

Capital Region Water

Financial Statements and Supplementary Information

Year Ended December 31, 2014 with
Independent Auditor's Report

MaherDuessel
Certified Public Accountants

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CAPITAL REGION WATER

YEAR ENDED DECEMBER 31, 2014

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Independent Auditor's Report

Members of the Board of Directors
Capital Region Water

We have audited the accompanying financial statements of Capital Region Water (CRW) as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise CRW'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 CRW as of December 31, 2014, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise CRW'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 28, 2015

CAPITAL REGION WATER

BALANCE SHEET

DECEMBER 31, 2014

Assets and Deferred Outflows of Resources

Assets:

Current assets:

Cash and cash equivalents	\$ 23,322,533
Accounts receivable, net of allowance for uncollectible accounts of \$7,671,742	7,020,518
Other receivables	1,370,830
Prepaid expenses	452,506
Inventory	525,602
Total current assets	<u>32,691,989</u>

Restricted assets:

Cash and cash equivalents - restricted under trust indentures and guarantee agreement	2,922,838
Investments - restricted under trust indentures	55,058,565
Total restricted assets	<u>57,981,403</u>

Noncurrent assets:

Capital assets, not being depreciated	23,682,064
Capital assets, net of accumulated depreciation of \$109,927,151	93,103,133
Prepaid debt insurance costs	289,419
Total noncurrent assets	<u>117,074,616</u>

Total Assets

207,748,008

Deferred Outflows of Resources:

Deferred loss on refunding	<u>10,313,856</u>
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**Total Assets and Deferred Outflows
of Resources**

\$218,061,864

Liabilities and Net Position

Liabilities:

Current liabilities:

Accounts payable and accrued liabilities	\$ 7,709,376
Current portion of compensated absences	510,145
Total current liabilities	<u>8,219,521</u>

Liabilities payable from restricted assets:

Accrued interest payable	2,896,571
Current portion of notes payable	174,787
Current portion of bonds payable	5,005,000
Total liabilities payable from restricted assets	<u>8,076,358</u>

Noncurrent liabilities:

Compensated absences	227,292
Notes payable	8,477,834
Bonds outstanding, net of discount of \$672,526	165,528,474
Unearned revenue	904,748
Total noncurrent liabilities	<u>175,138,348</u>

Total Liabilities

191,434,227

Net Position:

Net investment in capital assets	(15,148,499)
Restricted:	
Guarantee agreement	250,000
Water operations	19,802,379
Sewer operations	20,626,935
Insurer agreement	686,455
Unrestricted	410,367
Total Net Position	<u>26,627,637</u>

Total Liabilities and Net Position

\$218,061,864

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

CAPITAL REGION WATER
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN NET POSITION
YEAR ENDED DECEMBER 31, 2014

Operating Revenues:	
User charges	\$ 36,339,138
Administrative fees	363,483
Total operating revenues	36,702,621
Operating Expenses:	
Operating	12,205,882
Administrative	3,047,588
Depreciation	4,000,541
Total operating expenses	19,254,011
Operating Income	17,448,610
Non-Operating Revenues (Expenses):	
Investment income	1,353,237
Miscellaneous income	202,298
Interest expense	(9,543,562)
Total non-operating revenues (expenses)	(7,988,027)
Change in Net Position Before Special Item	9,460,583
Special item	(389,217)
Change in Net Position	9,071,366
Net Position:	
Beginning of year	17,556,271
End of year	\$ 26,627,637

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

CAPITAL REGION WATER

STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2014

Cash Flows From Operating Activities:

Receipts from customers and users	\$ 37,974,882
Payments to employees	(3,624,309)
Payments to suppliers	(12,054,559)
Net cash provided by operating activities	<u>22,296,014</u>

Cash Flows From Investing Activities:

Purchases of investments, net	(25,959,626)
Investment income received	1,267,524
Net cash used in investing activities	<u>(24,692,102)</u>

Cash Flows From Capital and Related Financing Activities:

Proceeds from debt issuance	36,660,634
Bond discount	(148,300)
Acquisition and construction of capital assets	(13,679,132)
Interest paid	(8,327,431)
Principal paid on long-term debt	(4,464,973)
Payment to bond insurer	(901,682)
Net cash provided by capital and related financing activities	<u>9,139,116</u>

Increase in Cash and Cash Equivalents

6,743,028

Cash and Cash Equivalents:

Beginning of year	19,502,343
End of year	<u>\$ 26,245,371</u>

Reconciliation of Operating Income to Net

Cash Provided by Operating Activities:

Operating income	\$ 17,448,610
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	4,000,541
Miscellaneous nonoperating income	559,426
Increase in accounts receivable	(1,144,229)
Decrease in other receivable	1,634,819
Increase in prepaid expenses	(190,347)
Decrease in inventory	78,933
Decrease in accounts payable	(196,147)
Increase in compensated absences	104,408
Net cash provided by operating activities	<u>\$ 22,296,014</u>

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

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

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. In March 2014, the Authority filed Articles of Amendment with the Pennsylvania Department of State to change its name to Capital Region Water (CRW). The purpose of CRW is, among other things, to engage in public works projects relating to the ownership and operation of the water system and wastewater treatment and conveyance systems. CRW also maintains responsibility for winding down certain administrative, contractual, and minor operating activities of the previously owned resource recovery facility. Additionally, CRW issued nonrecourse tax-exempt debt for other entities for the purpose of financing capital improvement projects.

CRW determined that it is no longer a component unit of the City of Harrisburg (City) reporting entity as of and for the year ended December 31, 2014. Criteria considered in making this determination include appointment of CRW's Board of Directors (Board), financial interdependence, and CRW's potential to provide specific financial benefits to, or impose specific financial burdens on the City. The City bears no financial benefit or burden for CRW, and is not financially accountable for CRW. Therefore, the City does not include CRW in its financial statements as a component unit.

Basis of Presentation

All activities of CRW 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 CRW administration are financed or recovered through user charges, administration charges, and income on investments held by CRW.

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 CRW are charges for water and wastewater treatment and conveyance systems 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.

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

Basis of Accounting

CRW'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. CRW follows the accounting and financial reporting standards issued by the Governmental Accounting Standards Board (GASB).

The accounting and financial reporting treatment applied to CRW is determined by its measurement focus. The transactions of CRW 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 and deferred outflows of resources net of total liabilities) is segregated into "Net investment in capital assets;" "Restricted for" various purposes; and "Unrestricted" components.

Non-recourse Debt Issues

CRW participates in a single bond issue for which it has limited liability. CRW serves as a financing conduit. Although CRW is a party to the trust indenture with the associated Trustee, the agreement is structured such that there is no recourse against CRW in the case of default. As such, the corresponding debt is not reported in CRW's balance sheet, but is disclosed in Note 8.

Cash and Cash Equivalents

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

Investments

With the exception of investment contracts, which are at contract value, CRW accounts for investments at fair value. The fair value of CRW'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 REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

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 is calculated using a 2% annual rate. For acquisitions subsequent to this date, 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	50 years
Office equipment	5-15 years
Office furnishings	15 years
Operating equipment	10-50 years
Vehicles	7 years

Capital assets transferred to the Sewer Segment from the City, as part of the transition agreement, are depreciated using the straight-line method, over the estimated useful lives, as follows:

Buildings and improvements	5 to 100 years
Equipment and furniture	5 to 20 years
Infrastructure	5 to 100 years

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

Debt Financing Costs

Prepaid debt insurance 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 prepaid debt insurance costs are reported as an asset, deferred losses on refundings are reported as a deferred outflow of resources, and the unamortized discounts/premiums are reported as an reduction/addition from the outstanding bonds.

Unearned Revenue

Unearned revenue, consisting of monies received from a debt service forward delivery agreement, is being amortized to interest income over the life of the agreement using a method that approximates the interest rate method.

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 CRW's policy to use restricted resources first, then unrestricted resources as they are needed.

Use of Estimates

Management of CRW has made a number of estimates and assumptions relating to the reporting of assets, deferred outflows of resources, 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

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Special Item

Special items are significant transactions or other events within the control of management that are either unusual in nature or infrequent in occurrence.

Pending GASB Pronouncements

In June 2012, the GASB issued Statement No. 68, *“Accounting and Financial Reporting for Pension.”* In addition, in November 2013, the GASB issued Statement No. 71, *“Pension Transition for Contributions Made Subsequent to the Measurement Date.”* These Statements revise and establish reporting requirements for most governments that provide their employees with pension benefits. The provisions of GASB Statements No. 68 and 71 are effective for CRW’s December 31, 2015 financial statements.

In February 2015, the GASB issued Statement No. 72, *“Fair Value Measurement and Application.”* This Statement addresses accounting and financial reporting issues related to fair value measurements. The provisions of GASB Statement No. 72 are effective for CRW’s December 31, 2016 financial statements.

In June 2015, the GASB issued Statement No. 73, *“Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB 68, and Amendments to Certain Provisions of GASB Statements 67 and 68.”* This Statement establishes requirements for those pensions and pension plans that are not administered through a trust meeting specified criteria (those not covered by Statements No. 67 and 68). The provisions of GASB Statement No. 73 are effective for CRW’s December 31, 2016 financial statements – except those provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement No. 68, which are effective for CRW’s December 31, 2017 financial statements.

In June 2015, the GASB issued Statement No. 74, *“Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.”* This Statement addresses reporting by OPEB plans that administer benefits on behalf of governments. This Statement replaces Statement No. 43. The provisions of GASB Statement No. 74 are effective for CRW’s December 31, 2017 financial statements.

In June 2015, the GASB issued Statement No. 75, *“Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions.”* This Statement addressed reporting by governments that provide OPEB to their employees and for governments that finances OPEB for employees of other governments. This Statement replaces the requirements of Statement

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NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

No. 45. The provisions of GASB Statement No. 75 are effective for CRW's December 31, 2018 financial statements.

In June 2015, the GASB issued Statement No. 76, "*Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.*" This Statement identifies the hierarchy of generally accepted accounting principles (GAAP), reduces this hierarchy to two categories of authoritative GAAP, and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This Statement supersedes Statement No. 55. The provisions of Statement No. 76 are effective for CRW's December 31, 2016 financial statements.

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

2. SPECIAL ITEM

Resource Recovery Segment

On December 23, 2013, CRW sold its resource recovery facility for \$129.898 million, which after taking into account \$8 million released under the Indenture netted \$121.898 million. These proceeds, along with funds transferred from the City, cash on hand, and contributions from the bond insurer were used to pay the costs associated with the sale, termination fees associated with the resource recovery segment derivative financial instruments, and the outstanding debt of the facility. Costs to wind down the facility continued throughout the year ended December 31, 2014. In accordance with an agreement with the bond insurer, any proceeds remaining, after all reasonable expenses are paid out of the resource recovery segment, will be paid to the bond insurer. During the year ended December 31, 2014, approximately \$900,000 was paid to the bond insurer. This amount has been offset by a refund of insurance costs in the amount of approximately \$200,000 and the settlement of vendor payables in the amount of approximately \$300,000.

3. 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.

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

The deposit and investment policy of CRW 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 CRW at December 31, 2014 were as follows:

Cash and cash equivalents:	
Unrestricted	\$ 23,322,533
Restricted under trust indentures and guarantee agreement	<u>2,922,838</u>
	<u>\$ 26,245,371</u>

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. CRW does not have a deposit policy for custodial credit risk. As of December 31, 2014, CRW’s book balance was \$26,245,371 and the bank balance was \$26,377,628. Of the bank balance, \$820,317 was covered by federal depository insurance and \$25,557,311 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 investments of CRW at December 31, 2014 were as follows:

Restricted:	
Money market funds	\$ 38,402,875
U.S. Government agency obligations	2,799,690
Investment contracts	<u>13,856,000</u>
Total	<u>\$ 55,058,565</u>

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. CRW does not have a formal investment policy for custodial credit risk. All of CRW’s investments are held by the counterparty’s trust department or agent not in CRW’s name.

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

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

	Fair (Contract) Value	% of Total
JP Morgan Investment Contracts	\$ 13,856,000	25.17%

Credit Risk – CRW does not have a formal policy that would limit its investment choices with regard to credit risk. CRW's money market funds and fixed income investments had the following level of exposure to credit risk as of December 31, 2014:

	Fair (Contract) Value	Rating
Money market funds	\$ 38,402,875	AAA
U.S. Government agency obligations	2,799,690	AAA
Investment contract	4,731,000	AA+
Investment contract	6,300,000	A-
Investment contract	2,825,000	BBB-

Interest Rate Risk – CRW 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 CRW's money market and fixed income investments and their related average maturities:

	Fair (Contract) Value	Investment Maturity (in Years)			
		Less than 1	1-5	6-10	Greater than 10
Money market funds	\$ 38,402,875	\$ 38,402,875	\$ -	\$ -	\$ -
U.S. Government agency obligations	2,799,690	2,799,690	-	-	-
Investment contracts	13,856,000	-	-	-	13,856,000
Total	<u>\$ 55,058,565</u>	<u>\$ 41,202,565</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,856,000</u>

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

4. CAPITAL ASSETS

Capital assets for the year ended December 31, 2014 are as follows:

	Balance at January 1, 2014	Additions/ Transfers In	Retirements/ Transfers Out	Balance at December 31, 2014
Capital assets, not being depreciated:				
Land	\$ 361,421	\$ -	\$ -	\$ 361,421
Construction in progress	7,784,564	17,091,462	(1,555,383)	23,320,643
Total capital assets, not being depreciated	<u>8,145,985</u>	<u>17,091,462</u>	<u>(1,555,383)</u>	<u>23,682,064</u>
Capital assets, being depreciated:				
Land improvements	1,497,605	-	-	1,497,605
Buildings and improvements	67,541,117	165,957	-	67,707,074
Furniture and fixtures	363,779	281,904	-	645,683
Machinery and equipment	130,872,769	2,307,153	-	133,179,922
Total capital assets, being depreciated	<u>200,275,270</u>	<u>2,755,014</u>	<u>-</u>	<u>203,030,284</u>
Less: accumulated depreciation	<u>(105,926,610)</u>	<u>(4,000,541)</u>	<u>-</u>	<u>(109,927,151)</u>
Total capital assets being depreciated, net	<u>94,348,660</u>	<u>(1,245,527)</u>	<u>-</u>	<u>93,103,133</u>
Total capital assets, net	<u>\$ 102,494,645</u>	<u>\$ 15,845,935</u>	<u>\$ (1,555,383)</u>	<u>\$ 116,785,197</u>

5. UNEARNED REVENUE

CRW had entered into a derivative product agreement, which consists of a debt service forward delivery agreement with a financial intermediary that results in a forward swap of interest earned on amounts placed in the debt service sinking fund. In exchange for a cash payment to CRW at the inception of the agreement totaling approximately \$1.765 million, 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 amount received was recorded as unearned revenue in CRW's financial statements because the substance of this agreement effectively is to pay CRW currently for interest that normally would be earned in later years. The unearned revenue resulting from this transaction of \$904,748 at December 31, 2014 is being amortized over the life of the agreement under a method that approximates the interest method.

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NOTES TO FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2014

6. LONG-TERM DEBT

CRW has issued various revenue serial and term bonds and notes to finance various projects and refundings. A schedule of CRW's bonds and notes outstanding at December 31, 2014 follows:

	<u>Issue Amount</u>	<u>Maturity/ Mandatory Redemption</u>	<u>Interest Rates</u>	<u>Purpose</u>
2014 Sewer Revenue Bonds Series B	\$ 29,660,000	2017 - 2036	variable	Finance a portion of the engineering, design, and construction of improvements to CRW's wastewater treatment facility and various expenditures relating to CRW's long-term control plan, and CRW's geographic information system project
2014 Sewer Revenue Note Series C	21,500,000	2014 - 2030	1.27% - 2.55%	Payment of, and reimbursement of CRW for, certain capital expenditures including those related to engineering, design, and construction of improvements to CRW's wastewater treatment facility and various expenditures relating to CRW's long-term control plan, and CRW's geographic information system project
2009 Sewer Revenue Note	1,880,000	2011 - 2031	1.27% - 2.55%	Finance capital improvements and replacements to CRW's wastewater treatment facility
2008 Water Revenue Bonds	69,420,000	2024 - 2031	4.88% - 5.25%	Currently refund the outstanding balance of CRW's Variable Rate Water Revenue Refunding Bonds, Series A of 2003 and fund a swap termination payment
2004 Water Revenue Bonds	37,455,000	2005 - 2023	1.5% - 5.0%	Currently refund CRW's outstanding Water Revenue Refunding Bonds, Series A-1, A-2, and A-3 of 1994 and payment of 2004 swap termination payment

CAPITAL REGION WATER
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2014

	<u>Issue Amount</u>	<u>Maturity/ Mandatory Redemption</u>	<u>Interest Rates</u>	<u>Purpose</u>
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
Series B	23,035,000	2011 - 2017	variable	Purchase 1999 Series C Water Revenue Refunding Bonds
Series C	7,700,000	2013 - 2019	variable	Fund the 2002 Debt Service Reserve Fund Account
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
1998 Sewer Revenue Note:				
Series B	1,864,000	1999 - 2017	1.536% - 3.071%	Finance projects related to the sewage collection system

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NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

2002 Water Revenue Bonds, Series B

These Bonds bear interest at one month LIBOR plus 325 basis points, 3.4195 percent at December 31, 2014.

2002 Water Revenue Bonds, Series C

These Bonds bear interest at one month LIBOR plus 325 basis points, 3.4195 percent at December 31, 2014.

2014 Sewer Revenue Bonds, Series B

These Bonds bear interest at a LIBOR index rate plus a spread, .04 percent at December 31, 2014.

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NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2014

The following table presents annual principal and interest payments for long-term debt outstanding at December 31, 2014:

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Bonds outstanding:				
Water Revenue Bonds:				
Series of 2008	\$ 3,555,300	\$ 3,555,300	\$ 3,555,300	\$ 3,555,300
Series of 2004	1,960,200	1,964,000	2,177,400	7,092,000
Series A of 2002	767,000	767,000	767,000	767,000
Series B of 2002 (A)	3,822,011	4,743,256	4,800,605	-
Series C of 2002 (A)	235,032	239,105	239,105	239,105
Series A of 2001	1,501,500	-	-	-
Sewer Revenue Bonds:				
Series B of 2014 (A)	12,033	12,033	636,990	666,731
Total principal and interest, bonds	<u>\$ 11,853,076</u>	<u>\$ 11,280,694</u>	<u>\$ 12,176,400</u>	<u>\$ 12,320,136</u>
Less:				
Interest				
Unamortized discount				
Total bonds outstanding, net of discount				
Notes payable:				
Sewer Revenue Notes:				
Series C of 2014	\$ 70,006	\$ 70,006	\$ 386,346	\$ 386,346
Series of 2009	104,167	105,469	105,469	105,469
Series B of 1998	94,584	94,584	73,665	-
Total principal and interest, notes	<u>\$ 268,757</u>	<u>\$ 270,059</u>	<u>\$ 565,480</u>	<u>\$ 491,815</u>
Less:				
Interest				
Total notes payable				

(A) - Uses variable rate in effect at December 31, 2014 as disclosed on page 16.

<u>2019</u>	<u>2020 to 2024</u>	<u>2025 to 2029</u>	<u>2030 to 2034</u>	<u>2035 to 2039</u>	<u>2040 to 2041</u>	<u>Total</u>
\$ 3,555,300	\$ 18,191,500	\$ 57,407,112	\$ 27,103,538	\$ -	\$ -	\$120,478,650
7,476,250	27,157,500	-	-	-	-	47,827,350
767,000	17,337,750	1,887,500	-	-	-	23,060,250
-	-	-	-	-	-	13,365,872
239,105	1,195,525	7,611,898	-	-	-	9,998,875
-	-	-	-	-	-	1,501,500
<u>701,466</u>	<u>4,037,863</u>	<u>5,118,831</u>	<u>6,507,362</u>	<u>8,267,834</u>	<u>3,907,139</u>	<u>29,868,282</u>
<u>\$ 12,739,121</u>	<u>\$ 67,920,138</u>	<u>\$ 72,025,341</u>	<u>\$ 33,610,900</u>	<u>\$ 8,267,834</u>	<u>\$ 3,907,139</u>	<u>246,100,779</u>
						74,894,779
						<u>672,526</u>
						<u>\$170,533,474</u>
\$ 395,730	\$ 1,978,650	\$ 1,978,650	\$ 1,978,650	\$ 791,460	\$ -	\$ 8,035,844
105,469	527,345	527,345	105,469	-	-	1,686,202
-	-	-	-	-	-	262,833
<u>\$ 501,199</u>	<u>\$ 2,505,995</u>	<u>\$ 2,505,995</u>	<u>\$ 2,084,119</u>	<u>\$ 791,460</u>	<u>\$ -</u>	<u>9,984,879</u>
						1,332,258
						<u>\$ 8,652,621</u>

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

Long-term liability activity for the year ended December 31, 2014 was as follows:

	Beginning Balance at January 1, 2014	Additions	Amortization	Reductions	Ending Balance at December 31, 2014	Amounts Due Within One Year
Line of credit	\$ -	\$ 86,205	\$ -	\$ (86,205)	\$ -	\$ -
Notes payable	2,533,960	7,000,634	-	(881,973)	8,652,621	174,787
Bonds payable	145,129,000	29,660,000	-	(3,583,000)	171,206,000	5,005,000
Compensated absences	633,029	522,502	-	(418,094)	737,437	510,145
Total long-term liabilities	148,295,989	37,269,341	-	(4,969,272)	180,596,058	5,689,932
Less:						
Unamortized discount	(522,947)	(148,300)	(1,279)	-	(672,526)	-
	<u>\$ 147,773,042</u>	<u>\$ 37,121,041</u>	<u>\$ (1,279)</u>	<u>\$ (4,969,272)</u>	<u>\$ 179,923,532</u>	<u>\$ 5,689,932</u>

In March 2014, CRW issued Wastewater System Revenue Note, Series of 2014A (Series of 2014A Note), with a maximum principal amount outstanding at any time of \$2 million. The Series of 2014A Note was issued to serve as a revolving line of credit for the payment of and reimbursement to CRW for certain capital expenditures related to the engineering, design, and construction of the advanced wastewater treatment facility. Proceeds of the Sewer Revenue Bonds, Series of 2014B, were used to pay for amounts drawn on the Series of 2014A Note.

In July 2014, CRW issued Sewer Revenue Bonds, Series of 2014B, Variable Rate Demand Bonds (Series of 2014B Bonds) in the amount of \$29,660,000 to be applied to finance the costs of a project consisting of a portion of the engineering, design, and construction of improvements to CRW's advanced wastewater treatment facility and various expenditures relating to CRW's long-term control plan and CRW's geographic information system project; fund the various reserves, if required; the payment of interest during construction, if required; and the payment of costs of issuance of the Series of 2014B Bonds. The Series of 2014B Bonds are secured by a letter of credit issued by Manufacturers and Traders Trust Company, which expires (unless extended) on July 10, 2017. Upon issuance and prior to the conversion date to a different mode, the Series of 2014B Bonds other than pledged bonds will bear interest at the weekly rate, which will be a variable rate established by the remarking agent. In no event shall the weekly rate for the Series of 2014B Bonds exceed ten percent per annum unless increased in accordance with the terms of the indenture. As set forth in the indenture, the Series of 2014B Bonds may be converted or reconverted to bear interest in a weekly mode, monthly mode, multiannual mode, or bank purchase rate mode or converted to a fixed rate mode.

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

In order to provide additional funds to complete the advanced wastewater treatment facility project, CRW issued a Sewer Revenue Note, Series of 2014C (Series of 2014C Note) in the amount of \$21,500,000. The Series of 2014C Note is interest-only for three years and amortizes over a period of 20 years. Interest is fixed at 1% for years one through five and 1.275% thereafter.

On July 11, 2012, CRW'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. CRW's Variable Rate Water Revenue Refunding Bonds, Series B of 2002 were 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 and bore interest at Dexia's prime rate, plus 1%.

On July 11, 2012, CRW'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. CRW's Variable Rate Water Revenue Refunding Bonds, Series C of 2002 were 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 and bore interest at Dexia's prime rate, plus 1%.

In April 2014, CRW completed, with Amalgamated Bank, a direct purchase of the outstanding Bonds (\$15,393,000 in the case of the Variable Rate Water Revenue Refunding Bonds, Series B of 2002 and \$6,516,000 in the case of the Variable Rate Water Revenue Refunding Bonds, Series C of 2002) for a variable rate of interest and for approximately two years. Such direct purchase required CRW to amend its Ninth Supplemental Trust Indenture dated as of July 1, 2002 (Ninth Supplement) between CRW and The Bank of New York Mellon Trust Company, N.A., as successor trustee to J.P. Morgan Trust Company, National Association (Trustee), pursuant to which the 2002 Bonds were issued to allow for a "bank mode" interest rate. The Bonds were remarketed to Amalgamated Bank on April 10, 2014 for a term ending April 10, 2016 and at a variable interest rate which is reset monthly and is based on a LIBOR index rate plus a spread (which spread increases in the second year). During such two-year term, the mandatory sinking fund redemption schedule set forth in the Ninth Supplement for the Variable Rate Water Revenue Refunding Bonds, Series B of 2002 will be maintained, although the amount of Variable Rate Water Revenue Refunding Bonds, Series B of 2002 scheduled to be redeemed on July 15, 2014 was reduced to \$2,798,000 as a result of redemptions while the Bonds were held by the liquidity provider. If the Bonds are still held by Amalgamated Bank on April 10, 2016, then the Bonds will be subject to an accelerated mandatory sinking fund redemption schedule over the following four years.

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

Defeased Debt

CRW 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 CRW's financial statements. At December 31, 2014, the following defeased debt was outstanding:

Seventh Street Office & Parking Revenue Bonds, Series A of 1998	\$ 6,730,000
Seventh Street Office & Parking Revenue Bonds, Series B of 1998	6,185,000
Resource Recovery Bonds, Series A of 1998	6,460,000
Resource Recovery Bonds, Series B of 1998	4,565,000
Resource Recovery Bonds, Series C of 1998	2,040,000
Resource Recovery Notes, Series B of 2000	540,000
Total outstanding defeased debt	<u>\$ 26,520,000</u>

7. SEGMENT INFORMATION

CRW 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 provision of wastewater conveyance and treatment to customers of the Harrisburg Wastewater System. The Resource Recovery Segment accounts for the continued wind down of the activities at the Harrisburg Resource Recovery and Steam Generating Facility (resource recovery facility), which converted waste into energy. Selected segment information as of and for the year ended December 31, 2014 is as follows:

CAPITAL REGION WATER
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2014

CONDENSED BALANCE SHEET	Water Segment	Sewer Segment	Resource Recovery Segment
Assets:			
Current assets:			
Other current assets	\$ 9,206,509	\$ 21,212,681	\$ 846,875
Due from other funds	604,130	-	-
Total current assets	9,810,639	21,212,681	846,875
Restricted assets	31,233,193	26,498,210	-
Capital assets	61,644,550	55,012,753	-
Other noncurrent assets	289,419	-	-
Total Assets	102,977,801	102,723,644	846,875
Deferred Outflow of Resources	10,313,856	-	-
Total Assets and Deferred Outflow of Resources	\$ 113,291,657	\$ 102,723,644	\$ 846,875
Liabilities:			
Current liabilities:			
Other current liabilities	\$ 1,943,954	\$ 5,484,860	\$ 160,420
Due to other funds	-	320,157	-
Total current liabilities	1,943,954	5,805,017	160,420
Liabilities payable from restricted assets	7,901,571	174,787	-
Noncurrent liabilities	136,971,315	38,065,736	-
Total Liabilities	146,816,840	44,045,540	160,420
Net Position:			
Net investment in capital assets	(53,327,562)	38,051,169	-
Restricted	2,576,379	2,987,245	686,455
Unrestricted	17,226,000	17,639,690	-
Total Net Position	(33,525,183)	58,678,104	686,455
Total Liabilities and Net Position	\$ 113,291,657	\$ 102,723,644	\$ 846,875
CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION			
Operating revenues	\$ 18,086,942	\$ 18,252,196	\$ -
Operating expenses:			
Operating	4,608,400	7,294,397	303,085
Administration	1,336,463	1,347,080	-
Depreciation	2,124,166	1,865,314	-
Total operating expenses	8,069,029	10,506,791	303,085
Operating Income (Loss)	10,017,913	7,745,405	(303,085)
Non-operating revenues (expenses):			
Investment income	1,297,528	44,129	6,993
Miscellaneous income (expense)	(93,249)	285,707	(2,016)
Interest expense	(8,577,174)	(966,388)	-
Total non-operating revenues (expenses)	(7,372,895)	(636,552)	4,977
Change in Net Position Before Special Item	2,645,018	7,108,853	(298,108)
Special item	-	-	(389,217)
Change in Net Position	2,645,018	7,108,853	(687,325)
Net position - January 1, 2014	(36,170,201)	51,569,251	1,373,780
Net position - December 31, 2014	\$ (33,525,183)	\$ 58,678,104	\$ 686,455

CAPITAL REGION WATER
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2014

<u>CONDENSED STATEMENT OF CASH FLOWS</u>	<u>Water Segment</u>	<u>Sewer Segment</u>	<u>Resource Recovery Segment</u>
Net cash provided by operating activities	\$ 11,886,133	\$ 10,157,242	\$ 81,758
Net cash provided by (used in) investing activities	1,630,986	(26,357,622)	29,947
Net cash provided by (used in) capital and related financing activities	<u>(12,550,094)</u>	<u>22,661,696</u>	<u>(901,682)</u>
Increase (decrease) in cash and cash equivalents	967,025	6,461,316	(789,977)
Cash and cash equivalents, January 1, 2014	<u>7,445,117</u>	<u>9,027,659</u>	<u>1,636,852</u>
Cash and cash equivalents, December 31, 2014	<u>\$ 8,412,142</u>	<u>\$ 15,488,975</u>	<u>\$ 846,875</u>

At December 31, 2014, CRW has a net position deficit in the Water segment, primarily because CRW has extended the length of its debt service at various times and the costs associated with those extensions exceeding the depreciation expense on the Water System. Management anticipates that the deficit will be reduced through future profitability improvements.

8. NON-RECOURSE DEBT ISSUES

As discussed in Note 1, the following non-recourse debt issue was outstanding at December 31, 2014:

Harrisburg University, Series B of 2007	<u>\$ 60,225,000</u>
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CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

Harrisburg University

Pursuant to a Trust Indenture dated as of January 1, 2007 (Indenture), CRW 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, CRW 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 CRW 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 CRW, 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 March 2015, 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

CAPITAL REGION WATER

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YEAR ENDED DECEMBER 31, 2014

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 March 2015, 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 CRW is a party to the trust indenture with the University and the Trustee, such agreements are structured such that there is no recourse against CRW in the case of default.

9. COMMITMENTS AND CONTINGENCIES

Many of CRW's financings are insured by a bond insurance policy. On February 13, 2013, CRW issued a notice of material event with the Electronic Market Access System (EMMA) established by the Municipal Rulemaking Board, with respect to Moody's January 17, 2013 downgrade of the insurance financial strength rating of Assured Guaranty Municipal Corporation (AGM) from A2 to Aa3. On May 14, 2014, CRW issued a notice of material event with EMMA with respect to Standard & Poor's published research update report dated March 18, 2014, in which it upgraded AGM's financial strength rating to AA from AA-.

Under the continuing disclosure undertaking, CRW has covenanted to file its secondary market disclosures within 270 days of the end of their fiscal year. The financial statements for the year ended December 31, 2013 were not completed by this date.

Water Segment

On January 18, 2011, CRW issued a notice of material event with EMMA with respect to the Moody's Investor Service (Moody's) downgrade to Ba1 from A1 of CRW's 2008 Water Revenue Bonds. In addition, Moody's has removed CRW'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 CRW's 2008 Water Revenue Bonds and then withdrew the rating. Accordingly, CRW's 2008 Water Revenue Bonds are no longer rated by Moody's.

Under the trust indenture, CRW is required to maintain a minimum balance in the Water operating reserve account equal to 1/6 of the amount budgeted for operating expenses for the current fiscal year. At December 31, 2014, CRW's required balance was \$876,874 and the

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

amount in the operating reserve account was \$818,272. Deficiencies in the operating reserve account are to be repaid in 12 equal monthly payments. As of August 2015, CRW has not replenished the operating reserve account.

Sewer

Under the trust indenture, CRW is required to maintain a minimum balance in the Sewer 2014 PennVest loan account equal to \$55,000 through January 31, 2017. At December 31, 2014, the amount in the 2014 PennVest loan account was \$50,018. As of September 2015, CRW has not replenished the 2014 PennVest loan account.

Other

CRW 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 CRW at December 31, 2014.

A legal services firm has filed a claim for legal fees generated from a lawsuit over the appointment power to the Board of CRW which was resolved in 2009. The legal services firm seeks approximately \$90,000 in principal, together with costs of litigation, including attorney fees. CRW would defend this case vigorously and denies owing the legal services firm any amount for legal fees, as the legal services firm did not represent CRW's interest over the time period of its purported bills, nor did the legal services firm issue the bills to CRW for which it seeks payment.

CRW has guaranteed a line-of-credit on behalf of the National Civil War Museum limited to \$250,000. The maximum amount available under the line-of-credit is \$500,000. As required by the agreement, CRW has placed \$250,000 in a separate account and this amount is included on the Balance Sheet as restricted cash and cash equivalents. In the event the Bank utilizes CRW's deposit to pay sums due under the line of credit, the National Civil War Museum agrees to reimburse CRW by monthly depositing an amount equal to one thirty-sixth of the amount drawn from the account, together with interest calculated on the unpaid balance thereof at prime rate plus one percent. The line of credit is due upon demand and had an outstanding balance of \$487,500 at June 30, 2014.

CRW 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, 2014, excluding amounts in accounts payable, was approximately \$29.9 million.

In November 2013, the CRW and the City entered into a transfer agreement related to the Sewer Collection System (transfer agreement) and a transition agreement related to the

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

Water, Wastewater, and Stormwater Systems (transition agreement). In conjunction with the transfer and transition agreements, CRW and the City entered into a shared services agreement whereby the City agreed to perform certain services with respect to and for the benefit of the water system and combined sewer system and CRW agreed to perform certain services with respect to and for the benefit of the City's sanitation fund, Green Infrastructure Projects, and other initiatives. The services performed by the City under the shared services agreement relate to payment processing services, information technology services, operations and revenue services, and public works services. The services performed by CRW under the shared services agreement include revenue billing and collection functions for the City's sanitation fund including the implementation of a lockbox system. Each of these services, including the term of the services, is detailed in a shared services schedule incorporated into the shared services agreement.

CRW and the City, in advance of performing the services, are to prepare a budget for the total cost of the services and the total cost is to be agreed upon by both parties. Within 60 days after the end of the term of each shared service, CRW and the City are to reconcile the actual costs of providing the services to the budgeted costs. Payments due to either the CRW or the City are payable within 30 days of the finalization of the reconciliation. During the year ended December 31, 2014, CRW and the City were billed based on budgeted expenditures and certain receivables and payables have been recorded based on these budgeted amounts. A reconciliation based on actual cost incurred is still being negotiated and any changes will be made prospectively.

10. RISK MANAGEMENT

CRW 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 CRW carries commercial insurance. During the last three years, insurance settlements did not exceed insurance coverage.

11. PENSION PLAN

Plan Description

Pursuant to a transition agreement, water and sewer employees of the City transitioned to CRW during November 2013. Prior to the transition, the water and sewer employees participated in the City's non-uniform defined benefit plan which was administered by Pennsylvania Municipal Retirement System (PMRS), an agent multiple-employer Public Employees Retirement System (PERS). As part of the transition, CRW created a spin-off plan that is being separately administered by PMRS. CRW's pension plan is a single-employer defined

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

benefit pension plan controlled by the provisions of Resolution 2013-015 adopted pursuant to Act 15 of 1974. The plan participates in the PMRS who acts as a common investment and administrative agent for municipalities in the Commonwealth of Pennsylvania. PMRS issues a publicly available financial report that includes financial statements and required supplementary information for the PERS. The report may be obtained by writing to Pennsylvania Municipal Retirement System, P.O. Box 1165, Harrisburg, Pennsylvania 17108-1165.

The plan has been established to cover substantially all full-time employees. Employees become eligible for participation in a plan immediately upon employment and become fully vested in 10 years. In December 2014, CRW approved a revision to the plan, reducing the vesting period from 10 years of credited service to five years of credited service. This change became effective January 1, 2015.

The benefits provided by the plan are calculated at 2.0% per year of credited service multiplied by the final average annual salary. In no case may the benefit exceed 75% of the final average annual salary. Final average salary is based upon the annual average compensation paid during the highest three years of employment.

The plan provides retirement, disability, and death benefits to plan members and their beneficiaries.

Based on an actuarial calculation, PMRS transferred approximately \$1.96 million in cash and investments from the City's pension plan to CRW's plan as of December 31, 2013. During 2014, an additional \$6.55 million was transferred. In accordance with PMRS policy, a plan created due to a spin-off is to be fully funded at inception. An actuarial valuation will be performed on CRW's plan as of January 1, 2015.

Funding Policy and Contributions

All full-time employees are required to contribute five percent of their annual covered salary to the System. CRW's contributions to the System are governed by Act 205, Municipal Pension Plan Funding Standard and Recovery Act, which mandates minimum actuarial funding based upon the System's biennial actuarial valuation.

Administrative Costs

Administrative costs, including the investment manager, custodial trustee, and actuarial services are charged to the plan and funded through investment earnings.

CAPITAL REGION WATER

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2014

Annual Pension Cost

For the year ended December 31, 2013, CRW's annual pension cost was \$0 which was equal to CRW's required and actual contribution. For the year ended December 31, 2014, CRW's annual pension cost was \$144,159, which was equal to CRW's required and actual contribution. The net pension obligation at December 31, 2014 and 2013 was \$0.

12. SUBSEQUENT EVENTS

CRW entered into various construction and professional services contracts in 2015 related to the construction of the various facilities. The commitment under these contracts is approximately \$3.3 million.

In January 2015, CRW issued a 2014 Water System Improvement General Obligation Note in the amount of \$5.6 million. The loan bears interest at 1% and is interest-only for 26 months, followed by a 20-year amortization period. The proceeds are to be used to provide an enhanced geographic information system, restore reliability in the supervisory control and data acquisition system, and install a new water main and associated appurtenances.

In April 2015, CRW amended its administrative office lease. The amendment extended the lease for a five-year period, beginning when improvements were completed. Future obligations under the amended lease are:

Year 1	\$	196,095
Year 2		198,402
Year 3		200,709
Year 4		203,016
Year 5		205,323

Supplementary Information

CAPITAL REGION WATER
COMBINING BALANCE SHEET
DECEMBER 31, 2014

Assets and Deferred Outflows of Resources	<u>Water Segment</u>	<u>Sewer Segment</u>	<u>Resource Recovery Segment</u>	<u>Working Capital Fund</u>	<u>Eliminations</u>	<u>Total</u>
Assets:						
Current assets:						
Cash and cash equivalents	\$ 5,835,763	\$ 15,392,516	\$ 846,875	\$ 1,247,379	\$ -	\$ 23,322,533
Accounts receivable, net of allowance for uncollectible accounts of \$1,933,147, \$5,738,595, zero, and zero	2,690,950	4,201,741	-	127,827	-	7,020,518
Other receivables	562,140	808,690	-	-	-	1,370,830
Prepaid expenses	117,656	284,132	-	50,718	-	452,506
Inventory	-	525,602	-	-	-	525,602
Due from (to) other funds	604,130	-	-	-	(604,130)	-
Total current assets	9,810,639	21,212,681	846,875	1,425,924	(604,130)	32,691,989
Restricted assets:						
Cash and cash equivalents - restricted under trust indentures and guarantee agreement	2,576,379	96,459	-	250,000	-	2,922,838
Investments - restricted under trust indentures	28,656,814	26,401,751	-	-	-	55,058,565
Total restricted assets	31,233,193	26,498,210	-	250,000	-	57,981,403
Noncurrent assets:						
Capital assets, not being depreciated	2,645,807	21,036,257	-	-	-	23,682,064
Capital assets, being depreciated, net of accumulated depreciation of \$47,647,920, \$62,267,537, zero, and \$11,694	58,998,743	33,976,496	-	127,894	-	93,103,133
Prepaid debt insurance costs	289,419	-	-	-	-	289,419
Total noncurrent assets	61,933,969	55,012,753	-	127,894	-	117,074,616
Total Assets	102,977,801	102,723,644	846,875	1,803,818	(604,130)	207,748,008
Deferred Outflows of Resources:						
Deferred loss on refunding	10,313,856	-	-	-	-	10,313,856
Total Assets and Deferred Outflows of Resources	\$ 113,291,657	\$ 102,723,644	\$ 846,875	\$ 1,803,818	\$ (604,130)	\$ 218,061,864

(Continued)

CAPITAL REGION WATER
COMBINING BALANCE SHEET
DECEMBER 31, 2014
(Continued)

Liabilities and Net Position	<u>Water Segment</u>	<u>Sewer Segment</u>	<u>Resource Recovery Segment</u>	<u>Working Capital Fund</u>	<u>Eliminations</u>	<u>Total</u>
Liabilities:						
Current liabilities:						
Accounts payable and accrued liabilities	\$ 1,708,222	\$ 5,398,569	\$ 160,420	\$ 442,165	\$ -	\$ 7,709,376
Current portion of compensated absences	235,732	86,291	-	188,122	-	510,145
Due to other funds	-	320,157	-	283,973	(604,130)	-
Total current liabilities	<u>1,943,954</u>	<u>5,805,017</u>	<u>160,420</u>	<u>914,260</u>	<u>(604,130)</u>	<u>8,219,521</u>
Liabilities payable from restricted assets:						
Accrued interest payable	2,896,571	-	-	-	-	2,896,571
Current portion of notes payable	-	174,787	-	-	-	174,787
Current portion of bonds payable	5,005,000	-	-	-	-	5,005,000
Total liabilities payable from restricted assets	<u>7,901,571</u>	<u>174,787</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,076,358</u>
Noncurrent liabilities:						
Compensated absences	49,793	76,202	-	101,297	-	227,292
Notes payable	-	8,477,834	-	-	-	8,477,834
Bonds outstanding, net of discount of \$524,226, \$148,300, zero, and zero	136,016,774	29,511,700	-	-	-	165,528,474
Unearned revenue	904,748	-	-	-	-	904,748
Total noncurrent liabilities	<u>136,971,315</u>	<u>38,065,736</u>	<u>-</u>	<u>101,297</u>	<u>-</u>	<u>175,138,348</u>
Total Liabilities	<u>146,816,840</u>	<u>44,045,540</u>	<u>160,420</u>	<u>1,015,557</u>	<u>(604,130)</u>	<u>191,434,227</u>
Net Position:						
Net investment in capital assets	(53,327,562)	38,051,169	-	127,894	-	(15,148,499)
Restricted						
Guarantee agreement	-	-	-	250,000	-	250,000
Water operations	2,576,379	-	-	-	-	2,576,379
Sewer operations	-	2,987,245	-	-	-	2,987,245
Insurer agreement	-	-	686,455	-	-	686,455
Unrestricted	17,226,000	17,639,690	-	410,367	-	35,276,057
Total Net Position	<u>(33,525,183)</u>	<u>58,678,104</u>	<u>686,455</u>	<u>788,261</u>	<u>-</u>	<u>26,627,637</u>
Total Liabilities and Net Position	<u>\$ 113,291,657</u>	<u>\$ 102,723,644</u>	<u>\$ 846,875</u>	<u>\$ 1,803,818</u>	<u>\$ (604,130)</u>	<u>\$ 218,061,864</u>

(Concluded)

CAPITAL REGION WATER
COMBINING SCHEDULE OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION
YEAR ENDED DECEMBER 31, 2014

	Water Segment	Sewer Segment	Resource Recovery Segment	Working Capital Fund	Eliminations	Total
Operating Revenues:						
User charges	\$ 18,086,942	\$ 18,252,196	\$ -	\$ -	\$ -	\$ 36,339,138
Administrative fees	-	-	-	3,047,026	(2,683,543)	363,483
Total operating revenues	<u>18,086,942</u>	<u>18,252,196</u>	<u>-</u>	<u>3,047,026</u>	<u>(2,683,543)</u>	<u>36,702,621</u>
Operating Expenses:						
Operating	4,608,400	7,294,397	303,085	-	-	12,205,882
Administrative	1,336,463	1,347,080	-	3,047,588	(2,683,543)	3,047,588
Depreciation	2,124,166	1,865,314	-	11,061	-	4,000,541
Total operating expenses	<u>8,069,029</u>	<u>10,506,791</u>	<u>303,085</u>	<u>3,058,649</u>	<u>(2,683,543)</u>	<u>19,254,011</u>
Operating Income (Loss)	<u>10,017,913</u>	<u>7,745,405</u>	<u>(303,085)</u>	<u>(11,623)</u>	<u>-</u>	<u>17,448,610</u>
Non-Operating Revenues (Expenses):						
Investment income (loss)	1,297,528	44,129	6,993	4,587	-	1,353,237
Miscellaneous income (expense)	(93,249)	285,707	(2,016)	11,856	-	202,298
Interest expense	(8,577,174)	(966,388)	-	-	-	(9,543,562)
Total non-operating revenues (expenses)	<u>(7,372,895)</u>	<u>(636,552)</u>	<u>4,977</u>	<u>16,443</u>	<u>-</u>	<u>(7,988,027)</u>
Change in Net Position Before Special Item	2,645,018	7,108,853	(298,108)	4,820	-	9,460,583
Special item	-	-	(389,217)	-	-	(389,217)
Change in Net Position	2,645,018	7,108,853	(687,325)	4,820	-	9,071,366
Net Position:						
Beginning of year	(36,170,201)	51,569,251	1,373,780	783,441	-	17,556,271
End of year	<u>\$ (33,525,183)</u>	<u>\$ 58,678,104</u>	<u>\$ 686,455</u>	<u>\$ 788,261</u>	<u>\$ -</u>	<u>\$ 26,627,637</u>

CAPITAL REGION WATER
COMBINING SCHEDULE OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2014

	Water Segment	Sewer Segment	Resource Recovery Segment	Working Capital Fund	Eliminations	Total
Cash Flows From Operating Activities:						
Receipts from customers and users	\$ 18,076,224	\$ 18,537,903	\$ 1,058,889	\$ 301,866	\$ -	\$ 37,974,882
Receipts for interfund services	-	-	-	2,578,336	(2,578,336)	-
Payments to employees	(1,232,236)	(1,105,211)	-	(1,286,862)	-	(3,624,309)
Payments to suppliers	(3,731,549)	(6,390,250)	(510,301)	(1,422,459)	-	(12,054,559)
Payments for interfund services	(1,226,306)	(885,200)	(466,830)	-	2,578,336	-
Net cash provided by operating activities	11,886,133	10,157,242	81,758	170,881	-	22,296,014
Cash Flows From Investing Activities:						
Sales (purchases) of investments, net	419,171	(26,401,751)	22,954	-	-	(25,959,626)
Investment income received	1,211,815	44,129	6,993	4,587	-	1,267,524
Net cash provided by (used in) investing activities	1,630,986	(26,357,622)	29,947	4,587	-	(24,692,102)
Cash Flows from Capital and Related Financing Activities:						
Proceeds from debt issuance	-	36,660,634	-	-	-	36,660,634
Bond discount	-	(148,300)	-	-	-	(148,300)
Acquisition and construction of capital assets	(1,606,051)	(12,002,277)	-	(70,804)	-	(13,679,132)
Interest paid	(7,361,043)	(966,388)	-	-	-	(8,327,431)
Principal paid on long-term debt	(3,583,000)	(881,973)	-	-	-	(4,464,973)
Payment to bond insurer	-	-	(901,682)	-	-	(901,682)
Net cash provided by (used in) capital and related financing activities	(12,550,094)	22,661,696	(901,682)	(70,804)	-	9,139,116
Increase (Decrease) in Cash and Cash Equivalents	967,025	6,461,316	(789,977)	104,664	-	6,743,028
Cash and Cash Equivalents:						
Beginning of year	7,445,117	9,027,659	1,636,852	1,392,715	-	19,502,343
End of year	\$ 8,412,142	\$ 15,488,975	\$ 846,875	\$ 1,497,379	\$ -	\$ 26,245,371

(Continued)

CAPITAL REGION WATER
COMBINING SCHEDULE OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2014
(Continued)

	Water Segment	Sewer Segment	Resource Recovery Segment	Working Capital Fund	Eliminations	Total
Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities:						
Operating income (loss)	\$ 10,017,913	\$ 7,745,405	\$ (303,085)	\$ (11,623)	\$ -	\$ 17,448,610
Adjustments to reconcile operating income (loss) to cash provided by operating activities:						
Depreciation	2,124,166	1,865,314	-	11,061	-	4,000,541
Miscellaneous nonoperating income (expense)	(47,033)	285,707	308,896	11,856	-	559,426
(Increase) decrease in accounts receivable	(10,718)	(2,118,927)	1,058,889	(73,473)	-	(1,144,229)
(Increase) decrease in other receivables	(225,872)	1,860,691	-	-	-	1,634,819
Increase in prepaid expenses	(8,824)	(130,805)	-	(50,718)	-	(190,347)
Decrease in inventory	-	78,933	-	-	-	78,933
(Increase) decrease in due from (to) other funds	110,157	461,880	(466,830)	(105,207)	-	-
Increase (decrease) in accounts payable	(51,253)	174,095	(516,112)	197,123	-	(196,147)
Increase (decrease) in compensated absences	(22,403)	(65,051)	-	191,862	-	104,408
Net cash provided by operating activities	<u>\$ 11,886,133</u>	<u>\$ 10,157,242</u>	<u>\$ 81,758</u>	<u>\$ 170,881</u>	<u>\$ -</u>	<u>\$ 22,296,014</u>

(Concluded)