CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

REPORT ON AUDIT OF FINANCIAL STATEMENTS
For the year ended December 31, 2017

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

TABLE OF CONTENTS

	Page
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-14
Statement of Net Position	16-17
Statement of Revenues, Expenses and Changes in Net Position	19
Statement of Cash Flows	20-21
Notes to Financial Statements	23-51
Schedule of the Division's Proportionate Share of the Net Pension Liability Ohio Public Employees Retirement System	52
Schedule of Contributions Ohio Public Employees Retirement System	53

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CLARK SCHAEFER HACKETT
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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 year ended December 31, 2017 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 audit. We conducted our audit 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.

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, 2017, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

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, 2017, and the respective changes in its financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. 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 and schedules of net pension liability and pension contributions, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio
June 28, 2018

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 year ended December 31, 2017. Please read this information in conjunction with the Division's financial statements and footnotes that begin on page 16.

The Division services not only the City, but also seventy-five direct service communities, seven master meter communities and three emergency standby communities. They provide water to approximately 418,000 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 2017, the Division provided services to approximately 114,000 accounts located within Cleveland and approximately 304,000 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 23.2% of the Division's metered sales revenue, while the direct service and master meter communities accounted for 72.5% and 4.3% 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 12,000 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 $1,507,361,000 and $1,443,181,000 at December 31, 2017, and 2016, respectively. Of these amounts, $391,547,000 and $370,105,000 are unrestricted net position at December 31, 2017, and 2016, respectively and may be used to meet the Division's ongoing obligations to customers and creditors.

- The Division's overall net position increased by $64,180,000 in 2017. The increase is primarily attributed to an increase in capital and other contributions of $45,810,000 related to the acquisition of several suburban water mains.

FINANCIAL HIGHLIGHTS (Continued)

- The total long-term revenue bonds and loans payable of the Division decreased by $71,806,000 due to scheduled principal payments on the bonds and loans and the refunding of several series of revenue bonds.

- The unrestricted cash and cash equivalents balance increased by $45,142,000, mainly due to continued strong results from operating activities.

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 16 – 21 of this report.

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 23 - 51 of this report. Required supplementary information can be found on pages 52 - 53.

CONDENSED STATEMENT OF NET POSITION INFORMATION

Provided below is condensed statement of net position information for the Division as of December 31, 2017 and 2016:

	2017	2016
	(Amounts in Thousands)	
Assets:		
Capital assets, net	$ 1,709,310	$ 1,701,684
Restricted assets	67,522	94,761
Current assets	485,198	450,138
Total assets	2,262,030	2,246,583
Deferred outflows of resources	69,832	64,724
Net position:		
Net investment in capital assets	1,051,909	986,294
Restricted for capital projects	1	46
Restricted for debt service	63,904	86,736
Unrestricted	391,547	370,105
Total net positon	1,507,361	1,443,181
Liabilities:		
Long-term obligations	729,581	766,152
Current liabilities	81,378	85,786
Total liabilities	810,959	851,938
Deferred inflows of resources	13,542	16,188

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

Current Assets: The Division had an increase in current assets of $35,060,000, primarily due to increases in unrestricted cash and cash equivalents of $45,142,000 and investments of $20,051,000, offset by a decrease in unbilled revenue of $25,348,000. The decrease in unbilled revenue is attributed to the Division changing from quarterly to monthly billing. There was also a $5,629,000 decrease in net accounts receivable.

Restricted assets: The Division's restricted assets decreased by $27,239,000. The decrease is primarily related to a reduction of $22,832,000 in debt service funds at year-end.

Deferred outflows of resources: The Division's deferred outflows of resources increased by $5,108,000, primarily due to a $7,871,000 increase in pension outflows. This increase was partially offset by a $3,430,000 decrease in the fair value of the Division's interest rate swaps.

Capital Assets: The Division's investment in capital assets, as of December 31, 2017, amounted to $1,709,310,000 (net of accumulated depreciation). The total net increase in the Division's investment in net capital assets was approximately $7,626,000. A summary of the activity in the Division's capital assets during December 31, 2017, is as follows:

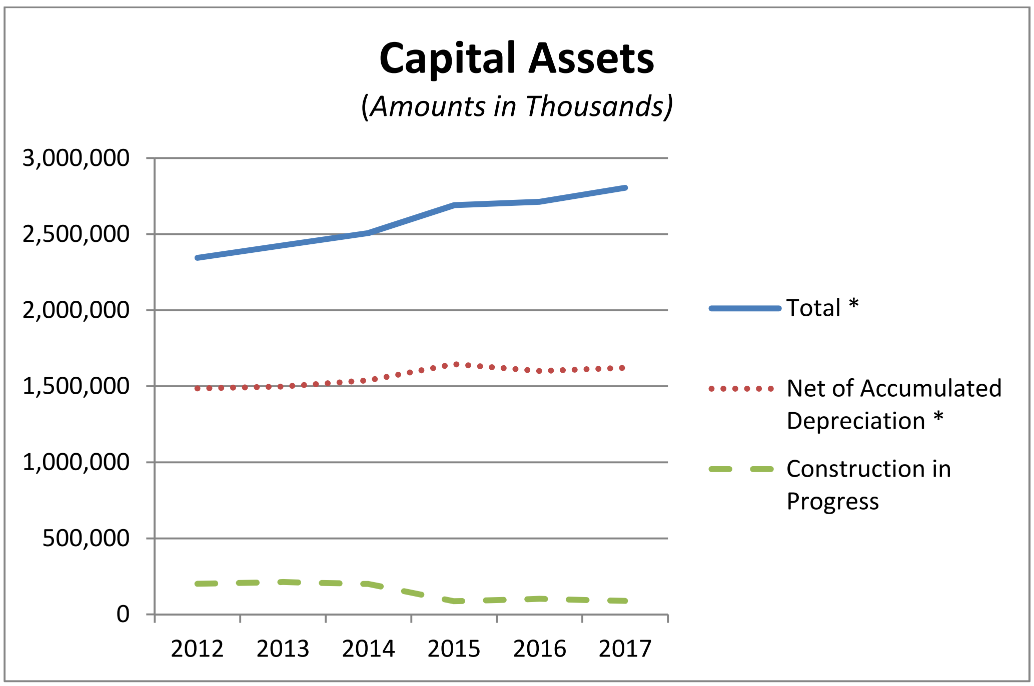
	Balance January 1, 2017	Additions	Reductions	Balance December 31, 2017
		(Amounts in Thousands)		
Land	$ 5,463	$	$ (20)	$ 5,443
Land improvements	17,427	187		17,614
Utility plant	1,808,978	111,170	(1,564)	1,918,584
Buildings, structures and improvements	266,517	746	(5,616)	261,647
Furniture, fixtures, equipment and vehicles	614,057	7,742	(19,813)	601,986
Construction in progress	101,665	35,335	(49,070)	87,930
Total	2,814,107	155,180	(76,083)	2,893,204
Less: Accumulated depreciation	(1,112,423)	(95,976)	24,505	(1,183,894)
Capital assets, net	$ 1,701,684	$ 59,204	$ (51,578)	$ 1,709,310

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

Utility plant had additions of $111,170,000, primarily due to the acquisition and completion of various suburban water mains. Additionally, construction in progress had additions and deletions of $35,335,000 and $49,070,000, respectively, resulting in a net decrease of $13,735,000 (See Note D).

Major projects still under construction chiefly consist of Suburban Watermain Renewals and related engineering services, AMR Phase II, Water Towers and Third High Pump Stations.

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.



* Construction in Progress not included

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

Long-term Obligations**:** In 2017, the factors contributing to the Division's net decrease in long-term obligations of $36,571,000 is primarily due to a decrease in the non-current portion of revenue bonds and OWDA loans amounting to $45,835,000 and $7,909,000, respectively, offset by an increase in the net pension liability of $17,942,000. The rise in the net pension liability is primarily due to the investment returns not meeting expectations.

Current Liabilities: In 2017, total current liabilities decreased by $4,408,000. The significant component of the change is a decrease of $8,067,000 in the current portion of long-term debt and $2,900,000 in accrued interest payable. The decreases were partially offset by an increase of $4,032,000 in the accounts payable, primarily due to the Division funding capital project expenses from non-revenue bond proceeds.

Pension Liability**:** During 2015, the Division adopted Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions—an Amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – An Amendment of GASB Statement No. 68*, which significantly revised accounting for pension costs and liabilities. For reasons discussed below, many end users of these financial statements will gain a clearer understanding of the Division's actual financial condition by adding deferred inflows of resources related to pension and the net pension liability to the reported net position and subtracting deferred outflows of resources related to pension.

GASB standards are national and apply to all government financial reports prepared in accordance with generally accepted accounting principles. When accounting for pension costs, GASB Statement No. 27 focused on a funding approach. This approach limited pension costs to contributions annually required by law, which may or may not be sufficient to fully fund each plan's net pension liability. GASB Statement No. 68 takes an earnings approach to pension accounting; however, the nature of Ohio's statewide pension systems and state law governing those systems requires additional explanation in order to properly understand the information presented in these statements.

Under the new standards required by GASB Statement No. 68, the net pension liability equals the Division's proportionate share of each plan's collective:

1. Present value of estimated future pension benefits attributable to active and inactive employees' past service

2. Minus plan assets available to pay these benefits

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

GASB notes that pension obligations, whether funded or unfunded, are part of the "employment exchange" – that is, the employee is trading his or her labor in exchange for wages, benefits and the promise of a future pension. GASB noted that the unfunded portion of this pension promise is a present obligation of the Division, part of a bargained-for benefit to the employee and should accordingly be reported by the Division as a liability since they received the benefit of the exchange. However, the Division is not responsible for certain key factors affecting the balance of this liability. In Ohio, the employee shares the obligation of funding pension benefits with the employer. Both employer and employee contribution rates are capped by State Statute. A change in these caps requires action of both Houses of the General Assembly and approval of the Governor. Benefit provisions are also determined by State Statute. The employee enters the employment exchange with the knowledge that the employer's promise is limited not by contract but by law. The employer enters the exchange also knowing that there is a specific, legal limit to its contribution to the pension system. In Ohio, there is no legal means to enforce the unfunded liability of the pension system against the public employer. State law operates to mitigate/lessen the moral obligation of the public employer to the employee, because all parties enter the employment exchange with notice as to the law. The pension system is responsible for the administration of the plan.

Most long-term liabilities have set repayment schedules or, in the case of compensated absences (i.e. sick and vacation leave), are satisfied through paid time-off or termination payments. There is no repayment schedule for the net pension liability. As explained above, changes in pension benefits, contribution rates, and return on investments affect the balance of the net pension liability, but are outside the control of the Division. In the event that contributions, investment returns and other changes are insufficient to keep up with required pension payments, State Statute does not assign/identify the responsible party for the unfunded portion. Due to the unique nature of how the net pension liability is satisfied, this liability is separately identified within the long-term liability section of the statement of net position.

In accordance with GASB Statement No. 68, the Division's statements prepared on an accrual basis of accounting include an annual pension expense for their proportionate share of each plan's change in net pension liability not accounted for as deferred inflows/outflows of resources.

As a result of implementing GASB Statement No. 68, the Division is reporting a net pension liability and deferred inflows/outflows of resources related to pension on the accrual basis of accounting.

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

Long-term Debt: At the end of 2017, the Division had total long-term debt outstanding of $648,484,000. 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.

The activity in the Division's debt obligations outstanding during the year ended December 31, 2017, is summarized below (excluding unamortized discounts and premiums):

	Balance January 1, 2017	Debt Issued	Debt Retired	Balance December 31, 2017
		(Amounts in Thousands)		
Long-Term Debt				
Water Revenue Bonds:				
Series G 1993	$ 56,300	$	$ (10,100)	$ 46,200
Series O 2007	3,395		(3,395)	-
Series P 2007	88,720		(82,695)	6,025
Series T 2009	48,090		(610)	47,480
Series U 2010	54,935			54,935
Series V 2010	26,495			26,495
Series W 2011	8,080		(6,550)	1,530
Series X 2012	44,410		(16,835)	27,575
Series Y 2015	116,205			116,205
Series Z 2015	15,105		(11,695)	3,410
Series AA 2015	90,800			90,800
Series BB 2017		15,760		15,760
Series CC 2017		54,730		54,730
Second Lien Series A 2012	76,710		(45,850)	30,860
Second Lien Series B 2017		43,095		43,095
Ohio Water Development Authority Loans	91,045		(7,661)	83,384
Total	$ 720,290	$ 113,585	$ (185,391)	$ 648,484

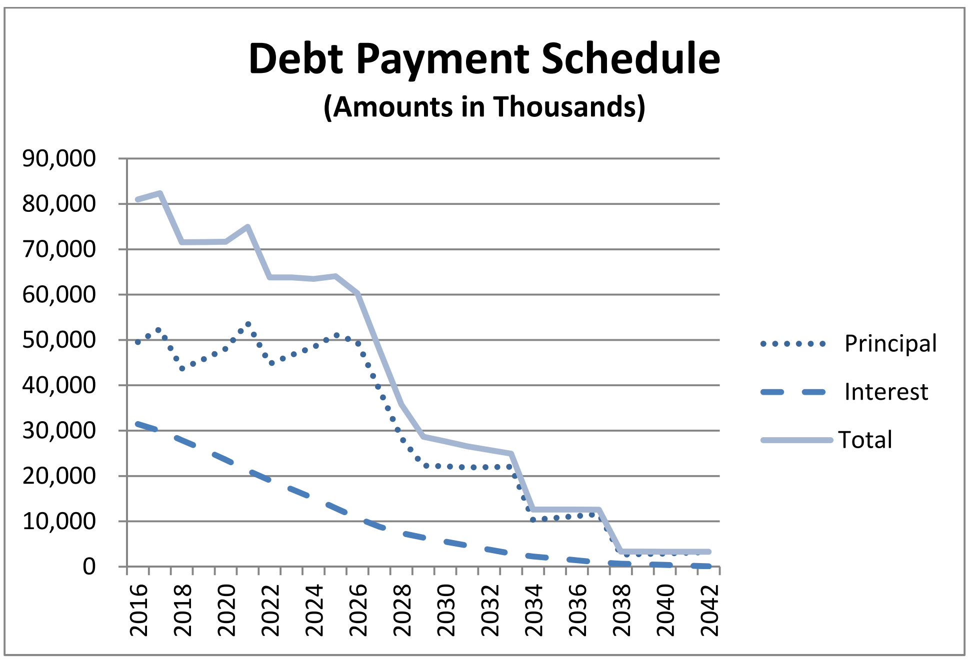
CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

The bond ratings for the Division's outstanding revenue bonds as of December 31, 2017, are as follows:

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

On August 9, 2017 S&P Global Ratings raised its rating on the Water Revenue Bonds to AA+ from AA and its rating on the Subordinate Lien Water Revenue Bonds to AA from 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, investors and creditors. The Division's revenue bond coverage for 2017 and 2016 was 266% and 250%, respectively.



Debt service on the Division's bonded debt will begin declining in 2018 and is expected to minimally impact its operations.

Additional information on the Division's long-term debt can be found in Note B on pages 28 - 37.

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

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 of resources exceed liabilities and deferred inflows of resources by $1,507,361,000 and $1,443,181,000 at December 31, 2017 and 2016, respectively.

Of the Division's net position, $1,051,909,000 at December 31, 2017, 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, $63,905,000 at December 31, 2017, 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, $391,547,000, at December 31, 2017, 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 2017 by $64,180,000. The following table identifies the key elements of the Division's results of operations for the years ended December 31, 2017 and 2016:

	2017	2016
	(Amounts in Thousands)	
Operating revenues	$ 301,453	$ 310,107
Operating expenses	263,202	240,199
Operating income (loss)	38,251	69,908
Non-operating revenue (expense):		
Investment income	4,518	1,775
Interest expense	(25,535)	(29,056)
Amortization of bond premiums and discounts	4,452	4,134
Gain (loss) on disposal of capital assets	(2,250)	(1,146)
Other	(1,066)	83
Total non-operating revenue (expense), net	(19,881)	(24,210)
Income (loss) before capital and other contributions	18,370	45,698
Capital and other contributions	45,810	12
Change in net position	$ 64,180	$ 45,710

Operating revenue: In 2017, total operating revenues of the Division decreased $8,654,000 or 2.8%. The reduction is primarily attributed to a decrease of $25,348,000 or 70.8% in unbilled revenue related to the conversion from quarterly to monthly billing. The decrease was partially offset by a $10,411,000 increase in fixed fee revenue.

Operating expenses: In 2017, the overall increase in operating expenses of $23,003,000 was primarily due to a $20,958,000 increase in operations expense. The rise is primarily attributed to a $7,832,000 increase in pension expense and a $4,770,000 increase in bad debts.

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

Non-operating revenue (expense): Net non-operating revenue (expense) changed by $4,329,000 in 2017 due to a change of $3,521,000 in interest expense. In addition, investment income increased by $2,743,000 due to higher interest rates on its investments.

Capital and other contributions: In 2017, capital and other contributions increased by $45,798,000 as compared to 2016. This was due to the Division acquiring distribution mains in the cities of Beachwood, Cleveland Heights, Valley View and Macedonia.

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.

BASIC FINANCIAL STATEMENTS

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENT OF NET POSITION
December 31, 2017
(Amounts in Thousands)

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	
CAPITAL ASSETS	
Land	$ 5,443
Land improvements	17,614
Utility plant	1,918,584
Buildings, structures and improvements	261,647
Furniture, fixtures, equipment and vehicles	601,986
	2,805,274
Less: Accumulated depreciation	(1,183,894)
	1,621,380
Construction in progress	87,930
CAPITAL ASSETS, NET	1,709,310
RESTRICTED ASSETS	
Cash and cash equivalents	67,470
Accrued interest receivable	52
TOTAL RESTRICTED ASSETS	67,522
CURRENT ASSETS	
Cash and cash equivalents	385,434
Restricted cash and cash equivalents	2,178
Investments	20,051
Receivables:	
Accounts receivable - net of allowance for doubtful accounts of $16,947,000	53,334
Unbilled revenue	10,478
Due from other City of Cleveland departments, divisions or funds	4,524
Due from other governments	25
Accrued interest receivable	17
Materials and supplies - at average cost	8,390
Prepaid expenses	767
TOTAL CURRENT ASSETS	485,198
DEFERRED OUTFLOWS OF RESOURCES	
Derivative instruments-interest rate swaps	11,107
Unamortized loss on bond refunding	24,486
Pension	34,239
TOTAL DEFERRED OUTFLOWS OF RESOURCES	69,832

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENT OF NET POSITION
December 31, 2017
(Amounts in Thousands)

NET POSITION, LIABILITIES AND DEFERRED INFLOWS OF RESOURCES		
NET POSITION		
Net investment in capital assets	$	1,051,909
Restricted for capital projects		1
Restricted for debt service		63,904
Unrestricted		391,547
TOTAL NET POSITION		1,507,361
LIABILITIES		
LONG-TERM OBLIGATIONS-excluding amounts due within one year		
Accrued wages and benefits		575
OWDA loans		75,475
Revenue bonds		565,687
Net pension liability		87,844
TOTAL LONG-TERM OBLIGATIONS		729,581
CURRENT LIABILITIES		
Accounts payable		11,814
Customer deposits and other liabilities		4,539
Current portion of accrued wages and benefits		8,326
Due to other City of Cleveland departments, divisions or funds		1,845
Accrued interest payable		8,362
Current payable from restricted assets		2,178
Current portion of long-term debt, due within one year		44,314
TOTAL CURRENT LIABILITIES		81,378
TOTAL LIABILITIES		810,959
DEFERRED INFLOWS OF RESOURCES		
Derivative instruments-interest rate swaps		11,107
Pension		2,435
TOTAL DEFERRED INFLOWS OF RESOURCES		13,542

See notes to financial statements.

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CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
For the Year Ended December 31, 2017
(Amounts in Thousands)

OPERATING REVENUES		
Charges for services	$	301,453
TOTAL OPERATING REVENUES		301,453
OPERATING EXPENSES		
Operations		120,860
Maintenance		64,507
Depreciation		77,835
TOTAL OPERATING EXPENSES		263,202
OPERATING INCOME (LOSS)		38,251
NON-OPERATING REVENUE (EXPENSE)		
Investment income		4,518
Interest expense		(25,535)
Amortization of bond premiums and discounts		4,452
Gain (loss) on disposal of capital assets		(2,250)
Other		(1,066)
TOTAL NON-OPERATING REVENUE (EXPENSE), NET		(19,881)
INCOME (LOSS) BEFORE CAPITAL AND OTHER CONTRIBUTIONS		18,370
Capital and other contributions		45,810
INCREASE (DECREASE) IN NET POSITION		64,180
NET POSITION, BEGINNING OF YEAR		1,443,181
NET POSITION, END OF YEAR	$	1,507,361

See notes to financial statements.

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2017
(Amounts in Thousands)

CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	$	325,994
Cash payments to suppliers for goods or services		(88,434)
Cash payments to employees for services		(74,270)
Other		(396)
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES		162,894
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of revenue bonds, loans and notes		134,798
Acquisition and construction of capital assets		(39,740)
Principal paid on long-term debt		(52,381)
Interest paid on long-term debt		(28,267)
Cash paid to escrow agent for refunding		(143,598)
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES		(129,188)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities		(20,079)
Proceeds from sale and maturity of investment securities		10,491
Interest received on investments		4,522
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES		(5,066)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		28,640
CASH AND CASH EQUIVALENTS, beginning of year		426,442
CASH AND CASH EQUIVALENTS, end of year	$	455,082

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2017
(Amounts in Thousands)

RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES

OPERATING INCOME (LOSS)	$	38,251
Adjustments:		
Depreciation		77,835
(Increase) decrease in assets:		
Accounts receivable, net		5,629
Unbilled revenue		25,348
Due from other City of Cleveland departments, divisions or funds		(721)
Materials and supplies, net		409
Prepaid expenses		(232)
(Increase) decrease in deferred outflows of resources - pension		(7,871)
Increase (decrease) in liabilities:		
Accounts payable		4,032
Customer deposits and other liabilities		890
Accrued wages and benefits		617
Due to other City of Cleveland departments, divisions or funds		(19)
Net pension liability		17,942
Increase (decrease) in deferred inflows of resources - pension		784
TOTAL ADJUSTMENTS		124,643
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	$	162,894

SCHEDULE OF NON-CASH CAPITAL AND RELTAED FINANCING ACTIVITIES

Contributions and accounts payable related to capital assets	$	47,988

See notes to financial statements.

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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 2015, GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement* 68*, and Amendments to Certain Provisions of GASB Statements 67 and 68* was issued. This Statement is effective for fiscal periods beginning after June 15, 2015—except those provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of GASB Statement No. 68, which are effective for fiscal years beginning after June 15, 2016. The objective of this Statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. This Statement establishes requirements for defined benefit pensions that are not within the scope of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of GASB Statement No. 68. It also amends certain provisions of GASB Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*, and GASB Statement No. 68 for pension plans and pensions that are within their respective scopes. As required, the Division has implemented GASB Statement No. 73 as of December 31, 2017.

In June of 2015, GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (OPEB), was issued. This Statement is effective for financial statements for fiscal years beginning after June 15, 2016. This Statement replaces GASB Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended and GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended, GASB Statement No. 43 and GASB Statement No. 50, *Pension Disclosures – an Amendment of GASB Statements No. 25 and No. 27.* The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity and creating additional transparency. The Division has determined that GASB Statement No. 74 has no impact on its financial statements as of December 31, 2017.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In January of 2016, GASB Statement No. 80, *Blending Requirements for Certain Component Units – an Amendment of GASB Statement No. 14* was issued. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. This Statement amends the blending requirements established in paragraph 53 of GASB Statement No. 14, *The Financial Reporting Entity*, as amended. This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units – an Amendment of GASB Statement No. 14.* The Division has determined that GASB Statement No. 80 has no impact on its financial statements as of December 31, 2017.

In March of 2016, GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, was issued. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2016, and should be applied retroactively. The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period. The Division has determined that GASB Statement No. 81 has no impact on its financial statements as of December 31, 2017.

In March of 2016, GASB Statement No. 82, *Pension Issues an amendment of GASB Statements No. 67, No. 68, and No. 73* was issued. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. The objective of this Statement is to address certain issues that have been raised with respect to GASB Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. As required, the Division has implemented GASB Statement No. 82 as of December 31, 2017.

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.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

Investments: The Division follows the provisions of GASB Statement No. 72, *Fair Value Measurement and Application* which requires governmental entities to record their investments at fair value within the fair value hierarchy. The hierarchy is based on the valuation inputs used to measure fair value of the assets. Level 1 inputs are quoted prices in an active market for identical assets. Level 2 inputs are significant other observable inputs. Level 3 inputs are significant unobservable inputs. The Division's investments in money market mutual funds and the State Treasury Asset Reserve of Ohio (STAR Ohio) funds are excluded from fair value measurement requirements under GASB Statement No. 72 and instead are reported at amortized cost.

The Division has invested funds in the STAR Ohio during 2017. STAR Ohio is an investment pool managed by the State Treasurer's Office, which allows governments within the State to pool their funds for investment purposes. STAR Ohio is not registered with the SEC as an investment company, but has adopted GASB Statement No. 79 for the purpose of measuring the value of shares in STAR Ohio. The Division measures their investment in STAR Ohio at the net asset value (NAV) per share provided by STAR Ohio. The NAV per share is calculated on an amortized cost basis that provides a NAV share that approximates fair value.

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 their acquisition value on the date contributed. 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

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 GASB 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 2017, total interest costs incurred amounted to $27,378,000, of which $1,837,000 was capitalized, net of interest income of $6,000.

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 of resources and is amortized over the shorter of the defeased bond or the newly issued bond.

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.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Pensions: For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the pension plans and additions to/deductions from their fiduciary net positon have been determined on the same basis as they are reported by the pension systems. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. The pension systems report investments at fair value.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS

Debt outstanding at December 31, 2017, is as follows:

	Interest Rate	Original Issuance	2017
	(Amounts in Thousands)		
Water Revenue Bonds:			
Series G 1993 due through 2021	5.50%	$ 228,170	$ 46,200
Series P 2007 due through 2018	5.00%	135,410	6,025
Series T 2009 due through 2021	4.00%-5.00%	84,625	47,480
Series U 2010 due through 2033	Variable	54,935	54,935
Series V 2010 due through 2033	Variable	26,495	26,495
Series W 2011 due through 2026	2.00%-5.00%	82,090	1,530
Series X 2012 due through 2042	3.63%-5.00%	44,410	27,575
Series Y 2015 due through 2037	4.00%-5.00%	116,205	116,205
Series Z 2015 due through 2019	3.00%-5.00%	15,930	3,410
Series AA 2015 due through 2033	Variable	90,800	90,800
Series BB 2017 due through 2032	3.00%-5.00%	15,760	15,760
Series CC 2017 due through 2028	5.00%	54,730	54,730
Second Lien Series A 2012 due 2022	4.00%-5.00%	76,710	30,860
Second Lien Series B 2017 due through 2027	5.00%	43,095	43,095
Ohio Water Development Authority Loans			
payable annually through 2032	0.00%-3.00%	152,767	83,384
		$ 1,222,132	648,484
Adjustments:			
Unamortized discount and premium			36,992
Current portion			(44,314)
Total Long-Term Debt			$ 641,162

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Year Ended December 31, 2017

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

Summary: Changes in long-term obligations for the year ended December 31, 2017, are as follows:

	Balance January 1, 2017	Increase	Decrease	Balance December 31, 2017	Due Within One Year
			(Amounts in Thousands)		
Water Revenue Bonds:					
Series G 1993 due through 2021	$ 56,300	$	$ (10,100)	$ 46,200	$ 10,650
Series O 2007 due through 2017	3,395		(3,395)	-	
Series P 2007 due through 2018	88,720		(82,695)	6,025	6,025
Series T 2009 due through 2021	48,090		(610)	47,480	10,415
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	8,080		(6,550)	1,530	150
Series X 2012 due through 2042	44,410		(16,835)	27,575	
Series Y 2015 due through 2037	116,205			116,205	
Series Z 2015 due through 2019	15,105		(11,695)	3,410	2,415
Series AA 2015 due through 2033	90,800			90,800	
Series BB 2017 due through 2032		15,760		15,760	45
Series CC 2017 due through 2028		54,730		54,730	
Second Lien Series A 2012 due through 2022	76,710		(45,850)	30,860	6,105
Second Lien Series B 2017 due through 2027		43,095		43,095	600
Ohio Water Development Authority Loans payable annually through 2032	91,045		(7,661)	83,384	7,909
Total revenue bonds/loans	720,290	113,585	(185,391)	648,484	44,314
Accrued wages and benefits	8,284	7,557	(6,940)	8,901	8,326
Net pension liability	69,902	17,942		87,844	
Total	$ 798,476	$ 139,084	$ (192,331)	$ 745,229	$ 52,640

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
	(Amounts in Thousands)		
2018	$ 44,314	$ 25,508	$ 69,822
2019	45,226	24,880	70,106
2020	47,476	22,695	70,171
2021	43,870	20,571	64,441
2022	43,778	18,647	62,425
2023-2027	228,602	63,501	292,103
2028-2032	114,733	27,669	142,402
2033-2037	65,920	9,319	75,239
2038-2042	14,565	1,893	16,458
Total	$ 648,484	$ 214,683	$ 863,167

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 is 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 2017, the Division did not take out any new loans. OWDA completed an interest rate buy-down which resulted in interest rate savings on current loans. Market rate loans with interest rates higher than 4.0% saw a reduction in rates to 4.0% while rates over 3.0% on OWDA loans were reduced to 3.0%. The buy-down commenced retroactively to the January 1, 2016 payment.

At December 31, 2017, the amount financed on these eleven loan projects, less principal payments made, totaled $83,384,000 and is reflected in the debt service payment schedule.

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

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 the following amounts of defeased debt outstanding at December 31, 2017:

Series P, 2007	$70,325,000
Series X, 2012	$16,835,000
Second Lien Series A, 2012	$45,850,000

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 were 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 may be maintained for certain series of bonds and charges for fees to customers must be sufficient in amount, 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, 2017, the Division was in compliance with the terms and requirements of the bond indenture.

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 reserve 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. Not all series of bonds are covered by the reserve fund.

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

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

Construction Fund: Proceeds from the various series of 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.

On September 7, 2017, Water Revenue Bonds, Series BB, 2017, were issued in the amount of $15,760,000. The bonds were issued to advance refund $16,835,000 of outstanding Series X Water Revenue Bonds, 2012. Net bond proceeds in the amount of $19,078,451, along with $126,167 from the Series X debt service fund, were placed in an irrevocable escrow account to pay the principal and interest on the refunded bonds when due. As a result of this refunding, the City realized an economic gain (the difference between the present values of the old and new debt service) of $1,367,000 or 8.1% and achieved debt service savings of $1,727,000.

At the same time the City sold the Series BB Bonds, the City also sold $54,730,000 Water Revenue Bonds, Series CC, on a forward delivery basis. The Series CC Bonds were ultimately issued effective October 3, 2017 to refund $70,325,000 of outstanding Water Revenue Bonds, Series P, 2005. Net bond proceeds in the amount of $64,119,219, along with $874,438 from the Series P Interest account and $7,080,119 released from the debt service reserve fund, were placed in an irrevocable escrow account to pay the principal and interest on the refunded bonds. The City realized present value savings of $10,760,000 or 15.3% from this refunding.

Effective October 10, 2017, the City issued $43,095,000 Water Revenue Bonds, Second Lien Series B, 2017. These bonds provided funds to advance refund $45,850,000 of outstanding Second Lien Series A Bonds, 2012. Net bond proceeds in the amount of $51,753,988, along with $566,000 from the Second Lien Series A Interest account, were placed in an irrevocable escrow account to pay the principal and interest on the refunded bonds. As a result of this refunding, the City achieved net present value debt service savings of $3,103,000 or 6.8%.

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 Division entered into new direct purchase agreements on both series of bonds. Effective December 1, 2017, the $54,935,000 Water Series U Bonds and the $26,495,000 Water Series V Bonds were directly purchased by PNC Bank, National Association. The Division is 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 Water Revenue Bonds, Second Lien 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 behalf of the Senior Lien Bonds. Bonds issued under this indenture are subordinate to those issued as senior lien bonds under the Division's Amended and Restated Indenture.

The City has pledged future water system revenues, net of specified operating expenses, to repay $565,100,000 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 42% of net revenues. The total principal and interest remaining to be paid on the various Senior and Subordinate Lien Water Revenue Bonds is $767,850,000. Amounts deposited for principal and interest in the current year on the Senior Lien Bonds and total net revenues were $49,546,000 and $120,604,000, 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. The portion of the swap associated with Series Q remained unchanged. The Series Q Bonds were then refunded in 2015 and the swap associated with these bonds was transferred to the new Series AA Bonds.

<u>Terms:</u> 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.

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. 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).

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

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 (now the Series AA 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.

Objective: 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.

Basis Risk: 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 and Financial Markets Association (SIFMA) (tax-exempt) and LIBOR (taxable) interest rates has been 67% over time, 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 beginning in 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, such as the one recently enacted, might increase the percentage relationship between SIFMA and LIBOR and may potentially increase the cost of the financing.

Counterparty Risk: 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 was 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.

Termination Risk: 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.

Fair Value: The fair value of the swaps (including accrued amounts) at December 31, 2017, as reported by JPM and Morgan Stanley totaled $11,107,000, which would be payable by the City.

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

Derivative Instruments: Derivative instruments are contracts, based upon 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 derivatives 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.

The derivative instruments are classified as Level 2 inputs of the fair value hierarchy and are considered to be significant other observable inputs. The derivative instruments are calculated using the zero-coupon discounting method which takes into consideration the prevailing interest rate environment, the specific terms and conditions of a given transaction, and assumes that the current forward rate implied by the yield curve are the market's best estimate of future spot interest rates. The income approach is then used to obtain the fair value of the swaps, where future amounts are converted to a single current (discounted) amount, using a rate of return that takes into account the relative risk of nonperformance associated with the cash flows, and time value of money.

	Changes in Fair Value		Fair Value at December 31, 2017		
	Classification	**Amount**	**Classification**	**Amount**	**Notional**
			(Amounts in Thousands)		
Hedging Derivatives:					
Floating to fixed interest rate swaps					
2015 AA Water Swap	Deferred inflow	$ 1,403	Debt	$ (1,696)	$ 50,105
2010 U Water Swap	Deferred inflow	1,352	Debt	(6,284)	54,735
2010 V Water Swap	Deferred inflow	675	Debt	(3,127)	26,295

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

The following table presents the objective and significant terms of the Division's derivative instruments at December 31, 2017, along with the credit rating of each swap counterparty.

Bonds	Type	Objective	Notional Amount	Effective Date	Maturity Date	Terms	Counterparty Credit Rating
Water Series AA	Pay Fixed Interest Rate Swap	Hedge of changes in cash flow on the Series AA Water System Bonds	$ 32,670,000	8/10/2004	1/1/2021	Pay 3.553%, receive 61.25% of LIBOR + 28 bps	Aa3/A+/AA-
Water Series AA	Pay Fixed Interest Rate Swap	Hedge of changes in cash flow on the Series AA Water System Bonds	$ 17,435,000	8/10/2004	1/1/2021	Pay 3.5975%, receive 61.25% of LIBOR + 28 bps	A3/BBB+/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+/AA-
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	A3/BBB+/A

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

The following table presents the aggregate debt service requirements on the Division's hedged debt and net receipts/payments on the associated hedging derivative instruments as of December 31, 2017. These amounts assume that the interest rates on variable rate bonds and the reference rates in existence as of December 31, 2017, 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. The following table is the total amount of the bond issuances that have hedging, although some of the bonds are not hedged.

Fiscal Year Ending December 31	Principal	Interest	Hedging Derivatives, Net	Total
		(Amounts in Thousands)		
2018	$	$ 2,383	$ 2,828	$ 5,211
2019		2,384	2,524	4,908
2020		2,390	2,205	4,595
2021	2,170	2,356	1,874	6,400
2022	14,830	2,162	1,530	18,522
2023-2027	81,415	7,391	2,782	91,588
2028-2032	61,730	2,526	217	64,473
2033	12,085	14	1	12,100
Total	$ 172,230	$ 21,606	$ 13,961	$ 207,797

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 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, 2017, totaled $5,393,000 and the Division's bank balances were $6,941,000 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*, $6,941,000 of the bank balances at December 31, 2017, was insured or collateralized with securities held by the City or by its agent in the City's name.

NOTE C – DEPOSITS AND INVESTMENTS (Continued)

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.

Investments: In accordance with GASB Statement No. 72, *Fair Value Measurement and Application*, the City reports its investments at fair value based on quoted market values, where applicable and recognized the corresponding change in the fair value of the investments recorded in investment earnings in the year in which the change occurs. 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 (STAR Ohio); 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.

The Division categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure fair value of the assets. Level 1 inputs are quoted prices in an active market for identical assets. Level 2 inputs are significant other observable inputs. Level 3 inputs are significant unobservable inputs.

NOTE C – DEPOSITS AND INVESTMENTS (Continued)

The following is a summary of the fair value hierarchy of the fair value of investments of the Division (excluding Star Ohio and money market mutual funds) as of December 31, 2017:

Type of Investment	Fair Value	Fair Value Measurement Using Level 1	Level 2
	(Amounts in Thousands)		
U.S. Treasury Bonds	$ 20,051	$ 20,051	$
Commercial Paper	9,254		9,254
Total Investments	$ 29,305	$ 20,051	$ 9,254

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, 2017, include U.S. Treasury Bonds, STAR Ohio, commercial paper and money market mutual funds. Investments in the U.S. Treasury Bonds carry a Moody's rating of Aaa, which is the highest rating given by Moody's. Investments in STAR Ohio, 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 STAR Ohio 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, 2017, 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, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Accounting*, since they have a maturity of three months or less:

Type of Investment	2017 Value	2017 Cost	Investment Maturities Less than One Year
	(Amounts in Thousands)		
U.S. Treasury Bonds	$ 20,051	$ 20,079	$ 20,079
STAR Ohio	366,840	366,840	366,840
Commercial Paper	9,254	9,254	9,254
Money Market Mutual Funds	73,595	73,595	73,595
Total Investments	469,740	469,768	469,768
Total Deposits	5,393	5,393	5,393
Total Deposits and Investments	$ 475,133	$ 475,161	$ 475,161

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 STAR Ohio and money market mutual funds. These investments are carried at cost which approximates fair value.

As of December 31, 2017, the investments in U.S. Treasury Bonds, STAR Ohio, commercial paper, and money market mutual funds are approximately 4.3%, 78.1%, 2.0%, and 15.6%, respectively, of the Division's total investments.

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Year Ended December 31, 2017

NOTE D – CAPITAL ASSETS

Capital Asset Activity: Capital asset activity for the year ended December 31, 2017 was as follows:

	Balance January 1, 2017	Additions	Deletions	Balance December 31, 2017
		(Amounts in Thousands)		
Capital assets, not being depreciated:				
Land	$ 5,463	$	$ (20)	$ 5,443
Construction in progress	101,665	35,335	(49,070)	87,930
Total capital assets, not being depreciated	107,128	35,335	(49,090)	93,373
Capital assets, being depreciated:				
Land improvements	17,427	187		17,614
Utility plant	1,808,978	111,170	(1,564)	1,918,584
Buildings, structures and improvements	266,517	746	(5,616)	261,647
Furniture, fixtures, equipment and vehicles	614,057	7,742	(19,813)	601,986
Total capital assets, being depreciated	2,706,979	119,845	(26,993)	2,799,831
Less: Accumulated depreciation	(1,112,423)	(95,976)	24,505	(1,183,894)
Total capital assets being depreciated, net	1,594,556	23,869	(2,488)	1,615,937
Capital assets, net	$ 1,701,684	$ 59,204	$ (51,578)	$ 1,709,310

Commitments: The Division has outstanding commitments at December 31, 2017, of approximately $147,052,000 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

Net Pension Liability: The net pension liability reported on the statement of net position represents a liability to employees for pensions. Pensions are a component of exchange transactions-–between an employer and its employees—of salaries and benefits for employee services. Pensions are provided to an employee—on a deferred-payment basis—as part of the total compensation package offered by an employer for employee services each financial period. The obligation to sacrifice resources for pensions is a present obligation because it was created as a result of employment exchanges that already have occurred.

The net pension liability represents the Division's proportionate share of each pension plan's collective actuarial present value of projected benefit payments attributable to past periods of service, net of each pension plan's fiduciary net position. The net pension liability calculation is dependent on critical long-term variables, including estimated average life expectancies, earnings on investments, cost of living adjustments and others. While these estimates use the best information available, unknowable future events require adjusting this estimate annually.

Ohio Revised Code limits the Division's obligation for this liability to annually required payments. The Division cannot control benefit terms or the manner in which pensions are financed; however, the Division does receive the benefit of employees' services in exchange for compensation including pension.

GASB Statement No. 68 assumes the liability is solely the obligation of the employer, because (1) they benefit from employee services; and (2) State Statute requires all funding to come from these employers. All contributions to date have come solely from these employers (which also includes costs paid in the form of withholdings from employees). State Statute requires the pension plans to amortize unfunded liabilities within 30 years. If the amortization period exceeds 30 years, each pension plan's board must propose corrective action to the State legislature. Any resulting legislative change to benefits or funding could significantly affect the net pension liability. Resulting adjustments to the net pension liability would be effective when the changes are legally enforceable.

The proportionate share of each plan's unfunded benefits is presented as a long-term net pension liability on the accrual basis of accounting. Any liability for the contractually-required pension contribution outstanding at the end of the year is included in accrued wages and benefits on both the accrual and modified accrual bases of accounting.

Ohio Public Employees Retirement System (OPERS): The Division's employees, other than full-time police and firefighters, participate in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans. The traditional pension plan is a cost-sharing, multiple-employer defined benefit pension plan. The member-directed plan is a defined contribution plan and the combined plan is a cost-sharing, multiple-employer defined benefit pension plan with defined contribution features. While members (e.g. Division's employees) may elect the member-directed plan and the combined plan, substantially all employee members are in OPERS' traditional plan; therefore, the following disclosure focuses on the traditional pension plan.

NOTE E – DEFINED BENEFIT PENSION PLAN (Continued)

OPERS provides retirement, disability, survivor and death benefits and annual cost of living adjustments to members of the traditional plan. Authority to establish and amend benefits is provided by Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report that includes financial statements, required supplementary information and detailed information about OPERS' fiduciary net position that may be obtained by visiting https://www.opers.org/financial/reports.shtml, by writing to the Ohio Public Employees Retirement System, 277 East Town Street, Columbus, Ohio 43215-4642, or by calling (800) 222-7377.

Senate Bill (SB) 343 was enacted into law with an effective date of January 7, 2013. In the legislation, members were categorized into three groups with varying provisions of the law applicable to each group. The following table provides age and service requirements for retirement and the retirement formula applied to final average salary (FAS) for the three member groups under the traditional plan as per the reduced benefits adopted by SB 343 (see OPERS CAFR referenced above for additional information):

Group A Eligible to retire prior to January 7, 2013 or five years after January 7, 2013	**Group B** 20 years of service credit prior to January 7, 2013 or eligible to retire ten years after January 7, 2013	**Group C** Members not in other Groups and members hired on or after January 7, 2013
State and Local	**State and Local**	**State and Local**
Age and Service Requirements: Age 60 with 60 months of service credit or Age 55 with 25 years of service credit	**Age and Service Requirements:** Age 60 with 60 months of service credit or Age 55 with 25 years of service credit	**Age and Service Requirements:** Age 57 with 25 years of service credit or Age 62 with 5 years of service credit
Formula: 2.2% of FAS multiplied by years of service for the first 30 years and 2.5% for service years in excess of 30	**Formula:** 2.2% of FAS multiplied by years of service for the first 30 years and 2.5% for service years in excess of 30	**Formula:** 2.2% of FAS multiplied by years of service for the first 35 years and 2.5% for service years in excess of 35

FAS represents the average of the three highest years of earnings over a member's career for Groups A and B. Group C is based on the average of the five highest years of earnings over a member's career. Members who retire before meeting the age and years of service credit requirement for unreduced benefits receive a percentage reduction in the benefit amount.

When a benefit recipient has received benefits for 12 months, an annual cost of living adjustment (COLA) is provided. This COLA is calculated on the base retirement benefit at the date of retirement and is not compounded. For those retiring prior to January 7, 2013, the COLA will continue to be a 3.0% simple annual COLA. For those retiring subsequent to January 7, 2013, beginning in calendar year 2019, the COLA will be based on the average percentage increase in the Consumer Price Index, capped at 3.0%.

NOTE E – DEFINED BENEFIT PENSION PLAN (Continued)

Funding Policy: The Ohio Revised Code provides statutory authority for member and employer contributions as follows:

	State and Local
2017 Statutory Maximum Contribution Rates	
Employer	14.0 %
Employee	10.0
2017 Actual Contribution Rates	
Employer:	
Pension	13.0
Post-employment Health Care Benefits	1.0
Total Employer	14.0 %
Employee	10.0 %

Employer contribution rates are actuarially determined and are expressed as a percentage of covered payroll. The Division's contractually required contribution was $6,855,000 for 2017. All required payments have been made.

Pension Liabilities, Pension Expense, Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions: The net pension liability for OPERS was measured as of December 31, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. Following is information related to the proportionate share and pension expense:

	OPERS (Amounts in Thousands)
Proportionate Share of the Net Pension Liability	$ 87,844
Proportion of the Net Pension Liability	0.379883%
Change in proportion	(0.016438)%
Pension Expense	$ 18,585

NOTE E – DEFINED BENEFIT PENSION PLAN (Continued)

At December 31, 2017, the Division's reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	OPERS (Amounts in Thousands)	
Deferred Outflows of Resources		
Net difference between projected and actual earnings on pension plan investments	$	13,548
Differences in Expected and Actual Economic Experience		117
Change in Assumptions		13,719
Division's contributions subsequent to the measurement date		6,855
Total Deferred Outflows of Resources	$	34,239
Deferred Inflows of Resources		
Differences between expected and actual experience	$	625
Change in Division's proportionate share		1,810
Total Deferred Inflows of Resources	$	2,435

The $6,855,000 reported as deferred outflows of resources related to pension resulting from the Division's contributions subsequent to the measurement date which will be recognized as a reduction of the net pension liability in the year ending December 31, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pension will be recognized in pension expense as follows:

Year Ending December 31:	OPERS (Amounts in Thousands)	
2018	$	10,089
2019		10,578
2020		4,690
2021		(386)
2022		(8)
Thereafter		(14)
Total	$	24,949

NOTE E – DEFINED BENEFIT PENSION PLAN (Continued)

Actuarial Assumptions – OPERS: Actuarial valuations of an ongoing plan involve estimates of the values of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and cost trends. Actuarially determined amounts are subject to continual review or modification as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employers and plan members) and include the types of benefits provided at the time of each valuation. The total pension liability in the December 31, 2016, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

	December 31, 2016 Valuation	December 31, 2015 and prior valuations
Wage Inflation	3.25%	3.75%
Future Salary Increases, including inflation	3.25% to 10.75% including wage inflation	4.25% to 10.05% including wage inflation
COLA or Ad Hoc COLA	3.25%, simple	3%, simple
	Pre 1/7/2013 retirees: 3%, simple	Pre 1/7/2013 retirees: 3%, simple
	Post 1/7/2013 retires: 3%, simple	Post 1/7/2013 retires: 3%, simple
	through 2018, then 2.15%, simple	through 2018, then 2.8%, simple
Investment Rate of Return	7.5%	8%
Actuarial Cost Method	Individual Entry Age	Individual Entry Age
Mortality Tables	RP-2014	RP-2000

Mortality rates are based on the RP-2014 Healthy Annuitant Mortality table. For males, Healthy Annuitant Mortality tables were used, adjusted for mortality improvement back to the observation period base of 2006 and then established the base year as 2015. For females, Healthy Annuitant Mortality tables were used, adjusted for mortality improvements back to the observation period base year of 2006 and then established the base year as 2010. The mortality rates used in evaluating disability allowances were based on the RP-2014 Disabled mortality tables, adjusted for mortality improvement back to the observation base year of 2006 and then established the base year as 2015 for males and 2010 for females. Mortality rates for a particular calendar year for both healthy and disabled retiree mortality tables are determined by applying the MP-2015 mortality improvement scale to the above described tables.

The most recent experience study was completed for the five year period ended December 31, 2015.

The long-term rate of return on defined benefit investment assets was determined using a building-block method in which best-estimate ranges of expected future real rates of return are developed for each major asset class. These ranges are combined to produce the long-term expected real rate of return by weighting the expected future real rates of return by the target asset allocation percentage, adjusted for inflation.

NOTE E – DEFINED BENEFIT PENSION PLAN (Continued)

During 2016, OPERS managed investments in four investment portfolios: the Defined Benefit portfolio, the 401(h) Health Care Trust portfolio, the 115 Health Care Trust portfolio and the Defined Contribution portfolio. The 401(h) Health Care Trust portfolio was closed as of June 30, 2016 and the net position transferred to the 115 Health Care Trust portfolio on July 1, 2016. The Defined Benefit portfolio contains the investment assets of the Traditional Pension Plan, the defined benefit component of the Combined Plan and the annuitized accounts of the Member-Directed Plan. The Defined Benefit portfolio historically included the assets of the Member-Directed retiree medical accounts funded through the Voluntary Employees' Beneficiary Association (VEBA) Trust. However, the VEBA Trust was closed as of June 30, 2016 and the net position transferred to the 115 Health Care Trust portfolio on July 1, 2016. Within the Defined Benefit portfolio, contributions into the plans are all recorded at the same time, and benefit payments all occur on the first of the month. Accordingly, the money-weighted rate of return is considered to be the same for all plans within the portfolio. The annual money-weighted rate of return expressing investment performance, net of investment expenses and adjusted for the changing amounts actually invested, for the Defined Benefit portfolio is 8.3% for 2016.

The allocation of investment assets with the Defined Benefit portfolio is approved by the Board of Trustees as outlined in the annual investment plan. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a fully funded status for the benefits provided through the defined benefit pension plans. The table below displays the Board-approved asset allocation policy for 2016 and the long-term expected real rates of return:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return (Arithmetic)
Fixed Income	23.00 %	2.75 %
Domestic Equities	20.70	6.34
Real Estate	10.00	4.75
Private Equity	10.00	8.97
International Equities	18.30	7.95
Other investments	18.00	4.92
Total	100.00 %	5.66 %

Discount Rate: The discount rate used to measure the total pension liability was 7.5%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members and those of the contributing employers are made at the statutorily required rates. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefits payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

NOTE E – DEFINED BENEFIT PENSION PLAN (Continued)

Sensitivity of the Division's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate: The following table presents the Division's proportionate share of the net pension liability calculated using the current period discount rate assumption of 7.5%, as well as what the Division's proportionate share of the net pension liability would be if it were calculated using a discount rate that is one-percentage-point lower (6.5%) or one-percentage-point higher (8.5%) than the current rate:

	1% Decrease 6.50%	Current Discount Rate 7.50%	1% Increase 8.50%
	(Amounts in Thousands)		
Division's proportionate share of the net pension liability	$ 134,963	$ 87,844	$ 48,577

NOTE F – OTHER POSTEMPLOYMENT BENEFITS

***Plan Description - 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 post-employment health care trust, which funds multiple health care plans including medical coverage, prescription drug coverage and deposits to a Health Reimbursement Arrangement to qualifying benefit recipients of both the Traditional Pension and the Combined plans. This trust is also used to fund health care for Member-Directed Plan participants, in the form of a Retiree Medical Account (RMA). At retirement or refund, Member-Directed Plan participants may be eligible for reimbursement of qualified medical expenses from their vested RMA balance.

In order to qualify for health care coverage, age-and-service retirees under the Traditional Pension and Combined plans must have 20 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 Post Employment Benefit (OPEB) as described in GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Please see the Plan Statement in the OPERS 2016 CAFR for details.

The Ohio Revised Code permits, but does not require, OPERS to provide health care to its eligible benefit recipients. Authority to establish and amend health care coverage is provided to the OPERS Board of Trustees (OPERS Board) 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/financial/reports.shtml, by writing to OPERS, 277 East Town Street, Columbus, OH 43215-4642, or by calling 614-222-5601 or 800-222-7377.

NOTE F – OTHER POSTEMPLOYMENT BENEFITS (Continued)

***Funding Policy - Ohio Public Employees Retirement System*:** 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 to fund OPERS health care plans.

Employer contribution rates are expressed as a percentage of the covered payroll of active members. In 2017, State and Local employers contributed at a rate of 14.0% of covered payroll. These are the maximum employer contribution rates permitted by the Ohio Revised Code. Active member contributions do not fund health care.

Each year, the OPERS Board determines the portion of the employer contribution rate that will be set aside to fund health care plans. The portion of employer contributions allocated to health care for members in the Traditional Pension Plan and Combined Plan was 1.0% during calendar year 2017. As recommended by OPERS' actuary, the portion of employer contributions allocated to health care beginning January 1, 2018 decreased to 0.0% for both plans. The OPERS Board 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 employer contribution as a percentage of covered payroll deposited for Member-Directed Plan participants for 2017 was 4.0%.

The Division's actual contributions to OPERS to fund postemployment benefits were $527,000 in 2017, $1,028,000 in 2016 and $1,032,000 in 2015. The required payments due in 2017, 2016 and 2015 have been made.

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 2017.

The City provides the choice of two separate health insurance plans to its employees. The operating funds 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, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, 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.

NOTE G – CONTINGENT LIABILITIES AND RISK MANAGEMENT (Continued)

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.

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, collection and various 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 from the Division of Water Pollution Control for such services was approximately $2,645,000 in 2017. The Division also provides miscellaneous services to other departments and divisions of the City. Revenue realized from such services was approximately $624,000 in 2017.

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 year ended December 31, 2017 was as follows:

	(Amounts in Thousands)
Electricity purchases	$ 15,625
City administration	3,985
Motor Vehicle Maintenance	2,693
Telephone Exchange	1,125
Utilities Administration and Utilities Fiscal Control	7,871
Radio Communication	301

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 $5,320,000 for December 31, 2017.

NOTE J – SUBSEQUENT EVENTS

On May 17, 2018, the Water Revenue Bonds, Series AA, 2015 were directly purchased by Royal Bank of Canada for a period of three years upon the expiration of the previous direct placement. The bonds remain in a variable rate mode with the Division now paying on a monthly basis an amount equal to SIFMA plus a spread.

CITY OF CLEVELAND
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
Required Supplementary Information
Schedule of the Division's Proportionate Share of the Net Pension Liability
Ohio Public Employees Retirement System
Last Four Measurement Years (1), (2)

	2017	2016	2015	2014
		(Amounts in Thousands)		
Division's Proportion of the Net Pension Liability	0.379883%	0.396321%	0.411161%	0.411161%
Division's Proportionate Share of the Net Pension Liability (Asset)	$ 87,844	$ 69,902	$ 49,432	$ 48,397
Division's Covered Payroll	$ 50,392	$ 50,533	$ 51,458	$ 46,600
Division's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of its Covered Payroll	174.32%	138.33%	96.06%	103.86%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	77.25%	81.08%	86.45%	86.36%

(1) Information presented for each year was determined as of the Division's measurement date, which is the prior year end.

(2) Information prior to 2013 was not available. The Division will continue to present information for years available until a full ten-year trend is compiled.

Notes to Schedule:

Change in assumptions. In 2017, changes in assumptions were made based upon an updated experience study that was completed for the five-year period ended December 31, 2015. Significant changes included a reduction of the discount rate from 8.0% to 7.5%, a reduction in the wage inflation rate from 3.75% to 3.25% and transition from the RP-2000 mortality tables to the RP-2014 mortality tables.

CITY OF CLEVELAND
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
Required Supplementary Information (Continued)
Schedule of Contributions
Ohio Public Employees Retirement System
Last Five Years (1)

	2017	2016	2015	2014	2013
			(Amounts in Thousands)		
Contractually Required Contributions	$ 6,855	$ 6,047	$ 6,064	$ 6,175	$ 6,058
Contributions in Relation to the Contractually Required Contributions	(6,855)	(6,047)	(6,064)	(6,175)	(6,058)
Contribution Deficiency (Excess)	$ -	$ -	$ -	$ -	$ -
Division's Covered Payroll	$ 52,731	$ 50,392	$ 50,533	$ 51,458	$ 46,600
Contributions as a Percentage of Covered Payroll	13.00%	12.00%	12.00%	12.00%	13.00%

(1) Represents employer's calendar year. Information prior to 2013 was not available. The Division will continue to present information for years available until a full ten-year trend is compiled.