CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

REPORT ON AUDITS OF FINANCIAL STATEMENTS
For the years ended December 31, 2014 and 2013

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

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CLARK SCHAEFER HACKETT
STRENGTH IN NUMBERS

INDEPENDENT AUDITORS' REPORT

To the Honorable Frank G. Jackson, Mayor, Members of Council and the Audit Committee
Division of Water
Department of Public Utilities
City of Cleveland, Ohio:

Report on the Financial Statements

We have audited the accompanying financial statements of the Division of Water, Department of Public Utilities, City of Cleveland, Ohio (the Division) as of and for the years ended December 31, 2014 and 2013 and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the Division of Water, Department of Public Utilities, City of Cleveland, Ohio, (as of December 31, 2014 and 2013, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As described in Note A to the basic financial statements, the financial statements present only the Division and do not purport to, and do not present fairly the financial position of the City of Cleveland as of December 31, 2014 and 2013, and the respective changes in its financial position and cash flows for the years then ended in accordance 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 on pages 3 through 15 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.

Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio
June 24, 2015

CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

MANAGEMENT'S DISCUSSION AND ANALYSIS

GENERAL

As management of the City of Cleveland's (the City) Department of Public Utilities, Division of Water (the Division), we offer readers of the Division's financial statements this narrative overview and analysis of the financial activities of the Division for the years ended December 31, 2014 and 2013. Please read this information in conjunction with the Division's financial statements and footnotes that begin on page 18.

The Division services not only the City, but also sixty-eight direct service communities, eight master meter communities, and three emergency standby communities. They provide water to approximately 418,381 city and suburban accounts in the Cleveland metropolitan area. They also sell water to master meter communities that operate their own distribution systems, and they provide billing and payment services for the Northeast Ohio Regional Sewer District and other communities.

During 2014, the Division provided services to approximately 123,512 accounts located within Cleveland and approximately 294,869 accounts located in direct service communities. Water provided to each master meter community is metered at each community's boundary. Consumers within the City of Cleveland accounted for 24% of the Division's metered sales revenue, while the direct service and master meter communities accounted for 66% and 10% of metered sales revenue, respectively.

The Division, along with the Division of Utilities Fiscal Control (UFC), provides a complete array of processing services including billing, payment processing, mailing delinquency notices, terminating water service on delinquent accounts and distributing the money collected to the communities. UFC processes approximately 5,000 payments daily, which include bills for water only, sewer only, water and sewer, final notices and delinquent bills.

COMPARISON OF CURRENT YEAR'S AND PRIOR YEARS' DATA

FINANCIAL HIGHLIGHTS

- The Division's net position was $1,372,821,000, $1,287,764,000 and $1,254,321,000 at December 31, 2014, 2013 and 2012, respectively. Of these amounts, $322,072,000, $274,517,000 and $252,427,000 are unrestricted net position at December 31, 2014, 2013 and 2012, respectively, and may be used to meet the Division's ongoing obligations to customers and creditors.

- In 2014, total operating revenues of the Division increased $30,734,000 or 11.3%. The increase was primarily due to an increase in fixed fee rates and usage charges beginning January 1, 2014, in addition to an increase in net consumption of 3.7%. The major users of water consumption were ArcelorMittal, Cuyahoga Metropolitan Housing Authority, Stouffer/Nestle USA, Cleveland Clinic Foundation, Northeast Ohio Regional Sewer District, Pepsi Inc., Case Western Reserve University and Alcoa Inc.

- In 2013, total operating revenues of the Division decreased by $7,649,000 or 2.7%, mainly due to a water pumpage decrease of 4.6%. The major users of water consumption were ISG-Cleveland, Cuyahoga Metropolitan Housing Authority, Nestle Inc., Cleveland Clinic Foundation, Northeast Ohio Regional Sewer District, Pepsi Inc., Case Western Reserve University and Alcoa Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

FINANCIAL HIGHLIGHTS (Continued)

- The Division's overall net position increased by $85,057,000 and $33,443,000 in 2014 and 2013, respectively.

- The Division had increases in capital assets, net of accumulated depreciation, of $27,640,000, and $24,224,000 in 2014 and 2013, respectively. In 2014, the Division added water mains for two suburbs totaling $29,391,000, net of accumulated depreciation. Major additions were related to renewing and replacing water mains. The major projects that were capitalized included Suburban Watermain Renewal for 14 Cities, Morgan Raw Water Pump Station, Opportunity Corridor Phase I and Secondary Station Improvements, which are part of the larger restructuring work for the Division's storage facilities. Construction is underway at these sites on modification of tanks to ensure these assets are conforming to Environmental Protection Agency (EPA) and Occupational Safety and Health Administration (OSHA) standards.

- The Division added water mains for three suburbs in 2013 totaling $11,030,000, net of accumulated depreciation. The major additions during 2013 were related to the continuing renovation projects for plant enhancements at the Morgan, Baldwin, Crown and Nottingham sites, suburban water main renewal and the meter reading program.

- The total long-term revenue bonds and loans payable of the Division decreased by $46,922,000 due to scheduled principal payments. The total long-term revenue bonds and loans payable of the Division were paid as scheduled in the amount of $37,895,000 in 2013. The Division also issued $11,950,000 of Ohio Water Development Authority Loans in 2013.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Division's basic financial statements. The accompanying financial statements present financial information for the City's Division of Water Fund, in which the City accounts for the operations of the Department of Public Utilities, Division of Water.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The Division is considered an Enterprise Fund because the operations of the Division are similar to a private sector business enterprise. Accordingly, in accounting for the activities of the Division, the economic resources measurement focus and the accrual basis of accounting is used. This is similar to businesses in the private sector.

The basic financial statements of the Division can be found on pages 18 – 23 of this report.

OVERVIEW OF THE FINANCIAL STATEMENTS (Continued)

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to financial statements can be found on pages 25 - 48 of this report.

CONDENSED STATEMENT OF NET POSITION INFORMATION

Provided below is condensed statement of net position information for the Division as of December 31, 2014, 2013 and 2012:

	2014	2013	2012
		(In thousands)	
Assets:			
Capital assets, net	$ 1,738,803	$ 1,711,163	$ 1,686,939
Restricted assets	137,297	169,617	211,843
Current assets	359,633	332,252	308,093
Total assets	2,235,733	2,213,032	2,206,875
Deferred outflows of resources:			
Derivative instruments-interest rate swaps	19,455	17,206	27,699
Loss on bond refunding	20,972	23,338	25,704
Total deferred outflows of resources	40,427	40,544	53,403
Total assets and deferred outflows	2,276,160	2,253,576	2,260,278
Net Position, Deferred Inflows and Liabilities:			
Net position:			
Net investment in capital assets	955,410	916,392	914,193
Restricted for capital projects	99	99	99
Restricted for debt service	95,240	96,756	87,602
Unrestricted	322,072	274,517	252,427
Total net positon	1,372,821	1,287,764	1,254,321
Deferred inflows of resources:			
Derivative instruments-interest rate swaps	19,455	17,206	27,699
Total deferred inflows of resources	19,455	17,206	27,699
Liabilities:			
Long-term obligations	800,751	854,030	894,744
Current liabilities	83,133	94,576	83,514
Total liabilities	883,884	948,606	978,258
Total net position, deferred inflows and liabilities	$ 2,276,160	$ 2,253,576	$ 2,260,278

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

Total Assets and Deferred Outflows: The Division's investment in total assets and deferred outflows as of December 31, 2014, amounted to $2,276,160,000, which is an increase of $22,584,000 from 2013. The Division had an increase in current assets of $27,381,000, due primarily to an increase in unrestricted cash and cash equivalents of $23,367,000 and an increase in accounts receivable – net of allowance for doubtful accounts of $4,621,000, as well as materials and supplies of $3,407,000. Restricted assets decreased by $32,320,000, primarily due to payments to vendors from revenue bond proceeds. Deferred outflows of resources decreased by $117,000, primarily due to a $2,366,000 decrease in unamortized loss on debt refunding, offset by an increase in interest rate swaps by $2,249,000. The Division's net capital assets as of December 31, 2014, amounted to $1,738,803,000, which is an increase of $27,640,000.

The Division's investment in restoration and renovation of water mains are the primary reason for the increase in capital assets in 2014. Utility plant increased by $100,816,000, primarily due to the additions, restoration, and cost to add on infrastructure from 14 cities. This includes several assets that were moved from construction in progress because they were completed in 2014. Completed assets include approximately $56,000,000 in suburban water mains, the Morgan Raw Water Pump Station, Watermain Rehabilitation 2012, Brainard Road Express Main, Opportunity Corridor Phase I, Tower City Center Water Infrastructure, 800 MHz, and Secondary Station Improvements. Also, included in this increase is $29,391,000, net of accumulated depreciation, of distribution mains acquired from two suburbs. This is offset by furniture, equipment and vehicles, which decreased by $20,436,000 primarily due to retirement of sludge equipment totaling $21,981,000.

Additionally, construction in progress had additions and deletions of $69,291,000 and $81,795,000, resulting in a net decrease of $12,504,000, (See Note D) due to the completion of several major projects which are being capitalized into assets. Several ongoing major projects include the Meter Automation & Replacement Program which added approximately $36,000,000 to construction in progress, Suburban Watermain Renewal Program, Watermain Renewal 2014, and Nottingham Filter Roofs.

The Division's investment in total assets and deferred outflows as of December 31, 2013, amounted to $2,253,576,000, which is a decrease of $6,702,000 from 2012. The decrease in restricted assets of $42,226,000 is due primarily to the repayment of revenue bonds of $37,895,000. The Division had a decrease in deferred outflows of resources of $12,859,000, primarily due to the fair value of the Division's interest rate swap agreements decreasing from $27,699,000 in 2012 to $17,206,000 in 2013. The fair value of the swaps is determined by the taxable London Interbank Offered Rate (LIBOR) as of December 31, 2013. The Division's net capital assets as of December 31, 2013, amounted to $1,711,163,000, which is an increase of $24,224,000 from the previous year.

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

Capital Assets: The Division of Water entered into amended Water Service Agreements with two member communities, Olmsted Falls and Broadview Heights, who transferred the ownership of their distribution mains to the Division. These new assets account for $29,391,000, net of accumulated depreciation, or 26.9% of the net additions recorded in 2014.

The Division's investment in capital assets, as of December 31, 2014, amounted to $1,738,803,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for the current year was approximately 1.6%. The Division's investment in capital assets, as of December 31, 2013 amounted to $1,711,163,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for 2013 was approximately 1.4%. A summary of the activity in the Division's capital assets during the years ended December 31, 2014 and 2013 is as follows:

	Balance January 1, 2014	Additions	Reductions	Balance December 31, 2014
	(In thousands)			
Land	$ 5,463	$	$	$ 5,463
Land improvements	16,549	878		17,427
Utility plant	1,543,875	113,187	(12,371)	1,644,691
Buildings, structures and improvements	262,087	215		262,302
Furniture, fixtures, equipment and vehicles	598,431	6,760	(27,196)	577,995
Construction in progress	212,426	69,291	(81,795)	199,922
Total	2,638,831	190,331	(121,362)	2,707,800
Less: Accumulated depreciation	(927,668)	(80,870)	39,541	(968,997)
Capital assets, net	$ 1,711,163	$ 109,461	$ (81,821)	$ 1,738,803

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

	Balance January 1, 2013	Additions	Reductions	Balance December 31, 2013
	(In thousands)			
Land	$ 5,463	$	$	$ 5,463
Land improvements	16,549			16,549
Utility plant	1,497,878	48,192	(2,195)	1,543,875
Buildings, structures and improvements	238,532	23,555		262,087
Furniture, fixtures, equipment and vehicles	586,549	24,126	(12,244)	598,431
Construction in progress	201,167	87,710	(76,451)	212,426
Total	2,546,138	183,583	(90,890)	2,638,831
Less: Accumulated depreciation	(859,199)	(82,748)	14,279	(927,668)
Capital assets, net	$ 1,686,939	$ 100,835	$ (76,611)	$ 1,711,163

Major events during 2014 affecting the Division's capital assets included the following:

- Projects completed in 2014 included the Suburban Watermain Renewal for 14 Cities, Morgan Raw Water Pump Station, Opportunity Corridor Phase I, Secondary Station Improvements for upgrades, betterments and refurbishing of Dover Tower, Keller Tower, Kirtland and the Green Pump Station, as well as the Plant Enhancement Program. Additions to construction in progress totaled $69,291,000, include water mains totaling $65,454,000. The major projects still under construction include: Meter Automation & Replacement Program, Suburban Watermain Renewal, Crown Water Plant, Watermain Renewal 2013, Watermain Rehab Year 2010, General Engineering Services Phase VII which consist of multiple projects, including but not limited to, Boosted Third High Pump station which is an elevated storage tank regulating water capacity and fire flow fluctuations, Watermain Renewal 2014, Transmission Main Renewal Program and Watermain Rehab 2011.

- The Division of Water entered into amended Water Service Agreements with two member communities, Olmsted Falls and Broadview Heights and transferred the ownership of their distribution mains to the Division in the amount of $29,391,000, net of accumulated depreciation.

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

Major events during 2013 affecting the Division's capital assets included the following:

- The Construction, Renovations and Plant Enhancements Phase II Project, as well as the Customer Service Information System Project were completed in 2013. Capital project expenses totaling $75,816,000 involved additions to the rehabilitation of watermains and water tanks. The major projects still under construction include: Security Enhancements Program, Plant Enhancement Program, Pump Station Enhancement Program, Water Tank Rehabilitation, Suburban Watermain Renewal and Automated Meter Reading Program.

- Three suburbs signed asset transfer agreements that turned over their distribution water mains in the amount of $11,030,000, net of accumulated depreciation.

Additional information on the Division's capital assets, including commitments made for future capital expenditures, can be found in Note D to the basic financial statements.

Liabilities**:** In 2014, the factors for the Division's net decrease in long-term obligations of $53,279,000 are primarily attributed to debt retirement of $46,922,000 and a decrease in the unamortized discount and premium of $4,835,000.

In 2013, the factors for the Division's net decrease in long-term obligations of $40,714,000 are primarily attributed to debt retirement of $37,895,000 and a decrease in the unamortized discount and premium of $5,681,000, offset by the issuance of $11,950,000 of new loans.

Current Liabilities: In 2014, total current liabilities decreased by $11,443,000. The significant component of the change was a decrease to the current payable from restricted assets of $7,539,000, which was primarily due to lower capital related expenses at year-end. Other decreases included customer deposits and other liabilities of $2,317,000 and accounts payable of $1,945,000. These decreases were offset by an increase in the current portion of long-term debt, due within one year, of $1,515,000.

In 2013, total current liabilities increased by $11,062,000. The significant component of the change was an increase to the current portion of long-term debt obligations of $9,118,000, which was primarily due to the current portion of Series O and Series P becoming due. Other increases included customer deposits and other liabilities of $1,877,000, accrued interest of $1,221,000, due to other city divisions of $744,000 and accounts payable of $1,377,000. These increases were offset by decreases in accrued wages and benefits of $1,802,000 and payable from restricted assets of $1,473,000.

Long-term Debt: At the end of 2014, the Division had total long-term debt outstanding of $820,072,000. All bonds are backed by the revenues generated by the Division. The Ohio Water Development Authority (OWDA) loans do not have a lien on revenues of the Division.

At the end of 2013, the Division had total long-term debt outstanding of $866,994,000. All bonds are backed by the revenues generated by the Division. The Ohio Water Development Authority (OWDA) loans do not have a lien on revenues of the Division.

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

The activity in the Division's debt obligations outstanding during the year ended December 31, 2014, is summarized below (excluding unamortized discounts and premiums):

	Balance January 1, 2014	Debt Issued	Debt Retired	Balance December 31, 2014
	(In thousands)			
Long-Term Debt				
Water Revenue Bonds:				
Series G 1993	$ 66,550	$	$ (330)	$ 66,220
Series N 2005	22,735		(870)	21,865
Series O 2007	130,610		(2,950)	127,660
Series P 2007	113,280		(9,290)	103,990
Series Q 2008	90,800			90,800
Series T 2009	65,150		(8,130)	57,020
Series U 2010	54,935			54,935
Series V 2010	26,495			26,495
Series W 2011	62,760		(18,340)	44,420
Series X 2012	44,410			44,410
Second Lien Series A 2012	76,710			76,710
Ohio Water Development				
Authority Loans	112,559		(7,012)	105,547
Total	$ 866,994	$ -	$ (46,922)	$ 820,072

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

The activity in the Division's debt obligations outstanding during the year ended December 31, 2013, is summarized below (excluding unamortized discounts and premiums):

	Balance January 1, 2013	Debt Issued	Debt Retired	Balance December 31, 2013
	(In thousands)			
Long-Term Debt				
Water Revenue Bonds:				
Series G 1993	$ 66,860	$	$ (310)	$ 66,550
Series N 2005	28,015		(5,280)	22,735
Series O 2007	130,610			130,610
Series P 2007	113,280			113,280
Series Q 2008	90,800			90,800
Series T 2009	71,330		(6,180)	65,150
Series U 2010	54,935			54,935
Series V 2010	26,495			26,495
Series W 2011	82,090		(19,330)	62,760
Series X 2012	44,410			44,410
Second Lien Series A 2012	76,710			76,710
Ohio Water Development Authority Loans	107,404	11,950	(6,795)	112,559
Total	$ 892,939	$ 11,950	$ (37,895)	$ 866,994

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

The bond ratings for the Division's outstanding revenue bonds as of December 31, 2014, are as follows:

	Moody's Investors Service	Standard & Poor's
Waterworks Improvement Revenue Bonds	Aa1	AA
Second Lien Water Revenue Bonds	Aa2	AA-

The ratio of net revenue available for debt service to debt service requirements (revenue bond coverage) is a useful indicator of the Division's debt position to management, customers and creditors. The Division's revenue bond coverage for 2014, 2013 and 2012 was 221%, 173% and 231%, respectively.

Additional information on the Division's long-term debt can be found in Note B on pages 29 - 39.

Net Position: Net position serves as a useful indicator of a government's financial position. In the case of the Division, assets and deferred outflows exceed liabilities and deferred inflows by $1,372,821,000, $1,287,764,000 and $1,254,321,000 at December 31, 2014, 2013 and 2012, respectively.

Of the Division's net position, $955,410,000 or 69.6% and $916,392,000 or 71.2% at December 31, 2014 and 2013, respectively, reflects its investment in capital assets, net of accumulated depreciation, less any related, still-outstanding debt used to acquire those assets. The Division uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the Division's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other resources since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Division's net position, $95,339,000 or 6.9% and $96,855,000 or 7.5%, at December 31, 2014 and 2013, respectively, represents resources that are subject to external restrictions. These funds are set aside for the payment of revenue bonds and capital projects. The remaining balance of unrestricted net position, $322,072,000 or 23.5% and $274,517,000 or 21.3%, at December 31, 2014 and 2013, respectively, may be used to meet the Division's ongoing obligations to customers and creditors.

CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION INFORMATION

The Division's net position increased during 2014 and 2013 by $85,057,000 and $33,443,000, respectively. The following table identifies the key elements of the Division's results of operations as of and for the years ended December 31, 2014, 2013 and 2012:

	2014	2013	2012
	(In thousands)		
Operating revenues	$ 303,408	$ 272,674	$ 280,323
Operating expenses	225,187	229,164	216,624
Operating income (loss)	78,221	43,510	63,699
Non-operating revenue (expense):			
Investment income	774	1,650	1,965
Interest expense	(28,138)	(28,413)	(28,322)
Amortization of bond premiums and discounts	4,835	5,681	5,118
Gain (loss) on disposal of capital assets	(26)	(84)	(15)
Other revenue (expense)			(1,468)
Total non-operating revenue (expense), net	(22,555)	(21,166)	(22,722)
Income (loss) before capital and other contributions	55,666	22,344	40,977
Capital and other contributions	29,391	11,099	20,118
Increase (decrease) in net position	85,057	33,443	61,095
Net position, beginning of year	1,287,764	1,254,321	1,193,226
Net position, end of year	$ 1,372,821	$ 1,287,764	$ 1,254,321

Operating revenue: In 2014, total operating revenues of the Division increased $30,734,000 or 11.3%. The increase was primarily due to an increase in fixed fee rates and usage charges at January 1, 2014, in addition to an increase in net consumption of 3.7%. The major users of water were as follows: ArcelorMittal, Cuyahoga Metropolitan Housing Authority, Cleveland Clinic Foundation, Stouffer/Nestle USA, Northeast Ohio Regional Sewer District, Pepsi Cola Bottling, Alcoa Inc., Case Western Reserve University, Charter Steel and University Hospitals Health System.

CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION INFORMATION (Continued)

In 2013, total operating revenues decreased by $7,649,000, primarily due to a decrease in net consumption of 4.6%, offset by a rate increase. The major users of water were as follows: ISG-Cleveland, Cuyahoga Metropolitan Housing Authority, Nestle Inc., Cleveland Clinic Foundation, Northeast Ohio Regional Sewer District, Pepsi Inc., Case Western Reserve University and Alcoa Inc.

Operating expenses: In 2014, the overall decrease in operating expenses of $3,977,000 was primarily due to a $2,589,000 decrease in depreciation expense and a $1,809,000 decrease in maintenance expense. The decrease in depreciation expense is primarily attributed to capital assets concluding their scheduled useful life including the Coordinated Geographic Information System (GIS), Customer Care & Billing (CC&B) software and water mains from 1914.

In 2013, the overall increase in operating expenses of $12,540,000 was primarily due to a $1,720,000 increase in sewer charges, a $1,521,000 increase in professional services charges, a $3,357,000 increase in maintenance of utility systems and a $6,762,000 increase in depreciation expense. Depreciation increased because several assets were brought into service during the year.

Non-operating revenue (expense): Total non-operating revenue (expense) decreased by $1,389,000 in 2014. Investment income decreased by $876,000 while amortization of bond premiums and discounts decreased by $846,000. These items were offset by decrease in interest expense of $275,000.

The major changes in 2013 were an increase in other revenues (expenses) of $1,468,000 due to not incurring bond issuance costs in 2013, offset by a decrease in investment income of $315,000 primarily caused by the maturity of a high-yield guaranteed investment contract in June 2013.

Capital and other contributions: In 2014, capital and other contributions increased by $18,292,000 as compared to 2013. The increase is primarily attributed to the Division acquiring two suburban distribution mains totaling $29,391,000, net of accumulated depreciation.

In 2013, there was a $9,019,000 decrease in capital and other contributions as compared to 2012, due to the acquisition of three smaller community distribution mains totaling $11,030,000, net of accumulated depreciation. The decrease is primarily attributed to the Division acquiring twenty-four suburban distribution mains in 2012.

FACTORS EXPECTED TO IMPACT THE DIVISION'S FUTURE FINANCIAL POSITION OR RESULTS OF OPERATIONS

Water rate increases will continue to have a positive impact on the financial position of the Division:

WATER RATES				
CLEVELAND - PER 1st .6 MCF (Thousand cubic feet)			CLEVELAND - PER ADDITIONAL MCF (Thousand cubic feet)	
EFFECTIVE	REGULAR	HOMESTEAD	REGULAR	HOMESTEAD
January 1, 2015	$19.26	$12.52	$32.74	$12.52

WATER RATES				
DIRECT SERVICE SUBURBS - PER 1st .6 MCF (Thousand cubic feet)			DIRECT SERVICE SUBURBS-PER ADDITIONAL MCF (Thousand cubic feet)	
EFFECTIVE	REGULAR	HOMESTEAD	REGULAR	HOMESTEAD
January 1, 2015	$25.04-$35.63	$16.27-$23.16	$42.56-$60.57	$16.27-$23.16

These increase in rates, fixed customer charges and recommended modifications to the Division's water rate structure were adopted by the Cleveland City Council on May 23, 2011. The new fixed customer charges are based on meter size. The first increase in a series of annual increases in water consumption charges became effective January 1, 2012. The annual rate increases for 2015 are expected to increase operating revenues to adequately cover anticipated operating expenses. The increases in rates within the City of Cleveland average 11.1% for the first .6 MCF and 4.9% for each additional MCF in 2015. The increases in rates within the Direct Service Suburbs average 6.0% for the first .6 MCF and 0.1% for each additional MCF in 2015. The increases for fixed customer charges for the City and surrounding communities average 12.5% for 2015.

On April 14, 2015, the City sold $132,135,000 Water Revenue Bonds, Series 2015 consisting of $116,205,000 Water Revenue Bonds, Series Y and $15,930,000 Water Revenue Bonds, Series Z. As a result of this refunding, the Division will achieve net present value debt service savings of $12.8 million or 9.6%.

Effective May 27, 2015 the City issued $90,800,000 Water Revenue Bonds, Series AA. These bonds were issued to refund the outstanding $90,800,000 Water Revenue Bonds, Series Q upon the expiration of the existing letter of credit. The bonds were issued as variable rate bonds with the City paying 65.1% of LIBOR plus a spread and were directly purchased by Bank of America, N.A.

ADDITIONAL INFORMATION

This financial report is designed to provide a general overview of the Division's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Office of the Finance Director, City Hall, Room 104, 601 Lakeside Avenue, Cleveland, Ohio 44114.

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BASIC FINANCIAL STATEMENTS

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF NET POSITION
December 31, 2014 and 2013

	(In thousands) 2014	2013
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		
CAPITAL ASSETS		
Land	$ 5,463	$ 5,463
Land improvements	17,427	16,549
Utility plant	1,644,691	1,543,875
Buildings, structures and improvements	262,302	262,087
Furniture, fixtures, equipment and vehicles	577,995	598,431
	2,507,878	2,426,405
Less: Accumulated depreciation	(968,997)	(927,668)
	1,538,881	1,498,737
Construction in progress	199,922	212,426
CAPITAL ASSETS, NET	1,738,803	1,711,163
RESTRICTED ASSETS		
Cash and cash equivalents	137,286	169,569
Accrued interest receivable	11	48
TOTAL RESTRICTED ASSETS	137,297	169,617
CURRENT ASSETS		
Cash and cash equivalents	235,891	212,524
Restricted cash and cash equivalents	3,743	11,282
Investments	10,037	10,021
Receivables:		
Accounts receivable - net of allowance for doubtful accounts $16,860,000 in 2014 and of $15,727,000 in 2013	50,408	45,787
Unbilled revenue	32,825	31,171
Due from other City of Cleveland departments, divisions or funds	17,395	15,599
Accrued interest receivable		1
Materials and supplies - at average cost, net of allowance for obsolescence of $79,000 in 2014 and $80,000 in 2013	8,076	4,669
Prepaid expenses	1,258	1,198
TOTAL CURRENT ASSETS	359,633	332,252
DEFERRED OUTFLOWS OF RESOURCES		
Derivative instruments-interest rate swaps	19,455	17,206
Unamortized loss on bond refunding	20,972	23,338
TOTAL DEFERRED OUTFLOWS OF RESOURCES	40,427	40,544
TOTAL ASSETS AND DEFERRED OUTFLOWS	$ 2,276,160	$ 2,253,576

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF NET POSITION
December 31, 2014 and 2013

	(*In thousands*)	
	2014	**2013**
NET POSITION, LIABILITIES AND DEFERRED INFLOWS OF RESOURCES		
NET POSITION		
Net investment in capital assets	$ 955,410	$ 916,392
Restricted for capital projects	99	99
Restricted for debt service	95,240	96,756
Unrestricted	322,072	274,517
TOTAL NET POSITION	1,372,821	1,287,764
LIABILITIES		
LONG-TERM OBLIGATIONS-excluding amounts due within one year		
Revenue bonds	701,053	747,088
OWDA loans	98,310	105,547
Accrued wages and benefits	1,388	1,395
TOTAL LONG-TERM OBLIGATIONS	800,751	854,030
CURRENT LIABILITIES		
Current portion of long-term debt, due within one year	48,437	46,922
Accounts payable	4,383	6,328
Current payable from restricted assets	3,743	11,282
Due to other City of Cleveland departments, divisions or funds	3,742	3,374
Accrued interest payable	13,888	14,742
Current portion of accrued wages and benefits	7,629	8,281
Other accrued expenses	376	395
Customer deposits and other liabilities	935	3,252
TOTAL CURRENT LIABILITIES	83,133	94,576
TOTAL LIABILITIES	883,884	948,606
DEFERRED INFLOW OF RESOURCES		
Derivative instruments-interest rate swaps	19,455	17,206
TOTAL DEFERRED INFLOWS OF RESOURCES	19,455	17,206
TOTAL NET POSITION, LIABILITIES AND DEFERRED INFLOWS	$ 2,276,160	$ 2,253,576

See notes to financial statements. (Concluded)

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CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
For the Years Ended December 31, 2014 and 2013

(*In thousands)*

	2014	2013
OPERATING REVENUES		
Charges for services	$ 303,408	$ 272,674
TOTAL OPERATING REVENUES	303,408	272,674
OPERATING EXPENSES		
Operations	99,286	98,865
Maintenance	54,273	56,082
Depreciation	71,628	74,217
TOTAL OPERATING EXPENSES	225,187	229,164
OPERATING INCOME (LOSS)	78,221	43,510
NON-OPERATING REVENUE (EXPENSE)		
Investment income	774	1,650
Interest expense	(28,138)	(28,413)
Amortization of bond premiums and discounts	4,835	5,681
Gain (loss) on disposal of capital assets	(26)	(84)
TOTAL NON-OPERATING REVENUE (EXPENSE), NET	(22,555)	(21,166)
INCOME (LOSS) BEFORE CAPITAL AND OTHER CONTRIBUTIONS	55,666	22,344
Capital and other contributions	29,391	11,099
INCREASE (DECREASE) IN NET POSITION	85,057	33,443
NET POSITION, beginning of year	1,287,764	1,254,321
NET POSITION, end of year	$ 1,372,821	$ 1,287,764

See notes to financial statements.

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2014 and 2013

	(In thousands) 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	$ 287,531	$ 271,954
Cash payments to suppliers for goods or services	(79,201)	(73,222)
Cash payments to employees for services	(74,591)	(76,436)
Other		195
NET CASH PROVIDED BY(USED FOR) OPERATING ACTIVITIES	133,739	122,491
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(67,887)	(77,308)
Capital grant proceeds		69
Proceeds of OWDA loan		11,950
Principal paid on long-term debt	(46,922)	(37,895)
Interest paid on long-term debt	(36,235)	(36,561)
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	(151,044)	(139,745)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	(14,996)	(69,929)
Proceeds from sale and maturity of investment securities	14,991	59,982
Interest received on investments	855	1,685
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	850	(8,262)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(16,455)	(25,516)
CASH AND CASH EQUIVALENTS, beginning of year	393,375	418,891
CASH AND CASH EQUIVALENTS, end of year	$ 376,920	$ 393,375

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2014 and 2013

	(In thousands) 2014	2013
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
OPERATING INCOME (LOSS)	$ 78,221	$ 43,510
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	71,628	74,217
Changes in assets and liabilities:		
Accounts receivable, net	(4,621)	3,081
Unbilled revenue	(1,654)	369
Due from other City of Cleveland departments, divisions or funds	(1,796)	(937)
Materials and supplies, net	(3,407)	45
Prepaid expenses	(60)	(20)
Accounts payable	(1,945)	1,377
Due to other City of Cleveland departments, divisions or funds	368	744
Other accrued expenses	(19)	
Accrued wages and benefits	(659)	(1,772)
Customer deposits and other liabilities	(2,317)	1,877
TOTAL ADJUSTMENTS	55,518	78,981
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	$ 133,739	$ 122,491

	2014	2013
SCHEDULE OF NON-CASH CAPITAL AND RELATED FINANCING ACTIVITIES		
Contribution of capital assets	$ 29,391	$ 11,030

(Concluded)

See notes to financial statements.

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NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2014 and 2013

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Division of Water (the Division) is reported as an Enterprise Fund of the City of Cleveland's Department of Public Utilities and is a part of the City of Cleveland's (the City) primary government. The Division was created for the purpose of supplying water services to customers within the metropolitan area. The following is a summary of the more significant accounting policies.

Reporting Model and Basis of Accounting: The accounting policies and financial reporting practices of the Division comply with accounting principles generally accepted in the United States of America applicable to governmental units.

In June of 2012, Governmental Accounting Standards Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans – An Amendment of GASB Statement No. 25* was issued. This Statement is effective for fiscal periods beginning after June 15, 2013. GASB Statement No. 67 replaces the requirements of GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and GASB Statement No. 50 – *An Amendment of GASB Statements No. 25 and No. 27* as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria. The Division has determined that GASB Statement No. 67 has no impact on its financial statements as of December 31, 2014.

In January of 2013, Governmental Accounting Standards Board (GASB) Statement No. 69, *Government Combinations and Disposals of Government Operations* was issued. This Statement is effective for fiscal periods beginning after December 15, 2013. GASB Statement No. 69 establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term government combinations include a variety of transactions referred to as mergers, acquisitions, and transfers of operations. The Division has determined that GASB Statement No. 69 has no impact on its financial statements as of December 31, 2014.

In April of 2013, Governmental Accounting Standards Board (GASB) Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees* was issued. This Statement is effective for fiscal periods beginning after June 15, 2013. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. Some governments extend financial guarantees for the obligations of another government, a not-for-profit entity, or a private entity without directly receiving equal or approximately equal value in exchange (a nonexchange transaction). As a part of this nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity that issued the obligation does not fulfill its payment requirements. Also, some governments issue obligations that are guaranteed by other entities in a nonexchange transaction. The Division has determined that GASB Statement No. 70 has no impact on its financial statements as of December 31, 2014.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Division's net position is accounted for in the accompanying statement of net position and the net position is divided into the following categories:

- Net investment in capital assets
- Amount restricted for capital projects
- Amount restricted for debt service
- Remaining unrestricted amount

In addition, certain financial information regarding the Division is included in these footnotes.

Basis of Accounting: The Division's financial statements are prepared under the accrual basis of accounting. Under this method, revenues are recognized when earned and measurable and expenses are recognized as incurred.

Revenues: Revenues are derived primarily from sales of water to residential, commercial and industrial customers based upon actual water consumption and from a fixed charge based upon meter size. Water rates are authorized by City Council and billings are made on a cyclical basis. Estimates for services between the ends of the various cycles and the end of the year are recorded as unbilled revenue.

Statement of Cash Flows: The Division utilizes the direct method of reporting for the statement of cash flows as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Non-expendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. In a statement of cash flows, cash receipts and cash payments are classified according to operating, noncapital financing, capital and related financing, and investment activities.

Cash and Cash Equivalents: Cash and cash equivalents represent cash on hand and cash deposits maintained by the City Treasurer on behalf of the Division. Cash equivalents are defined as highly liquid investments with a maturity of three months or less when purchased and include certificates of deposit, U.S. Treasury bills, State Treasury Asset Reserve of Ohio (STAROhio) and repurchase agreements. The City's policy is to enter into repurchase agreements with local commercial banks and to obtain confirmation of securities pledged.

Investments: The Division follows the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, which requires governmental entities to report certain investments at fair value in the balance sheet and recognize the corresponding change in the fair value of investments in the year in which the change occurred. The fair value is based on quoted market prices.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The City has invested funds in STAROhio during 2014 and 2013. STAROhio is an investment pool managed by the State Treasurer's Office, which allows governments within the State to pool their funds for investment purposes. STAROhio is not registered with the SEC as an investment company, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Investments in STAROhio are valued at STAROhio's share price, which is the price the investment could be sold for on December 31, 2014 and 2013.

Restricted Assets: Proceeds from debt and amounts set aside in various fund accounts for payment of revenue bonds are classified as restricted assets since their use is limited by the bond indentures.

Capital Assets and Depreciation: Capital assets are stated on the basis of historical cost, or if contributed, at fair market value as of the date received. Depreciation is computed by allocating the cost of capital assets over the estimated useful lives of the assets using the straight-line method. A capital asset is defined as an item with a useful life in excess of one year and an individual cost of more than $5,000 for land, furniture, fixtures, equipment and vehicles and $10,000 for all other assets. When capital assets are disposed, the cost and related accumulated depreciation are removed from the accounts with gains or losses on disposition being reflected in operations. The estimated useful lives are as follows:

Utility plant	5 to 100 years
Land improvements	15 to 100 years
Buildings, structures and improvements	5 to 60 years
Furniture, fixtures, equipment and vehicles	3 to 60 years

The Division's policy is to capitalize interest on construction projects up to the point in time that the project is substantially completed. Capitalized interest is included in the cost of the assets and is depreciated on the straight-line basis over the estimated useful lives of such assets. The Division applies Governmental Accounting Standards Board guidance pertaining to capitalization of interest costs for its revenue bonds. This statement requires capitalization of interest cost of eligible borrowings, less interest earned on investment of the related bond proceeds from the date of borrowing until the assets constructed from the bond proceeds are ready for their intended use.

For 2014 and 2013, total interest costs incurred amounted to $37,748,000 and $40,257,000, respectively, of which $9,557,000 and $11,771,000, respectively, was capitalized, net of interest income of $53,000 in 2014 and $73,000 in 2013.

Bond Issuance Costs, Discounts, Premiums and Unamortized Losses on Debt Refundings: Bond issuance costs are expensed when incurred. Deferred bond discounts/premiums are netted against long-term debt. The discounts/premiums are amortized over the lives of the applicable bonds. Unamortized loss on debt refundings are categorized as a deferred outflow and is amortized over the shorter of the defeased bond or the newly issued bond.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Compensated Absences: The Division accrues for compensated absences such as vacation, sick leave and compensatory time using the termination payment method specified under GASB Statement No. 16, *Accounting for Compensated Absences*. These amounts are recorded as accrued wages and benefits in the accompanying statement of net position. The portion of the compensated absence liability that is not expected to be paid or utilized within one year is reported as a long-term liability.

Normally, all vacation time is to be taken in the year available. The Division allows employees to carryover vacation from one year to the next. Sick days not taken may be accumulated until retirement. An employee is paid one-third of accumulated sick leave upon retirement, calculated at the three highest year average base salary rate, with the balance being forfeited.

Interfund Transactions: During the course of normal operations the Division has numerous transactions between other City divisions and departments. Unpaid amounts at year end are generally reflected as due to or due from in the accompanying financial statements.

Deferred Outflows/Inflows of Resources: In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to future period(s) and so will *not* be recognized as an outflow of resources (expense) until then.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to future period(s) and so will *not* be recognized as an inflow of resources (revenues) until that time.

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2014 and 2013

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS

Debt outstanding at December 31, 2014 and 2013 is as follows:

	Interest Rate	Original Issuance	2014	2013
			(In thousands)	
Water Revenue Bonds:				
Series G 1993 due through 2021	5.50%	$ 228,170	$ 66,220	$ 66,550
Series N 2005 due through 2023	3.50%-5.00%	64,480	21,865	22,735
Series O 2007 due through 2037	4.25%-5.00%	143,570	127,660	130,610
Series P 2007 due through 2028	4.50%-5.00%	135,410	103,990	113,280
Series Q 2008 due through 2033	Variable	90,800	90,800	90,800
Series T 2009 due through 2021	2.50%-5.00%	84,625	57,020	65,150
Series U 2010 due through 2033	Variable	54,935	54,935	54,935
Series V 2010 due through 2033	Variable	26,495	26,495	26,495
Series W 2011 due through 2026	2.00%-5.00%	82,090	44,420	62,760
Series X 2012 due through 2042	3.63%-5.00%	44,410	44,410	44,410
Second Lien Series A 2012 due 2027	4.00%-5.00%	76,710	76,710	76,710
Ohio Water Development Authority Loans payable annually through 2033	0.00%-4.14%	153,828	105,547	112,559
		$ 1,185,523	820,072	866,994
Adjustments:				
Unamortized discount and premium			27,728	32,563
Current portion			(48,437)	(46,922)
Total Long-Term Debt			$ 799,363	$ 852,635

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2014 and 2013

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

Summary: Changes in long-term obligations for the year ended December 31, 2014 are as follows:

	Balance January 1, 2014	Increase	Decrease	Balance December 31, 2014	Due Within One Year
			(In thousands)		
Water Revenue Bonds:					
Series G 1993 due through 2021	$ 66,550	$	$ (330)	$ 66,220	$ 345
Series N 2005 due through 2023	22,735		(870)	21,865	905
Series O 2007 due through 2037	130,610		(2,950)	127,660	3,080
Series P 2007 due through 2028	113,280		(9,290)	103,990	9,755
Series Q 2008 due through 2033	90,800			90,800	
Series T 2009 due through 2021	65,150		(8,130)	57,020	8,335
Series U 2010 due through 2033	54,935			54,935	
Series V 2010 due through 2033	26,495			26,495	
Series W 2011 due through 2026	62,760		(18,340)	44,420	18,780
Series X 2012 due through 2042	44,410			44,410	
Second Lien Series A 2012 due through 2027	76,710			76,710	
Ohio Water Development Authority Loans payable annually through 2033	112,559		(7,012)	105,547	7,237
Total revenue bonds/loans	866,994	-	(46,922)	820,072	48,437
Accrued wages and benefits	9,676	7,622	(8,281)	9,017	7,629
Total	$ 876,670	$ 7,622	$ (55,203)	$ 829,089	$ 56,066

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

Summary: Changes in long-term obligations for the year ended December 31, 2013 are as follows:

	Balance January 1, 2013	Increase	Decrease	Balance December 1, 2013	Due Within One Year
			(In thousands)		
Water Revenue Bonds:					
Series G 1993 due through 2021	$ 66,860	$	$ (310)	$ 66,550	$ 330
Series N 2005 due through 2023	28,015		(5,280)	22,735	870
Series O 2007 due through 2037	130,610			130,610	2,950
Series P 2007 due through 2028	113,280			113,280	9,290
Series Q 2008 due through 2033	90,800			90,800	
Series T 2009 due through 2021	71,330		(6,180)	65,150	8,130
Series U 2010 due through 2033	54,935			54,935	
Series V 2010 due through 2033	26,495			26,495	
Series W 2011 due through 2026	82,090		(19,330)	62,760	18,340
Series X 2012 due through 2042	44,410			44,410	
Second Lien Series A 2012 due through 2027	76,710			76,710	
Ohio Water Development Authority Loans payable annually through 2033	107,404	11,950	(6,795)	112,559	7,012
Total revenue bonds/loans	892,939	11,950	(37,895)	866,994	46,922
Accrued wages and benefits	11,448	8,311	(10,083)	9,676	8,281
Total	$ 904,387	$ 20,261	$ (47,978)	$ 876,670	$ 55,203

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

Minimum principal and interest payments on long-term debt for the next five years and thereafter are as follows:

	Principal	Interest	Total
		(In thousands)	
2015	$ 48,437	$ 36,119	$ 84,556
2016	48,754	33,849	82,603
2017	51,499	31,439	82,938
2018	47,058	29,102	76,160
2019	49,170	26,828	75,998
2020-2024	243,948	99,628	343,576
2025-2029	188,149	49,353	237,502
2030-2034	96,493	21,022	117,515
2035-2039	38,455	5,753	44,208
2040-2042	9,170	703	9,873
Total	$ 821,133	$ 333,796	$ 1,154,929

The above schedule of minimum principal and interest payments on long-term debt includes the amortization on eleven loans provided to the City by the Ohio Water Development Authority (OWDA).

OWDA provided the City with the amount expected to be financed, the interest rate, initial repayment date and other significant items(s) for each of the eleven loans. From the information received, the City prepared a detailed amortization schedule for each loan based upon the amount expected to be financed. However, the amortization schedule is tentative and will be adjusted if, and when, OWDA revises the amount to be financed.

Further, OWDA requires the City to begin making semi-annual payments for each loan based on the agreed upon initial repayment date, regardless of whether the City has received all loan proceeds or has completed the project(s).

In 2014, the Division did not take out any loans. However, in 2013, the Division expended $9,747,000 on the Crown Chemical project which is funded by a 2.0% OWDA loan maturing in July 2032. The Division also expended $2,203,000 on a new Shaker Heights Watermain Replacement project. This project is funded by a 20 year 1.88% loan from OWDA which matures in January 2033.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

At December 31, 2014, the amount financed on these eleven loan projects, less principal payments made, totaled $106,608,000 and is reflected in the debt service payment schedule. However, the total of the actual loan balances received by the Division was $105,547,000 as reflected on the schedules of long-term debt outstanding and changes in long-term debt obligations as of December 31, 2014. The difference of $1,061,000 will be received or accrued in future years.

The Division has, from time to time, defeased certain Revenue Bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Division's financial statements. The Division had no defeased debt outstanding at December 31, 2014 and 2013.

In 1996, the City authorized the adoption of the eighth supplemental indenture to amend and restate the existing indenture, subject to the receipt of consent of the requisite number of bondholders. With the issuance of the Series J bonds, the City reached the 66.7% consent required to enact the Amended and Restated Indenture. Effective October 5, 2001, all outstanding bonds and any future bonds are secured by the Amended and Restated Indenture. Under the new indenture, the bonds are no longer secured by a mortgage lien. All bonds are secured by the Division's net revenues and by the pledged funds.

The Division's indentures have certain restrictive covenants and principally require that bond reserve funds be maintained for certain series of bonds, and charges for fees to customers are sufficient amounts, as defined, to satisfy the obligations under the indenture agreements. In addition, special provisions exist regarding covenant violations, redemption of principal and maintenance of properties in good condition.

The indenture requires that at all times the Division will charge rates and fees for the products and services of the waterworks system, so that revenues will be at least sufficient to provide funds for the payment in each year of the necessary operating and maintenance expenses of the waterworks system and the greater of (1) an amount equal to 1.25 times the payments of principal, premium, if any, and interest on the revenue bonds then outstanding due in that year or (2) an amount sufficient to maintain the required balances in all funds and accounts created under the indenture. As of December 31, 2014 and 2013, the Division was in compliance with the terms and requirements of the bond indenture.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

The indenture establishes the following fund accounts for the application of revenues:

Revenue Fund: All revenues will be deposited into this fund and will be used for payment of current operating expenses and deposits into other funds. An amount equal to one-sixth of the operating expenses, before depreciation, for the preceding fiscal year must be maintained in this fund.

Debt Service Fund: Deposits will be made from the revenue fund to cover succeeding principal and interest payments as they become due on the revenue bonds.

Debt Service Reserve Fund: Deposits will be made to this fund if the amount in the debt service fund at any time is less than the debt service reserve requirement. Amounts in the fund were deposited from the proceeds of the revenue bonds secured by the reserve fund and represent the maximum annual debt service requirement of these bonds.

Contingency Fund: The balance in this fund must be maintained at $3,500,000.

Construction Fund: Proceeds from the revenue bonds were deposited into this fund to be used, along with earnings from investments of amounts held therein, for the payment of capital costs. Capital costs include all costs of additions, extensions, renewals, replacements, alterations, betterments and any other capital improvements to the waterworks system. Amounts held in this fund are subject to a lien in favor of bondholders and may be used to pay principal of outstanding revenue bonds to the extent that amounts in all other funds are insufficient. No payments need be made into a fund if the amounts in such fund are equal to the required fund balance, if any.

Amounts held in any fund may be invested by the City Treasurer or the trustee in permitted investments. However, the use of funds is limited by the bond indenture and accordingly, the funds are classified as restricted assets in the accompanying financial statements.

Upon the mandatory tender by the direct purchasers of the Water Revenue Bonds, Series U, 2010 and the Water Revenue Bonds, Series V, 2010, the City entered into new direct purchase agreements on both series of bonds. Effective November 1, 2013, the $54,935,000 Water Series U Bonds were directly purchased by PNC Bank, National Association and subsequently, on December 2, 2013, the $26,495,000 Water Series V Bonds were also directly purchased by PNC Bank. The City will be paying an interest rate equal to 65.001% of one month LIBOR plus a spread for three years.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

In conjunction with the issuance of the Second Lien Water Revenue Bonds, Series A, 2012 in October 2012, the Division established a Subordinate Bonds Indenture. Bonds issued under this indenture are special obligations of the City payable solely from and secured solely by a pledge of and lien on the Subordinate Pledged Revenues and the Subordinate Pledged funds. The Subordinate Pledged Revenues generally consist of the net revenues of the Division which remain after the payment of all operating expenses and the deposit of all funds required to be made on the Senior Lien Bonds. Bonds issued under this indenture are subordinate to those issued as senior lien bonds under the Amended and Restated Indenture.

The City has pledged future water system revenues, net of specified operating expenses, to repay $714,525,000 in various Senior Lien Water Revenue Bonds and Subordinate Lien Bonds issued in various years since 1993. Proceeds from the bonds provided financing for Water System improvements. The bonds are payable from water system net revenues and are payable through 2042. Annual principal and interest payments on the bonds are expected to require less than 47% of net revenues. The total principal and interest remaining to be paid on the various Water Revenue Bonds is $1,025,800,000. Principal and interest requirements for the current year on the senior lien bonds and total net revenues were $69,363,000 and $150,623,000, respectively.

Interest Rate Swap Transactions:

Upon the refunding of the Series M Bonds in 2009, the Division's swap became associated with the Series Q, Series R and Series S Bonds. When the Series R and Series S Bonds were refunded in 2010, the swap associated with these bonds was transferred to a portion of the new Series U and Series V Bonds.

Terms: Simultaneously with the issuance of the City's $175,000,000 Water Revenue Bonds, Series M, on August 10, 2004, the City entered into floating to fixed rate swap agreements with notional amounts equal to the total declining balance of the Series M Bonds. Bear Stearns Financial Products Inc. (Bear Stearns), (which has since been acquired by JPMorgan Chase Bank, N.A. (JPM)), was the counterparty on a two-thirds pro-rata share of the transaction and Morgan Stanley Capital Services Inc. (Morgan Stanley) was the counterparty on a one-third pro-rata share of the transaction.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

Under the original swap agreements for the Series M Bonds, the Water System was the fixed rate payor, paying a fixed rate of 3.533%. Each counterparty was a floating rate payor, with each paying the Water System 61.25% of one month LIBOR plus a spread of 28 basis points. Net payments were exchanged semiannually on January 1 and July 1. The obligation of the Water System to make periodic payments (but not any termination payment) was secured by a pledge of and lien on the net revenues of the Water System on a parity with the pledge and lien securing the payment of debt service on the bonds. Both the bond debt service payments on the Series M bonds and the periodic swap payments were insured by Financial Security Assurance (FSA). As part of the refunding of the Series M Bonds, the City amended and restated the original swap agreements to (a) eliminate the swap insurance and related insurer rights, (b) modify the payment frequency, (c) transfer the original swap agreement from Bear Stearns to JPM and (d) split each original swap agreement into two separate interest rate swaps in order to hedge separate series of bonds. The original Bear Stearns swap, which has been assumed by JPM, hedged the entire principal amount of Series R and certain maturities of the Series Q Bonds. The original Morgan Stanley swap hedged the entire principal amount of Series S and a portion of the Series Q Bonds. The floating rate received by the City was not altered. However, the fixed rate paid by the City was adjusted to 3.553% for the JPM swap and 3.5975% for the Morgan Stanley swap. The termination date for the swaps associated with the Series Q Bonds is January 1, 2021 while the termination date for the Series R and Series S swaps is January 1, 2033. Net payments are now exchanged monthly. With the refunding of the Series R and Series S Bonds, the JPM swap now hedges all but $200,000 of the Series U Bonds and the Morgan Stanley Swap hedges all but $200,000 of the Series V Bonds.

<u>Objective</u>: The City entered into the swaps in order to maximize the savings associated with the refunding of the bonds. The actual savings to be realized by the Water System will depend upon the payments made on the variable rate bonds and the payments received under the swap agreement.

<u>Basis Risk</u>: By entering into swaps based upon the 30 day LIBOR rate of interest, the City has undertaken basis risk associated with a change in tax rates and structure. While the average relationship between Securities Industry Financial Markets Association (SIFMA) (tax-exempt) and LIBOR (taxable) interest rates has been 67%, this relationship may not always apply. If the payments received from the counterparties are less than the amount paid on the variable rate bonds, the Water System must make up the difference in addition to paying the fixed rate resulting from the swap. As a result of the turmoil in the financial markets since 2008, the SIFMA/LIBOR ratio has been both significantly higher and lower than 67% for large periods of time. In addition, a reduction in federal income tax rates might increase the percentage relationship between SIFMA and LIBOR and may potentially increase the cost of the financing.

<u>Counterparty Risk</u>: The City selected highly rated counterparties in order to minimize this risk. However, in the wake of the subprime mortgage crisis, Bear Stearns was acquired by JPM. The portion of the City’s swap with Bears Stearns as the counterparty has been assumed by JPM. Over the long-term it is possible that the credit strength of JPM and/or Morgan Stanley could change and this event could trigger a termination payment on the part of the City.

<u>Termination Risk</u>: The swap agreement may be terminated prior to its stated termination date under certain circumstances. Upon termination, a payment may be owed by the City to JPM and Morgan Stanley, or by JPM and Morgan Stanley to the City, depending upon the prevailing economic circumstances at the time of the termination.

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2014 and 2013

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

Fair Value: The fair value of the swaps (including accrued amounts) at December 31, 2014 and December 31, 2013 as reported by JPM and Morgan Stanley totaled $19,455,000 and $17,206,000, respectively, which would be payable by the City.

Derivative Instruments: Derivative instruments are contracts, the value of which depends upon, or derives from, the value of an underlying asset, index or rate. The most common types of derivatives used by governments are interest rate swaps and interest rate locks. The City has entered into various derivative or hedging agreements since 1999. A detailed description of each outstanding derivative, including its terms, objectives, risks and fair value, can be found in the section discussing the bonds to which the derivative relates.

	Changes in Fair Value		Fair Value at December 31, 2014		
	Classification	**Amount**	**Classification**	**Amount**	**Notional**
			(In thousands)		
Hedging Derivatives:					
Floating to fixed interest rate swaps					
2008 Q Water Swap	Deferred inflow	$ 837	Debt	$ (5,416)	$ 61,370
2010 U Water Swap	Deferred outflow	(2,083)	Debt	(9,386)	54,735
2010 V Water Swap	Deferred outflow	(1,003)	Debt	(4,653)	26,295

	Changes in Fair Value		Fair Value at December 31, 2013		
	Classification	**Amount**	**Classification**	**Amount**	**Notional**
			(In thousands)		
Hedging Derivatives:					
Floating to fixed interest rate swaps					
2008 Q Water Swap	Deferred inflow	$ 3,316	Debt	$ (6,253)	$ 69,880
2010 U Water Swap	Deferred inflow	4,793	Debt	(7,303)	54,735
2010 V Water Swap	Deferred inflow	2,384	Debt	(3,650)	26,295

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

The following table presents the objective and significant terms of the City's derivative instruments at December 31, 2014, along with the credit rating of each swap counterparty.

Bonds	Type	Objective	Notional Amount	Effective Date	Maturity Date	Terms	Counterparty Credit Rating
Water Series Q	Pay Fixed Interest Rate Swap	Hedge of changes in cash flow on the Series Q Water System Bonds	$ 40,185,000	8/10/2004	1/1/2021	Pay 3.553%, receive 61.25% of LIBOR + 28 bps	Aa3/A+/A+
Water Series Q	Pay Fixed Interest Rate Swap	Hedge of changes in cash flow on the Series Q Water System Bonds	$ 21,185,000	8/10/2004	1/1/2021	Pay 3.5975%, receive 61.25% of LIBOR + 28 bps	Baa2/A-/A
Water Series U	Pay Fixed Interest Rate Swap	Hedge in changes in cash flow on the Series U Water System Bonds	$ 54,735,000	2/12/2009	1/1/2033	Pay 3.553%, receive 61.25% of LIBOR + 28 bps	Aa3/A+/A+
Water Series V	Pay Fixed Interest Rate Swap	Hedge in changes in cash flow on the Series V Water System Bonds	$ 26,295,000	2/12/2009	1/1/2033	Pay 3.5975%, receive 61.25% of LIBOR + 28 bps	Baa2/A-/A

The following table presents the aggregate debt service requirements on the City's hedged debt and net receipts/payments on the associated hedging derivative instruments as of December 31, 2014. These amounts assume that the interest rates on variable rate bonds and the reference rates in existence as of December 31, 2014 remain the same for the life of the hedging agreement. However, these rates will vary over time and the actual interest payments on the variable rate bonds and the net receipts/payments on the hedging derivative instruments will deviate from the numbers presented.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

Fiscal Year Ending December 31	Principal	Interest	Hedging Derivatives, Net	Total
		(In thousands)		
2015	$	$ 430	$ 4,287	$ 4,717
2016		430	4,229	4,659
2017		430	4,190	4,620
2018		430	3,864	4,294
2019		430	3,448	3,878
2020-2024	48,430	1,688	10,357	60,475
2025-2029	75,930	333	1,289	77,552
2030-2033	47,870	47	119	48,036
Total	$ 172,230	$ 4,218	$ 31,783	$ 208,231

Ohio Water Development Authority (OWDA) Loans: These loans are payable from net revenues derived from the Waterworks System. These obligations do not have a lien on revenues of the Division. The Division received an increase in OWDA loans in the amount of $11,950,000 during 2013. The current loans are being paid directly to the contractor by the State of Ohio, but accounted for as if the Division received and disbursed those monies.

NOTE C – DEPOSITS AND INVESTMENTS

Deposits: The carrying amount of the Division's deposits at December 31, 2014 and 2013 totaled $79,973,000 and $91,649,000, respectively, and the Division's bank balances were $76,258,000 and $85,060,000, respectively. The differences represent positions in pooled bank accounts and normal reconciling items. Based on the criteria described in GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* and GASB Statement No. 40, Deposit and Investment Risk Disclosures – an Amendment of GASB Statement No. 3, $76,258,000 and $85,060,000 of the bank balances at December 31, 2014 and 2013, respectively, were insured or collateralized with securities held by the City or by its agent in the City's name.

Custodial credit risk for deposits is the risk that in the event of bank failure, the Division will not be able to recover deposits or collateral for securities that are in possession of an outside party. At year end, the Division's deposits were fully insured or collateralized. All deposits are collateralized with eligible securities pledged and deposited either with the City or with a qualified trustee by the financial institution as security for repayment of all public monies deposited in the financial institution whose market value at all times is equal to at least 110% of the carrying value of the deposits being secured.

NOTE C – DEPOSITS AND INVESTMENTS (Continued)

Investments: The City's investment policies are governed by state statutes and City ordinances which authorize the City to invest in obligations of the U.S. Treasury, agencies and instrumentalities; State Treasurer Asset Reserve Fund (STAROhio); commercial paper; US Government Money Market Mutual Funds; guaranteed investment contracts; manuscript debt; bonds and other State of Ohio obligations; certificates of deposit; and repurchase transactions. Such repurchase transactions must be purchased from financial institutions or registered broker/dealers and are not to exceed a period of one year and confirmation of securities pledged must be obtained.

Generally, investments are recorded and are kept at the Federal Reserve Bank in the depository institution's separate custodial account for the City, apart from the assets of the depository institution. Ohio statute prohibits the use of reverse repurchase agreements.

Investment securities are exposed to various risks such as interest rate, market and credit. Market values of securities fluctuate based on the magnitude of changing market conditions; significant changes in market conditions could materially affect portfolio value.

Interest rate risk: As a means of limiting its exposure to fair value losses caused by rising interest rates, the Division invests primarily in both short and long-term investments maturing within five years from the date of purchase. The intent is to avoid the need to sell securities prior to maturity. Investment maturities are disclosed in the *Concentration of Credit Risk* section.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Division will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. The Division does not have an investment policy dealing with investment custodial credit risk beyond the requirement in the State statute.

Credit Risk: The Division's investments as of December 31, 2014 and 2013 include U.S. Treasury Notes, STAROhio, commercial paper, mutual funds, guaranteed investment contracts and other investments. The Division maintains the highest ratings for their investments. Investments in the U.S. Treasury Notes carry a Fitch rating of AAA, which is the highest rating given by Fitch. Investments in STAROhio, the PNC Treasury Money Market Fund and the First American Government Obligations Fund carry a rating of AAAm, which is the highest money market fund rating given by Standard & Poor's. Ohio law requires that STAROhio maintain the highest rating provided by at least one nationally recognized standard rating service. The Division's investment in U.S. Bank N.A. Open Commercial Paper carries a Standard & Poor's rating of A-1+.

NOTE C – DEPOSITS AND INVESTMENTS (Continued)

Concentration of Credit Risk: The Division places a limitation on the amount it may invest in any one issuer to help minimize the concentration of credit risk. The Division had the following investments at December 31, 2014 and 2013, which include those classified as cash and cash equivalents in the Statement of Net Position in accordance with the provisions of GASB Statement No. 9 since they have a maturity of three months or less:

Type of Investment	2014 Fair Value	2014 Cost	2013 Fair Value	2013 Cost	Investment Maturities Less than One Year	Investment Maturities 1 - 5 Years
			(In thousands)			
U.S. Treasury Notes	$ 10,037	$ 9,989	$ 10,021	$ 9,984	$	$ 10,037
STAROhio	161,223	161,223	129,575	129,575	161,223	
Commercial Paper	125,563	125,563	102,901	102,901	125,563	
Mutual Funds	10,161	10,161	7,400	7,400	10,161	
Guaranteed Investment Contracts			16,850	16,850		
Other Investments			45,000	45,000		
Total Investments	306,984	306,936	311,747	311,710	296,947	10,037
Total Deposits	79,973	79,973	91,649	91,649	79,973	
Total Deposits and Investments	$ 386,957	$ 386,909	$403,396	$403,359	$ 376,920	$ 10,037

These amounts are monies invested by the City Treasurer on behalf of the Division and are used in daily operations with excess monies invested daily in STAROhio and mutual funds. These investments are carried at cost which approximates market value. Investment type "Other Investments" consist of deposits into collective cash escrow pools managed by U.S. Bank as trustee.

The City's guaranteed investment contracts are not categorized as investments on the financial statements because they are reserved against future debt service requirements and may need to be liquidated prior to maturity.

As of December 31, 2014, the investments in U.S. Treasury Notes, STAROhio, commercial paper, and mutual funds are approximately 3%, 53%, 41% and 3%, respectively, of the Division's total investments. As of December 31, 2013, the investments in U.S. Treasury Notes, STAROhio, commercial paper, mutual funds, guaranteed investment contracts and other are approximately 3%, 42%, 33%, 2%, 5% and 15%, respectively, of the Division's total investments.

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2014 and 2013

NOTE D – CAPITAL ASSETS

Capital Asset Activity: Capital asset activity for the year ended December 31, 2014 was as follows:

	Balance January 1, 2014	Additions	Deletions	Balance December 31, 2014
	(In thousands)			
Capital assets, not being depreciated:				
Land	$ 5,463	$	$	$ 5,463
Construction in progress	212,426	69,291	(81,795)	199,922
Total capital assets, not being depreciated	217,889	69,291	(81,795)	205,385
Capital assets, being depreciated:				
Land improvements	16,549	878		17,427
Utility plant	1,543,875	113,187	(12,371)	1,644,691
Buildings, structures and improvements	262,087	215		262,302
Furniture, fixtures, equipment and vehicles	598,431	6,760	(27,196)	577,995
Total capital assets, being depreciated	2,420,942	121,040	(39,567)	2,502,415
Less: Accumulated depreciation	(927,668)	(80,870)	39,541	(968,997)
Total capital assets being depreciated, net	1,493,274	40,170	(26)	1,533,418
Capital assets, net	$ 1,711,163	$ 109,461	$ (81,821)	$ 1,738,803

NOTE D – CAPITAL ASSETS (Continued)

Capital Asset Activity: Capital asset activity for the year ended December 31, 2013 was as follows:

	Balance January 1, 2013	Additions	Deletions	Balance December 31, 2013
	(In thousands)			
Capital assets, not being depreciated:				
Land	$ 5,463	$	$	$ 5,463
Construction in progress	201,167	87,710	(76,451)	212,426
Total capital assets, not being depreciated	206,630	87,710	(76,451)	217,889
Capital assets, being depreciated:				
Land improvements	16,549			16,549
Utility plant	1,497,878	48,192	(2,195)	1,543,875
Buildings, structures and improvements	238,532	23,555		262,087
Furniture, fixtures, equipment and vehicles	586,549	24,126	(12,244)	598,431
Total capital assets, being depreciated	2,339,508	95,873	(14,439)	2,420,942
Less: Accumulated depreciation	(859,199)	(82,748)	14,279	(927,668)
Total capital assets being depreciated, net	1,480,309	13,125	(160)	1,493,274
Capital assets, net	$ 1,686,939	$ 100,835	$ (76,611)	$ 1,711,163

Commitments: The Division has outstanding commitments at December 31, 2014 and 2013 of approximately $82,311,000 and $102,497,000, respectively, for future capital expenditures. It is anticipated that these commitments will be financed from the Division's cash balances; however, at the discretion of the Division, additional long-term debt may be issued in the future to finance a portion of the costs.

NOTE E – DEFINED BENEFIT PENSION PLAN

***Ohio Public Employees Retirement System*:** All full-time employees, other than non-administrative full-time police officers and firefighters, participate in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans as described below:

1) The Traditional Pension Plan – a cost-sharing, multiple-employer defined benefit pension plan.
2) The Member-Directed Plan – a defined contribution plan in which the member invests both member and employer contributions (employer contributions vest over five years at 20% per year). Under the Member-Directed Plan, members accumulate retirement assets equal to the value of member and (vested) employer contributions plus any investment earnings.

NOTE E – DEFINED BENEFIT PENSION PLAN (Continued)

3) The Combined Plan – a cost-sharing, multiple-employer defined benefit pension plan. Under the Combined Plan, OPERS invests employer contributions to provide a formula retirement benefit similar in nature to the Traditional Pension Plan benefit. Member contributions, the investment of which is self-directed by the members, accumulate retirement assets in a manner similar to the Member-Directed Plan.

OPERS provides retirement, disability, survivor and death benefits and annual cost-of-living adjustments to members of the Traditional Pension and Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits. Authority to establish and amend benefits is provided in Chapter 145 of the Ohio Revised Code.

OPERS issues a stand-alone financial report. Interested parties may obtain a copy by visiting https://www.opers.org/investments/cafr.shtml, by writing to OPERS, 277 East Town Street, Columbus, Ohio 43215-4642, or by calling (614) 222-5601 or (800) 222-7377.

The Ohio Revised Code provides statutory authority for member and employer contributions. For 2014, member and employer contribution rates were consistent across all three plans. Member contribution rates were 10.00% in 2014, 2013 and 2012. The employer contribution rates were 14.00% of covered payroll in 2014, 2013 and 2012.

The Division's required employer contributions to OPERS for the pension portion of all the plans for the years ending December 31, 2014, 2013 and 2012 were $6,333,000, $6,921,000, and $5,452,000 each year, respectively. The required payments due in 2014, 2013 and 2012 have been made.

In June 2012, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. This accounting standard replaces GASB Statement No. 27, and it is effective for employer fiscal years beginning after June 15, 2014.

NOTE F – OTHER POSTEMPLOYMENT BENEFITS

Ohio Public Employees Retirement System**:** All full-time employees, other than non-administrative full-time police officers and firefighters, participate in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans: The Traditional Pension Plan – a cost-sharing, multiple-employer defined benefit pension plan; the Member-Directed Plan – a defined contribution plan; and the Combined Plan – a cost-sharing, multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan. OPERS maintains a cost-sharing multiple employer defined benefit postemployment health care plan, which includes a medical plan, prescription drug program and Medicare Part B premium reimbursement, to qualifying members of both the Traditional Pension and the Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits, including postemployment health care coverage. In order to qualify for postemployment health care coverage, age-and-service retirees under the Traditional Pension and Combined Plans must have 10 or more years of qualifying Ohio service credit. Health care coverage for disability benefit recipients and qualified survivor benefit recipients is available. The health care coverage provided by OPERS meets the definition of an Other Postemployment Benefit (OPEB) as described in GASB Statement No. 45. OPERS' eligibility requirements for postemployment health care coverage changed for those retiring on and after January 1, 2015. Please see the Plan Statement in the OPERS 2013 CAFR for details. The Ohio Revised Code permits, but does not mandate, OPERS to provide OPEB benefits to its eligible members and beneficiaries. Authority to establish and amend benefits is provided in Chapter 145 of the Ohio Revised Code.

OPERS issues a stand-alone financial report. Interested parties may obtain a copy by visiting https://www.opers.org/investments/cafr.shtml,writing to OPERS, 277 East Town Street, Columbus, Ohio 43215-4642, or by calling (614) 222-5601 or (800) 222-7377.

The Ohio Revised Code provides the statutory authority requiring public employers to fund post-retirement health care through their contributions to OPERS. A portion of each employer's contribution to OPERS is set aside for the funding of post-retirement health care benefits. Employer contribution rates are expressed as a percentage of the covered payroll of active members. The employer contribution rates were 14.00% of covered payroll in 2014, 2013 and 2012. The Ohio Revised Code currently limits the employer contribution to a rate not to exceed 14.00% of covered payroll. Active members do not make contributions to the OPEB Plan. OPERS' Postemployment Health Care plan was established under, and is administrated in accordance with, Internal Revenue Code 401(h). Each year, the OPERS Board of Trustees determines the portion of the employer contribution rate that will be set aside for funding of postemployment health care benefits. Employer contribution rates used to fund postemployment benefits were 2.00% for members of the Traditional Plan in 2014 and 1.00% in 2013 and 4.00% in 2012, 2.00% for members of the Combined Plan in 2014 and 1.00% for 2013 and 6.05% for 2012. Effective January 1, 2015, the portion of employer contributions allocated to health care remains at 2.00% for both plans, as recommended by the OPERS' Actuary. The OPERS Board of Trustees is also authorized to establish rules for the retiree or their surviving beneficiaries to pay a portion of the health care provided. Payment amounts vary depending on the number of covered dependents and the coverage selected. The Division's actual contributions to OPERS to fund postemployment benefits were $1,055,000 in 2014, $532,000 in 2013 and $2,180,000 in 2012. The required payments due in 2014, 2013 and 2012 have been made.

NOTE F – OTHER POSTEMPLOYMENT BENEFITS (Continued)

Changes to the health care plan were adopted by the OPERS Board of Trustees on September 19, 2012, with a transition plan commencing January 1, 2014. With the recent passage of pension legislation under SB343 and the approved health care changes, OPERS expects to be able to consistently allocate 4.00% of the employer contributions toward the health care fund after the end of the transition period.

NOTE G – CONTINGENT LIABILITIES AND RISK MANAGEMENT

Contingent Liabilities: Various claims are pending against the City involving the Division for personal injuries, property damage and other matters. The City is responsible for the suits. The City's management is of the opinion that ultimate settlement of such claims will not result in a material adverse effect on the Division's financial position, results of operations or cash flows.

Risk Management: The Division is exposed to various risks of loss related to torts; thefts of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Division is generally self-insured. No material losses, including incurred but not reported losses, occurred in 2014 or 2013.

The City provides the choice of four separate health insurance plans to its employees. On April 1, 2014 the City became self-insured for three of the four health care plans offered while one health care plan continues to be provided to employees through commercial insurance. The Divisions are charged a monthly rate per employee by type of coverage. The City participates in the State of Ohio workers' compensation retrospective rating program.

In accordance with GASB Statement No. 10, claims liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported.

The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, and damage awards. Accordingly, claims are re-evaluated periodically to consider the effects of inflation, recent claim settlement trends (including frequency and amount of pay-outs), and other economic and social factors.

The estimate of the claims liability also includes amounts for incremental claim adjustment expenses related to specific claims and other claim adjustment expenses, regardless of whether allocated to specific claims. Estimated recoveries, for example from salvage or subrogation, are another component of the claims liability estimate. Claims liability for the Division is immaterial.

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2014 and 2013

NOTE H – RELATED PARTY TRANSACTIONS

Revenues and Accounts Receivable: The Division provides water services to the City, including its various departments and divisions. Standard consumption rates are charged, except for the Division of Fire, public buildings and certain other facilities owned by the City, which by ordinance are provided free water services.

The Division performs billing and collection services for the Division of Water Pollution Control for a fee. This fee is based on the number of billings made on behalf of that division during the year at the same rates as charged to other users of the billing system. Revenue realized from the Division of Water Pollution Control for such services was approximately $2,425,000 and $2,426,000 in 2014 and 2013, respectively. The Division also provides miscellaneous services to other departments and divisions of the City. Revenue realized from such services was approximately $5,631,000 and $4,778,000 in 2014 and 2013, respectively.

Operating Expenses: The Division utilizes various intra-city services. Charges are based on actual use or on a reasonable pro-rata basis. The more significant costs for the years ended December 31 were as follows:

	2014	2013
	(In thousands)	
Electricity purchases	$ 15,393	$ 13,585
City administration	2,675	2,655
Motor Vehicle Maintenance	3,012	2,998
Telephone Exchange	1,183	1,074
Utilities Administration and Utilities Fiscal Control	5,115	3,961
Street Construction	358	152

NOTE I – CUYAHOGA COUNTY REAL PROPERTY TAXES

The Division is required by ordinance to keep records of the estimated property taxes which would be payable to Cuyahoga County were it subject to such taxes. The estimated property taxes for the Division, based on book value of real estate at the current tax rates, would have been approximately $5,756,000 and $5,955,000 for the years ended December 31, 2014 and 2013, respectively.

NOTE J – SUBSEQUENT EVENT

On April 14, 2015 the City sold $132,135,000 Water Revenue Bonds, Series 2015 consisting of $116,205,000 Water Revenue Bonds, Series Y and $15,930,000 Water Revenue Bonds, Series Z. These bonds were issued to refund certain outstanding Series N Water Revenue Bonds and Series O Water Revenue Bonds for debt service savings. A portion of the Series O Bonds were tendered for purchase and cancelled in lieu of being refunded. The Series Y Bonds were issued effective May 27, 2015. The Series Z Bonds were sold on a forward delivery basis and are expected to close on or about October 5, 2015. As a result of this refunding the Division will achieve net present value debt service savings of $12.8 million or 9.6%.

NOTE J – SUBSEQUENT EVENT (Continued)

Effective May 27, 2015 the City issued $90,800,000 Water Revenue Bonds, Series AA. These bonds were issued to refund the outstanding $90,800,000 Water Revenue Bonds, Series Q upon the expiration of the existing letter of credit. The bonds were issued as variable rate bonds with the City paying 65.1% of LIBOR plus a spread and were directly purchased by Bank of America, N.A.