

DELAWARE MUNICIPAL ELECTRIC CORPORATION
FINANCIAL STATEMENTS
DECEMBER 31, 2006 AND 2005

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Delaware Municipal Electric Corporation
Smyrna, Delaware

We have audited the accompanying balance sheets of Delaware Municipal Electric Corporation as of December 31, 2006 and 2005, and the related statements of operations and fund balances, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Delaware Municipal Electric Corporation as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The statistical data listed in the table of contents is presented for purposes of additional analysis and is not a required part of the general purpose financial statements of Delaware Municipal Electric Corporation. Such information has not been subject to the auditing procedures applied in the audit of the general purpose financial statements, and, accordingly, we express no opinion on it.

Papaleo, Rosen & Chelf, PA

Smyrna, Delaware
May 16, 2007

DELAWARE MUNICIPAL ELECTRIC CORPORATION

BALANCE SHEETS

DECEMBER 31, 2006 AND 2005

ASSETS

	2006	2005
Current Assets		
Cash	\$ 2,337,881	\$ 1,251,132
Accounts receivable	7,384,225	9,591,613
Total Current Assets	9,722,106	10,842,745
Property and Equipment		
Generation facility	31,387,916	31,395,690
Equipment	47,326	48,264
	31,435,242	31,443,954
Less: Accumulated depreciation	2,950,645	2,325,300
Total Property and Equipment	28,484,597	29,118,654
Assets Limited As To Use		
Under bond indenture, less current portion	2,731,271	2,616,068
Other Assets		
Deferred financing costs, net of accumulated amortization	859,350	916,336
Total Assets	\$ 41,797,324	\$ 43,493,803

LIABILITIES AND FUND EQUITY

Current Liabilities		
Current portion of long-term debt	\$ 1,028,000	\$ 998,000
Accounts payable	7,378,189	9,332,765
Accrued interest	748,281	763,721
Payroll taxes payable	1,279	-0-
Renewable Energy Fund	158,325	-0-
Total Current Liabilities	9,314,074	11,094,486
Long-Term Debt – Less Current Portion	30,335,848	31,381,890
Total Liabilities	39,649,922	42,476,376
Fund Equity		
Fund balance – unreserved	2,147,402	1,017,427
Total Liabilities and Fund Equity	\$ 41,797,324	\$ 43,493,803

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

DELAWARE MUNICIPAL ELECTRIC CORPORATION
STATEMENTS OF OPERATIONS AND FUND BALANCES
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Revenue	\$ 94,151,498	\$ 85,877,964
Operating Expenses		
Administration expense	23,327	24,364
Amortization	56,986	56,986
Audit	6,500	6,500
Depreciation	628,482	633,830
Dues and subscriptions	49,927	71,208
Employee benefits	53,049	46,634
Energy expense	89,505,703	81,881,215
Consulting services	241,339	359,894
Information services	5,293	19,970
Insurance	9,982	8,133
Interest expense	1,495,694	1,530,992
Legal	155,759	189,850
Legislative representation	7,535	14,283
Pension expense	16,420	15,740
Plant operation and maintenance	670,420	610,573
Salaries	252,422	241,978
Taxes – payroll	18,118	17,193
Telephone	3,480	3,947
Travel/meetings	18,324	15,590
Total Operating Expenses	93,218,760	85,748,880
Operating Income	932,738	129,084
Other Income (Expense)		
Active load management services - net	(9,135)	(15,871)
Interest income	206,172	112,304
Loss on disposal of assets	200	(8,036)
Total Other Income (Expense)	197,237	88,397
Net Income	1,129,975	217,481
Fund Balance – Beginning of Year	1,017,427	799,946
Fund Balance – End of Year	\$ 2,147,402	\$ 1,017,427

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

DELAWARE MUNICIPAL ELECTRIC CORPORATION

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Cash Flows From Operating Activities		
Net Income	\$ 1,129,975	\$ 217,481
Adjustments to reconcile net income to net cash		
Provided by operating activities:		
Depreciation and amortization	685,468	690,816
Amortization of bond premium	(18,042)	(18,042)
(Gain) Loss on disposal of assets	(200)	8,036
(Increase) decrease in:		
Accounts receivable	2,207,388	(5,453,732)
Assets limited to use	(115,203)	717,630
Increase (decrease) in:		
Accounts payable	(1,954,576)	5,198,842
Payroll taxes payable	1,279	(7,038)
Accrued interest	(15,440)	(19,399)
Net Cash Provided By Operating Activities	1,920,649	1,334,594
Cash Flows From Investing Activities		
Proceeds from disposal of assets	200	8,200
Purchase of equipment	(2,199)	-0-
Refund of prior year equipment purchase	7,774	-0-
Net Cash Provided By Investing Activities	5,775	8,200
Cash Flows From Financing Activities:		
Payments on long-term debt	(998,000)	(953,000)
Renewable Energy Fund	158,325	-0-
Net Cash Provided (Used) by Financing Activities	(839,675)	(953,000)
Net Increase in Cash	1,086,749	389,794
Cash – Beginning of Year	1,251,132	861,338
Cash – End of Year	\$ 2,337,881	\$ 1,251,132

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

DELAWARE MUNICIPAL ELECTRIC CORPORATION

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2006 AND 2005

Note A - Summary of Significant Accounting Policies

The Reporting Entity

Delaware Municipal Electric Corporation was formed in 1979 by various municipalities of the State of Delaware to undertake the planning, financing, development, acquisition, construction, reconstruction, improvement, enlargement, betterment, operation and maintenance of a project or projects to supply electric power and energy for the present and future needs of its members and others.

Property and Equipment

Property and equipment are carried at cost. Depreciation is provided principally on the straight-line method over the estimated useful lives of the respective assets. Maintenance and repairs are charged to expense as incurred; major renewals and betterments are capitalized. When items of property and equipment are sold or retired, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is included in the results of operations.

Generation equipment consists of capitalized acquisition and construction costs of the generation facility located in Smyrna, Delaware. The facility was placed in service May 1, 2002.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and disclosures. Accordingly, actual results could differ from those estimates. Any adjustments to estimated amounts are recognized in the year in which such adjustments are determined.

Deferred Financing Costs

Costs incurred in connection with the issuance of bonds are amortized to expense.

Assets Limited As To Use

Assets limited as to use, consists of short-term investments and are recorded on the balance sheet at fair value. These assets represent amounts held by the trustee for the repayment of obligations under the outstanding bond indenture.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Corporation considers all short-term debt securities purchased with a maturity of three months or less to be cash equivalents.

Note B – Concentrations of Credit Risk

The Corporation maintains its cash balances in one financial institution. The balances are insured by the Federal Deposit Insurance Corporation up to \$100,000. At December 31, 2006, the Corporation's uninsured cash balances were 100% collateralized with securities held by Wilmington Trust Company.

DELAWARE MUNICIPAL ELECTRIC CORPORATION

NOTES TO FINANCIAL STATEMENTS, CONTINUED

DECEMBER 31, 2006 AND 2005

Note C – Accounts Receivable

Accounts receivable consists of amounts due from the member municipalities and the operating agreement of Galt Power, Inc. as of December 31:

	2006	2005
Clayton	\$ 107,840	\$ 109,738
Galt Power, Inc.	-	320,472
Middletown	887,067	1,050,268
Milford	1,521,804	1,947,599
Miscellaneous	101	151
Newark	2,841,028	3,601,723
New Castle	546,555	697,994
Seaford	837,388	1,071,156
Smyrna	642,442	792,512
	\$ 7,384,225	\$ 9,591,613

Note D – Long-Term Debt

Long-term debt at December 31 consisted of the following:

	2006	2005
Delaware Municipal Electric Corporation Electric Revenue Bonds, Series 2001	\$ 31,015,848	\$ 31,973,890
Delaware Municipal Electric Corporation Electric Revenue Bonds, Series 2002	348,000	406,000
	31,363,848	32,379,890
Less: current portion	1,028,000	998,000
	\$ 30,335,848	\$ 31,381,890

In September 2001, the Corporation issued Electrical Revenue Bonds, Series 2001 for \$35,241,059 to fund the cost of acquisition and construction of the initial facilities, including the reimbursement to the project participants, any amounts previously advanced and the payment of any bond anticipation note previously issued, the proceeds of which were applied to pay such costs. The bonds mature serially from 2002 through 2021 at fixed rates from 3.5% to 5.25%. Additionally, there are term bonds, which mature in 2026. Interest on the term bonds is paid at a fixed rate of 5%.

In December 2002, the Corporation issued Electrical Revenue Bonds, Series 2002 for \$580,000 pursuant to Sections 2.2(a) and 2.3(a) of the Original Indenture for the purpose of completing the cost of acquisition and construction of the initial facilities. Principal on the 2002 Bond is payable in ten equal annual payments beginning on July 1, 2005. The interest rate on the 2002 Bond is variable, based on the one-month London Interbank Offered Rate plus 2.25 percentage points. The interest rate as of December 31, 2006 was 7.599%.

DELAWARE MUNICIPAL ELECTRIC CORPORATION

NOTES TO FINANCIAL STATEMENTS, CONTINUED

DECEMBER 31, 2006 AND 2005

Note D – Long-Term Debt, Continued

Gross receipts and real and personal property of the Corporation have been pledged as collateral. The seven participants in the project are contractually bound to pay debt service and other costs through power sales contracts. Each participant has a share in the project corresponding to its share of load, which is also the amount of debt service for which the project participant is responsible. The power sales contracts run as long as the bonds are outstanding on the project. If a participant defaults in its payment obligation, the remaining participants must pay their respective pro rata share of the defaulted amounts, not to exceed 125% of its initial pro rata share.

<u>Participant</u>	<u>Share %</u>
Clayton	1.5
Middletown	6.8
Milford	20.8
New Castle	8.9
Newark	47.4
Seaford	7.1
Smyrna	7.5

The Corporation is required to meet a debt service reserve requirement that is the lesser of the maximum annual debt service on the bonds, 125% of average annual debt service, or 10% of the original principal amount of the bonds.

The debt service requirements on the above bonds are as follows:

<u>December 31</u>	<u>Principal</u>	<u>Amortization Premium</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 1,028,000	\$ 18,042	\$ 1,466,040	\$ 2,512,082
2008	1,063,000	18,042	1,432,756	2,513,798
2009	1,113,000	18,042	1,383,178	2,514,220
2010	1,153,000	18,042	1,336,825	2,507,867
2011	1,198,000	18,042	1,287,718	2,503,760
Thereafter	<u>25,448,000</u>	<u>270,638</u>	<u>10,586,394</u>	<u>36,305,032</u>
	<u>\$ 31,003,000</u>	<u>\$ 360,848</u>	<u>\$ 17,492,911</u>	<u>\$ 48,856,759</u>

Note E – Cash Flow Information

Cash paid for interest for the years ended December 31, 2006 and 2005 was \$1,529,176 and \$1,568,434, respectively.

DELAWARE MUNICIPAL ELECTRIC CORPORATION
NOTES TO FINANCIAL STATEMENTS, CONTINUED
DECEMBER 31, 2006 AND 2005

Note F – Assets Limited as to Use

The components of assets limited as to use at December 31 are as follows:

	2006	2005
Debt Service Reserve	\$ 2,730,814	\$ 2,615,992
Debt Service Interest	454	73
Debt Service Principal	3	3
	\$ 2,731,271	\$ 2,616,068

Note G – Deferred Financing Costs

Amortization of deferred financing costs is calculated by the straight-line method over twenty-five years for the Electrical Revenue Bonds, Series 2001 and ten years for the Electrical Revenue Bonds, Series 2002.

	2006	2005
Deferred Financing Costs	\$ 1,138,711	\$ 1,138,711
Less: accumulated amortization	(279,361)	(222,375)
	\$ 859,350	\$ 916,336

Note H – Renewable Energy Fund

Delaware Municipal Electric Corporation is acting as administrator of the Delaware Municipal Utilities' Green Energy Fund Program for its members. This program was mandated by the State of Delaware to support renewable energy technologies, energy efficiency technologies, or demand side management programs. The members submit their required contributions to DEMEC who administers the grant program and releases funds for approved grants.

Funds held for participating members as of December 31, 2006 are as follows:

Town of Clayton	\$ 1,246
City of Dover	69,152
City of Lewes	6,871
Town of Middletown	10,340
City of Milford	18,153
City of New Castle	7,553
City of Newark	25,976
City of Seaford	10,842
Town of Smyrna	8,192
	\$ 158,325

Note I – Letter of Credit

At December 31, 2006, a standby letter of credit of \$10,000,000 was issued under an agreement expiring June 29, 2007. The letter is maintained to secure certain obligations under existing Transmission Provider Agreements.

STATISTICAL DATA

DELAWARE MUNICIPAL ELECTRIC CORPORATION

HISTORICAL ENERGY REQUIREMENTS

FISCAL YEARS ENDED 2005, 2004 AND 2003

Participant	<u>2005</u>		<u>2004</u>		<u>2003</u>	
	<u>Peak Demand KW</u>	<u>Total Demand MWH</u>	<u>Peak Demand KW</u>	<u>Total Demand MWH</u>	<u>Peak Demand KW</u>	<u>Total Demand MWH</u>
Milford	44,612	196,655	33,477	179,218	36,698	187,155
Newark	89,553	436,528	80,379	424,831	85,720	418,703
Others	103,928	422,407	85,420	395,166	76,375	242,539
	<u>238,093</u>	<u>1,055,590</u>	<u>199,276</u>	<u>999,215</u>	<u>198,793</u>	<u>848,397</u>

DELAWARE MUNICIPAL ELECTRIC CORPORATION
ELECTRIC SYSTEM SUMMARY OF OPERATING RESULTS
FISCAL YEARS ENDED 2005, 2004 AND 2003

CITY OF NEWARK

Fiscal Year Ended December 31	2005	2004	2003
Electricity Revenues	\$ 34,773,723	\$ 31,629,134	\$ 31,301,421
Operating Transfers In	422,299	-0-	-0-
Non-Operating Revenues	5,879	296,119	174,493
Total Revenues	35,201,901	31,925,253	31,475,914
Power Purchases	33,023,557	21,267,060	22,864,724
O & M Expenses	2,969,383	2,376,589	2,688,249
Operating Transfer Out	7,392,360	9,195,000	6,860,604
Total Expenses	\$ 43,385,300	\$ 32,838,649	\$ 32,413,577
Net Income (Loss)	(\$ 8,183,399)	(\$ 913,396)	(\$ 937,663)
Retained Earnings	\$ 10,128,879	\$ 15,399,771	\$ 16,969,446

CITY OF MILFORD

Fiscal Year Ended June 30	2005	2004	2003
Electricity Revenues	\$ 16,698,825	\$ 16,617,640	\$ 15,666,154
Operating Transfers In	477,551	322,520	-0-
Non-Operating Revenues (Expense)	(93,540)	(156,459)	345,581
Total Revenues	17,082,836	16,783,701	16,011,735
Power Purchases	9,549,922	9,935,069	10,382,569
O & M Expenses	3,055,694	2,380,468	2,327,262
Operating Transfer Out	2,750,000	3,010,000	3,031,525
Total Expenses	\$ 15,355,616	\$ 15,325,537	\$ 15,741,356
Net Income	\$ 1,727,220	\$ 1,458,164	\$ 270,379
Retained Earnings	\$ 11,599,937	\$ 9,872,717	\$ 8,619,249

DELAWARE MUNICIPAL ELECTRIC CORPORATION
CONDENSED BALANCE SHEET FOR THE ELECTRIC UTILITY
FISCAL YEARS ENDED 2005, 2004 AND 2003

CITY OF NEWARK

As of December 31	<u>2005</u>	<u>2004</u>	<u>2003</u>
Assets			
Net Property, Plant & Equipment	\$ 8,079,408	\$ 8,131,982	\$ 8,411,141
Current Assets	<u>6,307,853</u>	<u>10,449,384</u>	<u>9,058,450</u>
Total Assets	<u>\$ 14,387,261</u>	<u>\$ 18,581,366</u>	<u>\$ 17,469,591</u>
Liabilities and Equity			
Current Liabilities	\$ 4,227,532	\$ 2,234,120	\$ 488,850
Non Current Liabilities	30,850	34,968	-0-
Contributed Capital	10,860	11,254	11,295
Retained Earnings	<u>10,118,019</u>	<u>16,301,024</u>	<u>16,969,446</u>
Total Liabilities and Equity	<u>\$ 14,387,261</u>	<u>\$ 18,581,366</u>	<u>\$ 17,469,591</u>

CITY OF MILFORD

As of June 30	<u>2005</u>	<u>2004</u>	<u>2003</u>
Assets			
Current Assets	\$ 8,360,854	\$ 6,333,518	\$ 5,553,890
Net Fixed Assets	<u>8,385,603</u>	<u>8,517,914</u>	<u>8,905,824</u>
Total Assets	<u>\$ 16,746,457</u>	<u>\$ 14,851,432</u>	<u>\$ 14,459,714</u>
Liabilities and Equity			
Current Liabilities	\$ 1,420,658	\$ 1,315,315	\$ 1,858,394
Long-Term Debt	3,725,862	3,663,400	3,982,071
Retained Earnings	<u>11,599,937</u>	<u>9,872,717</u>	<u>8,619,249</u>
Total Liabilities and Equity	<u>\$ 16,746,457</u>	<u>\$ 14,851,432</u>	<u>\$ 14,459,714</u>

DELAWARE MUNICIPAL ELECTRIC CORPORATION

PROJECT PARTICIPANTS' COVERAGE RATIOS

FISCAL YEAR DECEMBER 31, 2005

Participant Entitlement Share	Town of Clayton	Town of Middletown	City of Milford	City of Newark	City of Seaford	Town of Smyrna	City of New Castle
	1.50%	6.80%	20.80%	47.40%	7.10%	7.50%	8.90%
Estimated Average							
Annual Debt Service	\$ 42,658	\$ 193,383	\$ 591,524	\$ 1,347,992	\$ 201,914	\$ 213,290	\$ 253,104
Revenues	\$ 1,376,653	\$ 11,348,556	\$ 16,698,825	\$ 35,201,901	\$ 10,905,723	\$ 10,053,229	\$ 7,249,345
Power Purchase	\$ 943,890	\$ 5,216,999	\$ 9,549,922	\$ 33,023,557	\$ 6,402,386	\$ 6,815,359	\$ 4,177,431
Expenditures	\$ 1,204,231	\$ 10,988,491	\$ 15,325,537	\$ 43,385,300	\$ 10,938,422	\$ 8,352,408	\$ 6,155,618
Excess Revenues	\$ 172,422	\$ 360,065	\$ 1,727,220	(\$ 8,183,399)	(\$ 32,699)	\$ 1,700,821	\$ 1,093,727
Retained Earnings	\$ 3,182,938	\$ 4,707,143	\$ 11,599,937	\$ 10,128,879	\$ 8,227,866	\$ 5,516,072	\$ 6,929,619
Debt Service Including 1.10 coverage as a % of:							
Revenues	3.10%	1.70%	3.54%	3.83%	1.85%	2.12%	3.49%
Power Purchase	4.52%	3.71%	6.19%	4.08%	3.15%	3.13%	6.06%
Expenditures	3.54%	1.76%	3.86%	3.11%	1.85%	2.55%	4.11%
Excess Revenues	24.74%	53.71%	34.25%	(16.47%)	(617.49%)	12.54%	23.14%
Retained Earnings	1.34%	4.11%	5.10%	13.31%	2.45%	3.87%	0.04%