

City of Lancaster Sewer Fund

Financial Statements and Required
Supplementary Information

Years Ended December 31, 2016 and 2015
with Independent Auditor's Report

MaherDuessel

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CITY OF LANCASTER SEWER FUND

YEARS ENDED DECEMBER 31, 2016 AND 2015

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Independent Auditor's Report

To the Honorable J. Richard Gray, Mayor
and Members of City Council
City of Lancaster, Pennsylvania

We have audited the accompanying financial statements of the Sewer Fund of the City of Lancaster as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

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.

Accounting principles generally accepted in the United States of America require that the historical pension and other post-employment benefit (OPEB) information on pages 32 through 35 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Sewer Fund's basic financial statements. The Schedules of Net Cost of Operations of the City Sewer System, Direct Expenses and Costs, and Cost of Treating Each 1,000 Gallons of Sewage are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The Schedule of Net Cost of Operations of the City Sewer System and Schedule of Direct Expenses and Costs are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Net Cost of Operations of the City Sewer System and Schedule of Direct Expenses and Costs are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The Schedule of Cost of Treating Each 1,000 Gallons of Sewage has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Sewer Fund and do not purport to, and do not, present fairly the financial position of the City of Lancaster, as of December 31, 2016 and 2015, the changes in its financial position, or, where applicable, its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Maher Duessel

Harrisburg, Pennsylvania
July 12, 2017

CITY OF LANCASTER SEWER FUND

BALANCE SHEETS

DECEMBER 31, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
Assets and Deferred Outflows of Resources		
Assets:		
Current assets:		
Cash and cash equivalents	\$ 300	\$ 300
Cash and cash equivalents - restricted	27,076,614	26,068,653
Receivables:		
Regular	1,272,172	873,743
Bulk - net of allowance for uncollectible accounts of \$4,116,162 and \$4,170,161 in 2016 and 2015, respectively	3,743,506	3,110,259
Unbilled	996,872	776,682
Industrial waste surcharge	68,610	106,476
Prepaid expenses	17,891	4,480
Total current assets	<u>33,175,965</u>	<u>30,940,593</u>
Long-term assets:		
Due from other governments	138,906	136,878
Prepaid debt insurance	435,651	498,894
Capital assets, not being depreciated	18,797,193	12,522,842
Capital assets, being depreciated, net	86,645,807	87,467,470
Total long-term assets	<u>106,017,557</u>	<u>100,626,084</u>
Total Assets	<u>139,193,522</u>	<u>131,566,677</u>
Deferred Outflows of Resources:		
Deferred charge on refunding	853,840	689,118
Deferred outflows of resources for pension	74,079	81,635
Total Deferred Outflows of Resources	<u>927,919</u>	<u>770,753</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 140,121,441</u>	<u>\$ 132,337,430</u>

(Continued)

	2016	2015
Liabilities, Deferred Inflows of Resources, and Net Position		
Liabilities:		
Current liabilities:		
Accounts payable	\$ 3,222,180	\$ 3,890,387
Accrued expenses	377,009	378,307
Due to City of Lancaster General Fund	5,502,566	4,162,394
Due to other governments	9,374,906	5,357,946
Unearned revenue	185,000	185,000
Compensated absences, current portion	21,327	16,373
Capital lease, current portion	232,458	197,245
Notes payable, current portion	618,192	410,000
Bonds payable, current portion	1,415,000	1,595,000
Total current liabilities	<u>20,948,638</u>	<u>16,192,652</u>
Long-term liabilities:		
Compensated absences, net of current portion	71,358	54,781
Workers' compensation payable	1,276	-
Net pension liability	690,742	673,621
Net other post-employment liability	4,160,472	3,811,392
Capital lease, net of current portion	123,796	247,847
Notes payable, net of current portion	12,646,066	10,764,611
Bonds payable, net of current portion	35,625,311	36,783,041
Total long-term liabilities	<u>53,319,021</u>	<u>52,335,293</u>
Total Liabilities	<u>74,267,659</u>	<u>68,527,945</u>
Deferred Inflows of Resources:		
Deferred inflows of resources for pension	23,948	26,141
Total Deferred Inflows of Resources	<u>23,948</u>	<u>26,141</u>
Net Position:		
Net investment in capital assets	64,647,725	68,077,378
Restricted for capital acquisition	8,586,696	3,008,650
Unrestricted	(7,404,587)	(7,302,684)
Total Net Position	<u>65,829,834</u>	<u>63,783,344</u>
Total Liabilities, Deferred Inflows of Resources, and Net Position	<u>\$ 140,121,441</u>	<u>\$ 132,337,430</u>

(Concluded)

The accompanying notes are an integral part of these financial statements.

CITY OF LANCASTER SEWER FUND
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES
IN FUND NET POSITION

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Operating Revenues:		
Sewage treatment revenue:		
Sewage treatment	\$ 8,822,430	\$ 8,187,832
Industrial waste surcharge	372,230	452,828
Bulk treatment	4,348,215	3,898,553
Maintenance fee income	177,290	169,443
Miscellaneous	72,292	92,406
Total operating revenues	13,792,457	12,801,062
Operating Expenses:		
Administration	3,725,911	3,844,851
Depreciation	3,153,135	3,082,197
Collection system	1,346,437	997,536
Sewage pumping station	1,208,807	1,118,761
Sewage treatment plants	4,413,497	4,439,130
Sewer grounds maintenance	45,041	35,887
Total operating expenses	13,892,828	13,518,362
Operating Loss	(100,371)	(717,300)
Non-Operating Revenue (Expenses):		
State pension contribution	137,844	141,570
Investment income	20,280	20,460
Insurance proceeds	91,748	-
Amortization expense	(47,689)	(53,994)
Bad debt expense	-	(254,923)
Interest expense	(1,995,237)	(2,065,653)
Loss on disposal of capital assets	(1,896)	(4,152)
Total non-operating revenue (expenses)	(1,794,950)	(2,216,692)
Loss before transfers and capital contributions	(1,895,321)	(2,933,992)
Transfers out	-	(3,605)
Capital contributions	3,491,811	2,397,321
Change in Net Position before Extraordinary Item	1,596,490	(540,276)
Extraordinary Item:		
Legal settlement (Note 12)	450,000	-
Change in Net Position	2,046,490	(540,276)
Net Position:		
Beginning of year	63,783,344	64,323,620
End of year	\$ 65,829,834	\$ 63,783,344

The accompanying notes are an integral part of these financial statements.

CITY OF LANCASTER SEWER FUND

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Cash Flows From Operating Activities:		
Cash received from users	\$ 12,576,429	\$ 13,518,408
Cash paid to suppliers	(8,110,399)	(5,780,633)
Cash paid to employees	(2,624,989)	(2,453,352)
Net cash provided by operating activities	1,841,041	5,284,423
Cash Flows From Investing Activities:		
Net sale of investments	-	265,366
Investment income	20,280	20,460
Net cash provided by investing activities	20,280	285,826
Cash Flows From Capital and Related Financing Activities:		
Principal payments on notes payable	(410,000)	(895,000)
Proceeds from bond payable	7,911,067	-
Principal payments on capital lease	(197,244)	(273,055)
Proceeds from note payable	2,499,647	1,936,482
Cash paid for debt issuance costs	(133,317)	-
Payments to bond escrow agent	(7,777,750)	-
Principal payments on bonds payable	(1,595,000)	(870,000)
Interest paid	(2,014,351)	(2,116,895)
Acquisition of capital assets	(8,664,947)	(11,106,892)
Insurance proceeds	91,748	-
Legal settlement proceeds	450,000	-
Net change in escrow deposits	7,508,771	408,466
Net cash used in capital and related financing activities	(2,331,376)	(12,916,894)
Cash Flows From Non-Capital Financing Activities:		
Transfers in	-	9,363
Due to the City of Lancaster General Fund	1,340,172	562,489
State pension contribution	137,844	141,570
Net cash provided by non-capital financing activities	1,478,016	713,422
Net Increase (Decrease) in Cash and Cash Equivalents	1,007,961	(6,633,223)
Cash and Cash Equivalents:		
Beginning of year	26,068,953	32,702,176
End of year	\$ 27,076,914	\$ 26,068,953

(Continued)

CITY OF LANCASTER SEWER FUND

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2016 AND 2015

(Continued)

	2016	2015
Reconciliation of Operating Loss to Net Cash Provided by Operating Activities:		
Operating loss	\$ (100,371)	\$ (717,300)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation expense	3,153,135	3,082,197
Amortization	18,231	18,231
Changes in assets, deferred outflows of resources, liabilities, and deferred inflows of resources:		
Receivables	(1,214,000)	713,586
Due from other governments	(2,028)	3,760
Prepaid expenses	(13,411)	(41)
Deferred outflows of resources for pension	(12,853)	(102,044)
Accounts payable	(401,903)	1,763,924
Accrued expenses	25,248	(32,748)
Compensated absences	21,531	(5,272)
Workers' compensation payable	1,276	(1,831)
Net pension liability	17,121	68,005
Net other post-employment liability	349,080	465,637
Deferred inflows of resources for pension	(15)	28,319
Total adjustments	1,941,412	6,001,723
Net cash provided by operating activities	\$ 1,841,041	\$ 5,284,423
Noncash Capital Financing Activities:		
Issuance of capital lease	\$ 108,406	\$ 47,784
Debt transferred to Stormwater Fund	\$ -	\$ (12,968)

(Concluded)

The accompanying notes are an integral part of these financial statements.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements include the transactions of the Sewer Fund of the City of Lancaster, Pennsylvania (Sewer Fund). It does not include any other funds of the City of Lancaster (City) and, therefore, does not present fairly the financial position and the changes in financial position of the City in conformity with accounting principles generally accepted in the United States of America.

Basis of Presentation and Accounting

The Sewer Fund's financial statements are presented on the full accrual basis in accordance with accounting principles generally accepted in the United States of America. All activities of the Sewer Fund are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the Sewer Fund is charges for sewer services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The accounting and financial reporting treatment applied to the Sewer Fund is determined by its measurement focus. The transactions of the Sewer Fund are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets, deferred outflows of resources, liabilities, and deferred inflows of resources associated with the operations are included on the balance sheets. Net position (i.e., total assets and deferred outflows of resources, net of total liabilities and deferred inflows of resources) is segregated into "net investment in capital assets," "restricted for capital acquisition," and "unrestricted" components.

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

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Cash and Cash Equivalents

For the purposes of reporting cash flows, the Sewer Fund considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Capital Assets

The sewer system's capital assets are recorded at their estimated historical cost. Donated capital assets are recorded at acquisition value at the date of donation. Acquisition value is the price that the Sewer Fund would have paid to acquire an asset with equivalent service potential in an orderly market transaction at the acquisition date.

Depreciation is computed on using the composite remaining life method using the average life term of group assets. The following are the estimated useful lives used for capitalization of sewer system capital assets:

Sewer systems	55 - 65 years
Equipment and vehicles	4 - 40 years

The Sewer Fund capitalizes all assets valued over \$10,000 with a useful life longer than one year.

Capitalization of Interest

Interest expense that relates to the cost of acquiring or constructing capital assets by the City is capitalized. Interest capitalized for the years ended December 31, 2016 and 2015 totaled \$100,671 and \$71,327, respectively.

Prepaid Debt Insurance/Deferred Charge on Refunding

Prepaid debt insurance and deferred charge on refunding are amortized on the effective interest method over the life of the bonds.

Restricted Assets

Certain cash accounts are classified as restricted assets on the balance sheets because these accounts hold shared money to which a certain percentage is owed to various municipalities. This is due to agreements with the City and other municipalities to share costs associated with sewer projects. The amounts owed to the municipalities are included in Due to Other Governments.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

The unexpended 2011 and 2014 bond proceeds as of December 31, 2016 and 2015 are also included in the restricted assets.

Net Position

Net position is classified in the following categories:

Net Investment in Capital Assets – This category groups all capital assets into one component of net position. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction, or improvement of these assets reduce this category. Deferred outflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt are also included in this category. Debt related to unspent proceeds or other restricted cash is excluded from the determination.

Restricted Net Position – This category presents external restrictions imposed by creditors, grantors, contributors, laws, or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

Unrestricted Net Position – This category represents the net position of the Sewer Fund that is not restricted for any project or other purpose.

Use of Estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain amounts and disclosures. Accordingly, actual results may differ from estimated amounts.

Pension Plans

The City sponsors and administers a defined benefit plan and defined contribution plan, which cover the Sewer Fund employees.

Deferred Inflows and Outflows of Resources for Pension

In conjunction with pension accounting requirements, the effect of the differences in the Sewer Fund's expected and actual experience and the difference between projected and actual earnings on pension plan investments are recorded as deferred inflows or outflows of resources related to pension on the financial statements. These amounts are determined based

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

on the actuarial valuation performed for the pension plan. Note 6 presents additional information about the pension plan.

Pending Changes in Accounting Principles

In June of 2015, the Governmental Accounting Standards Board (GASB) issued Statement No. 74, “*Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.*” This Statement addresses reporting by other post-employment benefit (OPEB) plans that administer benefits on behalf of governments. The provisions of GASB Statement No. 74 are effective for the City’s December 31, 2017 financial statements.

In June of 2015, the GASB issued Statement No. 75, “*Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions.*” This Statement addresses reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions of GASB Statement No. 75 are effective for the City’s December 31, 2018 financial statements.

In March of 2016, the GASB issued Statement No. 82, “*Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73.*” This Statement addresses certain issues that have been raised with respect to previous pension standards. The provisions of GASB Statement No. 82 are effective for the City’s December 31, 2017 and 2018 financial statements.

In March of 2017, the GASB issued Statement No. 85, “*Omnibus 2017.*” This Statement addresses practice issues identified during implementation and application of certain GASB Statements related to a variety of topics, including blending component units, goodwill, fair value measurement and application, and post-employment benefits. The provisions of GASB Statement No. 85 are effective for the City’s December 31, 2018 financial statements.

In May of 2017, the GASB issued Statement No. 86, “*Certain Debt Extinguishment Issues.*” This Statement improves consistency in accounting and financial reporting for certain debt extinguishments. The provisions of GASB Statement No. 86 are effective for the City’s December 31, 2018 financial statements.

The effect of implementation of these Statements has not yet been determined.

2. DEPOSITS

Pennsylvania statutes provide for investment of governmental funds into 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

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

acceptances, insured or collateralized time deposits, and certificates of deposit. The statutes do not prescribe regulations related to demand deposits; however, they do allow the pooling of governmental funds for investment purposes.

The deposit and investment policy of the City adheres to state statutes, the Third Class City Code, and prudent business practice.

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 Sewer Fund does not have a deposit policy for custodial credit risk.

As of December 31, 2016 and 2015, the Sewer Fund's non-pooled book balances were \$17,961,902 and \$8,366,896, respectively, and the bank balances were \$17,961,602 and \$8,366,596, respectively. At December 31, 2016 and 2015, \$250,000 and \$250,000, respectively, was covered by federal depository insurance and \$17,711,602 and \$8,116,596, respectively, was collateralized under Act No. 72 (Act) of the 1971 Session of the Pennsylvania General Assembly, in which financial institutions were granted the authority to secure deposits of public bodies by pledging a pool of assets, as defined in the Act, to cover all public funds deposited in excess of federal depository insurance limits.

The Sewer Fund pools certain of its deposits with the City. At December 31, 2016 and 2015, the book balance of the pooled deposits was \$44,187,502 and \$48,195,690, respectively, and the bank balance was \$45,255,571 and \$50,183,103, respectively. The Sewer Fund's position in the pooled deposits was \$9,115,012 and \$17,702,057 at December 31, 2016 and 2015, respectively. At December 31, 2016, \$500,000 was insured by federal depository insurance and the remaining balance of \$8,615,012 was collateralized under Act No. 72. At December 31, 2015, \$500,000 was insured by federal depository insurance and the remaining balance of \$17,202,057 was collateralized under the Act.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

3. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2016 and 2015 is as follows:

	<u>December 31,</u> <u>2015</u>	<u>Increase/</u> <u>Transfers In</u>	<u>Decrease/</u> <u>Transfers Out</u>	<u>December 31,</u> <u>2016</u>
Capital assets not being depreciated:				
Land	\$ 1,484,824	\$ -	\$ -	\$ 1,484,824
Construction-in-progress	<u>11,038,018</u>	<u>6,352,566</u>	<u>(78,215)</u>	<u>17,312,369</u>
Total capital assets, not being depreciated	<u>12,522,842</u>	<u>6,352,566</u>	<u>(78,215)</u>	<u>18,797,193</u>
Capital assets being depreciated:				
Sewer system	156,253,305	2,182,978	(43,453)	158,392,830
Equipment and vehicles	<u>2,972,428</u>	<u>150,390</u>	<u>-</u>	<u>3,122,818</u>
Total capital assets, being depreciated	<u>159,225,733</u>	<u>2,333,368</u>	<u>(43,453)</u>	<u>161,515,648</u>
Less accumulated depreciation for:				
Sewer system	(70,859,736)	(2,936,801)	41,557	(73,754,980)
Equipment and vehicles	<u>(898,527)</u>	<u>(216,334)</u>	<u>-</u>	<u>(1,114,861)</u>
Total accumulated depreciation	<u>(71,758,263)</u>	<u>(3,153,135)</u>	<u>41,557</u>	<u>(74,869,841)</u>
Capital assets being depreciated, net	<u>87,467,470</u>	<u>(819,767)</u>	<u>(1,896)</u>	<u>86,645,807</u>
Capital assets, net	<u>\$ 99,990,312</u>	<u>\$ 5,532,799</u>	<u>\$ (80,111)</u>	<u>\$ 105,443,000</u>

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

	December 31, 2014	Increase/ Transfers In	Decrease/ Transfers Out	December 31, 2015
Capital assets not being depreciated:				
Land	\$ 1,484,824	\$ -	\$ -	\$ 1,484,824
Construction-in-progress	1,840,742	9,245,487	(48,211)	11,038,018
Total capital assets, not being depreciated	<u>3,325,566</u>	<u>9,245,487</u>	<u>(48,211)</u>	<u>12,522,842</u>
Capital assets being depreciated:				
Sewer system	154,194,375	2,058,930	-	156,253,305
Equipment and vehicles	2,944,547	107,647	(79,766)	2,972,428
Total capital assets, being depreciated	<u>157,138,922</u>	<u>2,166,577</u>	<u>(79,766)</u>	<u>159,225,733</u>
Less accumulated depreciation for:				
Sewer system	(67,975,487)	(2,884,249)	-	(70,859,736)
Equipment and vehicles	(735,779)	(221,788)	59,040	(898,527)
Total accumulated depreciation	<u>(68,711,266)</u>	<u>(3,106,037)</u>	<u>59,040</u>	<u>(71,758,263)</u>
Capital assets being depreciated, net	<u>88,427,656</u>	<u>(939,460)</u>	<u>(20,726)</u>	<u>87,467,470</u>
Capital assets, net	<u>\$ 91,753,222</u>	<u>\$ 8,306,027</u>	<u>\$ (68,937)</u>	<u>\$ 99,990,312</u>

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

4. LONG-TERM LIABILITIES

A summary of long-term liabilities for the year ended December 31, 2016 is as follows:

Date of Issue/ Maturity	Amount of Original Issue	Description and Interest Rates	Balance Outstanding December 31, 2016
2009/2025	\$ 14,030,000	General Obligation Notes, 2.50% - 4.875%	\$ 8,495,000
2011/2041	22,460,000	General Obligation Bonds, 1.75% - 5.00%	21,585,000
2014/2034	7,415,000	General Obligation Bonds, 3.00% - 5.00%	7,235,000
2014/2034	5,500,000	Note Payable to Financing Agency, 1.00% - 1.74%	4,769,258
2016/2022	7,000,000	General Obligation Bonds, 4.00% - 5.00%	7,000,000
			<u>\$ 49,084,258</u>

Bonds Payable

In 1998, the City issued \$61,915,000 of general obligation bonds. The portion allocable to the Sewer Fund amounted to \$27,390,000, bearing interest at rates ranging from 3.2% to 5.25%. The proceeds of the bond issuance were used to finance the acquisition of the sewer system through the refunding of the Lancaster Municipal Authority's outstanding (a) Sewer Revenue Bonds, Series of 1987; (b) Sewer Revenue Bonds, Series of 1991; and (c) Sewer Project Notes, Series of 1996. These bonds were currently refunded through the issuance of General Obligation Notes, Series of 2009.

In 2007, the City issued \$125,315,000 of general obligation bonds. The portion allocable to the Sewer Fund amounted to \$12,150,000, bearing interest at rates ranging from 4.00% to 5.00%. The proceeds of the bond issuance were used to fund general municipal projects, upgrades and improvements to the City's sewer system, and the current refunding of the 2004 note payable. These bonds were advance refunded through the issuance of General Obligations Bonds, Series of 2016. The balance outstanding on the defeased General Obligation Bonds, Series of 2007, on December 31, 2016 is \$114,975,000, of which \$7,300,000 is the Sewer Fund's portion.

In 2011, the City issued \$38,860,000 of general obligation bonds. The portion allocable to the Sewer Fund amounted to \$22,460,000, bearing interest at rates ranging from 1.75% to 5.00%. The proceeds of the bond issuance were used for improvements and upgrades to the wastewater treatment plant and various miscellaneous capital projects.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

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In 2014, the City issued \$42,490,000 of general obligation bonds. The portion allocable to the Sewer Fund amounted to \$7,415,000, bearing interest at rates ranging from 3.00% to 5.00%. The proceeds of the bond issuance were used for improvements and upgrades to the wastewater treatment plant and various miscellaneous capital projects.

In 2016, the City issued \$118,820,000 of general obligation bonds. The portion allocable to the Sewer Fund amounted to \$7,000,000, bearing interest at rates ranging from 4.00% to 5.00%. The proceeds of the bond issuance were used for the advance refunding of the General Obligations Bonds, Series of 2007. The City completed the advance refunding to reduce its total debt service payments by \$9,514,789 through the year 2046 and resulted in an economic gain (difference between the present values of the old and new debt service payments) of \$9,152,042. As a result of the advance refunding, the Sewer Fund reduced its total debt service payments by \$465,655 through the year 2022, with an economic gain of \$451,609.

Notes Payable

In 2009, the City issued \$43,990,000 of general obligation notes. The portion allocable to the Sewer Fund amounted to \$14,030,000, bearing interest at rates ranging from 2.50% to 4.875%. The proceeds of the note issuance were used to currently refund the City's outstanding General Obligation Bonds, Series A of 1998, and to pay the termination costs of the Swaption agreement with Wachovia Bank.

In 2014, the City issued \$5,500,000 Guaranteed Revenue Note of 2014. This is a Pennvest drawdown loan that is for the construction of the North Pump Station Preliminary Treatment Facility and Diversion Chamber. This Note bears interest at a rate of 1.00% for the first five years and 1.74% thereafter. As of December 31, 2016, \$4,769,258 was drawn down on the Guaranteed Revenue Note of 2014.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Principal and interest maturities on the bonds and notes payable are as follows:

<u>Year Ending December 31,</u>	<u>Principal Maturity</u>	<u>Interest Maturity</u>	<u>Total</u>
2017	\$ 2,033,192	\$ 1,976,853	\$ 4,010,045
2018	2,453,127	1,893,405	4,346,532
2019	2,555,670	1,787,594	4,343,264
2020	2,668,238	1,676,858	4,345,096
2021	2,775,833	1,562,464	4,338,297
2022-2026	12,785,302	6,095,337	18,880,639
2027-2031	8,572,596	4,328,881	12,901,477
2032-2036	8,225,300	2,593,692	10,818,992
2037-2041	7,015,000	1,008,353	8,023,353
	<u>\$ 49,084,258</u>	<u>\$ 22,923,437</u>	<u>\$ 72,007,695</u>

Capital Lease

From 2013 through 2016, the City purchased multiple vehicles and equipment under long-term lease agreements that are classified as capital leases. As of December 31, 2016 and 2015, the Sewer Fund includes these vehicles and equipment at a cost of \$904,855 and \$992,928, respectively, with accumulated depreciation of \$147,197 and \$126,321, respectively.

The future minimum payments under these capital leases and the present value of the minimum lease payments at December 31, 2016 are as follows:

<u>Year Ending December 31,</u>	<u>Total</u>
2017	\$ 245,653
2018	85,558
2019	28,329
2020	15,318
Total minimum lease payments	374,858
Less amount representing interest	<u>(18,604)</u>
Present value of future minimum lease payments	<u>\$ 356,254</u>

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Changes in long-term liabilities for the years ended December 31, 2016 and 2015 are as follows:

	December 31, 2015	Increase	Decrease	December 31, 2016	Amount Due Within One Year
Bonds payable	\$ 37,715,000	\$ 7,000,000	\$ (8,895,000)	\$ 35,820,000	\$ 1,415,000
Unamortized premium	663,041	911,067	(353,797)	1,220,311	-
Notes payable	11,174,611	2,499,647	(410,000)	13,264,258	618,192
Capital lease	445,092	108,406	(197,244)	356,254	232,458
Compensated absences	71,154	411,193	(389,662)	92,685	21,327
Workers' compensation payable	-	1,531	(255)	1,276	-
	<u>\$ 50,068,898</u>	<u>\$ 10,931,844</u>	<u>\$ (10,245,958)</u>	<u>\$ 50,754,784</u>	<u>\$ 2,286,977</u>

	December 31, 2014	Increase	Decrease	Transfer Out	December 31, 2015	Amount Due Within One Year
Bonds payable	\$38,585,000	\$ -	\$ (870,000)	\$ -	\$37,715,000	\$ 1,595,000
Unamortized premium	757,064	-	(94,023)	-	663,041	-
Notes payable	10,133,129	1,936,482	(895,000)	-	11,174,611	410,000
Capital lease	683,331	47,784	(273,055)	(12,968)	445,092	197,245
Compensated absences	76,426	366,672	(371,944)	-	71,154	16,373
Workers' compensation payable	1,831	-	(1,831)	-	-	-
	<u>\$50,236,781</u>	<u>\$ 2,350,938</u>	<u>\$ (2,505,853)</u>	<u>\$ (12,968)</u>	<u>\$50,068,898</u>	<u>\$ 2,218,618</u>

In conjunction with the Basis Swap transaction described in Note 5, the City received an upfront cash payment. This upfront cash payment received by the City was considered to be a borrowing at a rate of 4.4%. As of December 31, 2016 and 2015, the borrowing had an outstanding balance of zero and \$1,112,801, respectively, which is reflected in the governmental activities portion of the City's financial statement. Payments on the borrowing commenced on May 1, 2009, the date the Basis Swap became effective, and were scheduled to mature on May 1, 2028. On March 9, 2016, the City made a payment totaling \$261,700 to effectively terminate the Basis Swap. Interest was accreted to the principal amount annually. Accreted interest on the borrowing was zero and \$818,587 at December 31, 2016 and 2015, respectively.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

As noted above, the borrowing was reflected in the governmental activities section of the City's financial statement and, as such, the Sewer Fund did not report a portion of the City's borrowing.

5. DERIVATIVE AGREEMENTS

During the year ended December 31, 1998, the City issued its \$61,915,000, aggregate principal amount, General Obligation Bonds, Series A of 1998 (the "Series A Bonds"). During the year ended December 31, 2004, because of the market conditions, the City entered into a forward interest rate swap agreement (Basis Swap) with PNC Bank, N.A., as the counterparty in connection with the Series A Bonds through the final maturity date of the Series A Bonds (May 1, 2028). Beginning on May 1, 2009 and ending on the final maturity date of May 1, 2028, the City was to pay a variable interest rate equal to the SIFMA index based on the notional amount remaining on the Series A Bonds and receive a variable interest rate equal to 67% of the 1-Month LIBOR rate. The Basis Swap agreement contained an embedded interest rate cap, providing that the floating rate to be paid by the City shall not exceed 25%. PNC Bank, N.A. paid a premium to the City in the amount of \$1,715,700 for the Basis Swap. The Basis Swap became effective on May 1, 2009 and was assigned to a proportionate share of the City's General Obligation Notes, Series of 2009 which refunded the Series A Bonds. On March 9, 2016, the City made a payment totaling \$261,700 to effectively terminate the Basis Swap.

6. PENSION PLANS

The City administers a single-employer defined benefit pension plan for its nonuniformed employees – the Cash Balance Pension Plan (CBPP).

The CBPP does not issue stand-alone financial reports.

A. *Summary of Significant Accounting Policies*

Basis of Accounting

The CBPP's financial statements are prepared using the accrual basis of accounting. The CBPP member contributions are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Method Used to Value Investments

Investments are reported at fair value.

B. Plan Description and Contribution Information

Plan Participants

At December 31, 2016 and 2015, employee membership data related to the CBPP was as follows:

	<u>2016</u>	<u>2015</u>
Inactive plan members or beneficiaries currently receiving benefits	55	50
Inactive plan members entitled to but not yet receiving benefits	32	30
Active plan members	<u>317</u>	<u>298</u>
	<u>404</u>	<u>378</u>

Plan Description and Administration

The CBPP is a single-employer defined benefit pension plan that covers all full-time, nonuniformed employees of the City. The CBPP provides retirement, disability, and death benefits to plan members and their beneficiaries. The CBPP provisions are established and may be amended by the Nonuniformed Pension Board (Board). The Nonuniformed Pension Board consists of the Mayor, City Controller, the superintendent of finance, two nonuniformed employees, and a member of City Council.

Retirement Benefit

A participant is eligible for normal retirement at age 65 and completion of ten years of service. The normal retirement pension is payable monthly during the participant's lifetime. Payments cease upon the participant's death.

The amount of monthly pension is equal to the greater of (a) or (b) where (a) equals 0.8% of average monthly compensation times credited service after December 1, 1986, plus accrued benefit on December 1, 1986, and (b) equals the actuarial equivalent of the participant benefit account balance. The participant benefit account balance is equal to the sum of (1) the accrued benefit on November 30, 1986, plus (2) for each plan year beginning on or after January 1, 1987, an annual benefit credit equal to 4% of earnings for a participant who accrues credited service plus (3) after January 1, 1987, interest credited to the account balance equal to 5.5% compounded annually.

CITY OF LANCASTER SEWER FUND

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Average monthly compensation is based upon the five consecutive plan years of highest compensation out of the last ten years preceding retirement.

If a participant continues working after his/her normal retirement date, his/her pension would not start until retirement, subject to minimum distribution rules at age 70 ½ or later. The late retirement benefit is the pension accrued to the late retirement date.

A participant is eligible for early retirement after attainment of age 55 and completion of ten years of service. The early retirement benefit is the actuarial equivalent of the pension accrued to the date of early retirement. The reduction is 7.2% for each of the first five years prior to normal retirement, and 3.6% for each of the next five years.

If a participant who has completed ten years of service becomes totally and permanently disabled, he/she is eligible for disability retirement after six months of disability. The disability retirement benefit is the greater of the accrued pension or 30% of the participant's average monthly compensation as of his/her date of disability.

Disability payments will be made until the earlier of recovery, death or normal retirement age. At normal retirement age, the participant shall receive the normal retirement pension.

The death benefit for an active vested participant who has completed five years of service is a 50% survivor pension for his beneficiary. Payment of the survivor benefit would begin on the date on which the participant would first have been eligible for retirement. The amount of survivor benefit would be the 50% survivor benefit payable under a joint and 50% survivor pension option, based upon the pension accrued to the date of death and reduced for early commencement of benefits, if applicable. The death benefit cannot be less than the participant's benefit account balance or the lump sum value of the vested accrued benefit.

Contributions

The CBPP is funded by the City on an annual basis pursuant to the provisions of the Act 205 of 1984 of the Commonwealth of Pennsylvania. The CBPP members are not required to contribute to the CBPP. The City is required to make actuarial determined periodic contributions at rates that for individual employees increase over time so that sufficient assets will be available to pay benefits when due.

The annual required contribution is determined annually during the budgeting process. The results of actuarial valuations are used in budgeting for future years.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

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The City contributed \$931,774 and \$900,704, respectively, to the CBPP for the years ended December 31, 2016 and 2015. Of the amount contributed by the City, the Sewer Fund contributed \$137,844 and \$141,570 to the CBPP for the years ended December 31, 2016 and 2015, respectively.

Changes in the Net Pension Liability

The changes in the net pension liability of the City for the years ended December 31, 2016 and 2015 were as follows:

	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability
Balances at December 31, 2015	\$ 15,253,792	\$ 10,818,054	\$ 4,435,738
Service cost	569,268	-	569,268
Interest	1,168,991	-	1,168,991
Contributions - employer	-	931,774	(931,774)
Net investment income	-	722,581	(722,581)
Benefit payments, including refunds	(473,019)	(473,019)	-
Administrative expense	-	(26,770)	26,770
Net changes	1,265,240	1,154,566	110,674
Balances at December 31, 2016	\$ 16,519,032	\$ 11,972,620	\$ 4,546,412
Plan fiduciary net position as a percentage of the total pension liability			72.48%

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability
Balances at December 31, 2014	\$ 14,733,676	\$ 10,740,515	\$ 3,993,161
Service cost	542,160	-	542,160
Interest	1,096,819	-	1,096,819
Changes for experience	(184,304)	-	(184,304)
Contributions - employer	-	900,704	(900,704)
Net investment income	-	139,124	(139,124)
Benefit payments, including refunds	(934,559)	(934,559)	-
Administrative expense	-	(27,730)	27,730
Net changes	520,116	77,539	442,577
Balances at December 31, 2015	\$ 15,253,792	\$ 10,818,054	\$ 4,435,738
Plan fiduciary net position as a percentage of the total pension liability			70.92%

The net pension liability was measured as of December 31, 2016 and 2015 and was determined by rolling forward the liabilities from the January 1, 2015 actuarial valuation. No significant events or changes occurred between the valuation date and the fiscal year-ends.

The Sewer Fund's portion of the net pension liability as of December 31, 2016 and 2015 was \$690,742 and \$673,621, respectively.

Actuarial Assumptions - The January 1, 2015 actuarial valuation included the following assumptions:

Actuarial cost method	Entry age normal
Amortization method	Level dollar closed
Remaining amortization period	14 years
Actuarial assumptions:	
Investment rate of return	7.50%
Projected salary increases	5.00%
Underlying inflation rate	3.00%
RP2000 mortality table	

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

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Investment Policy - The CBPP's policies in regard to the allocation of invested assets are established and may be amended by the Board. The Board seeks to optimize the total return of the CBPP's portfolio through a policy of balanced investments, structured to achieve the maximum returns possible, as measured on the total portfolio, consistent with a policy that emphasizes the prudent management of risk.

Long-Term Expected Rate of Return - The long-term expected rate of return on CBPP investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by the target asset allocation percentage and by adding expected inflation.

The target allocation and best estimates of arithmetic real rates of return for each major asset class for the CBPP as of December 31, 2016 and 2015 are summarized in the following table:

<u>Asset Class</u>	<u>2016 Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Domestic equity	66.0%	5.5% - 7.5%
Fixed income	30.0%	1.0% - 3.0%
Cash	4.0%	0.0% - 1.0%
	<u>100.0%</u>	

<u>Asset Class</u>	<u>2015 Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Domestic equity	66.0%	5.5% - 7.5%
Fixed income	30.0%	1.0% - 3.0%
Cash	4.0%	0.0% - 1.0%
	<u>100.0%</u>	

Rate of Return – The money-weighted rate of return expresses investment performance net of investment expense, adjusted for the changing amounts actually invested. For the years ended December 31, 2016 and 2015, the annual money-weighted rate of return on CBPP investments, net of investment expense, was 6.86% and 1.23%, respectively.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

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Concentrations – At December 31, 2016, none of the CBPP’s investments were more than five percent of the CBPP’s total asset value.

Discount Rate – The discount rate used to measure the total pension liability as of December 31, 2016 and 2015 was 7.50%. The CBPP’s fiduciary net position is projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investment was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Net Pension Liability Changes in the Discount Rate – The following presents the net pension liability of the CBPP calculated using the discount rate described above, as well as what the CBPP’s net pension liabilities would be if they were calculated using a discount rate that is one-percentage-point lower or higher than the current rates:

December 31, 2016:

1% Decrease (6.50%)	Current Discount Rate (7.50%)	1% Increase (8.50%)
<u>\$ 6,647,839</u>	<u>\$ 4,546,412</u>	<u>\$ 2,792,326</u>

December 31, 2015:

1% Decrease (6.50%)	Current Discount Rate (7.50%)	1% Increase (8.50%)
<u>\$ 6,415,359</u>	<u>\$ 4,435,738</u>	<u>\$ 2,783,696</u>

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pension

For the years ended December 31, 2016 and 2015, the Sewer Fund recognized pension expense of \$160,328 and \$154,081, respectively. At December 31, 2016 and 2015, the Sewer Fund reported deferred outflows of resources and deferred inflows of resources related to pension from the following sources:

	<u>2016</u>	<u>2015</u>
<u>Deferred Outflows of Resources</u>		
Differences between expected and actual experience	\$ 74,079	\$ 81,635
Total Deferred Outflows of Resources	<u>\$ 74,079</u>	<u>\$ 81,635</u>
<u>Deferred Inflows of Resources</u>		
Net difference between projected and actual earnings on pension plan investments	\$ 23,948	\$ 26,141
Total Deferred Inflows of Resources	<u>\$ 23,948</u>	<u>\$ 26,141</u>

The differences in the Sewer Fund's expected and actual experience are recognized over the average expected remaining service lives of active and inactive members. The difference between projected and actual earnings on the pension plan investments is recognized over five years. Amounts reported as deferred outflows of resources and deferred inflows of resources related to pension will be recognized in pension expense as follows:

<u>Year ending December 31,</u>	
2017	\$ 21,441
2018	21,441
2019	21,441
2020	1,048
2021	(2,177)
Thereafter	<u>(13,063)</u>
	<u>\$ 50,131</u>

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Defined Contribution Plan

The City administers a single-employer defined contribution plan, the Supplemental Savings Plan (SSP), in which all eligible, full-time, nonuniformed employees of the City may elect to participate. As of December 31, 2016 and 2015, there were 181 and 184 plan participants, respectively. The SSP participants may elect to contribute up to 10% of their after-tax pay. The City will match 25% of the participant's contribution, on the first 5% contributed by each participant. Participant contributions in excess of 5% of compensation will not be matched. The Plan provisions are established and may be amended by the Nonuniformed Pension Board. During the year ended December 31, 2016, plan participants and the City made contributions of \$538,221 and \$89,696, respectively. During the year ended December 31, 2015, plan participants and the City made contributions of \$519,490 and \$93,475, respectively. Of the amount contributed by the City, the Sewer Fund contributed \$15,159 and \$14,659 for the years ended December 31, 2016 and 2015, respectively.

The SSP uses the same basis of accounting and methods to value investments as the City's defined benefit plans.

7. OTHER POST-EMPLOYMENT BENEFITS

Plan Description

In addition to the retirement benefits described in Note 6, the City provides single-employer health care benefits for all retired employees, their spouses, and dependents. These benefit provisions and all other requirements are established under the various union contracts and City policy for non-organized employees. Those employees are required to pay a portion of the cost of the plan, which generally ranges from approximately 2% to 10% of the annual premiums.

Nonuniformed employees are eligible to retire after completion of 10 years of service and attainment of age 55 or upon disability after completion of 10 years of service.

Any nonuniformed employee who elects coverage will make monthly contributions. Once any retiree or spouse becomes eligible for Medicare, he/she must apply for Medicare Part A and Part B. For those eligible for Medicare coverage, medical insurance provided by the City will supplement Medicare.

A nonuniformed employee will be eligible for \$7,000 (\$15,000 for disability) of life insurance upon 10 years of service and attainment age of 55 or upon disability after completion of 10 years of service.

CITY OF LANCASTER SEWER FUND

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The union labor contract establishes the post-retirement health care plan provisions for nonuniformed union employees. The union contract does not require City Council approval and may be amended through future negotiations. The post-retirement health care plan provisions for non-union employees are established through the City's human resources policies, which are approved by the Mayor.

Funding Policy and Annual OPEB Costs

The City's Sewer and Water Funds have been making contributions to the OPEB trust fund based on a percentage of the annual required contribution, as determined by an actuarial valuation. The balance of the City's contribution is based on projected pay-as-you-go financing requirements through the General Fund. For the years ended December 31, 2016 and 2015, respectively, the City's net cost of providing health benefits and life insurance for retired employees was \$5,034,792 and \$5,126,642. Of the amount contributed by the City, the Sewer Fund contributed \$319,589 and \$302,566 for the years ended December 31, 2016 and 2015, respectively. A portion of the contributions made during the years ended December 31, 2016 and 2015, in the amount of \$100,416 and \$100,416, respectively, was made directly to the City's OPEB trust fund by the City's Sewer Fund. Plan members receiving benefits contributed \$47,410 and \$47,313 through their contributions as required by the cost sharing provisions of the plans for the years ended December 31, 2016 and 2015, respectively.

The nonuniformed union labor contract and the City's human resource policies establish and amend the obligations of the plan members and the City to contribute to the plan.

Any nonuniformed employee who elects coverage will make monthly contributions. For eligible nonuniformed individuals under the age of 65, the monthly costs for the retiree, spouse, and eligible dependent children are \$65, \$110, and \$60, respectively. For eligible nonuniformed individuals over the age of 65, the monthly costs for the retiree and spouse are \$50 and the monthly costs for eligible dependent children is \$65.

The City pays the entire cost of the life insurance benefits.

The City's annual OPEB costs (expense) for the plan is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

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funded status of the plan and the ARC are subject to continual revision as actual results are compared to past expectations and new estimate are made about the future.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan and include the types of benefits provided at the time of the valuation and on the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities consistent with the long-term perspective of the calculation. The projections of benefits for financial reporting purposes do not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

Information as of the latest actuarial valuation follows:

Valuation date	1/1/2016
Actuarial cost method	Entry age normal, level dollar
Actuarial assumptions	
Interest rate	4.5%
Salary increases	5% per year
Medical inflation	6.5% in 2016, 6.0% in 2017, 5.5% in 2018 through 2020. Rates gradually decrease from 5.4% in 2021 to 3.8% in 2075 and later
Amortization period	30 years, open period

CITY OF LANCASTER SEWER FUND

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Annual OPEB Cost and Net OPEB Obligation

The Sewer Fund's portion of the City's annual OPEB costs and net OPEB obligations to the plan for the years ended December 31, 2016 and 2015 were as follows:

	2016	2015
Annual required contribution	\$ 731,143	\$ 823,045
Interest on net OPEB obligation	171,513	150,559
Adjustment to annual required contribution	(233,987)	(205,401)
Annual OPEB cost	668,669	768,203
Contribution made	(319,589)	(302,566)
Change in Net OPEB obligation	349,080	465,637
Net OPEB obligation, beginning	3,811,392	3,345,755
Net OPEB obligation, ending	\$ 4,160,472	\$ 3,811,392

Three-Year Trend Information

Year	Annual OPEB Cost (AOC)	Percentage of AOC Contributed	Net OPEB Obligation
2014	\$ 775,759	40.6%	\$ 3,345,755
2015	768,203	39.4%	3,811,392
2016	668,669	47.8%	4,160,472

Funded Status and Schedule of Funding Progress

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

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1/1/2016	\$ 278,954	\$ 6,722,767	\$ 6,443,813	4.15%	\$ 1,988,388	324.07%

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

8. RISK MANAGEMENT

The City maintains both insurance contracts and self-funded arrangements to deal with the risk of loss arising from the following events: torts; theft of, damage to, or destruction of assets; business interruptions; errors and omissions; job-related illnesses or injuries to employees; acts of God; and losses resulting from providing fringe benefits to employees and their dependents.

Insurance contracts cover public officials, law enforcement, automobile, excess workers' compensation, excess health claims, and umbrella liabilities. The contracts also provide employee, tax collector/treasurer, mayor, controller, city engineer, and employee blanket bonds.

Self-Insurance-Workers' Compensation

The City has a self-funded third-party administered workers' compensation arrangement through Murray Risk Management and Insurance. During 2016, the City was limited to \$750,000 per each accident and \$750,000 per each employee for disease. Claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated.

A summary of workers' compensation claims for the Sewer Fund for the years ended December 31, 2016 and 2015 is as follows:

Unpaid claims as of January 1, 2015	\$ 1,831
Incurred claims during 2015	-
Payments during 2015	<u>(1,831)</u>
Unpaid claims as of January 1, 2016	-
Incurred claims during 2016	1,531
Payments during 2016	<u>(255)</u>
Unpaid claims as of December 31, 2016	<u><u>\$ 1,276</u></u>

9. CONTINGENCIES

Litigation

In the normal course of business, there are various claims and lawsuits pending against the City. In the opinion of City management, after consultation with legal counsel, the potential loss, if any, on all claims and lawsuits will not materially affect the City's financial position.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

With the exception of workers' compensation and health insurance, the City purchases commercial insurance for all risks of loss. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years. There were no significant reductions in insurance coverage in 2016.

10. CONTRACT COMMITMENTS

During the years ended December 31, 2016 and 2015, the Sewer Fund contracted for pumping stations upgrades and maintenance and collection system improvements. As a result of this, the City entered into contracts with construction contractors totaling \$19,268,511. The commitment remaining on the contracts at December 31, 2016 was \$2,495,475.

11. NEGATIVE UNRESTRICTED NET POSITION

Sewer rate increases for inside City customers were approved by City Council in 2010 (10%), 2011 (20%), 2012 (35%), 2016 (10%), and again in 2017 (10%). The Pennsylvania Public Utility Commission (PUC) also approved a rate increase for outside City sewer customers in April 2013 for an annualized revenue increase of \$399,000. The City is currently reviewing options for another PUC sewer rate case with its PUC counsel and consulting engineers.

In 2014, the City also created the Stormwater Management Fund (SWMF) as a new enterprise fund with its own dedicated revenue source (stormwater management fees). The creation of the SWMF removed stormwater related expenses from the Sewer Fund. The additional revenues to the Sewer Fund generated by the series of rate increases and the movement of stormwater related expenses to the SWMF has incrementally improved the Sewer Fund's operating budget results and cash flow.

In March 2015, following a binding arbitration decision favorable to the City in 2014, East Lampeter Township made a payment to the City of \$1.685 million. In mid-June 2015 another payment on the amount due from East Lampeter Township was made in the amount of \$171,000. Final payment from East Lampeter Township is scheduled to occur the week of July 3rd, 2017, following discussions with East Lampeter Township's legal counsel.

In March 2015, the City initiated the process to begin binding arbitration with the Lancaster Area Sewer Authority to resolve this bulk sewer treatment expense dispute. Through 2015, the amount due to the City for the period from 2003 to 2015, based on the East Lampeter Township arbitration award and subsequent modifications to the City's billing process, was just over \$3.3 million. At year-end 2016, the City's bulk sewer treatment expense dispute with the Lancaster Area Sewer Authority was still unresolved and continued to be a drag on

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Sewer Fund revenues and cash flow. It is currently anticipated by the City's legal counsel that this dispute will go to binding arbitration in late 2017.

12. EXTRAORDINARY ITEM – LEGAL SETTLEMENT

Extraordinary items are transactions or other events that are both unusual in nature and infrequent in occurrence. During the year ended December 31, 2016, the City filed legal proceedings against businesses for breach of contract, breach of warranty, negligence, and professional negligence relating to deficiencies in a completed pump station project. In April 2016, the court ordered in favor of the City and the matter was settled in the amount of \$450,000. The settlement revenue has been presented on the statement of revenues, expenses and changes in fund net position as an extraordinary item for the year ended December 31, 2016.

**Required Supplementary
Information**

CITY OF LANCASTER SEWER FUND

SCHEDULES OF REQUIRED SUPPLEMENTARY INFORMATION - PENSION PLAN

SCHEDULE OF CHANGES IN THE CASH BALANCE PENSION PLAN'S NET PENSION LIABILITY AND RELATED RATIOS

	2016*	2015*	2014*
Total Pension Liability:			
Service cost	\$ 569,268	\$ 542,160	\$ 533,032
Interest	1,168,991	1,096,819	1,048,689
Changes for experience	-	(184,304)	-
Benefit payments, including refunds	(473,019)	(934,559)	(595,063)
Net Changes in Total Pension Liability	1,265,240	520,116	986,658
Total Pension Liability - Beginning	15,253,792	14,733,676	13,747,018
Total Pension Liability - Ending (a)	<u>\$ 16,519,032</u>	<u>\$ 15,253,792</u>	<u>\$ 14,733,676</u>
Plan Fiduciary Net Position:			
Contributions - employer	\$ 931,774	\$ 900,704	\$ 697,517
Net investment income	722,581	139,124	854,651
Benefit payments, including refunds	(473,019)	(934,559)	(595,063)
Administrative expense	(26,770)	(27,730)	(24,140)
Net Change in Plan Fiduciary Net Position	1,154,566	77,539	932,965
Plan Fiduciary Net Position - Beginning	10,818,054	10,740,515	9,807,550
Plan Fiduciary Net Position - Ending (b)	<u>\$ 11,972,620</u>	<u>\$ 10,818,054</u>	<u>\$ 10,740,515</u>
Net Pension Liability - Ending (a-b)	<u>\$ 4,546,412</u>	<u>\$ 4,435,738</u>	<u>\$ 3,993,161</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	<u>72.48%</u>	<u>70.92%</u>	<u>72.90%</u>
Covered Employee Payroll	<u>\$ 15,105,036</u>	<u>\$ 14,312,665</u>	<u>\$ 13,618,505</u>
Net Pension Liability as a Percentage of Covered Employee Payroll	<u>30.10%</u>	<u>30.99%</u>	<u>29.32%</u>

* This schedule is intended to illustrate information for 10 years. However, until a full 10-year trend is compiled, the City is presenting information for those years only for which information is available.

See accompanying note to required supplementary information - pension plan.

CITY OF LANCASTER SEWER FUND
SCHEDULES OF REQUIRED SUPPLEMENTARY INFORMATION -
PENSION PLAN
SCHEDULE OF CITY CONTRIBUTIONS AND INVESTMENT RETURNS

CASH BALANCE PENSION PLAN:

<u>Schedule of City Contributions</u>	2016*	2015*	2014*	2013	2012	2011	2010	2009	2008	2007
Actuarially determined contribution	\$ 931,774	\$ 900,704	\$ 697,516	\$ 658,895	\$ 516,512	\$ 504,280	\$ 499,125	\$ 475,248	\$ 459,603	\$ 410,346
Contributions in relation to the actuarially determined contribution	931,774	900,704	697,517	658,895	516,512	504,280	499,125	475,248	459,603	410,346
Contribution deficiency (excess)	\$ -	\$ -	\$ (1)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Covered employee payroll	<u>\$ 15,105,036</u>	<u>\$ 14,312,665</u>	<u>\$ 13,618,505</u>							
Contributions as a percentage of covered employee payroll	6.17%	6.29%	5.12%							
<u>Investment Returns</u>										
Annual money-weighted rate of return, net of investment expense	6.86%	1.23%	8.89%							

* This schedule is intended to illustrate information for 10 years. However, until a full 10-year trend is compiled, the City is presenting information for those years only for which information is available.

See accompanying note to required supplementary information - pension plan.

CITY OF LANCASTER SEWER FUND

NOTE TO REQUIRED SUPPLEMENTARY INFORMATION – PENSION PLAN

1. ACTUARIAL METHODS AND ASSUMPTIONS

The information presented in the required supplementary information was determined as part of the actuarial valuations at the dates indicated. Methods and assumptions used to determine contribution rates required under Act 205 are as follows:

Contribution Year	12/31/2016	12/31/2015
Actuarial valuation date	1/1/2013	1/1/2013
Actuarial cost method	Entry age normal	Entry age normal
Amortization method	Level dollar closed	Level dollar closed
Remaining amortization period	15 years	15 years
Asset valuation method	Smoothed value with a corridor of 80% to 120% of market value	Smoothed value with a corridor of 80% to 120% of market value
Actuarial assumptions:		
Investment rate of return	6.5-7.5%	6.5-7.5%
Projected salary increases	5.0%	5.0%
Underlying inflation rate	3.0%	3.0%
Mortality table	RP2000 mortality table RP2000 mortality table	

Changes in Actuarial Assumptions

In the January 1, 2013 actuarial valuation, the asset valuation method was updated from smoothed value with a corridor of 70% to 130% of market value to smoothed value with a corridor of 80% to 120% of market value. The remaining amortization method was also updated from 16 years to 15 years and the investment rate of return was updated from 7.5% to 6.5-7.5%.

CITY OF LANCASTER SEWER FUND

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS - OPEB

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1/1/2008	\$ -	\$ 4,496,765	\$ 4,496,765	0.00%	\$ 1,897,820	236.94%
1/1/2010	-	4,715,588	4,715,588	0.00%	1,761,965	267.63%
1/1/2012	-	5,703,505	5,703,505	0.00%	1,899,710	300.23%
1/1/2014	-	7,063,327	7,063,327	0.00%	2,085,629	338.67%
1/1/2016	278,954	6,722,767	6,443,813	4.15%	1,988,388	324.07%

Note: Valuation as of 1/1/08 represents the initial valuation of the plan.

SCHEDULE OF EMPLOYER CONTRIBUTIONS - OPEB

Year	Annual Required Contribution	Percentage Contributed
2011	\$ 574,517	22.9%
2012	652,488	33.4%
2013	652,488	34.0%
2014	823,045	38.2%
2015	823,045	36.8%
2016	731,143	43.7%

Supplementary Information

CITY OF LANCASTER SEWER FUND

SCHEDULE OF NET COST OF OPERATIONS OF THE CITY SEWER SYSTEM

YEAR ENDED DECEMBER 31, 2016

Direct Expenses and Costs:

Collection system	\$ 1,282,827
Sewage treatment plants	4,183,469
Sewage pumping station	1,208,807
City Bureau of Sewers	1,862,899
Sewage grounds maintenance	45,041
	<hr/>
	8,583,043
Allowance per contracts for indirect expenses and costs (\$8,583,043 x 5.0%)	<hr/>
	429,152
	<hr/>
	9,012,195
	<hr/>
Less reimbursements (as defined in agreements):	
Miscellaneous	293,900
Industrial waste surcharge	372,230
Management and operation service fee	177,290
	<hr/>
	843,420
	<hr/>
Net Cost of Operations of the City Sewer System	\$ 8,168,775
	<hr/> <hr/>

CITY OF LANCASTER SEWER FUND

SCHEDULE OF DIRECT EXPENSES AND COSTS

YEAR ENDED DECEMBER 31, 2016

Collection System:

Salaries and wages	\$ 612,470
Vehicle maintenance	105,355
Gasoline and oil	33,100
Miscellaneous expenses	531,902
	<hr/>
	1,282,827

Sewage Treatment Plants:

Salaries and wages	814,880
Chemicals and laboratory supplies	510,054
Equipment maintenance	320,030
Vehicle maintenance	17,810
Gasoline, oil, and fuel	66,982
Water utility expense	79,738
Power	1,004,164
Building maintenance	31,631
Sludge disposal	1,286,112
Miscellaneous expenses	52,068
	<hr/>
	4,183,469

Sewage Pumping Station:

Salaries and wages	699,140
Equipment maintenance	61,041
Building maintenance	1,296
Fuel	8,360
Power	426,487
Miscellaneous expenses	12,483
	<hr/>
	1,208,807

City Bureau of Sewers:

Salaries and wages	240,516
Consultant and contract services	280,970
Special training	16,196
Uniforms	8,565
Telephone	27,973
Miscellaneous expense	32,992
Fringe benefits	1,255,687
	<hr/>
	1,862,899

Sewer Grounds Maintenance:

Salaries and wages	12,934
Operating equipment	25,694
Fringe benefits	6,413
	<hr/>
	45,041

Total Direct Expenses and Costs

\$ 8,583,043

CITY OF LANCASTER SEWER FUND

SCHEDULE OF COST OF TREATING EACH 1,000 GALLONS OF SEWAGE

YEAR ENDED DECEMBER 31, 2016

Net cost of operation of the City of Lancaster sewer system	\$ 8,168,775
Number of units of 1,000 gallons of sewage treated per records of the City of Lancaster (unaudited)	<u>6,646,159</u>
Net Cost of Treating 1,000 Gallons of Sewage	<u><u>\$ 1.2291</u></u>