CITY OF BALTIMORE
WASTEWATER 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
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KPMG LLP
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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 Wastewater 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.

KPMG

Opinion

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of the Wastewater 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 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, 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

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, 2014 and June 30, 2013.

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 2014, total operating revenues were $221.2 million, which represents an increase of 20.5% from the previous year's revenues. For fiscal year 2013, total operating revenues were $183.5 million, which represents an increase of 2.0% from the previous year's revenues.
- Total operating expenses for fiscal year 2014 were $162.1 million, an increase of $.1 million over fiscal year 2013 operating expenses of $162.0 million.
- Net position increased in fiscal years 2014 and 2013 by $163.2 million and $109.1 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.

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.

Financial Analysis of Net Position

(Expressed in thousands)

	June 30			Change	
	2014	2013 (restated)	2012	2014–2013	2013–2012
Current and other assets	$ 433,397	$ 267,433	$ 293,520	$ 165,964	$ (26,087)
Capital assets	2,024,345	1,821,444	1,689,671	202,901	131,773
Deferred outflows of resources	26,514	27,239	—	(725)	27,239
Total assets	$ 2,484,256	$ 2,116,116	$ 1,983,191	$ 368,140	$ 132,925
Current liabilities	$ 156,085	$ 99,068	$ 77,597	$ 57,017	$ 21,471
Noncurrent liabilities	884,433	736,463	734,131	147,970	2,332
Total liabilities	$ 1,040,518	$ 835,531	$ 811,728	$ 204,987	$ 23,803
Net position:					
Invested in capital assets, net of related debt	$ 1,347,263	$ 1,172,110	$ 1,091,025	$ 175,153	$ 81,085
Restricted	83,593	69,857	69,019	13,736	838
Unrestricted	12,882	38,618	11,419	(25,736)	27,199
Total net position*	$ 1,443,738	$ 1,280,585	$ 1,171,463	$ 163,153	$ 109,122

* As a result of implementary 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 $1,443.7 million and $1,280.6 million in fiscal years 2014 and 2013, respectively. The fund's net position include its investment of $1,347.3 million and $1,172.1 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 2014 and 2013, 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, $83.6 million, represents restricted resources that are legally obligated for revenue bond repayment requirements for fiscal year 2014. The fund had unrestricted net position of $12.8 million and $38.6 million as of June 30, 2014 and June 30, 2013, respectively.

During fiscal years 2014 and 2013, the fund expended $241.2 million and $167.2 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 of $320.0 million ($296.0 million issued difference due to premiums on sale, $128.8 million utilized to refund existing debt) and $31.8 million in fiscal years 2014 and 2013, 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	
	2014	2013 (restated)	2012	2014–2013	2013–2012
Operating revenues	$ 221,181	$ 183,521	$ 179,873	$ 37,660	$ 3,648
Operating expenses:					
Salaries and wages	37,441	38,760	39,518	(1,319)	(758)
Other personnel costs	17,753	17,354	16,711	399	643
Contractual services	59,370	59,877	54,572	(507)	5,305
Material and supplies	9,047	8,479	8,069	568	410
Minor equipment	382	745	486	(363)	259
Depreciation	38,083	36,794	34,903	1,289	1,891
Total operating expenses	162,076	162,009	154,259	67	7,750
Operating income	59,105	21,512	25,614	37,593	(4,102)
Nonoperating (expense), net	(15,012)	(14,610)	(15,783)	(402)	1,173
Income before capital contributions	44,093	6,902	9,831	37,191	(2,929)
Capital contributions	119,060	104,325	73,264	14,735	31,061
Change in net position	163,153	111,227	83,095	$ 51,926	$ 28,132
Total net position – beginning	1,280,585	1,169,358	1,088,368		
Total net position – ending	$ 1,443,738	$ 1,280,585	$ 1,171,463		

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

The overall increase in the fund's net position amounted to $163.2 million, and $109.1 million, for fiscal years 2014, and 2013, respectively. These increases are due to improved operating margins that resulted from the implementation of a 15% and 9% wastewater rate increase in fiscal years 2014 and 2013, respectively to customers located in Baltimore City, offset by a decline in consumer consumption in 2013.

Capital Assets

The fund's capital assets as of June 30, 2014 and June 30, 2013 amounted to $2,024.3 million and $1,821.4 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 $202.9 million and $131.8 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 at June 30			Change	Change
	2014	2013	2012	2014–2013	2013–2012
Land, net	$ 9,254	$ 8,931	$ 8,931	$ 323	$ —
Construction in progress	688,047	502,596	443,186	185,451	59,410
Buildings and improvements, net	1,153,541	1,167,353	1,156,543	(13,812)	10,810
Equipment, net	32,592	35,735	38,190	(3,143)	(2,455)
Infrastructure, net	140,911	106,829	42,821	34,082	64,008
Total capital assets, net	$ 2,024,345	$ 1,821,444	$ 1,689,671	$ 202,901	$ 131,773

As of June 30, 2014, the fund had commitments of $583.6 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 $894 million and $729.7 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 2014, and 2013, the fund's debt increased by $164.3 million and $8.5 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. 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. In fiscal years 2014 and 2013, the City Board of Estimates approved annual rate increases of 15% and 9%, respectively 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.

CITY OF BALTIMORE
WASTEWATER UTILITY FUND

Statements of Fund Net Position

June 30, 2014 and 2013

(Expressed in thousands)

		2014		2013
Assets and deferred outflow of resources:				
Current assets:				
Cash and cash equivalents	$	104,725	$	48,753
Accounts receivable, net:				
Service billings		46,354		39,392
Other		2		187
Due from other governments		47,890		48,115
Inventories		262		285
Restricted assets:				
Cash and cash equivalents		42,819		36,507
Total current assets		242,052		173,239
Noncurrent assets:				
Restricted assets:				
Cash and cash equivalents		124,572		61,435
Due from other governments		66,773		32,759
Capital assets, net of accumulated depreciation		1,327,044		1,309,917
Capital assets not being depreciated		697,301		511,527
Total noncurrent assets		2,215,690		1,915,638
Total assets		2,457,742		2,088,877
Deferred outflow of resources:				
Deferred loss on refundings		16,716		2,638
Interest rate swaps		9,798		24,601
Total deferred outflows of resources		26,514		27,239
Total assets and deferred outflows of resources		2,484,256		2,116,116
Liabilities and deferred inflows of resources:				
Current liabilities:				
Accounts payable and accrued liabilities		7,710		6,444
Accrued interest payable		17,868		12,408
Due to other governments		20,383		17,804
Compensated absences		2,867		2,906
Accounts payable from restricted assets		81,906		35,018
Capital leases		399		389
Revenue bonds payable		24,951		24,099
Total current liabilities		156,084		99,068
Noncurrent liabilities:				
Compensated absences		3,681		3,903
Capital leases		1,840		2,239
Derivative instrument liability		9,922		24,756
Revenue bonds payable, net		868,991		705,565
Total noncurrent liabilities		884,434		736,463
Total liabilities		1,040,518		835,531
Net position:				
Net investment in capital assets		1,347,263		1,172,110
Restricted for:				
Debt service		83,593		69,857
Unrestricted		12,882		38,618
Total net position	$	1,443,738	$	1,280,585

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, 2014 and 2013

(Expressed in thousands)

		2014		2013
Operating revenues:				
Charges for sales and services:				
Wastewater service	$	220,902	$	183,267
Rents, fees, and other income		279		254
Total operating revenues		221,181		183,521
Operating expenses:				
Salaries and wages		37,441		38,760
Other personnel costs		17,753		17,354
Contractual services		59,370		59,877
Materials and supplies		9,047		8,479
Minor equipment		382		745
Depreciation		38,083		36,794
Total operating expenses		162,076		162,009
Operating income		59,105		21,512
Nonoperating revenues (expenses):				
Loss on sale of investments		(67)		(47)
Bond issuance costs		(508)		—
Interest income		659		951
Interest expense		(15,096)		(15,514)
Total nonoperating expenses, net		(15,012)		(14,610)
Income before capital contributions		44,093		6,902
Capital contributions		119,060		104,325
Change in net position		163,153		111,227
Total net position – beginning, as restated (note 12)		1,280,585		1,169,358
Total net position – ending	$	1,443,738	$	1,280,585

See accompanying notes to financial statements.

CITY OF BALTIMORE
WASTEWATER 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	$ 214,404	$ 177,816
Payments to employees	(55,381)	(56,159)
Payments to suppliers	(65,004)	(64,985)
Net cash provided by operating activities	94,019	56,672
Cash flow from capital and related financing activities:		
Proceeds from revenue bonds	275,015	—
Drawdown of proceeds from state issued bonds	10,909	4,766
Principal paid on revenue bonds	(25,035)	(22,676)
Paid to escrow account for refunding of bonds	(131,599)	—
Principal paid on general long-term debt	—	(19)
Interest received	659	951
Interest paid	(10,357)	(15,360)
Acquisition and construction of capital assets	(194,096)	(153,380)
Capital contributions received	119,285	79,773
Bond issuance cost paid	(508)	—
Capital lease payments	(389)	(375)
Swap termination payment	(12,415)	—
Net cash provided by capital and related financing activities	31,469	(106,320)
Cash flows from investing activities:		
Loss of sale of investments	(67)	(47)
Net cash provided by investing activities	(67)	(47)
Net increase in cash and cash equivalents	125,421	(49,695)
Cash and cash equivalents, beginning of year	146,695	193,390
Cash and cash equivalents, end of year	$ 272,116	$ 143,695
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 59,105	$ 21,512
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	38,083	36,794
Changes in assets and liabilities:		
Accounts receivable – service billings	(6,962)	(5,813)
Accounts receivable – other	185	109
Inventories	23	(2)
Due to/from other governments	2,579	5,141
Accounts payable and accrued liabilities	1,265	(1,045)
Compensated absences	(259)	(24)
Total adjustments	34,914	35,160
Net cash provided by operating activities	$ 94,019	$ 56,672
Noncash activity from capital and related financing activities:		
Acquisition and construction of capital assets financed by debt	$ 46,888	$ 15,188
Increase in issuance of state water quality loans	$ 44,923	$ 31,844

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 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 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 Baltimore 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 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

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, while the remaining trust accounts are classified as current & noncurrent restricted cash and cash equivalents.

(e) ***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. Securities traded on national exchanges are valued at the last reported sales price.

(f) ***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 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 these types of financing arrangements.

(g) ***Inventories***

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

(h) ***Service Billings Accounts Receivable – Unbilled Wastewater Utility User Charges***

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).

(i) ***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.

(j) ***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.

(k) ***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.

(l) ***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.

(m) ***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

(n) ***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.

On December 3, 2013, the fund issued Wastewater Revenue Bonds, Series 2013-C, 2013-D, and 2013-E in the amounts of $123,750,000, $100,860,000, and $26,405,000, respectively, and totaling $251,015,000. Of these amounts $123,750,000 were issued for various capital projects, and $127,265,000 were refunding bonds that refunded certain maturities totaling $118,995,000, and advanced refunded certain outstanding maturities totaling $9,785,000.

The Series 2013 Wastewater Refunding Revenue Bond issuance reduced total debt service payments by approximately $444,000, to obtain an economic gain of approximately $238,000. Additionally, the City used $13,128,000 to reduce its derivative swap exposure.

(o) ***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 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, 2014, it is estimated that accumulated nonvested sick leave for the fund approximated $5,993,000. 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 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, 2014 and June 30, 2013 is $6,548,000 and $6,808,000, respectively.

(p) 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 quarterly by the local government and remitted to the State. At June 30, 2014 and June 30, 2013, the fund held $20,383,000 and $17,804,000 respectively, in fees due to the State.

(q) Capital Asset Financing

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

(r) 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.

(s) 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.

(t) 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 increased net cash provided by operating activities and net cash used by capital and related financing activities by approximately $36 million and increased net cash used by investing activities by $47 thousand. The line items impacted by these errors have been corrected in the FY 2013 statement of cash flows.

(u) Reclassifications

The FY 2013 financial statements were reclassified to the 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) Deposits and Investments

The fund participates in the City's pooled cash account. At June 30, 2014 and June 30, 2013, the fund's share of the City's pooled cash account, including both restricted and unrestricted cash, was $94.3 million and $38.8 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.

(Continued)

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):

		Investment maturities by months		
	Fair value	Less than 6	6 to 12	Greater than 12
June 30, 2014 investment type:				
Debt securities:				
U.S. agencies	$ 105	$ 84	$ 21	$ —
Money market mutual funds	89,355	89,355	—	—
Federated government obligation fund	88,045	88,045	—	—
	177,505	$ 177,484	$ 21	$ —
Less cash equivalents	177,505			
Total investments	$ —			

		Investment maturities by months		
	Fair value	Less than 6	6 to 12 (in months)	Greater than 12
June 30, 2013 Investment type:				
Debt securities:				
U.S. agencies	$ 280	$ 280	$ —	$ —
Money market mutual funds	7,793	7,793	—	—
Wilmington U.S. government money market fund	94,479	94,479	—	—
Federated government obligation fund	5,332	5,332	—	—
	107,884	$ 107,884	$ —	$ —
Less cash equivalents	107,884			
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, 2014 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**	**AA+**	**AAA**	**A1**
Debt securities:				
U.S. agencies:				
Federal home loan mortgage association note	$ 105	$ 105	$ —	$ —
Money market mutual funds:				
Wilmington U.S. government money market fund	89,355	—	—	89,355
Federal government obligation fund	88,045	—	88,045	—
Total rated debt investments	$ 177,505	$ 105	$ 88,045	$ 89,355

	June 30, 2013			
		Quality ratings		
Investment type	**Fair value**	**AA+**	**AAA**	**A1**
Debt securities:				
U.S. agencies:				
Federal home loan mortgage association note	$ 7,793	$ 7,793	$ —	$ —
Money market mutual funds:				
Wilmington U.S. government money market fund	94,479	—	—	94,479
Federal government obligation fund	5,332	—	—	5,332
Total rated debt investments	$ 107,604	$ 7,793	$ —	$ 99,811

(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 $14,282,000 and $16,141,000 as of June 30, 2014 and June 30, 2013, 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, 2014, 2013 and 2012 were as follows (expressed in thousands):

	Balance June 30, 2013	Additions	Deductions	Balance June 30, 2014
Capital assets, not being depreciated:				
Land	$ 8,931	$ 323	$ —	$ 9,254
Construction in progress	502,596	240,898	55,447	688,047
Total capital assets, not being depreciated	511,527	241,221	55,447	697,301
Capital assets, being depreciated:				
Buildings and improvements	1,648,337	18,073	—	1,666,410
Equipment	125,235	513	—	125,748
Infrastructure	108,782	36,624	—	145,406
Total capital assets, being depreciated	1,882,354	55,210	—	1,937,564
Less accumulated depreciation for:				
Buildings and improvements	480,984	31,885	—	512,869
Equipment	89,500	3,656	—	93,156
Infrastructure	1,953	2,542	—	4,495
Total accumulated depreciation	572,437	38,083	—	610,520
Total capital assets, being depreciated, net	1,309,917	17,127	—	1,327,044
Total capital assets, net	$ 1,821,444	$ 258,348	$ 55,447	$ 2,024,345

	Balance June 30, 2012	Additions	Deductions	Balance June 30, 2013
Capital assets, not being depreciated:				
Land	$ 8,931	$ —	$ —	$ 8,931
Construction in progress	443,186	167,173	107,763	502,596
Total capital assets, not being depreciated	452,117	167,173	107,763	511,527
Capital assets, being depreciated:				
Buildings and improvements	1,606,236	42,356	255	1,648,337
Equipment	123,734	1,536	35	125,235
Infrastructure	43,254	65,528	—	108,782
Total capital assets, being depreciated	1,773,224	109,420	290	1,882,354
Less accumulated depreciation for:				
Buildings and improvements	449,693	31,291	—	480,984
Equipment	85,544	3,983	27	89,500
Infrastructure	433	1,520	—	1,953
Total accumulated depreciation	535,670	36,794	27	572,437
Total capital assets, being depreciated, net	1,237,554	72,626	263	1,309,917
Total capital assets, net	$ 1,689,671	$ 239,799	$ 108,026	$ 1,821,444

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 2014 and 2013, interest cost of $16,502,000 and $13,708,000, respectively (net of interest earned of $1,013,000 and $1,127,000 respectively), was capitalized.

At June 30, 2014, the fund had outstanding commitments for construction of $583,600,000.

(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, 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	$ 717,555	$ 295,938	$ 153,815	$ 859,678	$ 24,951
Add bond premium	12,109	24,126	1,971	34,264	—
Total revenue bonds payable	$ 729,664	$ 320,064	$ 155,786	$ 893,942	$ 24,951
Capital lease	$ 2,628	$ —	$ 389	$ 2,239	$ 399
Compensated absences	$ 6,808	$ —	$ 260	$ 6,548	$ 2,867

	Balance June 30, 2012	Additions	Reductions	Balance June 30, 2013	Amounts due within one year
Long-term financing with State of Md.(a)	$ 20	$ —	$ 20	$ —	$ —
Total general long-term debt	$ 20	$ —	$ 20	$ —	$ —
Revenue bonds	$ 708,386	$ 31,844	$ 22,675	$ 717,555	$ 24,099
Add bond premium	12,752	124	767	12,109	—
Total revenue bonds payable	$ 721,138	$ 31,968	$ 23,442	$ 729,664	$ 24,099
Capital lease	$ 3,003	$ —	$ 375	$ 2,628	$ 389
Compensated absences	$ 6,834	$ —	$ 26	$ 6,808	$ 2,906

(a) Under the provisions of Chapter 445, Laws of Maryland, 1968, and Chapter 286, Laws of Maryland, 1974, loans were made available to counties and municipalities charged with providing sewerage facilities to assist in the construction of such facilities. These loans bear interest ranging from 6.10% to 8.19%, and interest of $1,000 will be due thereon in future years.

The City has issued revenue bonds, the proceeds of which were used to provide funds for capital improvements to Wastewater facilities. Certain assets and revenues of the fund are pledged as collateral for the bonds and notes. During fiscal year 2014, the City issued Wastewater Revenue Bonds, Series 2013-C, 2013-D, and 2013-E, which totaled $251,015,000. A portion of these bonds was used to refund term bonds series 2002-A, serial bonds series 2003-A, and auction rate notes series 2004-A. Bonds and notes outstanding as of June 30 consist of (amounts expressed in thousands):

	2014	2013
Serial bonds series 1994-B manning in a final annual installment of $406,000 on February 1, 2015, with interest rate at 2.25%, payable semiannually	$ 406	$ 802
Serial bonds series 1994-C manning in a final annual installment of $387,000 on February 1, 2015, with interest rate at 2.5%, payable semi-annually	387	765
Serial bonds series 1994-D maturing in a final annual installment of $295,000 on February 1, 2015, with interest rate at 3.6%, payable semiannually	295	581
Serial bonds series 1996-B maturing in annual installments from $148,000 to $208,000 through February 1, 2017, with interest rate at 3.17%, payable semiannually	606	795
Serial bonds series 1998-A maturing in annual installments from $287,000 to $414,000 through February 1, 2019, with interest rate at 2.87%, payable semiannually	1,759	2,320
Serial bonds series 1999-A maturing in annual installments from $122,000 to $167,000 through February 1, 2019, with interest rate at 2.52%, payable semiannually	771	915
Serial bonds series 1999-B maturing in annual installments from $433,000 to $652,000 through February 1, 2021, with interest rate at 2.61%, payable semiannually	3,671	4,215
Serial bonds series 2001-A maturing in annual installments from $569,000 to $819,000 through February 1, 2022, with interest rate at 2.3%, payable semiannually	5,870	6,552
Serial bonds series 2002-A maturing in annual installments from $1,145,000 to $1,660,000 through July 1, 2021, with variable interest through July 1, 2016 and a fixed rate of 4.85 – 5.0% thereafter, payable semiannually	4,560	11,730
Serial bonds series 2003-A maturing in annual installments from $1,930,000 to $2,095,000 from July 1, 2023 through July 1, 2025, with interest ranging from 4.125% to 4.2% payable semiannually	—	6,035
Serial bonds series 2003-B maturing in annual installments from $308,000 to $984,000 through February 1, 2024, with interest rate at 0.40%, payable semiannually	2,876	3,194
Serial bonds series 2004-B maturing in annual installments from $586,000 to $972,000 through February 1, 2022, with interest rate at 0.45%, payable semiannually	7,270	8,216
Serial bonds series 2004-C maturing in annual installments from $846,000 to $984,000 through February I, 2024 with interest rate at 0.25%, payable semiannually	8,914	9,786

CITY OF BALTIMORE
WASTEWATER UTILITY FUND

Notes to Financial Statements

June 30, 2014 and 2013

		2014		2013
Serial bonds series 2005-A maturing in annual installments from $984,000 to $1,030,000 through February 1, 2024 with interest rate at 0.25%, payable semiannually	$	9,866	$	10,929
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		4,820		12,530
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		15,704		17,191
Serial bonds series 2006-B maturing in annual installments from $338,000 to $362,000 through February 1, 2026 with interest rate at 0.40%, payable semiannually		4,074		4,420
Serial bonds series 2006-C maturing in annual installments from $990,000 to $2,090,000 through July 1, 2026, with interest rates of 4.0% to 5.0%, payable semiannually		17,750		21,895
Serial bonds series 2007-A maturing in annual installments from $1,833,000 to $2,184,000 through February 1, 2026, with interest rate at 0.4%, payable semiannually		25,158		27,239
Serial bonds series 2007-C maturing in annual installments from $35,000 to $3,935,000 through July 1, 2027, with interest rates of 3.6% to 4.5%, payable semiannually		10,865		10,910
Serial bonds series 2007 – B maturing in annual installments from $134,000 to $161,000 through February 1, 2027, with Interest rate at 0.4%, payable semiannually		2,047		2,200
Serial bonds series 2007-D maturing in annual installments from $1,890,000 to $4,330,000 through July 1, 2027, with interest rate at 5.0%, payable semiannually		44,995		47,180
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 5.00%, payable semiannually		23,630		24,750
Serial bonds series 2009-A maturing in annual installments of $426,167 through February 1, 2029 with interest rate at 0%		6,393		6,819
Serial bonds series 2009-B maturing in annual installments of $91,149 through February 1, 2029, with interest rate at 0.0%		1,375		1,466
Serial bonds series 2009-C maturing in annual installments from $370,000 to $570,000 through July 1, 2022, with interest rates of 2.00% to 4.50% payable semiannually		6,270		6,860
Term bonds series 1993-A with interest at 5.6%, payable semiannually, due July 1, 2013		—		1,600
Term bonds series 1993-A with interest at 5.65%, payable semiannually, due July 1, 2020		14,000		14,000
Term bonds series 1994-A with interest at 6.0%, payable semiannually, due July 1, 2015		1,615		2,355
Term bonds series 1994-A with interest at 5.0%, payable semiannually, due July 1, 2022		7,115		7,115

(Continued)

	2014	2013
Term bonds series 2002-A with interest at 5.0%, payable semiannually, due July 1, 2023	$ —	$ 2,470
Term bonds series 2002-A with interest at 5.0%, payable semiannually, due July 1, 2027	—	6,070
Term bonds series 2002-A with interest at 5.2%, payable semiannually, due July 1, 2032	—	9,480
Term bonds series 2002-A with interest at 5.125%, payable semiannually, due July 1, 2042	—	31,630
Term bonds series 2006-C with interest at 5.0%, payable semiannually, due July 1, 2029	6,920	6,920
Term bonds series 2007-C with interest at 4.5%, payable semiannually, due July 1, 2032	29,795	29,795
Term bonds series 2007-C with interest at 4.5%, 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, 2032	25,120	25,120
Term bonds series 2007-D with interest at 5.0%, payable semiannually, due July 1, 2037	32,050	32,050
Term bond series 2008-A with interest at 5.0%, payable semiannually, due July 1, 2033	12,205	12,205
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, 2024	1,720	1,720
Term bonds series 2009-C with interest at 5.00%, payable semiannually, due July 1, 2029	5,115	5,115
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
Auction rate notes series 2002-B, payable monthly, due July 1, 2032	9,600	25,300
Auction rate notes series 2002-C, payable monthly, due July 1, 2032	19,400	45,300
Auction rate notes series 2004-A, payable monthly, due July 1, 2034	—	17,500
Serial bonds series 2009-E maturing in annual installment of $157,842 from February 1, 2015 through February 1, 2032, with an interest rate of 0.00%	2,841	3,000
Serial bonds series 2010-A maturing in annual installments from $15,764 to $37,150 from February 1, 2014 through February 1, 2040, with an interest rate of 0.00%	—	750
Serial bonds series, 2011-A maturing in annual installments of $915,000 to $3,940,000 through February 1, 2031 with interest rates from 2.00% to 5.00%	48,610	50,295

	2014	2013
Serial bonds series, 2011-B maturing in annual installments of \$168,332 to \$203,363 from February 1, 2015 through February 1, 2033, with interest rates from 1.00%	\$ 3,538	\$ 3,706
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
Serial bonds series, 2013-A maturing in annual installments of \$1,558,483 to \$1,798,836 from February 1, 2016 through February 1, 2034, with interest rate of 0.80%, payable semiannually	31,844	31,844
Serial bonds series, 2013-C maturing in annual installments of \$1,160,000 to \$4,725,000 from July 1, 2014 through July 1, 2033, with interest rates from 3.00% to 5.00% payable semiannually	61,330	—
Term bond series 2013-C with interest at 5.00%, payable semiannually, due July 1, 2038	27,420	—
Term bond series 2013-C with interest at 5.00%, payable semiannually, due July 1, 2043	35,000	—
Serial bonds series, 2013-D maturing in annual installments of \$45,000 to \$3,640,000 from July 1, 2014 through July 1, 2033, with interest rates from 3.00% to 5.00% payable semiannually	70,180	—
Term bond series 2013-D with interest at 5.00%, payable semiannually, due July 1, 2038	14,835	—
Term bond series 2013-D with interest at 5.00%, payable semiannually, due July 1, 2042	15,845	—
Serial bonds series, 2013-E maturing in annual installments of \$20,000 to \$3,300,000 from July 1, 2014 through July 1, 2026, with interest rates from 3.00% to 5.00% payable semiannually	26,405	—
Serial bonds series, 2014-A maturing in annual installments of \$2,040,192 to \$2,464,774 from February 1, 2016 through February 1, 2035, with interest rates at 1.00% payable semiannually	44,923	—
	859,678	717,555
Unamortized bond premium	34,264	12,109
	\$ 893,942	\$ 729,664

(Continued)

At June 30, 2014 and June 30, 2013, the fund had $29,000,000 and $88,100,000 of auction rate notes, 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, shown at gross, are as follows (amounts expressed in thousands):

	Principal	Interest	Interest rate swap net[a]
Fiscal year:			
2015	$ 24,951	$ 33,726	$ 1,288
2016	30,640	32,144	1,289
2017	31,455	31,254	1,289
2018	31,724	30,299	1,289
2019	32,566	29,296	1,289
2020–2024	163,919	130,231	6,443
2025–2029	160,760	100,546	6,143
2030–2034	180,878	68,159	1,951
2035–2039	131,685	33,098	—
2040–2044	71,100	7,811	—
	$ 859,678	$ 496,564	$ 20,981

(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, 2014, 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 $859,678,000 and $717,555,000 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 wastewater utility systems. The bonds are payable solely from the revenues of the fund and are payable through 2044. Annual principal and interest payments on these revenue bonds are expected to require 52.7% of pledged revenues. Total principal and interest, remaining to be paid on the revenue bonds for the fund is $1,377,223,000 and $1,141,505,000 at June 30, 2014 and June 30, 2013, respectively. Principal and interest paid for the current year and current pledged revenue for the fund were

$51,224,000 and $97,188,000 respectively. While principal and interest and pledged revenue for fiscal year 2013 were $51,586,000 and $1,077,000, 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 value, and credit risk rating of the outstanding swaps, as of June 30, 2014, were as follows. 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.

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 ($9,798,000) and ($24,601,000), respectively. The notional amounts for these hedged derivative instruments at June 30, 2014 and June 30, 2013 were $33,560,000 and $94,020,000, respectively. During fiscal years 2014 and 2013, the fair values of these instruments increased $14,803,000 and $9,127,000, respectively. All hedges are cash flow hedges. The following schedule provides a detailed analysis of derivative instruments held at June 30, 2014 and 2013:

	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	7/1/2032	4.55%	67% LIBOR	$ 29,000,000	$ (9,764,208)	A-/Baa2
2002 revenue bonds	5/7/2002	7/1/2014	4.39	CPI	2,040,000	(5,412)	A-/Baa2
2002 revenue bonds	5/7/2002	7/1/2015	5.00	CPI	1,240,000	(9,439)	A-/Baa2
2002 revenue bonds	5/7/2002	7/1/2016	4.61	CPI	1,280,000	(19,345)	A-1Baa2
Total swaps outstanding					$ 33,560,000	$ (9,798,404)	

	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	7/1/2032	4.56%	67% LIBOR	$ 70,000,000	$ (19,016,865)	A-/Baa1
2002 revenue bonds	5/7/2002	7/1/2013	4.30	Bond rate/CPI	1,960,000	(18,052)	A-/Baa1
2002 revenue bonds	5/7/2002	7/1/2014	4.39	Bond rate/CPI	2,040,000	(45,482)	A-/Baa1
2002 revenue bonds	5/7/2002	7/1/2015	4.50	Bond rate/CPI	1,240,000	(39,799)	A-/Baa1
2002 revenue bonds	5/7/2002	7/1/2016	4.61	Bond rate/CPI	1,280,000	(51,956)	A-/Baa1
2004 revenue bonds	6/11/2004	7/1/2034	5.21	SIFMA	17,500,000	(5,428,873)	A-/Baa1
Total swaps outstanding					$ 94,020,000	$ (24,601,027)	

(c) *Credit Risk*

As of June 30, 2014, 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, 2014, none of the City's swap agreements met this requirement.

(d) *Basis 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 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 prior 52-week period ranged from 0.03% to 0.12%, whereas the City's tax-exempt market rate ranged from 0.05% to 0.23%. For one of the swaps, the City will receive a percent of LIBOR or a percent of LIBOR plus basis points spread, each rate was 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 prior 52-weeks ranged from 0.15% to 0.20%, whereas the City's taxable market rate 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 earnings 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 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.

Investment Derivative Instruments

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

	Investment derivative instruments				
	Changes in fair value		Fair value at June 30, 2014		
	Classification	Amount	Classification	Amount	Notional
Fixed to floating	Investment revenue	$ 31,820	Debt	$ (123,239)	$ (7,469,047)

	Investment derivative instruments				
	Changes in fair value		Fair value at June 30, 2013		
	Classification	Amount	Classification	Amount	Notional
Fixed to floating	Investment revenue	$ (29,195)	Debt	$ (155,059)	$ (7,469,047)

(g) *Credit Risk*

At June 30, 2014 and 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 A+/Aa3 for derivative instruments held by the fund.

(h) *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, the fund had $48,995,000 and $60,035,000, respectively of debt outstanding that is considered defeased.

(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 Wastewater Utility's share of contributions to the plan was $8,542,000 in 2014 and $7,524,000 in 2013. The fund contributed 100% of the required contribution each of the three years. The 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 $5.3 and $6.1 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 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 $1,900,000 and $1,829,000, respectively.

(11) Commitments and Contingencies

The fund has received Federal grants 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 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, 2013, 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 $88.00 and $43.30 up to the guaranteed and excess tonnage amounts, respectively. Payments under the agreement in fiscal year 2014 were $2.379 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 $274,061 and $265,622 for the Back River and Patapsco Wastewater Treatment Plants, respectively. The service tipping fees were $395.50 and $397.19 per ton for the Back River and Patapsco Wastewater Treatment Plants, respectively. Payments under the agreements in fiscal year 2014 were $20.081 million. The agreements extend to 2015 and 2017 for the Back River and Patapsco Wastewater Treatment Plants, respectively.

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 U.S. 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. The City has committed to financing these remedial efforts through a combination of Water and Wastewater revenue bonds in conjunction with all available State and Federal assistance.

(12) Beginning Balance Adjustments

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 totals 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	$	1,282,690
Less bond issuance costs written off		2,105
Total net position – June 30, 2013 (as restated)	$	1,280,585

(13) Subsequent Events

On December 3, 2014, the City issued Wastewater Project and Refunding Revenue Bonds, Series 2014 in the amount of $226.2 million, of which $138.4 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.

On June 12, 2015, the City entered into two Wastewater loan agreements with the Maryland Department of Environment for amount of $72,103,000 and $19,696,000.

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.