

**CITY OF YORK SEWER AUTHORITY
(A Component Unit of the City of York, Pennsylvania)**

ANNUAL FINANCIAL REPORT

Years Ended December 31, 2016 and 2015



Certified Public Accountants and Business Consultants

CITY OF YORK SEWER AUTHORITY

(A Component Unit of the City of York, Pennsylvania)

YEARS ENDED DECEMBER 31, 2016 AND 2015

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Independent Auditors' Report

To the Members of the Board
City of York Sewer Authority
York, Pennsylvania

We have audited the accompanying financial statements of the City of York Sewer Authority (a component unit of the City of York, Pennsylvania), which comprise the statements of net position as of December 31, 2016 and 2015, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

To the Members of the Board
City of York Sewer Authority
York, Pennsylvania

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of York Sewer Authority as of December 31, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America (GAAP).

Emphasis of Matter

For the year ended December 31, 2016, the City of York Sewer Authority adopted new accounting guidance, implementing Governmental Accounting Standards Board Statements No. 72, *Fair Value Measurement and Application*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Maillie LLP

Oaks, Pennsylvania
November 20, 2017

CITY OF YORK SEWER AUTHORITY

(A Component Unit of the City of York, Pennsylvania)

STATEMENTS OF NET POSITION

DECEMBER 31, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
Assets		
Cash and cash equivalents	\$ 31,139	\$ 28,240
Restricted assets:		
Cash and cash equivalents	10,616,208	4,853,192
Investments	-	5,929,255
	<u>10,616,208</u>	<u>10,782,447</u>
Net investment in direct financing lease	<u>43,694,127</u>	<u>47,363,749</u>
Total Assets	<u>54,341,474</u>	<u>58,174,436</u>
Liabilities		
Accounts payable	12,200	14,125
Liabilities payable from restricted assets:		
Funds held on behalf of the City of York	6,521,720	6,520,699
Bonds payable:		
Due within one year	3,611,313	4,139,808
Due in more than one year	<u>40,082,814</u>	<u>43,459,090</u>
Total Liabilities	<u>50,228,047</u>	<u>54,133,722</u>
Net Position		
Restricted for:		
Debt service	1,701	435,810
Construction	4,092,788	3,825,938
Unrestricted	<u>18,938</u>	<u>(221,034)</u>
Total Net Position	<u>\$ 4,113,427</u>	<u>\$ 4,040,714</u>

See accompanying notes to basic financial statements.

CITY OF YORK SEWER AUTHORITY

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STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

YEARS ENDED DECEMBER 31, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
Operating Revenues:		
Lease investment income	\$ 2,065,646	\$ 2,302,642
Total operating revenues	<u>2,065,646</u>	<u>2,302,642</u>
Operating Expenses:		
Interest expense	1,929,158	2,175,897
Professional services	7,534	27,010
Miscellaneous expense	21,068	24,916
Total operating expenses	<u>1,957,760</u>	<u>2,227,823</u>
Operating Income	<u>107,886</u>	<u>74,819</u>
Non-Operating Revenues (Expenses):		
Investment income	13,717	1,609
Miscellaneous income	20,448	87,015
Transfers to City of York	(69,338)	(16,090)
Total non-operating revenues (expenses)	<u>(35,173)</u>	<u>72,534</u>
Change in Net Position	72,713	147,353
Net Position:		
Beginning of year	<u>4,040,714</u>	<u>3,893,361</u>
End of year	<u>\$ 4,113,427</u>	<u>\$ 4,040,714</u>

See accompanying notes to basic financial statements.

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STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Cash Flows From Operating Activities:		
Cash paid for administrative expenses	\$ (30,527)	\$ (49,790)
Net cash used in operating activities	(30,527)	(49,790)
Cash Flows From Investing Activities:		
Sales (purchases) of investment securities	5,929,255	(5,061,976)
Cash received from others	20,448	87,015
Interest received	13,717	1,609
Net cash provided by (used in) investing activities	5,963,420	(4,973,352)
Cash Flows From Capital and Related Financing Activities:		
Transfers to City of York	(69,338)	(16,090)
Payments received on investment in direct financing lease	5,666,951	5,728,346
Transfers from restricted investment accounts	69,338	16,090
Capital assets purchased	-	(4,854)
Principal paid on revenue bonds	(4,139,930)	(4,138,318)
Interest paid on revenue bonds	(1,693,999)	(1,699,514)
Net cash used in capital and related financing activities	(166,978)	(114,340)
Net Increase (Decrease) in Cash and Cash Equivalents	5,765,915	(5,137,482)
Cash and Cash Equivalents:		
Beginning of year	4,881,432	10,018,914
End of year	\$ 10,647,347	\$ 4,881,432
Reconciliation of Operating Income to Net Cash Used in Operating Activities:		
Operating income	\$ 107,886	\$ 74,819
Adjustments to reconcile operating income to net cash used in operating activities:		
Interest expense	1,929,158	2,175,897
Lease investment income	(2,065,646)	(2,302,642)
Changes in assets and liabilities:		
Accounts payable	(1,925)	2,136
Total adjustments	(138,413)	(124,609)
Net cash used in operating activities	\$ (30,527)	\$ (49,790)
Non-Cash Capital and Related Financing Activities:		
Principal accretion of revenue bonds	\$ 235,159	\$ 476,383

See accompanying notes to basic financial statements.

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NOTES TO BASIC FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Purpose

The City of York Sewer Authority (Authority) was incorporated November 27, 1950, under the provisions of the Municipality Authorities Act of 1945, as amended (Act), for all the purposes authorized by the Act and shall have and exercise all powers granted to such Authorities under the Act. Through December 31, 2016, its operations have been primarily to acquire, construct, improve, and lease sewer systems and sewage treatment works.

Reporting Entity

The Authority is a component unit of the City of York (City) reporting entity. Criteria considered in making this determination include appointment of the Authority's Board, financial interdependence, and the Authority's potential to provide specific financial benefits to, or impose specific financial burdens on, the City.

The Authority's financial statements are blended with the City's sewer fund and accounted for within the sewer fund, an Enterprise Fund in the City's basic financial statements.

Basis of Accounting and Presentation

The accounting records of the Authority are maintained on the accrual basis and its operations are accounted for as an enterprise fund. Enterprise funds are used to account for activities similar to those found in the private sector where the determination of net income is necessary for sound financial administration. Costs of construction, debt reduction, and Authority administration are financed or recovered through lease rentals received from the City and income on investments held by the Authority.

Enterprise funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with an enterprise fund's principal ongoing operations. The principal operating revenue of the Authority is lease rental income. Operating expenses include the interest expense of the debt and administrative expenses. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

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YEARS ENDED DECEMBER 31, 2016 AND 2015

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The transactions of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the statements of net position. Net position (i.e., total assets net of total liabilities) is segregated into “restricted for debt service and construction,” and “unrestricted” components.

Cash and Cash Equivalents

For the purpose of the statements of cash flows, the Authority considers all highly liquid instruments with original maturities of three months or less to be cash equivalents.

Investments

In accordance with the terms of the trust indentures securing the bonded debt, monies of the Authority are accounted for in various funds, segregated for specific use and for the security of the bondholders and, except for the operating account which is directly maintained by the Authority, are maintained by an independent trustee.

Investments are recorded at fair value. The Authority categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets. Level 2 inputs are significant other observable inputs. Level 3 inputs are significant unobservable inputs.

Restricted Assets

Certain proceeds of revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statements of net position because their use is limited by applicable trust indentures or other agreements.

Funds Held on Behalf of the City

In accordance with the Lease, as referred to in Note 4, the City shall receive credits against minimum annual rentals for (1) net income of the Authority from its real property rentals, not part of the Sewer System, (2) excess funds from the debt service reserve funds, and (3) income from debt service funds, clearing funds, and sinking funds. The balance of unapplied credits as well as the balance of the debt service reserve fund comprise the liability due to the City as of December 31, 2016 and 2015.

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NOTES TO BASIC FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Net Position

Net position comprises the various net earnings from operating and non-operating revenues and expenses. Net position is classified in the following two components: restricted for debt service and construction; and unrestricted net position. Restricted for debt service and construction consists of net position for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations, and enabling legislation, including self-imposed legal mandates, less any related liabilities. Unrestricted consists of all other net position not included in the above categories.

Restricted Resources

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

Transfers to City of York

Transfers to the City of York represent capital expenditures incurred by the Authority for the year to improve the City-owned sewer infrastructure.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts and disclosures. Actual results could differ from those estimates.

Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Authority purchases commercial insurance for all risks of loss. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

2. DEPOSITS AND INVESTMENTS

The Act provides for investment of public funds in certain authorized investment types including U.S. Treasury bills, other short-term U.S. government obligations, short-term commercial paper issued by a public corporation, banker's acceptances, and insured or

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collateralized time deposits and certificates of deposit. The Act also allows pooling of governmental funds for investment purposes.

The deposit and investment policy of the Authority adheres to state statutes, prudent business practices, and the applicable trust indentures. The Authority deposits cash in local financial institutions.

Deposits

Custodial Credit Risk - Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of December 31, 2016, the Authority's deposit balance was as follows:

Cash and cash equivalents per financial statements:	
Unrestricted	\$ 31,139
Restricted	10,616,208
	<u>10,647,347</u>
Less money market funds	<u>(10,616,208)</u>
Total deposits	<u>\$ 31,139</u>

The full balance of \$31,139 was covered by federal depository insurance as of December 31, 2016 and is presented as cash and cash equivalents on the statement of net position. The remaining balance of \$10,616,208 was invested in money market funds as of December 31, 2016 and is presented as restricted cash and cash equivalents on the statement of net position. These money market funds are described in further detail below.

Investments

The Authority's investment in money market funds, totaling \$10,616,208, is considered Level 1 based on quoted market prices at December 31, 2016.

Custodial credit risk – Custodial credit risk is the risk that the counterparty to an investment transaction will fail and the government will not recover the value of the investment or collateral securities that are in possession of an outside party. The Authority does not have an investment policy for custodial credit risk. The Authority's investments are not exposed to custodial credit risk because they are not evidenced by securities in book entry or paper form.

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Concentration of credit risk – The Authority places no limit on the amount the Authority may invest in any one issuer.

Credit risk – The Authority does not have a formal policy that would limit its investment choices with regard to credit risk. At December 31, 2016, the money market funds were rated AAAM by Standard & Poor's.

Interest rate risk – The Authority does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. At December 31, 2016, the Authority's money market funds had a weighted average maturity of less than one year.

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3. BONDS PAYABLE

The Authority has issued revenue bonds to finance various projects and refundings. A schedule of the Authority's bonds follows:

	Issue Amount	Maturity	Interest Rate	Purpose
Guaranteed Sewer Revenue Bonds - Series of 1990	\$69,775,000	2016	0%	Refund a portion of the revenue bonds, Series of 1987. Upgrade Sewage Treatment System.
Guaranteed Sewer Revenue Bonds - Series of 2008	\$10,000,000	2022	3.2-3.25%	To: 1) finance capitalized interest; 2) fund a deposit to the debt service reserve fund; 3) plan, design, and construction of additions, improvements, renovations, and extraordinary repairs to the various buildings and facilities of the Authority; 4) pay the costs and expenses related to the issuance of Bonds.
Guaranteed Sewer Revenue Bonds - Series of 2010	\$22,745,000	2027	4.5-5.00%	To: 1) finance projects of the Authority; 2) fund a deposit to the debt service reserve fund; 3) capitalize interest on the Bonds through December 1, 2010; 4) pay the costs and expenses related to the issuance of the Bonds.
Guaranteed Sewer Revenue Bonds - Series A of 2010	\$10,540,000	2019	2.5-4.00%	To: 1) currently refund the Guaranteed Sewer Revenue Bonds, Series of 2007; 2) fund a debt service reserve fund; 3) pay the costs and expenses related to the issuance of the Bonds.
Guaranteed Sewer Revenue Bonds - Series of 2011	\$1,500,000	2021	1.00%	For utilization, development, and construction of alternative and lean energy projects.

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Long-term liability activity for the year ended December 31, 2016 was as follows:

	Beginning of Year	Additions	Retirements	Accretion	End of Year	Current Portion
Revenue Bonds	\$ 47,598,898	\$ -	\$ (4,139,930)	\$ 235,159	\$ 43,694,127	\$ 3,611,313

Long-term liability activity for the year ended December 31, 2015 was as follows:

	Beginning of Year	Additions	Retirements	Accretion	End of Year	Current Portion
Revenue Bonds	\$ 51,260,833	\$ -	\$ (4,138,318)	\$ 476,383	\$ 47,598,898	\$ 4,139,808

The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series of 2008 at December 31, 2016:

Years Ending December 31,	Principal	Interest	Total
2017	\$ -	\$ 320,000	\$ 320,000
2018	-	320,000	320,000
2019	445,000	320,000	765,000
2020	3,775,000	305,680	4,080,680
2021	3,925,000	184,960	4,109,960
2022	1,855,000	60,288	1,915,288
	<u>\$ 10,000,000</u>	<u>\$ 1,510,928</u>	<u>\$ 11,510,928</u>

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The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series of 2010 at December 31, 2016:

<u>Years Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ -	\$ 1,065,119	\$ 1,065,119
2018	-	1,065,119	1,065,119
2019	-	1,065,119	1,065,119
2020	-	1,065,118	1,065,118
2021	-	1,065,118	1,065,118
2022-2026	20,555,000	3,632,794	24,187,794
2027	2,190,000	104,025	2,294,025
	<u>\$ 22,745,000</u>	<u>\$ 9,062,412</u>	<u>\$ 31,807,412</u>

The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series A of 2010 at December 31, 2016:

<u>Years Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 3,460,000	\$ 297,275	\$ 3,757,275
2018	3,555,000	205,775	3,760,775
2019	3,215,000	96,450	3,311,450
	<u>\$ 10,230,000</u>	<u>\$ 599,500</u>	<u>\$ 10,829,500</u>

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The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series of 2011 at December 31, 2016:

Years Ending December 31,	Principal	Interest	Total
2017	\$ 151,313	\$ 6,500	\$ 157,813
2018	152,833	4,980	157,813
2019	154,368	3,445	157,813
2020	155,919	1,894	157,813
2021	104,694	393	105,087
	<u>\$ 719,127</u>	<u>\$ 17,212</u>	<u>\$ 736,339</u>

4. LEASES AND RELATED PARTY TRANSACTIONS

In 1987, the Authority entered into a 30-year direct financing lease with the City for the sewer system. The sewer system and related assets are, therefore, not reflected in the accompanying financial statements. Under this lease, the City is required to pay the Authority semiannual installments on May 15 and November 15 of each year, an amount equal to one hundred five percent (105%) of the principal, interest, and all other amounts due under the 1987 Bond Indenture. The installment payments may be reduced in certain instances.

In July 2008, the Authority issued Guaranteed Sewer Revenue Bonds, Series of 2008 (Series of 2008 Bonds), in the principal amount of \$10,000,000. The Series of 2008 Bonds initially bore interest at an annual rate of 4.04%, with semi-annual payments of interest commencing on December 1, 2008. Annual payments of principal were to commence on June 1, 2019, with a final payment on December 1, 2022. In March 2011, the Authority approved a modification agreement for the Series of 2008 Bonds, which changed the interest rate to 3.75% and extended the final payment to December 1, 2025. In September 2014, the Authority approved a second modification agreement for the Series of 2008 Bonds, which changed the interest rate to 3.20% to 3.25% and shortened the final payment to December 1, 2022. The purpose of the Series of 2008 Bonds is described in Note 3. Under this lease, the City is required to pay the Authority an amount equal to one hundred five percent (105%) of the principal, interest, and all other amounts due under the Fourth Supplemental Lease of the 1987 Bond Indenture. The City has pledged its full faith, credit, and taxing power to guarantee the debt service payments related to both principal and interest due on the Series of 2008 Bonds.

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In April 2010, the Authority issued Guaranteed Sewer Revenue Bonds, Series of 2010 (Series of 2010 Bonds), in the principal amount of \$22,745,000. Semi-annual payments of interest commenced on December 1, 2010. Annual payments of principal are to commence on December 1, 2022, with a final payment on December 1, 2027. The purpose of the Series of 2010 Bonds is described in Note 3. Under this lease, the City is required to pay the Authority an amount equal to one hundred five percent (105%) of the principal, interest, and all other amounts due under the Fifth Supplemental Lease of the 1987 Bond Indenture. The City has pledged its full faith, credit, and taxing power to guarantee the debt service payments related to both principal and interest due on the Series of 2010 Bonds.

In August 2010, the Authority issued Guaranteed Sewer Revenue Bonds, Series A of 2010 (Series A of 2010 Bonds), in the principal amount of \$10,540,000. Semi-annual payments of interest commenced on December 1, 2010. Annual payments of principal commenced on December 1, 2014, with a final payment on December 1, 2019. The purpose of the Series A of 2010 Bonds is described in Note 3. Under this lease, the City is required to pay the Authority an amount equal to one hundred five percent (105%) of the principal, interest, and all other amounts due under the Sixth Supplemental Lease of the 1987 Bond Indenture. The City has pledged its full faith, credit, and taxing power to guarantee the debt service payments related to both principal and interest due on the Series A of 2010 Bonds.

In March 2011, the Authority issued Guaranteed Sewer Revenue Bonds, Series of 2011 (Series of 2011 Bonds), in the principal amount of \$1,500,000. Monthly payments of principal and interest commenced on September 1, 2011, with a final payment on August 1, 2021. The purpose of the Series of 2011 Bonds is described in Note 3. Under this lease, the City is required to pay the Authority an amount equal to one hundred five percent (105%) of the principal, interest, and all other amounts due under the Seventh Supplemental Lease of the 1987 Bond Indenture. The City has pledged its full faith, credit, and taxing power to guarantee the debt service payments related to both principal and interest due on the Series of 2011 Bonds.

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The following is a schedule of future minimum lease payments under the lease agreements and all supplements as of December 31, 2016:

<u>Years Ending December 31,</u>	<u>Amount</u>
2017	\$ 5,565,217
2018	5,568,892
2019	5,564,351
2020	5,568,793
2021	5,544,303
2022-2026	27,408,237
2027	<u>2,408,726</u>
Total minimum lease receivable	57,628,519
Less unearned interest	<u>(13,934,392)</u>
Net investment in direct financing lease receivable	<u>\$ 43,694,127</u>

5. ECONOMIC DEFEASANCE OF GUARANTEED SEWER REVENUE BONDS AND LEASE RESTRUCTURING

On July 15, 1998, the Authority entered into an escrow deposit agreement for partial defeasance of the 1990 York City Sewer Authority Bonds (1990 Bonds). \$5,000,000 was deposited into this escrow from grant money received for reimbursement of capital improvements made by the Authority. This transaction is not considered a legal defeasance. Therefore, the bonds and restricted investments are recorded in the financial statements. The 1990 Bonds matured in 2016 and were paid in full.

6. COMMITMENTS AND CONTINGENCIES

Under the terms of federal and state grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to reimbursement to the grantor agencies. Authority management believes disallowances, if any, will be immaterial.

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7. SUBSEQUENT EVENTS

On February 10, 2017, the Authority entered into a Modification Agreement for the Series of 2008 Bonds, reducing the annual fixed rate to 2.94%. Also in accordance with the Modification Agreement, the Series of 2008 Bonds are subject to a prepayment fee of 2% of the principal sum being prepaid or redeemed during the period of February 10, 2017 through December 31, 2018 and 1% of the principal sum being prepaid or redeemed during the period of December 2, 2018 through December 1, 2021. Thereafter, outstanding principal is subject to prepayment without penalty.

In April 2017, the Authority approved a contract for the wastewater treatment plant electrical substation #3 replacement project totaling \$1,227,203.