

# New York City Water and Sewer System

(A Component Unit of The City of New York)

Financial Statements as of and for the  
Years Ended June 30, 2012 and 2011,  
Required Supplementary Information, and  
Independent Auditors' Report

# NEW YORK CITY WATER AND SEWER SYSTEM

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## INDEPENDENT AUDITORS' REPORT

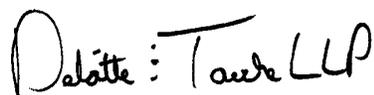
To the Joint Audit Committee of  
New York City Municipal Water Finance Authority  
and New York City Water Board

We have audited the accompanying combining balance sheets of the business-type activities of the New York City Municipal Water Finance Authority and the New York City Water Board, which collectively comprise the New York City Water and Sewer System (the "System"), a component unit of The City of New York, New York, as of June 30, 2012 and 2011, and the related combining statements of revenues, expenses and changes in net assets (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the business-type activities of the New York City Municipal Water Finance Authority and the New York City Water Board of the System as of June 30, 2012 and 2011, and the respective changes in their net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the schedule of funding progress for the other postemployment benefit plan on pages 2-10 and 45 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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.



October 10, 2012

# NEW YORK CITY WATER AND SEWER SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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### Overview of the Financial Statements

The following is an overview of the financial activities of the New York City Water and Sewer System (the "System") for the fiscal years ended June 30, 2012 and 2011. The System is a joint operation consisting of two legally separate and independent entities, the New York City Municipal Water Finance Authority (the "Authority") and the New York City Water Board (the "Board"). The System is a component unit of The City of New York ("The City").

The basic financial statements of the System, which include the balance sheets, the statements of revenues, expenses and changes in net assets and the statements of cash flows, are presented for the purposes of displaying entity-wide information, in accordance with Governmental Accounting Standards Board (GASB) standards. These financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting.

### Financial Analysis and Results of Operations

The following summarizes the activities of the System for the fiscal years 2012, 2011 and 2010 (in thousands):

	2012	2011	2010	Variance	
				2012 v 2011	2011 v 2010
REVENUES:					
Water supply and distribution	\$ 1,238,352	\$ 1,158,977	\$ 1,005,045	\$ 79,375	\$ 153,932
Sewer collection and treatment	1,857,527	1,797,777	1,562,777	59,750	235,000
Other operating revenues	<u>140,595</u>	<u>111,552</u>	<u>190,251</u>	<u>29,043</u>	<u>(78,699)</u>
Total operating revenues	3,236,474	3,068,306	2,758,073	168,168	310,233
Subsidy income	196,241	180,986	128,110	15,255	52,876
Investment income	<u>48,936</u>	<u>38,313</u>	<u>65,760</u>	<u>10,623</u>	<u>(27,447)</u>
Total revenues	<u>3,481,651</u>	<u>3,287,605</u>	<u>2,951,943</u>	<u>194,046</u>	<u>335,662</u>
EXPENSES:					
Operations and maintenance	1,373,038	1,294,533	1,539,846	78,505	(245,313)
Other operating expenses	73,814	103,334	289,989	(29,520)	(186,655)
Bad debt expense	28,541	76,799	14,032	(48,258)	62,767
Administration and general	47,402	40,424	40,257	6,978	167
Depreciation and amortization	733,425	628,339	574,483	105,086	53,856
Capital distribution	42,005	53,591	32,580	(11,586)	21,011
Loss on retirement of capital assets	1,646	3,426	23,254	(1,780)	(19,828)
Interest expense	<u>1,196,647</u>	<u>1,178,226</u>	<u>1,019,633</u>	<u>18,421</u>	<u>158,593</u>
Total expenses	<u>3,496,518</u>	<u>3,378,672</u>	<u>3,534,074</u>	<u>117,846</u>	<u>(155,402)</u>
Net loss before capital contributions	(14,867)	(91,067)	(582,131)	76,200	491,064
CAPITAL CONTRIBUTIONS	<u>26,903</u>	<u>18,696</u>	<u>30,424</u>	<u>8,207</u>	<u>(11,728)</u>
CHANGE IN NET ASSETS	12,036	(72,371)	(551,707)	84,407	479,336
NET ASSETS — Beginning	<u>(352,888)</u>	<u>(280,517)</u>	<u>271,190</u>	<u>(72,371)</u>	<u>(551,707)</u>
NET (DEFICIT) ASSETS — Ending	<u>\$ (340,852)</u>	<u>\$ (352,888)</u>	<u>\$ (280,517)</u>	<u>\$ 12,036</u>	<u>\$ (72,371)</u>

# NEW YORK CITY WATER AND SEWER SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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### *Operating Revenue*

#### **2012-2011**

Operating revenues increased by \$168.2 million or 5.5% due predominantly to a rate increase of 7.5%.

#### **2011-2010**

Operating revenues increased by \$310.2 million or 11.2% due predominantly to a rate increase of 12.9%.

The following summarizes other operating revenues for fiscal years 2012, 2011, and 2010 (in thousands):

	2012	2011	2010	Variance	
				2012 v 2011	2011 v 2010
Upstate water fees	\$ 60,891	\$ 64,737	\$ 40,876	\$ (3,846)	\$ 23,861
Late payment fees	44,069	30,270	29,107	13,799	1,163
Change in residual interest in sold liens	12,777	(1,734)	2,156	14,511	(3,890)
Release of escrow/trust	7,353	4,406	98,820	2,947	(94,414)
Federal funding	2,632	2,504	2,733	128	(229)
Litigation settlement receipt	-	-	8,867	-	(8,867)
Connection fees and permits	<u>12,873</u>	<u>11,369</u>	<u>7,692</u>	<u>1,504</u>	<u>3,677</u>
Total other operating revenues	<u>\$140,595</u>	<u>\$111,552</u>	<u>\$190,251</u>	<u>\$29,043</u>	<u>\$(78,699)</u>

### *Other Operating Revenue*

#### **2012-2011**

In fiscal year 2012, the New York State Department of Environmental Conservation ("DEC") returned \$7.4 million of escrowed funds to the System, as the New York City Department of Environmental Protection ("DEP") met the requirement for secondary treatment at its Newtown Creek Wastewater Treatment Plant in advance of the established milestone date. The escrow fund had been established in 2009 to cover potential penalties that would be incurred in the event DEP missed mandated construction milestones.

Upstate water fees decreased by \$3.8 million or 5.9% compared to 2011. The decrease is due primarily to a reduction in consumption.

The change in residual interest in sold liens increased by \$14.5 million as a bond sale transaction by the purchasing trust had not been completed as of June 30, 2012.

Connection fees and permits increased by \$1.5 million or 13.2% due to a special initiative to bring buildings into compliance with the New York State Sanitary Code regarding backflow prevention.

Late payment fees increased by \$13.8 million or 45.6% primarily due to the rate increase and a decrease in billing adjustments. The substantial completion of DEP's installation of its wireless meter reading system has increased the number of actual readings and reduced the number of estimated readings that had previously resulted in billing adjustments.

Federal funding of \$2.6 million was received by the Water Board in fiscal 2012 to support technical assistance in developing a Contamination Warning System Demonstration Pilot Program.

# NEW YORK CITY WATER AND SEWER SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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### 2011-2010

In fiscal 2011 the System received \$4.4 million from two trust accounts established in 2004. These trust funds were established to pay for fines pertaining to nitrogen removal and combined sewer overflow abatement pursuant to consent orders from the New York State Department of Environmental Conservation. By meeting certain conditions, the System was entitled to use the funds from the trust accounts.

Upstate water fees increased by \$23.9 million or 58.4% compared to 2010. The increase is due primarily to consumption related to weather in the summer of 2010 and a rate increase of 24.7%.

The change in residual interest in sold liens decreased by \$3.9 million.

Connection fees and permits increased by \$3.7 million or 47.8% due to increased new construction activity.

Federal funding was received by the Water Board in fiscal 2011 to support technical assistance in developing a Contamination Warning System Demonstration Pilot Program.

# NEW YORK CITY WATER AND SEWER SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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### *Investment Income*

#### **2012-2011**

Investment income increased by \$10.6 million or 27.7%. The increase was due to a reduction of the unrealized loss on the agreements to purchase securities in fiscal 2012 of \$6.1 million compared to a loss of \$14.4 million in fiscal 2011. The reduction is primarily due to the maturity of a portion of the agreements to purchase securities. The fair values of the contracts change as a result of changes in market interest rates.

#### **2011-2010**

Investment income decreased by \$27.4 million or 41.7%. The decrease was due to lower interest rates on invested assets and an unrealized loss of \$14.4 million due to the change in the fair market value of agreements to purchase securities in fiscal 2011 compared to a loss of \$0.3 million in fiscal 2010. The fair values of the contracts change as a result of changes in market interest rates.

### *Operating Expenses*

#### **2012-2011**

Operations and maintenance expenses increased by \$78.5 million or 6.1% due primarily to an increase in the fringe benefit rate applicable to City employees from 30% in fiscal year 2011 to 46% in fiscal year 2012. Water Board general and administrative expenses increased by approximately \$2.5 million, primarily due to expenditures incurred under new contracts. Water Authority general and administrative expenses increased by \$4.5 million primarily due to remarketing and liquidity fees in connection with new variable rate debt.

#### **2011-2010**

Operations and maintenance expenses decreased by \$245.3 million or 15.9% because of a large collective bargaining settlement that had increased operations and maintenance costs in fiscal 2010. Water Board general and administration expenses decreased by \$3.4 million due to decreases in certain outside contractor costs. Water Authority general and administration expenses increased by \$3.6 million primarily for increases in fees related to variable rate debt.

### *Non-operating Expenses*

#### **2012-2011**

Interest expense increased by \$18.4 million or 1.6%, primarily due to an increase in bonds outstanding of \$1.5 billion or 5.5%.

#### **2011-2010**

Interest expense increased by \$158.6 million or 15.6%, primarily due to an increase in bonds outstanding of \$2.5 billion or 10.6%.

# NEW YORK CITY WATER AND SEWER SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

### *Changes in Net Assets*

#### **2012-2011**

The change in net assets represents the net total of operating income, non-operating losses, and capital contributions. Net assets increased by \$12.0 million in fiscal year 2012.

#### **2011-2010**

The change in net assets represents the net total of operating income, non-operating losses, and capital contributions. Net assets decreased by \$72.4 million in fiscal year 2011.

Following is a summary of the System's assets, liabilities and net assets as of June 30, (in thousands):

	2012	2011	2010	Variance	
				2012 v 2011	2011 v 2010
Current assets	\$ 2,496,428	\$ 2,251,021	\$ 2,132,321	\$ 245,407	\$ 118,700
Residual interest in sold liens	51,777	39,000	40,734	12,777	(1,734)
Deferred outflows from hedging	134,752	53,216	71,930	81,536	(18,714)
Deferred bond and financing expenses	176,618	176,139	163,703	479	12,436
Capital assets	<u>26,474,776</u>	<u>24,988,836</u>	<u>23,016,469</u>	<u>1,485,940</u>	<u>1,972,367</u>
Total assets	<u>\$ 29,334,351</u>	<u>\$ 27,508,212</u>	<u>\$ 25,425,157</u>	<u>\$ 1,826,139</u>	<u>\$ 2,083,055</u>
Long-term liabilities	\$ 27,914,458	\$ 26,115,749	\$ 23,549,533	\$ 1,798,709	\$ 2,566,216
Current liabilities	<u>1,760,745</u>	<u>1,745,351</u>	<u>2,156,141</u>	<u>15,394</u>	<u>(410,790)</u>
Total liabilities	<u>29,675,203</u>	<u>27,861,100</u>	<u>25,705,674</u>	<u>1,814,103</u>	<u>2,155,426</u>
Net assets (deficit):					
Invested in capital assets — net of related debt	(372,021)	(215,322)	920,728	(156,699)	(1,136,050)
Restricted for debt service	687,656	573,461	239,192	114,195	334,269
Restricted for operations and maintenance	212,885	199,636	191,772	13,249	7,864
Unrestricted (deficit)	<u>(869,372)</u>	<u>(910,663)</u>	<u>(1,632,209)</u>	<u>41,291</u>	<u>721,546</u>
Total net (deficit) assets	<u>(340,852)</u>	<u>(352,888)</u>	<u>(280,517)</u>	<u>12,036</u>	<u>(72,371)</u>
Total liabilities and net assets	<u>\$ 29,334,351</u>	<u>\$ 27,508,212</u>	<u>\$ 25,425,157</u>	<u>\$ 1,826,139</u>	<u>\$ 2,083,055</u>

#### **2012-2011**

Current assets increased by \$245.4 million or 10.9%. The increase is due to an increase in monies held by the Authority for debt service in fiscal 2013.

Deferred outflows from hedging increased by \$81.5 million due to a decrease in the fair value of the hedging derivative instruments.

Long term liabilities increased by \$1.8 billion primarily due to the increase in long term portion of bonds payable of \$1.5 billion.

Pollution remediation obligations have increased by \$5.6 million.

# NEW YORK CITY WATER AND SEWER SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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Current liabilities increased by \$15.4 million or less than 1%, primarily due to an increase of \$15.9 million in the service credits on customer accounts.

### **2011-2010**

Current assets increased by \$118.7 million or 5.6%. The increase is due to excess monies held by the Authority for debt service in fiscal 2012.

Deferred outflows from hedging decreased by \$18.7 million due to an increase in the fair value of the hedging derivative instruments.

Long term liabilities increased by \$2.6 billion primarily due to the increase in long term portion of bonds payable of \$2.5 billion.

Pollution remediation obligations have increased by \$28.4 million.

Current liabilities decreased by \$410.8 million or 19.1% primarily due to a decrease of \$285.6 million in the amount payable to The City primarily for capital costs, a decrease of \$200 million in commercial paper notes payable, and offset by other changes.

# NEW YORK CITY WATER AND SEWER SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

### Capital Assets

The System's capital assets include buildings, equipment, vehicles, water supply and distribution and wastewater collection and treatment systems. Capital assets as of June 30, are detailed as follows (in thousands):

	2012	2011	2010	Variance	
				2012 v 2011	2011 v 2010
Nondepreciable assets — Utility plant under construction	\$ 8,422,470	\$ 7,804,563	\$ 6,112,362	\$ 617,907	\$ 1,692,201
Utility plant in service:					
Buildings	34,877	34,877	24,193	-	10,684
Equipment	2,014,704	1,723,907	1,538,451	290,797	185,456
Vehicles	150,531	150,591	157,179	(60)	(6,588)
Water supply, treatment and distribution, and sewage collection, treatment and disposal systems	<u>25,669,088</u>	<u>24,407,185</u>	<u>23,740,818</u>	<u>1,261,903</u>	<u>666,367</u>
Total utility plant in service	<u>27,869,200</u>	<u>26,316,560</u>	<u>25,460,641</u>	<u>1,552,640</u>	<u>855,919</u>
Less accumulated depreciation for:					
Buildings	(19,820)	(18,447)	(16,444)	(1,373)	(2,003)
Equipment	(790,180)	(667,675)	(573,595)	(122,505)	(94,080)
Vehicles	(98,639)	(93,086)	(98,852)	(5,553)	5,766
Water supply, treatment and distribution, and sewage collection, treatment and disposal systems	<u>(8,908,255)</u>	<u>(8,353,079)</u>	<u>(7,867,643)</u>	<u>(555,176)</u>	<u>(485,436)</u>
Total accumulated depreciation	(9,816,894)	(9,132,287)	(8,556,534)	(684,607)	(575,753)
Total — net utility plant in service	<u>18,052,306</u>	<u>17,184,273</u>	<u>16,904,107</u>	<u>868,033</u>	<u>280,166</u>
Total capital assets — net	<u>\$ 26,474,776</u>	<u>\$ 24,988,836</u>	<u>\$ 23,016,469</u>	<u>\$ 1,485,940</u>	<u>\$ 1,972,367</u>

The increase in the System's capital assets, net of depreciation during fiscal 2012 was \$1.5 billion or 5.9%. Capital asset additions for fiscal 2012 were \$2.3 billion. See Note 3 (Utility Plant) for further details.

The increase in the System's capital assets, net of depreciation during fiscal 2011 was \$1.9 billion or 8.6%. Capital asset additions for fiscal 2011 were \$2.6 billion. See Note 3 (Utility Plant) for further details.

### Debt Administration

The Authority issues debt to pay for the capital improvements to the System and certain related costs. Certain costs related to the System's filtration avoidance determination, including land acquisition in the upstate watershed, costs for parks improvements related to the Croton filtration plant, and costs associated with pollution remediation are financed with debt, but they are not recorded as System's assets on the balance sheet. These costs or distributions are reported as expenses in the System's combining statements of revenues, expenses and changes in net assets (deficit) in the years incurred. Land purchased is granted to The City and becomes The City's capital asset because it is not subject to the capital lease under which the System reports water supply, treatment and distribution and sewer collection and treatment capital assets.

# NEW YORK CITY WATER AND SEWER SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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The debt program of the Authority includes commercial paper, long-term debt of the Authority and a bond anticipation note and subsidized bonds issued through the New York State Environmental Facilities Corporation ("EFC"). The commercial paper program is the main source of financing to reimburse The City for payments made for water and sewer projects. The Authority then issues long-term debt of its own or through EFC to retire outstanding commercial paper. The Authority also periodically issues refunding bonds to refinance higher-coupon debt. See Note 9 (Short Term Debt) and Note 10 (Long-Term Debt) for further details.

At June 30, 2012, the total outstanding debt of the System was \$28.4 billion, of which \$400 million was commercial paper and \$108.1 million was outstanding against bond anticipation notes issued to EFC. The remaining \$27.9 billion consisted of variable and fixed-rate bonds maturing in varying installments through 2045. The total outstanding long-term debt at June 30, 2012 was as follows (in thousands):

### Issue Date

2012	\$ 3,735,182
2011	4,541,205
2010	3,114,624
2009	3,481,104
2008	2,813,339
2007 and prior	<u>10,292,825</u>
Total long-term debt	<u>\$27,978,279</u>

In the summary above, bonds retired through refunding in fiscal 2012 are removed from the year in which the refunded bonds were issued, and the refunding bonds are included in the fiscal 2012 amount.

In fiscal 2012, the Authority issued \$3.0 billion of water and sewer revenue bonds directly to the public, including \$857.4 million of refunding bonds and \$2.2 billion of new money bonds. The Authority also issued \$669.3 million of Clean Water and Drinking Water State Revolving Fund ("SRF") bonds to EFC, all of which were refunding bonds. The Authority also drew down an additional \$55.7 million against its Fiscal 2010 Series 1 bond anticipation note issued to EFC. The Authority used new money bond proceeds to finance capital improvements to the System, to provide long-term financing of commercial paper notes, which had previously financed capital improvements to the system, and to pay the costs of issuance on the bonds.

On September 22, 2011, the Authority issued \$450.9 million of new money and refunding tax-exempt fixed rate Second General Resolution bonds, Fiscal 2012 Series AA General Bonds. The new money bonds included a term bond maturing in 2044. The Authority used the new money bond proceeds to pay for capital improvements to the System and to pay the costs of issuance of the bonds. The refunding bonds refunded portions of the Authority's outstanding First Resolution 2001C and 2002G bonds. The refunding bonds included serial bonds maturing from 2032 through 2034.

On September 29, 2011, the Authority issued \$200 million of new money tax-exempt adjustable rate bonds under its First General Resolution, Fiscal 2012 Series A-1 and A-2 bonds. The bonds are backed by a standby bond purchase agreement from a bank. These bonds will mature in 2044 and were used to refund the Authority's commercial paper notes.

Additionally, on September 29, 2011, EFC entered into an agreement to provide the Authority a direct loan in an amount up to \$30 million. The Authority expects to receive these funds to pay for certain capital projects over the next several years. As of June 30, 2012, the Authority has not drawn on this loan.

On November 29, 2011, the Authority issued \$450 million of new money tax-exempt fixed rate Second General Resolution Revenue bonds, Fiscal 2012 Series BB. This bond issue included term bonds maturing in

# NEW YORK CITY WATER AND SEWER SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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2039 and 2044. The Authority used proceeds to pay for capital improvements to the System, refund commercial paper notes, and to pay the costs of issuance of the bonds.

On January 30, 2012, the Authority issued \$350 million of new money tax-exempt fixed rate Second General Resolution Revenue bonds, Fiscal 2012 Series CC and \$50 million of Fiscal 2012 Series DD bonds. The Series CC bond issue included a term bond maturing in 2045 and the Series DD bond issue included two refundable principal installment bonds maturing in 2018 and 2027. The Authority used proceeds to pay for capital improvement to the System, refund commercial paper notes, and to pay the costs of issuance of the bonds.

On March 19, 2012, the Authority issued \$522.5 million of new money and refunding tax-exempt fixed rate Second General Resolution Revenue Bonds, Fiscal 2012 Series EE bonds. The new money bonds included a term bond maturing in 2045. The refunding bonds refunded portions of the Authority's outstanding First Resolution 2001 A, 2004 B, and 2004 C bonds and the Authority's outstanding Second General Resolution 2007 DD bonds. The refunding bonds included serial bonds maturing from 2019 through 2039. The Authority used the new money bond proceeds to refund commercial paper issuance and to pay the costs of issuance of the bonds.

On March 27, 2012, the Authority issued \$325 million of new money tax-exempt adjustable rate First Resolution Revenue Bonds, Fiscal 2012 Series B bonds. The bonds will mature in 2045. The Authority used the proceeds to pay for capital improvements to the System, refund commercial paper notes, and to pay the costs of issuance of the bonds.

On May 31, 2012, the Authority issued \$669.4 million of Second General Resolution fixed-rate, refunding, Fiscal 2012 Series 2 and 3 bonds to EFC. The source of funds to the Authority for its Series 2 bonds was from tax-exempt bonds issued by EFC (2012 A). The source of funds for the Authority's Series 3 bonds was SRF program funds. All proceeds from the issuance will refund the entire par amount outstanding of EFC's 2002 B, D, and J bonds (except for the 2012 maturity in each series) and the Authority's Fiscal 2002 Series 3, 4 and 5 bonds and its 2003 Series 1 bonds, issued to EFC as security for EFC bonds being refunded.

On June 28, 2012, the Authority issued \$611.7 million of new money and refunding tax-exempt fixed rate Second General Resolution Revenue Bonds, Fiscal 2012 Series FF and \$50 million of new money tax-exempt fixed rate Fiscal 2012 Series GG bonds. The 2012 Series FF bond issue refunded \$33.3 million of the Authority's outstanding First Resolution 2003 Series A, \$41.3 million of its 2004 Series C, and \$147.9 million of its 2005 Series B bonds. The 2012 Series GG bond issue included two refundable principal installment bonds maturing in 2017 and 2019. The Authority used the new money bond proceeds to finance capital improvements to the System, refund commercial paper notes, and to pay the costs of issuance of the bonds.

### **Economic Factors and Next Year's Rates**

Rates are adopted each year by the Board in May for the following fiscal year. A rate increase of 7% for fiscal 2013, based on projected revenues and cost, became effective July 1, 2012.

### **Request for Information**

This financial report is provided as an overview of the System's finances. Questions concerning any of the information in this report or requests for additional information should be directed to Raymond Orlando, Director of Media and Investor Relations, New York City Municipal Water Finance Authority, 255 Greenwich Street, New York, New York 10007. His phone number is (212) 788-5875 and his fax number is (212) 788-9721.

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# NEW YORK CITY WATER AND SEWER SYSTEM

## COMBINING BALANCE SHEET

JUNE 30, 2012

(In thousands)

	New York City		Eliminations	Total
	Water Board	Municipal Water Finance Authority		
<b>ASSETS</b>				
<b>CURRENT ASSETS:</b>				
Unrestricted cash and cash equivalents	\$ 5,453	\$ 7	\$ -	\$ 5,460
Restricted cash and cash equivalents	49	1,158,351	-	1,158,400
Restricted investments	212,836	391,836	-	604,672
Accrued interest and subsidy receivable	-	27	-	27
Accounts receivable:				
Billed — less allowance for uncollectable water and sewer receivables of \$339,317	370,643	-	-	370,643
Unbilled	294,855	-	-	294,855
Receivable from The City of New York	62,371	-	-	62,371
<b>Total current assets</b>	<b>946,207</b>	<b>1,550,221</b>	<b>-</b>	<b>2,496,428</b>
<b>NON-CURRENT ASSETS:</b>				
Utility plant in service — less accumulated depreciation of \$9,816,893	18,052,306	-	-	18,052,306
Utility plant construction	8,422,470	-	-	8,422,470
<b>Total capital assets</b>	<b>26,474,776</b>	<b>-</b>	<b>-</b>	<b>26,474,776</b>
Residual interest in sold liens	51,777	-	-	51,777
Deferred outflows from hedging	-	134,752	-	134,752
Long-term deferred bond and financing expenses	-	176,618	-	176,618
Revenue required to be billed by and received from the Board	-	16,044,536	(16,044,536)	-
<b>Total non-current assets and deferred items</b>	<b>26,526,553</b>	<b>16,355,906</b>	<b>(16,044,536)</b>	<b>26,837,923</b>
<b>TOTAL</b>	<b>\$ 27,472,760</b>	<b>\$ 17,906,127</b>	<b>\$ (16,044,536)</b>	<b>\$ 29,334,351</b>

See notes to combining financial statements.

(Continued)

# NEW YORK CITY WATER AND SEWER SYSTEM

## COMBINING BALANCE SHEET

JUNE 30, 2012

(In thousands)

	New York City		Eliminations	Total
	Water Board	Municipal Water Finance Authority		
<b>LIABILITIES AND NET ASSETS</b>				
LONG-TERM LIABILITIES:				
Bonds and notes payable — net of current portion	\$ -	\$ 27,526,870	\$ -	\$ 27,526,870
Net premium on bonds and notes payable	-	465,991	-	465,991
Unamortized deferred bond refunding costs	-	(309,633)	-	(309,633)
Pollution remediation obligation	108,300	-	-	108,300
OPEB liability	-	790	-	790
Interest rate swap agreement — net	-	122,140	-	122,140
Revenue requirements payable to the Authority	<u>16,044,536</u>	<u>-</u>	<u>(16,044,536)</u>	<u>-</u>
Total long-term liabilities	<u>16,152,836</u>	<u>27,806,158</u>	<u>(16,044,536)</u>	<u>27,914,458</u>
CURRENT LIABILITIES:				
Accounts payable and accrued expenses	45,524	54,358	-	99,882
Revenue received in advance	51,296	-	-	51,296
Commercial paper payable	-	400,000	-	400,000
Current portion of bonds and notes payable	-	451,409	-	451,409
Payable to The City of New York	-	677,880	-	677,880
Service credits on customer accounts	<u>80,278</u>	<u>-</u>	<u>-</u>	<u>80,278</u>
Total current liabilities	<u>177,098</u>	<u>1,583,647</u>	<u>-</u>	<u>1,760,745</u>
Total liabilities	<u>16,329,934</u>	<u>29,389,805</u>	<u>(16,044,536)</u>	<u>29,675,203</u>
NET ASSETS:				
Invested in capital assets — net of related debt	26,474,776	(26,846,797)	-	(372,021)
Restricted for debt service	-	687,656	-	687,656
Restricted for operations and maintenance	212,885	-	-	212,885
Unrestricted (deficit)	<u>(15,544,835)</u>	<u>14,675,463</u>	<u>-</u>	<u>(869,372)</u>
Total net assets	<u>11,142,826</u>	<u>(11,483,678)</u>	<u>-</u>	<u>(340,852)</u>
TOTAL	<u>\$ 27,472,760</u>	<u>\$ 17,906,127</u>	<u>\$ (16,044,536)</u>	<u>\$ 29,334,351</u>

See notes to combining financial statements.

(Concluded)

# NEW YORK CITY WATER AND SEWER SYSTEM

## COMBINING BALANCE SHEET

JUNE 30, 2011

(In thousands)

	New York City		Eliminations	Total
	Water Board	Municipal Water Finance Authority		
<b>ASSETS</b>				
<b>CURRENT ASSETS:</b>				
Unrestricted cash and cash equivalents	\$ 14,866	\$ 9	\$ -	\$ 14,875
Restricted cash and cash equivalents	173,276	1,045,479	-	1,218,755
Restricted investments	26,360	340,397	-	366,757
Accrued interest and subsidy receivable	-	24	-	24
Accounts receivable:				
Billed — less allowance for uncollectible water and sewer receivables of \$310,776	340,039	-	-	340,039
Unbilled	274,283	-	-	274,283
Receivable from The City of New York	36,288	-	-	36,288
	<u>865,112</u>	<u>1,385,909</u>	<u>-</u>	<u>2,251,021</u>
Total current assets				
<b>NON-CURRENT ASSETS:</b>				
Utility plant in service — less accumulated depreciation of \$9,132,287	17,184,273	-	-	17,184,273
Utility plant construction	7,804,563	-	-	7,804,563
	<u>24,988,836</u>	<u>-</u>	<u>-</u>	<u>24,988,836</u>
Total capital assets				
Residual interest in sold liens	39,000	-	-	39,000
Deferred outflows from hedging	-	53,216	-	53,216
Long-term deferred bond and financing expenses	-	176,139	-	176,139
Revenue required to be billed by and received from the Board	-	15,519,332	(15,519,332)	-
	<u>25,027,836</u>	<u>15,748,687</u>	<u>(15,519,332)</u>	<u>25,257,191</u>
Total non-current assets and deferred items				
<b>TOTAL</b>	<u>\$ 25,892,948</u>	<u>\$ 17,134,596</u>	<u>\$ (15,519,332)</u>	<u>\$ 27,508,212</u>

See notes to combining financial statements.

(Continued)

# NEW YORK CITY WATER AND SEWER SYSTEM

## COMBINING BALANCE SHEET

JUNE 30, 2011

(In thousands)

	New York City		Eliminations	Total
	Water Board	Municipal Water Finance Authority		
<b>LIABILITIES AND NET ASSETS</b>				
LONG-TERM LIABILITIES:				
Bonds and notes payable — net of current portion	\$ -	\$ 26,078,417	\$ -	\$ 26,078,417
Net premium on bonds and notes payable	-	197,357	-	197,357
Unamortized deferred bond refunding costs	-	(300,850)	-	(300,850)
Pollution remediation obligation	102,652	-	-	102,652
OPEB Liability	-	699	-	699
Interest rate swap agreement — net	-	37,474	-	37,474
Revenue requirements payable to the Authority	<u>15,519,332</u>	<u>-</u>	<u>(15,519,332)</u>	<u>-</u>
Total long-term liabilities	<u>15,621,984</u>	<u>26,013,097</u>	<u>(15,519,332)</u>	<u>26,115,749</u>
CURRENT LIABILITIES:				
Accounts payable and accrued expenses	45,052	61,618	-	106,670
Revenue received in advance	61,517	-	-	61,517
Commercial paper payable	-	400,000	-	400,000
Current portion of bonds and notes payable	-	430,452	-	430,452
Payable to The City of New York	-	682,345	-	682,345
Service credits on customer accounts	<u>64,367</u>	<u>-</u>	<u>-</u>	<u>64,367</u>
Total current liabilities	<u>170,936</u>	<u>1,574,415</u>	<u>-</u>	<u>1,745,351</u>
Total liabilities	<u>15,792,920</u>	<u>27,587,512</u>	<u>(15,519,332)</u>	<u>27,861,100</u>
NET ASSETS:				
Invested in capital assets — net of related debt	24,988,836	(25,204,158)	-	(215,322)
Restricted for debt service	-	573,461	-	573,461
Restricted for operations and maintenance	199,636	-	-	199,636
Unrestricted (deficit)	<u>(15,088,444)</u>	<u>14,177,781</u>	<u>-</u>	<u>(910,663)</u>
Total net assets (deficit)	<u>10,100,028</u>	<u>(10,452,916)</u>	<u>-</u>	<u>(352,888)</u>
TOTAL	<u>\$ 25,892,948</u>	<u>\$ 17,134,596</u>	<u>\$ (15,519,332)</u>	<u>\$ 27,508,212</u>

See notes to combining financial statements.

(Concluded)

# NEW YORK CITY WATER AND SEWER SYSTEM

## COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2012

(In thousands)

	New York City		Total
	Water Board	Municipal Water Finance Authority	
<b>OPERATING REVENUES:</b>			
Water supply and distribution	\$ 1,238,352	\$ -	\$ 1,238,352
Sewer collection and treatment	1,857,527	-	1,857,527
Other operating revenues	<u>140,595</u>	<u>-</u>	<u>140,595</u>
Total operating revenues	<u>3,236,474</u>	<u>-</u>	<u>3,236,474</u>
<b>OPERATING EXPENSES:</b>			
Operation and maintenance	1,373,038	-	1,373,038
Bad debt expense	28,541	-	28,541
Administration and general	9,478	37,924	47,402
Other operating expenses	<u>73,814</u>	<u>-</u>	<u>73,814</u>
Total operating expenses	<u>1,484,871</u>	<u>37,924</u>	<u>1,522,795</u>
DEPRECIATION AND AMORTIZATION	<u>692,296</u>	<u>41,129</u>	<u>733,425</u>
OPERATING INCOME (LOSS)	1,059,307	(79,053)	980,254
<b>NON-OPERATING REVENUE (EXPENSES):</b>			
Interest expense	-	(1,196,647)	(1,196,647)
Loss on retirement of capital assets	(1,646)	-	(1,646)
Subsidy income	-	196,241	196,241
Capital distribution	(42,005)	-	(42,005)
Investment income	<u>239</u>	<u>48,697</u>	<u>48,936</u>
NET INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS	1,015,895	(1,030,762)	(14,867)
CAPITAL CONTRIBUTION	<u>26,903</u>	<u>-</u>	<u>26,903</u>
CHANGE IN NET ASSETS	1,042,798	(1,030,762)	12,036
NET ASSETS (DEFICIT) — Beginning of year	<u>10,100,028</u>	<u>(10,452,916)</u>	<u>(352,888)</u>
NET ASSETS (DEFICIT) — End of year	<u>\$ 11,142,826</u>	<u>\$ (11,483,678)</u>	<u>\$ (340,852)</u>

See notes to combining financial statements.

## NEW YORK CITY WATER AND SEWER SYSTEM

### COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (DEFICIT) YEAR ENDED JUNE 30, 2011 (In thousands)

	<u>New York City</u>		<b>Total</b>
	<b>Water Board</b>	<b>Municipal Water Finance Authority</b>	
<b>OPERATING REVENUES:</b>			
Water supply and distribution	\$ 1,158,977	\$ -	\$ 1,158,977
Sewer collection and treatment	1,797,777	-	1,797,777
Other operating revenues	<u>111,552</u>	<u>-</u>	<u>111,552</u>
Total operating revenues	<u>3,068,306</u>	<u>-</u>	<u>3,068,306</u>
<b>OPERATING EXPENSES:</b>			
Operation and maintenance	1,294,533	-	1,294,533
Bad debt expense	76,799	-	76,799
Administration and general	6,409	34,015	40,424
Other operating expenses	<u>103,334</u>	<u>-</u>	<u>103,334</u>
Total operating expenses	<u>1,481,075</u>	<u>34,015</u>	<u>1,515,090</u>
DEPRECIATION AND AMORTIZATION	<u>593,996</u>	<u>34,343</u>	<u>628,339</u>
OPERATING INCOME (LOSS)	993,235	(68,358)	924,877
<b>NON-OPERATING REVENUE (EXPENSES):</b>			
Interest expense	-	(1,178,226)	(1,178,226)
Loss on retirement of capital assets	(3,426)	-	(3,426)
Subsidy income	-	180,986	180,986
Capital distribution	(53,591)	-	(53,591)
Investment income	<u>672</u>	<u>37,641</u>	<u>38,313</u>
NET INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS	936,890	(1,027,957)	(91,067)
CAPITAL CONTRIBUTION	<u>18,696</u>	<u>-</u>	<u>18,696</u>
CHANGE IN NET ASSETS	955,586	(1,027,957)	(72,371)
NET ASSETS (DEFICIT) — Beginning of year	<u>9,144,442</u>	<u>(9,424,959)</u>	<u>(280,517)</u>
NET ASSETS (DEFICIT) — End of year	<u>\$10,100,028</u>	<u>\$(10,452,916)</u>	<u>\$ (352,888)</u>

See notes to combining financial statements.

# NEW YORK CITY WATER AND SEWER SYSTEM

## COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2012

(In thousands)

	New York City		Total
	Water Board	Municipal Water Finance Authority	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Receipts from customers	\$ 3,147,038	\$ -	\$ 3,147,038
Payments for operations and maintenance	(1,399,122)	-	(1,399,122)
Payments for administration	(6,373)	(37,557)	(43,930)
Net cash provided by (used in) operating activities	<u>1,741,543</u>	<u>(37,557)</u>	<u>1,703,986</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>			
Proceeds from issuing bonds, notes and other borrowings — net of issuance costs	-	5,039,373	5,039,373
Acquisition and construction of capital assets	293	(2,267,908)	(2,267,615)
Payments by the Board to the Authority	(1,738,239)	1,738,239	-
Repayments of bonds, notes and other borrowings	-	(3,344,945)	(3,344,945)
Interest paid on bonds, notes and other borrowings	-	(1,002,007)	(1,002,007)
Net cash (used in) provided by capital and related financing activities	<u>(1,737,946)</u>	<u>162,752</u>	<u>(1,575,194)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Proceeds from sales and maturities of investments	-	49,541	49,541
Purchase of investments	(187,260)	(105,823)	(293,083)
Interest on investments	1,023	43,957	44,980
Net cash used in investing activities	<u>(186,237)</u>	<u>(12,325)</u>	<u>(198,562)</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(182,640)	112,870	(69,770)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>188,142</u>	<u>1,045,488</u>	<u>1,233,630</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 5,502</u>	<u>\$ 1,158,358</u>	<u>\$ 1,163,860</u>

See notes to combining financial statements.

(Continued)

# NEW YORK CITY WATER AND SEWER SYSTEM

## COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2012

(In thousands)

	New York City		Total
	Water Board	Municipal Water Finance Authority	
RECONCILIATION OF OPERATING (LOSS) INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:			
Operating income (loss)	\$ 1,059,307	\$ (79,053)	\$ 980,254
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:			
Depreciation and amortization	692,296	41,129	733,425
Operations and maintenance expense paid for with bond proceeds	44,092	-	44,092
Pollution remediation expense	24,074	-	24,074
Changes in assets and liabilities (net):			
Pollution remediation liability	5,648	-	5,648
Receivables — net	(51,176)	-	(51,176)
Receivable from The City	(26,083)	(25)	(26,108)
Residual interest in sold liens	(12,777)	-	(12,777)
Accounts payable	472	392	864
Revenues received in advance	(10,221)	-	(10,221)
Service credits on customer accounts	15,911	-	15,911
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	<u>\$ 1,741,543</u>	<u>\$ (37,557)</u>	<u>\$ 1,703,986</u>

The following are the noncash capital and related financing activities:

Interest expense includes the amortization of net (premium) and discount in the amount of \$17,493 in 2012.

Capital expenditures in the amount \$677,880 had been incurred but not paid at June 30, 2012.

The Board received capital assets of \$26,611 in 2012 which represented capital contributed by The City.

The Board received capital assets of \$292 in 2012 which represented capital contributed by Westchester County.

See notes to combining financial statements.

(Concluded)

# NEW YORK CITY WATER AND SEWER SYSTEM

## COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2011

(In thousands)

	New York City		Total
	Water Board	Municipal Water Finance Authority	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Receipts from customers	\$ 2,922,730	\$ -	\$ 2,922,730
Payments for operations and maintenance	(1,242,579)	-	(1,242,579)
Payments for administration	(3,826)	(33,419)	(37,245)
Net cash provided by (used in) operating activities	<u>1,676,325</u>	<u>(33,419)</u>	<u>1,642,906</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>			
Proceeds from issuing bonds, notes and other borrowings — net of issuance costs	-	6,410,737	6,410,737
Acquisition and construction of capital assets	-	(2,965,506)	(2,965,506)
Payments by the Board to the Authority	(1,661,360)	1,661,360	-
Repayments of bonds, notes and other borrowings	-	(4,069,142)	(4,069,142)
Interest paid on bonds, notes and other borrowings	-	(956,950)	(956,950)
Net cash (used in) provided by capital and related financing activities	<u>(1,661,360)</u>	<u>80,499</u>	<u>(1,580,861)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Proceeds from sales and maturities of investments	1,134	75,289	76,423
Purchases of investments	-	(80,969)	(80,969)
Interest on investments	706	51,463	52,169
Net cash provided by (used in) investing activities	<u>1,840</u>	<u>45,783</u>	<u>47,623</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	16,805	92,863	109,668
CASH AND CASH EQUIVALENTS — Beginning of year	<u>171,337</u>	<u>952,625</u>	<u>1,123,962</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 188,142</u>	<u>\$ 1,045,488</u>	<u>\$ 1,233,630</u>

See notes to combining financial statements.

(Continued)

# NEW YORK CITY WATER AND SEWER SYSTEM

## COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2011

(In thousands)

	<u>New York City</u>		Total
	Water Board	Municipal Water Finance Authority	
RECONCILIATION OF OPERATING (LOSS) INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:			
Operating income (loss)	\$ 993,235	\$ (68,358)	\$ 924,877
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:			
Depreciation and amortization	593,996	34,343	628,339
Operations and maintenance expense paid for with bond proceeds	56,040	-	56,040
Pollution remediation expense	18,902	-	18,902
Changes in assets and liabilities (net):			
Pollution remediation liability	28,392	-	28,392
Receivables — net	(71,850)	-	(71,850)
Receivable from The City	51,953	-	51,953
Residual interest in sold liens	1,734	-	1,734
Accounts payable	78	596	674
Revenues received in advance	4,188	-	4,188
Service credits on customer accounts	(343)	-	(343)
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b><u>\$ 1,676,325</u></b>	<b><u>\$ (33,419)</u></b>	<b><u>\$ 1,642,906</u></b>

The following are the noncash capital and related financing activities:

Interest expense includes the amortization of net (premium) and discount in the amount of (\$979) in 2011.

Capital expenditures in the amount of \$635,323 had been incurred but not paid at June 30, 2011.

The Board received capital assets of \$18,412 in 2011 which represented capital contributed by The City.

The Board received capital assets of \$284 in 2011 which represented capital contributed by Westchester County.

See notes to combining financial statements.

(Concluded)

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

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### 1. ORGANIZATION

The New York City Water and Sewer System (the “System”) provides water supply, treatment and distribution, and sewage collection, treatment, and disposal for The City of New York (“The City”). The System, as presented in the accompanying financial statements, began operations on July 1, 1985 and is a joint operation consisting of two legally separate and independent entities, the New York City Municipal Water Finance Authority (the “Authority”) and the New York City Water Board (the “Board”). The Authority is a public benefit corporation created in accordance with the New York City Municipal Water Finance Act (the “Act”), duly enacted into law as Chapter 513 of the laws of 1984 of the State of New York, as amended by Chapter 514 of the laws of 1984 of the State of New York. The Board was created by Chapter 515 of the laws of 1984 of the State of New York. The Act empowers the Authority to issue bonds or notes to finance the cost of capital improvements to the System, and to refund any and all outstanding bonds and general obligation bonds of The City issued for water and sewer purposes. The Act empowers the Board to lease the System from The City and to fix and collect rates, fees, rents and other charges for the use of, or for services furnished, rendered, or made available by, the System, to produce cash sufficient to pay debt service on the Authority’s bonds and to place the System on a self-sustaining basis.

The Financing Agreement (the “Agreement”) provides that the Authority will issue bonds to finance the cost of capital investment and related costs in the System serving The City. It also sets forth the funding priority for the debt service costs of the Authority, operating costs of the System, and the rental payment to The City.

The physical operation and capital improvements of the System are performed by The City’s Department of Environmental Protection subject to contractual agreements with the Authority and the Board.

In accordance with Governmental Accounting Standards Board (“GASB”) standards, the Board and the Authority are considered to be part of the same reporting entity (the “System”) since they are fiscally interdependent. Accordingly, the accompanying financial statements for the System present the individual financial statements of the Board and the Authority as major funds. In addition, the accompanying financial statements present a total column which represents the entity-wide financial statements of the System. Transactions and balances between the Board and the Authority are eliminated in the entity-wide financial statements.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the System have been prepared on the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. Other significant accounting policies are:

*Component Unit* — The System is a component unit of The City. The System leases the water and sewer related capital assets from The City, which is responsible for the operations, maintenance and capital improvement of the system. The System reimburses The City for costs incurred for operations and maintenance and issues debt to pay for capital improvements.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

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### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

*Investments and Cash Equivalents* — Investments and cash equivalents consist principally of securities of the United States and its agencies, certificates of deposit, guaranteed investment contracts, and repurchase agreements. All investments are carried at fair value with the exception of money market funds which are carried at cost plus accrued interest. For purposes of the statement of cash flows and statement of net assets, the System generally considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

*Restricted Assets — Net Asset Classification* — Proceeds from the issuance of debt and monies set aside for the operation and maintenance of the System are classified as restricted based on the requirements of the applicable bond indentures in the net asset classification.

*Lien Sales and Residual Interest in Sold Liens* — The City periodically sells tax liens secured by water and sewer rents and surcharges, for which the Board receives the applicable sale proceeds. At the time of sale, the Board recognizes the proceeds as operating revenue and removes the related receivables. The Board maintains a residual interest in the liens, which represents the amount estimated to be received by the Board if and when liens held by the purchasing trusts generate cash flows above the amounts needed by the trusts to pay their bondholders and satisfy reserve requirements.

*Bond Discount and Bond Issuance Costs* — Bond discount and bond issuance costs are amortized over the life of the related bond issue, using the effective yield method of amortization for bond discount and bond issuance costs.

*Utility Plant* — Utility plant acquired through purchase or internal construction is recorded at cost, net of retirements. It is the Board's policy to capitalize assets with a cost of \$35,000 or more and a useful life of five years or longer. Contributed utility plant is recorded at its estimated historical cost based on appraisals or other methods when historical cost information is not available, net of depreciation. Depreciation is computed using the straight-line method based upon estimated useful lives, as follows:

	Years
Buildings	40–50
Water supply and wastewater treatment systems	15–50
Water distribution and sewage collection systems	15–75
Equipment	5–35
Vehicles	10

Maintenance and repairs of property are charged to maintenance expense. Replacements and betterments are recorded as additions to utility plant. The System pays for some improvements for assets that are not owned by The City or the System, as well as certain pollution remediation activities, through bond proceeds. These costs are shown as other operating expenses in the statements of revenues, expenses and changes in net assets.

*Operating Revenues and Operating Expenses* — Operating revenues consist of customer payments for services of the System. Revenues are based on billing rates imposed by the Board and upon customers' water and sewer usage or, in some cases, characteristics of customer properties. The System records estimated unbilled revenue at year-end. Operating expenses includes but is not limited to administration,

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

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### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

maintenance, repair and operations of the System; administration costs of the Board and the Authority; rental payments to The City and bad debt expense.

*Deferred Revenues* — Revenues received in advance of the period to which they relate are deferred and recorded as revenue when earned. Customer account credit balances are included in refunds payable not in accounts receivable.

*Deferred Bond Refunding Costs* — Deferred bond refunding costs represent the gains or losses incurred in advance refundings of outstanding bonds. Gains or losses arising from debt refundings are deferred and amortized over the lesser of the remaining life of the old debt or the life of the new debt.

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

*New Accounting Standards* — In November 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Agreements*. The Statement establishes the financial reporting for service concession agreements. The Statement is effective for financial statement periods beginning after December 15, 2011. The System has not entered into any service concession agreements. GASB Statement No. 60 is not expected to have an impact on its financial statements.

In November 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus — An Amendment of GASB Statement No. 14 and No. 34*. The Statement amends existing standards relating to the composition and reporting of the governmental financial reporting entity. The Statement is effective for financial statement periods beginning after June 15, 2012. The System has completed the process of evaluating GASB Statement No. 61 and it does not have an impact on the System's financial statements.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 GASB and AICPA Pronouncements*. The Statement incorporates a large volume of FASB and AICPA accounting pronouncements into the GASB hierarchy of generally accepted accounting principles for governments. The Statement is effective for financial statement periods beginning after December 15, 2011. The System has completed the process of evaluating GASB Statement No. 62 and the Statement does not have an impact on the System's financial statements.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The Statement establishes new reporting requirements of two elements (deferred outflows of resources and deferred inflows of resources) and renames the statement of net assets to statement of net position, as well as reported net assets, and components thereof, to net position. The Statement is effective for financial statements for periods beginning after December 15, 2011. The System has not completed the process of evaluating GASB Statement No. 63, but the Statement is expected to change only the formatting and naming of the System's statement of position and components thereof, with no overall financial impact.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

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### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In June 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provision*. GASB 64 clarifies the existing requirements for the termination of hedge accounting upon default or termination of a swap counterparty or swap counterparty's credit support provider. GASB Statement No. 64 is effective for financial statements for periods beginning after June 15, 2011. As The System has not experienced a default or termination of such agreements, GASB Statement No. 64 does not have an impact on the System's financial statements.

In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. GASB Statement No. 65 establishes accounting and reporting standards that reclassify certain items that are currently reported as assets and liabilities to deferred outflows of resources or deferred inflows of resources and that recognizes certain items currently being reported as assets and liabilities as outflows and inflow of resources. In addition, it limits the use of the term deferred in the financial statement presentation. The provisions of GASB Statement No. 65 are effective for financial statement for periods beginning after December 15, 2012. The System has not completed the process of evaluating GASB Statement No. 65, but it expects that the required accounting change will have an effect to debt issuance cost recognition and reporting in the statement of net assets upon implementation.

In March 2012, GASB issued Statement No. 66, *Technical Corrections-2012 an amendment of GASB Statements No. 10 and No. 62*. GASB Statement No. 66 resolves conflicting accounting and reporting guidance that resulted from the issuance of two pronouncements, GASB Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions*, and GASB Statement No. 62 *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The provisions of GASB Statement No. 66 are effective for financial statements for periods beginning after December 15, 2012. The System has not completed the process of evaluating GASB Statement No. 66, but it does not expect it to have an impact on the System's financial statements.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*. GASB Statement No. 67 establishes standards of financial reporting for defined benefit pension plans. As The System is not a pension plan, GASB Statement No. 67 is not applicable to it and will have no direct impact on its financial statements, other than the related implementation of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, discussed below.

In June 2012, GASB also issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. GASB Statement No. 68 establishes standards of accounting and financial reporting for defined benefit pensions and defined contribution pensions provided to the employees of state and local governmental employers. The requirements of GASB Statement No. 68 are effective for fiscal years beginning after June 15, 2014. The System has not completed the process of evaluating GASB Statement No. 68, but because the System participates in a cost sharing multiple-employer pension system as defined by GASB Statement No. 68, implementation is expected to result in recognition of pension expense as well as the reporting of deferred outflows and inflows of resources and a net pension liability based on the System's proportionate share of those of the plan, calculated as specified in GASB Statement No. 68. Additional footnote and supplementary disclosures will also be required upon implementation. The System expects to implement GASB Statement No. 68 in the same year that The City does so.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 3. UTILITY PLANT

The following is a summary of utility plant activity for the fiscal years ended June 30, 2012 and 2011 (in thousands):

	Balance at June 30, 2010	Additions	Deletions	Balance at June 30, 2011	Additions	Deletions	Balance at June 30, 2012
Nondepreciable assets/ utility construction	\$ 6,112,362	\$2,569,789	\$877,588	\$ 7,804,563	\$2,254,102	\$1,636,195	\$ 8,422,470
Depreciable assets/ utility plant in service							
Buildings	24,193	10,684	-	34,877	-	-	34,877
Equipment	1,538,451	185,577	121	1,723,907	290,946	149	2,014,704
Vehicles	157,179	6,826	13,414	150,591	-	60	150,531
Water supply, treatment and distribution, and sewage collection, treatment and disposal systems	23,740,818	674,500	8,133	24,407,185	1,345,248	83,345	25,669,088
Total depreciable assets	25,460,641	877,587	21,668	26,316,560	1,636,194	83,554	27,869,200
Less accumulated depreciation for:							
Buildings	(16,444)	(2,003)	-	(18,447)	(1,373)	-	(19,820)
Equipment	(573,595)	(94,080)	-	(667,675)	(122,535)	(30)	(790,180)
Vehicles	(98,852)	5,766	-	(93,086)	(5,611)	(58)	(98,639)
Water supply, treatment and distribution, and sewage collection, treatment and disposal systems	(7,867,643)	(485,436)	-	(8,353,079)	(572,646)	(17,470)	(8,908,255)
Total accumulated depreciation	(8,556,534)	(575,753)	-	(9,132,287)	(702,165)	(17,558)	(9,816,894)
Total utility plant in service — net	16,904,107	301,834	21,668	17,184,273	934,029	65,996	18,052,306
Total capital assets — net	\$23,016,469	\$2,871,623	\$899,256	\$24,988,836	\$3,188,131	\$1,702,191	\$26,474,776

### 4. INVESTMENTS AND CASH DEPOSITS

**Investments** — Pursuant to the Water and Sewer General Revenue Bond Resolution and the Authority's and the Board's investment guidelines, the Authority and the Board may generally invest in obligations of, or guaranteed by, the U.S. government, certain highly rated obligations of the State of New York or any subdivision or instrumentality thereof, certain certificates of deposit and similar instruments issued by highly rated commercial banks, certain highly rated corporate securities or commercial paper securities, certain repurchase agreements with highly rated institutions, certain investment agreements with highly rated institutions, certain highly rated money market funds, and other certain highly rated municipal obligations.

**Cash Deposits** — The System follows the New York City Banking Commission designations for the System's bank depositories. The Commission consists of the Comptroller, the Mayor, and the Finance Commissioner of The City and uses independent bank rating agencies in part to assess the financial soundness of each bank, and the banking relationships are under constant operational and credit reviews. Each bank in which the System's cash is deposited is required to have its principal office in New York State and have capital stock, surplus, and undivided earnings aggregating at least \$100 million. The System had \$532 million and \$546 million respectively, on deposit at June 30, 2012 and 2011, which was covered by Federal depository insurance.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 4. INVESTMENTS AND CASH DEPOSITS (CONTINUED)

Cash and cash equivalents, including restricted and unrestricted balances were comprised of the following at June 30, 2012 and 2011 (in thousands):

	2012	2011
Cash	\$ 531,694	\$ 546,833
Cash equivalents	<u>632,166</u>	<u>686,797</u>
Cash and cash equivalents	<u>\$1,163,860</u>	<u>\$1,233,630</u>

The System had the following investments at June 30, 2012 and 2011 (in thousands):

Investments	Fair Value	
	2012	2011
U.S. Government Sponsored Entities	\$ 835,692	\$ 673,660
New York State Instrumentalities	290,192	232,649
Dreyfus Government Money Market	9,311	39,497
Guaranteed Investment Contracts	90,354	92,913
Repurchase agreements market value adjustment	<u>11,289</u>	<u>14,835</u>
Total investments including cash equivalents	1,236,838	1,053,554
Less amounts reported as cash equivalents	<u>(632,166)</u>	<u>(686,797)</u>
Investments	<u>\$ 604,672</u>	<u>\$ 366,757</u>

The System invests funds which are not immediately required for operations, debt service or capital project expenses and funds that are held for debt service and operations and maintenance reserves. Each account of the Authority is held pursuant to the Resolution and may be invested in securities or categories in investments that are specifically enumerated as permitted investments for such account pursuant to the Resolution. Reserves for operations and maintenance are invested as permitted by the Board's investment guidelines

**Credit Risk** — Investment guidelines and policies are designed to protect principal by limiting credit risk. This is accomplished through ratings, collateral, and diversification requirements that vary according to the type of investment. Investments held by the System at June 30, 2012 and 2011 include obligations of, or guaranteed by, the United States of America, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association or the Federal Farm Credit System, and shares of money market funds, all of which are rated "AAA" or "A-1+" by S&P and "Aaa" or "P-1" by Moody's. Also held by the Authority are direct obligations of, or obligations guaranteed by the State of

New York or direct obligations of any agency or public authority thereof, which are rated, at the time of purchase, in one of the two highest rating categories. In addition, the Authority has entered into investment agreements and guaranteed investment contracts with financial institutions whose long-term debt obligations, or whose obligations under such an investment agreement or guaranteed investment contract, are guaranteed by a financial institution whose senior long-term debt obligations have a rating

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 4. INVESTMENTS AND CASH DEPOSITS (CONTINUED)

in one of the two highest rating categories for comparable types of obligations by each rating agency then maintaining a rating on the Authority's bonds at the time such agreement or contract was entered into.

**Interest Rate Risk** — The System has no formal policy relating to interest rate risk. Approximately 35% of the System's investments are agreements to purchase securities or Guaranteed Investment Contracts ("GIC") with guaranteed fixed rates of return. The par value of the agreements to purchase securities and interest earned are held as cash on June 30, 2012. The fair value of the agreements to purchase securities is susceptible to changes in market interest rates.

#### Segmented Time Distribution on Investments and Cash Equivalents

Maturity Date	Fair Value Amount
Under 6 months <sup>1</sup>	\$ 711,175
Over 6 months to 1 year	218,457
Over 1 year to 3 years	56,732
Over 3 years and beyond	148,831
Over 3 years and beyond (GIC and repurchase agreements) <sup>2</sup>	<u>101,643</u>
Total	<u>\$ 1,236,838</u>

<sup>1</sup> Includes variable rate demand obligations with maturities greater than three years which can be tendered weekly at par.

<sup>2</sup> Includes the fair value of agreements to purchase securities and \$90,354,000 GIC with a one-time option to terminate at par by provider on 6/15/2013, which is expected to be exercised.

**Custodial Credit Risk** — For an investment, custodial credit risk is the risk that, in the event of the failure of the custodian, The System may not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The System's investments, other than repurchase agreements, are not collateralized. All investments are held in the Trustee's name by the Trustee or in the Board's name by its custodian bank.

### 5. DERIVATIVE INSTRUMENTS

As of June 30, 2012 the Authority had the following:

Type	Notional Amount	Effective Date	Maturity Date	Terms	Fair Value	Counterparty Credit Rating (Moody's/S&P/Fitch)
<b>Hedging Derivatives</b>						
Muni-CPI	\$ 20,000,000	7/9/2002	6/15/2013	pay 4.15% receive muni-CPI rate	\$ (305)	Baa1/A-/A
Synthetic fixed rate	240,600,000	10/24/2007	6/15/2036	pay 3.439% receive 67% of 1-month LIBOR	(80,668)	Aa2/AAA/NR
Synthetic fixed rate	160,400,000	10/24/2007	6/15/2036	pay 3.439% receive 67% of 1-month LIBOR	(53,779)	A3/A/A
<b>Investment Derivative</b>						
Synthetic variable rate	\$ 200,000,000	12/23/2003	6/15/2014	Pay SIFMA Index receive 3.567%	\$ 12,612	A2/AA-/A+

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

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### 5. DERIVATIVE INSTRUMENTS (CONTINUED)

**Hedging Derivative Instruments** — The Authority executed an interest rate exchange agreement (the “Muni-CPI agreement”) effective July 9, 2002 in conjunction with its sale of \$20 million of muni-CPI Bonds in the 2013 maturity of its Fiscal 2003 Series A Water and Sewer System Revenue Bonds (the “CPI Bonds”). The CPI Bonds pay the holder a floating rate tied to the consumer price index [a fixed spread of 1.53% plus a floating rate equal to the change in the Consumer Price Index — Urban (“CPI-U”) for a given period]. Under the interest rate exchange agreement, the Authority pays the counterparty a fixed interest rate of 4.15% while it receives a floating interest rate matching the rate on the CPI Bonds. This allowed the Authority to achieve a fixed rate 10 basis points lower than conventional fixed rate debt in the 2013 maturity at the time of issuance. The interest rate exchange agreement terminates upon the maturity of the CPI Bonds on June 15, 2013. The Authority’s obligations under the interest rate exchange agreement are payable as Authority expenses.

The Authority executed two interest rate exchange agreements (the “synthetic fixed rate agreements”) effective October 24, 2007, in conjunction with its sale of \$401 million of Adjustable Rate Fiscal 2008 Series BB Second Resolution Bonds on October 24, 2007. Under these agreements, the Authority pays a fixed interest rate of 3.439% in exchange for a floating rate based on 67% of one-month LIBOR on the combined notional amount of \$401 million. The agreements are with two counterparties, with one agreement in the amount of \$240.6 million and the second agreement in the amount of \$160.4 million. These agreements allowed the Authority to achieve a fixed rate cost lower than conventional fixed rate debt at the time of issuance. The Authority’s obligations under these interest rate exchange agreements are payable on a parity with the related second resolution bonds.

*Credit Risk* — The Authority is exposed to the risk that the counterparty (or its guarantor) will default under its agreement. For the Muni-CPI agreement, the Authority would have to pay another counterparty to assume the position of the defaulting counterparty or face unhedged risk on changes in the CPI-U. The Authority has the right to terminate the Muni-CPI interest rate exchange agreement if the counterparty is downgraded below BBB- by Standard and Poor’s or Baa3 by Moody’s. Under the synthetic fixed rate agreements, the Authority has the right to terminate the swap, regardless of collateral posting, if the counterparty’s ratings fall below both A3 and A-.

The counterparties under the interest rate exchange agreements must post collateral if their ratings fall below A3 by Moody’s or A- by Standard and Poor’s and the amount the counterparty would owe the Authority upon termination exceeds specified threshold amounts.

The Authority may exercise its right to assign the agreements to another counterparty, if necessary, in its judgment, to mitigate counterparty risk, even in the absence of a significant credit rating downgrade.

*Termination Risk* — The counterparties could terminate the agreements upon the occurrence of certain events, when the mark-to-market value is such that the Authority would owe a termination payment to the counterparty. The counterparties may terminate the agreement only upon the occurrence of certain events such as payment defaults by the Authority, other defaults which remain uncured for 30 days after notice, bankruptcy or insolvency of the Authority (or similar events) or a downgrade of the Authority’s credit rating below BBB-/Baa3

*Basis Risk* — Since, during the term of the agreement, the rate on the CPI Bonds will exactly match the rate being paid by the counterparty, there is no basis risk for the Muni-CPI agreement. The Authority is exposed to basis risk on its synthetic fixed rate agreements because the amount the Authority receives

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

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### 5. DERIVATIVE INSTRUMENTS (CONTINUED)

under the synthetic fixed rate interest rate exchange agreement may be lower than the average monthly variable interest paid on the bonds associated with the agreement, which would require the Authority to make up the shortfall.

*Interest Rate Risk* — The Authority is exposed to the risk that changes in interest rates will adversely affect the fair values of the Authority's financial instruments or cash flows. There is no interest rate risk with the Muni-CPI agreement. The fixed rate paid by the Authority on its synthetic fixed rate agreements may exceed the rate received (67% of LIBOR).

**Investment Derivative** — The Authority executed an interest rate exchange agreement (the "synthetic variable rate agreement") against its existing portfolio of second general resolution fixed rate bonds issued through the New York State Environmental Facilities Corporation ("EFC"). Pursuant to the interest rate exchange agreement, the Authority receives a fixed payment of 3.567% and pays a floating rate based on the SIFMA Municipal Swap Index. The agreement provides the Authority with floating rate debt at a lower cost than variable rate demand bonds. The Authority's obligations under the Interest Rate Exchange Agreement are payable as operating expenses.

*Credit Risk* — The counterparty under this interest rate exchange agreement must post collateral if its ratings fall below A3 by Moody's or A- by Standard and Poor's and the amount the counterparty would owe the Authority upon termination exceeds specified threshold amounts.

The Authority has the right to terminate the swap, regardless of collateral posting, if the counterparty's ratings fall below both A3 and A-. If interest rates at the time of Counterparty default are lower than they were at the time the transaction was entered into, the Authority may not be able to replace the Counterparty on the same terms and conditions without incurring added cost.

*Interest Rate Risk* — During the term of the synthetic variable rate agreement, the rate paid by the Authority (SIFMA Municipal Swap Index) may exceed the fixed rate received.

*Financial Statements Effect* — The market value of derivatives at June 30, 2012 and June 30, 2011, was negative \$122.1 million and negative \$37.5 million, respectively. The market value of hedge derivatives at June 30, 2012 and June 30, 2011, was negative \$134.8 million and negative \$53.2 million, respectively. These amounts are shown as deferred outflows in the balance sheet. The decrease in market value of the non-hedge derivative at June 30, 2012 and June 30, 2011 was \$3.1 million and \$1.2 million, respectively.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

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### 6. LEASE AGREEMENT

The Board is party to a long-term lease (the "Lease") with The City, which transfers the water and sewer related property to the Board for the term of the Lease. The Lease term commenced on July 1, 1985, and continues until the later of, the fortieth anniversary of the commencement of the lease or the date on which all bonds, notes or other obligations of the Authority are paid in full or provision for such payment has been made pursuant to the applicable debt instrument. The Lease provides for payments to The City to cover the following:

- a. an amount sufficient to pay the cost of administration, maintenance, repair and operation of the leased property, which includes overhead costs incurred by The City attributable to the leased property, net of the amount of any Federal, State, or other operating grants received by The City;
- b. an amount sufficient to reimburse The City for capital costs incurred by The City for the construction of capital improvements to the leased property which are not paid or reimbursed from any other source.

In addition to the payments described above, the Board pays rent to The City in each fiscal year in an amount not to exceed the greater of (a) the principal and interest payable on general obligation bonds issued by The City for water and sewer purposes certified by The City to be paid within such fiscal year or (b) 15% of principal and interest payable on the bonds of the Authority to be paid within such fiscal year. A summary of operation and maintenance and rental expenses for the years ended June 30 is as follows (in thousands):

	<b>2012</b>	<b>2011</b>
Water supply, treatment, transmission and distribution	\$ 441,726	\$ 402,603
Sewer collection and treatment systems	477,381	494,740
City agency support cost	63,440	62,181
Fringe benefits	185,388	117,961
Judgments and claims	<u>8,693</u>	<u>11,658</u>
Operation and maintenance	1,176,628	1,089,143
Rental payments to the City	<u>196,410</u>	<u>205,390</u>
Total operations maintenance and rental payments	<u>\$1,373,038</u>	<u>\$1,294,533</u>

### 7. PAYABLE TO AND RECEIVABLE FROM THE CITY

As of June 30, 2012 and 2011, all utility construction and other projects financed by Authority debt recorded by the System which have not been reimbursed to The City have been recorded as a payable to The City, net of the amount of any State or Federal capital grants received by The City.

As of June 30, 2012 and 2011, the System had a net payable of \$615.5 million and \$646.1 million, respectively, to The City for payments of utility construction and for overpayment of operations and maintenance expense.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 8. OTHER OPERATING EXPENSES

A summary of other operating expenses for the year ended June 30, is as follows (in thousands):

	2012	2011
Pollution remediation	\$ 29,722	\$ 47,294
Payments for watershed improvements	<u>44,092</u>	<u>56,040</u>
Total other operating expenses	<u>\$ 73,814</u>	<u>\$ 103,334</u>

The City's Department of Environmental Protection manages both the System's operations and its capital program, and it also manages other projects with long-term benefits to the System which do not result in capital assets of the System and which are paid for using Authority debt proceeds, similarly to capital projects. Such long-term benefit projects include payment for environmental protection and related improvement in the watershed areas, and pollution remediation projects throughout the System.

### 9. SHORT TERM DEBT

In fiscal 2012 and 2011, the changes in short-term debt were as follows (in thousands):

	Balance at June 30, 2010	Additions	Deletions	Balance at June 30, 2011	Additions	Deletions	Balance at June 30, 2012
Commercial paper (1)	<u>\$600,000</u>	<u>\$1,800,000</u>	<u>\$2,000,000</u>	<u>\$400,000</u>	<u>\$1,778,300</u>	<u>\$1,778,300</u>	<u>\$400,000</u>

(1) Commercial paper is used to pay construction costs in advance of long-term bond financing. It is reported as part of the current portion of bonds and notes payable on the System's balance sheets.

Commercial paper activity is comprised of the following for the year ended June 30, 2012 (in thousands):

	Balance at June 30, 2011	Issued	Retired	Balance at June 30, 2012
Commercial Paper Series 1 — Variable Rate, Short-term Rolling Maturity Backed by Line of Credit	\$ -	\$ 586,700	\$ 586,700	\$ -
Commercial Paper Series 6 — Variable Rate, Short-term Rolling Maturity Backed by Line of Credit	-	400,000	200,000	200,000
Commercial Paper Series 7 — Variable Rate, Short-term Rolling Maturity	200,000	400,000	400,000	200,000
Commercial Paper Series 8 — Variable Rate, Short-term Rolling Maturity	<u>200,000</u>	<u>391,600</u>	<u>591,600</u>	<u>-</u>
Total commercial paper payable	<u>\$ 400,000</u>	<u>\$ 1,778,300</u>	<u>\$ 1,778,300</u>	<u>\$ 400,000</u>

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 10. LONG-TERM DEBT

In fiscal 2012, the changes in long-term debt were as follows (in thousands):

<b>Bonds Payable</b>	<b>Balance at June 30, 2011</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance at June 30, 2012</b>
First resolution	\$ 8,813,677	\$ 525,000	\$ 1,098,733	\$ 8,239,944
Second resolution	<u>17,695,192</u>	<u>3,210,182</u>	<u>1,167,039</u>	<u>19,738,335</u>
Total bonds payable	26,508,869	3,735,182	2,265,772	27,978,279
Due within one year	(430,452)	-	-	(451,409)
Less discounts (net)	(197,357)	(298,721)	(30,087)	(465,991)
Less deferred refunding costs	<u>300,850</u>	<u>36,649</u>	<u>(27,866)</u>	<u>309,633</u>
Total bonds payable	<u>\$25,974,924</u>	<u>\$ 3,473,110</u>	<u>\$ 2,263,551</u>	<u>\$ 27,683,228</u>

The debt program of the Authority includes commercial paper, long-term debt of the Authority and a bond anticipation note and subsidized bonds issued through the New York State Environmental Facilities Corporation (“EFC”). The commercial paper program is the main source of financing to reimburse The City for payments made for water and sewer projects. The Authority then issues long-term debt of its own or through EFC to retire outstanding commercial paper. The Authority also periodically issues refunding bonds to refinance higher-coupon debt.

In the detailed listing of bonds payable, the bonds issued through EFC are differentiated by their numerical bond serial designation.

With respect to all series, the Board has agreed to maintain rates and charges to provide revenues at levels sufficient to pay principal and interest requirements as well as to meet certain debt service coverage and operating cost funding requirements. All series are specific obligations of the Authority payable solely from and secured by a pledge of and lien on the gross revenue of the System, as defined.

As part of the American Recovery and Reimbursement Act of 2009, the System has and will receive funding through EFC of \$217.5 million for certain projects. Each project included is tracked for spending, and funding is received from EFC after submission of required documentation. The funding is in the form of a bond anticipation note payable by the Authority. The total \$217.5 million note is expected to be forgiven by EFC after the note is fully drawn. Based on the expected length of projects, the note is a long-term liability.

The System also will receive funding through EFC of \$30 million for certain projects. Each project is tracked for spending and funding is received from EFC after submission of required documentation. The funding is in the form of a bond anticipation note payable by the Authority. The total \$30 million note is expected to be forgiven by EFC after the note is fully drawn. Based on the expected length of projects the note is a long-term liability.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 10. LONG-TERM DEBT (CONTINUED)

During fiscal 2012, the Authority issued \$1.5 billion of bonds to refund \$1.7 billion of outstanding bonds. These refundings resulted in a loss of \$36.7 million. The Authority in effect reduced its aggregate debt service for principal and interest by \$267.6 million and obtained an economic benefit of \$196.4 million.

During fiscal 2012, the Authority defeased \$228.44 million of outstanding bonds using current revenue. This resulted in a loss of \$4.5 million.

During fiscal 2011, the Authority issued \$1.6 billion of bonds to refund \$1.4 billion of outstanding bonds and \$200 million of Commercial Paper Series 5. These refundings resulted in a loss of \$17.3 million. The Authority in effect reduced its aggregate debt service by \$139 million.

The Authority has defeased cumulatively \$14.8 billion and \$13.1 billion of outstanding bonds as of June 30, 2012 and 2011, respectively through the EFC and by placing proceeds of refunding bonds issued in an irrevocable escrow account to provide for all future debt service payments on defeased bonds. Proceeds were used to purchase U.S. Government securities that were placed in the irrevocable escrow account. Accordingly, the escrow account assets and liabilities for the defeased bonds are not included in the Authority's financial statements. As of June 30, 2012 and 2011, \$13.2 billion and \$11.7 billion of the defeased bonds, respectively, had been retired using the assets of the escrow accounts.

Debt service requirements to maturity, including amounts relating to commercial paper and the bond anticipation notes, at June 30, 2012 are as follows (in thousands):

June 30	Principal (1)	Interest (2)	Total
2013	\$ 851,409	\$ 1,298,110	\$ 2,149,519
2014	355,304	1,329,160	1,684,464
2015	360,618	1,318,524	1,679,142
2016	432,912	1,303,344	1,736,256
2017	470,723	1,287,231	1,757,954
2018–2022	2,956,652	6,092,134	9,048,786
2023–2027	3,339,804	5,400,535	8,740,339
2028–2032	4,048,542	4,535,445	8,583,987
2033–2037	5,039,335	3,494,029	8,533,364
2038–2042	6,473,000	2,126,988	8,599,988
2043–2045	4,049,980	376,053	4,426,033
	<u>\$28,378,279</u>	<u>\$28,561,553</u>	<u>\$56,939,832</u>

(1) Includes \$400 million of commercial paper due in 2013.

(2) Includes interest for variable rate bonds at 3.00% for FY 2013, and 4.25% for FY 2014 and thereafter. Variable rate bonds are remarketed daily or weekly, and interest rates are determined by the market on the day of sale.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 10. LONG-TERM DEBT (CONTINUED)

Bonds, notes payable, and commercial paper are comprised of the following for the year ended June 30, 2012 (in thousands):

	Balance at June 30, 2011	Issued	Retired/ defeased	Balance at June 30, 2012
1991 Fiscal Series B — 7.00% Serial and Term Bonds maturing in varying installments through 2012	\$ 615	\$ -	\$ 615	\$ -
1992 Fiscal Series B — 6.80% to 6.81% Serial and Term Bonds maturing in varying installments through 2014	1,067	-	778	289
1993 Fiscal Series A — 5.50% Serial, Term, and Capital Appreciation Bonds maturing in varying installments through 2012	-	-	-	-
1994 Fiscal Series 1 — 5.75% to 5.88% Serial Bonds maturing in varying installments through 2013	20,140	-	7,385	12,755
1995 Fiscal Series 1 — 6.88% Serial Bonds maturing in varying installments through 2016	11,775	-	3,560	8,215
1997 Fiscal Series A — 6.00% term Bonds maturing in 2021	25,000	-	-	25,000
1998 Fiscal Series D — Capital Appreciation Bonds maturing in varying installments through 2020	110,330	-	-	110,330
1998 Fiscal Series 1 — 5.25% to 5.35% Serial Bonds maturing in varying installments through 2017	18,825	-	2,715	16,110
1998 Fiscal Series 3 — 6.00% Serial Bonds maturing in varying installments through 2012	43,915	-	43,915	-
1998 Fiscal Series 4 — 5.00% to 5.20% Serial Bonds maturing in varying installments through 2018	6,415	-	855	5,560
1999 Fiscal Series A — 4.75% to 5.00% Serial Bonds maturing in varying installments through 2031	-	-	-	-
2000 Fiscal Series C — Adjustable Rate Term Bonds maturing in 2033	107,500	-	-	107,500
2000 Fiscal Series 2 — 5.60% to 5.96% Serial Bonds maturing in varying installments through 2019	6,650	-	680	5,970
2001 Fiscal Series C — 5.13% Term Bonds maturing in varying installments through 2033	112,040	-	112,040	-
2001 Fiscal Series D — Capital Appreciation Bonds maturing in varying installments through 2021	79,845	-	-	79,845
2001 Fiscal Series E — 4.50% to 5.25% Serial and Term Bonds maturing in varying installments through 2031	-	-	-	-
2001 Fiscal Series F — Adjustable Rate Bonds maturing in varying installments through 2033	184,130	-	-	184,130
2002 Fiscal Series G — 5.13% Term Bonds maturing in varying installments through 2032	100,000	-	100,000	-
2002 Fiscal Series 3 — 4.04% to 5.22% Serial Bonds maturing in varying installments through 2031	386,874	-	386,874	-
2002 Fiscal Series 4 — 5.06% to 6.74% Serial Bonds maturing in varying installments through 2023	154,399	-	154,399	-
2002 Fiscal Series 5 — 3.82% to 5.27% Serial Bonds maturing in varying installments through 2031	135,513	-	135,513	-
2002 Fiscal Series 6 — 3.71% to 5.40% Serial Bonds maturing in varying installments through 2019	54,611	-	6,046	48,565
2002 Fiscal Series 7 — 7.50% Serial Bonds maturing in varying installments through 2012	360	-	360	-
2003 Fiscal Series A — 4.15% Muni-CP1 Bonds maturing in 2013	490,160	-	470,160	20,000
2003 Fiscal Series D — 4.00% to 5.25% Serial and Term Bonds maturing in varying installments through 2017	56,645	-	56,645	-

(Continued)

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 10. LONG-TERM DEBT (CONTINUED)

	Balance at June 30, 2011	Issued	Retired/ defeased	Balance at June 30, 2012
2003 Fiscal Series E — 5.00% Term Bonds maturing in 2034 and 2038	\$ 367,265	\$ -	\$ -	\$ 367,265
2003 Fiscal Series F — Adjustable Rate Bonds maturing in 2035	201,655	-	-	201,655
2003 Fiscal Series 1 — 4.62% to 4.89% Serial Bonds maturing in varying installments through 2032	112,746	-	112,746	-
2003 Fiscal Series 2 — 4.97% to 5.24% Serial Bonds maturing in varying installments through 2028	497,998	-	14,213	483,785
2003 Fiscal Series 3 — 0.48% to 5.75% Serial Bonds maturing in varying installments through 2025	16,090	-	840	15,250
2003 Fiscal Series 4 — 0.35% to 5.80% Serial Bonds maturing in varying installments through 2025	25,570	-	1,350	24,220
2003 Fiscal Series 5 — 3.36% to 5.00% Serial Bonds maturing in varying installments through 2032	231,758	-	9,577	222,181
2004 Fiscal Series A — 5.00% Term Bonds maturing in 2027 and 2035	217,000	-	-	217,000
2004 Fiscal Series B — 3.40% to 5.00% Serial bonds maturing in varying installments through 2023	333,160	-	115,205	217,955
2004 Fiscal Series C — 3.10% to 5.00% Serial and Term Bonds maturing in varying installments through 2035	592,750	-	82,980	509,770
2004 Fiscal Series 1 — 3.58% to 5.00% Serial Bonds maturing in varying installments through 2033	241,964	-	9,522	232,442
2004 Fiscal Series 2 — 1.70% to 4.84% Serial Bonds maturing in varying installments through 2026	209,155	-	8,393	200,762
2005 Fiscal Series A — 5.00% Term Bonds maturing in 2039	150,000	-	-	150,000
2005 Fiscal Series B — 3.38% to 5.00% Serial and term Bonds maturing in varying installments through 2036	915,510	-	149,110	766,400
2005 Fiscal Series C — 3.50% to 5.00% Serial Bonds maturing in varying installments through 2031	571,860	-	850	571,010
2005 Fiscal Series D — 5.00% Serial Bonds maturing in varying installments through 2039	559,205	-	-	559,205
2005 Fiscal Series 1 — 3.98% to 5.00% Serial Bonds maturing in varying installments through 2034	189,770	-	6,998	182,772
2005 Fiscal Series 2 — 2.58% to 5.00% Serial Bonds maturing in varying installments through 2034	321,394	-	12,362	309,032
2006 Fiscal Series A — 3.63% to 5.00% Serial Bonds maturing in varying installments through 2039	517,350	-	420	516,930
2006 Fiscal Series B — 5.00% Term Bonds maturing in 2036	150,000	-	-	150,000
2006 Fiscal Series C — 4.50% to 4.75% Serial Bonds maturing in varying installments through 2033	350,345	-	-	350,345
2006 Fiscal Series D — 4.50% to 5.00% Serial Bonds maturing in varying installments through 2038	406,205	-	-	406,205
2006 Fiscal Series AA — Adjustable rate bonds maturing in varying installments through 2032	400,000	-	-	400,000
2006 Fiscal Series BB — 3.60% to 5.00% Serial Bonds maturing in varying installments through 2016	50,000	-	10,000	40,000
2006 Fiscal Series 1 — Adjustable rate bonds maturing in varying installments through 2035	192,285	-	7,333	184,952
2006 Fiscal Series 2 — Adjustable rate bonds maturing in varying installments through 2036	178,166	-	5,738	172,428
2006 Fiscal Series 3 — Adjustable rate bonds maturing in varying installments through 2036	227,613	-	7,234	220,379
2007 Fiscal Series A — 4.25% to 4.75% Serial Bonds maturing in varying installments through 2039	587,975	-	-	587,975
2007 Fiscal Series AA — 4.50% to 5.00% Term Bonds maturing in 2037	199,910	-	-	199,910

(Continued)

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 10. LONG-TERM DEBT (CONTINUED)

	Balance at June 30, 2011	Issued	Retired/ defeased	Balance at June 30, 2012
2007 Fiscal Series BB — 3.75% to 5.00% Serial Bonds maturing in varying installments through 2021	\$ 131,745	\$ -	\$ -	\$ 131,745
2007 Fiscal Series CC — Adjustable rate bonds maturing in 2038	210,500	-	-	210,500
2007 Fiscal Series DD — 4.75% to 5.00% Serial Bonds maturing in varying installments through 2038	395,000	-	125,000	270,000
2007 Fiscal Series 1 — 2.55% to 5.00% Serial Bonds maturing in varying installments through 2036	203,354	-	6,918	196,436
2007 Fiscal Series 2 — 2.60% to 4.80% Serial Bonds maturing in varying installments through 2036	259,343	-	8,626	250,717
2007 Fiscal Series 3 — 4.17% to 6.42% Serial Bonds maturing in varying installments through 2024	149,330	-	-	149,330
2008 Fiscal Series A — 5.00% term Bonds maturing in 2037 and 2038	446,245	-	-	446,245
2008 Fiscal Series B — Adjustable rate bonds maturing in varying installments through 2025	535,000	-	-	535,000
2008 Fiscal Series C — 3.00% to 5.25% Serial Bonds maturing in varying installments through 2021	108,790	-	9,930	98,860
2008 Fiscal Series AA — 4.50% to 5.00% Serial Bonds maturing in varying installments through 2039	400,000	-	-	400,000
2008 Fiscal Series BB — Adjustable rate bonds maturing in varying installments through 2036	401,000	-	-	401,000
2008 Fiscal Series DD — 4.50% to 5.00% Serial Bonds maturing in varying installments through 2039	504,905	-	-	504,905
2008 Fiscal Series 1 — 3.00% to 5.00% Serial Bonds maturing in varying installments through 2037	237,922	-	13,031	224,891
2008 Fiscal Series 2 — 3.04% to 5.00% Serial Bonds maturing in varying installments through 2037	209,496	-	7,057	202,439
2009 Fiscal Series AA — 3.25% to 5.00% Serial Bonds maturing in varying installments through 2022	334,075	-	-	334,075
2009 Fiscal Series BB — Adjustable rate bonds maturing in varying installments through 2039	200,870	-	-	200,870
2009 Fiscal Series CC — 4.75% to 5.25% Serial Bonds maturing in varying installments through 2034	150,100	-	-	150,100
2009 Fiscal Series A — 5.00% to 5.75% Serial Bonds maturing in varying installments through 2040	536,030	-	-	536,030
2009 Fiscal Series DD — 5.25% to 6.00% Serial Bonds maturing in varying installments through 2040	325,580	-	-	325,580
2009 Fiscal Series EE — 2.50% to 5.50% Serial Bonds maturing in varying installments through 2040	645,455	-	-	645,455
2009 Fiscal Series FF — 3.00% to 5.50% Serial Bonds maturing in varying installments through 2040	362,830	-	-	362,830
2009 Fiscal Series 1 — 3.86% to 5.16% Serial Bonds maturing in varying installments through 2038	363,591	-	8,845	354,746
2009 Fiscal Series 2 — 4.87% Serial Bonds maturing in varying installments through 2038	76,041	-	4,623	71,418
2009 Fiscal Series GG — 4.13% to 5.25% Serial Bonds maturing in varying installments through 2040	500,000	-	-	500,000
2010 Fiscal Series AA — 5.75% to 6.25% Term Bonds maturing in 2041	504,240	-	-	504,240
2010 Fiscal Series BB — 2.50% to 5.00% Serial Bonds maturing in varying installments through 2027	218,820	-	2,795	216,025
2010 Fiscal Series CC — Adjustable rate bonds maturing in 2041	200,000	-	-	200,000
2010 Fiscal Series DD — 5.95% to 6.45% Term Bonds maturing in 2041 and 2042	400,000	-	-	400,000

(Continued)

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 10. LONG-TERM DEBT (CONTINUED)

	Balance at June 30, 2011	Issued	Retired/ defeased	Balance at June 30, 2012
2010 Fiscal Series EE — 6.01% to 6.49% Term Bonds maturing in 2041 and 2042	\$ 500,000	\$ -	\$ -	\$ 500,000
2010 Fiscal Series FF — 3.00% to 5.00% Serial Bonds maturing in varying installments through 2031	359,110	-	-	359,110
2010 Fiscal Series 2 — 0.13% to 5.00% Serial Bonds maturing in varying installments through 2039	131,319	-	9,384	121,935
2010 Fiscal Series 3 — 3.61% Serial Bonds maturing in varying installments through 2039	66,430	-	3,620	62,810
2010 Fiscal Series 4 — 4.98% to 5.81% Serial Bonds maturing in varying installments through 2039	196,460	-	-	196,460
2010 Fiscal Series GG — 5.72% to 6.12% Term Bonds maturing in 2042	554,045	-	-	554,045
2010 Fiscal Series 1 Bond Anticipation Note	52,410	55,657	-	108,067
2011 Fiscal Series AA — 5.44% to 5.79% Term Bonds maturing in 2041 and 2043	750,000	-	-	750,000
2011 Fiscal Series BB — 3.00% to 5.00% Serial Bonds maturing in varying installments through 2031	209,510	-	-	209,510
2011 Fiscal Series CC — 5.88% to 6.28% Term Bonds maturing in 2042 through 2044	750,000	-	-	750,000
2011 Fiscal Series DD — Adjustable rate bonds maturing in 2043	275,000	-	-	275,000
2011 Fiscal Series EE — 5.38% to 5.50% Term Bonds maturing in 2040 through 2043	450,000	-	-	450,000
2011 Fiscal Series FF — Adjustable rate bonds maturing in 2044	200,000	-	-	200,000
2011 Fiscal Series GG — 3.13% to 5.00% Serial Bonds maturing in varying installments through 2043	541,810	-	2,155	539,655
2011 Fiscal Series HH — 4.00% to 5.00% Serial Bonds maturing in 2026 through 2032	662,245	-	-	662,245
2011 Fiscal Series 1 and 2 — 3.58% Serial Bonds maturing in varying installments through 2041	678,762	-	26,377	652,385
2012 Fiscal Series A — Adjustable rate bonds maturing in 2044	-	200,000	-	200,000
2012 Fiscal Series B — Adjustable rate bonds maturing in 2045	-	325,000	-	325,000
2012 Fiscal Series 2 and 3 — 2.00% to 5.00% Serial Bonds maturing in varying installments through 2029	-	669,375	-	669,375
2012 Fiscal Series AA — 5.00% Serial Bonds maturing in varying installments through 2034; 5.00% Term Bond maturing in 2044	-	450,900	-	450,900
2012 Fiscal Series BB — 4.13% to 5.25% Term Bonds maturing in 2039 and 2044	-	450,000	-	450,000
2012 Fiscal Series CC — 5.00% Term Bonds maturing in 2045	-	350,000	-	350,000
2012 Fiscal Series DD — 3.00% to 4.00% Refundable Principal Installment due in 2018; 5.00% Refundable Principal Installment due in 2027	-	50,000	-	50,000
2012 Fiscal Series EE — 3.00% to 5.25% Serial Bonds maturing in varying installments through 2039; 4.00% Term Bond maturing in 2045	-	522,505	-	522,505
2012 Fiscal Series FF — 3.25% to 5.00% Serial Bonds maturing in varying installments between 2020 and 2033; 3.75% to 5.00% Term Bond maturing in 2034 and 2045	-	611,745	-	611,745
2012 Fiscal Series GG — 5.00% Refundable Principal Installments maturing in 2017 and 2019	-	50,000	-	50,000
	<u>26,508,869</u>	<u>\$3,735,182</u>	<u>\$2,265,772</u>	<u>27,978,279</u>
Current portion of bonds and notes payable	<u>430,452</u>			<u>451,409</u>
Bonds and notes payable, less current portion	<u>\$26,078,417</u>			<u>\$27,526,870</u>

(Concluded)

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

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### 11. RESTRICTED ASSETS

As of June 30, 2012 and 2011, certain cash, investments, and accrued interest of the System are restricted as follows (in thousands):

	2012	2011
The Board:		
Operation and maintenance reserve account	\$ 212,836	\$ 199,626
Operation and maintenance reserve fund	<u>49</u>	<u>10</u>
Subtotal — Board	<u>212,885</u>	<u>199,636</u>
The Authority:		
Revenue fund	492,391	363,608
Debt service reserve fund	887,262	865,727
Debt service fund	-	5,517
Construction fund	<u>170,534</u>	<u>151,024</u>
Subtotal — Authority	<u>1,550,187</u>	<u>1,385,876</u>
Total restricted assets	<u>\$1,763,072</u>	<u>\$1,585,512</u>

The operation and maintenance reserve account is established as a depository to hold the operations and maintenance reserve fund as required by the Resolution. It is required to hold one-sixth of the operating expenses as set forth in the annual budget. It is funded through the cash receipts of the Board. The operation and maintenance reserve general account is established as a depository to hold all excess funds of the Board after all legally mandated transfers have been made. It is available to meet any deficiencies in the flow of funds including debt service and alternatively can be used as a financing source for capital expenditures.

The revenue fund is established as a depository to fund the debt service, Authority expenses, debt service reserve and escrow funds. It is funded through cash transfers from the Board. The debt service reserve fund is established as a depository to hold the First Resolution Bond maximum annual debt service requirement for the next current or any future fiscal year. It is funded through revenue bond proceeds and the revenue fund.

The debt service fund is established as a depository to pay all principal and interest payments on the Authority's debt for the current fiscal year. It is funded through the revenue fund. The construction fund is established as a depository to pay all capital construction costs incurred by The City and reimbursed by the Authority. It is funded through the proceeds of commercial paper, bond and note sales. The escrow fund is established as a depository to refund debt in future years. It is funded through bond proceeds.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

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### 12. COMMITMENTS AND CONTINGENCIES

- a. **Construction** — The System has contractual commitments of approximately \$4.7 billion and \$7.5 billion at June 30, 2012 and 2011, respectively, for water and sewer projects.
- b. **Risk Financing Activities** — The System is self-insured and carries no commercial or insurance policies other than Directors and Officers insurance for the Authority. Any claims made against the System are resolved through The City's legal support, and the amounts of the maximum liability for such judgments are described in (c) below. The System is subject to claims for construction delays, property damage, personal injury and judgments related to delays in construction deadlines under consent agreements.
- c. **Claims and Litigation** — In accordance with the Lease, the Board is required to reimburse The City for any judgment or settlement paid by The City arising out of a tort claim to the extent that The City's liability is related to capital improvements and the operation or maintenance of the System. However, in no event shall the payment made to The City, in any fiscal year, exceed an amount equal to 5% of the aggregate revenues shown on the prior year's audited financial statements of the System. In addition, the System is required to reimburse The City, to the extent requested by The City, for the payment of any judgment or settlement arising out of a contract claim with respect to the construction of capital improvements of the System. In addition, The City has agreed, subject to certain conditions, to indemnify the Authority, the Board and their staffs against any and all liability in connection with any act done or omitted in the exercise of their powers, which is taken or omitted in good faith in pursuance of their purposes under the Act. Currently, The City is a defendant in a significant number of lawsuits pertaining to the System. The litigation includes, but is not limited to, actions commenced and claims asserted against The City arising out of alleged torts, alleged breaches of contract, condemnation proceedings and other alleged violations of law. As of June 30, 2012, the potential future liability attributable to the System for claims outstanding against The City was estimated to be \$168.6 million. This amount is included in the estimated liability for unsettled claims, which is reported in The City's balance sheet. The potential future liability is The City's best estimate based on available information. The estimate may be revised as further information is obtained and as pending cases are litigated.
- d. **Arbitrage Rebate** — To maintain the exemption from Federal income tax of interest on bonds issued subsequent to January 1, 1986, the System will fund amounts required to be rebated to the Federal Government pursuant to Section 148 of the Internal Revenue Code of 1986, as amended (the "Code"). The Code requires the payment to the United States Treasury of the excess of the amount earned on all non-purpose obligations over the amount that would have been earned if the gross proceeds of the issue were invested at a rate equal to the yield on the issue, together with any earnings attributable to such excess. Construction funds, debt service funds or any other funds or accounts funded with proceeds of such bonds, including earnings, or pledged to or expected to be used to pay interest on such bonds are subject to this requirement. Payment is to be made after the end of the fifth bond year and after every fifth bond year thereafter, and within 60 days after retirement of the bonds. During fiscal 2012 and 2011, the System paid \$3.5 million and \$2.1 million, respectively, in rebates. At June 30, 2012 and 2011, the Authority had a liability of \$2.1 million and \$7.9 million, respectively. These amounts are included in accrued payable expense in the balance sheets.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

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### 13. PENSION PLANS

During fiscal 2012 and 2011, the Authority was billed and contributed \$157.3 thousand and \$112.9 thousand, respectively, for 11 employees who participate in the defined benefit pension plan. All other personnel are employees of The City and are covered under The City's pension plan. The System pays the costs of The City employees' pension through an allocation of fringe benefit costs, which is included principally within operations and maintenance expenses in the accompanying financial statements.

The following table shows the amount the Authority was billed and contributed (in thousands):

Date	Required Contribution	Actual Contribution	%
June 30, 2012	\$ 157	\$ 157	100 %
June 30, 2011	113	113	100
June 30, 2010	112	112	100

### 14. OTHER POST-EMPLOYMENT BENEFITS

**Plan Description** — The Authority's policy is to provide certain health and related benefits to eligible retirees of the Authority, which constitutes an other postemployment benefit ("OPEB") plan (the "Plan") in accordance with GASB Statement No. 45, ("GASB 45") *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

The Authority's policy is to follow the eligibility criteria applicable to retirees of The City and to provide benefits substantially the same as those provided to City retirees and eligible beneficiaries/dependents. OPEB benefits include health insurance, Medicare Part B premium reimbursements and employee welfare fund contributions.

**Funding Policy** — The Authority is not required to provide funding for OPEB, other than the pay-as-you-go amount necessary to provide current benefits to retirees and eligible beneficiaries/dependents. For the years ended June 30, 2012 and 2011, the Authority had three retirees and made contributions of \$8.7 thousand and \$5.7 thousand respectively. Members are not required to contribute; although, retirees may elect basic health insurance programs and/or optional coverage that require contributions.

**Annual OPEB Cost and Net OPEB Obligation** — The Authority's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer ("ARC"), an amount that was actuarially determined in accordance with the parameters of GASB 45. The frozen entry age cost method was used in the actuarial valuation prepared as of June 30, 2011, which was the basis for the fiscal 2012 ARC calculation.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 14. OTHER POST-EMPLOYMENT BENEFITS (CONTINUED)

The following table shows the elements of the Authority's annual OPEB cost, the amounts actually contributed, and changes in the Authority's net OPEB obligation for the fiscal years ended June 30, 2012 and 2011 (in thousands):

	2012	2011
Annual required contribution	\$ 799	\$ 705
Interest on net OPEB obligations	28	21
Adjustment to annual required contribution	<u>(727)</u>	<u>(555)</u>
Annual OPEB cost	100	171
Payments	(9)	(6)
Net OPEB obligation — beginning of year	<u>699</u>	<u>534</u>
Net OPEB obligation — end of year	<u>\$ 790</u>	<u>\$ 699</u>

The Authority's annual OPEB cost, the percentage of annual OPEB cost contributed, and the net OPEB obligation for the fiscal years ended June 30, 2010 through 2012 were as follows (in thousands):

	Annual OPEB Cost	Percentage of Annual OPEB Cost contributed	Net OPEB Obligation
June 30, 2012	\$ 100	8.8 %	\$ 790
June 30, 2011	171	3.3	699
June 30, 2010	143	3.1	534

**Funded Status and Funding Progress** — As of June 30, 2011, the most recent actuarial valuation date, the cost was 0% funded. The actuarial accrued liability for benefits was \$662.4 thousand, and the actuarial value of assets was \$0, resulting in an unfunded actuarial accrued liability ("UAAL") of \$662.4 thousand. The covered payroll (annual payroll of active employees covered by the Plan) was \$918.6 thousand, and the ratio of the UAAL to the covered payroll was 72.0%

**Actuarial Methods and Assumptions** — Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future, such as assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the Plan and the annual required contributions of the Authority are subject to continual revision 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 types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and employees to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

### 14. OTHER POST-EMPLOYMENT BENEFITS (CONTINUED)

The System's funding progress information as of June 30, 2012 is as follows:

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Liability (AAL) — Entry Age	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
June 30, 2011	\$ -	\$662	\$ 662	- %	\$919	72.0 %

The schedule of funding progress, presented as required supplementary information following the notes to the combined financial statements, presents multiyear trend information about whether the actuarial value of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

### 15. POLLUTION REMEDIATION OBLIGATIONS

The System reports pollution remediation obligations ("PROs") as required by GASB standards. The System's PROs may arise as a result of: (1) federal, state and local laws and regulations, (2) violations of pollution-related permits or licenses, (3) because the System has determined that there is an imminent endangerment to public health and safety as a result of an existing pollution condition, (4) because the System has been named in a lawsuit to compel remediation or has been identified by a regulator as a party responsible or potentially responsible for remediation and/or (5) because the System has voluntarily commenced remediation. As of June 30, 2012 and 2011, the System reported \$108.3 million and \$102.6 million of liabilities for known PROs, respectively.

The System has estimated these amounts based on the current value of outlays expected to be incurred for pollution remediation which it is currently obligated to perform. Actual future outlays will differ from the estimated amounts if the prices or techniques for remediation measures change or differ from estimates, if and when additional information about existing pollution conditions becomes known to the System in the future and/or if applicable laws or regulations change.

Remediation outlays for certain pollution conditions currently known to the System are not included in the reported liabilities because they are not yet reasonably estimable. These include certain locations that the System has been informed may be designated, under federal law, as Superfund sites, to address hazardous substances, pollutants, or contaminants at these sites and for which the System may be named as a potentially responsible party for the remediation because there are System facilities operated at these locations.

### 16. RELATED PARTY TRANSACTIONS

During fiscal 2012 and 2011 the Authority bought \$0 million and \$6.3 million, respectively of New York City Transitional Finance Authority ("TFA") bonds. The Authority held no TFA bonds at June 30, 2012 and 2011.

# NEW YORK CITY WATER AND SEWER SYSTEM

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)

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### 17. SUBSEQUENT EVENTS

On July 12, 2012 the Authority issued Fiscal 2013 Series 1 Bonds to EFC in the amount of \$316.79 million to refund principal of \$48.6 million and \$323.2 million of Fiscal 2002 Series 6 and Fiscal 2003 Series 2 bonds respectively, and to pay the costs of issuance of the bonds.

On July 17, 2012 the Authority issued \$200 million of commercial paper notes, Series 1, to pay for construction costs of the System.

On August 22 2012 the Authority issued \$200 million of commercial paper notes, Series 8, to pay for construction costs of the System.

On August 19, 2012 the Authority drew down \$5.4 million of Fiscal 2010 Series 1 BANS.

On September 27, 2012 the Authority issued Fiscal 2013 Series 2 Bond Anticipation Notes (BANs) to EFC in the amount of \$217 million. The Authority has not drawn on this BAN.

On October 4, 2012 the Authority issued Fiscal 2013 Series AA new money tax-exempt adjustable rate bonds in the amount of \$200 million to refund its commercial paper notes series 6.

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**REQUIRED SUPPLEMENTARY INFORMATION**

# NEW YORK CITY WATER AND SEWER SYSTEM

## REQUIRED SUPPLEMENTARY INFORMATION SCHEDULE OF FUNDING PROGRESS FOR THE OTHER POSTEMPLOYMENT BENEFIT PLAN (UNAUDITED)

JUNE 30, 2012 AND 2011

(In thousands)

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Year Ended	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Liability (AAL) Entry Age	Unfunded ALL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
June 30, 2012	June 30, 2011	\$ -	\$ 662	\$ 662	- %	\$ 919	72.0 %
June 30, 2011	June 30, 2010	-	563	563	-	1,026	54.8
June 30, 2010	June 30, 2009	-	431	431	-	676	63.7