CITY OF BALTIMORE
WATER UTILITY FUND

Financial Statements

June 30, 2014 and 2013

(With Independent Auditors' Report Thereon)

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Financial Statements

June 30, 2014 and 2013

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CITY OF BALTIMORE
STEPHANIE RAWLINGS-BLAKE
Mayor

DEPARTMENT OF AUDITS
Room 321, City Hall
Baltimore, Maryland 21202

KPMG LLP
Suite 12000
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Independent Auditors' Report

The Mayor, City Council, Comptroller and
Board of Estimates
City of Baltimore, Maryland

Report on the Financial Statements

We have jointly audited the accompanying financial statements of the Water Utility Fund (fund) of the City of Baltimore, Maryland, (City), which comprise the statements of net position as of June 30, 2014 and June 30, 2013, and the related statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, except for the matter discussed in the following paragraph. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

The City Auditor did not have an external peer review by an unaffiliated audit organization as required by Chapter 3 of *Government Auditing Standards* at least once every three years. The last external peer review was for the period ending December 31, 2011. The City Auditor is in the process of engaging an unaffiliated audit organization to conduct an external peer review for the three-year period ending December 31, 2014.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of the Water Utility Fund of the City of Baltimore, Maryland, as of June 30, 2014 and June 30, 2013, and the changes in financial positions and cash flows thereof for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matters

Reporting Entity

As discussed in note 1.a, the financial statements present only the Water Utility Fund and do not purport to, and do not, present fairly the financial position of the City of Baltimore, Maryland, as of June 30, 2014 and June 30, 2013, the changes in its financial position, or its cash flows for the years ended in accordance with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Change in Accounting Principle

As discussed in note 1.c and note 12 to the financial statements, in fiscal year 2014, the fund implemented the Governmental Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated July 18, 2016 on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.

KPMG LLP

Robert L. McCarty Jr., CPA
City Auditors
Department of Audits
July 18, 2016

Independent Auditors

This section of the City of Baltimore, Maryland's (City) Water Utility Fund (fund) financial statements presents our discussion and analysis of the fund's financial performance during the years ended June 30, 2014 and June 30, 2013.

Background

The fund supplies water to the City, as well as to portions of Baltimore, Anne Arundel, Carroll, Harford, and Howard counties. The fund serves over 1.8 million people by supplying approximately 73 billion gallons of water annually. Approximately 51% of the fund's customers and 42% of water usage are currently within the City, with the remaining 49% of customers and 58% of water usage being in the surrounding Maryland counties.

Highlights

- For fiscal year 2014, total operating revenues were $158.7 million, which represents an increase of 2.6% from fiscal year 2013 revenues. For fiscal year 2013, total operating revenues were $154.7 million, which represents an increase of 16.9% from fiscal year 2012 revenues.
- Total operating expenses for fiscal year 2014 were $136.1 million, an increase of $14.1 million over fiscal year 2013 operating expenses of $122.0 million, an increase of $7.1 million over fiscal year 2012 operating expenses of $114.9 million.
- Net position increased in fiscal years 2014 and 2013, by $18.7 million and $42.1 million, respectively.

Overview of the Financial Statements

This report consists of three parts: 1) management's discussion and analysis (this section), 2) financial statements, and 3) notes to the financial statements.

The financial statements provide both long-term and short-term information about the fund's overall financial status. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the fund's financial statements

(Continued)

The fund's financial statements are prepared in conformity with accounting principles generally accepted in the United States as applied to governmental units on an accrual basis. Under this basis, revenues are recognized in the period in which they are earned, expenses are recognized in the period in which they are incurred, and depreciation of assets is recognized in the statement of revenues, expenses, and changes in net position. All assets and liabilities associated with the operation of the fund are included in the statement of net position.

Financial Analysis of Net Position

(Expressed in thousands)

	June 30 2014	June 30 2013 (restated)	June 30 2012	Change 2014–2013	Change 2013–2012
Current and other assets	$ 253,340	$ 166,401	$ 236,657	$ 86,939	$ (70,256)
Capital assets	1,076,330	1,026,480	956,713	49,850	69,767
Deferred outflow of resources	40,707	40,267	—	440	40,267
Total assets	$ 1,370,377	$ 1,233,148	$ 1,193,370	$ 137,229	$ 39,778
Current liabilities	$ 49,961	$ 54,429	$ 39,134	$ (4,468)	$ 15,295
Noncurrent liabilities	669,200	546,182	561,511	123,018	(15,329)
Total liabilities	$ 719,161	$ 600,611	$ 600,645	$ 118,550	$ (34)
Net position:					
Invested in capital assets, net of related debt	$ 536,159	$ 528,427	$ 499,486	$ 7,732	$ 28,941
Restricted	68,885	53,772	52,321	15,113	1,451
Unrestricted	46,172	50,338	40,918	(4,166)	9,420
Total net position*	$ 651,216	$ 632,537	$ 592,725	$ 18,679	$ 39,812

* As a result of implementing GASB 65, the City restated net position for fiscal year 2013. However, fiscal year 2012 was not restated as it was not practical to adjust those amounts. See note 12 for additional information.

Analysis of Net Position

Net position may serve as a useful indicator of the fund's financial position. For the fund, assets exceeded liabilities by $651.2 million and $632.5 million in fiscal years 2014 and 2013, respectively. The fund's net position include its investment of $536.2 million and $528.4 million in capital assets (e.g., land, buildings, equipment, infrastructure), which is net of any related outstanding debt used to acquire those assets, at the end of fiscal years 2014 and 2013, respectively. The fund uses these capital assets to provide water services to citizens; consequently, these assets are not available for future spending.

Although the fund's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from customers of the fund through rates and charges, since the capital assets themselves cannot be liquidated for these liabilities. An additional portion of the fund's restricted net assets, $68.9 million in 2014 and $53.8 million in 2013, represents restricted resources that are legally obligated for revenue bond repayment requirements. The fund had unrestricted net assets of $46.2 million and $50.3 million as of June 30, 2014 and June 30, 2013, respectively.

During fiscal years 2014 and 2013, the fund expended $71.7 million and $89.5 million for capital assets, respectively. These assets primarily represent facility enhancements to comply with environmental regulations. The assets were funded primarily through cash reserves and proceeds of revenue bonds. Bond proceeds of $347 million (includes a premium of $28.3 million) were received in fiscal year 2014, of which $188.2 million was utilized to refund existing debit. The fund did not receive any bond proceeds during fiscal year 2013. Moody's Investor Services, Inc., and Standard & Poor's Rating Services show the utilities' bonds are rated Aa2 and AA for senior lien debt and Aa3 and AA- for subordinate lien debt, respectively.

Revenues, Expenses, and Changes in Net Position

(Expressed in thousands)

	June 30 2014	June 30 2013 (restated)	June 30 2012	Change 2014–2013	Change 2013–2012
Operating revenues	$ 158,678	$ 154,680	$ 132,340	$ 3,998	$ 22,340
Operating expenses:					
Salaries and wages	39,454	37,093	36,100	2,361	993
Other personnel costs	17,181	16,341	14,777	840	1,564
Contractual services	46,581	37,638	35,305	8,943	2,333
Material and supplies	10,052	8,982	8,591	1,070	391
Minor Equipment	679	791	613	(112)	178
Depreciation	22,118	21,122	19,551	996	1,571
Total operating expenses	136,065	121,967	114,937	14,098	7,030
Operating income	22,613	32,713	17,403	(10,100)	15,310
Nonoperating expense, net	(16,379)	(12,937)	(12,465)	(3,442)	(472)
Income before capital contributions	6,234	19,776	4,938	(13,542)	14,838
Capital contributions	12,445	22,328	26,858	(9,883)	(4,530)
Change in net position	18,679	42,104	31,796	$ (23,425)	$ 10,308
Beginning net position	632,537	590,433	560,929		
Ending net position	$ 651,216	$ 632,537	$ 592,725		

(Continued)

Analysis of Revenues, Expenses, and Changes in Fund Net Position

The overall increase in the fund's net position amounted to $18.7 million and $42.1 million for fiscal years 2014, and 2013, respectively, due to the implementation of a 15% and 9% water rate increase in fiscal years 2014 and 2013 respectively, to customers located in Baltimore City, Anne Arundel, Howard, and Carroll counties, successfully minimizing increases in operating expenses, and capital contributions, primarily from Baltimore County, corresponding to increases in the cost of the Capital Improvement Program.

Capital Assets

The fund's capital assets as of June 30, 2014 and June 30, 2013 amounted to $1,076.3 million and $1,026.5 million (net of accumulated depreciation), respectively. Capital assets include land, equipment, buildings, improvements, construction in progress and infrastructure. Total increases in the fund's net capital assets for fiscal years 2014 and 2013 were $49.9 million and $69.8 million, respectively. These increases were funded primarily by issuance of revenue bonds. The following schedule presents the capital asset activities for fiscal years 2014 and 2013 (amounts expressed in thousands):

	Balance June 30, 2014	Net change	Balance June 30, 2013	Net change	Balance June 30, 2012
Land	$ 12,540	$ —	$ 12,540	$ —	$ 12,540
Construction in progress	256,990	26,376	230,614	14,562	216,052
Buildings and improvements, net	639,712	(14,285)	653,997	(812)	654,809
Equipment, net	8,536	(1,816)	10,352	(670)	11,022
Infrastructure, net	158,552	39,575	118,977	56,687	62,290
Total capital assets, net	$ 1,076,330	$ 49,850	$ 1,026,480	$ 69,767	$ 956,713

As of June 30, 2014, the fund had commitments of $92.8 million for the acquisition and construction of capital assets. See note 4 for further information.

Debt Administration

For fiscal years 2014 and 2013, the fund had long-term obligations of $656.1 million and $510.4 million, respectively. These long-term obligations consisted primarily of governmental revenue bonds, which are secured by revenue from the sale of water.

The fund issued revenue bonds during fiscal year 2014 to fund the cost of acquisition and construction of various capital projects. During fiscal years 2014 and 2013, the fund's debt increased by $145.7 million in 2014 and decreased by $10.1 million in 2013. See note 5 for further information.

(Continued)

Economic Condition of the Water Utility Fund

The fund is a large regional utility system that provides service to the diverse Baltimore metropolitan area, which includes Baltimore City as well as portions of Baltimore, Anne Arundel, Howard, Carroll, and Harford counties. Modest growth is expected in the future. The fund's long-term water supply is good, with water primarily coming from the Loch Raven, Prettyboy, and Liberty Reservoirs. Additional water can be drawn from the Susquehanna River, providing the fund with additional capacity. Although the fund is expected to make substantial investments in capital improvements to meet the Safe Drinking Water Act requirements and to rehabilitate aging infrastructure, management expects continued good financial performance, including adequate debt service coverage and liquidity.

CITY OF BALTIMORE
WATER UTILITY FUND

Statements of Net Position

June 30, 2014 and 2013

(Expressed in thousands)

		2014		2013
Assets and deferred outflows of resources				
Current assets:				
Cash and cash equivalents	$	58,527	$	25,075
Accounts receivable, net:				
Service billings		45,556		53,400
Other		50		132
Due from other governments		13,136		12,824
Inventories		7,890		9,355
Restricted assets:				
Cash and cash equivalents		27,281		19,841
Total current assets		152,440		120,627
Noncurrent assets:				
Restricted assets:				
Cash and cash equivalents		100,900		44,536
Due from other governments		—		1,238
Capital assets, net of accumulated depreciation		806,800		783,326
Capital assets not being depreciated		269,530		243,154
Total noncurrent assets		1,177,230		1,072,254
Total assets		1,329,670		1,192,881
Deferred outflows of resources:				
Deferred loss on bond refundings		28,389		33,739
Interest rate swaps		12,318		6,528
Total deferred outflows of resources		40,707		40,267
Total assets and deferred outflows of resources		1,370,377		1,233,148
Liabilities:				
Current liabilities:				
Accounts payable and accrued liabilities		3,174		2,416
Accrued interest payable		15,032		9,011
Deposit subject to refund		15		15
Due to other funds		—		17,600
Compensated absences		2,412		2,418
Accounts payable paid from restricted assets		17,078		12,139
Revenue bonds payable		12,250		10,830
Total current liabilities		49,961		54,429
Noncurrent liabilities:				
Compensated absences		3,961		3,609
Derivative instrument liability		21,368		42,980
Revenue bonds payable, net		643,871		499,593
Total noncurrent liabilities		669,200		546,182
Total liabilities		719,161		600,611
Net position:				
Net investment in capital assets		536,159		528,427
Restricted for:				
Debt service		68,885		53,772
Unrestricted		46,172		50,338
Total net position	$	651,216	$	632,537

See accompanying notes to financial statements.

CITY OF BALTIMORE
WATER UTILITY FUND

Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2014 and 2013

(Expressed in thousands)

	2014	2013
Operating revenues:		
Water service	$ 144,942	$ 142,960
Rents, fees, and other income	2,409	1,819
Interest income	11,327	9,901
Total operating revenues	158,678	154,680
Operating expenses:		
Salaries and wages	39,454	37,093
Other personnel costs	17,181	16,341
Contractual services	46,581	37,638
Materials and supplies	10,052	8,982
Minor equipment	679	791
Depreciation	22,118	21,122
Total operating expenses	136,065	121,967
Operating income	22,613	32,713
Nonoperating revenues (expenses):		
Gain (loss) on sale of investments	(83)	6
Bond issuance costs	(687)	—
Interest income	1,527	1,184
Interest expense	(17,136)	(14,127)
Total nonoperating expenses, net	(16,379)	(12,937)
Income before capital contributions	6,234	19,776
Capital contributions	12,445	22,328
Changes in net position	18,679	42,104
Total net position – beginning, as restated (note 12)	632,537	590,433
Total net position – ending	$ 651,216	$ 632,537

See accompanying notes to financial statements.

CITY OF BALTIMORE
WATER UTILITY FUND

Statements of Cash Flows

Years ended June 30, 2014 and 2013

(Expressed in thousands)

		2014		2013
Cash flows from operating activities:				
Receipts from customers	$	166,604	$	148,948
Payments to employees		(56,171)		(53,084)
Payments to suppliers		(72,806)		(45,356)
Net cash provided by operating activities		37,627		50,508
Cash flow from capital and related financing activities:				
Proceeds from revenue bonds		344,396		—
Principal paid on revenue bonds		(10,830)		(10,344)
Payments on refunded debt		(191,549)		—
Interest received		1,527		1,184
Interest paid		(11,328)		(13,573)
Acquisition and construction of capital assets		(67,030)		(84,855)
Capital contributions received		13,371		27,851
Bond issuance costs paid		(687)		—
Swap termination payment		(18,158)		—
Net cash provided by capital and related financing activities		59,712		(79,737)
Cash flows from investing activities:				
Gain (loss) on sale of investments		(83)		6
Net cash used by investing activities		(83)		6
Net increase in cash and cash equivalents		97,256		(29,223)
Cash and cash equivalents, beginning of year		89,452		118,675
Cash and cash equivalents, end of year	$	186,708	$	89,452
Reconciliation of operating income to net cash provided by Operating activities:				
Operating income	$	22,613	$	32,713
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation expense		22,118		21,122
Changes in assets and liabilities:				
Accounts receivable - service billings		7,844		(5,976)
Accounts receivable – other		82		246
Due from other governments		—		(3,826)
Inventories		1,465		(2,957)
Accounts payable and accrued liabilities		759		(1,088)
Due to other funds		(17,600)		17,600
Compensated Absences		346		313
Due to other governments		—		(7,639)
Total adjustments		15,014		17,795
Net cash provided by operating activities	$	37,627	$	50,508
Noncash activity from capital and related financing activities:				
Acquisition and construction of capital assets financed by debt	$	4,939	$	6,033

See accompanying notes to financial statements.

CITY OF BALTIMORE
WATER UTILITY FUND

Notes to Financial Statements

June 30, 2014 and 2013

(1) Summary of Significant Accounting Policies

(a) Reporting Entity

The Water Utility Fund (fund) is a separate utility in the Bureau of Water and Waste Water, one of the four bureaus in the City of Baltimore, Maryland's (City) Department of Public Works. In November 1978, the voters approved a Charter Amendment establishing the fund as a separate enterprise and requiring it to be financially self-sustaining and operated without profit or loss to the other funds or programs of Baltimore City.

These financial statements are only of the fund's operations and are not intended to present the financial position, changes in financial position, or, where applicable, cash flows of the City.

(b) Basis of Presentation

The enterprise fund financial statements are reported using the economic resources management focus and are prepared on the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Operating revenues result from the services provided by the fund, and all other revenue is considered nonoperating.

(c) New Government Accounting Standards Board Pronouncements

During fiscal year 2014, the City implemented the Governmental Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities*, issued March 2012. This Statement "establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations." The adoption of this Statement had an effect on the fund's net position. See note 12 for additional information.

(d) Cash and Cash Equivalents on Deposit with the City of Baltimore, Maryland

The fund maintains its available cash in a cash and investment pool administered by the City. Such amounts are considered to be cash equivalents for purposes of the Statements of Cash Flows. To optimize investment returns, the fund's cash is invested together with all other City pooled funds, all of which are fully insured or collateralized. The City allocates, on a monthly basis, any investment earnings based on the fund's average balance in pooled cash and investments, less an administrative charge. Cash and cash equivalents include demand deposits, as well as short-term investments with a maturity date within three months of the date acquired by the fund.

The Fund's unrestricted and restricted cash is recorded in the operating and capital projects general ledger accounts "due to/due from fund" and the renovation and "restricted cash" (maintained in Trust with M&T general ledger accounts titled principal, interest, construction, and debt service reserve), respectively. Cash equivalents result from short-term investments made by M&T Bank, to maximize interest earnings, for the various trust account they manage on behalf of the Fund. The trust accounts fund future capital asset construction, the debt service reserve, the renovation account (for surplus operating/unrestricted funds) and pay principal and interest on capital asset financing. The renovation account is included in the "Statement of Net Position" as unrestricted cash and cash equivalents, while the remaining trust accounts are classified as current & noncurrent restricted cash and cash equivalents.

(e) Swaps

Interest rate swaps are entered into to take advantage of lower cost interest rates, through conversion of variable rate to fixed rates and fixed rate to variable rates. It is the policy of the fund to not record the fair value of the swap arrangements. Swap related transactions are recorded as payments are received and made. Note 6 provides more information on the various rewards and risks typical to these types of financing arrangements.

(f) Inventories

Inventories are stated at cost, using the moving average cost method.

(g) Service Billings Accounts Receivable – Unbilled Water Utility User Charges

Unbilled water user charges are estimated and accrued at year-end. They are included as service billing accounts receivable on the "Statement of Net Position", and as sewer service revenue on the "Statement of Revenues, Expenses and Changes in Net Position". An allowance for doubtful accounts is not calculated separately since an invoice has not been sent to the customer. An allowance is only calculated on billed receivables. (See note 3).

(h) Restricted Cash

The proceeds of the Fund's revenue bonds are retained in a construction trust account with M&T Bank for the purpose of constructing water facilities. There are additional trust accounts with M&T Bank for the repayment of principal and interest requirements on long term debt.

(i) Due from Other Governments

The restricted portion of due from other governments consists of bond proceeds held by the Maryland Water Quality Financing Administration, which are available to draw down upon submission of eligible expense reimbursements. The unrestricted portion consists of amounts due from Baltimore County for its portion of operational costs that are not covered by the revenue collected from the County's individual customers and construction progress billings to local jurisdictions for their cost share on a specific capital project(s). There is no allowance for this account since the city deems it fully collectable based on historical collections.

(j) Accounts Payable from Restricted Assets

Represents retainages withheld on contractor invoices related to the construction of a specific capital asset. These payables are first paid from restricted assets first, any remaining amount is paid from unrestricted funds.

(k) Use of Restricted Net Position

When an expense is incurred for which restricted and unrestricted resources are available to pay the expense, it is the fund's policy to apply the expense first to restricted resources, then to unrestricted resources.

(l) Capital Assets

Purchased or constructed capital assets are reported at historical cost. Capitalization thresholds are $50,000 for buildings and improvements and $5,000 for equipment.

Capital assets are depreciated using the straight-line method over the estimated useful lives, as follows:

Buildings	50 years
Improvements	20–50 years
Equipment	2–25 years
Mobile equipment	5–10 years
Infrastructure	80 years

(m) Gains and Losses on Early Extinguishment of Debt from Refundings

Gains and losses on the early extinguishment of debt are amortized over the shorter of the life of the new or old debt.

On December 3, 2013, the fund issued Water Revenue Bonds, Series 2013-A, 2013-B, and 2013-C in the amounts of $130,110,000, $155,990,000, and $31,740,000, respectively, and totaling $317,840,000. Of these amounts $130,110,000 were issued for various capital projects, and $187,730,000 were refunding bonds that refunded certain maturities totaling $188,240,000. A majority of the savings facilitated the refunding of the fund's auction rate debt portfolio and the termination of the underlying interest rate exchange agreements. Interest on the bonds is due on July 1st and January 1st, and the bonds mature between 2015 and 2044 depending on the particular series.

The Series 2013 Water Refunding Revenue Bond issuance reduced total debt service payments by approximately $1,405,000, to obtain an economic gain of approximately $755,000. Additionally, the City used $18,672,000 to reduce its derivative swap exposure.

(n) Compensated Absences

The liability for compensated absences reported in the fund statements consists of unpaid, accumulated annual sick, vacation and personal leave balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. Payments made to terminated employees for accumulated leave are charged as expenditures/expenses, primarily in the fund when paid.

Employees earn one day of sick leave for each completed month of service; there is no limitation on the number of sick leave days that may be accumulated. A portion of unused sick leave earned annually during each twelve month base period may be converted to cash for a maximum of three days, computed on an attendance formula.

Upon retirement with pension benefits, or termination of employment after completion of twenty or more years of service without pension benefits, employees receive either one day's pay for every three or four sick leave days accumulated, depending on union affiliation, and unused at the date of separation; under any other conditions of separation, unused sick leave is forfeited. At June 30, 2014, it is estimated that accumulated nonvested sick leave for the fund approximated $5,543,000. Sick leave benefit expenses are recorded as a percent of conversion value based on years of service, with a maximum of 100% for employees with twenty years or more of service

Employees can accumulate a maximum of 224 vacation and personal leave days depending upon length of service, which either may be taken through time off or carried until paid upon termination or retirement. Accumulated vacation and personal leave expenses are recorded when leave is earned

The total vacation, personal leave, and conversion value to unused sick leave recorded as a liability for compensated absences at June 30, 2014 and June 30, 2013 is $6,373,000 and $6,027,000, respectively.

(o) ***Long Term Obligation***

Consist of revenue bonds and long-term borrowings from the Maryland Water Quality Financing Administration.

(p) ***Capital Contributions***

Consist of federal or state grants, and cost reimbursements from the surrounding counties (i.e., primarily Baltimore County) for capital projects. Grant funding for capital projects is reflected in the "statement of revenues, expenses, and changes in fund net position" as a capital contribution.

(q) ***Net Position***

The composition of the fund balance for the fund consists of the following:

Net Investment in Capital Assets

Capital assets (e.g. land, buildings, equipment, etc.) less any related outstanding debt used to acquire those assets as of the end of the fiscal year.

Restricted for Debt Service

Represents those funds maintained in trust accounts at M&T Bank that are legally obligated for the repayment of principle and interest on long-term debt.

Unrestricted

Residual fund balance not included in the above categories.

(r) Correction of Immaterial Errors

In preparation of the current year financial statements, immaterial errors in the FY 2013 statement of cash flows were identified. These errors primarily related to the misclassification of cash flows from construction and capital asset financing. The correction of these errors decreased net cash provided by operating activities and net cash used by capital and related financing activities by approximately $11.3 million and increased net cash provided by investing activities by $6 thousand. The line items impacted by these errors have been corrected in the FY 2013 statement of cash flows.

(s) Reclassifications

The FY 2013 financial statements were reclassified to FY 2014 financial statement presentation requirements. The reclassifications have no material effect on total assets, liabilities, net position, or change in net position as previously reported.

(2) Deposit and Investment

The fund participates in the City's pooled cash account. At June 30, 2014 and June 30, 2013, the fund's share of the pooled cash account, including both restricted and unrestricted cash, was $46.5 million and $9.1 million, respectively. All of the City's pooled cash deposits are either insured through the Federal Depository Insurance Corporation or collateralized by securities held in the name of the City by the City's agent.

For other than pension funds, the City is authorized by state law to invest in direct or indirect obligations of the United States Government, repurchase agreements that are secured by direct or indirect obligations of the United States Government, certificates of deposit, commercial paper with highest letter and numerical rating, and mutual funds registered with the Securities and Exchange Commission. The City's investment policy limits the percentage of certain types of securities, with the exception of obligations for which the United Sates Government has pledged its full faith and credit. For investments held by the City in trust and/or to secure certain debt obligations, the City complies with the terms of the trust agreements. The City's Board of Finance has formally adopted the above policies and reviews and approves all security transactions.

The fund's investments at June 30, 2014 and June 30, 2013 are presented in the following table. All investments are presented by investment type, and debt securities are presented by maturity (amounts expressed in thousands):

	June 30, 2014			
		Investment maturities (in months)		
Investment type	Fair value	Less than 6	6 to 12	Greater than 12
Debt securities:				
U.S. agencies	$ 225	$ 180	$ 45	$ —
Money market mutual funds	69,981	69,981	—	—
Federated government obligation fund	67,770	67,770	—	—
Commercial paper	1,836	1,836	—	—
	139,812	$ 139,767	$ 45	$ —
Less cash equivalents	139,812			
Total investments	$ —			

	June 30, 2013			
		Investment maturities (in months)		
Investment type	Fair value	Less than 6	6 to 12	Greater than 12
Debt securities:				
U.S. agencies	$ 3,710	$ 3,710	$ —	$ —
Money market mutual funds	57,803	57,803	—	—
Commercial paper	6,178	6,178	—	—
	67,691	$ 67,691	$ —	$ —
Less cash equivalents	67,691			
Total investments	$ —			

Interest rate risk – Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of investments.

The City limits its interest rate risk in accordance with the City's Board of Finance policy by maintaining a minimum of 20% of the City's investment in funds in liquid investments to include United States Government securities, overnight repurchase agreements, and by limiting the par value of the portfolio invested for a period greater than one year at or below $100 million. Management believes the fund is in compliance with this policy.

Credit risk of debt securities – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation.

As discussed above, the City's Board of Finance limits City investments to only the highest rated investments in the categories discussed above. The fund's portions of the City's rated debt investments as of June 30, 2014 and June 30, 2013 were rated by a nationally recognized statistical rating agency, and are presented below using the Standard and Poor's rating scale (amounts expressed in thousands):

	June 30, 2014		
		Quality ratings	
Investment type	Fair value	AAA	A1 – P1
U.S. agencies:			
Federal Home Loan Mortgage Corp. Securities	$ 225	$ 225	$ —
Money market mutual funds:			
Wilmington Bank U.S. Government Money Market Fund	69,981	69,981	—
Federated government obligation fund	67,770	67,770	—
Commercial paper	1,836	—	1,836
Total rated debt investments	$ 139,812	$ 137,976	$ 1,836

	June 30, 2013		
		Quality ratings	
Investment type	Fair value	AAA	A1 – P1
U.S. agencies:			
Federal Home Loan Mortgage Corp. Securities	$ 3,710	$ 3,710	$ —
Money market mutual funds:			
Wilmington Bank U.S. Government Money Market Fund	57,803	57,803	—
Commercial paper	6,178	—	6,178
Total rated debt investments	$ 67,691	$ 61,513	$ 6,178

Concentration of credit risk – Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The City has not adopted a formal policy on the concentration of credit risk.

The fund had the following debt security investments at June 30, 2014 and June 30, 2013, which at June 30, 2013 was more than five percent of total investments (amounts expressed in thousands):

Investment		June 30, 2014 Fair value	June 30, 2014 Percentage of portfolio
None	$		

Investment		June 30, 2013 Fair value	June 30, 2013 Percentage of portfolio
Commercial paper – Mountcliff	$	6,178	9.13%

(3) Accounts Receivable, net

An allowance for doubtful accounts is recorded for accounts that are delinquent at least 260 days. Accounts receivable as of June 30, 2014 and June 30, 2013 are shown net of allowances of $20,274,000 and $9,842,000, respectively.

Penalty income derived from delinquent Baltimore City Water, Wastewater and Stormwater billings were credited exclusively to the Water Utility Fund, since all billings costs including's customer service costs attributable to billing inquiries were paid by the Water Utility Fund.

Adjustment unrelated to consumption resulted in reduction to income of $5.5 million on Baltimore City Water, Wastewater, and Stormwater accounts were recorded in the Water Utility Fund.

(4) Capital Assets

Capital assets activities for the years ended June 30, 2014, 2013 and 2012 was as follows (expressed in thousands):

	Balance June 30, 2013	Increases	Decreases	Balance June 30, 2014
Capital assets, not being depreciated:				
Land	$ 12,540	$ —	$ —	$ 12,540
Construction in progress	230,614	71,712	45,336	256,990
Total capital assets, not being depreciated	243,154	71,712	45,336	269,530
Capital assets, being depreciated:				
Buildings and improvements	1,027,719	2,904	—	1,030,623
Equipment	65,226	261	—	65,487
Infrastructure	121,450	42,427	—	163,877
Total capital assets, being depreciated	1,214,395	45,592	—	1,259,987
Less accumulated depreciation for:				
Buildings and improvements	373,722	17,189	—	390,911
Equipment	54,874	2,077	—	56,951
Infrastructure	2,473	2,852	—	5,325
Total accumulated depreciation	431,069	22,118	—	453,187
Total capital assets, being depreciated, net	783,326	23,474	—	806,800
Total capital assets, net	$ 1,026,480	$ 95,186	$ 45,336	$ 1,076,330

	Balance June 30, 2012	Increases	Decreases	Balance June 30, 2013
Capital assets, not being depreciated:				
Land	$ 12,540	$ —	$ —	$ 12,540
Construction in progress	216,052	89,506	74,944	230,614
Total capital assets, not being depreciated	228,592	89,506	74,944	243,154
Capital assets, being depreciated:				
Buildings and improvements	1,011,487	16,232	—	1,027,719
Equipment	63,675	1,570	19	65,226
Infrastructure	62,919	58,531	—	121,450
Total capital assets, being depreciated	1,138,081	76,333	19	1,214,395
Less accumulated depreciation for:				
Buildings and improvements	356,678	17,044	—	373,722
Equipment	52,653	2,235	14	54,874
Infrastructure	629	1,844	—	2,473
Total accumulated depreciation	409,960	21,123	14	431,069
Total capital assets, being depreciated, net	728,121	55,210	5	783,326
Total capital assets, net	$ 956,713	$ 144,716	$ 74,949	$ 1,026,480

Interest is capitalized on capital assets acquired with tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest cost incurred from the date of the borrowing until completion of the project, with interest earned on invested proceeds over the period. During fiscal years 2014 and 2013, interest cost of $10,676,000 and $9,658,000, respectively (net of interest earned of $1,394,000 and $1,635,000, respectively), was capitalized.

At June 30, 2014, the fund had outstanding commitments for construction of $92,833,000.

(5) Long-Term Obligations

The City does not have a debt limit; however, the Constitution of Maryland requires a three-step procedure for the creation of debt by the City of Baltimore:

- Act of the General Assembly of Maryland or resolution of the majority of Baltimore City delegates
- Ordinance of the Mayor and City Council of Baltimore

- Ratification by the voters of the City of Baltimore

Changes in long-term debt obligations for the years ended June 30, 2014 and June 30, 2013 are as follows (amounts expressed in thousands):

	Balance June 30, 2013	Additions	Reductions	Balance June 30, 2014	Amounts due within one year
Revenue bonds	$ 509,024	$ 317,840	$ 199,070	$ 627,794	$ 12,250
Add bond premiums	1,399	28,333	1,405	28,327	—
Total revenue bonds payable	$ 510,423	$ 346,173	$ 200,475	$ 656,121	$ 12,250
Compensated absences	$ 6,027	$ 346	$ —	$ 6,373	$ 2,412

	Balance June 30, 2012	Additions	Reductions	Balance June 30, 2013	Amounts due within one year
Revenue bonds	$ 519,367	$ —	$ 10,343	$ 509,024	$ 10,830
Add bond premiums	1,134	375	110	1,399	—
Total revenue bonds payable	$ 520,501	$ 375	$ 10,453	$ 510,423	$ 10,830
Compensated absences	$ 5,756	$ 271	$ —	$ 6,027	$ 2,418

The City has issued revenue bonds, the proceeds of which were used to provide funds for capital improvements to water facilities. Certain assets and revenues of the fund are pledged as collateral for the bonds and notes. During fiscal year 2014, the city issued Water Revenue Bonds, Series 2013-A, 2013-B, and 2013-C, which totaled $317,840,000. A portion of these bonds was used to refund term bonds series 2002-A, serial bonds series 2002-A, and auction rate notes series 2004-B. Bonds and notes outstanding as of June 30 consist of (amounts expressed in thousands):

	2014	2013
Term bonds series 1993-A with interest at 5.60%, payable semiannually, due July 1, 2013	$ —	$ 2,700
Term bonds series 1993-A with interest at 5.65%, payable semiannually, due July 1, 2020	23,900	23,900
Term bonds series 1994-A with interest at 6.00%, payable semiannually, due July 1, 2015	2,330	3,400
Term bonds series 1994-A with interest at 5.00%, payable semiannually, due July 1, 2024	10,280	10,280
Term bonds series 2002-A with interest at 5.00%, payable semiannually, due July 1, 2023	—	4,250
Term bonds series 2002-A with interest at 5.00%, payable semiannually, due July 1, 2027	—	9,845
Term bonds series 2002-A with interest at 5.125%, payable semiannually, due July 1, 2032	—	15,385
Term bonds series 2002-A with interest at 5.125%, payable semiannually, due July 1, 2042	5,625	64,840
Term bonds series 2003-A with interest at 4.20%, payable semiannually, due July 1, 2028	—	12,835
Term bonds series 2006-A with interest at 4.625%, payable semiannually, due July 1, 2031	5,930	5,930
Term bonds series 2006-A with interest at 4.625%, payable semiannually, due July 1, 2036	7,435	7,435
Term bonds series 2007-B with interest at 4.50%, payable semiannually, due July 1, 2032	22,995	22,995
Term bonds series 2007-B with interest at 4.50%, payable semiannually, due July 1, 2035	7,910	7,910
Term bonds series 2007-C with interest at 5.00%, payable semiannually, due July 1, 2032	9,115	9,115
Term bonds series 2007-C with interest at 5.00%, payable semiannually, due July 1, 2037	11,630	11,630
Term bonds series 2008-A with interest at 4.625%, payable semiannually, due July 1, 2033	5,740	5,740
Term bonds series 2008-A with interest at 4.73%, payable semiannually, due July 1, 2038	1,115	1,115
Term bonds series 2008-A with interest at 5.00%, payable semiannually, due July 1, 2038	6,150	6,150
Term bonds series 2009-A with interest at 5.00%, payable semiannually, due July 1, 2024	1,220	1,220

		2014		2013
Term bonds series 2009-A with interest at 5.125%, payable semiannually, due July 1, 2029	$	3,630	$	3,630
Term bonds series 2009-A with interest at 5.375%, payable semiannually, due July 1, 2034		4,680		4,680
Term bonds series 2009-A with interest at 5.75%, payable semiannually, due July 1, 2039		6,120		6,120
Serial bonds series 2002-A maturing in annual installments from $1,855,000 to $1,975,000 from July 1, 2013 through July 1, 2021, with variable interest through July 1, 2016 and a fixed rate of 4.85% to 5.0% thereafter payable semiannually		—		16,780
Serial bonds series 2003-B maturing in annual installments from $66,000 to $984,000 through February 1, 2024, with interest rate at 0.40%, payable semiannually		1,174		1,242
Serial bonds series 2005-A maturing in annual installments from $535,000 to $580,000 from July 1, 2023 through July 1, 2025, with interest rate of 4.00% to 5.00%, payable semiannually		1,670		1,670
Serial bonds series 2006-A maturing in annual installments from $515,000 to $1,035,000 through July 1, 2026, with interest rate of 4.00% to 4.50%, payable semiannually		10,525		11,125
Serial bonds series 2007-A maturing in annual installments from $64,000 to $80,000 through February 1, 2037, with interest rate at 0.40%, payable semiannually		1,520		1,592
Serial bonds series 2008-A maturing in annual installments from $475,000 to $1,005,000 through July 1, 2028, with interest rates of 2.00% to 4.50%, payable semiannually		11,505		12,075
Serial bonds series 2007-C maturing in annual installments from $740,000 to $1,570,000 through July 1, 2027, with interest rates of 3.75% to 5.00%, payable semiannually		16,390		17,220
Serial bonds series 2009-A maturing in annual installments from $475,000 to $1,005,000 through July 1, 2021, with interest rates of 2.00% to 4.50%, payable semiannually		4,400		4,815
Serial bonds series 2009-B maturing in annual installments of $586, 172 from February 1, 2015 through February 1, 2043, with an interest rates of 0.00%		17,000		17,000
Auction rate notes series 2002-B, payable monthly, due July 1, 2037		18,300		18,300
Auction rate notes series 2004-B, payable monthly, due July 1, 2034		—		45,100
Auction rate notes series 2002-C, payable monthly, due July 1, 2037		12,700		40,800

(Continued)

	2014	2013
Serial bonds series 2004-A maturing in annual installments from $197,000 to $984,000 through February 1, 2024, with interest rate at 0.45%, payable semiannually	$ 3,779	$ 3,983
Serial bonds series 2007-B maturing in annual installments from $30,000 to $3,860,000 through July 1, 2027, with interest rate of 3.60% to 4.50%, payable semiannually	19,680	19,716
Serial bonds series, 2011-A maturing in annual installments of $915,000 to $3,940,000 through February l, 2031, with interest rates from 2.00% to 5.00%	25,405	26,400
Serial bonds series, 2011-B maturing in annual installments of $130,193 to $172,023 from February 1, 2015 through February 1, 2043, with interest rates of 1.00%	4,356	4,356
Term bond series 2011-A with interest at 4.57%, payable semiannually, due July 1, 2036	11,400	11,400
Term bond series 2011-A with interest at 5.00%, payable semiannually, due July l, 2041	14,345	14,345
Serial bonds series, 2013-A maturing in annual installments of $1,185,000 to $4,980,000 from July 1, 2014 through July 1, 2033, with interest rates from 3.00% to 5.00% payable semiannually	64,370	—
Term bond series 2013-A with interest at 5.00%, payable semiannually, due July 1, 2038	28,880	—
Term bond series 2013-A with interest at 5.00%, payable semiannually, due July l, 2043	36,860	—
Serial bonds series, 2013-B maturing in annual installments of $85,000 to $6,690,000 from July 1, 2014 through July 1, 2033, with interest rates from 2.00% to 5.00% payable semiannually	91,270	—
Term bond series 2013-B with interest at 5.00%, payable semiannually, due July l, 2038	26,705	—
Term bond series 2013-B with interest at 4.50%, payable semiannually, due July 1, 2038	1,115	—
Term bond series 2013-B with interest at 5.00%, payable semiannually, due July 1, 2042	36,900	—
Serial bonds series, 2013-C maturing in annual installments of $10,000 to $2,000,000 from July 1, 2014 through July 1, 2025, with interest rates from 3.00% to 5.00% payable semiannually	31,740	—
	627,794	509,024
Unamortized bond premium	28,327	1,399
	$ 656,121	$ 510,423

At June 30, 2014 and June 30, 2013, the fund had $31,000,000 and $104,200,000 of auction rate notes outstanding, respectively. Interest rates for these notes are determined every 7 days. In the event of a failed auction, the auction agent assesses the failed auction rate to the issuers of the notes. Interest paid under these conditions is currently limited to 150% of the nonfinancial commercial paper rate depending on the rating of each bond issue. The failed auction rate on these notes during the fiscal year was less than 1%.

Principal maturities and interest on revenue bonds are as follows (amounts expressed in thousands):

	Principal	Interest	Interest rate swap net[a]
Fiscal year:			
2015	$ 12,250	$ 28,608	$ 1,208
2016	14,930	26,846	1,209
2017	15,633	26,204	1,209
2018	16,196	25,503	1,209
2019	16,898	24,779	1,209
2020–2024	92,769	111,685	6,047
2025–2029	107,541	89,261	6,047
2030–2034	139,381	61,354	5,789
2035–2039	125,023	33,289	1,520
2040–2044	87,173	9,344	(182)
	$ 627,794	$ 436,873	$ 25,265

[a] Interest rate swap net payments represent estimated payments for additional interest resulting from swap agreements to counterparties. The additional payments were computed using rates as of June 30, 2014, assuming current interest rates remain the same for the entire term of the bonds. As rates vary, variable rate bond interest payments and net swap payments will vary.

The fund has various revenue bond covenants that generally require the fund to maintain rates sufficient to meet the operating requirements of the fund and an operating reserve as defined in the revenue bond indentures. As of June 30, 2014, the rate requirements were met, and management believes the fund is in compliance with all significant requirements of the indentures.

Pledge Revenue

The fund has pledged future customer revenues to repay $627,794,000 and $509,024,000 of revenue bond debt, at June 30, 2014 and June 30, 2013, respectively. Proceeds from these revenue bonds were used to build and improve various aspects of the City's water utility system. The bonds are payable solely from the revenues of the fund and are payable through 2043. Annual principal and interest payments on these revenue bonds are expected to require 71% of pledged revenues. Total principal and interest remaining to be paid on the revenue bonds for the fund is $1,089,932,000 and $796,981,000 at June 30, 2014 and June 30, 2013, respectively. Principal and interest paid for the current year and current pledged revenue for the fund was $31,956,000 and $44,731,000 respectively. Principal and interest and pledged revenue for 2013 were $33,887,000 and $27,054,000, respectively.

(6) Interest Rate Swaps

(a) *Objectives of the Swaps*

The City has entered into swaps for three reasons: First, the majority of its swaps have been used to create synthetic fixed rate financings (by issuing floating-rate bonds and swapping them to fixed) as a way to provide lower-cost fixed rate financing to meet the City's capital needs. Second, the City has used swaps from fixed to floating to help the City manage its balance sheet for an appropriate mix of fixed and floating rate exposure. And, third, the City has used basis swaps to amend the floating rate on certain of its existing synthetic fixed rate swaps in order to provide a better hedge on the underlying floating rate bonds.

(b) *Terms, Fair Value, and Credit Risk*

The terms, fair values and credit risk ratings of the outstanding swaps, as of June 30, 2014, were as follows. The notional amounts of the swaps generally match the principal amount of the associated debt. The City's swap agreements contain scheduled reductions to outstanding notional amounts that are intended to track the scheduled or anticipated reductions in the associated "bonds payable" category.

Hedged Derivative Instruments

At June 30, 2014 and June 30, 2013, the fund had deferred outflows for various hedged derivative instruments with total fair values of these instruments in the amount of $(12,318,000) and $(33,739,000), respectively. The notional amounts for these hedged derivative instruments at June 30, 2014 and June 30, 2013 were $36,625,000 and $111,995,000, respectively. During fiscal year 2014 and 2013, the fair values of these instruments increased by $21,421,000 and $13,104,000, respectively. All hedges are cash flow hedges. The following schedule provides a detailed analysis of derivative instruments held at June 30, 2014:

	June 30, 2014						
Outstanding bonds	Effective date	Termination date	Interest rate paid by city	Interest rate received	Notional amount	Fair value	Counterparty credit rating
Floating to fixed swaps:							
2002 revenue bonds	5/7/2002	7/1/2037	4.55%	67% LIBOR	$ 31,000,000	$ (12,273,957)	A-/Baa2
2002 revenue bonds	5/7/2002	7/1/2014	4.39	CPI	2,325,000	(6,168)	A-/Baa2
2002 revenue bonds	5/7/2002	7/1/2015	4.50	CPI	1,615,000	(12,294)	A-/Baa2
2002 revenue bonds	5/7/2002	7/1/2016	4.61	CPI	1,685,000	(25,465)	A-/Baa2
Total swaps outstanding					$ 36,625,000	$ (12,317,884)	

	June 30, 2013						
Outstanding bonds	Effective date	Termination date	Interest rate paid by city	Interest rate received	Notional amount	Fair value	Counterparty credit rating
Floating to fixed swaps:							
2002 revenue bonds	5/7/2002	7/1/2037	4.56%	67% LIBOR	$ 59,100,000	$ (19,620,620)	A-/Baa1
2002 revenue bonds	5/7/2002	7/1/2013	4.30	Bond rate/CPI	2,170,000	(19,986)	A-/Baa1
2002 revenue bonds	5/7/2002	7/1/2014	4.39	Bond rate/CPI	2,325,000	(51,836)	A-/Baa1
2002 revenue bonds	5/7/2002	7/1/2015	4.50	Bond rate/CPI	1,615,000	(51,835)	A-/Baa1
2002 revenue bonds	5/7/2002	7/1/2016	4.61	Bond rate/CPI	1,685,000	(68,396)	A-/Baa1
2004 revenue bonds	6/1/2004	7/1/2034	5.21	SIFMA	45,100,000	(13,926,572)	A-/Baa1
Total swaps outstanding					$ 111,995,000	$ (33,739,245)	

(c) Credit Risk

As of June 30, 2014, the Water Utility Fund is not exposed to credit risk on all of the outstanding swaps because the swaps have negative fair values. All fair values were calculated using the mark-to-market or par value method. However, should interest rates change and the fair values of the swaps become positive, the Fund would be exposed to credit risk in the amount of the derivatives' fair value.

The swap agreements contain varying collateral agreements with counterparties. In general, these agreements require full collateralization of the fair value of the swap should the counterparty's credit rating fall below Baa as issued by Moody's or BBB as issued by Standard and Poor's. Collateral on all swaps is to be in the form of United States Government securities held by the City. As of June 30, 2014, none of the City's swap agreements met this requirement.

Although the City executes transactions with various counterparties, the 4 Water Utility Fund swaps are held with one counterparties. That counterparty is rated A-/Baa2.

(d) Basic Risk

The City's variable rate bonds are of three types: remarketed variable rate demand bonds (VRDBs), auction rate bonds (ARBs), and CPI index bonds. For those swaps associated with the VRDBs and ARBs, the City receives a floating rate based on either the SIFMA Index or the one-month LIBOR. For the SIFMA based swaps, the City is exposed to basis risk should the spread between the SIFMA and the VRDBs or ARBs rate change. If a change occurs that results in the spread widening, the expected cost savings may not be realized. As of June 30, 2014, the SIFMA rate for the 52-week period ranged from 0.03% to 0.12%, whereas the City tax-exempt market rate ranged from 0.05% to 0.23%. For one of the swaps, the City will receive a percent of LIBOR, a rate chosen to closely approximate the City's tax-exempt variable rate bond payments. Because this swap is LIBOR-based, there is an additional degree of basis risk. As of June 30, 2014, LIBOR for the 52-week period ranged from 0.15% to 0.20% whereas the City's taxable market ranged from 0.08% to 0.19%. For those swaps associated with CPI index bonds, there is no basis risk, because the floating rate on the swaps is identical to the floating rate on the bonds.

(e) Interest Rate Risk

For those swaps for which the City pays a floating rate and receives fixed rate payments, the City is exposed to interest rate risk. As floating rates increase, the City's expected savings could decrease. The City would, however, benefit from offsetting increases in its earning on short-term investments, whose return would be expected to go up in a higher interest rate environment.

(f) Termination Risk

The City or the counterparty may terminate a swap if the other party fails to perform under the terms of the contract. If at the time of termination the swap contract has a negative fair value, the City would be liable to the counterparty for that payment.

Investment Derivative Instruments

The fair value balance and notional amounts of derivative instruments outstanding at June 30, 2014 and June 30, 2013, classified by type and the changes in fair value of such derivative instruments for the year ended June 30, 2014 and June 30, 2013 are as follows:

	Changes in fair value		Fair value at June 30, 2014		
	Classification	Amount	Classification	Amount	Notional
Fixed to floating	Investment revenue	$ 58,179	Debt	$ (203,337)	$ (13,220,453)
Floating to fixed	Investment revenue	131,722	Debt	(8,847,153)	(71,455,000)
		$ 189,901		$ (9,050,490)	$ (84,675,453)

	Changes in fair value		Fair value at June 30, 2013		
	Classification	Amount	Classification	Amount	Notional
Fixed to floating	Investment revenue	$ (53,073)	Debt	$ (261,516)	$ (13,220,453)
Floating to fixed	Investment revenue	(242,857)	Debt	(8,978,926)	(71,455,000)
		$ (295,930)		$ (9,240,442)	$ (84,675,453)

Credit Risk – At June 30, 2014 and June 30, 2013, the government is not exposed to credit risk on the interest rate swaps, because they are in a negative fair value or liability position. However, if interest rates change and the fair values become positive, the fund would have exposure to credit risk. The counterparty's credit rating at June 30, 2014, was AA/Aa2 for derivative instruments held by the fund.

Interest rate risk – For those swaps for which the fund pays a floating rate and receives fixed rate payments, the fund is exposed to interest rate risk. As floating rates increase, the fund's expected savings could decrease. The fund would, however, benefit from offsetting increases in its earnings on short-term investments, whose return would be expected to go up in a higher interest environment.

(7) Prior-Year Defeasance of Debt

In prior years, the City defeased certain revenue bonds by placing the proceeds of new debt issues in an irrevocable trust to provide for all future debt service payments on the old debt. Accordingly, the trust account assets and the liability for the defeased debt are not included in the fund's financial statements. At June 30, 2014 and June 30, 2013, $54,855,000 and $92,560,000 of debt outstanding is considered defeased, respectively.

(8) Pension Plan

Classified employees of the fund are required to join the City of Baltimore's Employees' Retirement System (ERS). The ERS is a cost-sharing multiple-employer defined benefit pension plan which provides retirement, disability and death benefits to plan members and beneficiaries. The plan is managed by a Board of Trustees in accordance with Article 22 of the Baltimore City Code. Plan provisions may be amended only by the City Council. The fund's share of contributions to the plan was $8,116,000 in 2014, $6,829,000 in 2013 and $5,402,000 in 2012. The fund contributed 100% of the required contribution each of the three years. ERS issues a publicly available financial report that may be obtained by writing to the Baltimore City Retirement Systems, 7 East Redwood Street 12th Floor, Baltimore, MD 21202-3470.

(9) Other Postemployment Benefits

The City of Baltimore provides other postemployment benefits (OPEB) to all qualified City employees. The OPEB Plan (Plan) is a contributory, single employer defined benefit plan. The benefit and contribution provisions of the Plan are established and may be amended by the City. The Plan provides postemployment healthcare, prescription and life insurance benefits to retirees and their beneficiaries. In order to effectively manage the Plan, the City established an OPEB Trust Fund. All retiree and City contributions are deposited into the Trust Fund and all retiree related health and life insurance benefits are paid from the Trust Fund. The City also contracted with the Board of Trustees of the Employee's Retirement System to act as investment manager for the Trust Fund. BNY Mellon Bank Asset Servicing is the Trust Fund's asset custodian. The Plan does not issue standalone financial statements; however, the OPEB Trust Fund is included in the City's financial statements as a Trust and Agency Fund.

At June 30, 2014, the City's policy is to fund benefits on a pay as you go basis plus make additional contributions comprising the federal retiree drug subsidy payments and additional annual appropriation. Retirees are required to contribute at various rates ranging from approximately $58 to $1,331 on a monthly basis, depending on the health plan and level of coverage elected and whether Medicare supplemental coverage is present. At. June 30, 2014, there were 16,251 City retirees eligible for these benefits

For fiscal year 2014 and 2013, the Fund's total contributions to the Plan were $5.4 and $5.5 million, respectively.

(10) Risk Management

The fund participates in the City's risk management program. The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During fiscal year 1987, the City established the Risk Management Fund (an internal service fund) to account for and finance its uninsured risks. The City's risk financing techniques include a combination of risk retention through self-insurance and risk transfer through the purchase of commercial insurance. The Risk Management Fund services all claims for risk of loss, including general liability, property and casualty, workers' compensation, unemployment compensation, automobile physical damage and bodily injury, and sundry other risks. Commercial insurance coverage is provided for each property damage claim in excess of $500,000 with a cap of $500,000,000. Settled claims have not exceeded this commercial coverage in any of the past three years. The City also provides medical insurance coverage for all employees and retirees. Employees are required to pay a percentage of the annual cost of the medical plans, and the remaining costs are paid by the City's internal service fund. All funds of the City participate and make payments to the Risk Management Fund based on actuarial estimates and historical cost information of the amounts needed to pay prior and current year claims. During fiscal years 2014 and 2013, the fund's share of the City's cost was $1,899,000 and $1,835,000, respectively.

(11) Commitment and Contingencies

The fund has received Federal and State grants. Entitlement to grant resources is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable Federal and State regulations, including the expenditure of the resources for eligible purposes. Substantially all grants are subject to financial and compliance audits in accordance with grantors' requirements. Any disallowances as a result of these audits become a liability of the fund. As of June 30, 2014, management believes that no material liabilities will result from such audits.

The City has voluntarily entered into a Consent Decree to rehabilitate its aging sewer infrastructure and correct historical overflow mechanisms. The Consent Decree is one of many that the United States Department of Justice has currently negotiated with major east coast cities with aged sewer and storm water infrastructures. The City is proactively negotiating to increase its remedial efforts to address discharge and overflow concerns of the State and Federal regulatory agencies. These efforts are ambitious, and the costs of the construction and maintenance are estimated to be greater than $1 billion over the next decade and beyond. The City has committed to financing these remedial efforts through a combination of water and waste water revenue bonds in conjunction with all available State and Federal assistance.

(12) Beginning Balance Adjustment

During fiscal year 2014, the City implemented Government Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Under the provisions of this statement, the City can no longer amortize bond issuance costs over the life of the bonds, and any future issuance costs must be expensed in the period incurred. Therefore, the City has recalculated the fiscal year ending June 30, 2013 net position ($634,808,000) based on the effect of expensing the amounts carried as deferred bond issuance costs. The restated net position totals resulting from this accounting are as follows for the fund (expressed in thousands):

Total net position – June 30, 2013	$ 634,808
Less bond issuance costs written off	2,271
Total net position – June 30, 2013 (as restated)	$ 632,537

(13) Subsequent Events

On December 3, 2014, the City issued Water Project and Refunding Revenue Bonds, Series 2014 in the amount of $174.4 million, of which $75.2 million is applicable to bond refunding. The bonds will fund capital projects of each enterprise fund and refund certain outstanding auction and fixed rate bonds. The interest rates range from 2.50% to 5.00%, and interest is payable semiannually on July 1 and January 1 of each year beginning on July 1, 2015.

Council Bill 13-0247 established a new defined benefit and defined contribution Retirement System to provide separate eligibility, contributions, and benefits provisions for employees initially employed or re-employed with the City on or after July 1, 2014. These employees must, as a condition of employment, elect either: (i) a nonhybrid membership in the Retirement Savings Plan, or (ii) a hybrid membership consisting of a Class D membership in the Employees' Retirement System and membership in the Retirement Savings Plan. This change was enacted to strengthen the City's Employees' Retirement System starting in fiscal year 2015.

Effective July 1, 2015, the City will implement a new policy decreasing the amount of accrued vacation and personal leave that can be accumulated by the employees. This change in policy will have a significant impact on compensated absences beginning in fiscal year 2016.