ADDENDUM 2

AQUA PENNSYLVANIA, INC.

(a wholly-owned subsidiary of Aqua America, Inc.)

Consolidated Financial Statements
As of and for the years ended
December 31, 2010 and 2009

pwc

Report of Independent Auditors

To the Board of Directors and Stockholder of
Aqua Pennsylvania, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of cash flows, of capitalization and of stockholder's equity present fairly, in all material respects, the financial position of Aqua Pennsylvania, Inc. (a wholly-owned subsidiary of Aqua America, Inc.) and its subsidiaries at December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These consolidated 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 of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 our opinion.

PricewaterhouseCoopers LLP

April 21, 2011

PricewaterhouseCoopers LLP, Two Commerce Square, Suite 1700, 2001 Market Street, Philadelphia, PA 19103-7042
T: (267) 330 3000, F: (267) 330-3300, www.pwc.com/us

AQUA PENNSYLVANIA, INC.
Consolidated Balance Sheets
(In thousands of dollars)
December 31, 2010 and 2009

Assets	2010	2009
Utility plant, net of accumulated depreciation	$ 2,015,004	$ 1,819,156
Construction work-in-progress	26,998	30,346
Utility plant acquisition adjustment, net	(1,737)	(3,774)
Net utility plant	2,040,265	1,845,728
Investment in nonutility property, net of accumulated depreciation	2,379	2,400
Current assets:		
Cash and cash equivalents	1,230	11,651
Accounts receivable, less allowance for doubtful accounts of $2,370 and $2,526, in 2010 and 2009, respectively	25,739	21,445
Unbilled revenues	19,199	17,601
Materials and supplies	4,309	4,114
Taxes Receivable	24,204	-
Prepayments and other current assets	1,880	1,553
Total current assets	76,561	56,364
Deferred charges and non-current assets:		
Debt issuance expense, net of amortization	15,692	14,277
Regulatory assets	103,944	108,511
Other deferred charges, net	8,841	5,992
Funds restricted for construction activity	134,077	77,510
Goodwill	1,110	2,632
Total deferred charges and non-current assets	263,664	208,922
	$ 2,382,869	$ 2,113,414

Liabilities and Equity	2010	2009
Aqua Pennsylvania's stockholder's equity:		
Common stock, $100 par value, 1,000,000 shares authorized, 1,000 shares issued and outstanding, in 2010 and 2009, respectively	$ 100	$ 100
Capital in excess of par value	299,965	245,395
Retained earnings	523,822	475,513
Total Aqua Pennsylvania's stockholder's equity	823,887	721,008
Noncontrolling interest	236	225
Total equity	824,123	721,233
Long-term debt, excluding current portion	903,473	826,618
Current liabilities:		
Current portion of long-term debt	25,683	25,279
Loans payable	63,277	15,000
Accounts payable	26,981	30,991
Accounts payable-affiliates	4,452	12,304
Accrued interest	9,791	9,444
Income taxes payable	976	6,205
Other current liabilities	6,354	5,162
Total current liabilities	137,514	104,385
Deferred credits and other non-current liabilities:		
Customers' advances for construction	38,585	48,145
Deferred income taxes	370,090	317,585
Investment tax credits	4,907	4,899
Regulatory liabilities	17,066	12,777
Other	2,998	2,109
Total deferred credits and other non-current liabilities	433,646	385,515
Contributions in aid of construction	84,113	75,663
	$ 2,382,869	$ 2,113,414

See accompanying notes to consolidated financial statements.

AQUA PENNSYLVANIA, INC.
Consolidated Statements of Income
(In thousands of dollars)
Years ended December 31, 2010 and 2009

	2010	2009
Operating revenues	$ 378,881	$ 347,015
Operating expenses:		
Operating, maintenance and administrative expenses	113,577	107,241
Depreciation	61,224	56,756
Amortization	49	239
Taxes other than income taxes	11,131	10,210
Gain on sale of other assets	(221)	(214)
Total operating expenses	185,760	174,232
Operating income	193,121	172,783
Other (income) deductions:		
Interest on long-term debt	45,788	42,277
Other interest expense, net	665	750
Allowance for funds used during construction	(3,496)	(1,919)
Amortization of debt issuance costs	924	800
Other income, net	(1,777)	(2,017)
Total other (income) deductions	42,104	39,891
Income before income taxes	151,017	132,892
Provision for income taxes	60,208	52,559
Net income	$ 90,809	$ 80,333

See accompanying notes to consolidated financial statements.

AQUA PENNSYLVANIA, INC.
Consolidated Statements of Cash Flows
(In thousands of dollars)
Years ended December 31, 2010 and 2009

	2010	2009
Cash flows from operating activities:		
Net income	$ 90,809	$ 80,333
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Depreciation and amortization	62,197	57,795
Deferred income taxes and income tax credits	51,023	30,738
Provision for doubtful accounts	2,021	2,614
Stock based compensation	813	865
Gain on sale of other assets	(221)	(214)
Changes in current assets and current liabilities		
Receivables, unbilled revenue, materials and supplies and prepayments	(32,250)	(1,394)
Affiliate receivable/payable	(23,685)	(8,939)
Payables, accrued taxes and other accrued liabilities	(16,446)	(12,008)
Accrued interest	346	301
Other	1,799	(1,233)
Net cash provided by operating activities	136,406	148,858
Cash flows used in investing activities:		
Construction expenditures	(234,660)	(197,654)
Allowance for funds used during construction	(3,496)	(1,919)
Addition to funds restricted for construction activity	(143,365)	(128,419)
Release of funds previously restricted for construction activity	86,798	94,928
Acquisitions of water and wastewater systems	(60)	(1,159)
Net proceeds on sale of other assets	309	142
Other	(124)	(1,072)
Net cash used in investing activities	(294,598)	(235,153)
Cash flows from financing activities:		
Customers' advances and contributions in aid of construction	3,168	264
Repayments of customers' advances	(5,660)	(337)
Net borrowings (repayments) of loans payable	48,277	(45,734)
Proceeds from long-term debt	146,416	132,492
Debt issuance costs paid	(2,376)	(2,942)
Repayments of long-term debt	(69,121)	(5,086)
Change in cash overdraft position	567	(486)
Capital contribution from Aqua America, Inc.	69,000	30,000
Dividends paid - common stock	(42,500)	(11,273)
Net cash provided by financing activities	147,771	96,898
Net change in cash and cash equivalents	(10,421)	10,603
Cash and cash equivalents at beginning of year	11,651	1,048
Cash and cash equivalents at end of year	$ 1,230	$ 11,651

Cash paid for interest on all borrowings, net of amounts capitalized, was $41,946 and $40,057 in 2010 and 2009, respectively.
Cash paid for income taxes was $39,392 and $16,074 in 2010 and 2009, respectively.

See Note 1 - Summary of Significant Accounting Policies-Customers' Advances for Construction, Note 10 - Employee Stock and Incentive Plan and Note 12 - Affiliated Company Transactions for description of non-cash activities.
See accompanying notes to consolidated financial statements.

AQUA PENNSYLVANIA, INC.
Consolidated Statements of Capitalization
(In thousands of dollars)
December 31, 2010 and 2009

		2010	2009
Aqua Pennsylvania's stockholder's equity:			
Common stock at $100 par value, authorized 1,000,000 shares, 1,000 shares issued and outstanding		$ 100	$ 100
Capital in excess of par value		299,965	245,395
Retained earnings		523,822	475,513
Total Aqua Pennsylvania's stockholder's equity		823,887	721,008
Noncontrolling interest		236	225
Total equity		824,123	721,233
Long-term debt:			
Long-term debt of subsidiaries (substantially secured by utility plant):			
Interest Rate Range	Maturity Date Range		
1.00% to 1.99%	2011 to 2035	21,028	20,129
2.00% to 2.99%	2024 to 2029	9,862	9,916
3.00% to 3.99%	2016 to 2025	26,118	28,455
4.00% to 4.99%	2020 to 2043	321,569	223,647
5.00% to 5.99%	2012 to 2043	320,092	274,988
6.00% to 6.99%	2011 to 2030	68,861	112,202
7.00% to 7.99%	2025 to 2025	15,000	15,000
8.00% to 8.99%	2022 to 2025	9,000	9,000
9.00% to 9.99%	2011 to 2026	35,000	55,800
		826,530	749,137
Unsecured notes payable:			
Notes ranging from 5.50% to 5.95%, due 2014 through 2034		102,132	102,132
Installment note payable, 9.0% due in equal annual payments through 2013		494	628
		929,156	851,897
Current portion of long-term debt		25,683	25,279
Long-term debt, excluding current portion		903,473	826,618
Total capitalization		$ 1,727,596	$ 1,547,851

See accompanying notes to consolidated financial statements.

AQUA PENNSYLVANIA, INC.
Statements of Stockholder's Equity
(In thousands of dollars)
Years ended December 31, 2010 and 2009

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Total Stockholder's Equity
Balance at December 31, 2008	$ 100	$ 230,868	$ 406,453	$ 637,421
Net Income	-	-	80,333	80,333
Common Stock Dividends	-	-	(11,273)	(11,273)
Stock based compensation	-	1,007	-	1,007
Capital Contribution from Aqua America, Inc.	-	30,000	-	30,000
Return of Capital Contribution to Aqua America, Inc.	-	(16,480)	-	(16,480)
Balance at December 31, 2009	100	245,395	475,513	721,008
Net Income	-	-	90,809	90,809
Common Stock Dividends	-	-	(42,500)	(42,500)
Stock based compensation	-	1,075	-	1,075
Capital Contribution from Aqua America, Inc.	-	69,000	-	69,000
Return of Capital Contribution to Aqua America, Inc.	-	(15,505)	-	(15,505)
Balance at December 31, 2010	$ 100	$ 299,965	$ 523,822	$ 823,887

See accompanying notes to consolidated financial statements.

AQUA PENNSYLVANIA, INC.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009
(In thousands of dollars)

1. Summary of Significant Accounting Policies

Nature of Operations

Aqua Pennsylvania, Inc. ("the Company") is a regulated public utility which supplies water to residential, commercial and industrial customers. The Company's customers are principally located in the suburban areas north and west of the City of Philadelphia and in 25 other counties in Pennsylvania. No single customer accounted for more than one percent of the Company's operating revenues in 2010 or 2009. The Company is a wholly-owned subsidiary of Aqua America, Inc. ("the Parent"). The Company has wholly-owned subsidiaries that are regulated public utilities which provide water and wastewater services to customers in Pennsylvania.

The consolidated financial statements include the accounts of the Company and its subsidiary. All intercompany accounts and transactions have been eliminated in consolidation.

Basis of Presentation

The Company's financial statements are presented in accordance with U.S. generally accepted accounting principles.

The Company has evaluated the period from December 31, 2010, the date of the financial statements, through April 21, 2011, the date the financial statements were available for issuance, for subsequent events and determined that no material subsequent events occurred that would affect the information presented in these financial statements or require additional disclosure.

Use of Estimates in Preparation of Consolidated Financial Statement

The preparation of consolidated financial statements in conformity with accounting principles accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

1. Summary of Significant Accounting Policies (Continued)

Recognition of Revenues

Operating revenues include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the latest billing to the end of the accounting period.

Regulation

As a regulated public water utility, the Company is subject to regulation by the Pennsylvania Public Utility Commission ("PAPUC"), which has jurisdiction with respect to rates, service, accounting procedures, acquisitions and other matters. The Company defers certain costs and credits as regulatory assets and liabilities when it is probable that such amounts will be recognized in the rate making process in a period different from the period in which they would have been reflected in income by an unregulated company.

Utility Plant and Depreciation

Utility plant is stated at cost which includes contracted cost, direct labor and fringe benefits, materials, overheads, and for certain utility plant, an allowance for the cost of funds used during construction. Water systems acquired are recorded at estimated original cost when first devoted to utility service and the applicable depreciation is recorded in accumulated depreciation. Utility plant acquisition adjustment represents the difference between the estimated original cost, less applicable depreciation and the purchase price of utility plant assets acquired through business acquisitions. Acquisition adjustments are amortized over 20 years if recoverable in rate base.

Expenditures for maintenance and repairs, including major maintenance projects and minor renewals and betterments, are charged to operating expenses when incurred in accordance with the Uniform System of Accounts prescribed by the PAPUC. The cost of new units of property and betterments are capitalized. Utility expenditures for water main cleaning and relining of pipes are deferred and recorded in net property, plant and equipment. As of December 31, 2010, \$6,493 of costs have been incurred since the last rate proceeding and the Company expects to recover these costs in future rates.

1. Summary of Significant Accounting Policies (Continued)

Utility Plant and Depreciation (Continued)

The cost of software upgrades and enhancements are capitalized if they result in added functionality which enable the software to perform tasks it was previously incapable of performing. Certain information technology costs associated with major system installations, conversions and improvements, such as software training, data conversion and business process re-engineering costs, are deferred as a regulatory asset if the Company expects to recover these costs in future rates. If these costs are not deferred, then these costs are charged to operating expenses when incurred. As of December 31, 2010, $2,643 of costs have been incurred and deferred, since the last rate proceedings, as a regulatory asset, and the deferral is reported as a component of net property, plant and equipment.

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to utility plant and such value, together with the net cost of removal, is charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is recorded. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. These amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates.

The straight-line remaining life method is used to compute depreciation on utility plant. The straight-line method is used with respect to transportation and mechanical equipment, office equipment and laboratory equipment. Depreciation is recorded over the estimated useful lives of the assets which range from 14 to 97 years for utility plant and 5 to 78 years for both transportation and mechanical equipment and all non-utility plant, office equipment and laboratory equipment.

Long-lived assets of the Company, which consist primarily of utility plant in service and regulatory assets, are reviewed for impairment when changes in circumstances or events occur. There has been no change in circumstances or events that have occurred that require adjustments to the carrying values of these assets.

1. Summary of Significant Accounting Policies (Continued)

Allowance for Funds Used During Construction

The allowance for funds used during construction ("AFUDC") is a non-cash credit to income which represents the estimated cost of funds used to finance the construction of utility plant. AFUDC is applied to construction projects requiring more than one month to complete. No AFUDC is applied to projects funded by customer advances for construction or contributions in aid of construction. AFUDC includes the new cost of borrowed funds and a rate of return on other funds when used, and is recovered through water rates as the utility plant is depreciated. There was no AFUDC related to equity funds in 2010 and 2009.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less, which are not restricted for construction activity, to be cash equivalents.

The Company had a book overdraft of its disbursement cash accounts of $567 and $0 at December 31, 2010 and 2009, respectively. The balance of the book overdraft is reported as accounts payable and the change in the book overdraft balance is reported as cash flows from financing activities.

Accounts Receivable

Accounts receivable are recorded on the invoiced amounts. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in our existing accounts receivable, and is determined based on historical write-off experience and the aging of account balances. The Company reviews the allowance for doubtful accounts quarterly. Account balances are written off against the allowance when it is probable the receivable will not be recovered. When utility customers request extended payment terms, credit is extended based on regulatory guidelines and collateral is not required.

1. Summary of Significant Accounting Policies (Continued)

Deferred Charges

Deferred charges consist of debt issuance expenses, preliminary survey costs, retirement work in progress expenses and other expenses.

Deferred debt issuance expenses are amortized over the life of the related issues.

Call premiums related to the early redemption of long-term debt, along with the unamortized balance of the related issuance expense, are deferred and included in issuance expense amortized over the life of the long-term debt used to fund the redemption.

Other expenses, for which the Company has received or expects to receive prospective rate recovery, are deferred and amortized over the period of rate recovery.

Funds Restricted for Construction Activity

The proceeds received from certain financings for construction and capital improvement of utility facilities are held in escrow until the designated expenditures are incurred. These amounts are reported as funds restricted for construction activity and are expected to be released over time as the capital projects are funded.

(In thousands of dollars)

1. Summary of Significant Accounting Policies (Continued)

Goodwill

Goodwill represents the excess cost over the fair value of net tangible and identifiable assets acquired through acquisitions. Goodwill is not amortized but is tested for impairment annually, or more often if circumstances indicate a possible impairment may exist. The Company tested its goodwill for impairment as of July 31, 2010 in conjunction with the timing of the Company's annual strategic business plan. Based on a comparison of the estimated fair value of the Company to its respective carrying amount, the impairment test concluded that the estimated fair value of the Company was substantially in excess of its respective carrying amount, indicating that the Company's goodwill was not impaired. The following table summarizes the changes in the Company's goodwill:

Balance at December 31, 2008	$ 1,522
Goodwill acquired during year	1,110
Balance at December 31, 2009	2,632
Reclassification to utility plant acquisition adjustment	(1,522)
Balance at December 31, 2010	$ 1,110

The reclassification of goodwill to utility plant acquisition adjustment results from a mechanism approved by the PAPUC. The mechanism provides for the transfer over time, and the recovery through customer rates, of goodwill associated with certain acquisitions upon achieving certain objectives.

AQUA PENNSYLVANIA, INC.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009
(In thousands of dollars)

1. Summary of Significant Accounting Policies (Continued)

Income Taxes

The Company accounts for certain income and expense items in different time periods for financial reporting than for tax reporting purposes. Deferred income taxes are provided on the temporary differences between the tax basis of the assets and liabilities and the amounts at which they are carried in the consolidated financial statements. The income tax effect of temporary differences not reflected currently in rates is recorded as deferred taxes with an offsetting regulatory asset or liability. These deferred income taxes are based on the enacted tax rates expected to be in effect when such temporary differences are projected to reverse. Investment tax credits are deferred and amortized over the estimated useful lives of the related properties.

The Company's earnings are included with those of the Parent and affiliated companies for purposes of filing a consolidated Federal income tax return. The allocation of the Federal income tax to the Company is computed on a stand-alone basis. The liability for Federal income taxes is remitted to the Parent. The receivable for Federal income taxes will be remitted to the Company from the Parent.

Judgment is required in evaluating the Company's federal and state tax positions. Despite management's belief that the Company's tax return positions are fully supportable, the Company may establish reserves when it believes that certain tax positions are likely to be challenged and it may not fully prevail in these challenges. The Company's provision for income taxes includes interest, penalties and reserves for uncertain tax positions.

Customers' Advances for Construction

Water mains or, in some instances, cash advances to reimburse the Company its costs to construct water mains, are contributed to the Company by customers, real estate developers and builders in order to extend water service to their properties. The value of these contributions is recorded as Customers' Advances for Construction. The Company makes refunds on these advances over a specific period of time based on operating revenues related to the main or as new customers are connected to and take service from the main. After all refunds are made, any remaining balance is transferred to Contributions in Aid of

1. Summary of Significant Accounting Policies (Continued)

Customers' Advances for Construction (Continued)

Construction. Non-cash property, in the form of water mains, has been received, generally from developers as advances or contributions of $1,289 in 2010 and $3,548 in 2009.

Contributions in Aid of Construction

Contributions in aid of construction include direct non-refundable contributions and the portion of customers' advances for construction that have become non-refundable. Utility plant funded by contributions is excluded from rate base and is not depreciated. Non-cash property, in the form of water mains, has been received, generally from developers as contributions of $1,856 in 2010 and $239 in 2009.

Materials and Supplies

Materials and supplies are stated at cost under the first-in, first-out method.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

AQUA PENNSYLVANIA, INC.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009
(In thousands of dollars)

2. Utility Plant

Gross Utility Plant is composed of the following:

	December 31, 2010	December 31, 2009	Approximate range of remaining lives
Utility plant			
Mains and accessories	$ 1,299,730	$ 1,157,199	40 to 97 years
Services, hydrants, treatment plants and reservoirs	575,564	524,355	14 to 85 years
Operations structures and water tanks	92,192	76,477	13 to 49 years
Miscellaneous pumping and purification equipment	231,216	221,648	14 to 78 years
Meters, data processing, transportation and operating equipment	254,801	233,357	5 to 78 years
Land and other non-depreciable assets	37,709	36,452	-
Utility Plant	2,491,212	2,249,488	
Utility construction work-in-progress	26,998	30,346	-
Net utility plant acquisition adjustment	(1,737)	(3,774)	2 to 20 years
Total Utility Plant	2,516,473	2,276,060	
Accumulated Depreciation	(476,208)	(430,332)	
Utility Plant, net of accumulated depreciation	$ 2,040,265	$ 1,845,728	

(In thousands of dollars)

3. Acquisitions

During 2010, the Company acquired one wastewater and one water system. The acquisitions were recorded under the purchase method of accounting. The total purchase price for the systems acquired was $60 in cash and $327 by Parent. Operating revenues included in the consolidated financial statements during the period owned by the Company were $69.

During 2009, the Company acquired two wastewater and seven water systems. The acquisitions were recorded under the purchase method of accounting. The total purchase price for the systems acquired was $1,159 in cash. Operating revenues included in the consolidated financial statements related to the systems acquired were $637 in 2010 and $360 in 2009.

4. Income Taxes

The provision for income taxes is composed of the following:

	Years ended December 31,	
	2010	2009
Current:		
Federal	$ (1,455)	$ 13,819
State	10,640	8,002
	9,185	21,821
Deferred:		
Federal	49,957	28,982
State	1,066	1,756
	51,023	30,738
Total tax expense	$ 60,208	$ 52,559

AQUA PENNSYLVANIA, INC.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009
(In thousands of dollars)

4. Income Taxes (Continued)

The statutory Federal tax rate is 35% and the Pennsylvania Corporate Net Income tax rate is 9.99% for both years presented.

The reasons for the differences between amounts computed by applying the statutory Federal income tax rate to income before income tax expense and the actual income tax expense are as follows:

	Years ended December 31,	
	2010	2009
Computed Federal income tax expense at statutory rate	$ 52,855	$ 46,512
Increase in tax expense for depreciation expense to be recovered in future rates	181	199
Amortization of investment tax credits	(194)	(128)
Domestic production credit	-	(450)
Stock-based compensation	17	157
State income taxes, net of federal tax benefit	7,609	6,351
Other, net	(260)	(82)
Actual income tax expense	$ 60,208	$ 52,559

(In thousands of dollars)

4. Income Taxes (Continued)

The tax effects of temporary differences between book and tax accounting that give rise to the deferred tax assets and deferred tax liabilities are as follows:

	December 31, 2010	December 31, 2009
Deferred tax assets:		
Customers' advances for construction	$ 9,542	$ 9,090
Costs expensed for book not deducted for tax, principally accrued expenses	1,882	1,089
Tax loss carryforward	4,553	-
Stock options	395	-
Total deferred tax assets	16,372	10,179
Deferred tax liabilities:		
Utility plant, principally due to depreciation and differences in the basis of fixed assets due to variation in tax and book accounting	355,731	299,011
Deferred taxes associated with the gross-up of revenues necessary to recover, in rates, the effect of temporary differences	30,732	28,753
Investment tax credits	4,906	4,899
Total deferred tax liabilities	391,369	332,663
Net deferred tax liability	$ 374,997	$ 322,484

At December 31, 2010, the Company recorded a Federal net operating loss ("NOL") carryforward of $13,008. The Company believes the Federal NOL carryforward is more likely than not to be recovered and requires no valuation allowance. The NOL will be utilized on the consolidated Federal income tax return of the Parent. The NOL will expire in year 2030.

As of December 31, 2010, the Parent's Federal income tax returns for all years through 2006 have been closed. Tax years 2007 and 2008 have been examined by the Internal Revenue Service. There were no significant adjustments for the Company. For Federal income tax purposes, tax years 2009 and 2010 remain open for examination. For state income tax purposes, tax years 2007 through 2010 remain open for examination.

(In thousands of dollars)

5. Regulatory Assets and Liabilities

Regulatory assets represent costs that are expected to be fully recovered from customers in future rates while regulatory liabilities represent amounts that are expected to be refunded to customers in future rates. Except for income taxes and the competitive transition charge payment, regulatory assets and regulatory liabilities are excluded from the Company's rate base and do not earn a return. The components of regulatory assets and (liabilities) are as follows:

	December 31,	
	2010	2009
Income taxes, net	$ 74,760	$ 73,285
Competitive Transition Charge payment	-	1,147
Postretirement benefits -Pension	(17,066)	(12,777)
Postretirement benefits-OPEB	585	(258)
Utility plant retirement costs	27,720	33,403
Capital stock taxes	75	175
Rate case filing expenses	804	759
	$ 86,878	$ 95,734

Items giving rise to deferred state income taxes, as well as a portion of deferred Federal income taxes related to certain differences between tax and book depreciation expense, are recognized in the rate setting process on a cash or flow-through basis and will be recovered as they reverse.

The regulatory asset associated with the Competitive Transition Charge ("CTC") payment represents the full pay off in 2001, net of amortization, of the Company's allocable share of CTC as negotiated by the Company from the electric distribution company, PECO Energy Company. The Pennsylvania Electricity Generation Customer Choice and Competition Act permitted electric distribution utilities to recover their stranded costs from its customers in the form of CTC. Rate recovery of the $11,465 CTC payment began in 2000 and concluded in 2010.

5. Regulatory Assets and Liabilities (Continued)

Postretirement benefits include pension and other postretirement benefits. The regulatory liability for postretirement benefits represents amounts recovered through rates and before the costs are incurred. The regulatory asset for postretirement benefits includes deferred net pension expense in excess of amounts funded, which the Company believes will be recoverable in future years as pension funding is required. In addition, regulatory assets related to postretirement benefits other than pensions represents costs that were deferred between the time that the accrual method of accounting for these benefits was adopted in 1993 and the recognition of the accrual method in the Company's rates as prescribed in subsequent rate filings. Amortization of the amount deferred for postretirement benefits other than pensions began in 1994 and is currently being recovered in rates. Amortization will continue through December 2012.

The regulatory asset for utility plant retirement costs, representing cost of removal, represents costs already incurred that are expected to be recovered in future rates over a five year recovery period.

The regulatory asset related to capital stock taxes represents additional capital stock taxes incurred by the Company which it expects to receive rate recovery over a twelve month period.

The regulatory asset related to rate case filing expenses represents the costs associated with filing for rate increases that are deferred and amortized over periods that range from one to three years.

6. Commitments and Contingencies

The Company maintains agreements with other water purveyors for the purchase of water to supplement its water supply, particularly during periods of peak demands. The agreements stipulate purchases of minimum quantities of water or charge a monthly commitment fee through the year 2026. The Company is committed to a total of $84,082 in water purchase payments:

6. Commitments and Contingencies (Continued)

$13,114 in 2011, $8,672 in 2012, $8,163 in 2013, $8,041 in 2014 and $7,897 in 2015 and $38,195 thereafter. The Company purchased approximately $11,806 and $11,724 of water under these agreements during the years ended December 31, 2010 and 2009, respectively.

The Company leases motor vehicles, buildings, and other equipment under operating leases that are noncancelable. During the next five years, $1,137 of future minimum rental payments are due: $439 in 2011, $278 in 2012, $187 in 2013, $181 in 2014 and $52 in 2015 and $0 thereafter. The Company leases parcels of land on which treatment plants and other facilities are situated and adjacent parcels that are used for watershed protection. The two operating leases are noncancelable, expire in 2045 and 2052 and contain certain renewal provisions. The leases are subject to an adjustment every five years based on changes in the Consumer Price Index. During each of the next five years, subject to the aforesaid adjustment, $476 of rental payments for land are due and the aggregate of the years remaining approximates $16,937 thereafter. Rent expense was $917 and $1,090 for the years ended December 31, 2010 and 2009, respectively.

The Company is routinely involved in condemnation procedures and legal matters during the ordinary course of business. Although the results of legal proceedings cannot be predicted with certainty, there are no other pending legal proceedings to which the Company is a party or to which any of its properties is the subject that are material or are expected to have a material effect on the Company's financial position, results of operations or cash flows.

7. Long-term Debt and Loans Payable

The consolidated Statements of Capitalization provide a summary of long-term debt as of December 31, 2010 and 2009. The supplemental indentures with respect to certain issues of the First Mortgage Bonds restrict the ability of the Company to declare dividends, in cash or property, or repurchase or otherwise acquire the Company's stock. Approximately $503,822 and $456,000 of the Company's retained earnings were free of these restrictions as of December 31, 2010 and 2009, respectively. Certain supplemental indentures also prohibit the Company from making loans to, or purchasing the stock of the Parent.

(In thousands of dollars)

7. Long-term Debt and Loans Payable (Continued)

Sinking fund payments are required for certain issues of long-term debt. The future sinking fund payments and debt maturities of the Company's long-term debt are as follows:

Interest Rate Range	2011	2012	2013	2014	2015	Thereafter
1.00% To 1.99%	$ 2,097	$ 1,852	$ 1,824	$ 1,632	$ 1,542	$ 12,081
2.00% To 2.99%	653	587	600	624	643	6,755
3.00% To 3.99%	1,839	1,905	1,972	2,042	2,114	16,246
4.00% To 4.99%	147	153	159	166	172	320,772
5.00% To 5.99%	-	25,000	-	44,584	20,000	332,639
6.00% To 6.99%	15,000	-	-	-	12,000	41,862
7.00% To 7.99%	-	-	-	-	-	15,000
8.00% To 8.99%	-	-	-	-	-	9,000
9.00% To 9.99%	5,947	960	5,987	800	800	21,000
Total	$ 25,683	$ 30,457	$ 10,542	$ 49,848	$ 37,271	$ 775,355

In November 2010, the Company issued $141,385 of tax-exempt bonds secured by a supplement to its first mortgage indenture at the following terms: $25,910 at 5.00% due 2033, $19,270 at 5.05% due 2034, $15,000 at 4.75% due 2042 and $81,205 at 4.60% due 2043. The proceeds will be used to help finance part of the Company's capital projects and refinance existing debt. At various times during 2010, the Company issued other notes payable aggregating $3,193 at a weighted average interest rate of 1.30% due at various times ranging from 2024 to 2030.

In July 2009, the Company issued $58,000 of tax-exempt bonds secured by a supplement to its first mortgage indenture at the following terms: $58,000 at 5.23% due 2039. In November 2009, the Company issued an additional $74,685 of tax-exempt bonds secured by a supplement to its first mortgage indenture at the following terms: $62,165 at 4.88% due 2040 and $12,520 at 4.90% due 2040. The proceeds are restricted to funding certain capital projects during the period 2009 through 2012. At various times during 2009, the Company issued other notes payable aggregating $1,515 at a weighted average interest rate of 1.40% due at various times ranging from 2028 to 2030.

7. Long-term Debt and Loans Payable (Continued)

As of December 31, 2010, the Trustees for two issues held $134,077 pending construction of the projects to be financed with the issues and are reported in the consolidated balance sheet as funds restricted for construction activity.

The Company has a $100,000 364-day revolving credit facility with three banks. Funds borrowed under this agreement are classified as loans payable and are used to provide working capital. As of December 31, 2010 and 2009, funds borrowed under the Company's revolving credit agreements were $58,277 and $15,000, respectively. Interest under this facility is based, at the borrower's option, on the prime rate, an adjusted federal funds rate, an adjusted London Interbank Offered Rate corresponding to the interest period selected, an adjusted Euro-Rate corresponding to the interest period selected or at rates offered by the banks. This agreement restricts short-term borrowings of the Company. A renewal fee of 25 basis points was charged on the total commitment amount of the revolving credit agreement. The average cost of borrowing under this facility was 1.44% and 1.20%, and the average borrowing was $37,539 and $56,389 during 2010 and 2009, respectively. The maximum amount outstanding at the end of any one month was $65,676 in 2010 and $67,639 in 2009.

At December 31, 2010 and 2009, the Company had a discretionary line of credit of $10,000. Funds borrowed under this line are classified as loans payable and are used to provide working capital. As of December 31, 2010 and 2009, funds borrowed under the short-term lines of credit were $5,000 and $0, respectively. The average borrowing under the line was $4,791 and $4,750 during 2010 and 2009, respectively and the maximum amount outstanding at the end of any one month was $10,000 in 2010 and $10,000 in 2009. Interest under the line is based, at the borrower's option, on the prime rate, an adjusted federal funds rate, an adjusted London Interbank Offered Rate corresponding to the interest period selected, an adjusted Euro-Rate corresponding to the interest period

7. Long-term Debt and Loans Payable (Continued)

selected or at rates offered by the bank. The average cost of borrowings under this line during 2010 and 2009 was 1.46% and 1.57%, respectively.

8. Fair Value of Financial Instruments

The carrying amount of current assets and liabilities that are considered financial instruments approximates their fair values as of the dates presented. The carrying amount of the Company's long-term debt as of December 31, 2010 and 2009 is $929,156 and $851,897, respectively. The estimated fair value of the Company's long-term debt as of December 31, 2010 and 2009 is $883,468 and $767,531, respectively. The fair value of long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration.

The Company's customers' advances for construction and related tax deposits have carrying values of $38,585 and $48,145 at December 31, 2010 and 2009, respectively. Their relative fair values cannot be accurately estimated since future refund payments depend on several variables, including new customer connections, customer consumption levels and future rate increases. Portions of these non-interest bearing instruments are payable annually through 2025, and amounts not paid by the contract expiration dates become non-refundable. The fair value of these amounts would, however, be less than their carrying value due to the non-interest bearing feature.

9. Pension Plans and Other Postretirement Benefits

The Company participates in a noncontributory defined benefit pension plan sponsored by the Parent covering non-union employees hired prior to April 1, 2003 and select union employees. The eligibility of union employees is determined by the collective bargaining agreements covering those employees. Benefits under the plan are based on the participant's years of service and the annual average of the applicable compensation during the five consecutive computation periods of the final 10 computation periods as an active participant yielding the highest such average. Pension cost of the Company is based on amounts contributed to the pension plan as approved by the Parent and incorporated in rates approved by the PAPUC. Information regarding

9. Pension Plans and Other Postretirement Benefits (Continued)

accumulated and projected benefit obligations is not prepared at the subsidiary level.

The funding amount for the Pension Plan for Aqua America, Inc. Retirement Income Plan will be determined each year based on the recommendation of management and subject to approval by the Parent's Pension Committee. The funding amount will be an amount greater than or equal to the minimum required contribution and less than or equal to the maximum tax deductible contribution. The Company recorded pension amounts of $9,200 and $8,200 in 2010 and 2009, respectively.

The Company participates in two postretirement benefit plans sponsored by the Parent that provide certain life insurance benefits for retired employees and certain health care benefits for retired employees and their dependents. Employees may become eligible for these benefits if they have completed at least fifteen years of service and retire from the Company after reaching age 55 while still working for the Company. Retirees and their dependents under age 65 are covered by a point-of-service managed care plan that requires co-payments or an HMO. Employees hired after April 1, 2003 are not eligible for benefits.

Employees who elect to retire prior to attaining age 65 are generally required to make contributions towards their medical coverage until attaining age 65. Retirees and their dependents age 65 and over are required to purchase their own medical and drug coverage. The cost of this coverage is offset by Company contributions deposited in the plan's Premium Reimbursement Account. Costs of the Company are based on amounts contributed to the plans and incorporated in rates approved by the PAPUC.

The Company recorded costs for postretirement benefits other than pensions of $1,448 and $1,146 in 2010 and 2009, respectively. Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level.

9. Pension Plans and Other Postretirement Benefits (Continued)

The Company has a 401(k) savings plan that covers substantially all employees. The Company makes matching contributions that are invested in Aqua America, Inc. common stock based on a percentage of the employee's contribution, subject to certain limitations. The Company made matching contributions, recorded as compensation expense, of $747 and $747 for 2010 and 2009, respectively.

10. Employee Stock and Incentive Plan

The Company's employees participate in an Equity Compensation Plan sponsored by the Parent. Under the Aqua America, Inc. 2009 Omnibus Equity Compensation Plan, as approved by the Parent's shareholders to replace the 2004 Equity Compensation Plan, stock options, stock units, stock awards, stock appreciation rights, dividend equivalents, and other stock-based awards may be granted to the Company's employees and consultants and advisors equal to the market price of the stock on the day of the grant. The stock options are based upon the common stock of the Parent. Options are exercisable in installments of 33% annually, starting one year from the date of the grant and expire 10 years from the date of the grant. The Parent accounts for stock-based compensation using fair value.

The fair value of each option is amortized into compensation expense on a straight-line basis over their respective 36 month vesting period, net of estimated forfeitures. Compensation expense recognized by the Parent is allocated to its subsidiaries based on actual employee costs. Since the company is not obligated to reimburse the Parent for stock-based compensation costs incurred, the Company records these liabilities resulting from compensation costs to paid-in capital.

10. Employee Stock and Incentive Plan (Continued)

For the year ended December 31, 2010, the Company recognized share-based compensation as follows: operations and maintenance expense of $637; capitalized compensation costs within property, plant and equipment of $0, and lowered income tax expense by $206. For the year ended December 31, 2009, the Company recognized share-based compensation as follows: operations and maintenance expense of $799; capitalized compensation costs within property, plant and equipment of $29 and lowered income tax expense by $122.

Restricted stock awards provide the grantee with the rights of a shareholder, including the right to receive dividends and to vote such shares, but not the right to sell or otherwise transfer the shares during the restriction period. Restricted stock awards result in compensation expense which is equal to the fair market value of the stock on the date of the grant and is amortized ratably over the restriction period. During the years ended December 31, 2010 and 2009, the Company recorded stock-based compensation related to restricted stock awards as operations and maintenance expense in the amounts of $175 and $66, respectively.

11. Water Rates

On June 17, 2010, the PAPUC granted the Company a water rate increase designed to increase total operating revenues by $23,600 on an annualized basis. The rates in effect at the time of the filing included $24,256 in Distribution System Improvement Charges ("DSIC") or 7.5% above the prior base rates. Consequently, the total base rates increased by $47,856 on an annualized basis and the DSIC was reset to zero.

The DSIC enables water utilities in Pennsylvania to add a surcharge to customer bills to offset the additional depreciation and capital costs related to infrastructure system replacement and rehabilitation projects completed and placed into service between base rate filings. The Company is permitted to request adjustments to the DSIC quarterly to reflect subsequent capital expenditures and it is reset to zero when new base rates that reflect the costs of those additions become effective or when the Company's earnings exceed a

11. Water Rates (Continued)

PAPUC benchmark. The maximum DSIC that can be in effect at any time is 7.5%. The DSIC provided revenues in 2010 and 2009 of $12,237 and $15,168, respectively.

In addition to its base rates and the DSIC, the Company has utilized a surcharge or credit on its bills to reflect certain changes in Pennsylvania State Taxes until such time as the tax changes are incorporated into base rates. A rate surcharge increased operating revenues in 2010 and 2009 by $99 and $0, respectively.

12. Affiliated Company Transactions

The Company has service agreements with certain affiliates. The types of services rendered between these entities relate to general supervision and administrative functions, long-range planning, tax, accounting, financing, engineering, legal, data processing services and other specialized support.

Services provided by these certain affiliates amounted to approximately $22,030 and $18,417 for 2010 and 2009, respectively.

The Company also provides various management, advisory, and other services for certain affiliates and is reimbursed by these affiliates. The amounts billed out amounted to approximately $1,030 and $1,675 in 2010 and 2009, respectively.

The Company returned noncash equity contributions to the Parent of $15,330 and $16,414 in 2010 and 2009, respectively and is reported on the Statement of Stockholder's Equity as return of capital contributions. In 2010 and 2009, the return of these noncash equity contributions relate to the settlement of certain net intercompany receivables due from the Parent.

The Company received cash equity contributions from the Parent of $69,000 in 2010 and $30,000 in 2009 and is reported on the Statement of Stockholder's Equity as capital contribution. In 2010 and 2009, the cash equity contributions were used to reduce the Company's short-term borrowings.

AQUA PENNSYLVANIA, INC.
(a wholly-owned subsidiary of Aqua America, Inc.)

Consolidated Financial Statements
As of and for the years ended
December 31, 2009 and 2008

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia PA 19103-7042
www.pwc.com

Report of Independent Auditors

To the Board of Directors and Stockholder of
Aqua Pennsylvania, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of cash flows, of capitalization and of stockholder's equity present fairly, in all material respects, the financial position of Aqua Pennsylvania, Inc. (a wholly-owned subsidiary of Aqua America, Inc.) and its subsidiaries at December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These consolidated 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 of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 our opinion.

PricewaterhouseCoopers LLP

April 20, 2010

AQUA PENNSYLVANIA, INC.
Consolidated Balance Sheets
(In thousands of dollars)
December 31, 2009 and 2008

Assets	2009	2008
Utility plant, net of accumulated depreciation	$ 1,831,894	$ 1,682,567
Construction work-in-progress	30,346	13,650
Utility plant acquisition adjustment, net	(3,774)	(4,034)
Net utility plant	1,858,466	1,692,183
Investment in nonutility property, net of accumulated depreciation	2,400	2,052
Current assets:		
Cash and cash equivalents	11,651	1,048
Accounts receivable, less allowance for doubtful accounts of $2,526 and $2,839	21,445	23,015
Unbilled revenues	17,601	17,548
Materials and supplies	4,114	3,878
Prepayments and other current assets	1,553	1,285
Total current assets	56,364	46,774
Regulatory assets	108,511	102,022
Deferred charges and non-current assets:		
Debt issuance expense, net of amortization	14,277	12,195
Other deferred charges, net	5,992	4,307
Funds restricted for construction activity	77,510	44,018
Goodwill	2,632	1,522
Total deferred charges and non-current assets	100,411	62,042
	$ 2,126,152	$ 1,905,073

Liabilities and Equity	2009	2008
Aqua Pennsylvania's stockholder's equity:		
Common stock, $100 par value, 1,000,000 shares authorized, 1,000 shares issued and outstanding	$ 100	$ 100
Capital in excess of par value	245,395	230,868
Retained earnings	475,513	406,453
Total Aqua Pennsylvania's stockholder's equity	721,008	637,421
Noncontrolling interest	225	188
Total equity	721,233	637,609
Long-term debt, excluding current portion	826,618	719,548
Current liabilities:		
Current portion of long-term debt	25,279	5,002
Loans payable	15,000	60,734
Accounts payable	30,991	23,692
Accounts payable-affiliates	12,304	4,746
Accrued interest	9,444	9,143
Income taxes payable	6,205	7,981
Other current liabilities	5,162	5,160
Total current liabilities	104,385	116,458
Deferred credits and other non-current liabilities:		
Customers' advances for construction	48,145	45,190
Deferred income taxes	317,585	282,454
Investment tax credits	4,899	3,511
Regulatory liabilities	12,777	10,695
Other	2,109	1,964
Total deferred credits and other non-current liabilities	385,515	343,814
Contributions in aid of construction	88,401	87,644
	$ 2,126,152	$ 1,905,073

See accompanying notes to consolidated financial statements.

AQUA PENNSYLVANIA, INC.
Consolidated Statements of Income
(In thousands of dollars)
Years ended December 31, 2009 and 2008

	2009	2008
Operating revenues	$ 347,015	$ 327,384
Operating expenses:		
Operating, maintenance and administrative expenses	107,241	103,036
Gain on sale of other assets	(214)	(1,164)
Depreciation	56,756	49,036
Amortization	239	161
Taxes other than income taxes	10,210	10,197
Total operating expenses	174,232	161,266
Operating income	172,783	166,118
Other (income) deductions:		
Interest on long-term debt	42,277	38,448
Other interest expense, net	750	1,480
Allowance for funds used during construction	(1,919)	(2,206)
Amortization of debt issuance costs	800	551
Other income, net	(2,017)	(1,654)
Total other (income) deductions	39,891	36,619
Income before income taxes	132,892	129,499
Provision for income taxes	52,559	51,275
Net income	$ 80,333	$ 78,224

See accompanying notes to consolidated financial statements.

AQUA PENNSYLVANIA, INC.
Consolidated Statements of Cash Flows
(In thousands of dollars)
Years ended December 31, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Net income	$ 80,333	$ 78,224
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Depreciation and amortization	57,795	49,748
Deferred income taxes and income tax credits	30,738	30,973
Provision for doubtful accounts	2,614	2,180
Stock based compensation	865	1,011
Gain on sale of other assets	(214)	(1,164)
Changes in current assets and current liabilities		
Receivables, unbilled revenue, materials and supplies and prepayments	(1,394)	(5,612)
Affiliate receivable/payable	(8,939)	(17,702)
Payables, accrued taxes and other accrued liabilities	(12,008)	6,981
Accrued interest	301	824
Other	(1,233)	1,118
Net cash provided by operating activities	148,858	146,581
Cash flows used in investing activities:		
Construction expenditures	(197,654)	(169,934)
Allowance for funds used during construction	(1,919)	(2,206)
Addition to funds restricted for construction activity	(128,419)	(22,407)
Release of funds previously restricted for construction activity	94,928	36,335
Acquisitions of water and wastewater systems	(1,159)	(5,227)
Net proceeds on sale of other assets	142	1,247
Other	(1,072)	(1,244)
Net cash used in investing activities	(235,153)	(163,436)
Cash flows from financing activities:		
Customers' advances and contributions in aid of construction	264	918
Repayments of customers' advances	(337)	(2,132)
Net borrowings (repayments) of loans payable	(45,734)	41,746
Proceeds from long-term debt	132,492	24,479
Debt issuance costs paid	(2,942)	(893)
Repayments of long-term debt	(5,086)	(21,378)
Change in cash overdraft position	(486)	(710)
Capital contribution from Aqua America, Inc.	30,000	22,500
Dividends paid - common stock	(11,273)	(46,880)
Net cash provided by financing activities	96,898	17,650
Net change in cash and cash equivalents	10,603	795
Cash and cash equivalents at beginning of year	1,048	253
Cash and cash equivalents at end of year	$ 11,651	$ 1,048

Cash paid for interest on all borrowings, net of amounts capitalized, was $40,057 and $35,417 in 2009 and 2008, respectively.

Cash paid for income taxes was $16,074 and $9,339 in 2009 and 2008, respectively.

See Note 1 - Summary of Significant Accounting Policies-Customers' Advances for Construction, Note 10 - Employee Stock and Incentive Plan and Note 12 - Affiliated Company Transactions for description of non-cash activities.

See accompanying notes to consolidated financial statements.

AQUA PENNSYLVANIA, INC.
Consolidated Statements of Capitalization
(In thousands of dollars)
December 31, 2009 and 2008

		2009	2008
Aqua Pennsylvania's stockholder's equity:			
Common stock at $100 par value, authorized 1,000,000 shares,			
1,000 shares issued and outstanding		$ 100	$ 100
Capital in excess of par value		245,395	230,868
Retained earnings		475,513	406,453
Total Aqua Pennsylvania's stockholder's equity		721,008	637,421
Noncontrolling interest		225	188
Total equity		721,233	637,609
Long-term debt:			
Long-term debt of subsidiaries (substantially secured by utility plant):			
Interest Rate Range	Maturity Date Range		
1.00% to 1.99%	2011 to 2035	20,129	20,513
2.00% to 2.99%	2024 to 2027	9,916	10,463
3.00% to 3.99%	2010 to 2029	28,455	30,436
4.00% to 4.99%	2020 to 2041	223,647	148,884
5.00% to 5.99%	2012 to 2043	274,988	218,989
6.00% to 6.99%	2011 to 2030	112,202	112,182
7.00% to 7.99%	2025 to 2025	15,000	15,000
8.00% to 8.99%	2022 to 2025	9,000	9,000
9.00% to 9.99%	2010 to 2026	55,800	56,200
		749,137	621,667
Unsecured notes payable:			
Notes ranging from 5.00% to 5.99%, due 2014 through 2037		102,132	102,132
Installment note payable, 9.0% due in equal annual payments through 2013		628	751
		851,897	724,550
Current portion of long-term debt		25,279	5,002
Long-term debt, excluding current portion		826,618	719,548
Total capitalization		$ 1,547,851	$ 1,357,157

See accompanying notes to consolidated financial statements.

AQUA PENNSYLVANIA, INC.
Statements of Stockholder's Equity
(In thousands of dollars)
Years ended December 31, 2009 and 2008

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Total Stockholder's Equity
Balance at December 31, 2007	$ 100	$ 233,049	$ 375,109	$ 608,258
Net Income	-	-	78,224	78,224
Common Stock Dividends	-	-	(46,880)	(46,880)
Stock based compensation	-	1,393	-	1,393
Capital Contribution from Aqua America, Inc.	-	22,500	-	22,500
Return of Capital Contribution to Aqua America, Inc.	-	(26,074)	-	(26,074)
Balance at December 31, 2008	100	230,868	406,453	637,421
Net Income	-	-	80,333	80,333
Common Stock Dividends	-	-	(11,273)	(11,273)
Stock based compensation	-	941	-	941
Capital Contribution from Aqua America, Inc.	-	30,000	-	30,000
Return of Capital Contribution to Aqua America, Inc.	-	(16,414)	-	(16,414)
Balance at December 31, 2009	$ 100	$ 245,395	$ 475,513	$ 721,008

See accompanying notes to consolidated financial statements.

AQUA PENNSYLVANIA, INC.
Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(In thousands of dollars)

1. Summary of Significant Accounting Policies

Nature of Operations

Aqua Pennsylvania, Inc. ("the Company") is a regulated public utility which supplies water to residential, commercial and industrial customers. The Company's customers are principally located in the suburban areas north and west of the City of Philadelphia and in 25 other counties in Pennsylvania. No single customer accounted for more than one percent of the Company's operating revenues in 2009 or 2008. The Company is a wholly-owned subsidiary of Aqua America, Inc. ("the Parent"). The Company has wholly-owned subsidiaries that are regulated public utilities which provide water and wastewater services to customers in Pennsylvania.

The consolidated financial statements include the accounts of the Company and its subsidiary. All intercompany accounts and transactions have been eliminated in consolidation.

Basis of Presentation

The Company has evaluated subsequent events after the balance sheet date of December 31, 2009 through April 20, 2010. Certain prior period amounts have been reclassified to conform to the current period presentation.

Recognition of Revenues

Operating revenues include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the latest billing to the end of the accounting period.

1. Summary of Significant Accounting Policies (Continued)

Regulation

As a regulated public water utility, the Company is subject to regulation by the Pennsylvania Public Utility Commission ("PAPUC"), which has jurisdiction with respect to rates, service, accounting procedures, acquisitions and other matters. The Company defers certain costs and credits as regulatory assets and liabilities when it is probable that such amounts will be recognized in the rate making process in a period different from the period in which they would have been reflected in income by an unregulated company.

Utility Plant and Depreciation

Utility plant is stated at cost which includes contracted cost, direct labor and fringe benefits, materials, overheads, and for certain utility plant, an allowance for the cost of funds used during construction. Water systems acquired are recorded at estimated original cost when first devoted to utility service and the applicable depreciation is recorded in accumulated depreciation. Utility plant acquisition adjustment represents the difference between the estimated original cost, less applicable depreciation and the purchase price of utility plant assets acquired through business acquisitions. Acquisition adjustments are amortized over 20 years if recoverable in rate base.

Expenditures for maintenance and repairs, including major maintenance projects and minor renewals and betterments, are charged to operating expenses when incurred in accordance with the Uniform System of Accounts prescribed by the PAPUC. The cost of new units of property and betterments are capitalized. Utility expenditures for water main cleaning and relining of pipes are deferred and recorded in net property, plant and equipment. As of December 31, 2009, $15,643 of costs have been incurred since the last rate proceeding and the Company expects to recover these costs in future rates.

The cost of software upgrades and enhancements are capitalized if they result in added functionality which enable the software to perform tasks it was previously incapable of performing. Certain information technology costs

1. Summary of Significant Accounting Policies (Continued)

Utility Plant and Depreciation (Continued)

associated with major system installations, conversions and improvements, such as software training, data conversion and business process re-engineering costs, are deferred as a regulatory asset if the Company expects to recover these costs in future rates. If these costs are not deferred, then these costs are charged to operating expenses when incurred. As of December 31, 2009, $3,116 of costs have been incurred and deferred, since the last rate proceedings, as a regulatory asset, and the deferral is reported as a component of net property, plant and equipment.

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to utility plant and such value, together with the net cost of removal, is charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is recorded. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. These amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates.

The straight-line remaining life method is used to compute depreciation on utility plant. The straight-line method is used with respect to transportation and mechanical equipment, office equipment and laboratory equipment. Depreciation is recorded over the estimated useful lives of the assets which range from 14 to 85 years for utility plant and 6 to 78 years for both transportation and mechanical equipment and all non-utility plant, office equipment and laboratory equipment.

Long-lived assets of the Company, which consist primarily of utility plant in service and regulatory assets, are reviewed for impairment when changes in circumstances or events occur. There has been no change in circumstances or events that have occurred that require adjustments to the carrying values of these assets.

1. Summary of Significant Accounting Policies (Continued)

Allowance for Funds Used During Construction

The allowance for funds used during construction ("AFUDC") is a non-cash credit to income which represents the estimated cost of funds used to finance the construction of utility plant. AFUDC is applied to construction projects requiring more than one month to complete. No AFUDC is applied to projects funded by customer advances for construction or contributions in aid of construction. AFUDC includes the new cost of borrowed funds and a rate of return on other funds when used, and is recovered through water rates as the utility plant is depreciated. There was no AFUDC related to equity funds in 2009 and 2008.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less, which are not restricted for construction activity, to be cash equivalents.

The Company had a book overdraft of its disbursement cash accounts of \$0 and \$486 at December 31, 2009 and 2008, respectively. The balance of the book overdraft is reported as accounts payable and the change in the book overdraft balance is reported as cash flows from financing activities.

Accounts Receivable

Accounts receivable are recorded on the invoiced amounts. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in our existing accounts receivable, and is determined based on historical write-off experience and the aging of account balances. The Company reviews the allowance for doubtful accounts quarterly. Account balances are written off against the allowance when it is probable the receivable will not be recovered. When utility customers request extended payment terms, credit is extended based on regulatory guidelines and collateral is not required.

1. Summary of Significant Accounting Policies (Continued)

Deferred Charges

Deferred charges consist of debt issuance expenses, preliminary survey costs, retirement work in progress expenses and other expenses.

Deferred debt issuance expenses are amortized over the life of the related issues.

Call premiums related to the early redemption of long-term debt, along with the unamortized balance of the related issuance expense, are deferred and included in issuance expense amortized over the life of the long-term debt used to fund the redemption.

Other expenses, for which the Company has received or expects to receive prospective rate recovery, are deferred and amortized over the period of rate recovery.

Funds Restricted for Construction Activity

The proceeds received from certain financings for construction and capital improvement of utility facilities are held in escrow until the designated expenditures are incurred. These amounts are reported as funds restricted for construction activity and are expected to be released over time as the capital projects are funded.

Goodwill

Goodwill represents the excess cost over the fair value of net tangible and identifiable assets acquired through acquisitions. Goodwill is not amortized but is tested for impairment annually, or more often, if circumstances indicate a possible impairment may exist. The Company tested its goodwill for impairment as of July 31, 2009 in conjunction with the timing of the Company's annual strategic business plan. Based on a comparison of the estimated fair value of the Company to its respective carrying amount, the impairment test concluded that none of its goodwill was impaired. During 2009, the Company recorded an additional $1,110 of goodwill related to the finalization of the purchase price allocation for a 2008 acquisition.

1. Summary of Significant Accounting Policies (Continued)

Income Taxes

The Company accounts for certain income and expense items in different time periods for financial reporting than for tax reporting purposes. Deferred income taxes are provided on the temporary differences between the tax basis of the assets and liabilities and the amounts at which they are carried in the consolidated financial statements. The income tax effect of temporary differences not reflected currently in rates is recorded as deferred taxes with an offsetting regulatory asset or liability. These deferred income taxes are based on the enacted tax rates expected to be in effect when such temporary differences are projected to reverse. Investment tax credits are deferred and amortized over the estimated useful lives of the related properties.

The Company's earnings are included with those of the Parent and affiliated companies for purposes of filing a consolidated Federal income tax return. The allocation of the Federal income tax to the company is computed on a stand-alone basis. The liability for Federal income taxes is remitted to the Parent. The receivable for Federal income taxes will be remitted to the Company from the Parent.

Judgment is required in evaluating the Company's federal and state tax positions. Despite management's belief that the Company's tax return positions are fully supportable, the Company may establish reserves when it believes that certain tax positions are likely to be challenged and it may not fully prevail in these challenges. The Company's provision for income taxes includes interest, penalties and reserves for uncertain tax positions.

Customers' Advances for Construction

Water mains or, in some instances, cash advances to reimburse the Company its costs to construct water mains, are contributed to the Company by customers, real estate developers and builders in order to extend water service to their properties. The value of these contributions is recorded as Customers' Advances for Construction. The Company makes refunds on these advances over a specific period of time based on operating revenues related to the main or as new customers are connected to and take service from the main. After all refunds are made, any remaining balance is transferred to Contributions in Aid of

1. Summary of Significant Accounting Policies (Continued)

Customers' Advances for Construction (Continued)

Construction. Non-cash property, in the form of water mains, has been received, generally from developers as advances or contributions of $3,787 in 2009 and $4,620 in 2008.

Contributions in Aid of Construction

Contributions in aid of construction include direct non-refundable contributions and the portion of customers' advances for construction that have become non-refundable. Utility plant funded by contributions is excluded from rate base and is not depreciated.

Materials and Supplies

Materials and supplies are stated at cost under the first-in, first-out method.

Use of Estimates in Preparation of Consolidated Financial Statements

The preparation of consolidated financial statements in conformity with accounting principles accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

AQUA PENNSYLVANIA, INC
Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(In thousands of dollars)

2. Utility Plant

Gross Utility Plant is composed of the following:

	December 31, 2009	December 31, 2008	Approximate range of remaining lives
Utility plant			
Mains and accessories	$ 1,157,199	$ 1,041,793	40 to 82 years
Services, hydrants, treatment plants and reservoirs	524,355	493,279	14 to 85 years
Operations structures and water tanks	76,477	70,915	30 to 35 years
Miscellaneous pumping and purification equipment	221,648	227,516	14 to 78 years
Meters, data processing, transportation and operating equipment	233,357	217,830	6 to 78 years
Land and other non-depreciable assets	36,452	36,600	-
Utility Plant	2,249,488	2,087,933	
Utility construction work-in-progress	30,346	13,650	-
Net utility plant acquisition adjustment	(3,774)	(4,034)	2 to 20 years
Total Utility Plant	2,276,060	2,097,549	
Accumulated Depreciation	(417,594)	(405,366)	
Utility Plant, net of accumulated depreciation	$ 1,858,466	$ 1,692,183	

3. Acquisitions

During 2009, the Company acquired two wastewater and seven water systems. The acquisitions were recorded under the purchase method of accounting. The total purchase price for the systems acquired was $1,159 in cash. Operating revenues included in the consolidated financial statements during the period owned by the Company were $360.

(In thousands of dollars)

3. Acquisitions (Continued)

On September 30, 2008, the Company completed the merger of the Honesdale Consolidated Water Company ("HWC") for $4,227 in cash (net of cash acquired of $778) and the assumption of $1,734 of long-term debt. At the time of acquisition, HWC provided water service to 1,891 customers located within portions of Honesdale Borough and Texas Township, Wayne County, Pennsylvania. Operating revenues included in the consolidated financial statements related to the system acquired were $901 in 2009 and $238 in 2008.

The purchase price allocation as of September 30, 2008, as adjusted, is as follows:

Property, plant and equipment, net	$	4,497
Current assets		294
Goodwill		2,632
Total assets acquired		7,423
Current liabilities		256
Long-term debt		1,734
Other long-term liabilities		1,206
Total liabilities assumed		3,196
Net assets acquired	$	4,227

During 2008, the Company also acquired one wastewater and one water system. The acquisitions were recorded under the purchase method of accounting. The total purchase price for the systems acquired was $1,000 in cash. Operating revenues included in the consolidated financial statements related to the systems acquired were $248 in 2009 and $12 in 2008.

AQUA PENNSYLVANIA, INC.
Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(In thousands of dollars)

4. Income Taxes

The provision for income taxes is composed of the following:

	Years ended December 31,	
	2009	2008
Current:		
Federal	$ 13,819	$ 11,763
State	8,002	8,539
	21,821	20,302
Deferred:		
Federal	28,982	29,639
State	1,756	1,334
	30,738	30,973
Total tax expense	$ 52,559	$ 51,275

(In thousands of dollars)

4. Income Taxes (Continued)

The statutory Federal tax rate is 35% and the Pennsylvania Corporate Net Income tax rate is 9.99% for both years presented.

The reasons for the differences between amounts computed by applying the statutory Federal income tax rate to income before income tax expense and the actual income tax expense are as follows:

	Years ended December 31,	
	2009	2008
Computed Federal income tax expense at statutory rate	$ 46,512	$ 45,324
Increase in tax expense for depreciation expense to be recovered in future rates	199	314
Amortization of investment tax credits	(128)	(128)
Domestic production credit	(450)	(344)
Stock-based compensation	157	275
State income taxes, net of federal tax benefit	6,351	6,417
Deferred tax adjustment	-	(639)
Other, net	(82)	56
Actual income tax expense	$ 52,559	$ 51,275

(In thousands of dollars)

4. Income Taxes (Continued)

The tax effects of temporary differences between book and tax accounting that give rise to the deferred tax assets and deferred tax liabilities are as follows:

	December 31, 2009	December 31, 2008
Deferred tax assets:		
Customers' advances for construction	$ 9,090	$ 8,793
Costs expensed for book not deducted for tax, principally accrued expenses	1,089	932
Stock options	-	73
Total deferred tax assets	10,179	9,798
Deferred tax liabilities:		
Utility plant, principally due to depreciation and differences in the basis of fixed assets due to variation in tax and book accounting	299,011	264,446
Deferred taxes associated with the gross-up of revenues necessary to recover, in rates, the effect of temporary differences	28,753	27,783
Investment tax credits	4,899	3,511
Other	-	23
Total deferred tax liabilities	332,663	295,763
Net deferred tax liability	$ 322,484	$ 285,965

As of December 31, 2009, the Parent's Federal income tax returns for all years through 2005 have been closed. Tax years 2006 through 2009 remain open to examination by the major taxing jurisdictions to which we are subject.

AQUA PENNSYLVANIA, INC.
Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(In thousands of dollars)

5. Regulatory Assets and Liabilities

Regulatory assets represent costs that are expected to be fully recovered from customers in future rates while regulatory liabilities represent amounts that are expected to be refunded to customers in future rates. Except for income taxes and the competitive transition charge payment, regulatory assets and regulatory liabilities are excluded from the Company's rate base and do not earn a return. The components of regulatory assets and (liabilities) are as follows:

	December 31,	
	2009	2008
Income taxes, net	$ 73,285	$ 70,111
Competitive Transition Charge payment	1,147	2,293
Postretirement benefits	(13,035)	(12,869)
Merger costs	-	52
Utility plant retirement costs	33,403	31,027
Capital stock taxes	175	-
Rate case filing expenses	759	713
	$ 95,734	$ 91,327

Items giving rise to deferred state income taxes, as well as a portion of deferred Federal income taxes related to certain differences between tax and book depreciation expense, are recognized in the rate setting process on a cash or flow-through basis and will be recovered as they reverse.

The regulatory asset associated with the Competitive Transition Charge ("CTC") payment represents the full pay off in 2001, net of amortization, of the Company's allocable share of CTC as negotiated by the Company from the electric distribution company, PECO Energy Company. The Pennsylvania Electricity Generation Customer Choice and Competition Act permitted electric distribution utilities to recover their stranded costs from its customers in the form of CTC. Rate recovery of the $11,465 CTC payment began in 2000 and is expected to conclude in 2010.

5. Regulatory Assets and Liabilities (Continued)

Postretirement benefits include pension and other postretirement benefits. The regulatory liability for postretirement benefits represents amounts recovered through rates and before the costs are incurred. The regulatory asset for postretirement benefits includes deferred net pension expense in excess of amounts funded, which the Company believes will be recoverable in future years as pension funding is required. In addition, regulatory assets related to postretirement benefits other than pensions represents costs that were deferred between the time that the accrual method of accounting for these benefits was adopted in 1993 and the recognition of the accrual method in the Company's rates as prescribed in subsequent rate filings. Amortization of the amount deferred for postretirement benefits other than pensions began in 1994 and is currently being recovered in rates. Amortization will continue through December 2012.

The regulatory asset related to the recovery of merger costs represents the portion of merger costs of the Company's divisions that will be recovered in rates as a result of a rate settlement in 2000 and is being amortized over the recovery period of 10 years.

The regulatory asset for utility plant retirement costs, representing cost of removal, represents costs already incurred that are expected to be recovered in future rates over a five year recovery period.

The regulatory asset related to capital stock taxes represents additional capital stock taxes incurred by the Company which it expects to receive rate recovery over a five month period.

The regulatory asset related to rate case filing expenses represents the costs associated with filing for rate increases that are deferred and amortized over periods that range from one to three years.

6. Commitments and Contingencies

The Company maintains agreements with other water purveyors for the purchase of water to supplement its water supply, particularly during periods of peak demands. The agreements stipulate purchases of minimum quantities of water or charge a monthly commitment fee through the year 2026. The Company is committed to a total of $86,763 in water purchase payments:

6. Commitments and Contingencies (Continued)

$10,782 in 2010, $10,975 in 2011, $7,162 in 2012, $7,136 in 2013 and $7,026 in 2014 and $43,682 thereafter. The Company purchased approximately $11,724 and $10,903 of water under these agreements during the years ended December 31, 2009 and 2008, respectively.

The Company leases motor vehicles, buildings, and other equipment under operating leases that are noncancelable. During the next five years, $936 of future minimum rental payments are due: $447 in 2010, $291 in 2011, $135 in 2012, $48 in 2013 and $15 in 2014 and $0 thereafter. The company leases parcels of land on which treatment plants and other facilities are situated and adjacent parcels that are used for watershed protection. The two operating leases are noncancelable, expire in 2045 and 2052 and contain certain renewal provisions. The leases are subject to an adjustment every five years based on changes in the Consumer Price Index. During each of the next five years, subject to the aforesaid adjustment, $438 of rental payments for land are due and the aggregate of the years remaining approximates $14,347 thereafter. Rent expense was $1,090 and $1,214 for the years ended December 31, 2009 and 2008, respectively.

The Company is routinely involved in condemnation procedures and legal matters during the ordinary course of business. Although the results of legal proceedings cannot be predicted with certainty, there are no other pending legal proceedings to which the Company is a party or to which any of its properties is the subject that are material or are expected to have a material effect on the Company's financial position, results of operations or cash flows.

7. Long-term Debt and Loans Payable

The consolidated Statements of Capitalization provide a summary of long-term debt as of December 31, 2009 and 2008. The supplemental indentures with respect to certain issues of the First Mortgage Bonds restrict the ability of the Company to declare dividends, in cash or property, or repurchase or otherwise acquire the Company's stock. Approximately $456,000 and $386,000 of the Company's retained earnings were free of these restrictions as of December 31, 2009 and 2008, respectively. Certain supplemental indentures also prohibit the Company from making loans to, or purchasing the stock of the Parent.

(In thousands of dollars)

7. Long-term Debt and Loans Payable (Continued)

Sinking fund payments are required for certain issues of long-term debt. The future sinking fund payments and debt maturities of the Company's long-term debt are as follows:

Interest Rate Range	2010	2011	2012	2013	2014	Thereafter
1.00% To 1.99%	$ 1,727	$ 1,747	$ 1,582	$ 1,578	$ 1,368	$ 12,127
2.00% To 2.99%	555	566	575	599	613	7,008
3.00% To 3.99%	2,322	1,967	1,953	2,017	2,083	18,113
4.00% To 4.99%	141	147	153	159	165	222,882
5.00% To 5.99%	-	-	25,000	-	44,584	307,536
6.00% To 6.99%	-	15,000	-	-	-	97,202
7.00% To 7.99%	-	-	-	-	-	15,000
8.00% To 8.99%	-	-	-	-	-	9,000
9.00% To 9.99%	20,534	5,547	560	5,587	400	23,800
Total	$ 25,279	$ 24,974	$ 29,823	$ 9,940	$ 49,213	$ 712,668

In July 2009, the Company issued $58,000 of tax-exempt bonds secured by a supplement to its first mortgage indenture at the following terms: $58,000 at 5.23% due 2039. In November 2009, the Company issued an additional $74,685 of tax-exempt bonds secured by a supplement to its first mortgage indenture at the following terms: $62,165 at 4.88% due 2040 and $12,520 at 4.90% due 2040. The proceeds are restricted to funding certain capital projects during the period 2009 through 2012. At various times during 2009, the Company issued other notes payable aggregating $1,515 at a weighted average interest rate of 1.40% due at various times ranging from 2028 to 2030.

In December 2008, the Company issued $22,000 of tax-exempt bonds secured by a supplement to its first mortgage indenture at the following terms: $9,000 at 6.25% due 2017 and $13,000 at 6.75% due 2018. The proceeds are restricted to funding certain capital projects during the period 2009 through 2011. At various times during 2008, the Company issued other notes payable aggregating $2,658 at a weighted average interest rate of 1.47% due at various times ranging from 2016 to 2035. The proceeds from these issuances were used to reduce a portion of the balance of the short-term debt.

7. Long-term Debt and Loans Payable (Continued)

As of December 31, 2009, the Trustees for two issues held $77,510 pending construction of the projects to be financed with the issues and are reported in the consolidated balance sheet as funds restricted for construction activity.

The Company has a $70,000 364-day revolving credit facility with two banks. Funds borrowed under this agreement are classified as loans payable and are used to provide working capital. As of December 31, 2009 and 2008, funds borrowed under the Company's revolving credit agreements were $15,000 and $60,734, respectively. Interest under this facility is based, at the borrower's option, on the prime rate, an adjusted federal funds rate, an adjusted London Interbank Offered Rate corresponding to the interest period selected, an adjusted Euro-Rate corresponding to the interest period selected or at rates offered by the banks. This agreement restricts short-term borrowings of the Company. A commitment fee of 0.25% is charged on the total commitment amount of the revolving credit agreement. The average cost of borrowing under this facility was 1.20% and 3.05%, and the average borrowing was $56,389 and $46,796 during 2009 and 2008, respectively. The maximum amount outstanding at the end of any one month was $67,639 in 2009 and $62,669 in 2008.

At December 31, 2009 and 2008, the Company had a discretionary line of credit of $10,000. Funds borrowed under this line are classified as loans payable and are used to provide working capital. As of December 31, 2009 and 2008, funds borrowed under the short-term lines of credit were $0. The average borrowing under the line was $4,750 and $2,333 during 2009 and 2008, respectively and the maximum amount outstanding at the end of any one month was $10,000 in 2009 and $5,000 in 2008. Interest under the line is based, at the borrower's option, on the prime rate, an adjusted federal funds rate, an adjusted London Interbank Offered Rate corresponding to the interest period selected, an

7. Long-term Debt and Loans Payable (Continued)

adjusted Euro-Rate corresponding to the interest period selected or at rates offered by the bank. The average cost of borrowings under this line during 2009 and 2008 was 1.57% and 2.15%, respectively.

8. Fair Value of Financial Instruments

The carrying amount of current assets and liabilities that are considered financial instruments approximates their fair values as of the dates presented. The carrying amount of the Company's long-term debt as of December 31, 2009 and 2008 is $851,897 and $724,550, respectively. The estimated fair value of the Company's long-term debt as of December 31, 2009 and 2008 is $767,531 and $698,349, respectively. The fair value of long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration.

The Company's customers' advances for construction and related tax deposits have carrying values of $48,145 and $45,190 at December 31, 2009 and 2008, respectively. Their relative fair values cannot be accurately estimated since future refund payments depend on several variables, including new customer connections, customer consumption levels and future rate increases. Portions of these non-interest bearing instruments are payable annually through 2024, and amounts not paid by the contract expiration dates become non-refundable. The fair value of these amounts would, however, be less than their carrying value due to the non-interest bearing feature.

9. Pension Plans and Other Postretirement Benefits

The Company participates in a noncontributory defined benefit pension plan sponsored by the Parent covering non-union employees hired prior to April 1, 2003 and select union employees. The eligibility of union employees is determined by the collective bargaining agreements covering those employees. Benefits under the plan are based on the participant's years of service and the annual average of the applicable compensation during the five consecutive computation periods of the final 10 computation periods as an active participant yielding the highest such average. Pension cost of the Company is based on amounts contributed to the pension plan as approved by the Parent and incorporated in rates approved by the PAPUC. Information regarding

9. Pension Plans and Other Postretirement Benefits (Continued)

accumulated and projected benefit obligations is not prepared at the subsidiary level.

The funding amount for the Pension Plan for Aqua America, Inc. Retirement Income Plan will be determined each year based on the recommendation of management and subject to approval by the Parent's Pension Committee. The funding amount will be an amount greater than or equal to the minimum required contribution and less than or equal to the maximum tax deductible contribution. The Company recorded pension amounts of $8,200 and $8,200 in 2009 and 2008, respectively.

The Company participates in two postretirement benefit plans sponsored by the Parent that provide certain life insurance benefits for retired employees and certain health care benefits for retired employees and their dependents. Employees may become eligible for these benefits if they have completed at least fifteen years of service and retire from the Company after reaching age 55 while still working for the Company. Retirees and their dependents under age 65 are covered by a point-of-service managed care plan that requires co-payments or an HMO. Employees hired after April 1, 2003 are not eligible for benefits.

Employees who elect to retire prior to attaining age 65 are generally required to make contributions towards their medical coverage until attaining age 65. Retirees and their dependents age 65 and over are required to purchase their own medical and drug coverage. The cost of this coverage is offset by Company contributions deposited in the plan's Premium Reimbursement Account. Costs of the Company are based on amounts contributed to the plans and incorporated in rates approved by the PAPUC.

The Company recorded costs for postretirement benefits other than pensions of $1,146 and $1,975 in 2009 and 2008, respectively. Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level.

9. Pension Plans and Other Postretirement Benefits (Continued)

The Company has a 401(k) savings plan that covers substantially all employees. The Company makes matching contributions that are invested in Aqua America, Inc. common stock based on a percentage of the employee's contribution, subject to certain limitations. The Company made matching contributions, recorded as compensation expense, of $747 and $424 for 2009 and 2008, respectively.

10. Employee Stock and Incentive Plan

The Company's employees participate in an Equity Compensation Plan sponsored by the Parent. Under the Aqua America, Inc. 2009 Omnibus Equity Compensation Plan, as approved by the Parent's shareholders to replace the 2004 Equity Compensation Plan, stock options, stock units, stock awards, stock appreciation rights, dividend equivalents, and other stock-based awards may be granted to the Company's employees and consultants and advisors equal to the market price of the stock on the day of the grant. The stock options are based upon the common stock of the Parent. Options are exercisable in installments of 33% annually, starting one year from the date of the grant and expire 10 years from the date of the grant. The Parent accounts for stock-based compensation using fair value.

The fair value of each option is amortized into compensation expense on a straight-line basis over their respective 36 month vesting period, net of estimated forfeitures. Compensation expense recognized by the Parent is allocated to its subsidiaries based on actual employee costs. Since the company is not obligated to reimburse the Parent for stock-based compensation costs incurred, the Company records these liabilities resulting from compensation costs to paid-in capital.

10. Employee Stock and Incentive Plan (Continued)

For the year ended December 31, 2009, the Company recognized share-based compensation as follows: operations and maintenance expense of $799; capitalized compensation costs within property, plant and equipment of $29; lowered income tax expense by $122, and lowered net income by $677. For the year ended December 31, 2008, the Company recognized share-based compensation as follows: operations and maintenance expense of $972; capitalized compensation costs within property, plant and equipment of $158, lowered income tax expense by $65, and lowered net income by $907.

Restricted stock awards provide the grantee with the rights of a shareholder, including the right to receive dividends and to vote such shares, but not the right to sell or otherwise transfer the shares during the restriction period. Restricted stock awards result in compensation expense which is equal to the fair market value of the stock on the date of the grant and is amortized ratably over the restriction period. During the years ended December 31, 2009 and 2008, the Company recorded stock-based compensation related to restricted stock awards as operations and maintenance expense in the amounts of $66 and $39, respectively.

11. Water Rates

On November 18, 2009 the company filed an application with the PAPUC designed to increase water rates by $43,200, or 11.8% on an annual basis. The company anticipates a final order to be issued by August 2010.

On July 31, 2008, the PAPUC granted the Company a water rate increase designed to increase total operating revenues by $34,428 on an annualized basis. The rates in effect at the time of the filing included $14,269 in Distribution System Improvement Charges ("DSIC") or 5.0% above the prior base rates. Consequently, the total base rates increased by $48,697 on an annualized basis and the DSIC was reset to zero.

The DSIC enables water utilities in Pennsylvania to add a surcharge to customer bills to offset the additional depreciation and capital costs related to infrastructure system replacement and rehabilitation projects completed and placed into service between base rate filings. The Company is permitted to request adjustments to the DSIC quarterly to reflect subsequent capital expenditures and it is reset to zero when new base rates that reflect the costs of those additions become effective or when the Company's earnings exceed a

11. Water Rates (Continued)

PAPUC benchmark. The maximum DSIC that can be in effect at any time is 7.5%. The DSIC provided revenues in 2009 and 2008 of $15,168 and $9,863, respectively.

In addition to its base rates and the DSIC, the Company has utilized a surcharge or credit on its bills to reflect certain changes in Pennsylvania State Taxes until such time as the tax changes are incorporated into base rates. A rate surcharge increased operating revenues in 2009 and 2008 by $0 and $473, respectively.

12. Affiliated Company Transactions

The Company has service agreements with certain affiliates. The types of services rendered between these entities relate to general supervision and administrative functions, long-range planning, tax, accounting, financing, engineering, legal, data processing services and other specialized support.

Services provided by these certain affiliates amounted to approximately $18,417 and $11,932 for 2009 and 2008, respectively.

The Company also provides various management, advisory, and other services for certain affiliates and is reimbursed by these affiliates. The amounts billed out amounted to approximately $1,675 and $1,469 in 2009 and 2008, respectively.

The Company returned noncash equity contributions to the Parent of $16,414 and $26,074 in 2009 and 2008, respectively and is reported on the Statement of Stockholder's Equity as return of capital contributions. In 2009 and 2008, the return of these noncash equity contributions relate to the settlement of certain net intercompany receivables due from the Parent.

12. Affiliated Company Transactions (Continued)

The Company received cash equity contributions from the Parent of $30,000 in 2009 and $22,500 in 2008 and is reported on the Statement of Stockholder's Equity as net of return of capital contribution. In 2009 and 2008, the cash equity contributions were used to reduce the Company's short-term borrowings.