CITY OF BALTIMORE
WASTEWATER UTILITY FUND

(an enterprise fund of the City of Baltimore, Maryland)

Financial Statements

June 30, 2016 and 2015

(With Independent Public Accountants' Report Thereon)

CITY OF BALTIMORE
WASTEWATER UTILITY FUND

Financial Statements

June 30, 2016 and 2015

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SB & COMPANY, LLC
KNOWLEDGE • QUALITY • CLIENT SERVICE

CITY OF BALTIMORE
Catherine E. Pugh
Mayor

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

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

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

Report on the Financial Statements

We have jointly audited the accompanying financial statements of City of Baltimore Wastewater Utility Fund (the Fund) an enterprise fund of the City of Baltimore, Maryland (the City), which comprises the statement of fund net position as of June 30, 2016, and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

The City's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; 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.

Auditor's Responsibility

Our responsibility is to express opinions 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 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 five-year period ending December 31, 2016.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's 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 opinions.

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CITY OF BALTIMORE
Catherine E. Pugh
Mayor

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

Opinion

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Baltimore Wastewater Utility Fund, as of June 30, 2016, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

Reporting Entity

As discussed in note 1.a, the financial statements present only the City of Baltimore Wastewater 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, 2016 and June 30, 2015, 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.

Other Matters

2015 Financial Statements

The financial statements of the City of Baltimore Wastewater Utility Fund for the year ended June 30, 2015, were audited by another auditor who expressed an unmodified opinion on those statements on December 23, 2016.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, Schedules of Proportionate Share of the Net Pension Liability – ERS Plan, Schedule of Employer Contributions – ERS Plan, 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.

Restatements

As part of our audit of the 2016 financial statements, we also audited the adjustments described in note 13 that were applied to restate certain beginning balances in the 2016 financial statements. In our opinion, such adjustments are appropriate and have been properly applied We were not engaged to audit, review, or apply any procedures to the 2015 financial statements of the City other than with respect to the adjustments, and accordingly, we do not express an opinion or any other form of assurance on the 2015 financial statements as a whole.

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Catherine E. Pugh
Mayor

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Baltimore, Maryland 21202

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 28, 2017, 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.

July 14, 2017

SB & Company, LLC

SB & Company, LLC
Independent Public Accountants

Robert L. McCarty, Jr., CPA
City Auditor
Department of Audits

This section of the City of Baltimore, Maryland's Wastewater Utility Fund (Fund) financial statements presents our discussion and analysis of the Fund's financial performance during the years ended June 30, 2016 and June 30, 2015.

Background

The Fund, through its system of sanitary sewers, interceptors, pumping stations, and wastewater treatment facilities, provides for the treatment and disposal of sanitary sewage flow of approximately two-thirds of the population of the Baltimore metropolitan area. The wastewater system presently receives wastewater directly from Anne Arundel and Baltimore counties, as well as the City of Baltimore. In addition, portions of Anne Arundel and Howard counties discharge wastewater into the system through Baltimore County.

Highlights

- For fiscal year 2016, total operating revenue were $229.3 million, which represents an increase of 6.0% from the previous year's revenue. For fiscal year 2015, total operating revenues were $216.4 million, which represents a decrease of 2.1% from the previous year's revenues.
- Total operating expenses for fiscal year 2016 were $169.7 million, an increase of $6.8 million over fiscal year 2015 operating expenses of $162.8 million.
- Net position increased in fiscal year 2016 by $262.8 million as restated for the allocation of the risk management program deficit. In fiscal year 2015 net position based on operations increased by $226.5 million as a result of the implementation of GASB 68 and GASB 71.

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 fund net position. All assets and liabilities associated with the operation of the Fund are included in the statement of net position.

(Expressed in thousands)

	June 30			Change	
	2016	2015	2014	2016-2015	2015-2014
Current and other assets	$ 462,844	$ 552,333	$ 433,397	$ (89,489)	$ 118,936
Capital assets	2,636,211	2,336,017	2,024,345	300,194	311,672
Deferred outflows of resources	40,751	44,291	26,514	(3,540)	17,777
Total assets and deferred outflows	$ 3,139,806	$ 2,932,641	$ 2,484,256	$ 207,165	$ 448,385
Current liabilities	$ 175,041	$ 205,372	$ 156,085	$ (30,331)	$ 49,287
Noncurrent liabilities	1,088,541	1,109,253	874,511	(20,712)	234,742
Deferred inflows of resources	11,531	7,250	9,922	4,281	(2,672)
Total liabilities and deferred inflows	$ 1,275,113	$ 1,321,875	$ 1,040,518	$ (51,043)	$ 284,029
Net position:					
Invested in capital assets, net of related debt	$ 1,523,153	$ 1,540,041	$ 1,331,395	$ (16,888)	$ 208,646
Restricted	76,425	69,944	83,593	6,481	(13,649)
Unrestricted	265,115	781	28,750	264,334	(27,969)
Total net position	$ 1,864,693	$ 1,610,766	$ 1,443,738	$ 253,927	$ 167,028

Analysis of Financial Position

Net position may serve as a useful indicator of the Fund's financial position. For the Fund, assets exceeded liabilities by $1,864.7 million and $1,610.8 million in fiscal years 2016 and 2015, respectively. The Fund's net position includes its investment of $1,523.2 million and $1,540.0 million in capital assets (e.g., land, buildings, and equipment), which is net of any related outstanding debt used to acquire those assets, at the end of fiscal years 2016 and 2015, respectively. The Fund uses these capital assets to provide wastewater 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. A portion of the Fund's net position, $76.4 million and $69.9 million, represents restricted resources that are legally obligated for revenue bond repayment requirements for fiscal year 2016 and fiscal year 2015, respectively. The Fund had unrestricted net position of $265.1 million and $0.8 million as of June 30, 2016 and June 30, 2015, respectively.

(continued)

During fiscal years 2016 and 2015, the Fund expended $343.5 million and $351.6 million for capital assets, respectively. These assets primarily represent facility enhancements to comply with environmental regulations. The assets were funded primarily through proceeds of revenue bonds. The Fund entered into a $23.8 million Water Quality Loan agreement with the Water Quality Financing Administration of the Maryland Department of the Environment in fiscal year 2016. Bond proceeds of $350.6 million ($318.0 million issued difference due to premium on sale, $141.0 million utilized to refund existing debt) in fiscal year 2015. In addition, the State of Maryland provided $145.5 and $127.6 in grant funding and the surrounding counties contributed $63.0 and $59.0 million in FY 2015 and FY 2014, respectively. 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 Fund Net Position

(Expressed in thousands)

	June 30,			Change	
	2016	**2015**	**2014**	**2016–2015**	**2015 - 2014**
Operating revenues	$ 229,300	$ 216,428	$ 221,181	$ 12,872	$ (4,753)
Operating expenses:					
Salaries and wages	34,933	34,761	37,441	172	(2,680)
Other personnel costs	15,392	18,395	17,753	(3,003)	642
Contractual services	63,768	58,617	59,370	5,151	(753)
Material and supplies	11,700	10,701	9,047	999	1,654
Minor equipment	586	463	382	123	81
Depreciation	43,287	39,904	38,083	3,383	1,821
Total operating expenses	169,666	162,841	162,076	6,825	765
Operating income	59,634	53,587	59,105	6,047	(5,518)
Nonoperating (expense), net	(14,412)	(15,077)	(15,012)	665	(65)
Income before capital contributions	45,222	38,510	44,093	6,712	(5,583)
Capital contributions	217,625	187,944	119,060	29,681	68,884
Change in net position	262,847	226,454	163,153	$ 36,393	$ 63,301
Total net position – beginning (as restated)	1,601,846	1,384,312	1,280,585		
Total net position – ending	$ 1,864,693	$ 1,610,766	$ 1,443,738		

(continued)

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

Net position increased in fiscal year 2016 by $262.8 million. In fiscal year 2015 net position based on operations initial increased by $226.5 million as a result of implementation of GASB 68 and GASB 71. These increases are due to improved operating margins that resulted from the implementation of an annual 11% wastewater rate increase in fiscal years 2016 and 2015.

Capital Assets

The Fund's capital assets as of June 30, 2016 and June 30, 2015, amounted to $2,636.2 million and $2,336.0 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 2016 and 2015 were $300.2 million and $311.7 million, respectively. These increases were funded primarily by issuance of revenue bonds. The following schedule presents the capital asset activities for fiscal years 2016 and 2015 (expressed in thousands):

	Balance at June 30			Change	Change
	2016	2015	2014	2016–2015	2015–2014
Land, net	$ 9,254	$ 9,254	$ 9,254	$ —	$ —
Construction in progress	1,031,337	899,033	688,047	132,304	210,986
Buildings and improvements, net	1,262,614	1,237,632	1,153,541	24,982	84,091
Equipment, net	38,858	39,913	32,592	(1,055)	7,321
Infrastructure, net	294,148	150,185	140,911	143,963	9,274
Total capital assets, net	$ 2,636,211	$ 2,336,017	$ 2,024,345	$ 300,194	$ 311,672

As of June 30, 2016 and June 30, 2015, the Fund had commitments of $465.9 million and $653.7 million, respectively for the acquisition and construction of capital assets. See note 4 for further information.

Debt Administration

For fiscal years 2016, 2015, and 2014 the fund had long-term obligations of $1,068.7 million, $1,078.6 million, and 893.9 million, respectively. These long-term obligations consisted primarily of revenue bonds, which are secured by revenue derived from the treatment of wastewater. During fiscal years 2016, 2015, and 2014 the Fund's debt decreased by $9.9 million, and increased $184.6 million, respectively. See note 5 for further information.

Economic Condition of the Wastewater Utility Fund

The Fund is a large regional utility system that provides for the treatment and disposal of sanitary sewage flow for the diverse Baltimore metropolitan area, which includes Baltimore City, as well as portions of Baltimore, Anne Arundel, and Howard counties. Modest growth is expected in the future. The Fund has ample long-term wastewater treatment capacity. In fiscal years 2016 and 2015, the City Board of Estimates approved annual rate increases of 11% for Baltimore City. Increased costs of wastewater service are passed along to the counties under the terms of agreements with Baltimore and Anne Arundel counties.

The Fund is currently under a consent decree with the U.S. Environmental Protection Agency to eliminate sanitary and combined sewer overflows. Although the Fund is expected to make substantial investments in capital improvements to meet Clean Water Act and consent decree requirements, management expects continued good financial performance, including adequate debt service coverage and liquidity, through the establishment of a new rate structure simultaneously with the implementation of the new water billing system effective October 11, 2016 for Baltimore City residents, along with a change from quarterly to monthly billing.

The new rate structure eliminates the current declining block water rates which resulted in large volume water users paying a lower rate per unit of water. The new rate structure consists of two fixed components and a volumetric component that is based on usage. The fixed components consist of a flat monthly fee referred to as an "account management fee" that is designed to cover the cost of billing and related support services to customers, and the second component consists of an "infrastructure charge" to recover a portion of capital costs for construction of buildings, improvements, infrastructure, etc. This new rate structure combined with annual rate increases of 9.0 % through fiscal year 2019, is expected to meet the fund's requirements to be a self-sufficient enterprise fund.

CITY OF BALTIMORE
WASTEWATER UTILITY FUND
Statements of Fund Net Position
Years ended June 30, 2016 and 2015
(Expressed in thousands)

		2016		2015
Assets and deferred outflow of resources:				
Current assets:				
Cash and cash equivalents - operating	$	104,195	$	131,745
Accounts receivable, net:				
Service billings		54,725		46,496
Other		10		365
Due from other governments		63,571		50,235
Inventories		244		278
Restricted assets:				
Cash and cash equivalents		50,279		52,651
Total current assets		273,024		281,770
Noncurrent assets:				
Restricted assets:				
Cash and cash equivalents		91,674		143,643
Due from other governments		98,146		126,920
Capital assets, net of accumulated depreciation		1,595,620		1,427,730
Capital assets not being depreciated		1,040,591		908,287
Total noncurrent assets		2,826,031		2,606,580
Total assets		3,099,055		2,888,350
Deferred outflow of resources:				
Deferred loss on refundings		33,351		35,671
Deferred outflows related to pension		7,389		8,554
Interest rate swaps		11		66
Total deferred outflows of resources		40,751		44,291
Total assets and deferred outflows of resources		3,139,806		2,932,641
Liabilities and deferred inflows of resources:				
Current liabilities:				
Accounts payable and accrued liabilities		18,859		7,861
Accrued interest payable		16,394		21,166
Due to other governments		6,439		19,892
Compensated absences		1,927		2,913
Accounts payable from restricted assets		97,196		121,642
Capital leases		340		413
Revenue bonds payable		33,886		31,485
Total current liabilities		175,041		205,372
Noncurrent liabilities:				
Compensated absences		4,762		3,662
Capital leases		1,087		1,427
Derivative instrument liability		11		66
Net pension liability		47,855		57,006
Revenue bonds payable, net		1,034,826		1,047,092
Total noncurrent liabilities		1,088,541		1,109,253
Total liabilities		1,263,582		1,314,625
Deferred inflow of resources:				
Deferred inflow related to pension		11,531		7,250
Total deferred inflow of resources		11,531		7,250
Total liabilities and deferred inflows of resources		1,275,113		1,321,875
Net position:				
Net investment in capital assets		1,523,153		1,540,041
Restricted for:				
Debt service		76,425		69,944
Unrestricted, restated		265,115		781
Total net position	$	1,864,693	$	1,610,766

See accompanying notes to financial statements.

CITY OF BALTIMORE
WASTEWATER UTILITY FUND

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

Years ended June 30, 2016 and 2015

(Expressed in thousands)

	2016	2015
Operating revenues:		
Charges for sales and services:		
Wastewater service	$ 228,990	$ 216,163
Rents, fees, and other income	310	265
Total operating revenues	229,300	216,428
Operating expenses:		
Salaries and wages	34,933	34,761
Other personnel costs	15,392	18,395
Contractual services	63,768	58,617
Materials and supplies	11,700	10,701
Minor equipment	586	463
Depreciation	43,287	39,904
Total operating expenses	169,666	162,841
Operating income	59,634	53,587
Nonoperating revenues (expenses):		
Loss on disposal of Assets		(15)
Gain (loss) on sale of investments	(364)	33
Bond issuance costs		(334)
Interest income	785	880
Interest expense	(14,833)	(15,641)
Total nonoperating expenses, net	(14,412)	(15,077)
Income before capital contributions	45,222	38,510
Capital contributions	217,625	187,944
Change in net position	262,847	226,454
Total net position – beginning (as restated, see Note 13)	1,601,846	1,384,312
Total net position – ending	$ 1,864,693	$ 1,610,766

See accompanying notes to financial statements.

CITY OF BALTIMORE
WASTEWATER UTILITY FUND
Statements of Cash Flow
Years ended June 30, 2016 and 2015
(Expressed in thousands)

	2016	2015
Cash flows from operating activities:		
Receipts from customers	$ 221,425	$ 215,922
Payments to employees	(62,683)	(56,509)
Payments to suppliers	(78,627)	(70,483)
Net cash provided by operating activities	80,115	88,930
Cash flow from capital and related financing activities:		
Proceeds from revenue bonds		263,416
Drawdown of proceeds from state issued bonds	52,590	31,652
Principal paid on revenue bonds	(17,695)	(11,196)
Principal paid on water quality and revenue bonds	(13,790)	(13,755)
Paid to escrow account for refunding of bonds		(154,902)
Interest received	785	880
Interest paid	(19,483)	(11,816)
Acquisition and construction of capital assets	(367,926)	(311,854)
Capital contributions received	204,290	185,600
Bond issuance cost paid		(334)
Capital lease payments	(413)	(399)
Swap termination payment		(10,332)
Net cash provided by (used in) capital and related financing activities	(161,642)	(33,040)
Cash flows from investing activities:		
Gain (Loss) of sale of investments	(364)	33
Net cash provided by (used in) investing activities	(364)	33
Net increase in cash and cash equivalents	(81,891)	55,923
Cash and cash equivalents, beginning of year	328,039	272,116
Cash and cash equivalents, end of year	$ 246,148	$ 328,039
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 59,634	$ 53,587
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	43,287	39,904
Changes in assets and liabilities:		
Accounts receivable – service billings & other	(7,875)	(505)
Inventories	34	(15)
Deferred outflow pension	1,165	(8,554)
Due to/from other governments	(13,453)	(491)
Accounts payable and accrued liabilities	2,077	148
Deferred inflow pension	4,281	7,250
Pension liability (current period)	(9,150)	(2,421)
Compensated absences	115	27
Total adjustments	20,481	35,343
Net cash provided by operating activities	$ 80,115	$ 88,930
Noncash activity from capital and related financing activities:		
Acquisition and construction of capital assets financed by debt	$ (24,445)	$ 39,736
Increase in issuance of State issue bonds	52,590	91,799
Total noncash activity from capital and related financing activities	$ 28,145	$ 131,535

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

(a) Reporting Entity

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

These financial statements are only of the Fund and are not intended to present the net position, changes in net 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 non-operating.

(c) Cash and Cash Equivalents

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 (operating and capital) and restricted cash is recorded in the general ledger accounts "due to/due from fund" and Renovation Account; and "M&T Trust Accounts" (referred to in the general ledger as 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, the remaining trust accounts are classified as current & noncurrent restricted cash and cash equivalents.

(d) Investments

Investments are reported at fair value on the date of the "Statement of Net Position", based on market prices. Investments with maturities of less than one year from purchase date are reported at cost, which approximates fair value, and are presented as cash equivalents in the accompanying financial statements.

(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. Swap related transactions are recorded as payments are received and made and adjusted to fair value at the end of the year. Note 6 provide detail information on these types of financing arrangements.

(f) Inventories

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

(g) Service Billings Accounts Receivable

Unbilled wastewater 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 wastewater 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 unrestricted portion of due from other governments consists of construction progress billing to local jurisdictions with cost sharing agreements. The restricted portion includes financial proceeds that the Maryland Department of the Environment (Water Quality Financing Administration) have made available to the City for specific capital improvements. The City bills MDE as costs are incurred. The City deems these receivables to be fully collectible based on historical collections.

(j) Accounts Payable from Restricted Assets

Restricted accounts payable include retainage to be refunded to vendors once the project has been completed and approved by the City. These are paid from restricted funds since the project revenues are Grants or cost sharing agreements with other jurisdictions.

(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 follow:

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

(m) Gains and Losses on 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.

<u>FY 2016</u>

There was no bond sale related to refundings.

<u>FY 2015</u>

On December 3, 2014, the City issued wastewater revenue bonds, Series 2014 C, 2014 D, 2014 E, in the amount of $87,815,000, $115,520,000, and $22,850,000, respectively, and totaling $226,185,000. Of this amount, $87,815,000 were issued for various capital projects, and $138,370,000 were refunding bonds that current refunded certain outstanding maturities totaling, $29,000,000, and advanced refunded certain outstanding maturities totaling, $111,975,000. A majority of the savings facilitated the refunding of the City’s auction rate debt portfolio and the termination of the underlying interest rate exchange agreements. Interest on the bonds is due July 1st and January 1st, and mature between 2015 and 2044 depending on the particular series.

The Series 2014 wastewater refunding revenue bonds reduced total debt service payments by approximately $2,746,000, to obtain an economic gain of $1,505,000. Of this amount, $10,332,000 was used to reduce derivative swap exposure.

(n) Compensated Absences

Effective July 1, 2015, the City implemented a new policy decreasing the amount of accrued vacation and personal leave that can be accumulated by the employees.

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 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 as of the date of separation; under any other conditions of separation, unused sick leave is forfeited. At June 30, 2016, it is estimated that accumulated non-vested sick leave for the fund approximated $5.8 million. 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 prior to July 1, 2015 could accumulate a maximum of 224 vacation and personal leave days depending upon length of service, which may be taken either 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 of unused sick leave recorded as a liability for compensated absences at June 30, 2016 and June 30, 2015 is $6.7 million and $6.6 million, respectively.

(o) Due to Other Governments

Effective January 1, 2005, the State of Maryland implemented a Bay Restoration Fee to provide funding for the upgrade of Wastewater treatment facilities in the State. The fee is collected by the local government and remitted quarterly to the State. At June 30, 2016 and June 30, 2015, the fund held $6.4 million and $19.9 million respectively, in fees due to the State.

(p) Long Term Debt Obligation

Consist of revenue bonds, which include long term borrowings from the Maryland Water Quality Financing Administration.

(q) 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 "Statements of Revenues, Expenses, and Changes in Fund Net Position" as a capital contribution.

(r) 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.

(2) Deposits and Investments

The Fund participates in the City's pooled cash account. At June 30, 2016 and June 30, 2015, the Fund's share of the City's pooled cash account, including both restricted and unrestricted cash, was $92.9 million and $120.9 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 States 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, 2016 and June 30, 2015 are presented in the following table. Full disclosure of deposits and investments that are required by GASB 40 are available in the 2016 Baltimore City CAFR which can be found at http://finance.baltimorecity.gov/public-info/reports. All investments are valued based on market prices of the security and are categorized as level 1 investment according to GASB 72 All investments are presented by investment type, and debt securities are presented by maturity (expressed in thousands):

			Investment maturities by months	
		Fair value	**Less than 6**	**6 to 12**
June 30, 2016 investment type:				
Debt securities:				
U.S. agencies	$	62		$ 62
Money market mutual funds		86,553	$ 86,553	
Blackrock Liquidity fund		37,478	37,478	
Federated government obligation fund		29,064	29,064	
		153,157	$ 153,095	$ 62
Less cash equivalents		153,157		
Total investments	$			

			Investment maturities by months	
		Fair value	**Less than 6**	**6 to 12**
June 30, 2015 investment type:				
Debt securities:				
U.S. agencies	$	13,831		$ 13,831
Money market mutual funds		72,183	$ 72,183	
Blackrock Liquidity fund		73,395	73,395	
Federated government obligation fund		47,710	47,710	
		207,119	$ 193,288	$ 13,831
Less cash equivalents		207,119		
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 the 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. 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, 2016 were rated by a nationally recognized statistical rating agency, and are presented below using the Standard and Poor's rating scale (expressed in thousands):

	June 30, 2016			
		Quality ratings		
Investment type	**Fair value**	**AA+**	**AAA**	**A1**
Debt securities:				
U.S. agencies:				
Federal home loan mortgage association note	$ 62	$ 62		$
Money market mutual funds:				
Wilmington U.S. government money market fund	86,553		$ 86,553	
Blackrock liquidity fund	37,478		37,478	
Federal government obligation fund	29,064		29,064	
Total rated debt investments	$ 153,157	$ 62	$ 153,095	$ —

	June 30, 2015			
		Quality ratings		
Investment type	**Fair value**	**AA+**	**AAA**	**A1**
Debt securities:				
U.S. agencies:				
Federal home loan mortgage association note	$ 13,831	$ 13,831		$
Money market mutual funds:				
Wilmington U.S. government money market fund	72,183		$ 72,183	
Blackrock liquidity fund	73,395		73,395	
Federal government obligation fund	47,710		47,710	
Total rated debt investments	$ 207,119	$ 13,831	$ 193,288	$ —

The Fund did not have any debt securities investments at June 30, 2016 and 2015 that were more than five percent of total investments.

(Continued)

(3) Accounts Receivable, net

An allowance for doubtful accounts is recorded for accounts that are delinquent at least 260 days. Accounts receivable are shown net of an allowance of $11.6 million and $10.0 million as of June 30, 2016 and June 30, 2015, respectively. The allowance is calculated based on accounts that are both over $200 and greater than 260 days old.

Penalty income derived from delinquent Baltimore City Water, Wastewater & Storm Water 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.

(4) Capital Assets

Capital assets activities for the years ended June 30, 2016 and 2015 were as follow (expressed in thousands):

	Balance June 30, 2015	Additions	Deductions	Balance June 30, 2016
Capital assets, not being depreciated:				
Land	$ 9,254			$ 9,254
Construction in progress	899,033	$ 340,884	$ 208,580	1,031,337
Total capital assets, not being depreciated	908,287	340,884	208,580	1,040,591
Capital assets, being depreciated:				
Buildings and improvements	1,783,733	59,967		1,843,700
Equipment	135,514	2,607		138,121
Infrastructure	157,711	148,603		306,314
Total capital assets, being depreciated	2,076,958	211,177		2,288,135
Less accumulated depreciation for:				
Buildings and improvements	546,101	34,985		581,086
Equipment	95,601	3,662		99,263
Infrastructure	7,526	4,640		12,166
Total accumulated depreciation	649,228	43,287		692,515
Total capital assets, being depreciated, net	1,427,730	167,890		1,595,620
Total capital assets, net	$ 2,336,017	$ 508,774	$ 208,580	$ 2,636,211

	Balance June 30, 2014	Additions	Deductions	Balance June 30, 2015
Capital assets, not being depreciated:				
Land	$ 9,254			$ 9,254
Construction in progress	688,047	$ 347,993	$ 137,007	899,033
Total capital assets, not being depreciated	697,301	347,993	137,007	908,287
Capital assets, being depreciated:				
Buildings and improvements	1,666,410	117,323		1,783,733
Equipment	125,748	10,976	1,210	135,514
Infrastructure	145,406	12,305		157,711
Total capital assets, being depreciated	1,937,564	140,604	1,210	2,076,958
Less accumulated depreciation for:				
Buildings and improvements	512,869	33,232		546,101
Equipment	93,156	3,640	1,195	95,601
Infrastructure	4,495	3,031		7,526
Total accumulated depreciation	610,520	39,903	1,195	649,228
Total capital assets, being depreciated, net	1,327,044	100,701	15	1,427,730
Total capital assets, net	$ 2,024,345	$ 448,694	$ 137,022	$ 2,336,017

Interest is capitalized on assets acquired with tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest cost incurred from same period. During fiscal years 2016 and 2015, interest cost of $20,196,000 and $21,158,000, respectively (net of interest earned of $1,140,000 and $392,800 respectively), was capitalized.

At June 30, 2016, the Fund had outstanding commitments for construction of $465.9 million.

(5) Long-Term Obligations

The City does not have a debt limit; however, the Constitution of Maryland requires a three-step procedure for 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 obligations for the years ended June 30, 2016 and June 30, 2015 are as follow (expressed in thousands):

	Balance June 30, 2015	Additions	Reductions	Balance June 30, 2016	Amounts due within one year
Revenue bonds	$ 1,011,735	$ 23,817	$ 31,484	$ 1,004,068	$ 33,886
Add bond premium	66,842		2,198	64,644	—
Total revenue bonds payable	$ 1,078,577	$ 23,817	$ 33,682	$ 1,068,712	$ 33,886
Capital lease	$ 1,841	$	$ 414	$ 1,427	$ 340
Compensated absences, net	$ 6,575	$ 114	$	$ 6,689	$ 1,927

	Balance June 30, 2014	Additions	Reductions	Balance June 30, 2015	Amounts due within one year
Revenue bonds	$ 859,678	$ 317,984	$ 165,927	$ 1,011,735	$ 31,485
Add bond premium	34,264	32,578		66,842	—
Total revenue bonds payable	$ 893,942	$ 350,562	$ 165,927	$ 1,078,577	$ 31,485
Capital lease	$ 2,240	$	$ 399	$ 1,841	$ 413
Compensated absences, net	$ 6,548	$ 27	$	$ 6,575	$ 2,913

Bonds and notes outstanding as of June 30 consist of (expressed in thousands):

	2016	2015
Serial bonds series 1996-B maturing in annual installments from $208,000 through February 1, 2017, with interest rate at 3.17%, payable semiannually	$ 208	$ 410
Serial bonds series 1998-A maturing in annual installments from $213,000 to $403,000 through February 1, 2019, with interest rate at 2.87%, payable semiannually	1,008	1,388
Serial bonds series 1999-A maturing in annual installments from $149,000 to $161,000 through February 1, 2019, with interest rate at 2.52%, payable semiannually	476	628
Serial bonds series 1999-B maturing in annual installments from $92,000 to $636,000 through February 1, 2021, with interest rate at 2.61%, payable semiannually	2,539	3,112
Serial bonds series 2001-A maturing in annual installments from $632,000 to $800,000 through February 1, 2022, with interest rate at 2.30%, payable semiannually	4,457	5,171
Serial bonds series 2002-A maturing in annual installments from $1,280,000 through July 1, 2016, with variable interest through July 1, 2016	1,280	2,520
Serial bonds series 2003-B maturing in annual installments from $287,000 to $328,000 through February 1, 2023, with interest rate at 0.40%, payable semiannually	2,237	2,557
Serial bonds series 2004-B maturing in annual installments from $547,000 to $972,000 through February 1, 2022, with interest rate at 0.45%, payable semiannually	5,369	6,321
Serial bonds series 2004-C maturing in annual installments from $879,000 to $907,000 through February I, 2024 with interest rate at 0.25%, payable semiannually	7,159	8,038
Serial bonds series 2005-A maturing in annual installments from $104,000 to $1,102,000 through February 1, 2024 with interest rate at 0.25%, payable semiannually	7,727	8,799
Serial bonds series 2005 – B maturing in annual installments from $940,000 to $1,480,000 through July 1, 2025 with interest rates of 3.25% to 5.0%, payable semiannually		975
Serial bonds series 2006-A manning in annual installments from $495,000 to $1,548,000 through February 1, 2025 with interest rate at 0.40%, payable semiannually	12,710	14,210
Serial bonds series 2006-B maturing in annual installments from $185,000 to $362,000 through February 1, 2026 with interest rate at 0.40%, payable semiannually	3,380	3,728
Serial bonds series 2006-C maturing in annual installments from $1,305,000 through July 1, 2026, with interest rates of 4.00% to 5.00%, payable semiannually	1,305	2,560
Serial bonds series 2007-A maturing in annual installments from $1,704,000 to $2,174,000 through February 1, 2026, with interest rate at 0.40%, payable semiannually	20,970	23,068
Serial bonds series 2007-B maturing in annual installments from $154,000 to $161,000 through February 1, 2027, with Interest rate at 0.40%, payable semiannually	1,739	1,893

	2016	2015
Serial bonds series 2007-C maturing in annual installments from $35,000 to $3,935,000 through July 1, 2027, with interest rates of 3.60% to 4.50%, payable semiannually	$ 10,765	$ 10,815
Serial bonds series 2007-D maturing in annual installments from $2,530,000 to $2,660,000 through July 1, 2017, with interest rate at 5.00%, payable semiannually	5,190	7,600
Serial bonds series 2008-A maturing in annual installments from $210,000 to $2,115,000 through July 1, 2028, with interest rates of 2.00% to 5.00%, payable semiannually	13,380	14,570
Serial bonds series 2009-A maturing in annual installments of $426,167 through February 1, 2029 with interest rate at 0.00%	5,540	5,966
Serial bonds series 2009-B maturing in annual installments of $95,391 through February 1, 2030, with interest rate at 0.0%	1,193	1,284
Serial bonds series 2009-C maturing in annual installments from $625,000 to $775,000 through July 1, 2022, with interest rates of 2.00% to 4.50% payable semiannually	5,040	5,665
Term bonds series 1993-A with interest at 5.65%, payable semiannually, due July 1, 2020	10,500	12,300
Term bonds series 1994-A with interest at 6.0%, payable semiannually, due July 1, 2015		830
Term bonds series 1994-A with interest at 5.0%, payable semiannually, due July 1, 2022	7,115	7,115
Term bonds series 2007-C with interest at 4.50%, payable semiannually, due July 1, 2032	29,795	29,795
Term bonds series 2007-C with interest at 4.50%, payable semiannually, due July 1, 2036	19,255	19,255
Term bonds series 2007-D with interest at 5.0%, payable semiannually, due July 1, 2037	20,160	20,160
Term bond series 2008-A with interest at 5.0%, payable semiannually, due July 1, 2033	7,675	7,675
Term bond series 2008-A with interest at 5.0%, payable semiannually, due July 1, 2038	15,575	15,575
Term bonds series 2009-C with interest at 5.00%, payable semiannually, due July 1, 2029	3,215	3,215
Term bonds series 2009-C with interest at 5.125% payable semiannually, due July 1, 2034	6,545	6,545
Term bonds series 2009-C with interest at 5.625% payable semiannually, due July 1, 2039	8,490	8,490
Serial bonds series 2009-E maturing in annual installment of $157,842 through February 1, 2032, with an interest rate of 0.00%	2,525	2,683
Serial bonds series, 2011-A maturing in annual installments of $2,030,000 to $3,940,000 through February 1, 2031 with interest rates from 4.00% to 5.00%	45,015	46,855
Serial bonds series, 2011-B maturing in annual installments of $168,332 to $203,363 through February 1, 2033, with interest rates from 1.00%	3,196	3,368
Term bond series 2011-A with interest at 5.00%, payable semiannually, due July 1, 2036	22,870	22,870
Term bond series 2011-A with interest at 5.00%, payable semiannually, due July 1, 2041	29,185	29,185

 (Continued)

		2016		2015
Serial bonds series, 2013-A maturing in annual installments of $1,558,483 to $1,798,836 through February 1, 2034 with interest rate of 0.80%, payable semiannually	$	30,285	$	31,844
Serial bonds series, 2013-C maturing in annual installments of $1,160,000 to $4,725,000 through July 1, 2033 with interest rates from 3.00% to 5.00%, payable semiannually		58,130		60,170
Term bond series 2013-B with interest at 5.00%, payable semiannually, due July 1, 2038		27,420		27,420
Term bond series 2013-B with interest at 5.00%, payable semiannually, due July 1, 2043		35,000		35,000
Serial bonds series, 2013-D maturing in annual installments of $2,100,000 to $3,225,000 through July 1, 2033, with interest rates from 3.00% to 5.00% payable semiannually		69,025		70,135
Term bond series 2013-D with interest at 5.00%, payable semiannually, due July 1, 2038		14,835		14,835
Term bond series 2013-D with interest at 5.00%, payable semiannually, due July 1, 2042		15,845		15,845
Serial bonds series, 2013-E maturing in annual installments of $20,000 to $3,300,000 through July 1, 2026, with interest rates from 3.00% to 5.00% payable semiannually		24,900		26,385
Serial bonds series, 2014-A maturing in annual installments of $2,040,192 to $2,464,774 through February 1, 2035 with interest rates at 1.00% payable semiannually		42,883		44,923
Serial bonds series, 2014-C maturing in annual installments of $1,125,000 to $5,650,000 through July 1, 2034, with interest rates from 2.00% to 5.00% payable semiannually		42,710		43,555
Term bond series 2014-C with interest at 5.00%, payable semiannually, due July 1, 2039		19,445		19,445
Term bond series 2014-C with interest at 5.00%, payable semiannually, due July 1, 2044		24,815		24,815
Serial bonds series, 2014-D maturing in annual installments of $1,125,000 to $5,650,000 through July 1, 2034, with interest rates from 3.00% to 5.00% payable semiannually		115,520		115,520
Serial bonds series, 2014-E maturing in annual installments of $165,000 to $3,935,000 through July 1, 2032, with interest rates from 2.00% to 5.00% payable semiannually		22,850		22,850
Serial bonds series, 2015-A maturing in annual installment of $954,000 to $1,122,000 from February 1, 2017 through February 1, 2035, with interest rates of 0.90%, payable semiannually		19,696		19,696
Serial bonds series, 2015-B maturing in annual installment of $336,185 to $3,920,000 from February 1, 2018 through February 1, 2037, with interest rates of 0.90%, payable semiannually		72,103		72,103
Serial bonds series, 2016-A maturing in annual installments of $1,000 to $903,935 through February 1, 2047, with interest rate of 0.70%, payable semiannually		23,817		
		1,004,067		1,011,735
Unamortized bond premium		64,644		66,842
	$	1,068,711	$	1,078,577

Principal maturities and interest on revenue bonds, shown at gross, are as follow (expressed in thousands):

	Principal	Interest	Interest rate swap net[(a)]
Fiscal year:			
2017	$ 33,886	$ 37,697	$ (2,932)
2018	37,450	36,762	
2019	39,093	35,688	
2020	39,737	34,534	
2021	40,891	33,308	
2022–2026	195,676	147,769	
2027–2031	207,349	111,369	
2032–2036	211,810	67,926	
2037–2041	134,645	29,304	
2042–2046	62,626	4,603	
2047	905	6	
	$ 1,004,068	$ 538,966	$ (2,932)

(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, 2009, 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, 2016, the rate requirements were met, and management believes the Fund is in compliance with all significant requirements of the indentures.

Pledged Revenue

The Fund has pledged future customer revenues to repay $1,004.1 million and $1,011.7 million of revenue bond debt at June 30, 2016 and June 30, 2015, respectively. Proceeds from these revenue bonds were used to build and improve various aspects of the City's wastewater utility systems. The bonds are payable solely from the revenues of the fund and are payable through 2047. Annual principal and interest payments on these revenue bonds are expected to require 68.1% of pledged revenues. Total principal and interest, remaining to be paid on the revenue bonds for the fund is $1,540.1 million and $1,586.9 million at June 30, 2016 and June 30, 2015, respectively. Principal and interest paid for the current year and current pledged revenue for the fund were $70.9 million and $104.0 million respectively. Principal and interest and pledged revenue for fiscal year 2015 were $58.1million and $88.2 million, respectively.

(6) Interest Rate Swaps

(a) Objectives of the Swaps

The Fund enters 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 value, and credit risk rating of the outstanding swaps, as of June 30, 2016, are presented in the following table. The notional amounts of the swaps match the principal amount of the associated debt. The City's swap agreements contain scheduled reductions to outstanding notional amounts that are designed to track the scheduled or anticipated reductions in the associated "bonds payable" category.

(c) Hedged Derivative Instruments

At June 30, 2016 and June 30, 2015, the Fund had deferred outflows for various hedged derivative instruments with total fair values of these instruments in the amount of ($11,000) and ($66,000), respectively. The notional amounts for these hedged derivative instruments at June 30, 2016 and June 30, 2015 were $1.3 million and $2.5 million, respectively. During fiscal years 2016 and 2015, the fair values of these instruments increased $55,000 and $9.7 million, respectively. All hedges are cash flow hedges. The following schedule provides a detailed analysis of derivative instruments held at June 30, 2016 and 2015:

	June 30, 2016						
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	7/1/2016	4.61%	Bond Rate/CP	$ 1,280,000	$ (10,963)	A+/A3

	June 30, 2015						
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	7/1/2015	4.50%	CPI-Base Rate	$ 1,240,000	$ (23,154)	A-/A3
2002 revenue bonds	5/7/2002	7/1/2016	4.61%	CPI-Base Rate	1,280,000	(43,049)	A-/A3
Total swaps outstanding					$ 2,520,000	$ (66,203)	

i. Credit Risk

As of June 30, 2016, the Fund is not exposed to credit risk on any 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 cash or United States Government securities held by the City. As of June 30, 2016 and June 30, 2015, none of the City's swap agreements met this requirement.

ii. Basis Risk

The Fund's variable rate bonds are all Consumer Price Index bonds. These swaps are structured to capture the difference between expected and actual inflation without exposure to changes in the real interest rates.

iii. Termination Risk

The City or the counterparty may terminate the 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.

(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, 2016 and June 30, 2015, the fund had $129.4 million and $161.0 million, respectively of debt outstanding that is considered defeased.

(8) Pension Plan

The Fund contributes to a cost-sharing multiple employer defined benefit plan, the Employees' Retirement System Plan (ERS Plan or The Plan), established January 1, 1926. The ERS Plan provides retirement benefits as well as disability benefits to plan members and their beneficiaries. The ERS Plan is managed by a Board of Trustees in accordance with Article 22 of the Baltimore City Code. The Plan benefits provisions may be amended only by the City Council. The ERS Plan issues separate financial statements which may be obtained from the following website: www.bcers.org

The ERS Plan is considered to be part of the City of Baltimore's reporting entity and its' financial statements as a whole are included in the City's financial statements. The financial statements for The Plan are prepared using the accrual basis of accounting. Employer and member contributions are recognized in the period that the contributions are due, and the employer has made a formal commitment to provide the contributions.

(a) Plan Description

The ERS Plan covers City employees and the Baltimore City Public School System employees with the exception of those required to join the Maryland State Retirement System.

At June 30, 2015, the measurement date, the ERS Plan membership consisted of:

Active plan members	8,673
Retirees and beneficiaries - currently receiving benefits	8,898
Inactive members eliigible to, but not yet receiving benefits	1,068
Total	18,639

The ERS Plan provides service retirement benefits as well as death and disability benefits. Only the Mayor and City Council may amend the ERS Plan Provisions. The reduction of benefits is precluded by the City Code.

The ERS Plan is divided into three Classes: A, C and D for amendment of membership and benefit changes of the Plan Provisions.

Class "A" has 17 members. The "A" contributory class consists of all members hired prior to July 1, 1979 who did not elect to transfer to Class C, the non-contributory class. Membership was mandatory on the member's second anniversary of employment. However, the member could voluntarily enroll within the first two years of employment.

Class "C" is composed of 8,656 members of the ERS membership and consists of all employees hired on or after July 1, 1979 who automatically become members on the first anniversary of employment, and all members hired prior to July 1, 1979 who elected to transfer from the Class "A" contributory class.

Effective July 1, 2013, Ordinance 13-144 was enacted by the Mayor and City Council introducing contributions for active ERS Plan non-contributory members and eliminating the post retirement variable benefit increase. The Ordinance provides that effective July 1, 2013 members will contribute 1% of pay, to continue each year at 1% increments provided that 2% compensation is received for each year of contribution until employee contribution reaches 5% of compensation.

The ERS defined benefit class "C" was closed to new members on June 30, 2014 to establish the City of Baltimore's Retirement Saving Plan (RSP). The RSP consist of a 401a contributory non-hybrid and a hybrid contributory defined benefit "D" Plan. The RSP is not a separate plan, but is a separate class of the existing ERS plan, if the employee choses to belong to the hybrid defined benefit "D" plan. The waiting period of entry for the contributory non-hybrid plan is 180 days. The hybrid contributory defined benefit Plan waiting period is one year. Employees hired as of July 1, 2014 have 150 days of employment to select between the two Plans. Employees who do not select a Plan after 150 days of employment will automatically default into the hybrid contributory defined benefit "D" plan. The mandatory contribution to each of the Plan is 5%. Members have an option in both Plans to contribute to the City of Baltimore's 457 Deferred Compensation Plan and will receive a 50% match on the first two percent of their contributions.

The contributions required by the ERS Plan provisions for each membership class are as follow:

Membership classes	Percentage of compensation
A	4.0%
C	1.0-5.0%*

* Class C contributions increased from 2.0% to 3.0% for the fiscal year beginning July 1, 2015 through June 30, 2016.

Members of Classes A and B are eligible to retire at age 60 with 5 years of service or 30 years of membership service. Members of Classes C and D are eligible to retire at age 65 with 5 years of service or 30 years of service, regardless of age. Early retirement is allowed at age 55 with 5 years of service payable at age 65 or reduced for payment before age 65. Benefits for service retirement are paid as follow:

Classes A and B – The sum of:

1. An annuity of the actuarial equivalent of a members accumulated contributions: and,
2. A pension, which together with the annuity shall equal 1.935% (Class A) or 1.785% (Class B) of average final compensation times years of service.

Class C:

A pension of (1) 1.6% of average final compensation times years of service up to 30 years, plus (2) .25% of average final compensation in excess of covered compensation, times years of service up to 30 years, plus (3) 1.85% of average final compensation, times years of service in excess of 30 years.

Class D:

A pension of 1.00% of average final compensation, times years of service. If the member retires at or after age 62 with at least 20 years of service the member receives an enhanced benefit of 1.10% of average final compensation times years of service.

(b) Proportionate Share of Net Pension Liability

The measurement date for the Plan is June 30, 2015. Measurements are based on the fair value of assets as of June 30, 2015. The funds proportionate share of NPL is 8.27%. The following schedules are the proportionate share of net pension liability (NPL) and the sensitivity of the NPL to the discount rate.

The components of the proportionate share of the net pension liability of The Plan are as follow:

(Expressed in Thousands)

		Employees' Retirement System (Wastewater Portion)
Total Pension Liability	$	149,532
Less: Plan fiduciary net position		101,677
Net Pension Liability (Asset)	$	47,855
Plan Fiduciary Net Position as a Percentage of Total Pension Liability (Asset)		68.0%

The Actuarial Assumptions and the proportionate share of current year contributions for The Plan are:

(Expressed in Thousands)

		Employees' Retirement System (Wastewater Portion)
Proportionate Share of Contributions made	$	9,056
Actuarial assumptions:		
Investment rate of return:		
Pre-retirement		7.75%
Post retirement		6.65%
Projected salary increases		2.65%
Includes inflation rate at		2.65%
Cost-of-living adjustment		1.5-2.0%
Mortality	Sex distinct 1994 Uninsured Pensioners Generational Mortality with adjustments and improvement using Scale AA	
Last Experience Study Covered	July 1, 2010-June 30, 2014	

(c) Expected Returns, Discount Rate and Deferred Inflows/Outflows

The long term expected rate of return on pension plan investments was determined using a building block method in which best-estimate ranges of expected future real rates (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate or return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

Best estimates of arithmetic real rate of return for each major asset class included in the Plan's target asset allocation are summarized in the following table:

Long Term Expected Real Rate of Return/Target Allocation

Assets Class	Employees' Retirement System
U.S. equities	5.3%/36%
International equities	6.2%/14%
Private equity	10.9%/10%
Fixed income	0.1%/26%
Real estate	5.8%/9.0%
Hedge funds	3.2%/5%

The projection of the cash flows used to determine discount rate assumed that plan member contributions will continue to be made at the rates specified in the City Code. Expected member contributions for fiscal year 2015 were 2% of pay increasing to 3% of pay for Fiscal year 2016 will continue to increase annually up to 5% of compensation thereafter. Employer contributions were assumed to be made in accordance with the contribution policy in effect for the July 1, 2015 actuarial valuation. Based on these assumptions, the ERS Plan's fiduciary net position was projected to be available to make all projected future benefit payments for current members until the last payment for the current covered population is made as of the June 30, 2015 measurement date. The discount rate at June 30, 2015 is 7.75% for active and terminated vested participants and 6.55% for in-pay participants. The assumed long term expected rate of return on ERS investments is 7.75%.

The sensitivity of the net pension liability below presents the proportionate share of the net pension liability of the Plan calculated using the current discount rates as well as what the proportionate share of the Plan's net pension liability would be if it were calculated using a discount rate that is 1% lower or 1% higher than the current rate.

Sensitivity of the proportionate share of the pension liability to changes in the discount rate

(Expressed in Thousands)

Employees' Retirement System (Wastewater Proportionate Share)	1% Decrease 6.75% Active Part. 5.55% Retired Part.	Current Discount Rate 7.75% Active Part. 6.55% Retired Part.	1% Increase 8.75% Active Part. 7.55% Retired Part.
Net Pension Liability	$ 64,339	$ 47,855	$ 33,884
Plan Fiduciary Net Position as a Percentage of Total Pension Liability	61.2%	68.0%	75.0%

Deferred Inflows and Deferred Outflows. Exclusive of contributions made subsequent to the measurement date which will be recognized in pension expense in the next fiscal year, a summary of the proportionate share of the net deferred outflows/ (inflows) of resources to be recognized in pension expense in future years is presented below:

(Expressed in Thousands)

Deferred outflows (inflows) for years ended June 30:	Employees' Retirement System (Wastewater Portion)
2017	$ (2,856)
2018	(2,856)
2019	(2,923)
2020	732
	$ (7,903)

In addition to the amounts disclosed above $3,761,000 in deferred outflows will be recognized as a reduction of net pension liability in the year ended June 30, 2017.

The following presents a summary of deferred outflows/(inflows) of resources related to pensions:

(Expressed in Thousands)

	Employees' Retirement System (Wastewater Portion)
Deferred inflows of resources:	
Change in proportionate share	$ (6,091)
Assumption changes	(5,440)
Total Inflows	$ (11,531)
Deferred outflows of resources:	
Differences between actual and expected experience	$ 702
Differences between actual and expected earnings	2,926
Contributions subsequent to measurement date	3,761
Total Outflows	$ 7,389

(d) Deferred Compensation

The City offers its employees a deferred compensation plan in accordance with the Internal Revenue Code (IRC) Section 457. The Plan, available to all employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees or other beneficiaries until termination, retirement, death, or unforeseeable emergency.

The City has no administrative involvement and does not perform the investing function. The City has no fiduciary accountability for the plan and, accordingly, the plan assets and related liabilities to plan participants are not included in the basic financial statements.

(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, 2016, 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, 2016, there were 15,841 City retirees eligible for these benefits.

For fiscal year 2016 and 2015, the Fund's total contributions to the Plan were $4.7 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 program 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 program 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 medical plans, and the remaining costs are paid by the City.

All funds of the City participate and make payments to the risk management program based on actuarial estimates and historical cost information of the amounts needed to pay prior and current year claims. During fiscal years 2016 and 2015, the Fund contributed $3,025,000 and $2,211,000 to the program, respectively, while its' remaining share of the liability to the program in fiscal years 2016 and 2015 was $10,020,000 and $8,920,000, respectively

(11) Commitments and Contingencies

Claims, assessments, and lawsuits arise during the normal course of business that are pending or may be asserted against the City of Baltimore Wastewater Utility Fund. As of June 30, 2016, the City of Baltimore Wastewater Utility Fund had litigation claims outstanding, including claims that are early in the process of resolution. Management will vigorously defend against these claims and does not expect significant negative results from them. In the opinion of management, after consultation with legal counsel, such matters should not have a material effect on the City of Baltimore Wastewater Utility Fund financial position as of June 30, 2016, or its results of operations for the year ended June 30, 2016.

The Fund has received Federal grants and State grants for the construction of capital projects. 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, 2016 and June 30, 2015, management estimates that no material liabilities will result from such audits.

The Northeast Maryland Waste Disposal Authority Act, was enacted by the Maryland General Assembly to assist in the provision of waste disposal facilities for the Northeast Maryland area, including the facilities for the disposal of Wastewater treatment residue. The City agreed to perform the obligations of the Authority. The current agreement, approved in March 2008 provided that the Authority and Mayor and City Council of Baltimore (the City) entered into a service agreement, through June 30, 2014, with Veolia Water North America-Central, LLC, a Delaware limited liability company, which now owns and operates the Facility. This agreement has now been extended through June 30, 2018. The agreement allows the Fund to deliver up to approximately 2,167 wet tons of sewerage sludge per month and to pay a tipping fee comparable to alternative methods of sludge disposal currently being used by the fund. The debt service on variable rate bonds is a component of the tipping fee. The Fund's current tipping fee expense per wet ton for delivering sewerage sludge was $89.10 and $43.87 up to the guaranteed and excess tonnage amounts, respectively. Payments under the agreement in fiscal year 2016 were $2.648 million. The maximum commitment by the City is 26,004 wet tons per year.

The Fund also has an agreement with Synagro-Baltimore, L.L.C. a wholly owned subsidiary of Synagro Technologies for processing biosolids at the City's Back River and Patapsco Wastewater Treatment Plants. Under the agreements the Fund delivers approximately 19,000 dry tons of biosolids per year at each facility and pays base and service tipping fee. The debt service on the bonds is a component of the tipping fee. The Fund's current monthly base tipping fee expense for delivering biosolids is $254,236 for Patapsco Wastewater Treatment Plant. The base tipping fee at the Back River Waste Water Treatment Plant terminated in fiscal year 2015 with the completion of debt service payments. The service tipping fees were $415.26 and $408.15 per ton for the Back River and Patapsco Wastewater Treatment Plants, respectively. Payments under the agreements in fiscal year 2016 were $17.509 million. The agreements extend to 2025 and 2017 for the Back River and Patapsco Wastewater Treatment Plants, respectively.

(Continued)

(a) The City in 2002, 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 U.S. Department of Justice has currently negotiated with major east coast cities with aged sewer and storm water infrastructures. These efforts are ambitious and the costs of the construction and maintenance are estimated to be greater than $1 billion. The City has committed to financing these remedial efforts through a combination of Wastewater revenue bonds in conjunction with all available State and Federal assistance. During the life of the Consent Decree to date, the City has spent over $800 million to study, design, and begin improving the sanitary sewer system with the goal of eliminating sanitary sewer overflows. The consent decree expired January 1, 2016 and the City of Baltimore has been negotiating a new decree with Department of Justice, the Environmental Protection Agency, and the Maryland Department of the Environment.

On June 1, 2016 the City, the Environmental Protection Agency, the Department of Justice, and the Maryland Department of the Environment filed a proposed modification to the 2002 Consent Decree with the U. S. District Court. The revised decree is composed of the two phases with priority given to those projects that provide the greatest environmental benefits in the early years and is expected to cost $630.1 million in fiscal year 2017 to complete the remaining phase one projects. The second phase deadline is 2030 and focuses on increasing the capacity of the system, which is expected to cost $548.4 million. Following the filing of the proposed modification, the Consent Decree was subject to a public comment period that ended on August 8, 2016. The parties are currently negotiating potential changes to the proposed modification based on comments received from the public. Once the parties are in agreement, the Consent Decree will be filed with the U. S. District Court for review.

(12) Subsequent Events

On February 9, 2017, the City issued Water and Wastewater Project and Refunding Revenue Bonds, Series 2017 in the amount of $239.1 million and $247.2 million, respectively. The bonds will fund capital projects of each enterprise fund and refund certain outstanding fixed rate bonds. The interest rates range from 3.00% to 5.00%, and interest is payable semiannually on July 1 and January 1 of each year beginning July 1, 2017.

On April 11, 2017, the City entered into a Wastewater Loan agreement with the Maryland Water Quality Financing Administration Water Quality Revolving Loan in the amount of $4,635,000. The rate of interest on the loan is set at 0.80%.

(13) Beginning Balance Adjustment

During fiscal year 2015, the City implemented Government Accounting Standards Board Statement No. 68, "Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27". Under the provisions of this statement, the City must change the method of computing net pension liability. Therefore, the City has recalculated the fiscal year ending June 30, 2014, net position totals based on the effect of these changes. The restated net position totals resulting from this accounting are as follow for governmental activities and for the applicable proprietary funds affected (expressed in thousands):

	June 30, 2014 Net Position	GASB68 Pension Adjustments	Restated June 30, 2014 Net Position
Wastewater Utility Fund	$ 1,443,738	$ (59,426)	$ 1,384,312

During fiscal year 2016, the City allocated a portion of the risk management program's deficit to the Wastewater Fund. The restated net position totals resulting from this accounting are as follow for governmental activities and for the applicable proprietary funds affected (expressed in thousands):

	June 30, 2015 Net Position	GASB68 Pension Adjustments	Restated June 30, 2015 Net Position
Wastewater Utility Fund	$ 1,610,766	$ (8,920)	$ 1,601,846

Required Supplementary Information
(Unaudited)

CITY OF BALTIMORE
WASTEWATER UTILITY FUND

Notes to the Required Supplementary Information
(Unaudited)

Wastewater Utility Fund
Schedule of the City's Proportionate Share of Net Pension Liability
Employees' Retirement System Plan
For the Year Ended June 30, 2016
(Expressed in Thousands)
(Unaudited)

	2016	2015
Wastewater Fund's share of the net pension liability	8.27%	9.33%
Wastewater Fund's proportionate share of the net pension liability	$ 47,856	$ 57,006
Wastewater Fund's covered employee payroll	28,751	32,171
Wastewater Fund's proportionate share of the net pension liability as a percentage of its covered employee payroll	166.4%	177.2%
Plan fiduciary net position as a percentage of the total pension liability	68.0%	67.8%

The reporting date is June 30, 2016 and the measurement date is June 30, 2015

Wastewater Utility Fund
Schedule of Employer Contributions
Employees' Retirement System Plan
Ten-Year Trend Information
(Expressed in Thousands)
(Unaudited)

Description	2016	2015
Actuarial Determined Contribution	$ 8,433	$ 7,318
Contribution in Relation to the Actuarial Determined Contribution	9,056	7,609
Contribution Deficiency (Excess)	(623)	(291)
Wastewater Fund's Covered Employee Payroll	28,751	32,171
Contribution as Percentage of Covered Payroll	31.5%	23.7%

The reporting date is June 30, 2016 and the measurement date is June 30, 2015

(Continued)

Notes to the Required Supplementary Information
(Unaudited)

1. Baltimore City's Retirement – Wastewater Utility Fund

The pension plan is considered part of the Wastewater Utility Fund reporting entity. The plan issues a publicly available financial report that includes financial statements and the required supplementary information for that plan. The report for Retirement System may be obtained from the following website: www.bcers.org