

City of Chicago, Illinois Sewer Fund

Basic Financial Statements as of and
for the Years Ended December 31, 2012
and 2011, Statistical Data, and
Independent Auditors' Report

CITY OF CHICAGO, ILLINOIS SEWER FUND

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INDEPENDENT AUDITORS' REPORT

The Honorable Rahm Emanuel, Mayor,
and Members of the City Council
City of Chicago, Illinois

We have audited the accompanying basic financial statements of the Sewer Fund (the "Sewer Fund"), an enterprise fund of the City of Chicago, Illinois (the "City"), as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Sewer Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Basic 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 audits. We conducted our audits 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 basic financial statements referred to above present fairly, in all material respects, the financial position of the Sewer Fund as of December 31, 2012 and 2011, and the results of its operations and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

As discussed in Note 1 to the basic financial statements, the basic financial statements referred to above present only the Sewer Fund, an enterprise fund of the City, and do not purport to, and do not, present the financial position of the City as of December 31, 2012 and 2011, changes in its financial position, or, where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic financial statements that collectively comprise the Sewer Fund's basic financial statements. The statistical data, as listed in the foregoing table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. The statistical data has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Deloitte & Touche LLP

June 29, 2013

CITY OF CHICAGO, ILLINOIS SEWER FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the City of Chicago, Illinois (the "City"), Sewer Fund (the "Sewer Fund") financial performance provides an introduction and overview of the Sewer Fund's basic financial activities for the fiscal years ended December 31, 2012 and 2011. Please read this discussion in conjunction with the Sewer Fund's basic financial statements and the notes to basic financial statements following this section.

FINANCIAL HIGHLIGHTS

2012

- Operating revenues for 2012 increased by \$50.6 million (24.9%) compared to prior-year operating revenues due to changes in sewer billing rates.
- Operating expenses before depreciation and amortization for 2012 remained consistent with 2011.
- The Sewer Fund's total net position for 2012 increased by \$61.4 million or 12.2% compared to 2011.
- The Sewer Fund's total assets and deferred outflows were greater than total liabilities by \$565.6 million (net position) at December 31, 2012. Net position comprises \$455.2 million of net investment in capital assets, \$50.0 million of restricted for capital projects, and \$60.4 million of unrestricted.
- Capital asset additions, net, being depreciated for 2012 were \$246.6 million, principally due to completion of sewer construction and rehabilitation projects.

2011

- Operating revenues for 2011 increased by \$5.1 million (2.6%) compared to prior-year operating revenues.
- Operating expenses before depreciation and amortization for 2011 remained consistent with 2010.
- The Sewer Fund's total net position for 2011 increased by \$13.6 million or 2.8% compared to 2010.
- The Sewer Fund's total assets were greater than total liabilities by \$504.3 million (net position) at December 31, 2011. Total net position comprise \$454.1 million of investment in capital assets, net of related debt, \$24.6 million of restricted for capital projects, and \$25.6 million of unrestricted.
- Capital asset additions, net, being depreciated for 2011 were \$88.6 million, principally due to completion of sewer construction and rehabilitation projects.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Sewer Fund's basic financial statements. The Sewer Fund's basic financial statements comprise the basic financial statements and the notes to basic financial statements. In addition to the basic financial statements, this report also presents statistical data after the notes to basic financial statements.

The statements of net position present all of the Sewer Fund's assets, deferred outflows, and liabilities using the accrual basis of accounting, which is similar to the basis of accounting used by private-sector companies. The difference between assets, deferred outflows, and liabilities is reported as net position. The increase or decrease in net position may serve as an indicator, over time, whether the Sewer Fund's financial position is improving or deteriorating. However, the consideration of other nonfinancial factors may be necessary in the assessment of overall financial position and health of the Sewer Fund.

The statements of revenues, expenses, and changes in net position present all current fiscal year revenues and expenses, regardless of when cash is received or paid, and the ensuing change in net position.

The statements of cash flows report how cash and cash equivalents were provided and used by the Sewer Fund's operating, capital financing, and investing activities. These statements are prepared on a cash basis and present the cash received and disbursed, the net increase or decrease in cash and cash equivalents for the year, and the cash and cash equivalents balance at year-end.

The notes to basic financial statements are an integral part of the basic financial statements; accordingly, such disclosures are essential for a full understanding of the information provided in the basic financial statements.

In addition to the basic financial statements, this report includes statistical data. The statistical data section presents unaudited debt service coverage calculations and includes certain unaudited information related to the Sewer Fund's historical financial and nonfinancial operating results and capital activities.

FINANCIAL ANALYSIS

At December 31, 2012, the Sewer Fund's financial position continues to be strong with total assets and deferred outflows of \$2,244.1 million, total liabilities of \$1,678.4 million, and net position of \$565.6 million. A comparative condensed summary of the Sewer Fund's net position at December 31, 2012, 2011, and 2010, is as follows:

(In thousands)	Net Position		
	2012	2011	2010
Current assets	\$ 128,442	\$ 106,166	\$ 109,889
Restricted and other assets	354,346	144,718	262,764
Utility plant — net	1,671,339	1,494,682	1,362,328
Deferred outflows	<u>89,955</u>	<u>91,713</u>	<u>49,116</u>
Total assets and deferred outflows	<u>2,244,082</u>	<u>1,837,279</u>	<u>1,784,097</u>
Current liabilities	64,007	87,203	92,251
Derivative instrument liability	89,955	91,713	49,116
Long-term and liabilities payable from restricted assets	<u>1,524,475</u>	<u>1,154,086</u>	<u>1,152,026</u>
Total liabilities	<u>1,678,437</u>	<u>1,333,002</u>	<u>1,293,393</u>
Net position:			
Net invested in capital assets	455,195	454,079	414,766
Restricted for capital projects	50,014	24,610	11,110
Unrestricted	<u>60,436</u>	<u>25,588</u>	<u>64,828</u>
Total net position	<u>\$ 565,645</u>	<u>\$ 504,277</u>	<u>\$ 490,704</u>

2012

Current assets increased by \$22.3 million (20.9%) due to an increase in cash and cash equivalents and accounts receivable. Restricted and other assets increased by \$209.6 million (144.9%) and utility plant — net increased by \$176.7 million (11.8%) due principally to capital activities for sewer construction and rehabilitation projects. Deferred outflows decreased in the amount of \$1.8 million (1.9%) due to changes in the fair value of interest rate swaps. During 2012, the Sewer Fund increased its lining program, lining an additional 51.4 miles of sewers.

The decrease in current liabilities of \$23.2 million (26.6%) is primarily related to the decrease in accounts payable due to the timing of payments and an increase in deferred revenue as related to increased deferred billings, and accrued liabilities as related to an Illinois Environmental Protection Agency (IEPA) loan received during 2012. Derivative instrument liability decreased \$1.8 million (1.9%) due to changes in the fair value of interest rate swaps. Long-term and restricted liabilities increased by \$370.4 million (32.1%) due to debt issuance.

Net position may serve, over a period of time, as a useful indicator of the Sewer Fund's financial position. As of December 31, 2012, total net position was \$565.6 million, an increase of \$61.4 million (12.2%) from 2011.

2011

Current assets decreased by \$3.7 million (3.4%) due to a decrease in cash and cash equivalents and due from other City funds. Restricted and other assets decreased by \$118 million (44.9%) and utility plant — net increased by \$132.4 million (9.7%) due principally to capital activities for sewer construction and rehabilitation projects. Deferred outflows increased in the amount of \$42.6 million (86.7%) due to changes in the fair value of interest rate swaps. During 2011, the Sewer Fund increased its lining program, lining an additional 42.9 miles of sewers.

The decrease in current liabilities of \$5.0 million (5.5%) is primarily related to the decrease in deferred revenue and due to other City funds with a slight increase in accounts payables and accrued liabilities. Derivative instrument liability increased \$42.6 million (86.7%) due to changes in the fair value of interest rate swaps. Long-term and restricted liabilities increased by \$2.1 million (0.2%).

Net position may serve, over a period of time, as a useful indicator of the Sewer Fund's financial position. As of December 31, 2011, total net position was \$504.3 million, an increase of \$13.6 million (2.8%) from 2010.

A summary of revenues, expenses, and changes in net position for the years ended December 31, 2012, 2011, and 2010, is as follows:

(In thousands)	<u>Revenues, Expenses, and Changes in Net Position</u>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Revenues:			
Operating revenues:			
Sewer service	\$ 252,943	\$ 202,323	\$ 197,455
Other operating revenues	<u>969</u>	<u>1,026</u>	<u>774</u>
Total operating revenues	253,912	203,349	198,229
Nonoperating revenues	867	3,198	20,526
Capital grants	<u>2,500</u>	<u>1,864</u>	<u>3,136</u>
Total revenues	<u>257,279</u>	<u>208,411</u>	<u>221,891</u>
Expenses:			
Operating expenses before depreciation and amortization	113,575	113,930	113,881
Depreciation and amortization	27,735	25,917	23,775
Interest expense	<u>54,601</u>	<u>54,991</u>	<u>47,232</u>
Total expenses	<u>195,911</u>	<u>194,838</u>	<u>184,888</u>
Change in net position	61,368	13,573	37,003
Net position — beginning of year	<u>504,277</u>	<u>490,704</u>	<u>453,701</u>
Net position — end of year	<u>\$ 565,645</u>	<u>\$ 504,277</u>	<u>\$ 490,704</u>

2012

Sewer service revenues for the years ended 2012 and 2011 were \$252.9 million and \$202.3 million, respectively. Other revenue, which consists primarily of inspection fees and house drain fees, for the years ended 2012 and 2011 was \$0.9 and \$1.0 million, respectively. The increase in 2012 sewer service revenue of \$50.6 million (24.9%) is primarily due to an increase in water and sewer rates of 25% and 3%, respectively.

Nonoperating revenues decreased by \$2.3 million primarily as a result a decrease in investment income.

2011

Sewer service revenues for the years ended 2011 and 2010 were \$202.3 million and \$197.5 million, respectively. Other revenue, which consists primarily of inspection fees and house drain fees, for the years ended 2011 and 2010 was \$1.0 and \$0.8 million, respectively.

Nonoperating revenues decreased by \$17.3 million as a result of the amortization of up-front swap payments received during 2010 and 2009; the up-front payments are amortized over the life of the respective swap. On January 28, 2009, the City terminated the interest rate swap agreement with Lehman Brothers for the Series 2008C Wastewater Transmission Revenue Bonds. At that time, the City paid \$38.1 million to terminate the swap and received an up-front payment to execute a new swap of \$38.7 million. The termination fee and the 2009 portion of the up-front payment are recorded within nonoperating expenses within the statements of revenues, expenses, and changes in net position. In 2010, the remaining up-front payment was amortized as nonoperating revenues.

A comparative summary of the Sewer Fund's operating expenses, as classified in the basic financial statements, for the years ended December 31, 2012, 2011, and 2010, is as follows:

(In thousands)	Operating Expenses		
	2012	2011	2010
Repairs	\$ 35,708	\$ 38,805	\$ 42,509
General Fund reimbursements	31,709	29,124	27,065
Maintenance	21,819	23,655	24,075
Engineering	3,085	3,544	3,053
Administrative and general	<u>21,254</u>	<u>18,802</u>	<u>17,179</u>
Operating expenses before depreciation and amortization	113,575	113,930	113,881
Depreciation and amortization	<u>27,735</u>	<u>25,917</u>	<u>23,775</u>
Total operating expenses	<u>\$ 141,310</u>	<u>\$ 139,847</u>	<u>\$ 137,656</u>

2012

Overall, operating expenses before depreciation and amortization for 2012 remained consistent with 2011. Depreciation and amortization increased slightly due to an increase in utility plant.

2011

Overall, operating expenses before depreciation and amortization for 2011 remained consistent with 2010. Depreciation and amortization increased slightly due to an increase in utility plant.

A comparative summary of the Sewer Fund's cash flows for the years ended December 31, 2012, 2011, and 2010, is as follows:

(In thousands)	Cash Flows		
	2012	2011	2010
Cash from activities:			
Operating	\$ 143,573	\$ 81,012	\$ 98,291
Capital and related financing	76,755	(202,867)	81,440
Investing	<u>(160,955)</u>	<u>(4,359)</u>	<u>(85,935)</u>
Net change in cash and cash equivalents	59,373	(126,214)	93,796
Cash and cash equivalents:			
Beginning of year	<u>29,565</u>	<u>155,779</u>	<u>61,983</u>
End of year	<u>\$ 88,938</u>	<u>\$ 29,565</u>	<u>\$ 155,779</u>

2012

As of December 31, 2012, the Sewer Fund's cash and cash equivalents of \$88.9 million represent an increase of \$59.4 million from December 31, 2011, as compared to a decrease of \$126.2 million from December 31, 2010 to December 31, 2011, primarily due to positive cash flows from bonds issued in 2012. Total cash and cash equivalents at December 31, 2012, are composed of unrestricted and restricted cash and cash equivalents of \$17.7 million and \$71.2 million, respectively.

2011

As of December 31, 2011, the Sewer Fund's cash and cash equivalents of \$29.5 million represent a decrease of \$126.2 million compared to \$155.8 million at December 31, 2010, primarily due to acquisition and construction of capital projects. Total cash and cash equivalents at December 31, 2011, are composed of unrestricted and restricted cash and cash equivalents of \$6.5 million and \$23.0 million, respectively.

CAPITAL ASSET AND DEBT ADMINISTRATION

2012

At the end of 2012 and 2011, the Sewer Fund had net utility plant of \$1,671.3 million and \$1,494.7 million, respectively. During 2012, the Sewer Fund had capital additions being depreciated of \$246.6 million, and completed projects totaling \$79.2 million were transferred from construction in progress to applicable facilities and structures capital accounts.

2011

At the end of 2011 and 2010, the Sewer Fund had net utility plant of \$1,494.7 million and \$1,362.3 million, respectively. During 2011, the Sewer Fund had capital additions being depreciated of \$88.6 million, and completed projects totaling \$11.7 million were transferred from construction in progress to applicable facilities and structures capital accounts.

The Sewer Fund's net utility plant at December 31, 2012, 2011, and 2010, is summarized as follows:

(In thousands)	Net Utility Plant at Year-End		
	2012	2011	2010
Utility plant not depreciated:			
Land and land rights	\$ 560	\$ 560	\$ 560
Construction in progress	<u>33,011</u>	<u>79,210</u>	<u>11,709</u>
Total utility plant not depreciated	<u>33,571</u>	<u>79,770</u>	<u>12,269</u>
Utility plant being depreciated:			
Facilities and structures	2,041,833	1,794,330	1,709,455
Furniture and equipment	<u>30,709</u>	<u>31,630</u>	<u>27,880</u>
Total utility plant being depreciated	<u>2,072,542</u>	<u>1,825,960</u>	<u>1,737,335</u>
Less accumulated depreciation:			
Facilities and structures	(413,425)	(388,554)	(368,099)
Furniture and equipment	<u>(21,349)</u>	<u>(22,494)</u>	<u>(19,177)</u>
Total accumulated depreciation	<u>(434,774)</u>	<u>(411,048)</u>	<u>(387,276)</u>
Utility plant being depreciated — net	<u>1,637,768</u>	<u>1,414,912</u>	<u>1,350,059</u>
Utility plant — net	<u>\$ 1,671,339</u>	<u>\$ 1,494,682</u>	<u>\$ 1,362,328</u>

The Sewer Fund's capital activities are funded through Sewer Fund revenue bonds and Sewer Fund revenues. Additional information on the Sewer Fund's capital assets is presented in Note 5 of the notes to basic financial statements.

The Sewer Fund's outstanding debt at December 31, 2012, 2011, and 2010, is summarized as follows:

(In thousands)	Long-Term Outstanding Debt at Year-End		
	2012	2011	2010
Revenue bonds	\$ 1,363,774	\$ 1,112,089	\$ 1,125,992
Add interest accretion on Series 1998 capital appreciation bonds	41,151	37,242	33,532
Less unamortized deferred loss on bond refunding	(26,493)	(32,276)	(38,063)
Unamortized net bond discount/premium	<u>37,701</u>	<u>16,142</u>	<u>15,883</u>
Outstanding debt — net	<u>\$ 1,416,133</u>	<u>\$ 1,133,197</u>	<u>\$ 1,137,344</u>

The Sewer Fund's revenue bonds at December 31, 2012, have underlying credit ratings with each of the three major rating agencies as follows:

	Moody's Investor Services	Standard & Poor's	Fitch Ratings
Senior Lien Wastewater Revenue Bonds	Aa2	AA-	N/A
Junior Lien Wastewater Revenue Bonds	Aa3	A+	AA

At December 31, 2012, the Sewer Fund was in compliance with the debt covenants as stated in the Master Trust Indentures. Details regarding the Sewer Fund's long-term debt are in Note 4 of the notes to the basic financial statements.

REQUESTS FOR INFORMATION

This financial report is designed to provide the reader with a general overview of the Sewer Fund's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the City of Chicago Comptroller's Office.

CITY OF CHICAGO, ILLINOIS SEWER FUND

STATEMENTS OF NET POSITION AS OF DECEMBER 31, 2012 AND 2011 (In thousands)

	2012	2011		2012	2011
ASSETS AND DEFERRED OUTFLOWS			LIABILITIES AND NET POSITION		
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash and cash equivalents (Note 2)	\$ 17,722	\$ 6,528	Accounts payable	\$ 4,639	\$ 23,798
Investments (Note 2)	16,952	14,521	Due to other City funds	12,113	11,385
Accounts receivable — net of allowance for doubtful accounts of approximately \$30,662 in 2012 and \$23,755 in 2011	73,465	59,650	Deferred revenue	19,387	9,328
Due from other City funds	18,840	23,145	Deferred swap up-front payment	999	1,037
Inventories	<u>1,463</u>	<u>2,322</u>	Accrued liabilities	<u>26,869</u>	<u>41,655</u>
Total current unrestricted assets	<u>128,442</u>	<u>106,166</u>	Total current liabilities	<u>64,007</u>	<u>87,203</u>
RESTRICTED ASSETS (Notes 2 and 3):			LIABILITIES PAYABLE FROM RESTRICTED ASSETS:		
Cash and cash equivalents (Note 2)	71,216	23,037	Accounts payable	52,940	
Investments (Note 2)	270,573	110,536	Accrued liabilities	31,281	
Interest receivable	<u>863</u>	<u>252</u>	Current portion of revenue bonds payable (Note 4)	29,690	28,429
Total restricted assets	<u>342,652</u>	<u>133,825</u>	Accrued interest payable	<u>24,121</u>	<u>20,889</u>
NONCURRENT ASSETS:			Total liabilities payable from restricted assets	<u>138,032</u>	<u>49,318</u>
Other assets	<u>11,694</u>	<u>10,893</u>	NONCURRENT LIABILITIES:		
Utility plant:			Derivative instrument liability	89,955	91,713
Land and land rights	560	560	Revenue bonds payable (Note 4) — net of discount and deferred loss on bond refunding	<u>1,386,443</u>	<u>1,104,768</u>
Facilities and structures	2,041,833	1,794,330	Total noncurrent liabilities	<u>1,476,398</u>	<u>1,196,481</u>
Furniture and equipment	30,709	31,630	Total liabilities	<u>1,678,437</u>	<u>1,333,002</u>
Construction in progress	<u>33,011</u>	<u>79,210</u>	NET POSITION:		
Total utility plant	2,106,113	1,905,730	Net investment in capital assets	455,195	454,079
Less accumulated depreciation	<u>(434,774)</u>	<u>(411,048)</u>	Restricted for capital projects	50,014	24,610
Utility plant — net	<u>1,671,339</u>	<u>1,494,682</u>	Unrestricted	<u>60,436</u>	<u>25,588</u>
Total noncurrent assets	<u>1,683,033</u>	<u>1,505,575</u>	Total net position	565,645	504,277
Total assets	2,154,127	1,745,566			
DEFERRED OUTFLOWS	<u>89,955</u>	<u>91,713</u>			
TOTAL	<u>\$2,244,082</u>	<u>\$1,837,279</u>	TOTAL	<u>\$2,244,082</u>	<u>\$1,837,279</u>

See notes to basic financial statements.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)**

	2012	2011
OPERATING REVENUES:		
Sewer service	\$ 252,943	\$ 202,323
Other	<u>969</u>	<u>1,026</u>
Total operating revenues	<u>253,912</u>	<u>203,349</u>
OPERATING EXPENSES:		
Repairs	35,708	38,805
General Fund reimbursements	31,709	29,124
Maintenance	21,819	23,655
Engineering	3,085	3,544
Administrative and general	<u>21,254</u>	<u>18,802</u>
Total operating expenses before depreciation and amortization	113,575	113,930
Depreciation and amortization	<u>27,735</u>	<u>25,917</u>
Total operating expenses	<u>141,310</u>	<u>139,847</u>
OPERATING INCOME	<u>112,602</u>	<u>63,502</u>
NONOPERATING REVENUE (EXPENSES):		
Investment income	1,021	3,039
Interest expense	(54,601)	(54,991)
Other	(192)	(169)
Interest rate swap income — net (Note 4)	<u>38</u>	<u>328</u>
Total nonoperating expenses — net	<u>(53,734)</u>	<u>(51,793)</u>
CAPITAL GRANTS	<u>2,500</u>	<u>1,864</u>
CHANGE IN NET POSITION	61,368	13,573
TOTAL NET POSITION — Beginning of year	<u>504,277</u>	<u>490,704</u>
TOTAL NET POSITION — End of year	<u>\$ 565,645</u>	<u>\$ 504,277</u>

See notes to basic financial statements.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)**

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Received from customers	\$ 242,313	\$ 186,323
Transactions with other City funds	(26,720)	(27,210)
Payments to vendors	(28,740)	(34,064)
Payments to employees	<u>(43,280)</u>	<u>(44,037)</u>
Net cash provided by operating activities	<u>143,573</u>	<u>81,012</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition and construction of capital assets	(149,441)	(129,104)
Proceeds from issuance of bonds	309,487	
Interest paid on revenue bonds	(55,427)	(50,164)
Payment of bond issuance and discount costs	(1,973)	
Capital grant	2,500	1,864
Principal paid on bonds	(28,429)	(25,257)
Other	<u>38</u>	<u>(206)</u>
Net cash provided by (used in) capital and related financing activities	<u>76,755</u>	<u>(202,867)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Sales and purchases of investments — net	(162,467)	(7,284)
Investment interest	<u>1,512</u>	<u>2,925</u>
Net cash used in investing activities	<u>(160,955)</u>	<u>(4,359)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	59,373	(126,214)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>29,565</u>	<u>155,779</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 88,938</u>	<u>\$ 29,565</u>
RECONCILIATION TO CASH AND CASH EQUIVALENTS REPORTED ON THE STATEMENTS OF NET POSITION:		
Unrestricted	\$ 17,722	\$ 6,528
Restricted	<u>71,216</u>	<u>23,037</u>
TOTAL	<u>\$ 88,938</u>	<u>\$ 29,565</u>

(Continued)

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)**

	2012	2011
RECONCILIATION OF OPERATING INCOME TO CASH FLOWS FROM OPERATING ACTIVITIES:		
Operating income	\$ 112,602	\$ 63,502
Adjustments to reconcile:		
Depreciation and amortization	27,735	25,917
Provision for uncollectible accounts	8,842	9,792
Changes in assets and liabilities:		
Decrease in due from other City funds	4,305	3,792
Increase in accounts receivable	(22,658)	(10,728)
Decrease (increase) in inventories	859	(886)
Decrease in accrued liabilities	(991)	(1,540)
Increase (decrease) in accounts payable and due to other City funds	1,820	(2,540)
Increase (decrease) in deferred revenue	<u>11,059</u>	<u>(6,297)</u>
 CASH FLOWS FROM OPERATING ACTIVITIES	 <u>\$ 143,573</u>	 <u>\$ 81,012</u>

SUPPLEMENTAL DISCLOSURE OF NONCASH
ITEMS — Property additions in 2012 and 2011 of \$63,913
and \$35,178, respectively, have outstanding accounts payable
and accrued liabilities.

See notes to basic financial statements.

(Concluded)

CITY OF CHICAGO, ILLINOIS

SEWER FUND

NOTES TO BASIC FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011 (In thousands)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization — The Sewer Fund (the “Sewer Fund”) collects and transmits wastewater to the treatment facilities of the Metropolitan Water Reclamation District of Greater Chicago. The Sewer Fund is included in the City of Chicago, Illinois (the “City”), reporting entity as an enterprise fund.

The accompanying basic financial statements present only the Sewer Fund and are not intended to present the financial position of the City or the results of its operations and cash flows.

Basis of Accounting — The accounting policies of the Sewer Fund are based upon accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The accounts of the Sewer Fund are reported using the flow of economic resources measurement focus.

The Sewer Fund uses the accrual basis of accounting under which revenues are recognized when earned and expenses are recognized when the liability is incurred.

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

Annual Appropriated Budget — The Sewer Fund has a legally adopted annual budget that is not required to be reported.

Management’s Use of Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash, Cash Equivalents, and Investments — Cash, cash equivalents, and investments generally are held with the City Treasurer as required by the Municipal Code of Chicago (the “Code”). Interest earned on pooled investments is allocated to participating funds based upon their average combined cash and investment balances. Due to contractual agreements or legal restrictions, the cash and investments of certain funds are segregated and earn and receive interest directly.

The Code permits deposits only to City Council–approved depositories, which must be organized state or national banks and federal and state savings and loan associations, located within the City, whose deposits are federally insured.

Investments authorized by the Code include interest-bearing general obligations of the City, the State of Illinois (the “State”), and the U.S. government; U.S. Treasury bills and other non-interest-bearing general obligations of the U.S. Government purchased in the open market below face value; domestic

money market funds regulated by and in good standing with the Securities and Exchange Commission; and tax anticipation warrants issued by the City. The City is prohibited by ordinance from investing in derivatives, as defined, without City Council approval.

The Sewer Fund values its investments at fair value or amortized cost, as applicable. U.S. government securities purchased at a price other than par with a maturity of less than one year are reported at amortized cost. The fair value of U.S. agency securities, corporate bonds, and municipal bonds are estimated using recently executed transactions, market price quotations (where observable), or bond spreads.

Repurchase agreements can be purchased only from banks and certain other institutions authorized to do business in the State. The City Treasurer requires that securities pledged to secure these agreements have a market value equal to the cost of the repurchase agreement, plus accrued interest.

Investments, generally, may not have a maturity in excess of 10 years from the date of purchase. Certain other investment balances are held in accordance with the specific provisions of applicable bond ordinances.

Cash equivalents include certificates of deposit and other investments with maturities of three months or less when purchased.

Accounts Receivable — The Sewer Fund accounts receivable result from billings and collections for sewer services processed by the Department of Water Management. Management has provided an allowance for amounts recorded at year-end that may be uncollectible.

Transactions with the City — The City’s General Fund provides services to all other funds. The amounts allocated to other funds for these services are treated as operating expenses by the Sewer Fund and consist mainly of employee benefits, self-insured risks, and administrative expenses.

Inventories — Inventories, composed mainly of materials and supplies, are stated at cost, determined principally on the first-in, first-out method.

Utility Plant — Utility plant is recorded at cost or, for donated assets, at fair value at the date of acquisition. Utility plant is defined by the Sewer Fund as assets with an initial cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost if purchased. Depreciation is provided using the straight-line method and begins in the year following the year of acquisition or completion. Estimated useful lives are as follows:

Facilities and structures	75 years
Furniture and equipment	5–20 years
Sewer rehabilitation	50 years

Costs of repairs and maintenance that do not significantly extend the useful life of assets are charged to operations.

Net Position — Net position is composed of net earnings from operating and nonoperating revenues, expenses, and capital grants. Net position is displayed in three components: invested in capital assets, net of related debt; restricted for capital projects; and unrestricted. Net investment in capital assets consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt, net of debt service reserve, and unspent bond proceeds. Restricted for capital projects consists of assets on which constraints are placed by external parties (such as lenders and grantors) and laws, regulations, and

enabling legislation, reduced by liabilities and deferred inflows of resources related to those assets. Unrestricted consists of the net amount of all other assets, deferred outflows, liabilities, and deferred inflows not categorized as either of the above.

Employee Benefits — Employee benefits are granted for vacation and sick leave, workers' compensation, and health care. Unused vacation leave is accrued and may be carried over for one year. Sick leave is accumulated at the rate of one day for each month worked, up to a maximum of 200 days. Severance of employment terminates all rights to receive compensation for any unused sick leave. Sick leave pay is not accrued. Employee benefit claims outstanding, including claims incurred but not reported, are estimated and recorded as liabilities.

Employees are eligible to defer a portion of their salaries until future years under the City's deferred compensation plan created in accordance with Internal Revenue Code Section 457. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. The plan is administered by third-party administrators who maintain the investment portfolio. The plan's assets have been placed in trust accounts with the plan administrators for the exclusive benefit of participants and their beneficiaries and are not considered assets of the City.

The City is subject to the State Unemployment Compensation Act and has elected the reimbursing employer option for providing unemployment insurance benefits for eligible former employees. Under this option, the City reimburses the State for claims paid by the State.

Bond Issuance Costs, Bond Discounts, and Refunding Transactions — Bond issuance costs and bond discounts are deferred and amortized over the term of the related debt, except in the case of refunding debt transactions where the amortization period is over the term of the refunding or refunded debt, whichever is shorter.

Derivatives — The Sewer Fund enters into interest rate swap agreements to modify interest rates on outstanding debt. For existing swaps, the net interest expenditures resulting from these arrangements are recorded as interest expense. The fair value of derivative instruments that are deemed to be effective is accounted for as deferred outflows. Derivative instruments that are deemed not effective are adjusted to fair value with the change in fair value recorded to investment earnings. All interest rate swaps are approved by the City Council.

Capitalized Interest — Interest expense and interest income earned on construction bond proceeds are capitalized during construction of those capital projects that are paid for from the bond proceeds and are being amortized over the depreciable life of the related assets on a straight-line basis.

Capital Grants — Capital grants are reported as contributed revenue in the statements of revenues, expenses, and changes in net position.

Revenue Recognition — Sewer service revenue is billed as a percentage of the City's water billings and is recorded as revenue when the water is consumed by the customers. Of the accounts receivable balances, \$19.4 million and \$20.1 million represent revenue recognized on sewer service that had not yet been billed to customers at December 31, 2012 and 2011, respectively. Deferred revenue represents amounts collected from nonmetered customers prior to usage.

Revenues and Expenses — The Sewer Fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Sewer Fund's principal ongoing operations. The principal operating revenues of the Sewer Fund are charges to customers for sales and services.

Operating expenses include the cost of sales and services, administrative expenses, and depreciation and amortization on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Adopted Accounting Standards — In December 2010, the GASB issued GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The Sewer Fund implemented GASB Statement No. 62 on January 1, 2012. This Statement incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which do not conflict with or contradict GASB pronouncements:

- Financial Accounting Standards Board (FASB) Statements and Interpretations
- Accounting Principles Board Opinions
- Accounting Research Bulletins of the American Institute of Certified Public Accountants' Committee on Accounting Procedure

The Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. Those entities who chose to apply post-November 30, 1989, FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements can continue to apply those pronouncements as other accounting literature. The financial reporting impact resulting from the implementation of GASB Statement No. 62 was not material.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The Sewer Fund implemented GASB Statement No. 63 on January 1, 2012. Statement No. 63 standardizes the presentation of deferred outflows of resources and deferred inflows of resources and their effect on a government's net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. The financial reporting impact resulting from the implementation of GASB Statement No. 63 is the change in terminology from net assets to net position.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an Amendment to GASB Statement No. 53)*. The Sewer Fund implemented GASB Statement No. 64 on January 1, 2012. Statement No. 64 clarifies whether an effective hedge relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. There was no impact on the Sewer Fund's financial statements as a result of the implementation of Statement No. 64.

Upcoming Accounting Standards — Other accounting standards that the Sewer Fund is currently reviewing for applicability and potential impact on the financial statements include:

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, will be effective for the Sewer Fund beginning with its year ending December 31, 2013. The objective of this statement is to establish accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

GASB Statement No. 66, *Technical Corrections -2012- an amendment of GASB Statements No. 10 and No. 62*, will be effective for the Sewer Fund beginning with its year ending December 31, 2013. The objective of this statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, establishes new financial reporting requirements for most governments that provide their employees with pension benefits through these types of plans. Statement No. 68 will be effective for the Sewer Fund beginning with its year ending December 31, 2015. GASB Statement No. 68 replaces the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and GASB Statement No. 50, *Pension Disclosures*, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. GASB Statement No. 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. The Statement also enhances accountability and transparency through revised and new note disclosures and required supplementary information.

GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, establishes accounting and financial reporting standards related to government combinations and disposals of government operations. Statement No. 69 will be effective for the Sewer Fund beginning with its year ending December 31, 2014. GASB Statement No. 69 requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions.

GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, establishes accounting and financial reporting standards for financial guarantees that are nonexchange transactions (nonexchange financial guarantees) extended or received by a state or local government. Statement No. 70 will be effective for the Sewer Fund beginning with its year ending December 31, 2014. GASB Statement No. 70 requires a government that has issued an obligation guaranteed in a nonexchange transaction to report the obligation until legally released as an obligor. This Statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. This Statement also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units. Requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions.

2. RESTRICTED AND UNRESTRICTED CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash Equivalents and Investments — As of December 31, 2012, the Sewer Fund had the following cash equivalents and investments (in thousands):

	<u>Investment Maturities (in Years)</u>				Fair Value
	Less than 1	1–5	6–10	More than 10	
U.S. agencies	\$ 15,909	\$ 112,952	\$ 121,258	\$ -	\$ 250,119
Certificates of deposits and other short-term	71,339				71,339
Commercial paper		2,984			2,984
Corporate bonds		11,603			11,603
Municipal bonds	<u>100</u>	<u>7,980</u>	<u>995</u>	<u>—</u>	<u>9,075</u>
Subtotal	<u>\$ 87,348</u>	<u>\$ 135,519</u>	<u>\$ 122,253</u>	<u>\$ -</u>	345,120
Share of City’s pooled funds					<u>18,796</u>
Total					<u>\$ 363,916</u>

As of December 31, 2011, the Sewer Fund had the following cash equivalents and investments (in thousands):

	<u>Investment Maturities (in Years)</u>				Fair Value
	Less than 1	1–5	6–10	More than 10	
U.S. agencies	\$ 3,001	\$ 101,161	\$ 4,001	\$ -	\$ 108,163
Certificates of deposits and other short-term	61,073				61,073
Corporate bonds		5,488			5,488
Municipal bonds	<u>—</u>	<u>101</u>	<u>—</u>	<u>—</u>	<u>101</u>
Subtotal	<u>\$ 64,074</u>	<u>\$ 106,750</u>	<u>\$ 4,001</u>	<u>\$ -</u>	174,825
Share of City’s pooled funds					<u>14,391</u>
Total					<u>\$ 189,216</u>

U.S. agencies include investments in government-sponsored enterprises, such as Federal National Mortgage Association, Federal Home Loan Banks, and Federal Home Loan Mortgage Corporation.

Interest Rate Risk — As a means of limiting its exposure to fair value losses arising from rising interest rates, the City’s investment policy requires that investments generally may not have a maturity date in excess of 10 years from the date of purchase. Certain other investments are held in accordance with the specific provisions of applicable ordinances.

Credit Risk — The Code limits investments in commercial paper to banks whose senior obligations are rated in the top 10 rating categories by at least two national rating agencies and who are required to

maintain such rating during the term of such investment. The Code also limits investments to domestic money market mutual funds regulated by, and in good standing with, the Securities and Exchange Commission. Certificates of deposit are also limited by the Code to national banks that provide collateral of at least 102% by marketable U.S. government securities marked to market at least monthly; or secured by a corporate surety bond issued by an insurance company licensed to do business in Illinois and having a claims-paying rating in the top rating category, as rated by a nationally recognized statistical rating organization maintaining such rating during the term of such investment. A schedule summarizing the Sewer Fund's exposure to credit risk as of December 31, 2012 and 2011, is as follows (in thousands):

Quality Rating	2012	2011
Aaa/AAA	\$ 8,508	\$ 41,613
Aa/AA	258,168	113,753
A/A	7,106	
Not rated	<u>71,338</u>	<u>19,459</u>
Total	<u>\$ 345,120</u>	<u>\$ 174,825</u>

The Sewer Fund participates in the City's pooled cash and investments account, which includes amounts from other City funds and is maintained by the City Treasurer. Individual cash or investments are not specifically identifiable to any participant in the pool. The Treasurer's pooled fund is included in the City's financial statements.

Custodial Credit Risk — Cash and Certificates of Deposit — This is the risk that in the event of a bank failure, the City's deposits may not be returned. The City's investment policy states that in order to protect the City's deposits, depository institutions are to maintain collateral pledges on City deposits during the term of the deposit of at least 102% of marketable U.S. government, or approved securities or surety bonds, issued by top-rated insurers. Collateral is required as security whenever deposits exceed the insured limits of the Federal Deposit Insurance Corporation. The bank balance of cash and certificates of deposit with the City's various municipal depositories was \$532.3 million as of December 31, 2012. Of the bank balance, 100% was either insured or collateralized with securities held by City agents in the City's name.

A schedule summarizing the investments reported in the basic financial statements as of December 31, 2012 and 2011, is as follows (in thousands):

	2012	2011
Per Note 2:		
Investments — Sewer Fund	\$ 345,120	\$ 174,825
Investments — City Treasurer pooled fund	<u>18,796</u>	<u>14,391</u>
	<u>\$ 363,916</u>	<u>\$ 189,216</u>
Per financial statements:		
Restricted investments	\$ 270,573	\$ 110,536
Unrestricted investments	16,952	14,521
Investments included as cash and cash equivalents on the statements of net position	<u>76,391</u>	<u>64,159</u>
	<u>\$ 363,916</u>	<u>\$ 189,216</u>

3. RESTRICTED ASSETS AND ACCOUNTS

Sewer service revenues are pledged to pay outstanding Wastewater Revenue Bonds. The ordinances authorizing the issuance of outstanding Wastewater Revenue Bonds provide for the creation of separate accounts into which net revenues, as defined, or proceeds to be credited, are as follows:

Wastewater Revenue Bonds, Refunding Bonds Series 1993 (the “Senior Lien Bonds”) and 1998A Wastewater Capital Appreciation Bonds:

Bond Principal and Interest Account — No later than 10 days prior to each principal or interest payment date, an amount to pay principal; premium, if any; and interest becoming due, whether upon maturity, redemption, or otherwise.

Debt Service Reserve Account — For each series, an amount equal to the least of (i) the maximum annual debt service requirement; (ii) 10% of the original principal amount, less original issue discount; or (iii) 125% of the average annual debt service requirement. The required balance in this account was met by the purchase of surety bonds.

Construction Account — Proceeds of the Senior Lien Bonds were deposited in this account for the purpose of paying construction costs of projects as defined in the ordinance.

Wastewater Revenue Bonds, Series 2012, 2010, 2008, 2004, 2001, 2000, 1998 B (the “Second Lien Bond”), Refunding Series 2004, and Refunding Series 2006 (the “Second Lien Bonds”):

Bond Principal and Interest Account — No later than the business day immediately preceding January 1 and July 1, an amount to pay principal; redemption premium, if any; and interest on the bonds. The City is also required to make deposits in the Second Lien Bonds’ account to meet other payment obligations under the indenture authorizing Second Lien Parity Bonds.

Debt Service Reserve Account — For each series, an amount equal to the least of (i) the highest future debt service requirement; (ii) 10% of the original principal amount, less original issue discount; or (iii) 125% of the average annual debt service requirement. The required balance in this account was met by the purchase of a surety bond.

Construction Account — Proceeds of the Second Lien Bonds were deposited in this account for the purpose of paying construction cost of projects as defined in the ordinance.

Sewer Rate Stabilization Account — Any net revenues remaining after providing sufficient funds for all required deposits in the bond accounts may be transferred to the Sewer Rate Stabilization Account upon the direction of the City to be used for any lawful purpose of the Sewer Fund.

For accounts established by ordinances with balances, the amounts as of December 31, 2012 and 2011, are as follows (in thousands):

	2012	2011
Construction	\$ 258,349	\$ 58,552
Bond principal and interest	53,811	49,318
Sewer rate stabilization	<u>29,629</u>	<u>25,703</u>
Total	<u>\$ 341,789</u>	<u>\$ 133,573</u>

At December 31, 2012 and 2011, management was not aware of any instances of noncompliance with the above terms of the ordinances.

4. LONG-TERM DEBT

As of December 31, 2012 and 2011, long-term debt consisted of the following (in thousands):

	2012	2011
\$232,880 Series 1993 Wastewater Transmission Revenue Bonds Refunding issued March 1, 1993, due through 2013; interest at 5.125% to 6.5%	\$ 8,760	\$ 22,820
\$109,998 Series 1998A and B Wastewater Transmission Revenue Bonds issued March 18, 1998, due through 2030; interest at 4.0% to 5.25%	35,168	35,168
\$114,585 Series 2001A Wastewater Transmission Revenue Bonds issued December 6, 2001, due through 2036; interest at 3.5% to 5.5%		1,950
\$73,100 Series 2001 Wastewater Transmission Revenue Bonds issued December 6, 2001, due through 2031; interest at 4.0% to 5.5%	68,570	71,556
\$61,925 Series 2004B Wastewater Transmission Revenue Bonds issued July 29, 2004, due through 2016; interest at 3.0% to 5.25%	45,125	48,190
\$155,030 Series 2006A & B Wastewater Transmission Revenue Bonds issued November 1, 2006, due through 2039; Series A interest at 4.0% to 5.0% (4.0% at December 31, 2006); Series B interest at 4.0% to 5.0%	147,135	148,555
\$167,635 Series 2008A Wastewater Transmission Revenue Bonds issued November 5, 2008, due through 2038; interest at 3.5% to 5.5%	160,110	163,090
\$332,230 Series 2008C Wastewater Transmission Revenue Bonds (2004A Refunded) issued October 16, 2008, due through 2039; variable floating interest rate	332,230	332,230
\$275,865 Series 2010A & B Wastewater Transmission Revenue Bonds issued November 16, 2010, due through 2040; interest at 2.0% to 6.0%	274,810	275,865
\$1,546 Illinois Environmental Protection Agency Loan Agreement signed May 28, 2008, due through 2027; interest at 2.50%	1,242	1,377
\$276,470 Series 2012 Wastewater Transmission Revenue Bonds issued September 13, 2012, due through 2042; interest at 3.0% to 5.0%	276,470	
\$15,000 Illinois Environmental Protection Agency Loan Agreement signed January 20, 2010, due through 2031; interest at 0%	<u>14,154</u>	<u>11,288</u>
Total revenue bonds	1,363,774	1,112,089
Add accretion of Series 1998 Capital Appreciation Bonds	41,151	37,242
Add unamortized net bond discount/premium	37,701	16,142
Less current portion (payable from restricted assets)	(29,690)	(28,429)
Less unamortized deferred loss on bond refunding	<u>(26,493)</u>	<u>(32,276)</u>
Long-term portion — net	<u>\$ 1,386,443</u>	<u>\$ 1,104,768</u>

During the years ended December 31, 2012 and 2011, long-term debt changed as follows (in thousands):

	Balance January 1, 2012	Additions	Reductions	Balance December 31, 2012	Due within One Year
Revenue bonds	\$ 1,112,089	\$ 280,182	\$ (28,497)	\$ 1,363,774	\$ 29,690
Accretion of series 1998 capital appreciation bonds	37,242	3,909		41,151	
Unamortized net discount/premium	16,142	29,305	(7,746)	37,701	
Deferred loss on bond refunding	<u>(32,276)</u>		<u>5,783</u>	<u>(26,493)</u>	
Total revenue bonds	<u>\$ 1,133,197</u>	<u>\$ 313,396</u>	<u>\$ (30,460)</u>	<u>\$ 1,416,133</u>	<u>\$ 29,690</u>
	Balance January 1, 2011	Additions	Reductions	Balance December 31, 2011	Due within One Year
Revenue bonds	\$ 1,125,992	\$ 11,288	\$ (25,191)	\$ 1,112,089	\$ 28,429
Accretion of series 1998 capital appreciation bonds	33,532	3,710		37,242	
Unamortized net discount/premium	15,883	259		16,142	
Deferred loss on bond refunding	<u>(38,063)</u>		<u>5,787</u>	<u>(32,276)</u>	
Total revenue bonds	<u>\$ 1,137,344</u>	<u>\$ 15,257</u>	<u>\$ (19,404)</u>	<u>\$ 1,133,197</u>	<u>\$ 28,429</u>

Interest expense capitalized for 2012 and 2011 totaled \$5.9 million and \$11.4 million, respectively.

Interest expense includes amortization of the loss on bond refunding for 2012 and 2011 of \$5.8 million; amortization of net bond discount/premium of \$7.7 million and \$0.0 million, respectively; and accretion of Series 1998 capital appreciation bonds of \$3.9 million and \$3.7 million, respectively.

As defined in the ordinances, net revenues are pledged for the payment of principal and interest on the bonds. The ordinances require that net revenues available for bonds equal 115% of the senior lien debt service requirement and that net revenues available for bonds equal the sum of 100% of the aggregate annual senior lien debt service requirement and 100% of the aggregate annual second lien debt service requirement. The above requirements were met for 2012 and 2011.

Rate Increases — Sewer service rates are set by ordinance. The sewer service charge is established in an amount designed to pay the costs of Sewer Fund operations and capital improvements, including any related debt service. During 2012 and 2011, the charge for sewer service was increased and was an amount equal to 89% of the gross amount charged for water service, whether such water service is metered or nonmetered. The rate charged for water was increased and was \$18.75 per 1,000 cubic feet and \$15 per 1,000 cubic feet during 2012 and 2011, respectively.

Issuance of Debt — On January 20, 2010, a loan agreement was signed with the Illinois Environment Protection Agency to replace antiquated, damaged, and/or inadequate combined sewers. In 2011, the Sewer Fund drew \$11.3 million from this loan agreement. The loan has an interest rate of 0% with maturity dates from December 14, 2011 to June 14, 2031. In 2012, the Sewer Fund drew \$3.7 million from this loan agreement. The loan has an interest rate of 0% with maturity dates from June 21, 2013 to June 21, 2031.

Second Lien Wastewater Revenue Project, Series 2012 (\$276.5 million) were sold at a premium on September 13, 2012. The bonds have interest rates ranging from 3.0% to 5.0% and maturity dates from January 1, 2014 to January 1, 2042. Net proceeds of \$303.8 million will be used to finance certain costs of improvements and extensions to the wastewater system (\$300.0 million), and fund certain capitalized interest (\$3.8 million).

Following is a schedule of debt service requirements to maturity (in thousands):

Years Ending December 31	Principal	Interest	Total Debt Service
2013	\$ 29,690	\$ 53,479	\$ 83,169
2014	35,907	64,797	100,704
2015	37,599	63,159	100,758
2016	39,436	61,323	100,759
2017	41,296	59,438	100,734
2018–2022	208,921	296,409	505,330
2023–2027	221,817	285,511	507,328
2028–2032	248,848	196,756	445,604
2033–2037	306,870	104,977	411,847
2038–2042	<u>193,390</u>	<u>24,599</u>	<u>217,989</u>
Total	<u>\$1,363,774</u>	<u>\$1,210,448</u>	<u>\$2,574,222</u>

The Sewer Fund’s variable-rate bonds may bear interest from time to time at a flexible rate, a daily rate, a weekly rate, an adjustable long rate, a fixed rate or an index rate as determined from time to time by the City in consultation with the remarketing agent, as applicable. At December 31, 2012, the variable-rate bonds were in the index rate interest mode. For the requirements calculated above, interest on variable-rate debt was calculated at the swap rate in effect at December 31, 2012. The City has entered into continuing covenant agreements with the direct purchase providers, which expire December 1, 2014. In the event the bonds are not successfully remarketed upon expiration, the bonds will convert to a term loan. There is no principal due on potential term loans within the next fiscal year.

Derivatives

Pay-Fixed, Receive-Variable Interest Rate Swaps:

Objective of the Swaps — In order to protect against the potential of rising interest rates, the Sewer Fund has entered into various separate pay-fixed, receive-variable interest rate swaps at a cost less than what the Sewer Fund would have paid to issue fixed-rate debt.

Governmental Activities	Changes in Fair Value		Fair Value at December 31, 2012		Notional
	Classification	Amount	Classification	Amount	
Cash flow hedges — pay-fixed interest rate swaps	Deferred outflow of resources	<u>\$ (1,758)</u>	Deferred outflow of resources	<u>\$ 89,955</u>	<u>\$332,230</u>

Terms, Fair Values, and Credit Risk —The notional amounts of the swaps match the principal amounts of the associated debt. The Sewer Fund’s swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled or anticipated

reductions in the associated “bonds payable” category. Under the swap, the Sewer Fund pays the counterparty a fixed payment and receives a variable payment computed according to the London InterBank Offered Rate (LIBOR) and/or the Securities Industry and Financial Markets Association (SIFMA). The terms, including the fair value and credit ratings of the outstanding swaps, as of December 31, 2012, are as follows (in thousands):

Associated Bond Issue	Notional Amount	Effective Date	Terms	Fair Values	Maturity Date	Counter-Party Credit Rating
Hedging instruments:						
Wastewater transmission	\$232,560	1/3/2011	Pay 3.886%; receive 95% LIBOR	\$(62,760)	1/1/2039	A2/A+
Variable rent revenue	49,835	7/29/2004	Pay 3.886%; receive SIFMA	(13,681)	1/1/2039	A3/A
Series 2008C	<u>49,835</u>	7/29/2004	Pay 3.886%; receive SIFMA	<u>(13,514)</u>	1/1/2039	Aa3/A+
Total	<u>\$332,230</u>			<u>\$(89,955)</u>		

Fair Value — As of December 31, 2012 and 2011, the swaps had a negative fair value of \$89.9 million and \$91.7 million, respectively. As per industry convention, the fair values of the Sewer Fund’s outstanding swaps were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the forward rates implied by the yield curve correctly anticipate future spot rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap. Because interest rates declined subsequent to the date of execution, the Sewer Fund’s swaps had negative values.

Credit Risk — The Sewer Fund is exposed to credit risk (counterparty risk) through the counterparties with which it enters into agreements. If minimum credit rating requirements are not maintained, the counterparty is required to post collateral to a third party. This protects the Sewer Fund by mitigating the credit risk, and therefore the ability to pay a termination payment, inherent in a swap. Collateral on all swaps is to be in the form of cash or eligible collateral held by a third-party custodian. Upon credit events, the swaps also allow transfers, credit support, and termination, if the counterparty is unable to meet the said credit requirements.

Basis Risk — Basis risk refers to the mismatch between the variable-rate payments received on a swap contract and the interest payment actually owed on the bonds. The two significant components driving this risk are credit and Bond Market Association (BMA) ratios. Credit may create basis risk because the Sewer Fund’s bonds may trade differently than the swap index as a result of a credit change in the Sewer Fund. BMA ratios (or spreads) may create basis risk if BMA swaps of the Sewer Fund’s bonds trade higher than the BMA received on the swap. This can occur due to many factors, including, without limitation, changes in marginal tax rates, tax-exempt status of bonds, and supply and demand for variable-rate bonds. The Sewer Fund is exposed to basis risk on the swaps if the rate paid on the bonds is higher than the rate received. The Sewer Fund is liable for the difference. The difference would need to be available on the debt service payment date and would add additional underlying cost to the transaction.

Swap Risk — The swap exposes the Sewer Fund to tax risk or a permanent mismatch (shortfall) between the floating rate received on the swap and the variable-rate paid on the underlying variable-rate bonds due to tax law changes such that the federal or state tax exemption of municipal debt is eliminated or its value reduced. There have been no tax law changes since the execution of the Sewer Fund’s swap transactions.

Termination Risk — The risk that the swap could be terminated as a result of certain events, including a ratings downgrade for the issuer or swap counterparty, covenant violation, bankruptcy, payment default, or other defined events of default. Termination of a swap may result in a payment made by the issuer or to the issuer, depending upon the market at the time of termination.

Swap Payments and Associated Debt — As of December 31, 2012, debt service requirements for the Sewer Fund’s outstanding variable-rate debt and net swap payments, assuming current interest rates remain the same, for their term are as follows (in thousands):

Years Ending December 31	Variable-Rate Bonds		Interest Rate	Total
	Principal	Interest	Swaps — Net	
2013	\$ -	\$ 2,678	\$ 10,232	\$ 12,910
2014		2,678	10,232	12,910
2015		2,678	10,232	12,910
2016	16,980	2,678	10,232	29,890
2017	17,695	2,541	9,709	29,945
2018–2022	85,205	10,688	40,836	136,729
2023–2027	77,240	6,932	26,482	110,654
2028–2032	56,025	4,673	17,853	78,551
2033–2037	67,170	2,027	7,744	76,941
2038–2042	11,915	96	367	12,378
Total	<u>\$ 332,230</u>	<u>\$ 37,669</u>	<u>\$ 143,919</u>	<u>\$ 513,818</u>

5. UTILITY PLANT

During the years ended December 31, 2012 and 2011, utility plant changed as follows (in thousands):

	Balance January 1, 2012	Additions	Disposals and Transfers	Balance December 31, 2012
Utility plant not depreciated:				
Land and land rights	\$ 560	\$ -	\$ -	\$ 560
Construction in progress	<u>79,210</u>	<u>33,011</u>	<u>(79,210)</u>	<u>33,011</u>
Total utility plant not depreciated	<u>79,770</u>	<u>33,011</u>	<u>(79,210)</u>	<u>33,571</u>
Utility plant being depreciated:				
Facilities and structures	1,794,330	257,349	(9,846)	2,041,833
Furniture and equipment	<u>31,630</u>	<u>2,895</u>	<u>(3,816)</u>	<u>30,709</u>
Total utility plant being depreciated	<u>1,825,960</u>	<u>260,244</u>	<u>(13,662)</u>	<u>2,072,542</u>
Less accumulated depreciation:				
Facilities and structures	(388,554)	(24,871)		(413,425)
Furniture and equipment	<u>(22,494)</u>	<u>(1,729)</u>	<u>2,874</u>	<u>(21,349)</u>
Total accumulated depreciation	<u>(411,048)</u>	<u>(26,600)</u>	<u>2,874</u>	<u>(434,774)</u>
Utility plant being depreciated — net	<u>1,414,912</u>	<u>233,644</u>	<u>(10,788)</u>	<u>1,637,768</u>
Utility plant — net	<u>\$ 1,494,682</u>	<u>\$ 266,655</u>	<u>\$ (89,998)</u>	<u>\$ 1,671,339</u>
	Balance January 1, 2011	Additions	Disposals and Transfers	Balance December 31, 2011
Utility plant not depreciated:				
Land and land rights	\$ 560	\$ -	\$ -	\$ 560
Construction in progress	<u>11,709</u>	<u>79,210</u>	<u>(11,709)</u>	<u>79,210</u>
Total utility plant not depreciated	<u>12,269</u>	<u>79,210</u>	<u>(11,709)</u>	<u>79,770</u>
Utility plant being depreciated:				
Facilities and structures	1,709,455	94,712	(9,837)	1,794,330
Furniture and equipment	<u>27,880</u>	<u>5,287</u>	<u>(1,537)</u>	<u>31,630</u>
Total utility plant being depreciated	<u>1,737,335</u>	<u>99,999</u>	<u>(11,374)</u>	<u>1,825,960</u>
Less accumulated depreciation:				
Facilities and structures	(368,099)	(20,455)		(388,554)
Furniture and equipment	<u>(19,177)</u>	<u>(4,459)</u>	<u>1,142</u>	<u>(22,494)</u>
Total accumulated depreciation	<u>(387,276)</u>	<u>(24,914)</u>	<u>1,142</u>	<u>(411,048)</u>
Utility plant being depreciated — net	<u>1,350,059</u>	<u>75,085</u>	<u>(10,232)</u>	<u>1,414,912</u>
Utility plant — net	<u>\$ 1,362,328</u>	<u>\$ 154,295</u>	<u>\$ (21,941)</u>	<u>\$ 1,494,682</u>

6. PENSION PLANS

Eligible Sewer Fund employees participate in one of two of the City's single-employer defined benefit pension plans. These plans are the Municipal Employees' Annuity and Benefit Fund and the Laborers' and Retirement Board Employees' Annuity and Benefit Funds. These plans are administered by individual retirement boards represented by elected and appointed officials. Each plan issues publicly available financial statements for each of the pension plans that may be obtained at the respective fund's office.

The funds provide retirement, death, and disability benefits as established by State law. Benefits generally vest after 20 years of credited service. Employees who retire at or after age 55 with at least 10 years of credited service qualify to receive a money purchase annuity and those with more than 20 years of credited service qualify to receive a minimum formula annuity. The annuity is computed by multiplying the final average salary by a minimum of 2.4% per year of credited service. The final average salary is the employee's highest average annual salary for any four consecutive years within the last 10 years of credited service.

Participating employees contribute 8.5% of their salary to these funds as required by State law. By law, the City's contributions are based on the amounts contributed by the employees. Financing of the City's contribution is through a separate property tax levy and the personal property replacement tax. The Sewer Fund reimburses the City's General Fund for the estimated pension cost applicable to the covered payroll of the Sewer Fund employees. These reimbursements, recorded as expenses of the Sewer Fund, were \$4.7 million and \$4.3 million in 2012 and 2011, respectively. The annual pension costs are determined using the entry-age normal actuarial cost method and the level-dollar amortization method.

The funding policy mandated by State law requires City contributions at statutorily, not actuarially, determined rates. The rates are expressed as multiples of employee contributions. These contributions equal employee contributions made in the calendar year two years prior to the year for which the applicable tax is levied, multiplied by the statutory rates. The statutory rates in effect for the City's contributions made during the years ended December 31, 2012 and 2011, were 1.25 for the Municipal Employees' Annuity and Benefit Fund and 1.00 for the Laborers' and Retirement Board Employees' Annuity and Benefit Fund. The City has made the required contributions under State law.

The following table as of December 31, 2012, assists users in assessing each pension fund's progress in accumulating sufficient assets to pay benefits when due. The three-year historical information for each annuity and benefit fund, which includes all City employees within each respective annuity and benefit fund, is as follows (dollars in thousands):

	Annual Pension Cost	Percent of Pension Cost Contributed	Annual Required Contribution	Required Actual Contribution	Net Pension Obligation (Asset)
Municipal employees:					
2010	\$ 482,420	32.1 %	\$ 483,948	32.0 %	\$ 1,007,406
2011	609,491	24.1	462,482	24.0	1,469,886
2012	687,519	21.7	690,823	21.5	2,008,546
Laborers:					
2010	\$ 47,129	32.6 %	\$ 46,665	32.9 %	\$ (175,585)
2011	57,651	22.2	57,259	22.3	(129,712)
2012	77,858	15.2	77,566	15.3	(63,707)

The pension benefits information pertaining expressly to the Sewer Fund employees is not available, as the obligation is the responsibility of the general government. Accordingly, no amounts have been recorded in the accompanying basic financial statements for the net pension assets or liabilities of these plans. Amounts for the City are recorded within the City's government-wide financial statements.

7. OTHER POSTEMPLOYMENT BENEFITS — CITY OBLIGATION

In addition to providing pension benefits, under State law, the City provides certain health benefits to employees who retire from the City based upon their participation in the City's pension plans. Substantially all employees who qualify as municipal employees' or laborers' pension plan participants older than age 55 with at least 20 years of service may become eligible for postemployment benefits if they eventually become annuitants. Health benefits include basic benefits for annuitants and supplemental benefits for Medicare-eligible annuitants. Currently, the City does not segregate benefit payments to annuitants by fund. The cost of health benefits is recognized as claims are reported and are funded on a pay-as-you-go basis. The total cost to the City for providing health benefits to approximately 24,408 annuitants and their dependents was approximately \$97.5 million and \$99.1 million in 2012 and 2011, respectively.

The annuitants who retired prior to July 1, 2005, received a 55% subsidy from the City and the annuitants who retired on or after July 1, 2005, received a 50%, 45%, 40%, and 0% subsidy from the City based on the annuitant's length of actual employment with the City for the gross cost of retiree health care under a court-approved settlement agreement (the "Settlement Agreement"). During 2012 and 2011, the pension funds contributed \$65 for each Medicare-eligible annuitant and \$95 for each non-Medicare-eligible annuitant to their gross cost. The annuitants contributed a total of \$67.8 million and \$68.3 million in 2012 and 2011, respectively, to the gross cost of their retiree health care pursuant to premium amounts set forth in the above-referenced Settlement Agreement.

The City's net expense and the annuitants' contribution indicated above are preliminary and subject to the reconciliation per the Settlement Agreement.

Plan Description Summary — The City is party to a written legal Settlement Agreement outlining the provisions of the retiree health program, the Settlement Health Care Plans (the "Plans"), through June 30, 2013. The Settlement Agreement does not require or extend continuation of the Plans after June 30, 2013. Pursuant to the Settlement Agreement, the City administers a single-employer-defined benefit health care plan (the "Health Plan"), for which the City pays a portion of the costs on a pay-as-you-go method. Under the Settlement Agreement, the City sponsors health benefit plans for employees, former employees, and retired employees. The provisions of the program provide, in general, that the City pay a percentage of the cost (based upon an employee's service) for hospital and medical coverage to eligible retired employees and their dependents for a specified period, until June 30, 2013.

In addition, Illinois Compiled Statutes authorize the respective pension funds to provide a fixed monthly dollar subsidy to each annuitant who has elected coverage under the Health Plan through June 30, 2013. After that date, no supplements are authorized.

The liabilities for the monthly dollar supplements paid to annuitants enrolled in the retiree medical plan by their respective pension funds are included in the liabilities and reports of the respective pension funds (see Note 6).

Special Benefits under the Collective Bargaining Agreements (CBA) — Under the terms of the latest collective bargaining agreements for the Fraternal Order of Police and the International Association of Fire Fighters, certain employees who retire after attaining age 55 with the required years of service are

permitted to enroll themselves and their dependents in the healthcare benefit program offered to actively employed members. They may keep this coverage until they reach the age of Medicare eligibility. These retirees do not contribute towards the cost of coverage, but the Police pension fund contributes \$95 per month towards coverage for police officers (which is assumed to continue); the Fire Pension Fund does not contribute. Once CBA early retirees reach Medicare eligibility age, their healthcare benefits are provided under the provisions of the Settlement Plan.

No extension of the CBA has been negotiated as of the end of the governing contract period (June 30, 2012), and therefore this valuation assumes the expiration of the early retirement special benefits as of December 31, 2012, but includes the liabilities for continuation of payments to those members already retired under the CBA as of December 31, 2012.

Funding Policy — The City’s Health Plan is a single-employer plan that operates on a pay-as-you-go funding basis. No assets are accumulated or dedicated to funding the Health Plan benefits.

Annual OPEB Cost and Net OPEB Obligation — The City’s annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the employer. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and to amortize any unfunded actuarial liabilities over a period of one years (the remaining years of coverage under the Settlement Agreement).

The following table shows the components of the City’s annual OPEB costs for the year for the Health Plan, the amount actually contributed to the Health Plan, and changes in the City’s net OPEB obligation to the Health Plan. The net OPEB obligation is the amount entered upon the City’s statements of net position as of year-end as the net liability for the OPEBs. The amount of the annual cost for the Health Plan that is to be recorded in the statements of changes in net position is the annual OPEB cost (expense) (in thousands).

	Annual OPEB Cost and Contributions Made (In thousands)	
	2012 Health Plan	2011 Health Plan
Contribution rates:		
City	Pay as you go	Pay as you go
Plan members	N/A	N/A
Annual required contribution	\$ 252,747	\$ 200,062
Interest on net OPEB obligation	3,816	4,567
Adjustment to annual required contribution	<u>(179,586)</u>	<u>(155,675)</u>
Annual OPEB cost	76,977	48,954
Contributions made	<u>115,961</u>	<u>99,091</u>
Decrease in net OPEB obligation	(38,984)	(50,137)
Net OPEB obligation — beginning of year	<u>254,345</u>	<u>304,482</u>
Net OPEB obligation — end of year	<u>\$ 215,361</u>	<u>\$ 254,345</u>

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the Health Plan, and the net OPEB obligation for fiscal years 2012, 2011, and 2010 are as follows (in thousands):

Fiscal Years Ended	Schedule of Contributions, OPEB Costs, and Net Obligations		
	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
December 31, 2012	\$ 76,977	150.6 %	\$ 215,361
December 31, 2011	48,954	202.4	254,345
December 31, 2010	82,874	129.6	304,483

Funded Status and Funding Progress — As of December 31, 2011, the most recent actuarial valuation date, the actuarial accrued liability (AAL) for benefits for all eligible City employees and retirees was \$471.0 million, all of which was unfunded. The covered payroll (annual payroll of active employees covered by the Health Plan) was approximately \$2,518.8 million, and the ratio of the unfunded actuarial accrued liability (UAAL) to the covered payroll was 7.6%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the health care cost trend. Amounts determined regarding the funded status of the Health Plan and the ARC of the employer are subject to continual revisions as the results are compared with past expectations and new estimates are made about the future.

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL)	Funded Ratio	Covered Payroll
December 31, 2011	\$ -	\$ 470,952	\$ 470,952	- %	\$ 2,518,735
December 31, 2010		390,611	390,611		2,475,080

Actuarial Method and Assumptions — Projections of benefits for financial reporting purposes are based on the substantive plan (the plan understood by the employer and plan members) and included the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial method and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

For the Health Plan benefits (not provided by the pension funds) in the actuarial valuation for the fiscal years ended December 31, 2012 and 2011, the projected unit credit actuarial cost method was used. The actuarial assumptions included an annual health care cost trend rate of 10.5% initially, reduced by decrements to an ultimate rate of 5.0%. Both rates included a 3% inflation assumption. The Health Plan has not accumulated assets and does not hold assets in a segregated trust. However, the funds expected to be used to pay benefits are assumed to be invested for durations, which will yield an annual return rate of 1.5%. The unfunded accrued actuarial liability, as of December 31, 2012, is being amortized as a level-dollar amount over one to five years.

Summary of Assumptions and Methods		
Item	Health Plan	
	2012	2011
Actuarial valuation date	December 31, 2011	December 31, 2010
Actuarial cost method	Projected unit credit	Projected unit credit
Amortization method	Level dollar	Level dollar
Remaining amortization period	1 to 5 years	2 years
Asset valuation method	Market value	Market value
Actuarial assumptions:		
Investment rate of return	1.5%	1.5%
Projected salary increases	3.0%	2.5%
Healthcare inflation rate	10.5% initial to 5% ultimate	11.5% initial to 10.5% ultimate

The OPEB information pertaining expressly to the Sewer Fund employees is not available as the obligation is the responsibility of the general government. Accordingly, no amounts have been recorded in the accompanying basic financial statements. Amounts for the City are recorded within the City's government-wide financial statements.

8. RELATED-PARTY TRANSACTIONS

Included in operating expenses are reimbursements to the General Fund of the City and certain other funds for services provided by other City departments, employee fringe benefits, and certain payments made on behalf of the Sewer Fund. Such reimbursements amounted to \$31.7 million and \$29.1 million in 2012 and 2011, respectively.

9. COMMITMENTS AND CONTINGENCIES

The Sewer Fund has certain contingent liabilities resulting from litigation, claims, or commitments incident to the ordinary course of business. Management expects that final resolution of these contingencies will not have a material adverse effect on the financial position or results of operations of the Sewer Fund.

The Sewer Fund provides workers' compensation benefits and employee health benefits under self-insurance programs administered by the City. Such claims outstanding, including claims incurred but not reported, are estimated and recorded as liabilities in the basic financial statements.

Uninsured claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate for claims that have been incurred, but not reported. Changes in the claims liability amount for the years ended December 31, 2012 and 2011, are as follows (in thousands):

	2012	2011
Balance — January 1	\$ 16,794	\$ 18,404
Claims incurred on current and prior-year events	11,919	9,870
Claims paid on current and prior-year events	<u>(12,770)</u>	<u>(11,480)</u>
Balance — December 31	<u>\$ 15,943</u>	<u>\$ 16,794</u>

The City purchases annuity contracts from commercial insurers to satisfy certain liabilities; accordingly, no liability is reported for those claims. Property and casualty risks for the Sewer Fund are transferred to commercial insurers. Claims have not exceeded the purchased insurance coverage in the past three years.

At December 31, 2012 and 2011, the Sewer Fund entered into contracts with outstanding commitments of approximately \$63.9 million and \$35.2 million, respectively, for construction projects.

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STATISTICAL DATA

The statistical data section includes selected financial and operating information, generally presented on a multiyear basis. The statistical section information is presented in five categories: financial trends, revenue capacity, debt capacity, operating information, and demographic and economic information. Schedules in the statistical section are the following:

Financial Trends — These schedules contain trend information to help the reader understand how the Sewer Fund's financial performance and well-being have changed over time.

Revenue Capacity — These schedules contain information to help the reader assess the Sewer Fund's most significant revenue source, sewer sales.

Debt Capacity — These schedules present information to help the reader assess the affordability of the Sewer Fund's current levels of outstanding debt and the Sewer Fund's ability to issue additional debt in the future.

Operating Information — These schedules contain service and infrastructure data to help the reader understand how the information in the Sewer Fund's financial report relates to the services the Sewer Fund provides and the activities it performs.

Demographic and Economic Information — These schedules offer demographic and economic indicators to help the reader understand the environment within which the City's financial activities take place.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**NET POSITION BY COMPONENT
FIVE YEARS ENDED DECEMBER 31, 2008–2012
(In thousands)
(Unaudited)**

	2008	2009	2010	2011	2012
NET POSITION:					
Net investment in capital assets	\$ 413,481	\$ 391,248	\$ 414,766	\$ 454,079	\$ 455,195
Restricted for capital projects		9,533	11,110	24,610	50,014
Unrestricted	<u>54,333</u>	<u>52,920</u>	<u>64,828</u>	<u>25,588</u>	<u>60,436</u>
TOTAL	<u>\$ 467,814</u>	<u>\$ 453,701</u>	<u>\$ 490,704</u>	<u>\$ 504,277</u>	<u>\$ 565,645</u>

The Sewer Fund intends to provide ten years of information as it becomes available.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**CHANGES IN NET POSITION
FIVE YEARS ENDED DECEMBER 31, 2008–2012
(In thousands)
(Unaudited)**

	2008	2009	2010	2011	2012
OPERATING INCOME:					
Operating revenues	\$ 160,005	\$ 175,163	\$ 198,229	\$ 203,349	\$ 253,912
Operating expenses	98,487	109,643	113,881	113,930	113,575
Depreciation and amortization	<u>20,982</u>	<u>21,878</u>	<u>23,775</u>	<u>25,917</u>	<u>27,735</u>
Total operating income	40,536	43,642	60,573	63,502	112,602
NONOPERATING EXPENSES	<u>(37,849)</u>	<u>(57,755)</u>	<u>(26,706)</u>	<u>(51,793)</u>	<u>(53,734)</u>
INCOME BEFORE CAPITAL GRANTS	2,687	(14,113)	33,867	11,709	58,868
CAPITAL GRANTS	<u> </u>	<u> </u>	<u>3,136</u>	<u>1,864</u>	<u>2,500</u>
CHANGE IN NET POSITION	<u>\$ 2,687</u>	<u>\$ (14,113)</u>	<u>\$ 37,003</u>	<u>\$ 13,573</u>	<u>\$ 61,368</u>

The Sewer Fund intends to provide ten years of information as it becomes available.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
HISTORICAL FINANCIAL OPERATIONS
TEN YEARS ENDED DECEMBER 31, 2003–2012
(In thousands) (Unaudited)**

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
OPERATING REVENUES:										
Sewer sales	\$140,754	\$142,680	\$141,314	\$134,323	\$137,021	\$158,698	\$173,906	\$197,455	\$202,323	\$252,943
Other operating revenue	<u>1,619</u>	<u>2,308</u>	<u>2,208</u>	<u>2,114</u>	<u>1,660</u>	<u>1,307</u>	<u>1,257</u>	<u>774</u>	<u>1,026</u>	<u>969</u>
Total operating revenues	<u>142,373</u>	<u>144,988</u>	<u>143,522</u>	<u>136,437</u>	<u>138,681</u>	<u>160,005</u>	<u>175,163</u>	<u>198,229</u>	<u>203,349</u>	<u>253,912</u>
OPERATING EXPENSES:										
Repairs	35,196	31,023	33,981	34,770	35,759	37,786	42,110	42,509	38,805	35,708
Maintenance	23,772	19,315	18,966	18,964	19,034	18,626	24,380	24,075	23,655	21,819
Administrative and general	4,551	5,605	5,454	6,499	7,796	15,746	14,403	17,179	18,802	21,254
General Fund reimbursements	25,779	25,272	26,823	22,569	22,973	23,287	25,431	27,065	29,124	31,709
Engineering	<u>6,461</u>	<u>4,505</u>	<u>3,587</u>	<u>1,213</u>	<u>732</u>	<u>3,042</u>	<u>3,319</u>	<u>3,053</u>	<u>3,544</u>	<u>3,085</u>
Total operating expenses	<u>95,759</u>	<u>85,720</u>	<u>88,811</u>	<u>84,015</u>	<u>86,294</u>	<u>98,487</u>	<u>109,643</u>	<u>113,881</u>	<u>113,930</u>	<u>113,575</u>
NONOPERATING REVENUES	<u>276</u>	<u>140</u>	<u>802</u>	<u>1,063</u>	<u>939</u>	<u>817</u>	<u>234</u>	<u>643</u>	<u>2,870</u>	<u>867</u>
NET REVENUES — As defined	<u>\$ 46,890</u>	<u>\$ 59,408</u>	<u>\$ 55,513</u>	<u>\$ 53,485</u>	<u>\$ 53,326</u>	<u>\$ 62,335</u>	<u>\$ 65,754</u>	<u>\$ 84,991</u>	<u>\$ 92,289</u>	<u>\$141,204</u>

Source: City of Chicago Comptroller's Office.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
FIVE LARGEST CUSTOMERS
(In thousands) (Unaudited)**

	2008	2009	2010	2011	2012
	Amount of	Amount of	Amount of	Amount of	Amount of
	Sales	Sales	Sales	Sales	Sales
Department of Aviation	\$ 1,230	\$ 1,331	\$ 1,744	\$ 1,593	\$ 1,927
Humboldt Park	494	754	435	1,842	1,179
WR Grace and Company	285	347			
Calumet Park		270	315	316	
Pepsi Cola General Bottlers		237			
Lincoln Park	692			310	745
Northwestern University	541				
Columbus Park			258		
Chicago Park District					
University of Chicago — HCC				339	1,428
University of Illinois at Chicago					1,647
Hometown			546		
	<u>\$ 3,242</u>	<u>\$ 2,939</u>	<u>\$ 3,298</u>	<u>\$ 4,400</u>	<u>\$ 6,926</u>

The Sewer Fund intends to provide ten years of information as it becomes available.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
CUSTOMERS BY COMPONENT
(In thousands) (Unaudited)**

	2008 Amount of Sales	2009 Amount of Sales	2010 Amount of Sales	2011 Amount of Sales	2012 Amount of Sales
Residential	\$ 105,072	\$ 124,600	\$ 144,145	\$ 139,598	\$ 178,399
Industrial/commercial	34,363	38,376	44,540	50,915	57,598
Governmental	<u>8,931</u>	<u>10,930</u>	<u>9,544</u>	<u>12,836</u>	<u>17,915</u>
	<u>\$ 148,366</u>	<u>\$ 173,906</u>	<u>\$ 198,229</u>	<u>\$ 203,349</u>	<u>\$ 253,912</u>

The Sewer Fund intends to provide ten years of information as it becomes available.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
RECENT SEWER SERVICE RATES
(Unaudited)**

Effective Date	Gross Water Rate Per 1,000 Cubic Feet	Sewer Rate	
		Percent of Water Bill	Per 1000 Cubic Feet
January 1, 2003	9.38	83 %	\$ 7.49
January 1, 2004	9.66	83	8.02
January 1, 2005	9.95	83	8.26
January 1, 2006	9.95	83	8.26
January 1, 2007	9.95	83	8.26
January 1, 2008	11.44	84	9.61
January 1, 2009	13.16	85	11.18
January 1, 2010	15.00	86	12.90
January 1, 2011	15.00	86	12.90
January 1, 2012	18.75	89	16.69

Source: City of Chicago Department of Water Management.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
SEWER SYSTEM ACCOUNTS
TEN YEARS ENDED DECEMBER 31, 2003–2012
(Unaudited)**

Years Ended December 31	Water Accounts			Exempt	Sewer Accounts
	Non- Metered	Metered	Total		
2003	325,789	165,440	491,229	55,064	436,165
2004	324,689	167,545	492,234	54,809	437,425
2005	323,740	169,664	493,404	55,797	437,607
2006	322,193	171,861	494,054	58,599	435,455
2007	320,579	175,256	495,835	61,700	434,135
2008	319,205	178,457	497,662	63,929	433,733
2009	318,088	179,649	497,737	64,965	432,772
2010	314,002	183,618	497,620	65,450	432,170
2011	304,519	192,304	496,823	65,903	430,920
2012	290,863	205,097	495,960	61,502	434,458

Source: City of Chicago Department of Water Management.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
REVENUE BOND COVERAGE
TEN YEARS ENDED DECEMBER 31, 2003–2012
(In thousands) (Unaudited)**

COMBINED SENIOR LIEN AND SECOND LIEN DEBT SERVICE CALCULATION	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
REVENUES AVAILABLE FOR BONDS:										
Net revenues — as defined	\$ 46,890	\$ 59,408	\$ 55,513	\$ 53,485	\$ 53,326	\$ 62,335	\$ 65,754	\$ 84,991	\$ 92,289	\$ 141,204
Deposits to prior lien accounts										
Transfer (from) to sewer rate stabilization account and PAYGO Fund	(1,050)	2,500		4,000				10,000		35,691
Net revenues available for bonds	47,940	56,908	55,513	49,485	53,326	62,335	65,754	74,991	92,289	105,513
PRIOR LIEN DEBT SERVICE REQUIREMENT										
NET REVENUES AVAILABLE FOR BONDS	<u>\$ 47,940</u>	<u>\$ 56,908</u>	<u>\$ 55,513</u>	<u>\$ 49,485</u>	<u>\$ 53,326</u>	<u>\$ 62,335</u>	<u>\$ 65,754</u>	<u>\$ 74,991</u>	<u>\$ 92,289</u>	<u>\$ 105,513</u>
DEBT SERVICE REQUIREMENTS:										
Senior lien debt service requirement	\$ 25,579	\$ 25,576	\$ 18,523	\$ 19,010	\$ 16,784	\$ 16,753	\$ 16,777	\$ 15,970	\$ 15,287	\$ 9,231
Senior lien debt service coverage (1.15 required)	1.87	2.23	3.00	2.60	3.18	3.72	3.92	4.70	6.04	11.43
DEBT SERVICE REQUIREMENTS:										
1997 second lien bonds	4,195	4,193								
1998 second lien bonds	2,861	2,863	2,879	2,861	173	999	1,000	47		
2000 second lien bonds	4,155	4,155	743	2,643	748	2,707	2,710	2,711		
2001 second lien bonds	4,037	4,045	4,079	4,190	4,195	4,193	4,200	4,196	6,920	5,036
2001A second lien bonds	7,108	7,107	1,792	3,244	352	2,043	2,050	2,047	2,055	1,886
2004A and B second lien bonds		4,393	6,698	16,048	18,947	20,387	5,505	17,558	17,448	17,301
2006A and B second lien bonds					8,570	8,759	8,768	8,770	8,765	15,184
2008A second lien bonds							11,539	11,528	11,537	11,537
2008C second lien bonds						2,291	11,792	542	485	2,732
IEPA Loans								101	383	665
2010A & B second lien bonds								2,284	19,332	21,036
Second lien debt service requirement	22,356	26,756	16,191	28,986	32,985	41,379	47,564	49,784	66,925	75,377
COMBINED SENIOR AND SECOND LIEN DEBT SERVICE REQUIREMENTS	<u>\$ 47,935</u>	<u>\$ 52,332</u>	<u>\$ 34,714</u>	<u>\$ 47,996</u>	<u>\$ 49,769</u>	<u>\$ 58,132</u>	<u>\$ 64,341</u>	<u>\$ 65,754</u>	<u>\$ 82,212</u>	<u>\$ 84,608</u>
COMBINED SENIOR AND SECOND LIEN DEBT SERVICE COVERAGE (1.0 REQUIRED)	1.00	1.09	1.60	1.03	1.07	1.07	1.02	1.14	1.12	1.25
SEWER RATE STABILIZATION ACCOUNT YEAR-END BALANCE	<u>\$ 8,129</u>	<u>\$ 10,629</u>	<u>\$ 10,629</u>	<u>\$ 14,629</u>	<u>\$ 14,629</u>	<u>\$ 14,629</u>	<u>\$ 14,629</u>	<u>\$ 25,629</u>	<u>\$ 25,703</u>	<u>\$ 29,629</u>

Source: City of Chicago Comptroller's Office.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
LONG-TERM DEBT
FIVE YEARS ENDED DECEMBER 31, 2008–2012
(In thousands) (Unaudited)**

	2008	2009	2010	2011	2012
First Lien	\$ 60,815	\$ 48,825	\$ 36,175	\$ 22,820	\$ 8,760
Second Lien	863,234	854,015	1,089,817	1,077,981	1,340,860
Subordinate lien — IEPA loan	<u> </u>	<u> </u>	<u> </u>	<u>11,288</u>	<u>14,154</u>
Total	<u>\$ 924,049</u>	<u>\$ 902,840</u>	<u>\$ 1,125,992</u>	<u>\$ 1,112,089</u>	<u>\$ 1,363,774</u>

The Sewer Fund intends to provide ten years of information as it becomes available.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
CAPITAL IMPROVEMENT PROGRAM
2013–2017
(In thousands) (Unaudited)**

Years	Amount
2013	\$ 222,600
2014	251,800
2015	253,300
2016	265,000
2017	<u>341,900</u>
Total	<u>\$ 1,334,600</u>

Note: The information presented in the table above reflects the Sewer Fund's expected allocation of resources to various projects, but does not necessarily represent an expectation of actual cash expenditures for these projects.

Source: City of Chicago Department of Water Management.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
FULL-TIME EQUIVALENT SEWER FUND EMPLOYEES BY FUNCTION
FIVE YEARS ENDED DECEMBER 31, 2008–2012
(Unaudited)**

Function	2008	2009	2010	2011	2012
Agency management	5	5	5	5	4
Capital design and construction services	21	21	21	23	23
Engineering services					
Inspection services	18	18	18	18	18
System installation	10	10	9	8	8
System maintenance	517	521	521	521	523
Communications and coordination	<u>29</u>	<u>31</u>	<u>27</u>	<u>26</u>	<u>17</u>
	<u>600</u>	<u>606</u>	<u>601</u>	<u>601</u>	<u>593</u>

The Sewer Fund intends to provide ten years of information as it becomes available.

Source: City of Chicago’s 2011, 2010, 2009, and 2008 Program and Budget Summary.

Note: Schedule includes only Department of Water Management employees.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
OPERATING INDICATORS BY FUNCTION
(Unaudited)**

	2011	2012
Catch basins repaired	20,557	3,685

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
CAPITAL ASSET STATISTICS BY FUNCTION
(In miles) (Unaudited)**

	2011	2012
Sewers lined	42.9	51.4
New construction	11.8	17.4

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
POPULATION OF SERVICE AREA
LAST FIVE CENSUS PERIODS
(Unaudited)**

Years	Population
1970	3,369,357
1980	3,005,072
1990	2,783,726
2000	2,896,016
2010	2,695,598

Source: U.S. Department of Commerce — Census Bureau.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
PRINCIPAL EMPLOYERS (NON-GOVERNMENT)
CURRENT YEAR AND NINE YEARS AGO
(Unaudited)**

Employer	2012 (1)			2003 (1)		
	Number of Employees	Rank	Percentage of Total City Employment	Number of Employees	Rank	Percentage of Total City Employment
J.P. Morgan Chase (2)	8,168	1	0.76 %	10,192	1	0.95 %
United Airlines	7,521	2	0.70	7,634	2	0.71
Northern Trust	5,448	4	0.51	5,084		0.47
Jewel Food Stores, Inc.	4,572	5	0.43			
Bank of America NT	3,811	7	0.36			
Walgreen's Co.	2,789	10	0.26			
Accenture LLP	5,590	3	0.52		6	0.36
ABM Janitorial Midwest, Inc.	3,398	8	0.32			
American Airlines	3,076	9	0.29	4,403	5	0.41
Ameritech (3)				5,240	3	0.49
Ford Motor Company	4,187	6	0.39			

- (1) Source: City of Chicago, Department of Revenue, Employer's Expense Tax Return, June 30, 2012.
(2) J.P. Morgan Chase, formerly known as Banc One.
(3) SBC/AT&T, formerly known as Ameritech.

**CITY OF CHICAGO, ILLINOIS
SEWER FUND**

**STATISTICAL DATA
POPULATION AND INCOME STATISTICS
(Unaudited)**

Year	Population (1)	Median Age (2)	Number of Households (2)	Unemployment Rate (3)	Per Capita Income (4)	Total Income
2009	2,896,016	34.5	1,037,069	10.0	43,727	\$ 126,634,091,632
2010	2,695,598	34.8	1,045,666	10.1	45,957	123,881,597,286
2011	2,695,598	33.2	1,048,222	9.3	45,977	123,935,509,246
2012	2,695,598	33.0	1,030,746	8.9	N/A (5)	N/A (5)

Notes:

- (1) Source: U.S. Department of Commerce — Census Bureau.
- (2) Source: World Business Chicago Website, Claritas date estimates; Cook County’s Website.
- (3) Source: Bureau of Labor Statistics 2012, Unemployment rate for Chicago-Naperville-Illinois Metropolitan Area.
- (4) Source: U.S. Department of Commerce, Bureau of Economic Analysis, Per Capita Personal Income for Chicago-Naperville-Illinois Metropolitan Area (in 2012 dollars).
- (5) N/A means not available at time of publication.