The Harrisburg Authority

Financial Statements and Supplementary Information

Year Ended December 31, 2012 with
Independent Auditor's Report

THE HARRISBURG AUTHORITY

YEAR ENDED DECEMBER 31, 2012

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Independent Auditor's Report

Members of the Board of Directors
The Harrisburg Authority

We have audited the accompanying financial statements of The Harrisburg Authority (Authority), a component unit of the City of Harrisburg, Pennsylvania, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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 an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2012, and the changes in its financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Authority will continue as a going concern. The Resource Recovery Segment has experienced significant operating losses, has an accumulated deficit of approximately $210 million at December 31, 2012, and has not met its debt obligations as they come due. As discussed further in Note 12 to the financial statements, the Authority is in violation of certain covenants under its trust indentures and has issued multiple notices of material events, including, but not limited to, non-payment of required debt service with respect to certain of the Resource Recovery Facility bonds and notes.

The Water Segment has an accumulated deficit of approximately $33 million at December 31, 2012.

Management's plans in regard to these matters are described in Note 14. The financial statements do not include any adjustments that might result from the outcome of these uncertainties. Our opinion is not modified with respect to these matters.

Other Matters

Required Supplementary Information

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Authority's basic financial statements. The combining schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining schedules are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Maher Duessel

Harrisburg, Pennsylvania
September 25, 2013

THE HARRISBURG AUTHORITY

BALANCE SHEET

DECEMBER 31, 2012

Assets	
Current assets:	
Cash and cash equivalents	$ 12,842,083
Accounts receivable, net of allowance for uncollectible accounts of $1,507,193	4,139,146
Prepaid expenses	980,788
Due from the City of Harrisburg	1,121,182
Current portion of direct financing lease	80,163
Current portion of advances to the City of Harrisburg	193,024
Total current assets	19,356,386
Restricted assets:	
Cash and cash equivalents - restricted under trust indentures and guarantee agreement	9,419,975
Investments - restricted under trust indentures	38,480,096
Total restricted assets	47,900,071
Noncurrent assets:	
Direct financing leases, net of unearned income of $352,067	1,517,004
Advances to the City of Harrisburg	1,053,375
Capital assets, not being depreciated	689,957
Capital assets, net of accumulated depreciation of $80,262,268	169,251,214
Debt financing costs, net of accumulated amortization of $11,072,955	9,431,222
Deposits	350
Derivative assets	2,070,232
Total noncurrent assets	184,013,354
Total Assets	$251,269,811

Liabilities and Net Position

Liabilities:	
Current liabilities:	
Accounts payable and accrued liabilities	$ 100,420
Accrued interest payable	6,085,233
Current portion of capital lease payable	15,000,000
Current portion of amount due to the City of Harrisburg	77,670,196
Total current liabilities	98,855,849
Liabilities payable from restricted assets:	
Accounts payable	3,615,536
Accrued interest payable	6,197,140
Current portion of loan payable	8,645,310
Current portion of notes payable	1,213,187
Current portion of bonds payable	8,381,000
Total liabilities payable from restricted assets	28,052,173
Noncurrent liabilities:	
Due to the City of Harrisburg	64,924
Loan payable	11,178,190
Notes payable, net of premium of $738,439	68,099,176
Bonds outstanding, net of premium and deferred losses on refunding of $16,612,985	272,281,015
Derivative liabilities	5,794,328
Unearned revenue	2,951,299
Accrued landfill closure and post-closure liability	2,037,568
Liability for obligations to construct assets under direct financing leases	702,755
Total noncurrent liabilities	363,109,255
Total Liabilities	490,017,277
Net Position:	
Net investment in capital assets	(176,587,077)
Restricted:	
Debt service	213,239
Construction	3,310,965
Landfill closure	1,362,259
Guarantee agreement	250,000
Water operations	10,605,242
Unrestricted	(77,902,094)
Total Net Position	(238,747,466)
Total Liabilities and Net Position	$251,269,811

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

THE HARRISBURG AUTHORITY

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

YEAR ENDED DECEMBER 31, 2012

Operating Revenues:	
User charges	$ 41,202,894
Administrative fees	2,093,547
Total operating revenues	43,296,441
Operating Expenses:	
Operating	27,392,937
Administrative	3,079,912
Depreciation	7,477,409
Landfill closure and post-closure care expense	(227,768)
Total operating expenses	37,722,490
Operating Income	5,573,951
Non-Operating Revenues (Expenses):	
Investment loss	(1,116,517)
Lease rental income	58,714
Miscellaneous income	184,150
Interest expense	(23,714,212)
Gain on sale of assets	6,000
Amortization of debt financing costs	(1,188,312)
Total non-operating revenues (expenses)	(25,770,177)
Change in Net Position	(20,196,226)
Net Position:	
Beginning of year	(218,551,240)
End of year	$ (238,747,466)

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

THE HARRISBURG AUTHORITY

STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2012

Cash Flows From Operating Activities:	
Receipts from customers and users	$ 42,485,358
Payments to suppliers	(24,989,420)
Payments to management agent	(5,661,169)
Net cash provided by operating activities	11,834,769
Cash Flows From Investing Activities:	
Sales of investments, net	4,633,085
Investment income received	891,820
Payments received on direct financing leases	142,674
Net cash provided by investing activities	5,667,579
Cash Flows From Capital and Related Financing Activities:	
Increase in obligation to construct assets under direct financing lease	703,473
Decrease in advances to the City of Harrisburg	271,726
Acquisition and construction of capital assets	(4,232,106)
Interest paid	(16,192,292)
Principal paid on capital lease	(45,816)
Principal paid on long-term debt	(9,308,997)
Receipts from bond insurance and debt guarantees	11,181,675
Transfers to City's sewer operating fund	(324,659)
Net cash used in capital and related financing activities	(17,946,996)
Decrease in Cash and Cash Equivalents	(444,648)
Cash and Cash Equivalents:	
Beginning of year	22,706,706
End of year	$ 22,262,058
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:	
Operating income	$ 5,573,951
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	7,477,409
Miscellaneous nonoperating income	65,400
Decrease in accounts receivable	1,146,183
Increase in prepaid expenses	(380,788)
Decrease in accounts payable	(655,068)
Increase in due from City of Harrisburg	(1,164,550)
Decrease in accrued landfill closure and post-closure liability	(227,768)
Net cash provided by operating activities	$ 11,834,769

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Harrisburg Sewerage Authority (Sewerage Authority) was incorporated June 3, 1957, under the provisions of the Municipality Authorities Act of 1945. On December 1, 1987, the Sewerage Authority's Articles of Incorporation were amended to change its name to the Harrisburg Water and Sewer Authority (Water Authority). On January 30, 1990, the Water Authority filed Articles of Amendment with the Pennsylvania Department of State to change its name to The Harrisburg Authority (Authority), also broadening its purpose and extending the term of its existence. The purpose of the Authority is, among other things, to engage in public works projects relating to the ownership and operation of the water system and resource recovery facility and the leasing of the wastewater treatment and conveyance systems. The Authority also issues nonrecourse tax-exempt debt for other entities for the purpose of financing capital improvement projects.

The Authority is a component unit of the City of Harrisburg (City) reporting entity. Criteria considered in making this determination include appointment of the Authority's Board of Directors (Board), financial interdependence, and the Authority's potential to provide specific financial benefits to, or impose specific financial burdens on the City.

Basis of Presentation

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for activities similar to those found in the private sector where the determination of net income is necessary for sound financial administration. Costs of construction, debt reduction, and Authority administration are financed or recovered through lease rentals received from the City, user charges, administration charges, and income on investments held by the Authority.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Authority are charges for water and incinerator services and administrative fees for conduit debt issuance. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Basis of Accounting

The Authority's financial statements are presented using the accrual method of accounting, under which revenues are recorded in the period that they are earned and expenses are recorded when the liability is incurred. The Authority follows the accounting and financial reporting standards issued by the Governmental Accounting Standards Board (GASB).

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The transactions of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net position (i.e., total assets net of total liabilities) is segregated into "Net investment in capital assets;" "Restricted for" various purposes; and "Unrestricted" components.

Non-recourse Debt Issues

The Authority participates in various bond issues for which it has limited liability. Acting solely in an agency capacity, the Authority serves as a financing conduit, bringing the ultimate borrower and the ultimate lender together to do business. Although the Authority is a party to the trust indentures with the Trustees, the agreements are structured such that there is no recourse against the Authority in the case of default. As such, the corresponding debt is not reported in the Authority's balance sheet, but is disclosed in Note 9.

Cash and Cash Equivalents

For the purposes of the statement of cash flows, the Authority considers all highly liquid instruments with original maturities of three months or less to be cash equivalents.

Investments

The Authority accounts for investments at fair value. The fair value of the Authority's investments is based upon values provided by external investment managers and quoted market prices.

Restricted Assets

Certain proceeds of revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because their use is limited by applicable trust indentures or other agreements.

Capital Assets

Capital assets in service and construction in progress are carried at cost, if purchased or constructed. Assets acquired through contributions from developers or other customers are capitalized at their estimated fair value, if available, or at engineers' estimated fair value or cost to construct at the date of the contribution. Utility systems acquired from other governmental service providers are recorded at the purchase price, limited to fair value. Costs of studies that directly result in specific projects are capitalized. Capital assets are defined by the government as assets with an initial, individual cost of more than $5,000 and an estimated useful life in excess of one year.

Maintenance and repairs, which do not significantly extend the value or life of property, plant, and equipment, are expensed as incurred.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the asset constructed.

Depreciation expense for the Water Segment assets acquired prior to 1992 and for Resource Recovery Segment assets acquired prior to 1997 are calculated using a 2% annual rate. For acquisitions subsequent to these dates, capital assets are depreciated using the straight-line method, over the estimated useful lives, as follows:

Land improvements	25 years
Water mains and related accessories	75 years
Water meter equipment	25 years
Buildings (including Resource Recovery Facility)	50 years
Office equipment	5-15 years
Office furnishings	15 years
Operating equipment	10-50 years
Vehicles	7 years

Advances to the City of Harrisburg

Advances to the City represent construction in progress for sewer system improvements.

Amount Due to the City of Harrisburg

During the years ended December 31, 2009, 2010, 2011, and 2012, the City, bond insurer, and County were required to make certain debt service payments on behalf of the Authority under various guarantee/insurance agreements. These amounts are presented as due to the City on the balance sheet at December 31, 2012. In addition, the amounts due to the various entities include accrued interest at various interest rates, dependent upon the applicable agreement.

Debt Financing Costs

Financing costs and discounts/premiums are being amortized over the respective life of each bond issue using the effective interest rate method. Losses on debt refundings (including swap termination fees) are deferred and are being amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter. On the balance sheet, the unamortized debt financing costs are reported as an asset and the unamortized discounts/premiums and deferred losses on refundings are reported as a reduction from the outstanding bonds.

Unearned Revenue

Unearned revenue, consisting of monies received from debt service forward delivery agreements, is being amortized to interest income over the respective life of each of the agreements using a method that approximates the interest rate method. The balance of unearned revenue relates to management and operating rights as discussed in Note 5.

Net Position

Net position comprises the various net earnings from operating and non-operating revenues, expenses, and contributions of capital. Net position is classified in the following three components: Net investment in capital assets, restricted for various purposes, and unrestricted net position. Net investment in capital assets, consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction, and improvement of those assets. Debt related to unspent proceeds or other restricted cash and investments is excluded from the determination. Restricted for various purposes consists of net position for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates, less any related liabilities. Unrestricted consists of all other net position not included in the above categories.

Restricted Resources

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed.

Use of Estimates

Management of the Authority has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent liabilities to prepare the financial statements in conformity with accounting principles generally accepted in the

United States of America. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Pending GASB Pronouncements

In March 2012, GASB issued Statement No. 65, *"Items Previously Reported as Assets and Liabilities."* Statement No. 65 clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this Statement are effective for the Authority's December 31, 2013 financial statements.

In January 2013, GASB issued Statement No. 69, *"Government Combinations and Disposals of Government Operations."* Statement No. 69 establishes accounting and reporting standards related to government combinations and disposals of government operations. Should this Statement affect the Authority, the provisions would be effective for the Authority's December 31, 2014 financial statements.

In April 2013, GASB issued Statement No. 70, *"Accounting and Financial Reporting for Nonexchange Financial Guarantees."* Statement No. 70 improves accounting and financial reporting by governments that extend and receive nonexchange financial guarantees. The provisions of this Statement are effective for the Authority's December 31, 2014 financial statements.

The effect of implementation of these Statements has not yet been determined.

2. DEPOSITS AND INVESTMENTS

Deposits

Pennsylvania Act 72 provides for investment of public funds in certain authorized investment types including U.S. Treasury bills; other short-term obligations of the U.S. and federal agencies; general obligation bonds of the federal government, the Commonwealth of Pennsylvania or any state agency; insured or collateralized time deposits; and certificates of deposit. The statutes do not prescribe regulations related to demand deposits; however, they do allow the pooling of public funds for investment purposes.

The deposit and investment policy of the Authority adheres to state statutes, prudent business practices, and the applicable trust indentures, which are more restrictive than existing state statutes. Deposits are maintained in demand deposits and certificates of deposit.

The deposits of the Authority at December 31, 2012 were as follows:

Cash and cash equivalents	
Unrestricted	$ 12,842,083
Restricted under trust indentures	
and guarantee agreement	9,419,975
	$ 22,262,058

Custodial Credit Risk – Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of December 31, 2012, the Authority's book balance was $22,262,058 and the bank balance was $23,472,115. Of the bank balance, $515,954 was covered by federal depository insurance and $22,956,161 was collateralized under Act No. 72 of the 1971 Session of the Pennsylvania General Assembly (Act), in which financial institutions were granted the authority to secure deposits of public bodies by pledging a pool of assets, as defined in the Act, to cover all public funds deposited in excess of federal depository insurance limits.

Investments

The restricted investments of the Authority at December 31, 2012 were as follows:

Money market funds	$ 20,213,939
U.S. Government agency obligations	9,572,700
Municipal bonds	8,693,457
Total	$ 38,480,096

Custodial Credit Risk – Custodial credit risk is the risk that the counterparty to an investment transaction will fail and the government will not recover the value of the investment or collateral securities that are in possession of an outside party. The Authority does not have a formal investment policy for custodial credit risk. All of the Authority's investments are held by the counterparty's trust department or agent not in the Authority's name.

Concentration of Credit Risk - The Authority places no limit on the amount the Authority may invest in any one issuer. More than five percent of the Authority's investments are held as follows:

	Fair Value	% of Total
Federal National Mortgage Association	$ 7,345,192	19.09%
General Obligation Pension Bonds - Illinois State	6,293,196	16.35%
Taxable Pension Bonds - Scranton, PA	2,400,261	6.24%

Credit Risk –The Authority does not have a formal policy that would limit its investment choices with regard to credit risk. The Authority's money market funds and fixed income investments had the following level of exposure to credit risk as of December 31, 2012:

	Fair Value	Rating
Money market funds	$ 20,213,939	AAA
U.S. Government agency obligations	9,572,700	AA+
Municipal bonds	6,293,196	A
Municipal bonds	2,400,261	BBB-

Interest Rate Risk – The Authority does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The following is a list of the Authority's money market and fixed income investments and their related average maturities:

		Investment Maturity (in Years)			
	Fair Value	Less than 1	1-5	6-10	Greater than 10
Money market funds	$ 20,213,939	$ 20,213,939	$ -	$ -	$ -
U.S. Government agency obligations	9,572,700	2,776,193	-	-	6,796,507
Municipal bonds	8,693,457	-	-	-	8,693,457
Total	$ 38,480,096	$ 22,990,132	$ -	$ -	$ 15,489,964

As further described in Note 6, the Authority has several derivative instruments that are accounted for as investments. Credit and interest rate risks related to these investments are described in Note 6.

3. Capital Assets

Capital assets for the year ended December 31, 2012 are as follows:

	Balance at January 1, 2012	Additions/ Transfers In	Retirements/ Transfers Out	Balance at December 31, 2012
Capital assets, not being depreciated:				
Artifacts	$ 351,865	$ -	$ -	$ 351,865
Construction in progress	250,444	162,711	(75,063)	338,092
Total capital assets, not being depreciated	602,309	162,711	(75,063)	689,957
Capital assets, being depreciated:				
Land improvements	2,847,743	-	-	2,847,743
Buildings and improvements	130,277,114	405,991	-	130,683,105
Furniture and fixtures	663,695	-	-	663,695
Machinery and equipment	111,701,093	3,744,467	(126,621)	115,318,939
Total capital assets, being depreciated	245,489,645	4,150,458	(126,621)	249,513,482
Less: accumulated depreciation	(72,911,480)	(7,477,409)	126,621	(80,262,268)
Total capital assets being depreciated, net	172,578,165	(3,326,951)	-	169,251,214
Total capital assets, net	$ 173,180,474	$ (3,164,240)	$ (75,063)	$ 169,941,171

4. Leases

At December 31, 2012, the Authority, through its Sewer Fund, is the lessor or sublessor in a separate direct financing lease with the City. The lease relates to the wastewater treatment, conveyance, and collection systems. The lease provides for rentals to be 100% of debt service requirements.

The following table shows the future minimum rentals to be received under direct financing leases at December 31, 2012:

2013	$ 82,453
2014	100,207
2015	110,411
2016	110,411
2017	110,411
2018 - 2022	552,055
2023 - 2027	552,055
2028 - 2030	331,231
	1,949,234
Less unearned income:	(352,067)
Present value of net minimum lease payments	$ 1,597,167

During the year ended December 31, 2012, the Authority received basic lease rentals of $106,523 from the City. These amounts represent interest income of $22,563 and a reduction of the lease rental receivable of $83,960. The Authority also received $431,000 in administrative fees from the City during the year ended December 31, 2012.

5. UNEARNED REVENUE

Development and Service Agreement

During October 2000, the Authority was designated as the developer of certain parking facilities located at the National Civil War Museum. In order to fulfill the requirements as designated developer, the Authority entered into an agreement with the Harrisburg Parking Authority. Under this agreement, the Harrisburg Parking Authority is to act as the sole and exclusive manager and operator of such parking facilities, including management and oversight of the day-to-day operations of the parking facility through October 2024. In consideration for its appointment and designation as manager and operator of the parking facilities, the Harrisburg Parking Authority agreed to pay $2,850,000 to the Authority. Revenue from this agreement is being recognized by the Authority ratably over the life of the agreement. Unearned revenue was $1,395,312 as of December 31, 2012.

Debt Service Forward Delivery Agreements

The Authority has entered into five derivative product agreements, which consist of debt service forward delivery agreements with a financial intermediary that result in a forward swap of interest earned on amounts placed in the debt service sinking fund. In exchange for cash payments to the Authority at the inception of the agreements totaling approximately $3,278,698 at December 31, 2012, the financial intermediary has the right, under the debt service forward delivery agreement, to invest the funds on hand in the sinking fund and retain the investment earnings. The amounts received were recorded as unearned revenue in the Authority's financial statements because the substance of these agreements effectively is to pay the Authority currently for interest that normally would be earned in later years. The unearned revenue, resulting from these transactions of $1,555,987 at December 31, 2012, is being amortized over the respective life of each agreement under a method that approximates the interest method.

Development and service agreement	$ 1,395,312
Debt service forward delivery agreements	1,555,987
Total unearned revenue	$ 2,951,299

The Authority is still a party to several debt service forward delivery agreements with Lehman Brothers Special Financing, Inc. (Lehman Special Financing) in connection with certain bonds or notes relating to the Authority's Water System and the Authority's Resource Recovery Facility. In the fall of 2008, Lehman Special Financing filed for bankruptcy protection under the U. S. Bankruptcy Code. As of the date hereof, neither the Authority nor Lehman Special Financing has terminated the outstanding debt service forward delivery agreements, with the exception of the agreement on the Series A-1 of 1994 Water Bonds, which was terminated on March 31, 2011 and resulted in the Authority paying $173,300 to Lehman Special Financing.

Because debt service is not being paid by the Authority on certain Resource Recovery Facility obligations, there are limited funds to purchase securities under these agreements. Certain of the Resource Recovery Facility forward debt service delivery agreements give the provider the right, upon default, to terminate such agreements. If the provider determines to terminate the agreement, it must first give notice of such termination in accordance with the agreement. Upon termination, the Authority could owe an amount of money to the provider equal to the termination value which would be calculated in accordance with the agreement. The calculation would yield the present value at the time of termination of the amounts to be earned through the investment of the future remaining deposits. No such notice of termination has been given.

6. LONG-TERM DEBT

The Authority has issued various revenue serial and term bonds and notes to finance various projects and refundings. A schedule of the Authority's bonds and notes outstanding at December 31, 2012 follows:

	Issue Amount	Maturity/ Mandatory Redemption	Interest Rates	Purpose	Guaranteed by the City of Harrisburg	Guaranteed by the County of Dauphin
2009 Guaranteed Sewer Revenue Note	$ 1,880,000	2011 - 2031	1.27% - 2.55%	Finance capital improvements and replacements to the Authority's wastewater treatment facility	Yes	No
2008 Covanta Construction Loan	25,500,000	2009 - 2018	4.00% - 8.00%	Perform the Retrofit completion work	Yes	No
2008 Water Revenue Bonds	69,420,000	2024 - 2031	4.88% - 5.25%	Currently refund the outstanding balance of the Authority's Variable Rate Water Revenue Refunding Bonds, Series A of 2003 and fund a swap termination payment	No	No
2004 Water Revenue Bonds	37,455,000	2005 - 2023	1.5% - 5.0%	Currently refund the Authority's outstanding Water Revenue Refunding Bonds, Series A-1, A-2, and A-3 of 1994 and payment of 2004 swap termination payment	No	No
2003 Guaranteed Resource Recovery Revenue Bonds:						
Series A	22,555,000	2018 - 2034	5.50% - 6.25%	Advance refund or otherwise retire all of the outstanding 1998D Bonds and all of the outstanding 2000 Notes; and fund working capital to assist in paying costs of compliance with the Derating Agreements and of maintaining the site of the Waste Management Facility	Yes	No
Series D1 and D2	96,480,000	2017 - 2033	variable	Finance the costs of the Retrofit	Yes	Yes

	Issue Amount	Maturity/ Mandatory Redemption	Interest Rates	Purpose	Guaranteed by the City of Harrisburg	Guaranteed by the County of Dauphin
2003 Guaranteed Resource Recovery Revenue Bonds:						
Series E	14,500,000	2009 - 2017	4.45% - 5.05%	Pay transition costs of operating the Transfer Station and maintaining the Facility during the shutdown of the Resource Recovery Facility and the construction period for the Retrofit	Yes	Yes
Series F	14,020,000	2009 - 2017	4.50% - 5.10%	Provide working capital to the Authority to pay estimated interest on outstanding 1998A Bonds, 2002 Notes, and 2003 Notes during the construction period for the Retrofit	Yes	No
2003 Guaranteed Resource Recovery Revenue Notes:						
Series B	29,085,000	2025 - 2031	variable	Advance refund or otherwise retire a portion of the 1998A Bonds and a portion of the outstanding 2000A Notes	Yes	No
Series C	24,285,000	2031 - 2034	5.00%	Advance refund or otherwise retire a portion of the 1998A Bonds, all of the outstanding 1998B Bonds and 1998C Bonds, a portion of the 2000A Notes, and all of the outstanding 2000B Notes	Yes	No
2002 Water Revenue Bonds:						
Series A	15,340,000	2023, 2024, 2029	5.00%	Advance refund 1999 Series A Water Revenue Bonds, purchase 1999 Series B Water Revenue Refunding Bonds, current refund debt service on the 1994 Bonds due and payable in 2002	No	No
Series B	23,035,000	2011 - 2017	variable	Purchase 1999 Series C Water Revenue Refunding Bonds	No	No
Series C	7,700,000	2013 - 2019	variable	Fund the 2002 Debt Service Reserve Fund Account	No	No
2002 Guaranteed Resource Recovery Notes:						
Series A	17,000,000	2007 - 2022	5.72%	Fund acquisition of equipment, engineering studies, and working capital	Yes	No

	Issue Amount	Maturity/ Mandatory Redemption	Interest Rates	Purpose	Guaranteed by the City of Harrisburg	Guaranteed by the County of Dauphin
2001 Water Revenue Bonds:						
Series A	7,400,000	2002 - 2015	3.40% - 5.75%	Capital additions to the water system; completion of the water meter project	No	No
1998 Resource Recovery Revenue Bonds:						
Series A	33,110,000	2006 - 2021	4.45% - 5.00%	Advance refund remaining 1993 Series A Resource Recovery Revenue Bonds	Yes	No
1998 Guaranteed Sewer Revenue Notes:						
Series A	1,893,000	1999 - 2018	variable	Finance projects related to the sewage collection system	Yes	No
Series B	1,864,000	1999 - 2017	1.536% - 3.071%	Finance projects related to the sewage collection system	Yes	No

Derivative Financial Instruments - 2003 Guaranteed Resource Recovery Revenue Bonds, Series D1 and D2

Objective of the interest rate swaps – The Authority's asset/liability strategy is to have a combination of fixed and variable-rate debt. On December 30, 2003, the Authority issued its $96,480,000 Guaranteed Resource Recovery Facility Revenue Bonds, Series D of 2003 (2003 Resource Recovery Bonds, Series D) consisting of $31,480,000 Subseries D-1 (2003 D-1 Bonds) and $65,000,000 Subseries D-2 (2003 D-2 Bonds). The 2003 D-1 Bonds initially bore interest at a fixed rate of 4.00% to December 1, 2008, and the 2003 D-2 Bonds at a 5.00% fixed rate to December 1, 2013. After the expiration of these respective initial rate periods, the 2003 D-1 and D-2 Bonds are subject to conversion to different interest rates for different interest rate periods. On December 1, 2008, the Authority remarketed and converted $31,280,000 Guaranteed Resource Recovery Facility Revenue Bonds, Subseries D-1 of 2003, to a long-term rate period of December 1, 2008 to December 1, 2010 with a coupon rate of 6.75%. On December 1, 2010, the Subseries D-1 of 2003 Bonds were remarketed to a fixed rate of 5.25% through December 1, 2013. To convert the interest rate on the 2003 D-1 and 2003 D-2 Bonds to a synthetic variable rate at the time of their issuance in 2003, the Authority entered into fixed-to-floating interest rate swaps, thereby achieving a variable rate while eliminating the need for a liquidity facility and annual remarketing services, and avoiding basis risk associated with the weekly remarketing of its variable rate debt, had it issued the 2003 D-1 Bonds and 2003 D-2 Bonds as weekly floating rate bonds.

Terms – With respect to its 2003 Resource Recovery Bonds, Series D, the Authority entered into an interest rate swap agreement with Royal Bank of Canada (RBC), which swap agreement consists of two components: (i) a swap with the outstanding principal amount of the 2003 D-1 Bonds to December 1, 2008 as the notional amount (D-1 Swap) and (ii) a swap with the outstanding principal amount of the 2003 D-2 Bonds to December 1, 2013 as the notional amount (D-2 Swap). Under the D-1 Swap, which terminated on December 1, 2008, the Authority paid RBC floating amounts calculated by applying a floating rate per annum determined by reference to the SIFMA Index, and the Authority received fixed amounts calculated by applying a fixed rate of 2.66% per annum on the notional amount under the D-1 Swap. Under the D-2 Swap, scheduled to terminate on December 1, 2013, the Authority pays interest on the notional amount under the D-2 Swap at a floating rate determined by reference to the SIFMA Index, and receives interest on such notional amount at a rate of 3.37% per annum.

The D-2 Swap contains an embedded cap, capping at 12% the floating rate to be paid by the Authority to June 1, 2006, and providing a 6% cap from June 1, 2006 to December 1, 2013, the termination date of the D-2 Swap. The Authority also entered into an interest rate cap agreement (D-1/D-2 Cap) with RBC, which was to become effective on December 1, 2008. The D-1/D-2 Cap provided that RBC would pay the excess, if any, between the SIFMA Index and 6% on a notional amount equal to the scheduled principal amount of the D-1

Bonds and the D-2 Bonds outstanding after December 1, 2008 and December 1, 2013, respectively. In May 2004, the Authority and RBC amended the D-1/D-2 Cap to provide for RBC to pay the excess between 68% of LIBOR and 6%, rather than the excess between SIFMA and 6%. The Authority received $1,106,000 as a result of this amendment.

Pursuant to the agreements, the Authority pays to or receives from the counterparty a net swap payment. For the year ended December 31, 2012, the Authority received $2,097,297 with respect to the D-2 Swap and the embedded D-2 Cap. For the year ended December 31, 2011, the Authority paid $569,232 for the D-1/D-2 Cap, as noted below.

Fair value – As of December 31, 2012, it would cost the Counterparty $2,070,232 to terminate the D-2 Swap and the embedded D-2 Cap and this amount is presented as a derivative asset on the Balance Sheet. The fair values take into consideration the prevailing interest rate environment and the specific terms and conditions of each swap. All fair values were estimated using the zero-coupon discounting method. This method calculates the future payments required by the swap, assuming that the current forward rates implied by the yield curve are the market's best estimate of future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for a hypothetical zero-coupon rate bond due on the date of each future net settlement payment on the swaps.

As of December 31, 2012, it would cost the Authority $5,794,328 to terminate the D-1/D-2 Cap and this amount is presented as a derivative liability on the Balance Sheet. The Authority is obligated to make semi-annual payments of $284,616 beginning December 1, 2006 to and including December 1, 2033 for a total obligation of $11,707,282 as payment for the D-1/D-2 Cap. These payments are included as a component of interest expense as paid.

Changes in fair value for the year ended December 31, 2012 of ($1,697,084) and ($1,296,178) for the D-2 Swap and the embedded D-2 Cap and D-1/D-2 Cap, respectively, are recorded as a component of investment income (loss) on the Statement of Revenues, Expenses, and Changes in Net Position.

Credit risk – As of December 31, 2012, the Authority was not exposed to credit risk on the D-1/D-2 Cap because it had a negative fair value. However, should interest rates change and the fair value of the D-1/D-2 Cap become positive, the Authority would be exposed to credit risk in the amount of the D-1/D-2 Cap's fair value. The Authority is exposed to credit risk on the D-2 Swap and the embedded D-2 Cap in the amount of their fair value. As of December 31, 2012, RBC was rated Aa3 by Moody's Investors Service and AA- by Standard & Poor's, and AA by Fitch. If RBC's rating falls below A3 by Moody's Investors Service or A- by Standard & Poor's, and if the fair value of the D-2 Swap becomes positive for the Authority, then the Authority may choose to terminate the D-2 Swap to mitigate credit risk.

Interest rate risk – The Authority entered into the 2005 Swap and the D-1/D-2 Cap to fix the interest rate as noted above and to limit its exposure to changes in interest rates. However, the D-2 Swap exposes the Authority to interest rate risk, as it is highly sensitive to changes in interest rates and the changes will have a material impact on the valuation of the Swap.

Subsequent Event – As of September 6, 2013, it would cost the Counterparty $1,048,125 to terminate the D-2 Swap and the embedded D-2 Cap. As of September 6, 2013, it would cost the Authority $4,441,297 to terminate the D-1/D-2 Cap.

RBC was rated AA- by Standard & Poor's, Aa3 by Moody's Investor Service, and AA by Fitch as of September 2013.

<u>2003 Guaranteed Resource Recovery Revenue Notes, Series B</u>

These Notes bear interest at a tax-exempt weekly rate equal to the SIFMA index plus 75 basis points on each date of determination, .959 percent at December 31, 2012.

<u>2002 Water Revenue Bonds, Series B</u>

These Bonds bear interest at Dexia Credit Local's prime rate plus 100 basis points, 4.25 percent at December 31, 2012.

<u>2002 Water Revenue Bonds, Series C</u>

These Bonds bear interest at Dexia Credit Local's prime rate plus 100 basis points, 4.25 percent at December 31, 2012.

<u>1998 Guaranteed Sewer Revenue Notes, Series A</u>

These Notes bear interest at a variable rate, 2.4375 percent at December 31, 2012.

The following table presents annual principal and interest payments for long-term debt outstanding at December 31, 2012:

	2013	2014	2015	2016
Bonds outstanding:				
Water Revenue Bonds:				
Series of 2008	$ 3,555,300	$ 3,555,300	$ 3,555,300	$ 3,555,300
Series of 2004	1,956,080	1,960,900	1,960,200	1,964,000
Series A of 2002	767,000	767,000	767,000	767,000
Series B of 2002 (B)	3,899,627	4,406,804	4,243,264	4,079,724
Series C of 2002 (B)	1,481,897	1,431,577	1,381,257	1,330,937
Series A of 2001	740,162	741,425	1,501,500	-
Resource Recovery Revenue Bonds:				
Series A of 2003	1,294,525	1,294,525	1,294,525	1,294,525
Series D of 2003 (A)	2,796,700	5,065,200	5,065,200	5,065,200
Series E of 2003	2,096,775	2,097,692	2,094,317	2,091,650
Series F of 2003	2,027,535	2,030,680	2,029,490	2,028,965
Series A of 1998	558,250	558,250	678,250	2,082,250
Total principal and interest, bonds	$ 21,173,851	$ 23,909,353	$ 24,570,303	$ 24,259,551
Less:				
Interest				
Unamortized premium				
Unamortized deferred losses on refunding				
Total bonds outstanding, net of premium and deferred losses on refunding				
Notes payable:				
Guaranteed Resource Recovery Revenue Notes:				
Series B of 2003 (B)	$ 278,925	$ 278,925	$ 278,925	$ 278,925
Series C of 2003	1,214,250	1,214,250	1,214,250	1,214,250
Series A of 2002	1,656,231	1,661,717	1,663,722	1,663,734
Guaranteed Sewer Revenue Notes:				
Series of 2009	100,207	100,207	110,411	110,411
Series A and B of 1998 (B)	222,462	235,394	240,250	245,898
Total principal and interest, notes	$ 3,472,075	$ 3,490,493	$ 3,507,558	$ 3,513,218
Less:				
Interest				
Unamortized premium				
Total notes payable, net of premium				
Loan payable:				
Resource Recovery construction loan	$ 11,667,236	$ 2,975,259	$ 2,975,259	$ 2,975,259
Less:				
Interest				
Total loan payable, net				

(A) - Uses net payments under swap agreements as disclosed earlier in Note 6.

(B) - Uses variable rate in effect at December 31, 2012 as disclosed on page 20.

2017	2018 to 2022	2023 to 2027	2028 to 2032	2033 to 2034	Total
$ 3,555,300	$ 17,776,500	$ 43,021,556	$ 49,014,694	$ -	$127,589,250
2,177,400	37,226,500	4,499,250	-	-	51,744,330
767,000	3,835,000	15,263,250	1,661,000	-	24,594,250
3,917,170	-	-	-	-	20,546,589
1,280,617	1,834,519	-	-	-	8,740,804
-	-	-	-	-	2,983,087
1,294,525	12,425,125	12,229,175	2,250,000	8,100,000	41,476,925
8,335,200	44,924,676	43,720,187	42,222,913	8,267,387	165,462,663
1,444,438	-	-	-	-	9,824,872
1,418,850	-	-	-	-	9,535,520
2,080,750	8,967,750	-	-	-	14,925,500
$ 26,271,250	$126,990,070	$118,733,418	$ 95,148,607	$ 16,367,387	477,423,790
					180,148,790
					(5,172,559)
					21,785,544
					$280,662,015
$ 278,925	$ 1,394,625	$ 13,911,822	$ 16,794,753	$ -	$ 33,495,825
1,214,250	6,071,250	6,071,250	17,094,000	13,983,000	49,290,750
1,662,294	8,317,818	-	-	-	16,625,516
110,410	552,055	552,055	331,232	-	1,966,988
233,758	161,950	-	-	-	1,339,712
$ 3,499,637	$ 16,497,698	$ 20,535,127	$ 34,219,985	$ 13,983,000	102,718,791
					34,144,867
					(738,439)
					$ 69,312,363
$ 2,975,259	$ 1,560,648	$ -	$ -	$ -	$ 25,128,920
					5,305,420
					$ 19,823,500

Long-term liability activity for the year ended December 31, 2012 was as follows:

	Beginning Balance at January 1, 2012	Additions	Amortization	Reductions	Ending Balance at December 31, 2012	Amounts Due Within One Year
Loans payable	$ 19,823,500	$ -	$ -	$ -	$ 19,823,500	$ 8,645,310
Notes payable	69,737,921	-	-	(1,163,997)	68,573,924	1,213,187
Bonds payable	305,420,000	-	-	(8,145,000)	297,275,000	8,381,000
Total loans, notes, and bonds payable	386,574,993	-	-	(9,308,997)	385,672,424	18,239,497
Less:						
Unamortized premium (discount)	6,419,763	-	(508,765)	-	5,910,998	-
Deferred losses on refunding	(24,443,365)	-	2,657,821	-	(21,785,544)	-
	$ 368,551,391	$ -	$ 2,149,056	$ (9,308,997)	$ 369,797,878	$18,239,497

During 2007, the Authority entered into a First Amendment and Management and Professional Services Agreement with a waste management facility operator (operator). As part of that agreement, the operator agreed to advance the costs incurred in the retrofit completion up to $25,500,000. At December 31, 2012, the Authority had drawn down $20,461,000. This loan constitutes subordinate debt of the Authority pursuant to the provisions of the Authority’s various debt indentures. No interest accrued until July 1, 2011, at which time simple interest began to accrue at the rate of 4% per annum until July 1, 2012 and at a rate of 8% per annum thereafter. Interest was payable beginning October 1, 2011 and continuing thereafter in quarterly installments due and payable on the first day of each calendar quarter. Principal was to be paid beginning on July 1, 2009 in quarterly installments due and payable on the first day of each calendar quarter based on a 10-year, mortgage-style amortization schedule. This loan is guaranteed by the City. Refer to Note 12 for more information.

On July 11, 2012, the Authority’s Variable Rate Water Revenue Refunding Bonds, Series B of 2002 were purchased by Dexia Credit Local (Dexia), the liquidity facility provider, prior to the expiration of the standby bond purchase agreement, which was not extended. The Authority’s Variable Rate Water Revenue Refunding Bonds, Series B of 2002 will be subject to special mandatory sinking fund redemption on a level principal basis beginning on January 15, 2013 and on each January 15 and July 15 thereafter until July 15, 2017 and bear interest at Dexia’s prime rate, plus 1%.

On July 11, 2012, the Authority's Variable Rate Water Revenue Refunding Bonds, Series C of 2002 were purchased by Dexia, the liquidity facility provider, prior to the expiration of the standby bond purchase agreement, which was not extended. The Authority's Variable Rate Water Revenue Refunding Bonds, Series C of 2002 will be subject to special mandatory sinking fund redemption on a level principal basis beginning on January 15, 2013 and on each January 15 and July 15 thereafter until July 15, 2019 and bear interest at Dexia's prime rate, plus 1%.

Defeased Debt

The Authority has, from time to time, defeased certain debt by placing the proceeds of new debt in an irrevocable trust to provide for all future debt service payments on the old debt. The trust account assets and the liability of the defeased debt are not included in the Authority's financial statements. At December 31, 2012, the following defeased debt was outstanding:

Seventh Street Office & Parking Revenue Bonds, Series A of 1998	$ 8,920,000
Seventh Street Office & Parking Revenue Bonds, Series B of 1998	6,185,000
Resource Recovery Bonds, Series A of 1998	10,485,000
Resource Recovery Bonds, Series B of 1998	5,610,000
Resource Recovery Bonds, Series C of 1998	2,505,000
Resource Recovery Notes, Series B of 2000	540,000
Total outstanding defeased debt	$ 34,245,000

7. CAPITAL LEASE

On December 31, 2003, the Authority entered into the Non-Exclusive Technology Sub-Licensing Agreement and Technology Purchase Agreement with the original contractor of the Resource Recovery Retrofit. The original contractor granted the Authority a license to utilize the Combustion Technology at the Facility. The Sub-License Agreement is to continue in effect until the date on which the Combustion Technology is no longer used at the Facility.

To raise the funds necessary to complete the project, the original contractor sold its Technology License to CIT - Newcourt Capital for $25 million. In turn, the Authority and original contractor entered into a First Amended and Restated Nonexclusive Technology Sublicensing Agreement and Technology Purchase Agreement (Amended Purchase Agreement) granting continued right to the Authority to make full use of the Combustion Technology for all intended purposes under the Equipment Agreement, and for no other purpose; provided, that the Authority may expand or increase the number of units at the

Facility without the consent of the Licensor and without payment of any additional fees. This Amended Purchase Agreement has since been assigned to CIT.

Under the sublicense, the Authority will pay to CIT the following fees:

Base Fee - For each calendar quarter ending prior to January 1, 2026, the Authority will pay to Licensor/Seller, on or prior to the first business day of the immediately following calendar quarter (base fee) an amount equal to:

- For calendar quarters ending March 31, 2006 and June 30, 2006, $500,000;
- For each calendar quarter thereafter prior to the calendar quarter during which the $25 million is repaid, $750,000; and
- For each calendar quarter following the calendar quarter during which the $25 million has been repaid occurs and prior to the calendar quarter in which the Purchase Date occurs, $.50 per ton of waste processed through each Combustion Unit during the applicable calendar quarter.

Supplemental Fee - For each calendar year ending on or after December 31, 2006 and prior to the repayment of the $25 million, the Authority will pay to CIT, an amount equal to 95% of the excess revenues (defined as funds available after the payment of facility expenses defined as actual expenses incurred by the Authority in the operation, maintenance and ownership of the Facility: such expenses to include all operating and debt service expenses and mandated governmental fees and costs, and payments required to be made from the revenue fund into the following trust funds: the debt service fund, the debt service reserve fund, the operating reserve fund, the renewal and replacement fund and any other specified funds into which mandatory deposits or transfers are required under the terms of the existing authority indenture documents, but excluding the surplus fund and the redemption fund and disregarding amounts paid into and disbursed out of the purchase and remarketing fund).

During the year ended December 31, 2006, the Authority paid the base fee of $2.5 million to CIT under the Amended Purchase Agreement. There were no supplemental fees due for the year ended December 31, 2006. There were no payments made under this agreement from the year ended December 31, 2007 through December 31, 2012. At December 31, 2012, the Authority's Balance Sheet reflects the remaining balance due under this capital lease in the amount of $15,000,000, in addition to accrued interest of $6,085,233.

CIT and Aireal Technologies assert that, pursuant to one of the many agreements signed on or about January 11, 2006, the Authority is required to repay this obligation because of the ensuing bankruptcy of Barlow, the original designer and contractor of the Resource Recovery Facility's retrofit project. CIT further argues that the Authority's obligation is an "operating expense" and that it should be given priority in payment ahead of the Authority's debt service obligations. The District Court entered judgment against the Authority in the amount of $19.3 million as of January 2012. The case is presently on appeal with the Circuit Court of Appeals. The case was referred to mediation by the Third Circuit. There have been productive settlement discussions, but no formal settlement agreement has been signed. The Authority has defended against the claim by asserting that the agreements upon which CIT was basing its claims are unenforceable and ultra vires acts, and, among other arguments, that there was a lack of consideration for the agreements. The Authority will continue to pursue its position on appeal absent a formal settlement. The loss may be handled through payment via a plan under Act 47 (Municipalities Financial Recovery Act), as amended.

8. Segment Information

The Authority supports three separate segments. The Water Segment accounts for the provision of basic water service to customers of the Harrisburg Water System. The Sewer Segment accounts for the leasing of the wastewater conveyance and treatment system to the City under a direct financing lease. The Resource Recovery Segment accounts for the activities at the Harrisburg Resource Recovery and Steam Generating Facility (Resource Recovery Facility), which converts waste into energy. Selected segment information as of and for the year ended December 31, 2012 is as follows:

CONDENSED BALANCE SHEET	Water Segment	Sewer Segment	Resource Recovery Segment
Assets:			
Current assets:			
Other current assets	$ 9,549,539	$ 80,163	$ 7,330,816
Due from (to) other funds	911,570	231,510	(1,414,999)
Due from the City of Harrisburg	-	416,518	897,688
Total current assets	10,461,109	728,191	6,813,505
Restricted assets	34,004,745	3,524,204	10,121,122
Capital assets	61,196,477	-	108,392,829
Advances to the City of Harrisburg	-	1,053,375	-
Other noncurrent assets	3,595,691	1,517,004	7,906,113
Total Assets	$ 109,258,022	$ 6,822,774	$ 133,233,569
Liabilities:			
Current liabilities:			
Other current liabilities	$ 99,132	$ -	$ 21,085,233
Due to the City of Harrisburg	1,098,997	-	76,571,199
Total current liabilities	1,198,129	-	97,656,432
Liabilities payable from restricted assets	8,079,431	273,187	19,699,555
Noncurrent liabilities	132,703,641	3,283,492	225,661,886
Due to the City of Harrisburg	64,924	-	-
Total Liabilities	142,046,125	3,556,679	343,017,873
Net Position:			
Net investment in capital assets	(43,393,345)	-	(133,545,597)
Restricted	2,459,183	3,524,204	1,362,259
Unrestricted	8,146,059	(258,109)	(77,600,966)
Total Net Position	(32,788,103)	3,266,095	(209,784,304)
Total Liabilities and Net Position	$ 109,258,022	$ 6,822,774	$ 133,233,569
CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION			
Operating revenues	$ 16,625,586	$ 328,490	$ 24,577,308
Operating expenses:			
Operating	4,993,871	-	22,171,298
Administration	307,103	328,490	1,129,464
Depreciation	2,109,865	-	5,367,544
Total operating expenses	7,410,839	328,490	28,668,306
Operating Income	9,214,747	-	(4,090,998)
Non-operating revenues (expenses):			
Investment income	1,761,960	4,265	(2,889,059)
Lease rental income	-	58,714	-
Miscellaneous income (expense)	35,079	(7,707)	14,036
Interest expense	(8,884,223)	(170,806)	(14,659,183)
Gain on sale of assets	-	-	6,000
Amortization of debt financing costs	(411,594)	(3,316)	(773,402)
Total non-operating revenues (expenses)	(7,498,778)	(118,850)	(18,301,608)
Change in Net Position	1,715,969	(118,850)	(22,392,606)
Net position - January 1, 2012	(34,504,072)	3,384,945	(187,391,698)
Net position - December 31, 2012	$ (32,788,103)	$ 3,266,095	$ (209,784,304)

CONDENSED STATEMENT OF CASH FLOWS	Water Segment	Sewer Segment	Resource Recovery Segment
Net cash provided by (used in) operating activities	$ 10,324,148	$ (318,711)	$ 1,959,820
Net cash provided by investing activities	69,410	4,106,339	1,485,513
Net cash used in capital and related financing activities	(11,466,409)	(1,493,860)	(4,986,727)
Increase (decrease) in cash and cash equivalents	(1,072,851)	2,293,768	(1,541,394)
Cash and cash equivalents, January 1, 2012	10,066,119	1,017,197	10,169,378
Cash and cash equivalents, December 31, 2012	$ 8,993,268	$ 3,310,965	$ 8,627,984

At December 31, 2012, the Authority has net position deficits in the Water and Resource Recovery segments, primarily due to the Authority not charging enough to cover depreciation expense incurred since acquisition of the Water System and Resource Recovery Facility and not funding amortization of bond discounts, deferred bond issuance costs, and deferred losses on refundings. Management anticipates that the deficits will be reduced in the Water segment through future profitability improvements. Notes 12 and 14 discuss the deficit in the Resource Recovery segment.

9. NON-RECOURSE DEBT ISSUES

As discussed in Note 1, the following non-recourse debt issues were outstanding at December 31, 2012:

Haverford Township, Series of 2002	$ 4,525,000
Cumberland Valley School District, Series of 2002	19,260,000
Township of Uwchlan, Series of 2002	1,650,000
Township of West Brandywine, Series of 2002	3,695,000
Harrisburg University, Series B of 2007	60,225,000
	$ 89,355,000

Harrisburg University

Pursuant to a Trust Indenture dated as of January 1, 2007 (Indenture), the Authority issued its University Revenue Bonds, Series of 2007 (The Harrisburg University of Science and Technology Project) in the aggregate principal amount of $87,915,000, comprised of its University Revenue Bonds, Series A of 2007 in the aggregate principal amount of $27,690,000 (Series A Bonds) and its University Revenue Bonds, Series B of 2007 in the aggregate principal amount of $60,225,000 (Series B Bonds, and together with the Harrisburg University Series A Bonds, the Bonds). The Series A Bonds have been paid and are no longer outstanding under the Indenture.

In order to secure the Bonds, the Authority assigned to the Trustee under the Indenture all of its right, title, and interest in and to all funds and accounts established under the Indenture (other than the rebate fund created thereunder) and the pledged revenues, as defined in the Indenture. Further, the performance of the obligations of The Harrisburg University of Science and Technology (University) under a certain Loan Agreement dated as of January 1, 2007 (Loan Agreement) by and between the Authority and the University is secured by a certain Open-End Mortgage and Security Agreement dated as of January 1, 2007 (Mortgage). Capitalized terms not defined herein shall have the meanings ascribed to them in the Indenture and Loan Agreement, as applicable.

The Series B Bonds are also secured by the provisions of a certain credit support agreement (Credit Support Agreement) and a guaranty agreement (Guaranty), whereby the County will undertake for a ten-year period (commencing January 1, 2010 and subject to certain earlier rights of termination) to guarantee payment of a portion of the debt service on the Series B Bonds in the maximum amount of $1,500,000 each year over such ten-year period, for a total maximum amount of $15,000,000.

The Series B Bonds were also secured by a certain Standby Letter of Credit issued by Metro Bank, successor to Commerce Bank/Harrisburg, National Association (Letter of Credit Bank), as of January 1, 2007 (Standby Letter of Credit) under and pursuant to a Reimbursement Agreement dated as of January 1, 2007, by and among the Authority, the Harrisburg University and the Letter of Credit Bank (Reimbursement Agreement). The Standby Letter of Credit was initially issued in the amount of $3,300,000. The Standby Letter of Credit expired as of September 1, 2011. The Standby Letter of Credit has not been replaced.

During the year ending December 31, 2011 and through September 2013, the University has reported that it has been unable to make the required loan payments and, in some cases, has utilized the County guaranty to pay the required loan payments. The draw on the Guaranty does not constitute an event of default under the Indenture, the Loan Agreement, the Guaranty, the Credit Support Agreement, or any of the other finance documents relative to the Bonds. Under the Credit Support Agreement, in the event that any funds paid by the County to the Trustee are not returned to the County by close of business on the third Business Day following the debt service payment date for which such sums were advanced, the University is required to pay to the County interest on such funds, payable on demand and in any event on the date on which such funds are returned to the County, at a default rate of six (6%) percent, subject, however, to such different or additional terms as may be mutually acceptable to the University and the County.

During the year ended December 31, 2012 and through September 2013, in its multiple Notices of Default, the Trustee asserted that the failure to make the required loan payments constituted an event of default under the Loan Agreement and under the Indenture.

Although the Authority is a party to the trust indenture with the University and the Trustee, such agreements are structured such that there is no recourse against the Authority in the case of default.

10. DUE TO THE CITY OF HARRISBURG

The Authority has entered into a management agreement with the City to operate the Authority's Water System. The Water System's management agreement expires in 2020 (subject to annual renewal thereafter). The management agreement requires that the Mayor prepare an operating expenses budget for adoption by the City Council, with final approval by the Authority and the inclusion of such budgeted operating expenses in the Authority's annual budget. The Authority incurred $5,300,974 in expenses under the Water System management agreements in 2012.

At December 31, 2012, $1,163,921 is included in the amount due to the City for the Water Segment and $76,571,199 and $897,688 is included in the amount due to and due from the City, respectively, for the Resource Recovery Segment. The Authority has annually agreed to adopt Water rates sufficient to pay the operating expense budgets as approved as well as administrative and debt service expenses. The City, County, and bond insurer have paid debt service costs, on behalf of the Authority, for debt related to the Authority's Resource Recovery Facility. Those payments are due back to the City under various reimbursement agreements entered into at the time the debt was issued. Refer to Note 12 for more information.

On behalf of the Authority, the City entered into a capital lease for an energy resource management project and turbine equipment at the water treatment plant as well as various equipment purchases for the water treatment plant and the Resource Recovery Facility. For financial reporting purposes, minimum lease payments have been capitalized. The property acquired through the capital lease has a cost and a net book value of $730,855 and zero, respectively, as of December 31, 2012. The leases expire from March 2012 through December 2017. Amortization on the leased equipment is included in depreciation expense.

The future minimum lease payments under the capital lease are included in the amount due to the City. The future minimum lease payments under the capital lease and the net present value of the future minimum lease payments at December 31, 2012 are as follows:

2013	$	92,406
2014		45,344
2015		7,761
2016		7,762
2017		7,760
Total minimum lease payments		161,033
Amount representing interest		(9,762)
Present value of net minimum lease payments	$	151,271

The following represents the amounts due to the City at December 31, 2012:

Resource Recovery segment:		
Operating revenues	$	(897,688)
Utilities		326,344
Reimbursement agreements		76,244,855
Water segment:		
Operating expenses		75,324
Operating revenues		937,326
Water capital lease:		
Current portion		86,347
Long-term portion		64,924
Due to the City of Harrisburg	$	76,837,432

Under the Third Amendment to the Municipal Waste Disposal Agreement with the City, the City waived the requirement that the Authority pay a host municipality benefit fee to the City of $1 for every ton of waste delivered to the Resource Recovery Facility. In lieu of paying a host municipality benefit fee, the Authority had agreed to allow the City to occupy and/or access the Public Works Complex Facilities and the Dewatering & Drying Building (D & D Building) on the Resource Recovery Facility site and provide heat to these buildings at no cost to the City. During the year ended December 31, 2012, the City rescinded the third amendment to the Municipal Waste Disposal Agreement via Resolution No. 24-2012. The Authority at its November 28, 2012 meeting approved Resolution 2012-009: Authorization of Rescission of Third Amendment to the Municipal Waste Disposal Agreement between the Authority and the City (re: Reinstatement of host municipality benefit fees to be paid to the City by the Operator of the Harrisburg Resource Recovery Facility). The Board authorized the approval and execution of the Rescission of Third Amendment to the Municipal Waste Disposal Agreement between the Authority and the City, contingent upon the City's proper approval and execution of the Commercial Lease Agreements relative to the Public Works Complex Facility and the D & D Building for the period July 1, 2012 through December 31, 2012 located at the Harrisburg Resource Recovery Facility. Execution of the Rescission Agreement will reinstate the host municipality benefit fee payable to the City by the operator of the Harrisburg Resource Recovery Facility. Authorization and approval of execution of the Rescission of Third Amendment Agreement as stated above was previously approved by the City via Resolution No. 24-2012. The Authority has not received properly approved and executed Commercial Lease Agreements from the City and, consequently, the Authority has not issued or accrued host municipality benefit fee payments to the City.

11. LANDFILL CLOSURE AND POST-CLOSURE CARE COSTS

State and federal laws and regulations require the Authority to properly close and place a final impermeable cover on its Ash Residue Disposal Landfills when they no longer accept waste and to perform certain ongoing maintenance and monitoring activities at the site for up to thirty years after closure. The original estimated total cost of closure and post-closure care costs was $1,670,206, based on an agreement with the Commonwealth of Pennsylvania pursuant to state regulations and was subject to change with inflation, deflation, technology, or applicable laws and regulations. During 2007, under the original closure and post-closure agreement, the Authority was required by state regulations and its permit to make quarterly payments of $30,014 to the Consolidated Closure Trust.

On December 31, 2007, the original consolidated trust was terminated and a new account was established. At that time, the Authority estimated the closure and post-closure costs to be $1,442,617. A variable rate promissory note (Line of Credit) was entered into with a financial institution for $1,442,617. The Line of Credit supports the Letter of Credit #1805 issued to the Pennsylvania Department of Environmental Protection. On May 5, 2008, this Line of Credit was amended to $2,355,713 based on a revised closure and post-closure cost estimate.

In an effort to extend the life of the landfill, in April 2008, the Authority began mining the ash to recover ferrous and nonferrous metals contained in the ash residue. Beginning in August 2008, the ash from the processed metal was removed from the landfill and taken offsite. This resulted in reduced ash volume thereby further extending the life of the landfill area. To maintain continued ash disposal operations, a plan was prepared to extend the site life of the landfill until an expansion can be permitted and constructed. It is expected to take four years to complete the permitting and initial construction process. During that four-year period, mining and off-site disposal of processed ash will continue. During 2009, the Authority received a landfill permit extension for another four years. The capacity will last that long, if the Authority continues to remove ash from the landfill for disposal/beneficial use at another landfill, as fast as it is generated at the Harrisburg Resource Recovery Facility.

The Authority has accrued $2,037,568 for landfill closure and post-closure care costs as of December 31, 2012, which represents the use of 86.49% of the estimated capacity of the disposal area. Based on the annual usage at December 31, 2012, the estimated remaining life of the landfill is approximately one year. Under the new closure and post-closure agreement, the Authority is required by state regulations and its permit to make quarterly payments of $170,000 to the Consolidated Closure Trust until fully funded. The Authority is in compliance with those requirements at December 31, 2012.

In August 2013, the Department of Environmental Protection approved increasing the landfill closure and post-closure care costs bonding amount to $3,453,827.

As of December 31, 2012, cash and investments of $3,399,827 are held for closure and post-closure care expenses. Those funds are reported as restricted assets on the Balance Sheet.

12. Commitments and Contingencies

Many of the Authority’s financings are insured by a bond insurance policy. On January 17, 2013, Moody’s Investor Services downgraded the insurance financial strength rating of the Authority’s bond insurer from Aa3 to A2.

Resource Recovery Segment

The rate covenant calculation required under applicable trust indentures pertaining to the Resource Recovery Facility financing has not been met for the year ended December 31, 2012. If the facility fails to generate sufficient revenues to pay debt service on the Resource Recovery Facility Revenue Bonds, Series A, D, E, and F of 2003, the Resource Recovery Facility Revenue Notes, Series B and C of 2003, the Resource Recovery Facility Subordinate Variable Rate Revenue Notes, Series A of 2002, or the Resource Recovery Facility Revenue Bonds, Series A of 1998, or ceases revenue generating operations, or if other monies set aside for such purposes are insufficient, the City will be required to pay principal of and interest on such bonds and notes when due pursuant to respective Guaranty Agreements among the City, the Authority, and the respective Trustees for the bonds and notes. The County of Dauphin (County) has provided a secondary guarantee of the Resource Recovery Facility Revenue Bonds, Series D and E of 2003 collectively in the maximum aggregate principal amount not to exceed $113,000,000 by entering into a County Bond Guaranty

Agreement with the Authority and the Trustee for such bonds. The Resource Recovery Segment has incurred substantial accumulated losses, which have caused the Segment to experience cash flow difficulties.

Under the trust indentures, the Authority is required to maintain certain minimum balances in the Resource Recovery debt service reserve funds. At December 31, 2012, the Authority's balances in the debt service reserve funds and the related reserve requirements are as follows:

Bond Series	Balance at December 31, 2012	Reserve Requirement
1998	$ 3,032,958	$ 3,900,215
2002	-	800,000
2003A - C	-	7,200,000
2003D	68	8,000,000
2003E	2	1,000,000
2003F	-	1,000,000

Deficiencies in the Debt Service Reserve Accounts are to be repaid in not more than 12 substantially equal monthly payments on the first day of the month after the occurrence of such deficiency. As of September 2013, the Authority has not replenished the Debt Service Reserve Accounts.

Management has not instituted a system to calculate the rate covenant requirement noted earlier.

The Authority has issued multiple notices of material events with the Electronic Market Access System (EMMA) established by the Municipal Rulemaking Board, all with respect to its inability to make required debt service payments, including draws on debt service reserve funds, under guaranty agreements, and insurance policies with respect to the Authority's 1998 Series A, B, and C, Series A Notes of 2002, Series A, B, and C Bonds of 2003, Series D-1, D-2, E, and F Bonds of 2003, and Series C and D Notes of 2007, from 2009 through 2013. These draws were necessary for the Authority to make debt service payments under the respective bond issues.

Additionally, the County made payments from 2009 through 2011 under the County Guaranty with respect to the Series D-1 and D-2 Cap agreement and the Series D-1 and D-2 Swap agreement. Beginning in October 2010, the County began making monthly deposits into the Series D, E and F Debt Service Reserve Funds. These deposits have been used to make subsequent Swap/Cap payments.

The City made payments in the amount of $637,500 during July 2009, October 2009, and January 2010 under the guaranty with respect to construction loan from Covanta. There have been no subsequent payments to Covanta with respect to the construction loan.

The above-mentioned draws are presented as Due to the City of Harrisburg on the Balance Sheet. Draw activity by funding source, for the year ended December 31, 2012, is as follows:

	Beginning Balance at January 1, 2012	Additions	Ending Balance at December 31, 2012
City of Harrisburg	$ 5,521,082	$ -	$ 5,521,082
Dauphin County	46,007,341	4,765,052	50,772,393
Insurer	7,339,224	6,416,623	13,755,847
Total draws	58,867,647	11,181,675	70,049,322
Accrued interest	3,443,410	2,752,123	6,195,533
	$ 62,311,057	$ 13,933,798	$ 76,244,855

Other

On October 28, 2009, the City received notice that Moody's downgraded its rating on its outstanding obligations to Ba2 from Baa2. On February 11, 2010, Moody's downgraded its rating on the City's general obligation bonds again to a rating of B2, with a negative outlook. In a notice of material event with EMMA, filed by the City on March 29, 2011, the City stated its October 2009 downgrade and that it has not provided an annual report for the fiscal year ended December 31, 2009. Subsequently, through its notice of material event with EMMA filed on July 13, 2012, the City stated that it had not filed its comprehensive annual financial report for the fiscal years ended December 31, 2009, 2010, and 2011. However, the City filed its 2009, 2010, and 2011 comprehensive annual financial reports on August 6, 2012, December 20, 2012, and May 16, 2013, respectively. Through its notice of material event with EMMA filed on July 15, 2013, the City stated that it had not filed its comprehensive annual financial report for the fiscal year ended December 31, 2012.

In June 2010, the Authority entered into a Consent Order and Agreement (COA) with the Pennsylvania Department of Environmental Protection (DEP) relative to the Resource Recovery Facility for violations of air quality-related emissions limits as of January 2007. In lieu of paying the total fine for the violations, the COA established the following:

- Civil penalty of $125,000 due at execution of COA (paid in 2010)

- Additional civil penalty of $100,000 due no later than December 31, 2011, December 31, 2012, and December 31, 2013.

In lieu of paying civil penalties for the period of 2011 – 2013, the Authority may perform certain projects for the benefit of the residents of the City and/or the Borough of Steelton. In order for the funds expended on the projects to qualify as Project Credits under the COA, the Projects must be certain projects and meet certain conditions:

- Asthma Education Program for Community School Children – implement the American Lung Association's Open Airways for Schools Program. The Authority will provide funds to the Project Administrator (Hamilton Health Center).
- South Allison Hill Weed and Seed Revitalization Plan – bulk trash cleanup, cameras to monitor illegal dumping, and vacant lot cleanup. The Authority will participate by providing funds to Project Administrator (YMCA Weed and Seed).

For payments to qualify for the Project Credits, the Authority must:

- Receive written approval from the DEP for the draft contract between the Authority and the Project Administrators.
- Execute the DEP approved contract with the Project Administrator.
- Provide DEP with copy of executed contract with first quarterly report.
- Provide DEP with quarterly reports (within 30 days of the end of the quarter).

The $100,000 penalty for period of 2011 – 2013 will not be due for each year if the Authority demonstrates at least $50,000 of Project Credits pursuant to the Final Completion Reports submitted during each calendar year. If the Authority demonstrates any Project Credits pursuant to the Final Completion Reports submitted during the 2010 calendar year, the 2010 Project Credits shall be applied as Project Credits to the 2011 calendar year. If the Authority demonstrates more than $50,000 of Project Credits pursuant to Final Completion Reports submitted during 2011 and 2012 calendar years, the Project Credits exceeding $50,000 in any given year may be applied as Project Credits in the next calendar year. The project requirements were met and the Project Credits applied for the year ended December 31, 2012.

This is an equity matter where the County is seeking specific performance of the Authority's obligations under the Reimbursement Agreement in the amount of approximately $3.5 million. The Authority is obligated to reimburse all amounts the County had to pay under its guarantees under Series D and E of 2003 Bonds (including debt service reserve fund replenishment) and swap documents. The Authority was initially dismissed from this lawsuit as of August 6, 2010. The County sought reconsideration of the decision dismissing the Authority from the case and the Court granted reconsideration and reinstated the claims against the Authority. The Authority is required to file an answer to the compliant for specific performance. The Authority must file the answer on or before September 30, 2012. The Authority has defended the equity matter and was initially dismissed from the case. The Authority will continue to purpose that legal position and vigorously defend this claim for specific performance. The Authority believes that it has a reasonable and valid basis for its position. The loss may be handled through payment via a plan under Act 47, as amended.

The County is seeking $6,743,197 as of October 26, 2010 for reimbursement of payments it made as guarantor of Swap Payments in June and December of 2009, June 2010, and payments under Retrofit Indentures, Series D and E of 2003. The County also demands interest and costs. On February 15, 2011, the County is seeking $675,762 for reimbursement of payments made as guarantor of Swap Payments made in December 2010. The pleadings are closed and the case has been inactive. No trial date has been set. The Authority has defended by asserting that the County has frustrated the Authority's ability to charge rates that would have allowed it to meet its debt service. The Authority has also raised that the County has not been diligent in enforcing flow control ordinance, thus costing the Authority tipping fees, that otherwise, would have been recovered. The Authority will defend itself vigorously. The Authority believes that it has a reasonable and valid basis for its position. The loss may be handled through payment via a plan under Act 47, as amended.

The bond Trustees and the bond insurer have made a claim against the Authority to recover amounts the Authority has not paid by under its various debt service obligations. Plaintiffs further seek all costs and attorneys fees associated with the Authority default and that these costs and fees be a "first draw" on Resource Recovery Facility revenues. The Lower Court granted the request for a receiver which the Authority appealed and which is pending before the Commonwealth Court. Plaintiffs may seek payment of its costs and fees if a receiver is appointed. The portion of the claim requesting monetary relief has been inactive and no trial date has been set. The Authority has responded to the claim for monetary relief in two ways. First, for the claims of the bond Trustees, the Authority has defended that any amounts paid by the County cannot be recovered, and that the only rights to reimbursement are the County's under its Reimbursement Agreement. There does not appear to be a dispute that the bond insurer paid under its bond insurance policy, thus there is a likelihood that the insurer's claim for reimbursement will be successful. The potential loss is in excess of $9 million. The Authority believes there is a reasonable and valid basis for its position as to the Trustee/Plaintiffs' claim for payment. The Authority believes Plaintiffs' claims for costs and fees to be excessive and may challenge certain portions of the claim for costs. The amount due may be handled through payment via a plan under Act 47, as amended.

Unless resolved through a plan under Act 47, it is likely that for each payment the County or the bond insurer make as guarantor and insurer, respectively, they will make a claim against the Authority for the amounts paid as well as costs and attorneys fees. As of September 6

2013, the County and bond insurer have made payments to cover the Authority's debt service (including swap payments) of $55,054,580 and $17,107,694, respectively.

The Authority entered into an Administrative Services and Interim Operation and Maintenance Agreement (Interim Agreement) with Covanta Energy, Inc. (Covanta) for operation and management of the Resource Recovery Facility effective January 2, 2007 through March 31, 2007. During the interim agreement period, Covanta provided all day-to-day administrative services, provided a Construction Plan and coordinated all construction, start-up performance testing, operation and maintenance services for the Facility. The Authority deposited $100,000 with Covanta, which was used to pay for the first arising reimbursable expenses under the Agreement. On the 15th and 30th day of each month, the Authority paid Covanta 1/24th of the annual amount set forth in the estimated operating budget. Each month, Covanta reconciled the actual reimbursable expenses to the payments made by the Authority. For all reimburseable expenses incurred during the month in excess of such payments, Covanta submitted an invoice for such excess by the 10th day of the following month, which was to be paid by the Authority within 30 days. Reimbursable expenses are defined in the agreement. The Authority also paid an administrative service charge to Covanta in the amount of 11% of reimbursable expenses. The Interim Agreement was extended, on a month-to-month basis, through January 31, 2008.

The Authority then entered into a Management and Professional Services Agreement with Covanta to provide construction and operations management services for a period of ten years and the Retrofit Completion work. The terms and conditions of this agreement are substantially the same as the Interim Agreement, except that the management fee is $875,000 per month, escalated annually each calendar year.

The Authority had contractual relations with several vendors who completed the Resource Recovery Facility. These vendors were to be paid through a draw down from a construction advance provided by Covanta. Covanta failed to advance funds to pay these vendors when the Authority failed to reimburse Covanta on the advance, and the City failed under its guaranty of the Authority reimbursement. The Authority has been unable to pay the vendors since it does not believe the vendors costs are properly termed "operating expenses" and thus cannot be paid prior to debt service. The Authority has no defense to the claims as the work was approved by Covanta, the Authority, and the Authority's consulting engineer on the job. All have, at some point, demanded payment. One vendor has initiated a lawsuit which has been stayed due to an agreement to arbitrate all disputes. No movement toward arbitration has occurred. The Authority has stipulated to judgments of three vendors in the principal amount of $1,021,985 plus interest and court costs. Only one of the three vendors has sought payment through mandamus at this point. This vendor seeks an order that the Authority pay immediately. While not contesting the work or the right of each vendor to be paid, the Authority believes the vendors should be paid by Covanta through draw downs from the Covanta construction advance. Furthermore, the Authority recognizes the rights of the bond

Trustees which hold security interests in the Resource Recovery Facility revenues and has resisted paying the vendors ahead of debt service obligations. The Authority has involved the bond Trustees in discussions and litigation at this point. The Authority seeks to have the Court consider the equities and all interested parties and set forth a plan to get all vendors paid the amounts due. The Authority believes the law supports such an outcome. The Authority has a reasonable and valid basis for the positions it has taken. The principal amount due is accrued on the Authority's December 31, 2012 financial statements and may be handled through payment via a plan under Act 47, as amended.

During the years ended December 31, 2011 and 2012, the Authority conducted a forensic audit of the debt financings related to the Resource Recovery Facility. The Authority and other parties are evaluating the results of the forensic audit and any related outcome is subject to significant uncertainty.

When the Authority purchased the Resource Recovery Facility from the City in 1993, the Authority paid the City approximately $30 million in consideration. The Agreement of Sale allows for a maximum purchase price of $55 million, with the final purchase price to be based on the financial capability of the Resource Recovery Facility. The balance of the purchase price is to be paid only after the Authority completes financing of the improvements to the Facility described above, in such amount as is set forth in a report of the Authority's consulting engineer certifying that facility revenues upon completion of such improvements are sufficient to pay all operating expenses, debt service, and any other facility funding requirements. There were no additional payments required during the year ended December 31, 2012.

Water Segment

Management has not instituted a system to calculate the rate covenant requirement.

On January 18, 2011, the Authority issued a notice of material event with EMMA with respect to the Moody's Investor Service (Moody's) downgrade to Ba1 from A1 of the Authority's 2008 Water Revenue Bonds. In addition, Moody's has removed the Authority's 2008 Water Revenue Bonds from watchlist and a negative outlook has been assigned. On November 15, 2011, Moody's downgraded to Ba3 with negative outlook from Ba1 the rating on the Authority's 2008 Water Revenue Bonds and then withdrew the rating. Accordingly, the Authority's 2008 Water Revenue Bonds are no longer rated by Moody's.

On June 7, 2012, the Authority issued a notice of expiration of liquidity facility without replacement. The standby bond purchase agreement (liquidity facility), dated July 18, 2002, expired on July 18, 2012. The liquidity facility provides liquidity for the Authority's Variable Rate Water Revenue Refunding Bonds, Series B of 2002 and the Authority's Variable Rate Water Revenue Refunding Bonds, Series C of 2002. The Authority was notified that the liquidity facility would not be extended beyond the expiration date. As a result, the Authority issued a request for proposal dated April 12, 2012 seeking a replacement facility or a direct loan to replace the liquidity facility. Responses to the request for proposal were due on or before May 16, 2012. The Authority received no responses to this request for proposal.

Other

The Authority is involved in several lawsuits in the normal course of business. It is the opinion of management that any liabilities resulting from these proceedings would not materially affect the financial position of the Authority at December 31, 2012.

The Authority has guaranteed a line-of-credit on behalf of the National Civil War Museum. The maximum amount available under the line-of-credit is $500,000. As required by the agreement, the Authority has placed $250,000 in a separate account and this amount is included on the balance sheet as restricted cash and cash equivalents.

The Authority has entered into various construction and professional services contracts related to the construction of the various facilities. The outstanding commitment under these contracts at December 31, 2012, excluding amounts in accounts payable, was approximately $2.7 million.

13. RISK MANAGEMENT

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters for which the Authority carries commercial insurance. The Authority also requires the City to carry commercial insurance as part of the management agreement for the Water System. During the last three years, insurance settlements did not exceed insurance coverage.

14. LIQUIDITY

The Authority's Resource Recovery Facility, as required by the Environmental Protection Agency, was temporarily closed so that the Authority could undertake a modernization program. A significant financing was completed in December 2003 to fund the costs of the project. The contractor defaulted and was terminated as of December 31, 2006. In 2007, Covanta was retained to complete the project and take over management responsibilities. The Resource Recovery Segment has experienced significant operating losses, has an accumulated deficit of approximately $210 million at December 31, 2012, is in violation of certain covenants under the trust indentures, and payment defaults have occurred. The Authority has issued multiple notices of material events with EMMA with respect to certain bonds relating to the Resource Recovery Facility. Many of the above items were due to delays and significant cost overruns.

In the fall of 2007, the Authority developed a plan for the Resource Recovery Facility to complete construction and bring the three burners on line. The Authority engaged Covanta to manage and operate the Facility and to provide professional services. Included in Covanta's Agreement with the Authority was a construction management agreement to oversee the completion of construction. The recovery plan also included increased disposal fees and tipping fees and infusion of capital for construction and working capital.

The completion of the retrofit project and correction of design flaws caused by the original contractor were funded by a loan from Covanta to pay for such work. Payment of the debt service on the Covanta loan was subordinate in payment to the Authority's prior debt relating to the Resource Recovery Facility. Repayment of the debt service on the Covanta loan began prior to completion of the construction project. The Authority's revenues were insufficient to make payment on the loan and the City guarantee was called upon. The City made payments to Covanta until their financial situation precluded such payments in April 2010. Covanta has sued the Authority and the City for amounts that remain unpaid to Covanta under the loan. Additionally, approximately $2.0 million is owed to vendors on the retrofit completion project due to Covanta failing to release advance funds once the Authority and City were unable to make reimbursement payments.

The Authority also obtained funding for a working capital loan to cover costs and debt service during the expected time period for completion of the retrofit project by the issuance of capital appreciation notes. Such notes for the working capital loan were issued in December of 2007 and matured on December of 2010. Revenues from the Resource Recovery Facility were not pledged as security for the working capital loan. The working capital loan was guaranteed by the City and the County on the assumption that the working capital loan would be refinanced into long-term debt on or prior to December 2010. Only the County had the ability to refinance the working capital loan upon its maturity and did such at that time.

Since 2008, the Resource Recovery Facility has been able to cover operating expenses but unable to generate sufficient revenue to cover debt service and amounts due under the interest rate cap with RBC. As such, the Authority has drawn on debt service reserves, called upon guarantors, and insurance policies in order to make sure that bondholders were paid. Claims for fees associated with the guaranty and insurance agreements continue to accrue.

The Authority continues to pursue revenue enhancing and expense reducing activities, but will continue to rely upon reserves, guarantors and insurance until a coordinated solution is accomplished. To this end, the Authority is participating in the City's Act 47 process that seeks to provide a plan to eliminate the financial burden of the Resource Recovery Facility on the revenues, guarantors and insurance providers.

The Financially Distressed Municipalities Act, also known as Act 47, empowers the Pennsylvania Department of Community and Economic Development (DCED) to declare certain municipalities as financially distressed. On October, 1, 2010, Mayor Linda D. Thompson filed a request asking for the City to be designated a financially distressed municipality. DCED investigated the financial affairs of the City and, on December 15, 2010, following public hearings on the City's request, DCED issued a determination of municipal financial distress for the City.

A recovery plan (Coordinator's Act 47 Recovery Plan) was developed. However, on July 19, 2011, a majority of the Harrisburg City Council rejected the Coordinator's Act 47 Recovery Plan. Following the City Council's rejection of the Act 47 Recovery Plan, Mayor Thompson was tasked with developing and filing an alternate Recovery Plan pursuant the provisions of Act 47. The Mayor filed a Recovery Plan on August 22, 2011 and on August 31, 2011, a majority of Harrisburg City Council rejected Mayor Thompson's Recovery Plan and again rejected a modified plan on September 13, 2011.

On September 20, 2011, Governor Tom Corbett signed into law Senate Bill 1151, amending Act 47 and providing for a Declaration of Fiscal Emergency in circumstances in which a financially distressed city of the third class fails to adopt a financial recovery plan. Additionally, the law provides for the appointment and confirmation of a receiver if the distressed city fails to enact a consent agreement to adopt and implement a recovery plan.

As a result of the fiscal circumstances existing in the City, Governor Corbett declared a fiscal emergency on October 24, 2011. As part of the Emergency Declaration, Governor Corbett directed the Secretary of DCED, C. Alan Walker, to develop an Emergency Action Plan to ensure all vital and necessary services are maintained in the City until a fiscal recovery plan is enacted.

On November 18, 2011, a Receiver was appointed, who is tasked with developing and submitting a fiscal recovery plan to the Commonwealth Court, DCED Secretary, City Council, and the Mayor.

The Receiver's recovery plan was submitted, the Commonwealth Court held a hearing and the Court confirmed the Receiver's Recovery Plan.

At this time, the Office of the Receiver is pursuing implementation of the Receiver's Recovery Plan and actively negotiating resolution of the City's fiscal crisis and seeking resolution with creditors of the City and the Authority relating to the outstanding Resource

Recovery Facility debt. The Receiver's Recovery Plan includes the potential sale of the Resource Recovery Facility.

15. SUBSEQUENT EVENTS

Subsequent events with respect to material event notices with EMMA and debt related items are included in the respective notes.

In April 2011, the Authority applied for a PennVest loan, in the amount not to exceed $5.7 million for the purpose of financing the Authority's water system improvements. As of the date of this report, this loan has not settled.

In July 2013, the PennVest offered the Authority a loan, in the amount not to exceed $26 million for the purpose of financing the Authority's improvements to the Advanced Waste Treatment Facility. This is a 20-year low interest loan. As of the date of this report, this loan has not settled.

In 2013, the Authority has entered into multiple contracts with respect to the GIS project in the amount of approximately $2.3 million.

Supplementary Information

THE HARRISBURG AUTHORITY

COMBINING BALANCE SHEET

DECEMBER 31, 2012

Assets	Water Segment	Sewer Segment	Resource Recovery Segment	Working Capital Fund	Total
Current assets:					
Cash and cash equivalents	$ 6,534,085	$ -	$ 5,228,157	$ 1,079,841	$ 12,842,083
Accounts receivable, net of allowance for uncollectible accounts of $1,383,998, zero, $123,195, and zero	3,015,454	-	1,121,871	1,821	4,139,146
Prepaid expenses	-	-	980,788	-	980,788
Due from the City of Harrisburg	-	223,494	897,688	-	1,121,182
Due from (to) other funds	911,570	231,510	(1,414,999)	271,919	-
Current portion of direct financing lease	-	80,163	-	-	80,163
Current portion of advances to the City of Harrisburg	-	193,024	-	-	193,024
Total current assets	10,461,109	728,191	6,813,505	1,353,581	19,356,386
Restricted assets:					
Cash and cash equivalents - restricted under trust indentures and guarantee agreement	2,459,183	3,310,965	3,399,827	250,000	9,419,975
Investments - restricted under trust indentures	31,545,562	213,239	6,721,295	-	38,480,096
Total restricted assets	34,004,745	3,524,204	10,121,122	250,000	47,900,071
Noncurrent assets:					
Direct financing leases, net of unearned income of zero, $352,067, zero, and zero	-	1,517,004	-	-	1,517,004
Advances to the City of Harrisburg	-	1,053,375	-	-	1,053,375
Capital assets, not being depreciated	338,092	-	-	351,865	689,957
Capital assets, being depreciated, net of accumulated depreciation of $43,417,556, zero, $36,844,712, and zero	60,858,385	-	108,392,829	-	169,251,214
Debt financing costs, net of accumulated amortization of $3,704,674, zero, $7,368,281, and zero	3,595,691	-	5,835,531	-	9,431,222
Deposits	-	-	350	-	350
Derivative assets	-	-	2,070,232	-	2,070,232
Total noncurrent assets	64,792,168	2,570,379	116,298,942	351,865	184,013,354
Total Assets	$ 109,258,022	$ 6,822,774	$ 133,233,569	$ 1,955,446	$ 251,269,811

(Continued)

THE HARRISBURG AUTHORITY

COMBINING BALANCE SHEET

DECEMBER 31, 2012
(Continued)

Liabilities and Net Position	Water Segment	Sewer Segment	Resource Recovery Segment	Working Capital Fund	Total
Liabilities:					
Current liabilities:					
Accounts payable and accrued liabilities	$ 99,132	$ -	$ -	$ 1,288	$ 100,420
Accrued interest payable	-	-	6,085,233	-	6,085,233
Current portion of capital lease payable	-	-	15,000,000	-	15,000,000
Current portion of amount due to the City of Harrisburg	1,098,997	-	76,571,199	-	77,670,196
Total current liabilities	1,198,129	-	97,656,432	1,288	98,855,849
Liabilities payable from restricted assets:					
Accounts payable	-	-	3,615,536	-	3,615,536
Accrued interest payable	2,968,431	-	3,228,709	-	6,197,140
Current portion of loan payable	-	-	8,645,310	-	8,645,310
Current portion of notes payable	-	273,187	940,000	-	1,213,187
Current portion of bonds payable	5,111,000	-	3,270,000	-	8,381,000
Total liabilities payable from restricted assets	8,079,431	273,187	19,699,555	-	28,052,173
Noncurrent liabilities:					
Due to the City of Harrisburg	64,924	-	-	-	64,924
Loan payable	-	-	11,178,190	-	11,178,190
Notes payable, net of premium of zero, zero, $738,439, and zero	-	2,580,737	65,518,439	-	68,099,176
Bonds outstanding, net of premium and deferred losses on refunding of $13,477,356, zero, $3,135,629, and zero	131,651,644	-	140,629,371	-	272,281,015
Derivative liability	-	-	5,794,328	-	5,794,328
Unearned revenue	1,051,997	-	503,990	1,395,312	2,951,299
Accrued landfill closure and post-closure care liability	-	-	2,037,568	-	2,037,568
Liability for obligations to construct assets under direct financing leases	-	702,755	-	-	702,755
Total noncurrent liabilities	132,768,565	3,283,492	225,661,886	1,395,312	363,109,255
Total Liabilities	142,046,125	3,556,679	343,017,873	1,396,600	490,017,277
Net Position:					
Net investment in capital assets	(43,393,345)	-	(133,545,597)	351,865	(176,587,077)
Restricted					
Debt service	-	213,239	-	-	213,239
Construction	-	3,310,965	-	-	3,310,965
Landfill closure	-	-	1,362,259	-	1,362,259
Guarantee agreement	-	-	-	250,000	250,000
Water operations	2,459,183	-	-	-	2,459,183
Unrestricted	8,146,059	(258,109)	(77,600,966)	(43,019)	(69,756,035)
Total Net Position	(32,788,103)	3,266,095	(209,784,304)	558,846	(238,747,466)
Total Liabilities and Net Position	$ 109,258,022	$ 6,822,774	$ 133,233,569	$ 1,955,446	$ 251,269,811

(Concluded)

THE HARRISBURG AUTHORITY

COMBINING SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

YEAR ENDED DECEMBER 31, 2012

	Water Segment	Sewer Segment	Resource Recovery Segment	Working Capital Fund	Total
Operating Revenues:					
User charges	$ 16,625,586	$ -	$ 24,577,308	$ -	$ 41,202,894
Administrative fees	-	328,490	-	1,765,057	2,093,547
Total operating revenues	16,625,586	328,490	24,577,308	1,765,057	43,296,441
Operating Expenses:					
Operating	4,993,871	-	22,399,066	-	27,392,937
Administrative	307,103	328,490	1,129,464	1,314,855	3,079,912
Depreciation	2,109,865	-	5,367,544	-	7,477,409
Landfill closure and post-closure care expense	-	-	(227,768)	-	(227,768)
Total operating expenses	7,410,839	328,490	28,668,306	1,314,855	37,722,490
Operating Income (Loss)	9,214,747	-	(4,090,998)	450,202	5,573,951
Non-Operating Revenues (Expenses):					
Investment income (loss)	1,761,960	4,265	(2,889,059)	6,317	(1,116,517)
Lease rental income	-	58,714	-	-	58,714
Miscellaneous income (expense)	35,079	(7,707)	14,036	142,742	184,150
Interest expense	(8,884,223)	(170,806)	(14,659,183)	-	(23,714,212)
Gain on sale of assets	-	-	6,000	-	6,000
Amortization of debt financing costs	(411,594)	(3,316)	(773,402)	-	(1,188,312)
Total non-operating revenues (expenses)	(7,498,778)	(118,850)	(18,301,608)	149,059	(25,770,177)
Change in Net Position	1,715,969	(118,850)	(22,392,606)	599,261	(20,196,226)
Net Position:					
Beginning of year	(34,504,072)	3,384,945	(187,391,698)	(40,415)	(218,551,240)
End of year	$ (32,788,103)	$ 3,266,095	$ (209,784,304)	$ 558,846	$ (238,747,466)

THE HARRISBURG AUTHORITY

COMBINING SCHEDULE OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2012

	Water Segment	Sewer Segment	Resource Recovery Segment	Working Capital Fund	Total
Cash Flows From Operating Activities:					
Receipts from customers and users	$ 16,497,541	$ 112,289	$ 25,851,536	$ 23,992	$ 42,485,358
Receipts for interfund services	-	-	-	1,174,460	1,174,460
Payments to suppliers	-	-	(23,660,480)	(1,328,940)	(24,989,420)
Payments to management agent	(5,661,169)	-	-	-	(5,661,169)
Payments for interfund services	(512,224)	(431,000)	(231,236)	-	(1,174,460)
Net cash provided by (used in) operating activities	10,324,148	(318,711)	1,959,820	(130,488)	11,834,769
Cash Flows From Investing Activities:					
Sales (purchases) of investments, net	(763,343)	3,958,116	1,438,312	-	4,633,085
Investment income received	832,753	5,549	47,201	6,317	891,820
Payments received on direct financing leases	-	142,674	-	-	142,674
Net cash provided by investing activities	69,410	4,106,339	1,485,513	6,317	5,667,579
Cash Flows from Capital and Related Financing Activities:					
Increase in obligation to construct assets under direct financing lease	-	703,473	-	-	703,473
Decrease in advances to the City of Harrisburg	-	190,215	81,511	-	271,726
Acquisition and construction of capital assets	(493,639)	-	(3,738,467)	-	(4,232,106)
Interest paid	(7,626,954)	(58,892)	(8,506,446)	-	(16,192,292)
Principal paid on capital lease	(45,816)	-	-	-	(45,816)
Principal paid on long-term debt	(3,300,000)	(2,003,997)	(4,005,000)	-	(9,308,997)
Receipts from bond insurance and debt guarantees	-	-	11,181,675	-	11,181,675
Transfers to the City's sewer operating fund	-	(324,659)	-	-	(324,659)
Net cash used in capital and related financing activities	(11,466,409)	(1,493,860)	(4,986,727)	-	(17,946,996)
Increase (Decrease) in Cash and Cash Equivalents	(1,072,851)	2,293,768	(1,541,394)	(124,171)	(444,648)
Cash and Cash Equivalents:					
Beginning of year	10,066,119	1,017,197	10,169,378	1,454,012	22,706,706
End of year	$ 8,993,268	$ 3,310,965	$ 8,627,984	$ 1,329,841	$ 22,262,058

(Continued)

THE HARRISBURG AUTHORITY

COMBINING SCHEDULE OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2012
(Continued)

	Water Segment	Sewer Segment	Resource Recovery Segment	Working Capital Fund	Total
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities:					
Operating income (loss)	$ 9,214,747	$ -	$ (4,090,998)	$ 450,202	$ 5,573,951
Adjustments to reconcile operating income (loss) to cash provided by (used in) operating activities:					
Depreciation	2,109,865	-	5,367,544	-	7,477,409
Miscellaneous nonoperating income (expense)	35,079	(7,707)	14,036	23,992	65,400
(Increase) decrease in accounts receivable	(128,045)	-	1,274,228	-	1,146,183
Increase in prepaid expenses	-	-	(380,788)	-	(380,788)
(Increase) decrease in due from (to) other funds	(205,121)	(102,510)	898,228	(590,597)	-
Increase in due from City of Harrisburg	(750,599)	(208,494)	-	-	(959,093)
Increase (decrease) in accounts payable	48,222	-	(689,205)	(14,085)	(655,068)
Increase in due to City of Harrisburg	-	-	(205,457)	-	(205,457)
Decrease in accrued landfill closure and post-closure care liability	-	-	(227,768)	-	(227,768)
Net cash provided by (used in) operating activities	$ 10,324,148	$ (318,711)	$ 1,959,820	$ (130,488)	$ 11,834,769

(Concluded)