring practices, and tight management enabled us to project, absent a significant change in regulatory requirements, a three-year rate freeze for our customers in April 2002, a welcome relief for many of our customers who are experiencing the effects of the downturn in the economy.

On the horizon, we expect more stringent water quality standards and the need to service customers in more remote areas to add to operating costs. Increased employee health insurance and retirement costs as well as aging infrastructure in certain parts of our service territory will also call upon the resources of the Authority. However, given the large and high quality water supply in the aquifers that lie beneath us, and a customer base of nearly 360,000, of which 95 percent is residential, we are confident that the Authority's financial future will remain strong.

Operational challenges were met successfully during the fiscal year. Demand for water continued to increase to record levels. In the fiscal year, we pumped 67.6 billion gallons of water, an increase of 45% over the same period ten years ago. In large part, this record water usage has resulted from the installation of automated in-ground irrigation systems that proliferated through the heady economic times of the 1990's. While certainly good for the Authority's revenues, operationally, these systems have presented a significant challenge. Most automatic watering systems are programmed to begin watering in the early hours of the morning. This demand for water, coupled with early morning domestic demand for water, has placed a tremendous stress on our wells, tanks, and mains and has created peak-hour low-pressure situations in certain parts of our system. Certain of these low-pressure problem areas have been corrected through system design modifications and construction. However, rather than spending millions of dollars over the next several years to install larger water mains, build additional elevated tanks, and dig new wells to meet this peak demand, which exists from the late spring through the end of summer, it was decided that a new



We continued to support groundwater and aquifer research through the funding of the Long Island Groundwater Research Institute at Stony Brook University. The Institute not only conducts research but also serves as a vehicle for interested parties to obtain accurate information regarding our ground water supply and associated environmental concerns.

direction which would spread overall demand and decrease peak demand was necessary.

This past spring, we launched a major advertising campaign promoting odd/even lawn watering among our customers. Using both print and radio advertisements, we encouraged our customers to water their properties on odd or even calendar days, based upon their street number, and at times other than early in the morning. While the media was quick to pick up on this new idea, especially since the region was in the midst of a drought, we believe that it will take several years of promotion before our customers accept the program. Coupled with this new message, we also began to promote organic lawn and gardening techniques in an effort to reduce pesticide and herbicide use, both of which can eventually find their way into the groundwater. We believe that both odd/even watering, to reduce peak demand, and reduced pesticide and herbicide use, to avoid future filtration costs, will be beneficial environmentally and financially.

The Water Authority continued its role of Groundwater Guardian through the year. In addition to the aforementioned odd/even watering and organic gardening programs, we continued to support groundwater and aquifer research through the funding of the Long Island Groundwater Research Institute at Stony Brook University. The Institute not only conducts research but also serves as a vehicle for interested parties to obtain accurate information regarding our groundwater supply and associated environmental concerns. We have also strengthened our ties with responsible environmental organizations on Long Island such as The Neighborhood Network, which has provided invaluable assistance and technical advice in developing our organic lawn care program for our customers.

Twice during the year, we made use of an environmentally friendly and cost effective drilling technique to bring potable water to certain neighborhoods in Mattituck and to improve water supply and pressures for the Great River area. Called directional bore, this trench-less technique involved drilling under Long Creek in Mattituck and the Connetquot River in Great River with minimal environmental disturbance. In May, we announced a six-month moratorium of new customer hook-ups on the North Fork.

Since 1951, we have provided generations of customers with water that is pure, safe and constantly tested.

Michael A. LoGrande, Chairman

"It is this independence mandated by state law that has allowed us to make **extraordinary progress.**"

The fragile freshwater aquifer which supplies the North Fork has been impacted by the chemical by-products of farming as well as the surrounding salt-water of the Long Island Sound and the Peconic Bays and is of limited quality. This moratorium will allow us to study alternate sources of drinking water supply for the area so that we can ultimately supply those residents who do not have reliable potable water. This moratorium will also allow Southold Town to further develop its local zoning ordinances to control growth and development.

The fiscal year of 2001/2002 presented challenges that were never encountered before, with the aftermath of the September 11th attacks being the most important new challenge. While safeguarding the water system from potential terrorist activities has demanded a great deal of our attention and will continue to do so into the future, we have not diminished any of our other priorities. We continued to improve water quality and distribution systems, improved staff training and recruitment of top professionals, and protected and improved our properties to preserve overall value. We have been extraordinarily successful in strengthening and expanding our financial condition such that we are considered one of the best-managed Authorities in New York State from both a financial and operational standpoint.

It is important that the Authority remain as independent as possible in accordance with the Public Authorities Laws of New York State to protect the bondholders and ratepayers from any interference from any outside agencies without legal jurisdiction. We hold this responsibility to our bondholders and ratepayers as sacred. It is this philosophy and the independence mandated by state laws that has allowed us to make the extraordinary progress of this year and the past decade as well.

Michael A. LoGrande

Michael A. LoGrande

Authority Members *(from left to right):*
John E. Gee, Jr., Eric J. Russo, Esq., George Proios, Michael A. LoGrande and Melvin M. Fritz, D.O., M.D.

Authority Members

Michael A. LoGrande
Chairman

Melvin M. Fritz, D.O., M.D.
Secretary

John E. Gee, Jr.

Eric J. Russo, Esq.

George Proios

Management Staff

Stephen M. Jones
Chief Executive Officer

Nicolo DiBartolo
Chief Financial Officer

Michael R. Frank
Deputy Chief Executive Officer for Customer Service

Herman J. Miller, P. E.
Deputy Chief Executive Officer for Operations

Michael Stevenson
Deputy Chief Executive Officer for Administration

Timothy J. Hopkins, Esq.
General Counsel

William C. Arabio
Director of Information Services

Steven T. Burns, P. E.
Director of Distribution

Robert L. Murray
Director of Production Control

Joseph M. Pokorny, P. E.
Chief Engineer

Karen A. Randazzo
Director of Laboratory Services

Steven Romano
Director of Customer Service

Consultants

Van Nostrand & Martin
Counsel

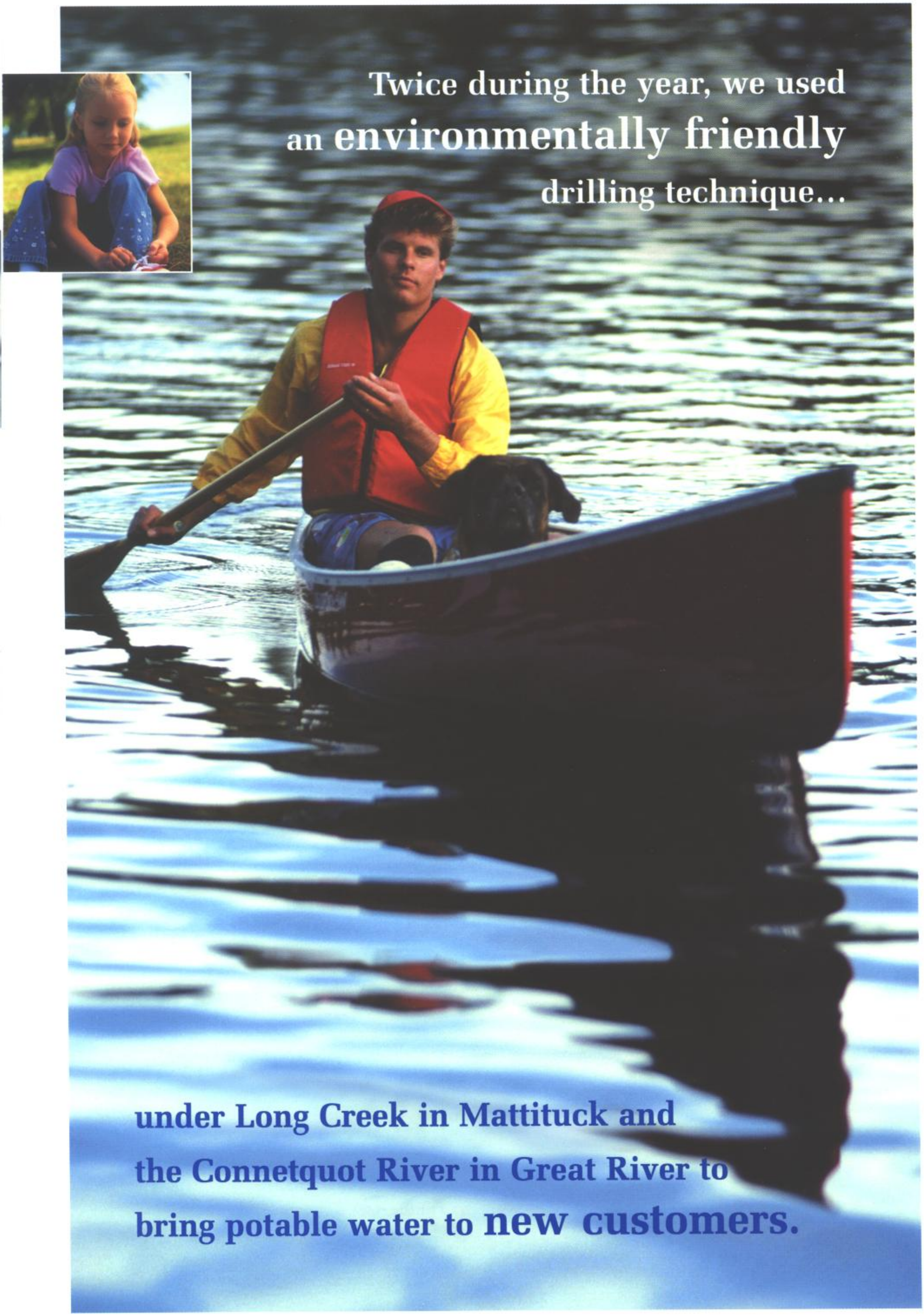
United States Trust Company of New York
Bond Trustee

PricewaterhouseCoopers LLP
Independent Accountants

Salomon Smith Barney
Financial Consultant

Nixon Peabody
Bond Counsel

Leggette, Brashears & Graham, Inc.
Consulting Groundwater Geologists



Twice during the year, we used an **environmentally friendly** drilling technique...

under Long Creek in Mattituck and the Connetquot River in Great River to bring potable water to **new customers.**

Financial Statements

Suffolk County Water Authority

Balance Sheets

May 31, 2002 and 2001

(Amounts in thousands)

Suffolk County Water Authority

	2002	2001
ASSETS		
Water plant, at cost less accumulated depreciation	**$ 808,613**	$769,354
Current assets		
Cash and cash equivalents	**4,590**	3,963
Investments	**68,305**	66,210
Accounts receivable, less allowance for doubtful accounts of $849	**8,486**	9,174
Accrued water services and fire protection revenues	**13,988**	16,387
Interest and other receivables	**861**	959
Materials and supplies, at average cost	**4,550**	4,512
Prepayments and other current assets	**2,117**	1,571
Total Current Assets	**102,897**	102,776
Investments	**24,423**	39,632
Debt service reserve and bond funds	**24,668**	25,769
Construction fund	**52,776**	22,399
Intangible assets	**4,839**	4,990
Deferred charges and other assets	**4,735**	5,958
	111,441	98,748
Total Assets	**$1,022,951**	$970,878
CAPITALIZATION AND LIABILITIES		
Capitalization		
Bonds payable, less current portion and unamortized discount	**$ 310,392**	$362,741
Bond anticipation notes payable	**138,100**	90,500
Contributions in aid of construction	**215,153**	202,751
Revenue invested in facilities	**270,765**	251,241
Total Capitalization	**934,410**	907,233
Current liabilities		
Current maturities on bond anticipation notes payable	**32,300**	—
Current maturities of bonds payable	**8,408**	10,078
Accounts payable	**5,193**	7,544
Accrued interest	**7,400**	9,187
Accrued employee welfare	**5,711**	5,408
Other accrued liabilities	**4,101**	2,984
Customer deposits	**4,888**	5,120
Deferred revenue	**1,000**	1,000
Accrued retirement contributions	**264**	403
Total Current Liabilities	**69,265**	41,724
Advances for construction	**17,694**	19,146
Deferred revenue	**1,000**	2,000
Obligation under capital lease	**582**	775
Commitments and contingencies	**—**	—
Total Capitalization and Liabilities	**$1,022,951**	$970,878

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

Statements of Revenue and Revenue Invested in Facilities
For the Years Ended May 31, 2002 and 2001
(Amounts in thousands)

Suffolk County Water Authority

	2002	2001
Revenue		
Operating	**$108,800**	$104,194
Interest income and other	**19,395**	18,756
Total revenue	**128,195**	122,950
Operating expenses		
Operations	**48,850**	46,816
Maintenance	**15,992**	15,395
Total operating expenses	**64,842**	62,211
Revenue invested in facilities before depreciation, amortization and interest expense	**63,353**	60,739
Deduct:		
Interest expense	**19,994**	20,641
Depreciation and amortization	**19,467**	18,645
	39,461	39,286
Revenue invested in facilities before extraordinary loss	**23,892**	21,453
Extraordinary loss	**4,368**	—
Revenue invested in facilities	**19,524**	21,453
At beginning of year	**251,241**	229,788
At end of year	**$270,765**	$251,241

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

Statements of Cash Flows
For the Years Ended May 31, 2002 and 2001
(Amounts in thousands)

Suffolk County Water Authority

	2002	2001
Cash flows from operating activities		
Revenue invested in facilities	**$ 19,524**	$ 21,453
Adjustments to reconcile revenue invested in facilities to net cash provided by operations		
Depreciation and amortization	**19,467**	18,645
Extraordinary loss	**4,368**	—
Changes in operating assets and liabilities		
Accounts receivable, net	**688**	674
Accrued water service and fire protection revenues	**2,399**	(4,365)
Interest and other receivables	**97**	227
Materials and supplies and prepayments	**(583)**	(863)
Other assets	**1,044**	1,542
Accounts payable	**(2,328)**	3,310
Accrued interest	**(1,787)**	198
Deferred revenue	**(1,000)**	(1,000)
Accrued retirement contributions	**(138)**	(704)
Accrued employee welfare	**303**	552
Other accrued liabilities	**1,117**	1,821
Customer deposits	**(232)**	(601)
Net cash provided by operating activities	**42,939**	40,889
Cash flows from investing activities		
Net proceeds from sales/(purchases) of investment securities	**13,115**	(26,909)
Net cash provided by (used in) investing activities	**13,115**	(26,909)
Cash flows from capital and related financing activities		
Defeasance of bonds payable	**(75,328)**	—
Additions to water plant, net of retirements	**(57,522)**	(55,656)
Disbursements from (designations to) the construction fund	**(30,377)**	30,150
Proceeds from issuance of EFC Bonds	**28,402**	15,988
Proceeds from issuance of water system revenue bonds	**—**	38,200
Proceeds from issuance of notes payable	**89,543**	—
Repayment of notes payable	**(10,100)**	(35,900)
Repayment of current maturities of Bonds payable	**(11,025)**	(9,407)
Repayment of capital lease obligation	**(217)**	(216)
Proceeds from advances for construction, net of refunds	**10,949**	10,569
Payment of bonds and notes payable issuance costs	**(853)**	(1,560)
Designations to the debt service reserve and bond funds	**1,101**	(4,942)
Net cash used in capital and related financing activities	**(55,427)**	(12,774)
Net increase (decrease) in cash and cash equivalents	**627**	1,206
Cash and cash equivalents at beginning of year	**3,963**	2,757
Cash and cash equivalents at end of year	**$ 4,590**	$ 3,963
Supplemental disclosures of cash flow information:		
Interest paid	**$ 21,840**	$ 21,397
Borrowings under capital lease obligation	**$ —**	$ 1,104

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Suffolk County Water Authority (the "Authority") is a public benefit corporation, created by resolution of the Suffolk County Board of Supervisors in 1937, with a two-fold purpose. The first was to acquire, construct, maintain and operate a public water supply for Suffolk County. The second was to develop a single, integrated public water supply and distribution system to serve all of Suffolk County. The accounts of the Authority are maintained generally in accordance with the Uniform System of Accounts prescribed by the New York State Public Service Commission ("PSC"), although the Authority is not subject to PSC rules and regulations. The rates established by the Authority do not require PSC or Suffolk County Legislative approval.

The Authority's financial statements are prepared in accordance with all applicable pronouncements of the Governmental Accounting Standards Board ("GASB"). In accordance with GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," the Authority also prepares its financial statements in accordance with all authoritative pronouncements applicable to non-governmental entities (i.e., Financial Accounting Standards Board ("FASB") statements) that do not conflict with GASB pronouncements.

Water Plant

Water plant is recorded at original cost. The capitalized cost of additions to water plant include charges for ancillary construction costs such as construction period interest, engineering, supervision, payroll taxes and pension benefits. The original cost of property replaced, retired or otherwise disposed of in ordinary retirements is deducted from plant accounts and together with costs to remove, less any salvage, is charged to accumulated depreciation. The costs of repairs, minor betterments and renewals are charged to maintenance expense as incurred. The Authority does not credit water plant for contributions in aid of construction.

Depreciation

Depreciation of water plant is provided on the straight-line basis using a composite annual rate of 2.14%, which is based on the average service lives and net salvage values of properties.

Cash and Cash Equivalents

Investments with maturity dates of ninety days or less are considered cash equivalents.

Debt Service Reserve and Bond Funds

In accordance with the 1988 General Bond Resolution, as amended (the "Resolution"), the Authority maintains a debt service reserve fund (or bond insurance, as described in Note 5) and a bond fund that is held by a Fiscal Agent.

The bond fund is used solely for the purpose of paying the principal and interest on the bonds, and for retiring the bonds prior to maturity. Amounts in the bond fund are invested in repurchase agreements, U.S. Treasury Notes and U.S. government securities.

Construction Fund

In accordance with the Resolution, monies in the construction fund are restricted to the costs of acquiring, constructing and replacing the water system.

Intangible Assets

Goodwill is recorded for the excess of the purchase price over the fair value of net assets acquired, and is being amortized over 40 years using the straight-line method.

Advances for Construction and Contributions in Aid of Construction

Under existing standard construction loan contracts with residential real estate developers and others, the developer advances to the Authority the estimated cost of new main installations. Upon completion of construction, the developer is either billed or refunded the difference between the advance and the actual cost. The resulting net completed cost is transferred to Contributions in Aid of Construction.

Contributions in Aid of Construction also includes the original cost of systems contributed to the Authority by municipalities and others as well as service, tapping and other fees.

Customer Deposits

As security for the payment of bills, the Authority generally requires a deposit from commercial customers and high volume water users. No interest is paid on such deposits.

Accrued Employee Welfare

The Authority accrues the expected value of all vacation and sick leave benefits earned by employees to date.

Revenue

Revenue is recognized based on actual customer water usage, including estimates for unbilled periods.

Income Taxes

As a public benefit corporation of the State of New York, the Authority is exempt from Federal, state and local income taxes.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, as well as disclosures within the financial statements. Actual results could differ from those estimates.

Concentration of Credit Risk

Financial instruments which subject the Authority to credit risk consist principally of residential, commercial and industrial customer receivables. The Authority maintains reserves for potential credit losses from such accounts receivable and actual losses have historically not been materially different from management's estimates.

Reclassifications

Certain fiscal 2001 balances have been reclassified in order to conform with the current year presentation.

Recent Accounting Pronouncements

Management's Discussion and Analysis for State and Local Governments

In June 1999, Governmental Accounting Standards Board issued GASB Statement No. 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments," which requires the basic financial statements to include management's discussion and analysis ("MD&A") and required supplementary information other than MD&A. The Authority will adopt GASB Statement No. 34 for periods beginning after the fiscal year ending May 31, 2002. The Authority does not expect that GASB No. 34 will have a significant impact on its financial position, revenues invested in facilities or cash flows.

Goodwill and Other Intangibles

In June 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 142, "Goodwill and Other Intangibles." This statement addresses financial accounting and reporting for acquired goodwill and other intangibles. The provisions of this statement are required to be applied starting with fiscal years beginning after December 15, 2001. As a result, management has estimated that amortization of intangibles will decrease annually by approximately $151 upon adoption, beginning on June 1, 2002.

Asset Retirement Obligations and Long-Lived Assets

In August 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations," and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," and addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The Authority does not expect the adoption of SFAS No. 143 and 144, effective June 1, 2002, to have a material impact on its financial position or results of operations.

Gains and Losses from Extinguishment of Debt

In April 2002, the Financial Accounting Standards Board issued SFAS No. 145, "Recission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This Statement rescinds FASB Statement No. 4, "Reporting Gains and Losses from Extinguishment of Debt" and an amendment of that Statement and FASB Statement No. 64, "Extinguishments of Debt

Made to Satisfy Sinking-Fund Requirements." SFAS No. 145 requires that gains and losses from extinguishment of debt be classified as extraordinary only if they meet certain provisions. The Authority does not expect the adoption of SFAS No. 145, effective June 1, 2002, to have a material impact on its financial position or results of operations.

2. WATER PLANT

	2002	2001
Land and land rights	$ 18,301	$ 17,644
Distribution systems	650,870	610,604
Wells, reservoirs and structures	89,390	84,518
Pumping and purification equipment	96,437	90,117
Other	56,044	54,362
Water plant in service	911,042	857,245
Less—accumulated depreciation	220,691	203,217
Net water plant in service	690,351	654,028
Construction in progress	118,262	115,326
Water plant	$808,613	$769,354

Depreciation expense amounted to $18,265 and $17,187 for the years ended May 31, 2002 and 2001, respectively.

Water plant includes approximately $1,104 of computer equipment recorded under a capital lease at May 31, 2002 and 2001.

3. CASH AND CASH EQUIVALENTS AND INVESTMENTS

Cash and Cash Equivalents

Cash consists of insured (FDIC) or collateralized deposits which have carrying values of $4,590 and $3,963 and bank balances of $9,953 and $5,197 at May 31, 2002 and 2001, respectively.

Investments

Investments consist of the following:

	2002	2001
Certificates of deposit	$ 13,775	$ 48,425
Debt service reserve and bond fund		
Repurchase agreements [a]	—	18,456
U.S. Treasury bills [a]	64	1,088
Short-term notes [a]	19,501	—
Medium-term notes [a]	—	4,306
Long-term notes [a]	5,082	1,778
Other [a]	21	141
Construction fund		
Certificates of deposit	10,400	8,700
Short-term notes [b]	19,475	—
Medium-term notes	20,613	13,572
Long-term notes [b]	2,163	—
Other [b]	125	127
Investment pool	45,207	41,318
Medium-term notes	33,705	16,099
Other	41	—
Investments*	$170,172	$154,010

(a) Funds are held by fiscal agent.
(b) Includes $20,210 of funds held by fiscal agent.
*Includes investments, construction fund, debt service reserve and bond funds.

Accrued interest on investments is included in interest and other receivables on the balance sheet. Investments bear interest rates that range from 1.32% to 6.8% and that mature at various dates through October 2022.

The Authority's investment policy states that securities underlying repurchase agreements must have a market value at least equal to the cost of the investment. All investments are either insured or registered and held by the Authority or its agent in the Authority's name.

The Authority's investment policies comply with the NYS Comptroller's guidelines for investment policies. Investment policies permit investments in, among others, obligations of the U.S. Treasury, its agencies, and repurchase agreements backed by such obligations. Investments are reported at fair market value.

In addition, the Authority invests in an external investment pool called New York Class. The pool invests in obligations permissible under the Authority's investment policies. The fair value of the position of the pool is equal to the value of the pool shares.

(Dollar amounts in thousands)

4. BONDS PAYABLE

Outstanding bonds are summarized as follows:

Series	Interest Rate	Final Maturity Date	May 31, 2001	Issued	Matured	Defeased	**May 31, 2002**
Water System Revenue Bonds							
(a) 1992B Senior Lien	5.10–5.63%	2017	$ 55,725	$ —	$ 480	$55,245	**$ —**
(a) 1993 Senior Lien	4.80–5.10%	2013	62,065	—	3,565	17,055	**41,445**
(a) 1993 Subordinate Lien	4.80–5.10%	2013	16,420	—	495	—	**15,925**
(a) 1994 Senior Lien	5.00%	2017	64,000	—	—	—	**64,000**
(a) 1994 Subordinate Lien	4.13–6.00%	2017	36,395	—	1,410	—	**34,985**
(a) 1997 Senior Lien	4.10–5.25%	2012	36,260	—	2,305	—	**33,955**
(a) 1997A Senior Lien	4.00–5.00%	2022	42,135	—	905	—	**41,230**
(b) 2001A Senior Lien	4.13–5.25%	2023	38,200	—	—	—	**38,200**
Environmental Facilities Corporation Revenue Bonds							
(b) 1998B	3.65–5.20%	2017	5,485	—	230	—	**5,255**
(b) 1999A	2.77–4.91%	2018	5,177	—	200	—	**4,977**
(b) 2000A	3.80–5.96%	2019	840		30	—	**810**
(b) 2000B	4.31–5.74%	2020	5,359	—	165	—	**5,194**
(b) 2001A	3.48–5.17%	2021	10,384	—	295	—	**10,089**
(b) 2001B	2.62–5.15%	2021	—	17,634	670	—	**16,964**
(b) 2002A	1.36–5.00%	2022	—	10,869	275	—	**10,594**
Total bonds outstanding			378,445	$28,503	$11,025*	$72,300	**323,623**
Less: Unamortized discount			5,626				**4,823**
Current maturities payable			10,078				**8,408**
			$362,741				**$310,392**

*Includes current year amortization.

(a) The payment of principal and interest is insured by a municipal bond insurance policy issued by MBIA Corporation or AMBAC Indemnity Corporation.

(b) The payment of principal and interest is assured by a minimum debt service fund balance maintained by the Authority.

Water System Revenue Bonds

The Water System Revenue Bonds were issued to finance the cost of acquisition and construction of improvements and additions to the water system. The Water System Senior Lien Revenue Bonds are payable solely from net revenues of the Authority's water system. The Water System Subordinate Revenue Bonds are payable solely from net revenues available after payment of debt service on Senior Lien Revenue Bonds issued by the Authority.

In March 2002, the Authority defeased its remaining Series 1992B Water System Revenue Bonds in the amount of $55,245, and $17,055 of its remaining Series 1993 Senior Lien Water System Revenue Bonds by making a payment of $75,328 to an irrevocable trust held by the Authority's fiscal agent. The transaction effectively transferred the obligation to repay the Series 1992B and $17,055 of the Series 1993 Senior Lien bonds from the Authority to the fiscal agent and therefore constituted a legal defeasance. The carrying amount of the bonds including current maturities, net of unamortized discount and issue costs of $1,340 was $70,960. The transaction resulted in an extraordinary loss of $4,368.

Environmental Facilities Corporation Revenue Bonds ("EFC Revenue Bonds")

The State of New York has established a State Drinking Water Program, which includes a State drinking water revolving fund (the "Revolving Fund") to be used for purposes of the Safe Drinking Water Act. The New York State Environmental Facilities Corporation (the "Corporation") is responsible for administering the Revolving Fund and to provide financial assistance from the Revolving Fund. The Corporation issues bonds in order to provide loans from the Revolving Fund to political subdivisions and public benefit corporations of the State of New York. The Authority has been issued a portion of the total bond proceeds in the amounts stated in the table above to finance safe drinking water projects.

On July 26, 2001, the Authority was issued $17,634 of proceeds under the Environmental Facilities Corporation 2001B Revenue Bond offering. The bonds have a final maturity date of May 26, 2021 and bear interest rates ranging from 2.62% to 5.15%. The interest cost of these bonds is subsidized by the State of New York drinking water revolving fund.

In March 2002, the Authority was issued $10,869 of proceeds under the Environmental Facilities Corporation 2002A Revenue Bond Offering. The bonds have a final maturity date of October 15, 2022 and bear interest at rates ranging from 1.21% to 5.00%. The interest cost of these bonds is subsidized by the State of New York drinking water revolving fund.

Interest expense on the bonds outstanding during the fiscal year was $18,232 and $17,516 for the years ended May 31, 2002 and 2001, respectively.

Bond maturities payable, including mandatory sinking fund redemptions, over the next five fiscal years are as follows:

Fiscal Year	Amount
2003	$ 8,408
2004	8,131
2005	8,359
2006	14,205
2007	16,680

5. DEBT SERVICE REQUIREMENTS

As prescribed in the Authority's Resolution, a minimum debt service reserve fund balance is to be maintained, which is the lesser of 10% of the proceeds of the Water System Revenue Bonds Series 1992B–1997A plus the EFC Revenue Bonds Series 1998B–2002A or the average of the annual installments of debt service with respect to Water System Revenue Bonds Series 1992B–2001A plus the EFC Revenue Bonds Series 1998B–2002A outstanding for the current and all future fiscal years. The Authority may purchase bond insurance in lieu of the debt service reserve fund requirement. The Authority has elected to maintain bond insurance on the Water System Revenue Bonds Series 1992B–1997A, for the payment of principal and interest on stated maturity and sinking fund installment dates and in the event of default by the Authority. For the Water System Revenue Bonds Series 2001A and EFC Revenue Bonds Series 1998B, 1999A, 2000A, 2000B, 2001A, 2001B and 2002A Bonds, the Authority elected to maintain a minimum debt service fund balance of 10% of the proceeds.

Revenue before interest expense and depreciation was equivalent to 2.24 times (2.26 in 2001) the debt service requirement, for the year ended May 31, 2002. The minimum debt service requirement on all bonds is 1.10.

6. NOTES PAYABLE

Outstanding bond anticipation notes ("BANS") payable are summarized as follows:

Series	Final Maturity Date	Balance at May 31, 2001	Issued	Redeemed	**Balance at May 31, 2002**
1997	11/01/02	$40,500	$ —	$ 8,200	**$ 32,300**
2000	05/01/05	50,000	—	1,900	**48,100**
2001	06/01/06	—	90,000	—	**90,000**
Total notes outstanding		$90,500	$90,000	$10,100	**$170,400**

These notes are issued in anticipation of the issuance of long-term revenue bonds or replacement BANS, the proceeds of which will be used to repay the notes payable.

These notes are periodically remarketed, and therefore, interest on these notes is based on the minimum interest rate that, under prevailing financial market conditions, enables the notes to be sold at par, subject to the applicable effective interest rate period. The effective interest rate period may be daily, weekly, monthly, or semi-annually. Interest is payable periodically, based upon the effective interest rate period, through November 1, 2002, May 1, 2005 and June 1, 2006, the date of principal maturity, for the 1997, 2000 and 2001 notes, respectively.

As of May 31, 2002 and 2001, the effective interest rate was 1.51% and 3.41%, respectively. Interest expense on the BANS was $2,785 and $4,243 for the years ended May 31, 2002 and 2001, respectively.

On June 27, 2001, the Authority issued $90,000 of variable rate bond anticipation notes to fund construction activities. The notes mature on June 1, 2006 and are expected to be periodically remarketed to bear interest based on the minimum interest rate that, under prevailing financial market conditions, enables the notes to be sold at par, subject to the applicable effective interest rate period.

7. PENSION PLAN

The Authority's employees are eligible to participate in the New York State and Local Employees' Retirement System, which is a cost-sharing, multi-employer, public employee retirement system. The benefits provided to members of this retirement system are established by New York State law and may be amended only by the State Legislature. The New York State and Local Employees' Retirement System issues a publicly available financial report. The report may be obtained from the New York State and Local Retirement Systems, Gov. Smith State Office Building, Albany, New York 12244. Benefit provisions vary as follows:

The Employees' Retirement System is subdivided into the following four classes:

Tier I — members who last joined prior to July 1, 1973.
Tier II — members who last joined on or after July 1, 1973 and prior to July 27, 1976.
Tier III — members who last joined on or after July 27, 1976 and prior to September 1, 1983.
Tier IV — members who joined on or after September 1, 1983.

Tier I members are eligible for retirement at age 55. If members retire with 20 or more years of total service, the service retirement benefit is 2% of the final average salary for each year of service. If members retire with less than 20 years of total service, the service retirement benefit is 1.66% of the final average salary for each year of service.

Tier II members are eligible to retire with full benefits at age 62; and with reduced benefits for retirement between ages 55 and 62. Retirement benefits are equivalent to Tier I members.

Tier III members with 5 or more years of credited service after July 1, 1973, are eligible to retire with full benefits at age 62 or at age 55 with 30 years of service and with reduced benefits for retirement between ages 55 and 62 with less than 30 years of service. Benefits are integrated with Social Security beginning at age 62. If members retire at age 62 and have 25 or more years of credited service, the service retirement benefit will be 2% of final average salary for each year of service (not to exceed 30 years), plus 1.5% of the final average salary for each year of credited service beyond 30 years. If members retire at age 62 with fewer than 25 years of credited service, the service retirement benefit will be 1.66% of the final average salary for each year of service.

Tier IV members with 5 or more years of credited service are eligible to retire with full benefits at age 62 or at age 55 with 30 years of service and with reduced benefits for retirement between ages 55 and 62 with less than 30 years of service. Benefits are equivalent to Tier III members.

Retirement benefits vest after 5 years of credited service and are payable at age 55 or greater. The Employees' Retirement System also provides death and disability benefits.

Tier I and II members are eligible to receive one month service credit for each year of service at retirement, with a maximum of 24 months.

Tier II, III and IV members will be able to purchase previous service credit (continuous service rules no longer apply) with member having at least two years of service to have previous service creditable.

Tier III and IV members are required by law to contribute 3% of their annual salary to the Employees' Retirement System (3% contribution ceases after 10 years of membership or 10 years of credited service) and eligible Tier I and II members may make contributions under certain conditions. The Authority is required by the same statute to contribute the remaining amounts necessary to pay benefits when due.

After 5 years in the retirement system, veterans will be able to purchase up to 3 years of military service credit, at a cost of 3% of their last year's salary, for each year of credit acquired. Member is required to have been on active duty for at least one day during the following eligible periods:

- World War 2 (12/7/41–12/31/46)
- Korean War (6/27/50–1/31/55)
- Viet Nam Era (2/28/61–5/7/75)

Pension expense contractually required by New York State and recorded in the Authority's accounts was $31 and zero for the years ended May 31, 2002 and 2001. The zero amount of pension expense in fiscal 2001 was the result of a change in the actuarial method utilized by New York State in 1994 in determining the contributions to be made to the Retirement System. The Authority has recorded an accrued retirement contribution liability for certain pensions costs of employees related to construction work in progress which have been capitalized to water plant.

8. DEFERRED COMPENSATION

All Authority employees may participate in a deferred compensation program designated as an Internal Revenue Code Section 457 plan. This program enables employees to contribute a portion of their salary, on a tax deferred basis, to group variable annuity contracts. The assets and related liabilities of the plan are recorded at the assets' market values and are excluded from the Authority's balance sheet. The Authority has no obligation to make contributions to the deferred compensation program. The Authority remits deferred compensation amounts withheld from employees' salaries to an outside fiduciary agent who administers the program and invests program assets as instructed by each of the participants. Assets in such program amounted to $12,548 and $12,533 at May 31, 2002 and 2001, respectively.

9. POSTRETIREMENT BENEFITS

The Authority's employees participate in the New York State Health Insurance Plan, a multi-employer plan, which provides certain health insurance benefits for retired employees. Substantially all the Authority's employees may become eligible for these benefits if they reach normal retirement age while working for the Authority. The cost of retiree health care benefits is recognized as an expense as costs are incurred. The expense amounted to $1,385 and $1,251 for the years ended May 31, 2002 and 2001, respectively.

10. CAPITAL LEASES

In June 2000, the Authority entered into a capital lease agreement for various computer equipment. Future minimum payments under the capital lease obligation are scheduled as follows:

Year ending May 31,	
2003	$217
2004	217
2005	216
2006	216
Total minimum lease payments	866
Less: amounts representing interest	109
Present value of minimum lease payments	757
Less: current portion	175
	$582

11. COMMITMENTS AND CONTINGENCIES

Operating Leases

As of May 31, 2002 and 2001, the Authority is obligated under several operating leases with various lease terms through 2006, for meter reading and computer equipment:

Year ending May 31,	
2003	$225
2004	218
2005	123
2006	—
2007	—
	$566

Rental expense for operating leases was $276 and $274 for the years ended May 31, 2002 and 2002, respectively.

Legal Proceedings

The Authority is involved in various litigation resulting from the ordinary course of business. In the opinion of management, and based on advice of legal counsel, the ultimate liability, if any, to the Authority will not have a material effect on the Authority's financial position, revenues invested in facilities or cash flows.

Report of Independent Accountants

To the Members of Suffolk County Water Authority

In our opinion, the accompanying balance sheets and the related statements of revenue and revenue invested in facilities and of cash flows present fairly, in all material respects, the financial position of Suffolk County Water Authority (the "Authority") at May 31, 2002 and 2001 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. These financial statements are the responsibility of the Authority's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

July 26, 2002

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Central Regional Office: Director of Customer Service **Steven Romano** • 2045 Route 112, Suite 1, Coram, NY 11727

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Port Jefferson Station
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Eastern Regional Office: Regional Manager **Dona Roberts** • 624 Old Riverhead Road, Westhampton Beach, NY 11978

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Mattituck Creek East
Mattituck Creek West
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New Suffolk
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Quogue
Remsenburg
Riverside*
Rose Grove
Sag Harbor
Sagaponack
Shinnecock Hills
Shirley
Southampton
Southold
Speonk
Village of Southampton
Village of Westhampton Dunes
Wainscott
Watermill
Westhampton
Westhampton Beach

*Included in Wholesale Water District
†Serves portion of area


LEGEND
SCWA Service Areas
SCWA Non-Service Areas

Groundwater Guardian Program

We have continued our involvement with the Groundwater Foundation, a non-profit educational organization based in Lincoln, Nebraska.

Suffolk County was originally named as a Groundwater Guardian Community by the group in 1998. This is a renewable designation, and the team meets on a regular basis to reevaluate its primary concerns and develop and coordinate ways to address them. The team's current focus is on public education, pollution prevention, and other environmental concerns that could affect our groundwater. The nine-member group includes two SCWA staff members, a citizen activist, and representatives from local government, business, agriculture and education.

The Groundwater Guardian designation enables this area to join with Groundwater Guardian communities throughout North America in a unified effort to motivate people to learn more about groundwater and help protect this essential resource.

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SUFFOLK COUNTY WATER AUTHORITY

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