



SAN FRANCISCO WATER ENTERPRISE

Financial Statements

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

SAN FRANCISCO WATER ENTERPRISE

June 30, 2012 and 2011

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KPMG LLP
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Independent Auditors' Report

The Honorable Mayor and Board of Supervisors
City and County of San Francisco

We have audited the accompanying financial statements of the San Francisco Water Enterprise (the Enterprise), an enterprise fund of the City and County of San Francisco, California (the City), as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the Enterprise's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in note 1, the financial statements of the Enterprise are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the City that is attributable to the transactions of the Enterprise. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2012 and 2011, the changes in its financial position, or, where applicable, the cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the San Francisco Water Enterprise of the City and County of San Francisco, California as of June 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2012, on our consideration of the Enterprise's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 19 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

October 25, 2012

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Management's Discussion and Analysis

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(Dollars in thousands, unless otherwise stated)

This section presents management's analysis of the San Francisco Water Enterprise's (the Enterprise) financial condition and activities as of and for the years ended June 30, 2012 and 2011. Management's Discussion and Analysis (MDA) is intended to serve as an introduction to the Enterprise's financial statements. This information should be read in conjunction with the audited financial statements that follow this section. All dollar amounts, unless otherwise noted, are expressed in thousands of dollars.

The information in this MDA is presented under the following headings:

- Organization and Business
- Overview of the Financial Statements
- Financial Analysis
- Capital Assets and Debt Administration
- Next Year's Rates
- Request for Information

Organization and Business

The San Francisco Public Utilities Commission (SFPUC or the Commission) is an agency of the City and County of San Francisco (the City) that is responsible for the maintenance, operation, and development of three utility enterprises: Wastewater, Hetch Hetchy Water and Power, and Water (the Enterprise). The Water Enterprise collects, transmits, treats, and distributes high-quality drinking water to a total population of approximately 2.6 million people, including retail customers in the City and wholesale customers located in San Mateo, Santa Clara, and Alameda Counties. The Enterprise sold approximately 212 million gallons per day of water in the year ended June 30, 2012. Approximately two-thirds of the water delivered by the Enterprise is to wholesale customers. Retail customers are primarily San Francisco consumers and include residential, commercial, industrial, and governmental users. The Enterprise recovers cost of service through user fees. Wholesale customers include cities, water districts, one private utility, and one non-profit university. Service to these customers is provided pursuant to the 25-year Water Supply Agreement (WSA) commencing on July 1, 2009, which establishes the basis for determining the costs of wholesale service.

Overview of the Financial Statements

The Enterprise's financial statements include:

Statements of Net Assets present information on the Enterprise's assets and liabilities as of year-end, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Enterprise is improving or deteriorating.

While the *Statements of Net Assets* provide information about the nature and amount of resources and obligations at year-end, the *Statements of Revenues, Expenses, and Changes in Net Assets* present the results of the

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Enterprise's operations over the course of the fiscal year and information as to how the net assets changed during the year. These statements can be used as an indicator of the extent to which the Enterprise has successfully recovered its costs through user fees and other charges. All changes in net assets are reported during the period in which the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in these statements from some items that will result in cash flows in future fiscal periods, such as delayed collection of operating revenues and the expenses of employee earned but unused vacation leave.

The *Statements of Cash Flows* present changes in cash and cash equivalents resulting from operational, capital, non-capital, and investing activities. These statements summarize the annual flow of cash receipts and cash payments, without consideration of the timing of the event giving rise to the obligation or receipt and exclude non-cash accounting measures of depreciation or amortization of assets.

The *Notes to Financial Statements* provide information that is essential to a full understanding of the financial statements that is not displayed on the face of the financial statements.

Financial Analysis

Financial Highlights for Fiscal Year 2012

- Total assets of the Enterprise exceeded total liabilities by \$358,495.
- Net assets decreased by \$37,763 or 9.5% during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by \$754,278 or 30.4% to \$3,234,166.
- During the fiscal year, charges for services, excluding interest and investment income, rental income, other operating and non-operating revenues, increased by \$52,782 or 19.4% to \$324,169.
- Operating expenses, excluding interest expense and other non-operating expenses, increased by \$42,635 or 16.3% to \$304,562.

Financial Highlights for Fiscal Year 2011

- Total assets of the Enterprise exceeded total liabilities by \$396,258.
- Net assets decreased by \$19,426 or 4.7% during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by \$615,535 or 33.0% to \$2,479,888.
- During the fiscal year, charges for services, excluding interest and investment income, rental income, other operating and non-operating revenues, increased by \$23,018 or 9.3% to \$271,387.
- Operating expenses, excluding interest expense and other non-operating expenses, decreased by \$16,043 or 5.8% to \$261,927.

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Financial Position

The following table summarizes changes in the Enterprise's changes in net assets.

Table 1

Comparative Condensed Net Assets

June 30, 2012, 2011, and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012 – 2011 change</u>	<u>2011 – 2010 change</u>
Total assets:					
Current and other assets	\$ 2,235,473	1,661,236	1,136,966	574,237	524,270
Capital assets, net of accumulated depreciation	<u>3,234,166</u>	<u>2,479,888</u>	<u>1,864,353</u>	<u>754,278</u>	<u>615,535</u>
Total assets	<u>5,469,639</u>	<u>4,141,124</u>	<u>3,001,319</u>	<u>1,328,515</u>	<u>1,139,805</u>
Current liabilities:					
Revenue and capital appreciation bonds	45,965	44,050	27,795	1,915	16,255
Certificates of participation	1,971	—	—	1,971	—
Commercial paper	174,000	150,000	—	24,000	150,000
Other liabilities	<u>218,491</u>	<u>192,318</u>	<u>130,541</u>	<u>26,173</u>	<u>61,777</u>
Subtotal current liabilities	<u>440,427</u>	<u>386,368</u>	<u>158,336</u>	<u>54,059</u>	<u>228,032</u>
Long-term liabilities:					
Revenue and capital appreciation bonds	4,447,544	3,145,003	2,221,384	1,302,541	923,619
Certificates of participation	119,755	122,115	122,496	(2,360)	(381)
Other liabilities	<u>103,418</u>	<u>91,380</u>	<u>83,419</u>	<u>12,038</u>	<u>7,961</u>
Subtotal long-term liabilities	<u>4,670,717</u>	<u>3,358,498</u>	<u>2,427,299</u>	<u>1,312,219</u>	<u>931,199</u>
Total liabilities:					
Revenue and capital appreciation bonds	4,493,509	3,189,053	2,249,179	1,304,456	939,874
Certificates of participation	121,726	122,115	122,496	(389)	(381)
Commercial paper	174,000	150,000	—	24,000	150,000
Other liabilities	<u>321,909</u>	<u>283,698</u>	<u>213,960</u>	<u>38,211</u>	<u>69,738</u>
Total liabilities	<u>5,111,144</u>	<u>3,744,866</u>	<u>2,585,635</u>	<u>1,366,278</u>	<u>1,159,231</u>
Net assets:					
Invested in capital assets, net of related debt	301,267	333,386	319,581	(32,119)	13,805
Restricted for debt service	27,213	30,840	12,073	(3,627)	18,767
Restricted for capital projects	13,665	19,163	4,346	(5,498)	14,817
Unrestricted	<u>16,350</u>	<u>12,869</u>	<u>79,684</u>	<u>3,481</u>	<u>(66,815)</u>
Total net assets	\$ <u>358,495</u>	\$ <u>396,258</u>	\$ <u>415,684</u>	<u>(37,763)</u>	<u>(19,426)</u>

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Net Assets, Fiscal Year 2012

For the year ended June 30, 2012, the Enterprise's assets exceeded liabilities by \$358,495. Total net assets decreased from prior year by \$37,763 or 9.5% (see Table 1). The decline in net assets was the result of a \$1,328,515 increase in total assets offset by a \$1,366,278 increase in total liabilities. Investment in capital assets, net of related debt, decreased from the prior year's \$333,386 to \$301,267 by \$32,119 or 9.6% primarily due to additional debt issued to finance construction activities during the year.

Current and other assets are primarily comprised of restricted and unrestricted balances of cash, receivables for water deliveries and services, interfund receivables due from other governmental agencies, and inventory. This also includes receivables which represent cumulative amounts due from the wholesale customers to match revenues with the Enterprise's costs of providing service (the "Balancing Account") in accordance with the provisions set forth in the Water Supply Agreement effective July 1, 2009. Balances due are recovered by future year rate increases.

During the fiscal year 2012, current and other assets increased by \$574,237 or 34.6%. The increases included \$580,159 in restricted and unrestricted cash and investments and \$10,771 in bond issuance costs due to new 2011 Series ABCD and 2012 Series ABC Water Revenue Bonds issuance. Other increases included \$12,871 in receivables for charges for services resulting from higher sales revenue from a planned rate increase, \$985 in restricted interest and other receivable for interest income subsidy from Build America Bonds and \$308 in interest receivables from higher cash balance from new Water Revenue Bonds issuance. The increases were offset by a decrease of \$22,243 in receivables due to repayment, adjustments, and collections from the wholesale customers that was consistent with the Water Supply Agreement terms. Wholesale customers are billed based on the estimated costs of service and usage, which are adjusted to actual costs and usage at year-end. As of June 30, 2012, \$18,783 was owed to the Enterprise. Refer to Note 10, Wholesale Balancing Account, for additional details. Other decreases included \$5,928 in receivables from the Wastewater and Hetch Hetchy Power Enterprises for the 525 Golden Gate Headquarters project construction cost reimbursement offset by Mission Bay project from Department of Public Works, \$2,335 in advances mainly due to reduction in prepaid expenses for the Pacifica Recycled Water project, \$284 collection from the High Efficiency Toilet Grant and the EPA Contamination Warning System Grant, and \$67 in inventory.

Capital assets, net of accumulated depreciation, increased by \$754,278 or 30.4%, reflecting an increase in construction and capital improvement activities. The largest portion of the Enterprise's net assets (\$301,267 or 84.0%) represents invested in capital assets, net of related debt.

Total liabilities increased by \$1,366,278 or 36.5% primarily due to the issuance of \$1,422,630 in 2011 Series ABCD and 2012 Series ABC Water Revenue Bonds, \$81,337 in capital appreciation bonds, premium and refunding loss net of amortization, and \$24,000 in additional commercial paper issued, offset by \$199,900 principal payment and refunding during the year. The increase of \$81,337 included \$83,687 in premium, \$295 in capital appreciation bonds, offset by \$2,645 in refunding loss. Increases also included \$34,358 in accounts payable and current liabilities payable from restricted assets from higher construction, repair and replacement activities, \$12,695 in other post-employment benefits obligation as a result of a higher annual required contribution, \$10,700 in pollution remediation liability for the Lake Merced area, \$6,417 in bond interest payable, \$1,677 in accrued payroll, \$289 in workers' compensation, \$968 in accrued vacation and sick leave, and increase of \$74 in arbitrage liability from prior year's \$517. These increases were offset by decreases of \$17,895

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in damage claims liability based on estimates and settlement of the Mitchell case, \$9,943 in interfund payable, and \$1,129 in deferred credit mainly due to recognition of an East Bay Municipal Utility District grant advance. Decrease of \$9,943 in interfund payable included a \$1,701 and a \$693 payable to Hetch Hetchy Power Enterprise for construction, and phone and data system purchase for the new 525 Golden Gate Headquarters Building, \$1,301 payable to the Arts Commission for art work for the Headquarters Building, offset by \$13,638 interfund payable to Hetch Hetchy Water to fund water storage and transmission facilities improvements.

Net Assets, Fiscal Year 2011

For the year ended June 30, 2011, the Enterprise's assets exceeded liabilities by \$396,258. Total net assets decreased from prior year by \$19,426 or 4.7% (see Table 1). The decline in net assets was the result of \$1,139,805 increase in total assets offset by a \$1,159,231 increase in total liabilities. Investment in capital assets, net of related debt, increased from the prior year's \$319,581 to \$333,386 by \$13,805 or 4.3% primarily due to the \$11,747 transfer of fixed assets from the Fire Department's Auxiliary Water Supply System (AWSS) to the Enterprise.

Current and other assets are primarily comprised of restricted and unrestricted balances of cash, receivables for water deliveries and services, interfund receivables due from other governmental agencies, and inventory. This also includes receivables which represent cumulative amounts due from the wholesale customers to match revenues with the Enterprise's costs of providing service (the "Balancing Account") in accordance with the provisions set forth in the Water Supply Agreement effective July 1, 2009. Balances due are recovered in future year rates.

During the fiscal year 2011, current and other assets increased by \$524,270 or 46.1%. The increases included \$506,068 in restricted and unrestricted cash and investment from bond issuance of \$979,355 and \$6,934 in receivables from the wholesale customers that was consistent with the new Water Supply Agreement terms. Wholesale customers are billed based on the estimated costs of service and usage, which are adjusted to actual costs and usage at year-end. As of June 30, 2011, the ending balance was \$41,026 owed to the Enterprise. Refer to Note 10, Wholesale Balancing Account, for additional details. Inventory increased by \$6,158 due to the transfer of AWSS assets from the Fire Department. Other increases included bond issuance costs of \$5,210, restricted receivables of \$3,920 primarily due to interest subsidies receivables from the Internal Revenue Service on taxable Build America Bonds, \$3,214 in prepaid expenses was explained by \$2,813 for the Pacifica Recycled Water project and \$401 for lease agreement with the San Francisco Recreation and Park Commission for the use of Civic Center Garage, and \$893 in capacity fee receivables. The increases were offset by decreases of \$4,224 in receivables from Wastewater and Hetch Hetchy Enterprises as a result of construction cost reimbursement for 525 Golden Gate Headquarters Building, \$3,479 in receivables for charges for services, as a result of unbilled revenue accrual for wholesale customers, \$372 from the High Efficiency Toilet Grant and the EPA Contamination Warning System Grant, and \$52 in interest receivables from pooled investments.

Total liabilities increased by \$1,159,231 or 44.8% primarily due to the issuance of \$939,493 in revenue bonds net of principal payment and \$150,000 in commercial paper. Increases also included \$30,791 in payables from restricted assets for the Water System Improvement Program, the Advanced Meter Infrastructure System, and the 525 Golden Gate Headquarters, \$14,716 in other post-employment benefits obligation as a result of a higher annual required contribution, \$13,614 in interfund payable which included \$13,638 due to Hetch Hetchy Enterprise for water storage and transmission facilities improvements, \$12,676 in bond interest payable, \$3,459

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in deferred credit including \$1,100 in grant advance, and \$1,800 of rent and utility deposits, \$2,480 in accounts payable from higher construction, repair and replacement activities, and \$118 in accrued payroll. These increases were offset by decreases of \$4,036 in arbitrage liability due to a payment made to the Internal Revenue Service in fiscal year 2011, \$2,750 in damage claims liability based on actuarial estimates, \$659 reduction in pollution remediation liability for the Baylands Peninsula Sportsman Club project as a result of completion of remediation, \$419 in workers' compensation, and \$252 in accrued vacation and sick leave.

Results of Operations

The following table summarizes the Enterprise's revenues, expenses, and changes in net assets.

Table 2
Comparative Condensed Revenues, Expenses and Changes in Net Assets

	Years ended June 30, 2012, 2011 and 2010				
	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012 – 2011 change</u>	<u>2011 – 2010 change</u>
Revenues:					
Charges for services	\$ 324,169	271,387	248,369	52,782	23,018
Rents and concessions	9,398	9,388	8,584	10	804
Other operating revenues	8,534	7,620	8,265	914	(645)
Interest and investment income	33,450	17,283	9,823	16,167	7,460
Other non-operating revenues	34,180	31,499	5,851	2,681	25,648
Total revenues	<u>409,731</u>	<u>337,177</u>	<u>280,892</u>	<u>72,554</u>	<u>56,285</u>
Expenses:					
Operating expenses	304,562	261,927	277,970	42,635	(16,043)
Interest expense	126,686	100,875	47,272	25,811	53,603
Non-operating expenses	2,661	2,121	1,773	540	348
Total expenses	<u>433,909</u>	<u>364,923</u>	<u>327,015</u>	<u>68,986</u>	<u>37,908</u>
Loss before capital contributions and transfers	<u>(24,178)</u>	<u>(27,746)</u>	<u>(46,123)</u>	<u>3,568</u>	<u>18,377</u>
Capital contribution	—	26,154	—	(26,154)	26,154
Transfers from City and County of San Francisco	1,500	—	—	1,500	—
Transfers to City and County of San Francisco	<u>(15,085)</u>	<u>(17,834)</u>	<u>(493)</u>	<u>2,749</u>	<u>(17,341)</u>
Changes in net assets	<u>(37,763)</u>	<u>(19,426)</u>	<u>(46,616)</u>	<u>(18,337)</u>	<u>27,190</u>
Net assets at beginning of year	<u>396,258</u>	<u>415,684</u>	<u>462,300</u>	<u>(19,426)</u>	<u>(46,616)</u>
Net assets at end of year	<u>\$ 358,495</u>	<u>396,258</u>	<u>415,684</u>	<u>(37,763)</u>	<u>(19,426)</u>

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Results of Operations, Fiscal Year 2012

The Enterprise's total revenues for the year of \$409,731 represented an increase of \$72,554 or 21.5% compared to the prior year (see Table 2). Increases included \$52,782 from charges for services, \$16,167 from interest and investment income, \$2,681 from other non-operating revenues, \$914 from other operating revenues such as capacity fees revenues and water sales to other city departments, and \$10 from rent and concessions.

Charges for services increased by \$52,782 or 19.4% due to increased revenues of \$29,895 from an average 12.5% planned retail rate increase along with \$22,887 resulting from an average 38.4% planned wholesale rate increase. Wholesale sales showed a slight increase as well as a \$22,243 planned repayment of the balancing account. Interest and investment income increased by \$16,167 or 93.5% as a result of unrealized gain/loss adjustment for cash and investments with City Treasury and outside City Treasury. Other non-operating revenues increased by \$2,681 or 8.5% due to a \$4,711 interest subsidy from the Internal Revenue Service for Build America Bonds in connection with the 2010 Series B, E and G Water Revenue Bonds, offset by a decrease of \$2,030 in miscellaneous revenues such as settlement revenue received during the year.

The Enterprise's total expenses increased by \$68,986 or 18.9% to \$433,909 over the prior year (see Table 2), due to increases of \$42,635 in operating expenses, \$25,811 in interest expense which included increases of \$30,527 for the new 2011 Series ABCD Water Revenue Bonds, \$2,093 for the new 2012 Series ABC Water Revenue Bonds, and \$59 for additional commercial paper issued, offset by a decrease of \$6,868 for old Water Revenue Bonds. Other non-operating expenses increased by \$540 mainly due to the Water Conservation Rebate Program. The increase of \$42,635 in operating expenses was mainly due to increases of \$52,160 in project expenses due to \$176,858 in construction contract net of \$124,698 capitalization for higher construction activities, \$5,843 in depreciation, \$3,087 in services provided by other City departments, and \$2,974 in personal services due to \$635 in salaries and \$2,339 in fringe benefits for higher OPEB contributions. These increases were offset by decreases of \$18,982 in general and administrative expenses mainly for judgments & claims based on settlement and estimate, \$1,699 in materials and supplies for various maintenance projects, and \$748 in contractual services primarily for building and structure maintenance.

In fiscal year 2011, the Enterprise received \$26,154 capital contribution from the San Francisco Fire Department consisting of \$11,747 in capital assets, \$8,397 in general obligation bond proceeds for the improvements of the Auxiliary Water Supply System, and \$6,010 in inventory.

The Enterprise received \$1,500 transfer in for the first installment of total \$6,272 purchase price by the City's General Fund for the 17th and Folsom property. The purchase will be completed in fiscal year 2013. Total transfers out decreased by \$2,749 mainly due to decreased transfers of \$2,114 to the Recreation and Park and Public Works departments for the Enterprise's landscape and irrigation projects related to funding water conservation projects, and \$1,070 to a special revenue fund for the City Surety Bond Program, offset by an increased transfer of \$435 to Hetch Hetchy Water for a total of \$14,073 to fund certain up-country water storage and transmission facilities improvements.

Results of Operations, Fiscal Year 2011

The Enterprise's total revenues for the year of \$337,177 represented an increase of \$56,285 or 20.0% compared to the prior year (see Table 2). Increases included \$25,648 from other non-operating revenues, \$23,018 from

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charges for services, \$7,460 from interest and investment income, and \$804 from rent and concessions, offset by a decrease of \$645 in other operating revenues of installation services.

Other non-operating revenues increased by \$25,648 or 438.4% primarily due to interest subsidies of \$21,647 from the Internal Revenue Service for Build America Bonds issued during the year in connection with the 2010 Series B and Series E. Charges for services increased by \$23,018 or 9.3% due to increased revenues from an average 15% of planned retail rate increase along with an average 15.2% of planned wholesale rate increase, offset by reduced consumption and a decrease in unbilled revenue accrual from wholesale customers. Interest and investment income increased by \$7,460 or 75.9% as a result of higher cash balance from the issuance of revenue bonds and commercial paper during the year.

The Enterprise's total expenses increased by \$37,908 or 11.6% to \$364,923 over the prior year (see Table 2), due to increases of \$53,603 in interest expense as a result of the issuance of revenue bonds and commercial paper, \$348 in non-operating expenses mainly for the Water Conservation Rebate Program, offset by a decrease of \$16,043 in operating expenses. The decrease of \$16,043 in operating expenses were due to decreases of \$19,460 in judgments & claims based on actuarial estimate, \$8,127 in non-capitalized project expenses, \$1,266 in services provided by other departments, and \$146 in general and administrative expenses. These decreases were offset by increases of \$6,181 in depreciation, \$3,185 in personal services due to a decrease of \$1,194 in salaries offset by an increase of \$4,379 in retirement and health care costs and contributions, \$2,499 in contractual services primarily for building and structure maintenance, and \$1,091 in materials and supplies for various maintenance projects.

The total transfers out has increased by \$17,341 mainly due to a \$13,638 transfer to the Hetch Hetchy Enterprise for certain up-country water storage and transmission facilities improvements. The Enterprise also transferred \$2,643 to the Recreation and Park and the Department of Public Works for the Enterprise's landscape and irrigation projects.

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Capital Assets and Debt Administration

Capital Assets

The following table summarizes changes in the Enterprise's capital assets.

Table 3

Capital Assets, Net of Depreciation

Years ended June 30, 2012, 2011, and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012 – 2011 change</u>	<u>2011 – 2010 change</u>
Facilities, improvements, machinery, and equipment	\$ 1,813,763	1,223,311	1,054,627	590,452	168,684
Intangible assets	9,832	9,191	4,652	641	4,539
Land	24,711	18,812	17,707	5,899	1,105
Construction work in progress	1,385,860	1,228,574	787,367	157,286	441,207
Total	<u>\$ 3,234,166</u>	<u>2,479,888</u>	<u>1,864,353</u>	<u>754,278</u>	<u>615,535</u>

Capital Assets, Fiscal Year 2012

The Enterprise has net capital assets of \$3,234,166 invested in a broad range of utility capital assets as of June 30, 2012 (see Table 3). The investment in capital assets includes land, facilities, improvements, water treatment plants, aqueducts, water transmission, distribution mains, water storage facilities, pump stations, water reclamation facilities, machinery and equipment. The Enterprise's net revenue and long-term debt are used to finance capital investments. Capital assets, net of depreciation, increased by \$754,278 from prior year as a result of increases of \$590,452 or 48.3% in structures, buildings and equipment, \$157,286 or 12.8% in construction work in progress, \$5,899 or 31.4% in land which included demolition costs of \$4,567 for 525 Golden Gate Headquarters, \$1,306 for purchase of land in Alameda, Sunol, and \$26 for Balboa Reservoir land exchange with the San Francisco City College, and \$641 or 7.0% in intangible assets. The increase in capital assets is consistent with the Enterprise's implementation of the ten-year capital plan, including the Water System Improvement Program (WSIP).

With the adoption of GASB Statement 51, the Enterprise reclassified \$4,652 in intangible assets as of June 30, 2010, composed of \$3,973 in Customer Care & Billing computer software and \$679 in easements. In fiscal year 2011, the Enterprise recorded a total of \$9,191, an additional \$4,539 in intangible assets which is comprised of \$5,017 in Supervisory Control & Data Acquisition (SCADA) System software and \$495 in San Francisco Online Invoicing System software, offset by \$973 in intangible assets related depreciation. In fiscal year 2012, the Enterprise recorded a total of \$9,832, an additional \$641 in intangible assets which is comprised of \$2,349 in Customer Care & Billing computer software enhancement, offset by \$1,708 in intangible assets related depreciation.

SAN FRANCISCO WATER ENTERPRISE

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(Dollars in thousands, unless otherwise stated)

Major additions to construction work in progress during the year ended June 30, 2012 include:

Irvington Tunnel Alternatives – New Irvington Tunnel	\$	104,632
San Joaquin Pipeline System		97,035
Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel		85,326
Calaveras Dam Replacement		80,545
Sunol Valley Water Treatment Plant Expansion and Treated Water Reservoir		56,652
Bay Division Pipeline (BDPL) Reliability Upgrade		55,348
525 Golden Gate Headquarters Project		53,518
Crystal Springs/San Andreas Transmission Pipeline Upgrade		53,262
Harry Tracy Water Treatment Plant Long-Term Improvements		35,417
Crystal Springs Pipeline No. 2 Replacements		30,329
Lower Crystal Springs Dam Improvements		19,910
Advanced Meter Infrastructure System		17,336
Environmental Impact Project (PEIR) – Habitat Restoration Program		14,055
Bay Division Pipeline No. 3 and 4 Cross Connection		13,767
Irvington Tunnel Alternatives – Alameda Siphon No. 4		12,309
Lake Merced Pump Station Upgrade		7,719
Tesla Treatment Facility		6,719
Groundwater Project – Regional Groundwater Storage and Recovery		5,931
Other project additions individually below \$5,000		73,295
	\$	<u>823,105</u>

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Major facilities, improvements, intangible assets, machinery and equipment placed in service, including transfers of completed projects from construction work in progress, during the year ended June 30, 2012 include:

525 Golden Gate Headquarters Project	\$	119,116
Bay Division Pipeline No. 5 Upgrade East Bay		98,749
Lower Crystal Springs Dam Improvements		44,938
New Crystal Springs Bypass Tunnel – Pipeline		41,975
Alameda Siphon No. 4 – Siphons Piping And Valves		37,130
New Crystal Springs Bypass Tunnel		34,770
Advanced Meter Infrastructure System		33,736
University Mound Reservoir North Basin - Structure		30,585
Pulgas Balancing Reservoir Rehabilitation - Roofing Work		19,191
University Mound Reservoir North Basin - Roof		12,247
New Crystal Springs Bypass Tunnel – South Shaft Site		12,232
San Joaquin Pipeline System – Pelican Crossover Pipes		8,486
San Joaquin Pipeline System – Emery Crossover Pipes		7,599
Alameda Siphon No. 4 – Overflow Pipeline		6,788
New Crystal Springs Bypass Tunnel - North Shaft Site		6,033
San Joaquin Pipeline System – Pelican Crossover Vault		5,492
San Joaquin Pipeline System – Emery Crossover Vault		5,325
Alameda Siphon No. 4 – Road Improvements		5,204
Other items individually below \$5,000		126,076
	\$	<u>655,672</u>

Water System Improvement Program

As of June 30, 2012, the SFPUC's Water Enterprise is midway through construction of its multi-billion dollar, multi-year program to upgrade the Hetch Hetchy Regional and Local Water Systems, known as the Water System Improvement Program (WSIP). The WSIP delivers capital improvements that enhance the Enterprise's ability to provide reliable, affordable, high quality drinking water to its twenty-seven wholesale customers and regional retail customers in Alameda, Santa Clara and San Mateo Counties, collectively serving some 1.8 million people outside of San Francisco, as well as another 800,000 retail customers in San Francisco, in an environmentally sustainable manner. The program is structured to cost effectively meet water quality requirements, improve seismic and delivery reliability, and meet long-term water supply objectives.

The program's target completion date is July 2016. As of June 30, 2012, one regional project is in Planning Phase, 3 in Design Phase, 2 in Bid & Award Phase, 15 in Construction phase, 10 in Close-Out phase, and 15 regional projects are completed.

WSIP costs total \$4.1 billion for capital projects and \$0.5 billion for net financing costs. The entire amount is fully appropriated, of which approximately \$2.2 billion of project appropriations have been expended through fiscal year ended June 30, 2012. To help meet this funding need, additional bonds sales are planned. Additional details regarding the WSIP are available on the Enterprise's web site at www.sfwater.org.

SAN FRANCISCO WATER ENTERPRISE

Management's Discussion and Analysis

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(Dollars in thousands, unless otherwise stated)

525 Golden Gate Avenue Headquarters Project

As of June 30, 2012, the Enterprise has incurred \$134,451 in construction costs for the 525 Golden Gate Headquarters project. The building consolidated divisions of the San Francisco Public Utilities Commission that were renting space at multiple locations in the Civic Center. Construction started in January 2010 and relocation of some SFPUC employees was already underway as of June 30, 2012. The entire SFPUC relocation was completed in July 2012.

Automated Water Meter Program

The SFPUC Advanced Meter Infrastructure System (AMI) will eliminate regular manual meter reading field visits, improve customer service by providing more accurate and frequent meter reading information and facilitate the timely detection of leaks, in addition to equipment issues, tampering, theft or other system losses. The estimated capital cost of this project, including the AMI system implementation in addition to nearly a full meter replacement program (about 5% of meters are being AMI retrofitted), is \$64,100. Phase I implementation of 58,006 meter replacements completed in August 2011. After successful system acceptance testing, Phase II implementation began in January 2012. At the end of fiscal year 2012, a total of 98,357 automated water meters were deployed. The projected completion date is April 2013.

Capital Assets, Fiscal Year 2011

The Enterprise has net capital assets of \$2,479,888 invested in a broad range of utility capital assets as of June 30, 2011 (see Table 3). The investment in capital assets includes land, facilities, improvements, water treatment plants, aqueducts, water transmission, distribution mains, water storage facilities, pump stations, water reclamation facilities, machinery and equipment. The Enterprise's net revenue and long-term debt are used to finance capital investments. Capital assets, net of depreciation, increased by \$615,535 from prior year as a result of increases of \$441,207 or 56.0% in construction work in progress, \$168,684 or 16.0% in structures, buildings and equipment, \$4,539 or 97.6% in intangible assets, and an increase of \$1,105 for purchase of land. The increase in capital assets is consistent with the Enterprise's implementation of the ten-year capital plan, including the Water System Improvement Program (WSIP).

The Enterprise recorded \$5,512 in intangible assets and \$973 in intangible assets related depreciation during the fiscal year. The intangible assets addition composed of \$5,017 in Supervisory Control & Data Acquisition (SCADA) System software and \$495 in San Francisco Online Invoicing System software. With the adoption of GASB Statement 51, the Enterprise reclassified \$4,652 in intangible assets as of June 30, 2010, composed of \$3,973 in Customer Care & Billing computer software and \$679 in easements.

In May 2010, the City and County of San Francisco Board of Supervisors and Mayor approved the transfer of costs of operating, maintaining and improving the auxiliary water supply system (AWSS) from the Fire Department to the Enterprise. In the fiscal year 2011, the Fire Department transferred \$11,747 in AWSS capital assets to the Enterprise comprising of cisterns, pump stations, storage tanks, valves and vaults.

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(Dollars in thousands, unless otherwise stated)

Major additions to construction work in progress during the year ended June 30, 2011 include:

Bay Division Pipeline (BDPL) Reliability Upgrade	\$ 101,469
New Irvington Tunnel	62,068
525 Golden Gate Headquarters	61,519
Bay Division Pipeline Reliability Upgrade - Tunnel	58,096
Sunol Valley Water Treatment Plant Expansion & Treated Water Reservoir	46,638
San Joaquin Pipeline System	27,691
Irvington Tunnel Alternatives - Alameda Siphon #4	24,812
Tesla Treatment Facility	23,768
Lake Merced Pump Station Upgrade	19,711
New Crystal Springs Bypass Tunnel	19,023
University Mound Reservoir - Upgrade (North Basin)	18,420
Crystal Springs/San Andreas Transmission Upgrade	17,397
Advanced Meter Infrastructure System	17,344
Calaveras Dam Replacement	16,803
Pulgas Balancing Reservoir Rehab - Pulgas Phase 3	15,202
Harry Tracy Water Treatment Plant Long Term Improvements	13,981
San Antonio Pump Station Upgrade	7,405
Crystal Springs pipeline #2 Replacement	6,838
Baden and San Pedro Valve Lot	6,574
San Andreas #3 Pipeline Installation	5,861
Lower Crystal Springs Dam Improvements	5,803
Environmental Impact Project - Habitat Restoration Program	5,187
Other project additions individually below \$5,000	77,477
	<u>\$ 659,087</u>

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(Dollars in thousands, unless otherwise stated)

Major facilities, improvements, intangible assets, machinery and equipment placed in service, including transfers of completed projects from construction work in progress, during the year ended June 30, 2011 include:

Tesla Treatment Facility - UV Building	\$	31,662
San Andreas Pipeline #3		28,334
Tesla Treatment Facility - Steel Pipes		21,996
San Joaquin Pipeline Rehab		15,440
Tesla Treatment Facility - UV Reactor & Valve Vault Valves		12,441
Auxiliary Water Supply System Infrastructure		11,744
Tesla Treatment Facility - Chemical Building		10,457
Baden Pump Station - Pumps, Motors, Drives and Vibration Monitoring System		9,912
Tesla Treatment Facility - San Joaquin pipeline Valves & Vault		7,797
SCADA Software & Hardware		5,018
Other project additions individually below \$5,000		77,174
	\$	<u>231,975</u>

Water System Improvement Program

As of June 30, 2011, the SFPUC's Water Enterprise is half-way completed with its multi-billion dollar, multi-year program to upgrade the Hetch Hetchy Regional and Local Water Systems, known as the Water System Improvement Program (WSIP). The WSIP delivers capital improvements that enhance the Enterprise's ability to provide reliable, affordable, high quality drinking water to its twenty-seven wholesale customers and regional retail customers in Alameda, Santa Clara and San Mateo Counties, collectively serving some 1.7 million people outside of San Francisco, as well as another 800,000 retail customers in San Francisco, in an environmentally sustainable manner. The program is structured to cost effectively meet water quality requirements, improve seismic and delivery reliability, and meet long-term water supply objectives.

The program is on target to achieve an overall completion date of December 2015, with construction phase started in early 2009. As of June 30, 2011, there are 2 regional projects in Planning Phase, 5 in Design Phase, 1 in Bid & Award Phase, 20 in Construction phase, 4 in Close-Out phase, and 14 regional projects are completed.

Total cost included \$4.1 billion for capital projects and \$0.5 billion for net financing costs. To date, the entire amount is fully appropriated for the WSIP, of which approximately \$1.6 billion of project appropriations have been expended through fiscal year ended June 30, 2011. To help meet this funding need, additional bonds sales are planned. Additional details regarding the WSIP are available on the Enterprise's web site at www.sfwater.org.

525 Golden Gate Avenue Headquarters Building

As of June 30, 2011 the Enterprise has incurred \$80,933 in construction costs for the 525 Golden Gate Avenue Headquarters project. The building is intended to consolidate divisions of the San Francisco Public Utilities Commission that are currently renting space at multiple locations in the Civic Center. Demolition of the existing

SAN FRANCISCO WATER ENTERPRISE

Management's Discussion and Analysis

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(Dollars in thousands, unless otherwise stated)

site was completed in June 2009. Construction started in January 2010 with an expected completion date of June 2012.

Advanced Meter Infrastructure System

The SFPUC is implementing the Advanced Meter Infrastructure System (AMI), which will largely eliminate manual meter reading field visits, improve customers' access to hourly usage information, facilitate the timely detection of tampering, theft and leaks, while enhancing usage or flow-tracking. The estimated total capital cost of this project is \$64,100, with Phase 1 implementation including 58,006 meter replacements throughout fiscal year 2010, and Phase 2 implementation replacing 120,000 meters with a projected completion date of December 2012.

Debt Administration

As of June 30, 2012, the Enterprise has \$4,789,235 total debt outstanding, an increase of \$1,328,067 over the prior year, as shown below in Table 4. More detailed information about the Enterprise's debt activity is presented in notes 6, 7, 8 and 9 to the financial statements.

Table 4
Outstanding Debt, Net of Amortized Costs
June 30, 2012, 2011, and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012 – 2011 change</u>	<u>2011 – 2010 change</u>
Revenue bonds	\$ 4,489,059	3,184,898	2,245,301	1,304,161	939,597
Capital appreciation bonds	4,450	4,155	3,878	295	277
Commercial paper	174,000	150,000	—	24,000	150,000
Certificates of participation	121,726	122,115	122,496	(389)	(381)
Total	<u>\$ 4,789,235</u>	<u>3,461,168</u>	<u>2,371,675</u>	<u>1,328,067</u>	<u>1,089,493</u>

The Enterprise has commercial paper notes of \$174,000 and \$150,000 outstanding at June 30, 2012 and 2011 respectively. Total debt outstanding at June 30, 2012 consisted of \$4,489,059 in fixed-rate long-term revenue bonds, \$4,450 (accrued value) in capital appreciation bonds, and \$121,726 in certificates of participation. The change in total debt outstanding was due to issuance of \$1,422,630 in revenue bonds and \$24,000 in commercial paper, retirement of revenue bond principal, accretion of capital appreciation bonds, and amortization of bond discounts, bond premium and refunding loss. See notes 7 and 9 for more details.

Credit Ratings and Bond Insurance – The Enterprise carried underlying ratings of “Aa3” and “AA-” from Moody's and Standard & Poor's (S&P), respectively, at June 30, 2012 and “Aa2” and “AA-” from Moody's and S&P, respectively, at June 30, 2011.

Debt Service Coverage – Pursuant to the Amended and Restated Indenture, the Enterprise is required to collect sufficient net revenues each fiscal year, together with any Enterprise funds (except Bond Reserve Funds) which

SAN FRANCISCO WATER ENTERPRISE

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(Dollars in thousands, unless otherwise stated)

are available for payment of debt service and are not budgeted to be expended, at least equal to 1.25 times annual debt service for said fiscal year. During fiscal years 2012 and 2011, the Enterprise's net revenues, together with fund balances available to pay debt service and not budgeted to be expended, were sufficient to meet the rate covenant requirements under the Enterprise's Amended and Restated Indenture.

Debt Authorization – Pursuant to the Charter, the Enterprise can incur indebtedness upon two-thirds vote of the Board of Supervisors, as approved by voters in Proposition E in November 2002. As of June 30, 2012, the Board of Supervisors has authorized the issuance of \$3,260,531 in revenue bonds under Proposition E with \$2,679,550 issued against this authorization. The Enterprise can also incur indebtedness of up to \$1,628,000 for improvements to the water system pursuant to Proposition A that was approved by the voters in November 2002. As of June 30, 2012, \$1,348,335 of the \$1,628,000 Proposition A authorized bonds were issued. The Enterprise is also authorized to issue up to \$500,000 in commercial paper. As of June 30, 2012, there was \$174,000 in taxable commercial paper outstanding, and as of June 30, 2011, there was \$150,000 in taxable commercial paper outstanding.

Cost of Debt Capital – The Enterprise's outstanding long-term debt has coupon interest rates ranging from 3.0% to 6.9% as of June 30, 2012 and ranged from 2.0% to 6.9% as of June 30, 2011. The Enterprise's short-term debt has interest rates ranging from 0.1% to 0.3% during fiscal year 2012. In the prior year, the Enterprise's short-term debt has interest rates ranging from 0.2% to 0.4%. More information about the Enterprise's debt activities is presented in notes 6, 7, 8, and 9 to the financial statements.

Next Year's Rates

Average retail water rate increases of 12.5%, 12.5%, and 6.5% have been approved for fiscal years ending June 30, 2012 through 2014, respectively. Wholesale water rates are adopted annually; the Commission approved a 38.4% increase for the fiscal year ended June 30, 2012 on May 10, 2011. The Commission also approved an 11.4% increase for the fiscal year ending June 30, 2013 on May 8, 2012.

Rate Setting Process

Proposition E, as approved by the Voters in November 2002, amended the City Charter by adding the new Article VIII B, entitled "Public Utilities," which changed the Commission's ability to issue new revenue bonds and set retail water rates. For the retail water rate-setting, the Commission is required to:

- Establish rates, fees, and charges based on cost of service;
- Retain an independent rate consultant to conduct cost of service studies at least every five years;
- Consider establishing new connection fees;
- Consider conservation incentives and lifeline rates;
- Adopt a rolling five-year forecast annually; and
- Establish a Rate Fairness Board.

The SFPUC successfully negotiated a new Water Supply Agreement (WSA) with the Wholesale Water Customers represented by the Bay Area Water Supply and Conservation Agency (BAWSCA) in early 2009. The WSA has a 25-year term, beginning on July 1, 2009, with two 5-year extension options.

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(Dollars in thousands, unless otherwise stated)

The following table is the Enterprise's average rate adjustments since July 1, 2004:

	Approved average rate adjustments	
	Retail	Wholesale
Effective date:		
July 1, 2004	0.0 %	2.7 %
July 1, 2005	15.0	(9.7) ¹
July 1, 2006	15.0	18.8
July 1, 2007	15.0 ²	6.3
July 1, 2008	15.0	10.0
July 1, 2009 ³	15.0 ⁴	15.7
July 1, 2010	15.0 ⁴	15.2
July 1, 2011	12.5 ⁴	38.4
July 1, 2012	12.5 ⁴	11.4
July 1, 2013	6.5 ⁴	7.2 ⁵

¹ Adjustment effective April 1, 2005

² Adjustment effective July 14, 2007

³ July 1, 2009 was the first year of the twenty-five year agreement

⁴ Adjustment effective July 1, 2009 through July 1, 2013

⁵ Wholesale rates are adopted annually, pursuant to the 25-year WSA. July 1, 2013 rate is an estimate.

Pursuant to the City and County of San Francisco Charter Section 8B.125, an independent rate study is performed at least once every five years. A rate study was undertaken in fiscal year 2009 to examine the future revenue requirements and cost of service of the Enterprise. This resulted in an approved 5-year retail rate schedule through fiscal year 2013-14.

Request for Information

This report is designed to provide our citizens, customers, investors, and creditors with an overview of the Enterprise's finances and to demonstrate the Enterprise's accountability for the money it receives. Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to San Francisco Public Utilities Commission, Chief Financial Officer, 525 Golden Gate Avenue, 13th Floor, San Francisco, CA 94102.

SAN FRANCISCO WATER ENTERPRISE

Statements of Net Assets

June 30, 2012 and 2011

(In thousands)

	2012	2011
Assets:		
Current assets:		
Cash and investments with City Treasury	\$ 78,960	83,410
Cash and investments outside City Treasury	162	253
Receivables:		
Charges for services (net of allowance for doubtful accounts of \$1,705 in 2012 and \$2,765 in 2011)	51,181	38,310
Wholesale balancing account	9,650	26,029
Due from other funds	194	6,122
Due from other governments	342	626
Interest	308	—
Advances and other	2,359	4,694
Total current receivables	64,034	75,781
Inventories	7,882	7,949
Restricted assets – cash and investments outside City Treasury	81,129	72,797
Total current assets	232,167	240,190
Non-current assets:		
Wholesale balancing account receivable	9,133	14,997
Restricted assets – cash and investments with City Treasury	1,596,856	1,093,431
Restricted assets – cash and investments outside City Treasury	358,309	285,366
Restricted assets – interest and other receivable	5,656	4,671
Capital assets not being depreciated	1,411,250	1,248,065
Capital assets, net of accumulated depreciation	1,822,916	1,231,823
Bond issuance costs (net of accumulated amortization of \$6,515 in 2012 and \$5,400 in 2011)	33,352	22,581
Total non-current assets	5,237,472	3,900,934
Total assets	5,469,639	4,141,124
Liabilities:		
Current liabilities:		
Accounts payable	8,490	12,641
Accrued payroll	9,355	7,678
Accrued vacation and sick leave, current portion	6,182	5,764
Accrued workers' compensation, current portion	1,403	1,324
Due to other funds	3,695	13,638
Damage claims liability, current portion	2,899	8,603
Deposits, advances, and other liabilities	7,396	8,525
Bond and loan interest payable	35,164	28,747
Revenue bonds, current portion	45,965	44,050
Certificates of participation, current portion	1,971	—
Commercial paper	174,000	150,000
Current liabilities payable from restricted assets	143,907	105,398
Total current liabilities	440,427	386,368
Long-term liabilities:		
Arbitrage rebate	591	517
Other post-employment benefits obligations	73,009	60,314
Accrued vacation and sick leave, less current portion	6,361	5,811
Accrued workers' compensation, less current portion	6,561	6,351
Damage claims liability, less current portion	6,196	18,387
Revenue bonds, less current portion	4,443,094	3,140,848
Capital appreciation bonds	4,450	4,155
Certificates of participation, less current portion	119,755	122,115
Pollution remediation obligation, less current portion	10,700	—
Total long-term liabilities	4,670,717	3,358,498
Total liabilities	5,111,144	3,744,866
Net assets:		
Invested in capital assets, net of related debt	301,267	333,386
Restricted for debt service	27,213	30,840
Restricted for capital projects	13,665	19,163
Unrestricted	16,350	12,869
Total net assets	\$ 358,495	396,258

See accompanying notes to financial statements.

SAN FRANCISCO WATER ENTERPRISE

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2012 and 2011

(In thousands)

	2012	2011
Operating revenues:		
Charges for services	\$ 324,169	271,387
Rents and concessions	9,398	9,388
Capacity fees	1,373	869
Other revenues	7,161	6,751
Total operating revenues	342,101	288,395
Operating expenses:		
Personnel services	114,337	111,363
Contractual services	14,838	15,586
Materials and supplies	12,140	13,839
Depreciation	64,595	58,752
Services provided by other departments	49,395	46,308
General and administrative and other	49,257	16,079
Total operating expenses	304,562	261,927
Operating income	37,539	26,468
Non-operating revenues (expenses):		
Federal and State grants	2,199	1,810
Interest and investment income	33,450	17,283
Interest expense	(126,686)	(100,875)
Net gain from sale of assets	6	39
Other non-operating revenues	31,975	29,650
Other non-operating expenses	(2,661)	(2,121)
Net non-operating expenses	(61,717)	(54,214)
Loss before capital contribution and transfers	(24,178)	(27,746)
Capital contribution	—	26,154
Transfers from the City and County of San Francisco	1,500	—
Transfers to the City and County of San Francisco	(15,085)	(17,834)
Net capital contribution and transfers	(13,585)	8,320
Changes in net assets	(37,763)	(19,426)
Net assets at beginning of year	396,258	415,684
Net assets at end of year	\$ 358,495	396,258

See accompanying notes to financial statements.

SAN FRANCISCO WATER ENTERPRISE

Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received from customers, including cash deposits	\$ 344,343	273,675
Cash received from tenants for rent	8,599	8,853
Cash received from settlements	1,700	3,896
Cash paid to employees for services	(96,647)	(94,332)
Cash paid to suppliers for goods and services	(125,412)	(64,874)
Cash paid for judgments and claims	(4,366)	(15,183)
Cash paid for rebates and program incentives	(1,433)	(1,049)
Cash received from miscellaneous revenue	3,917	4,107
Cash paid to miscellaneous expenses	<u>(1,228)</u>	<u>(1,071)</u>
Net cash provided by operating activities	<u>129,473</u>	<u>114,022</u>
Cash flows from non-capital financing activities:		
Transfers out	(28,723)	(17,834)
Cash received from operating grants	<u>1,385</u>	<u>3,280</u>
Net cash used in non-capital financing activities	<u>(27,338)</u>	<u>(14,554)</u>
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	6	39
Proceeds from bond issuance, net of discounts and issuance costs	1,509,434	1,002,870
Proceeds from commercial paper borrowings	24,000	150,000
Principal paid on revenue bonds	(199,900)	(59,365)
Interest paid on long-term debt	(194,679)	(145,906)
Interest paid on commercial paper	(324)	(250)
Issuance cost paid on long-term debt	(11,886)	(6,202)
Interfund loan receivable	6,122	4,224
Transfers in	1,500	—
Acquisition and construction of capital assets	(714,925)	(581,973)
Capital contribution	—	7,897
Federal interest income subsidy from Build America Bonds	<u>26,010</u>	<u>17,658</u>
Net cash provided by capital and related financing activities	<u>445,358</u>	<u>388,992</u>
Cash flows from investing activities:		
Interest income received	32,666	17,608
Proceeds from sale of investments outside City Treasury	508,076	527,561
Purchase of investments outside City Treasury	<u>(503,600)</u>	<u>(667,310)</u>
Net cash provided by (used in) investing activities	<u>37,142</u>	<u>(122,141)</u>
Increase in cash and cash equivalents	584,635	366,319
Cash and cash equivalents:		
Beginning of year	<u>1,266,903</u>	<u>900,584</u>
End of year	\$ <u><u>1,851,538</u></u>	\$ <u><u>1,266,903</u></u>
Reconciliation of cash and cash equivalents to the statement of net assets:		
Cash and investments with City Treasury:		
Unrestricted	\$ 78,960	83,410
Restricted	1,596,856	1,093,431
Cash and investments outside City Treasury:		
Unrestricted	162	253
Restricted	439,438	358,163
Less: Restricted (with maturity more than 90 days - see table in note 3)	<u>(263,878)</u>	<u>(268,354)</u>
Cash and cash equivalents at end of year on statements of cash flows	\$ <u><u>1,851,538</u></u>	\$ <u><u>1,266,903</u></u>

(Continued)

SAN FRANCISCO WATER ENTERPRISE

Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ <u>37,539</u>	<u>26,468</u>
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	64,595	58,752
Provision for uncollectible accounts	(1,060)	744
Write-off of capital assets and other non-cash items	8,729	1,123
Settlements	1,700	3,896
Rebates and program incentives	(1,433)	(1,049)
Miscellaneous expenses	(1,228)	(2,847)
Changes in operating assets and liabilities:		
Receivables:		
Charges for services	(11,811)	2,734
Wholesale balancing account	22,243	(6,934)
Interest and other	6,084	1,571
Inventories	67	355
Accounts payable	(4,151)	2,480
Due (from) to other City departments	(194)	13,614
Accrued payroll	1,677	118
Accrued other post-employment benefits obligation	12,695	14,716
Accrued vacation and sick leave	968	(252)
Accrued workers' compensation	289	(419)
Pollution remediation obligation	10,700	(659)
Damage claims liability	(17,895)	(2,750)
Deposits, advances, and other liabilities	(41)	2,361
Total adjustments	<u>91,934</u>	<u>87,554</u>
Net cash provided by operating activities	\$ <u><u>129,473</u></u>	<u><u>114,022</u></u>
Noncash transactions:		
Accrued capital asset costs	\$ 143,907	105,398
Interfund loans payable	3,695	—
Capital contribution	—	18,257

See accompanying notes to financial statements.

SAN FRANCISCO WATER ENTERPRISE

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(1) Description of Reporting Entity

The San Francisco Water Enterprise (the Enterprise) was established in 1930 under the provisions of the Charter of the City and County of San Francisco. The Enterprise acquired the fully developed, mature water works for San Francisco on March 3, 1930. Since then, the City and County of San Francisco (the City) has operated and maintained the water works as the San Francisco Water Enterprise. The Board of Supervisors of the City has adopted resolutions (the Water Resolutions) providing for the issuance of various water revenue and refunding bond series. The Enterprise, which consists of a system of reservoirs, storage tanks, water treatment plants, pump stations, and pipelines, is engaged in the distribution of water to San Francisco and certain suburban areas. In fiscal year 2012, the Enterprise sold approximately 77,400 million gallons of water to nearly 2.6 million people within San Francisco and certain suburban areas.

The San Francisco Public Utilities Commission (the Commission), established in 1932, is responsible for providing operational oversight of the public utility enterprises of the City, which include the Enterprise along with the City's power and sewer utilities (i.e. Hetch Hetchy Water and Power, of which the Power Enterprise is a component, and the San Francisco Wastewater Enterprise). The Commission is responsible for determining such matters as the rates and charges for services, approval of contracts, and organizational policy.

Until August 1, 2008, the Commission consisted of five members, all appointed by the Mayor. Proposition E, a City and County of San Francisco Charter amendment approved by the voters in the June 3, 2008 election, terminated the terms of all five existing members of the Commission, changed the process for appointing new members, and set qualifications for all members. Under the amended Charter, the Mayor continues to nominate candidates to the Commission, but nominees do not take office until the Board of Supervisors votes to approve their appointments by a majority (at least six members). The amended Charter provides for staggered four-year terms for the Commission members and requires them to meet the following qualifications:

- Seat 1 must have experience in environmental policy and an understanding of environmental justice issues.
- Seat 2 must have experience in ratepayer or consumer advocacy.
- Seat 3 must have experience in project finance.
- Seat 4 must have expertise in water systems, power systems, or public utility management.
- Seat 5 is an at-large member.

The Commission is a department of the City, and as such, the financial operations of the Enterprise, Hetch Hetchy Water and Power, and the Wastewater Enterprises are included in the Comprehensive Annual Financial Report of the City as enterprise funds. These financial statements are intended to present only the financial position, and the changes in financial position and cash flows of only that portion of the City that is attributable to the transactions of the Enterprise. They do not purport to,

SAN FRANCISCO WATER ENTERPRISE

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

and do not, present fairly the financial position of the City as of June 30, 2012 and 2011, the changes in its financial position, or, where applicable, the cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

(2) Significant Accounting Policies

(a) *Basis of Accounting and Measurement Focus*

The accounts of the Enterprise are organized on the basis of a proprietary fund type and are included as an enterprise fund of the City and County of San Francisco, California. The activities of this Enterprise are accounted for with a separate set of self-balancing accounts that comprise the Enterprise's assets, liabilities, net assets, revenues, and expenses. Enterprise funds account for activities (i) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or (ii) that are required by laws or regulations that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or (iii) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

The financial activities of the Enterprise are accounted for on a flow of economic resources measurement focus, using the accrual basis of accounting. Under this method, all assets and liabilities associated with its operations are included on the statements of net assets; revenues are recognized when earned, and expenses are recognized when liabilities are incurred. Operating revenues are defined as charges to customers, rental income and capacity fees.

The Enterprise does not apply Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989. The Enterprise applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, as well as statements and interpretations of the FASB, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

(b) *Cash and Cash Equivalents*

The Enterprise considers its pooled cash and investments held with the City Treasury to be demand deposits and, therefore, cash and cash equivalents for financial reporting. The City also holds non-pooled cash and investments for the Enterprise. Non-pooled restricted deposits and investments held outside the City Treasury with maturities of three months or less are also considered to be cash equivalents.

(c) *Investments*

Money market funds are carried at cost, which approximates fair value. All other investments are stated at fair value based on quoted market prices. Changes in fair value are recognized as investment gains or losses and are recorded as a component of non-operating revenue.

SAN FRANCISCO WATER ENTERPRISE

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(d) Inventory

Inventory consists primarily of construction materials and maintenance supplies and is valued at average cost. Inventory is expensed as it is consumed.

(e) Capital Assets

Capital assets are defined as assets with an initial individual cost of more than \$5 and an estimated useful life in excess of one year. Capital assets with an original acquisition date prior to July 1, 1977 are recorded in the financial statements at estimated cost, as determined by an independent professional appraisal, or at cost, if known. All subsequent acquisitions have been recorded at cost. All donated capital assets are valued at estimated fair value at the time of donation. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related assets, which range from 1 to 75 years for equipment and 1 to 200 years for buildings, structures, and improvements. No depreciation or amortization is recorded in the year of acquisition, and a full year's depreciation or amortization is recorded in the year of disposal.

(f) Intangible Assets

Under GASB Statement 51, *Accounting and Financial Reporting for Intangible Assets*, intangible assets are defined as identifiable, non-financial assets capable of being separated, sold, transferred, or licensed, and include contractual or legal rights. Examples of intangible assets include rights-of-way easements, land use rights, water rights, licenses, and permits. The accounting pronouncement also provides guidance on the capitalization of internally generated intangible assets, such as the development and installation of computer software by or on behalf of the reporting entity.

According to the standard, the Enterprise is required to capitalize intangible assets with a useful life extending beyond one reporting period. The Enterprise has established a capitalization threshold of \$100. GASB Statement 51 also requires amortization of intangible asset over the benefit period, except for certain assets having an indefinite useful life. Assets with an indefinite useful life generally provide a benefit that is not constrained by legal or contractual limitations or any other external factor, and therefore, are not amortized.

As of June 30, 2012 and 2011, intangible assets were \$9,832 and \$9,191 respectively.

(g) Construction Work in Progress

The cost of acquisition and construction of major plant and equipment is recorded as construction work in progress. Costs of discontinued construction projects are recorded as an expense in the year in which the decision is made to discontinue such projects.

SAN FRANCISCO WATER ENTERPRISE

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(h) Capitalization of Interest

A portion of the interest cost incurred on capital projects is capitalized for assets that require a period of time to construct or to otherwise prepare them for their intended use. Such amounts are amortized over the useful lives of the assets.

(i) Bond Discount, Premium, and Issuance Costs

Bond discount, premium, and issuance costs are amortized over the term of the related bonds on a method which approximates the effective interest method basis.

(j) Accrued Vacation and Sick Leave

Accrued vacation pay, which may be accumulated up to ten weeks per employee, is charged to expense as earned. Sick leave earned subsequent to December 6, 1978 is non-vesting and may be accumulated up to six months per employee.

(k) Workers' Compensation

The Enterprise is self-insured for workers' compensation claims and accrues the estimated cost of those claims, including the estimated cost of incurred but not reported claims.

(l) Damage Claims Liability

The Enterprise is self-insured for general liability and uninsurable property damage claims. Commercially uninsurable property includes assets that are underground or provide transmission and distribution. Maintained commercial coverage does not cover claims attributed to loss from earthquake, contamination, pollution remediation efforts and other specific naturally occurring contaminants such as mold. The liability represents an estimate of the cost of all outstanding claims, including adverse loss development, and estimated incurred but not reported claims.

(m) Arbitrage Rebate Payable

Certain bonds are subject to arbitrage rebate requirements in accordance with regulations issued by the U.S. Treasury Department. The requirements generally stipulate that earnings from the investment of the tax-exempt bond proceeds that exceed related interest costs on the bonds must be remitted to the federal government on every fifth anniversary of each bond issue. The arbitrage rebate liability was \$591 and \$517 at June 30, 2012 and 2011, respectively.

(n) Refunding of Debt

Gains or losses occurring from refunding of debt prior to maturity are deferred and amortized into interest expense over the remaining life of the old bonds or the life of the new bonds, whichever is shorter.

SAN FRANCISCO WATER ENTERPRISE

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(o) *Income Taxes*

As a government agency, the Enterprise is exempt from both Federal income taxes and California State franchise taxes.

(p) *Revenue Recognition*

Water service charges are based on water usage as determined by the Enterprise. Generally, customers are billed on a cyclical basis with large commercial and industrial customers billed monthly, and all other customers bi-monthly. Revenues earned but unbilled are accrued as charges for services receivables on the statements of net assets.

(q) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(r) *Reclassifications*

Certain reclassifications have been made to prior year amounts to conform to current year presentation.

(s) *Accounting and Financial Reporting for Pollution Remediation Obligations*

According to GASB Statement 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, a government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem;
- A government has violated a pollution prevention-related permit or license;
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the cleanup;
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution; or
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

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(Dollars in thousands, unless otherwise stated)

As a part of ongoing operations, situations may occur requiring the removal of pollution or other hazardous material. These situations typically arise in the process of acquiring an asset, preparing an asset for its intended use, or during the design phase of projects under review by the Project Managers. Other times, pollution may arise during the implementation and construction of a major or minor capital project. Examples of pollution may include, but are not limited to: asbestos or lead paint removal; leaking of sewage in underground pipes or neighboring areas; chemical spills; removal and disposal of known toxic waste; harmful biological and chemical pollution of water; or contamination of surrounding soils by underground storage tanks.

The Enterprise recorded \$10,700 of pollution remediation liability for the excavation of contaminated soil that contained polycyclic aromatic hydrocarbons from the Pacific Rod & Gun Club site in Lake Merced area as of June 30, 2012. The Enterprise did not have any pollution remediation liability as of June 30, 2011.

(3) Cash, Cash Equivalents and Investments

The Enterprise's cash, cash equivalents and investments with the City Treasury are invested in an unrated City pool pursuant to investment policy guidelines established by the City Treasurer. The objectives of the policy guidelines are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The City Treasurer allocates income from the investment of pooled cash at month end in proportion to the Enterprise's average daily cash balances. The primary objectives of the Enterprise's investment policy are consistent with the City's policy.

Restricted assets are held by an independent trustee outside the City's investment pool. The assets are held for the purpose of paying future interest and principal on the bonds and for eligible capital project expenditures. The balances as of June 30, 2012 and 2011 were \$439,438 and \$358,163, respectively. The Enterprise held all investments in guaranteed investment contracts, Treasury and Government Obligations, Commercial Paper, Corporate Bonds and Notes, as well as money market mutual funds consisting of Treasury and Government Obligations.

SAN FRANCISCO WATER ENTERPRISE

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

The following tables present the restricted cash and investments outside City Treasury as of June 30, 2012 and 2011.

Investments	Credit Ratings (S&P/Moody's)	June 30, 2012	
		Maturities	Fair Value
U.S. Treasury Notes	AA+/Aaa	August 31, 2016	\$ 29,701
U.S. Agencies	AAA/Aaa	April 18, 2016	63,435
U.S. Agencies	AAA/Aaa	August 20, 2015	7,067
U.S. Treasury Notes	AAA/N/a	October 15, 2014	903
U.S. Agencies	AAA/Aaa	May 19, 2014	28,540
U.S. Treasury Notes	AA+/Aaa	April 15, 2014	14,431
U.S. Agencies	AAA/Aaa	April 2, 2014	3,394
U.S. Agencies	AAA/Aaa	October 28, 2013	12,573
U.S. Treasury Notes	AA+/Aaa	October 15, 2013	14,339
U.S. Treasury Notes – State and Local Government Series	Not Applicable	May 1, 2013	8,584
U.S. Agencies	AAA/Aaa	April 15, 2013	12,295
U.S. Treasury Notes	AA+/Aaa	April 15, 2013	14,168
Guaranteed Investment Contract	A/A2	March 16, 2013	15,958
U.S. Treasury Notes – State and Local Government Series	Not Applicable	November 1, 2012	10,402
U.S. Agencies	AAA/Aaa	October 30, 2012	12,453
U.S. Treasury Notes	Not Applicable	October 18, 2012	14,295
U.S. Agencies	Not Applicable	October 9, 2012	1,340
U.S. Treasury Money Market Funds	AAA/Aaa	< 90 days	167,080
Money Market Funds	AAA/Aaa	< 90 days	5,995
Money Market Funds	AAA/Aaa	< 90 days	2,485
Total			<u>\$ 439,438</u>

SAN FRANCISCO WATER ENTERPRISE

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

Restricted Cash and Investments outside City Treasury			
Investments	Credit Ratings (S&P/Moody's)	June 30, 2011	
		Maturities	Fair Value
U.S. Treasury Notes	Not applicable	August 31, 2016	\$ 28,635
U.S. Agencies	AAA/Aaa	April 18, 2016	62,424
U.S. Agencies	AAA/Aaa	August 20, 2015	7,066
U.S. Agencies	AAA/Aaa	April 2, 2014	3,472
U.S. Agencies	AAA/Aaa	October 28, 2013	12,537
U.S. Treasury Notes - State and Local Government Series	Not applicable	May 1, 2013	8,584
U.S. Agencies	AAA/Aaa	April 15, 2013	12,416
Guaranteed Investment Contracts	A+/Aa3	March 16, 2013	15,958
U.S. Treasury Notes - State and Local Government Series	Not applicable	November 1, 2012	10,402
U.S. Agencies	AAA/Aaa	October 30, 2012	12,459
U.S. Treasury Notes - State and Local Government Series	Not applicable	May 1, 2012	11,677
Corporate Bonds & Notes	AAA/Aaa	April 30, 2012	12,090
U.S. Treasury Notes	AAA/Aaa	December 15, 2011	18,467
U.S. Agencies	AAA/Aaa	December 14, 2011	14,271
U.S. Treasury Notes - State and Local Government Series	Not applicable	November 1, 2011	25,451
Commercial Paper	Not applicable	November 1, 2011	12,445
U.S. Treasury Money Market Funds	AAA/Aaa	< 90 days	60,585
U.S. Agencies	AAA/Aaa	< 90 days	22,632
Corporate Bonds & Notes	AAA/Aaa	< 90 days	6,592
Total			\$ 358,163

The restricted cash and investments outside City Treasury as of June 30, 2012 included a \$4,350 unrealized gain due to increases in fair values on U.S. Treasury Notes and U.S. Agencies from June 30, 2011.

Funds held by the trustee established under the 2002 Amended and Restated Indentures agreements are invested in "Permitted Investments," as defined in the agreement, which includes money market funds and investment agreements. The agreement permits investment in money market funds registered under the Federal Investment Company Act of 1940 and whose shares are also registered under the Federal Securities Act of 1933 and having a rating by Standard & Poor's of "AAAm-G," "AAAm" or "AAm" and a rating by Moody's of "Aaa," "Aa1" or "Aa2." The credit ratings of the money market funds invested in as of June 30, 2012 and June 30, 2011 were "Aaa" by Moody's and "AAA" by Standard & Poor's. Investment agreements must be with a U.S. bank or trust company

SAN FRANCISCO WATER ENTERPRISE

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having a rating by Moody's and S&P of "A" or higher, or are guaranteed by any entity with a rating of "A" or higher, at the time the agreement is entered into.

Additional cash outside of the investment pool included revolving fund and cash in transit. The revolving fund has a balance of \$33 at June 30, 2012 and 2011, which is held in a commercial bank in non-interest bearing checking accounts covered by Federal Deposit Insurance Corporation depository insurance. These accounts were established as provided by the City's Administrative Code for revolving fund needs. The cash in transit was \$129 and \$220 at June 30, 2012 and 2011 respectively.

The Enterprise's cash, cash equivalents and investments are shown on the accompanying statements of net assets as follows:

	<u>2012</u>	<u>2011</u>
Current assets:		
Cash and investments with City Treasury	\$ 78,960	83,410
Cash and investments outside City Treasury	162	253
Restricted cash and investments outside City Treasury	81,129	72,797
Non-current assets:		
Restricted cash and investments with City Treasury	1,596,856	1,093,431
Restricted cash and investments outside City Treasury	<u>358,309</u>	<u>285,366</u>
Total cash, cash equivalents and investments	<u>\$ 2,115,416</u>	<u>1,535,257</u>

The following table shows the percentage distribution of the City's pooled investments by maturity as of June 30, 2012:

Investment maturities (in months)			
<u>Under 1</u>	<u>1 to less than 6</u>	<u>6 to less than 12</u>	<u>12 to 60</u>
1.9%	11.1%	8.0%	79.0%

The following table shows the percentage distribution of the City's pooled investments by maturity as of June 30, 2011:

Investment maturities (in months)			
<u>Under 1</u>	<u>1 to less than 6</u>	<u>6 to less than 12</u>	<u>12 to 60</u>
1.3%	13.2%	13.4%	72.1%

SAN FRANCISCO WATER ENTERPRISE

Notes to Financial Statements

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(4) Capital Assets

Capital assets as of June 30, 2012 and 2011 consist of the following:

	<u>Balance</u> <u>June 30, 2011</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2012</u>
Capital assets not being depreciated:				
Land	\$ 18,812	5,992	(93)	24,711
Intangible assets	679	—	—	679
Construction in progress	<u>1,228,574</u>	<u>823,105</u>	<u>(665,819)</u>	<u>* 1,385,860</u>
Total capital assets not being depreciated	<u>1,248,065</u>	<u>829,097</u>	<u>(665,912)</u>	<u>1,411,250</u>
Capital assets being depreciated:				
Facilities and improvements	1,745,099	629,486	(6)	2,374,579
Intangible assets	9,485	2,349	—	11,834
Machinery and equipment	<u>219,920</u>	<u>23,837</u>	<u>(196)</u>	<u>243,561</u>
Total capital assets being depreciated	<u>1,974,504</u>	<u>655,672</u>	<u>(202)</u>	<u>2,629,974</u>
Less accumulated depreciation for:				
Facilities and improvements	(631,412)	(50,315)	23	(681,704)
Intangible assets	(973)	(1,708)	—	(2,681)
Machinery and equipment	<u>(110,296)</u>	<u>(12,572)</u>	<u>195</u>	<u>(122,673)</u>
Total accumulated depreciation	<u>(742,681)</u>	<u>(64,595)</u>	<u>218</u>	<u>(807,058)</u>
Total capital assets being depreciated, net	<u>1,231,823</u>	<u>591,077</u>	<u>16</u>	<u>1,822,916</u>
Total capital assets, net	<u>\$ 2,479,888</u>	<u>1,420,174</u>	<u>(665,896)</u>	<u>3,234,166</u>

* Includes \$8,729 in capital project write-offs mainly relating to Recycle Water Projects in Golden Gate Park site and other discontinued sites.

SAN FRANCISCO WATER ENTERPRISE

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	<u>Balance</u> <u>June 30, 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2011</u>
Capital assets not being depreciated:				
Land	\$ 17,707	1,105	—	18,812
Intangible assets	679	—	—	679
Construction in progress	<u>787,367</u>	<u>659,087</u>	<u>(217,880)</u>	<u>1,228,574</u>
Total capital assets not being depreciated	<u>805,753</u>	<u>660,192</u>	<u>(217,880)</u>	<u>1,248,065</u>
Capital assets being depreciated:				
Facilities and improvements	1,548,575	196,524	—	1,745,099
Intangible assets	3,973	5,512	—	9,485
Machinery and equipment	<u>195,639</u>	<u>29,939</u>	<u>(5,658)</u>	<u>219,920</u>
Total capital assets being depreciated	<u>1,748,187</u>	<u>231,975</u>	<u>(5,658)</u>	<u>1,974,504</u>
Less accumulated depreciation for:				
Facilities and improvements	(584,860)	(46,552)	—	(631,412)
Intangible assets	—	(973)	—	(973)
Machinery and equipment	<u>(104,727)</u>	<u>(11,227)</u>	<u>5,658</u>	<u>(110,296)</u>
Total accumulated depreciation	<u>(689,587)</u>	<u>(58,752)</u>	<u>5,658</u>	<u>(742,681)</u>
Total capital assets being depreciated, net	<u>1,058,600</u>	<u>173,223</u>	<u>—</u>	<u>1,231,823</u>
Total capital assets, net	<u>\$ 1,864,353</u>	<u>833,415</u>	<u>(217,880)</u>	<u>2,479,888</u>

* Includes \$1,123 in capital project write-offs mainly relating to Thomas Shaft Disinfection Station and Access Road Improvements, and San Joaquin Pipeline Demolition.

Capital assets with a useful life of 50 years or greater include buildings and structures, reservoirs, dams, treatment plants, pump stations, certain water mains and pipelines, sewer systems, tunnels, and bridges.

SAN FRANCISCO WATER ENTERPRISE

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(Dollars in thousands, unless otherwise stated)

Financial Accounting Standards Board (FASB) Statement 34, *Capitalization of Interest Costs*, requires that interest expense incurred during construction of assets be capitalized. Interest included in the construction in progress and total interest expense incurred during the years ended June 30, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Interest expensed	\$ 126,686	100,875
Interest included in construction work in progress	<u>70,456</u>	<u>50,901</u>
Total interest incurred	<u>\$ 197,142</u>	<u>151,776</u>

During fiscal years ending in 2012 and 2011, the Enterprise expensed \$8,729 and \$1,123, respectively, related to capitalized design and planning costs on certain projects. The amounts of the write-offs were recognized as other operating expenses in the accompanying statements of revenues, expenses, and changes in net assets.

(5) Restricted Assets

Pursuant to the Indentures, all revenues of the Enterprise (except amounts on deposit in the rebate fund) are irrevocably pledged to the punctual payment of debt service on the Water Revenue and Refunding Bonds. Accordingly, the revenues of the Enterprise shall not be used for any other purpose while any of its Water Revenue and Refunding Bonds are outstanding, except as expressly permitted by the Indentures. Further, all revenues shall be deposited by the City Treasurer, by instruction of the Enterprise, in special funds designated as the Water Enterprise Revenue Fund (the Water Revenue Fund), which must be maintained in the City Treasury. These funds, held at the City Treasury, are recorded in the statements of net assets of the Enterprise as cash and investments with the City Treasury. Deposits in the Water Revenue Fund, including earnings thereon, shall be appropriated, transferred, expended, or used for the following purposes pertaining to the financing, maintenance, and operation of the Enterprise in accordance with the following priority:

1. The payment of operation and maintenance expenses for such utility and related facilities;
2. The payment of pension charges and proportionate payments to such compensation and other insurance or outside reserve funds as the Enterprise may establish or the Board of Supervisors may require with respect to employees of the Enterprise;
3. The payment of principal, interest, reserve, sinking fund, and other mandatory funds created to secure Revenue Bonds issued by the Enterprise for the acquisition, construction, or extension of facilities owned, operated, or controlled by the Enterprise;
4. The payment of principal and interest on General Obligation Bonds issued by the City for the Enterprise's purposes;
5. Reconstruction and replacement as determined by the Enterprise or as required by any of the Enterprise's Revenue Bond ordinances duly adopted and approved; and

SAN FRANCISCO WATER ENTERPRISE

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(Dollars in thousands, unless otherwise stated)

6. The acquisition of land, real property, or interest in real property for, and the acquisition, construction, enlargement, and improvement of, new and existing buildings, structures, facilities, equipment, appliances, and other property necessary or convenient to the development or improvement of such utility owned, controlled, or operated by the Enterprise; and for any other lawful purpose of the Enterprise, including the transfer of surplus funds pursuant to Section 6.407(e) of the City's Charter.

SAN FRANCISCO WATER ENTERPRISE

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(Dollars in thousands, unless otherwise stated)

In accordance with the Indenture, the bond financing program maintains that certain restricted cash and investment balances be held in trust. Restricted assets held in trust consisted of the following as of June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Cash and investments with City Treasury:		
Water revenue bond construction fund	\$ <u>1,596,856</u>	<u>1,093,431</u>
Cash and investments outside City Treasury:		
1991 Capital Appreciation Bond	15	15
2001A Water revenue bond fund	—	2,606
2002A Water revenue bond fund	2,552	3,285
2002B Water revenue bond fund	5,120	4,965
2006A Water revenue bond fund	26,900	26,392
2006B Water revenue bond fund	3,119	3,028
2006C Water revenue bond fund	2,068	2,013
2009A Water revenue bond fund	23,840	25,818
2009B Water revenue bond fund	23,574	27,482
2010ABC Water revenue bond fund	38,148	45,383
2010D Water revenue bond fund	7,544	10,061
2010E Water revenue bond fund	28,962	38,690
2010F Water revenue bond fund	23,934	32,281
2010G Water revenue bond fund	51,116	62,887
2011A Water revenue bond fund	83,241	—
2011B Water revenue bond fund	1,627	—
2011C Water revenue bond fund	1,616	—
2011D Water revenue bond fund	2,679	—
2012A Water revenue bond fund	93,685	—
2012B Water revenue bond fund	793	—
2012C Water revenue bond fund	4,503	—
2009C Certificates of participation - 525 Golden Gate	2,244	18,241
2009D Certificates of participation - 525 Golden Gate	<u>12,158</u>	<u>55,016</u>
Total cash and investments outside City Treasury	<u>439,438</u>	<u>358,163</u>
Interest receivable:		
Water bond construction fund	<u>477</u>	—
Total restricted assets	\$ <u><u>2,036,771</u></u>	<u><u>1,451,594</u></u>

Restricted assets listed above as cash and investments with City Treasury are held in sub-funds of the Water Revenue Fund.

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(6) Short-Term Debt

The Commission and the Board of Supervisors have authorized the issuance of up to \$250,000 in commercial paper pursuant to the voter-approved 2002 Proposition A and \$250,000 in commercial paper pursuant to the voter-approved 2002 Proposition E, for a combined total authorization of \$500,000. As of June 30, 2012, \$0 in commercial paper was outstanding under Proposition A and \$174,000 in commercial paper was outstanding under Proposition E. Commercial paper interest rates ranged from 0.1% to 0.27%.

With maturities up to 270 days, the Enterprise intends to maintain the program by remarketing the commercial paper upon maturity over the next five years, at which time outstanding commercial paper will be refunded with long-term revenue bonds. This is being done to take advantage of the continued low interest rate environment. If the commercial paper interest rates rise to a level that exceeds these benefits, the Enterprise will refinance the commercial paper with the long-term fixed rate debts.

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(7) Changes in Long-Term Liabilities

Long-term liability activities for the years ended June 30, 2012 and 2011 are as follows:

	Coupon interest rate *	Final maturity date	July 1, 2011	Additions	Reductions	June 30, 2012	Due within one year
Revenue Bonds:							
2001A revenue bonds	4.0 – 5.0%	2031	\$ 57,170	—	(57,170)	—	—
2002A revenue bonds	2.5 – 5.0	2032	109,265	—	(105,480)	3,785	3,785
2002B revenue refunding bonds	3.0 – 5.0	2015	38,410	—	(6,985)	31,425	7,305
2006A revenue bonds	4.0 – 5.0	2036	479,660	—	(9,350)	470,310	9,830
2006B revenue refunding bonds	4.0 – 5.0	2026	97,800	—	(3,465)	94,335	3,645
2006C revenue refunding bonds	4.0 – 5.0	2026	38,715	—	(2,590)	36,125	2,705
2009A revenue bonds	4.0 – 5.3	2039	412,000	—	(6,460)	405,540	6,785
2009B revenue bonds	4.0 – 5.0	2039	412,000	—	(6,610)	405,390	6,950
2010A revenue bonds	2.0 – 5.0	2030	56,945	—	(1,790)	55,155	1,835
2010B revenue bonds (Build America)	4.0 – 6.0	2040	417,720	—	—	417,720	—
2010C revenue refunding bonds	5.0	2015	14,040	—	—	14,040	3,125
2010D revenue and refunding bonds	3.0 – 5.0	2021	102,725	—	—	102,725	—
2010E revenue bonds (Build America)	4.9 – 6.0	2040	344,200	—	—	344,200	—
2010F revenue bonds	3.0 – 5.5	2030	180,960	—	—	180,960	—
2010G revenue bonds (Build America)	6.9	2050	351,470	—	—	351,470	—
2011A revenue bonds	4.3 – 5.0	2041	—	602,715	—	602,715	—
2011B revenue bonds	3.5 – 5.0	2041	—	28,975	—	28,975	—
2011C revenue bonds	3.0 – 5.0	2041	—	33,595	—	33,595	—
2011D revenue refunding bonds	4.0 – 5.0	2028	—	55,465	—	55,465	—
2012A revenue bonds	4.0 – 5.0	2043	—	591,610	—	591,610	—
2012B revenue bonds	4.0 – 5.0	2043	—	16,520	—	16,520	—
2012C1 revenue refunding bonds	4.0 – 5.0	2031	—	24,180	—	24,180	—
2012C2 revenue refunding bonds	4.0 – 5.0	2032	—	69,570	—	69,570	—
Less deferred amounts:							
For issuance premiums			85,410	91,349	(7,273)	169,486	—
For refunding loss			(13,592)	(4,545)	1,900	(16,237)	—
Total revenue bonds payable			3,184,898	1,509,434	(205,273)	4,489,059	45,965
1991 capital appreciation bonds	0.0	2019	4,155	295	—	4,450	—
2009C certificates of participation (COPs)	2.0 – 5.0	2022	27,218	—	—	27,218	1,971
2009C COPs issuance premiums			2,398	—	(389)	2,009	—
2009D COPs (Build America)	6.36 – 6.49	2041	92,499	—	—	92,499	—
Other post-employment benefits obligation			60,314	20,254	(7,559)	73,009	—
Arbitrage rebate payable			517	74	—	591	—
Accrued vacation and sick leave			11,575	8,331	(7,363)	12,543	6,182
Accrued workers' compensation			7,675	2,639	(2,350)	7,964	1,403
Damage claims liability			26,990	2,565	(20,460)	9,095	2,899
Pollution remediation obligation			—	10,700	—	10,700	—
Total			\$ 3,418,239	1,554,292	(243,394)	4,729,137	58,420

* After adjusting for the Federal interest subsidy, the true interest costs for revenue bonds 2010 Sub-Series B, Sub-Series E and Sub-Series G, all issued as Build America Bonds, are 3.9%, 3.8%, and 4.5%, respectively. After adjusting for the Federal interest subsidy, the true interest cost for the certificates of participation 2009 Series D, also issued as Build America Bonds, is 4.3%.

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	Coupon interest rate *	Final maturity date	July 1, 2010	Additions	Reductions	June 30, 2011	Due within one year
Revenue Bonds:							
2001A revenue bonds	4.0 – 5.0%	2031	\$ 60,235	—	(3,065)	57,170	3,195
2002A revenue bonds	2.5 – 5.0	2032	144,260	—	(34,995)	109,265	3,605
2002B revenue refunding bonds	3.0 – 5.0	2015	45,050	—	(6,640)	38,410	6,985
2006A revenue bonds	4.0 – 5.0	2036	488,555	—	(8,895)	479,660	9,350
2006B revenue refunding bonds	4.0 – 5.0	2026	101,100	—	(3,300)	97,800	3,465
2006C revenue refunding bonds	4.0 – 5.0	2026	41,185	—	(2,470)	38,715	2,590
2009A revenue bonds	4.0 – 5.3	2039	412,000	—	—	412,000	6,460
2009B revenue bonds	4.0 – 5.0	2039	412,000	—	—	412,000	6,610
2010A revenue bonds	2.0 – 5.0	2030	56,945	—	—	56,945	1,790
2010B revenue bonds (Build America)	4.0 – 6.0	2040	417,720	—	—	417,720	—
2010C revenue refunding bonds	5.0	2015	14,040	—	—	14,040	—
2010D revenue and refunding bonds	3.0 – 5.0	2021	—	102,725	—	102,725	—
2010E revenue bonds (Build America)	4.9 – 6.0	2040	—	344,200	—	344,200	—
2010F revenue bonds	3.0 – 5.5	2030	—	180,960	—	180,960	—
2010G revenue bonds (Build America)	6.9	2050	—	351,470	—	351,470	—
Less deferred amounts:							
For issuance premiums			64,115	26,920	(5,625)	85,410	—
For refunding loss			(11,904)	(3,405)	1,717	(13,592)	—
Total revenue bonds payable			2,245,301	1,002,870	(63,273)	3,184,898	44,050
1991 capital appreciation bonds	0.0	2019	3,878	277	—	4,155	—
2009C certificates of participation (COPs)	2.0 – 5.0	2022	27,218	—	—	27,218	—
2009C COPs issuance premiums			2,779	—	(381)	2,398	—
2009D COPs (Build America)	6.36 – 6.49	2041	92,499	—	—	92,499	—
Other post-employment benefits obligation			45,598	19,930	(5,214)	60,314	—
Arbitrage rebate payable			4,553	221	(4,257)	517	—
Accrued vacation and sick leave			11,827	7,269	(7,521)	11,575	5,764
Accrued workers' compensation			8,094	2,030	(2,449)	7,675	1,324
Damage claims liability			29,740	6,815	(9,565)	26,990	8,603
Pollution remediation obligation			659	—	(659)	—	—
Total			\$ 2,472,146	1,039,412	(93,319)	3,418,239	59,741

* After adjusting for the Federal interest subsidy, the true interest costs for revenue bonds 2010 Sub-Series B, Sub-Series E and Sub-Series G, all issued as Build America Bonds, are 3.9%, 3.8%, and 4.5%, respectively. After adjusting for the Federal interest subsidy, the true interest cost for the certificates of participation 2009 Series D, also issued as Build America Bonds, is 4.3%.

(a) *Capital Appreciation Bonds*

The capital appreciation bonds mature from November 1, 2018 through November 1, 2019. The bonds were insured by MBIA and carried “Aaa” and “AAA” ratings from Moody’s and Standard & Poor’s (S&P), respectively. In February 2009, the bonds were further reinsured by NPFGC and carried “Baa1” and “A” ratings from Moody’s and S&P, respectively. As of June 30, 2012, NPFGC had ratings of “Baa2” and “BBB” from Moody’s and S&P, respectively. Interest on the capital appreciation bonds is due upon maturity and is recognized as annual interest expense over the life of the bonds using the interest method. The Enterprise

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has recognized \$4,450 and \$4,155 of unpaid principal and interest on the capital appreciation bonds as of June 30, 2012 and 2011, respectively, and has reported it as capital appreciation bonds in the accompanying statements of net assets.

(b) Water Revenue Bonds Series 2001A

During fiscal year 2002, the Enterprise issued \$140,000 of 2001 Series A revenue bonds. The bonds were insured by Assured Guaranty (formerly FSA) and carried “Aaa” and “AAA” ratings from Moody’s and S&P, respectively. As of June 30, 2012, Assured Guaranty was rated “Aa3” and “AA-” by Moody’s and S&P, respectively. The revenue bonds include current interest serial and term bonds with interest rates varying from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2021 and the current interest term bonds mature on November 1, 2024, 2027, and 2031. In March 2006, \$45,630 of the 2001A serial and term bonds with maturities of November 2016 to November 2024 were refunded by the 2006 refunding Series B revenue bonds.

On June 17, 2010, the Enterprise issued \$14,040 of the 2010 Sub-Series C revenue bonds for the purpose of refunding \$14,400 of then-outstanding 2001 Series A revenue bonds. The 2010 bonds bear a coupon rate of 5.0% and mature serially from 2012 to 2015. The refunded Series 2001A bonds carried a coupon rate of 5.0% and also matured between 2012 and 2015. Unamortized Series 2001A bond issuance costs were \$126 at the date of the refunding. Although the refunding resulted in the recognition of a deferred accounting loss of \$1,044, the Enterprise achieved net present value debt service savings of \$919 or 6.4% of the refunded principal.

A portion of the proceeds on the 2010 Sub-Series C revenue bonds was deposited with the trustee, acting as escrow agent under the irrevocable Escrow Agreement, dated June 1, 2010, to refund and legally defease a portion of the outstanding 2001 Series A bonds. This deposit, together with certain other available moneys was held by the escrow agent under the Escrow Agreement and invested in non-callable Federal Securities consisting of United States Treasury Securities - State and Local Government Series (SLGS). The principal and interest on monies held by the escrow agent redeemed the refunded 2001 Series A bonds on November 1, 2011 by optional redemption on that date.

On August 4, 2011, the Enterprise issued \$55,465 of the 2011 Sub-Series D revenue bonds for the purpose of refunding \$28,375 of then-outstanding 2001 Series A revenue bonds and a portion of 2002 Series A revenue bonds. The 2011 bonds bear coupon rates of 4.0% and 5.0% and mature serially from 2014 to 2015 and from 2022 to 2028. The refunded Series 2001A bonds carried a coupon rate of 5.0% and mature between 2025 and 2028. Unamortized Series 2001A bond issuance costs were \$235 at the date of the refunding. Although the refunding resulted in the recognition of a deferred accounting loss of \$807, the Enterprise achieved combined net present value debt service savings of \$3,311 or 5.8% of the refunded 2001A and 2002A principal.

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A portion of the proceeds on the 2011 Sub-Series D revenue bonds was deposited with the trustee, acting as escrow agent under the irrevocable Escrow Agreement, dated August 1, 2011, to refund and legally defease a portion of the outstanding 2001 Series A bonds. This deposit, together with certain other available moneys was held by the escrow agent under the Escrow Agreement and invested in non-callable Federal Securities consisting of United States Treasury Securities – State and Local Government Series (SLGS). The principal and interest on monies held by the escrow agent redeemed the refunded 2001 Series A bonds on November 1, 2011 by optional redemption on that date.

On June 7, 2012, the Enterprise issued \$93,750 of the 2012 Sub-Series C revenue bonds for the purpose of refunding \$25,600 of then-outstanding 2001 Series A revenue bonds and a portion of 2002 Series A revenue bonds. The 2012 bonds bear coupon rates of 4.0% and 5.0% and mature serially from 2025 to 2032. The refunded Series 2001A bonds carried a coupon rate of 5.0% and matured between 2029 and 2031. Unamortized Series 2001A bond issuance costs were \$228 at the date of the refunding. Although the refunding resulted in the recognition of a deferred accounting loss of \$273, the Enterprise achieved net present value debt service savings of \$3,293 or 12.9% of the refunded principal.

A portion of the proceeds on the 2012 Sub-Series C revenue bonds was deposited with the trustee, acting as escrow agent under the irrevocable Escrow Agreement, dated June 1, 2012, to refund and legally defease a portion of the outstanding 2001 Series A bonds. This deposit, together with certain other available moneys was held by the escrow agent under the Escrow Agreement and invested in non-callable Federal Securities consisting of United States Treasury Securities – State and Local Government Series (SLGS). The principal and interest on monies held by the escrow agent redeemed the refunded 2001 Series A bonds on June 21, 2012 by optional redemption on that date.

As of June 30, 2012, all previously outstanding 2001 Series A bonds have been fully refunded.

(c) *Water Revenue Bonds Series 2002A*

During fiscal year 2003, the Enterprise issued \$164,000 of revenue bonds 2002 Series A. The bonds were insured by MBIA and carried “Aaa” and “AAA” ratings from Moody’s and S&P, respectively. In February 2009, the bonds were further reinsured by NPFGC and carried “Baa1” and “A” ratings from Moody’s and S&P, respectively. As of June 30, 2012, MBIA was rated “B3” and “B” by Moody’s and S&P, respectively, while NPFGC carried “Baa2” and “BBB” ratings from Moody’s and S&P, respectively. The revenue bonds include interest and serial and term bonds with interest rates varying from 2.5% to 5.0%. The current interest serial bonds mature through November 1, 2026, and the current interest term bonds mature on November 1, 2025 and 2032.

In August 2010, the Enterprise issued \$102,725 of the 2010 Sub-Series D revenue bonds for the purpose of refunding \$31,570 of then-outstanding 2002 Series A revenue bonds, providing \$72,243 in new money for WSIP implementation, funding the debt service reserve and capitalized interest funds and paying the costs of issuing the bonds. The 2010 bonds bear

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coupon rates of 3.0% to 5.0% and mature serially from 2015 to 2021. The refunded Series 2002A bonds carried a coupon rate of 5.0% and will mature between 2016 and 2021. Unamortized Series 2002A bond issuance costs were \$208 at the date of the refunding. Although the refunding resulted in the recognition of a deferred accounting loss of \$3,405, the Enterprise achieved net present value debt service savings of \$2,703 or 8.6% of the refunded principal.

A portion of the proceeds on the 2010 Sub-Series D revenue bonds was deposited with the trustee, acting as escrow agent under the irrevocable Escrow Agreement, dated August 1, 2010, to refund and legally defease a portion of the outstanding 2002 Series A bonds. This deposit, together with certain other available monies, was held by the escrow agent under the Escrow Agreement and invested in non-callable Federal Securities consisting of United States Treasury Securities-State and Local Government Series (SLGS). The principal and interest on monies held by the escrow agent will be sufficient to redeem the refunded 2002 Series A bonds on August 1, 2012 by optional redemption.

On August 4, 2011, the Enterprise issued \$55,465 of the 2011 Sub-Series D revenue bonds for the purpose of refunding \$28,295 of then-outstanding 2002 Series A revenue bonds and a portion of 2001 Series A revenue bonds. The 2011 bonds bear coupon rates of 4.0% and 5.0% and mature serially from 2014 to 2015 and from 2022 to 2028. The refunded Series 2002A bonds carried a coupon rates of 4.0% to 5.0% and matured serially between 2014 and 2015 and between 2022 and 2024. Unamortized Series 2002A bond issuance costs were \$177 at the date of the refunding. Although the refunding resulted in the recognition of a deferred accounting loss of \$1,912, the Enterprise achieved a combined net present value debt service savings of \$3,311 or 5.8% of the refunded 2001A and 2002A principal.

On June 7, 2012, the Enterprise issued \$93,750 of the 2012 Sub-Series C revenue bonds for the purpose of refunding \$73,580 of then-outstanding 2002 Series A revenue bonds and a portion of the 2001 Series A revenue bonds. The 2012 bonds bear coupon rates of 4.0% and 5.0% and mature serially from 2025 to 2032. The refunded Series 2002A bonds carried a coupon rates of 4.0 % to 5.0% and matured on 2013 and between 2025 and 2032. Unamortized Series 2002A bond issuance costs were \$463 at the date of the refunding. Although the refunding resulted in the recognition of a deferred accounting loss of \$1,554, the Enterprise achieved net present value debt service savings of \$8,322 or 11.3% of the refunded principal.

A portion of the proceeds on the 2012 Sub-Series C revenue bonds was deposited with the trustee, acting as escrow agent under the irrevocable Escrow Agreement, dated June 1, 2012, to refund and legally defease a portion of the outstanding 2002 Series A bonds. This deposit, together with certain other available moneys was held by the escrow agent under the Escrow Agreement and invested in non-callable Federal Securities consisting of United States Treasury Securities - State and Local Government Series (SLGS). The principal and interest on monies held by the escrow agent will be sufficient to redeem the refunded 2002 Series A bonds on November 1, 2012 by optional redemption on that date. As of June 30, 2012, the 2002 Series A bonds outstanding was \$3,785.

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(d) *Water Revenue Refunding Bonds Series 2002B*

During fiscal year 2003, the Enterprise issued revenue refunding bonds, 2002 Series B in the amount of \$85,260 with interest rates ranging from 3.0% to 5.0%. The bonds were insured by MBIA and carried “Aaa” and “AAA” ratings from Moody’s and S&P, respectively. In February 2009, the bonds were further reinsured by NPFGC and carried “Baa1” and “A” ratings from Moody’s and S&P, respectively. As of June 30, 2012, NPFGC has ratings of “Baa2” and “BBB” from Moody’s and S&P, respectively. The current interest serial bonds mature through November 1, 2015.

(e) *Water Revenue Bonds Series 2006A*

During fiscal year 2006, the Enterprise issued revenue bonds, 2006 Series A in the amount of \$507,815. The purpose of the bonds is to finance improvements to the City’s water systems pursuant to Proposition A and to retire commercial paper outstanding. The bonds were insured by Assured (formerly FSA) and carried “Aaa” and “AAA” ratings from Moody’s and S&P, respectively. As of June 30, 2012, Assured was rated “Aa3” and “AA-” by Moody’s and S&P, respectively. The 2006 Series A bonds include current interest and serial and term bonds with interest rates ranging from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2027 and the current interest term bonds mature on November 1, 2031 and 2033 and 2036.

(f) *Water Revenue Refunding Bonds Series 2006B*

During fiscal year 2006, the Enterprise issued revenue refunding bonds, 2006 Series B in the amount of \$110,065. The purpose of the bonds is to refund a portion of the 1996 Series A bonds and the 2001 Series A bonds. The bonds were insured by Syncora (formerly XL) and carried “Aaa” and “AAA” ratings from Moody’s and S&P, respectively. As of June 30, 2012, Syncora was rated “Ca” and “NR” by Moody’s and S&P, respectively. The 2006B refunding bonds include serial bonds with interest rates varying from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2026.

(g) *Water Revenue Refunding Bonds Series 2006C*

During fiscal year 2007, the Enterprise issued revenue refunding bonds, 2006 Series C in the amount of \$48,730 for the purpose of refunding the remaining portion of the outstanding 1996 Series A bonds maturing on and after November 1, 2007 (the Refunded 1996 Series A Bonds). The bonds were insured by Syncora (formerly XL) and carried “Aaa” and “AAA” ratings from Moody’s and S&P, respectively. As of June 30, 2012, Syncora was rated “Ca” and “NR” by Moody’s and S&P, respectively. The 2006 Series C refunding bonds include serial bonds with interest rates varying from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2026.

(h) *Water Revenue Bonds Series 2009A*

During fiscal year 2010, the Enterprise issued revenue bonds, 2009 Series A in the amount of \$412,000. The purpose of the bonds is to refund \$229,600 of outstanding Proposition A

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commercial paper notes and to provide \$139,218 in new money for WSIP capital projects, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated “AA-” and “A1” from S&P and Moody’s, respectively. The bonds include serial and term bonds with interest rates varying from 4.0% to 5.3%. The bonds mature through November 1, 2039. The 2009 Series A bonds have a true interest cost of 4.8%.

(i) Water Revenue Bonds Series 2009B

During fiscal year 2010, the Enterprise issued revenue bonds, 2009 Series B in the amount of \$412,000. The purpose of the bonds is to provide \$377,778 in new money for WSIP capital projects, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated “AA-” and “A1” from S&P and Moody’s, respectively. The bonds include serial and term bonds with interest rates varying from 4.0% to 5.0%. The bonds mature through November 1, 2039. The 2009 Series B bonds have a true interest cost of 4.5%.

(j) Water Revenue Bonds Series 2010 ABC

During fiscal year 2010, the Enterprise issued its revenue bonds, 2010 Series ABC in the combined principal amount of \$488,705. The purpose of the bonds is to refund \$14,400 of outstanding 2001 Series A revenue bonds, to provide \$58,748 in proceeds for the AMI Project and to provide \$364,757 in new money for WSIP capital projects, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated “AA-” and “Aa2” from S&P and Moody’s, respectively. The bonds included serial and term bonds with interest rates varying from 2.0% to 6.0%.

The \$56,945 Sub-Series A bonds were issued as tax-exempt bonds to provide funds for the AMI Project as well as financing costs. The Sub-Series A bonds were issued as serial bonds with coupons ranging from 2.0% to 5.0% and have a final maturity of 2030. The sub-series A bonds have a true interest cost of 3.8%.

The \$417,720 Sub-Series B bonds were issued as taxable Build America Bonds (with Direct Pay Subsidy) to provide \$364,757 in new money for WSIP capital projects as well as to pay financing costs. The Sub-Series B bonds were issued as serial and term bonds with coupons ranging from 4.0% to 6.0% and have a final maturity of 2040. The Sub-Series B bonds have a true interest cost (net of federal subsidy) of 3.9%.

The \$14,040 Sub-Series C bonds were issued to advance refund \$14,400 of outstanding revenue bonds, 2001 Series A and to pay financing costs. The Sub-Series C bonds were issued as serial bonds with 5.0% coupons and a final maturity of 2015, and have a true interest cost of 1.6%.

(k) Water Revenue Bonds Series 2010 DE

In July 2010, the Enterprise issued revenue bonds 2010 Series DE in the combined principal amount of \$446,925. The purpose of the bonds is to advance refund \$31,570 of outstanding 2002 Series A revenue bonds and to provide \$372,689 in new money for WSIP capital

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projects, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated “AA-“ and “Aa2” from S&P and Moody’s, respectively. The bonds included serial and term bonds with interest rates varying from 3.0% to 6.0%.

The \$102,725 Sub-Series D bonds were issued as tax-exempt bonds to provide \$72,243 in new money for WSIP capital projects and \$35,080 to advance refund a portion of outstanding 2002 Series A revenue bonds. The Sub-Series D bonds were issued as serial bonds with coupons ranging from 3.0% to 5.0% and have a final maturity of 2021. The Sub-Series D bonds have a true interest cost of 2.5%. (refer to note (c) Water Revenue Bond Series 2002A in relation to the refunding).

The \$344,200 Sub-Series E bonds were issued as taxable Build America Bonds (with Direct Pay Subsidy) to provide \$300,446 in new money for WSIP capital projects. The Sub-Series E bonds were issued as serial and term bonds with coupons ranging from 4.9% to 6.0% and have a final maturity of 2040. The Sub-Series E bonds have a true interest cost (net of federal subsidy) of 3.8%.

(l) Water Revenue Bonds Series 2010FG

In December 2010, the Enterprise issued revenue bonds 2010 Series FG in the combined principal amount of \$532,430. The purpose of the bonds is to provide \$437,980 in new money for WSIP capital projects, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated “AA-“ and “Aa2” from S&P and Moody’s, respectively. The bonds included serial and term bonds with interest rates varying from 3.0% to 7.0%.

The \$180,960 Sub-Series F bonds were issued as tax-exempt bonds to provide \$149,728 in new money for WSIP capital projects. The Sub-Series F bonds were issued as serial and term bonds with coupons ranging from 3.0% to 5.5% and have a final maturity of 2030. The Sub-Series F bonds have a true interest cost of 4.8%.

The \$351,470 Sub-Series G bonds were issued as taxable Build America Bonds (with Direct Pay Subsidy) to provide \$288,252 in new money for WSIP capital projects. The Sub-Series G bonds were issued as term bonds with a coupon of 7.0% and have a final maturity of 2050. The Sub-Series G bonds have a true interest cost (net of federal subsidy) of 4.5%.

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(m) Water Revenue Bonds Series 2011 ABCD

In August 2011, the Enterprise issued revenue bonds, 2011 Series ABCD in the combined principal amount of \$720,750. The purpose of the bonds is to provide new money for WSIP capital projects, to finance Hetch Hetchy Water Improvements, and to finance the Local Water Main Replacement Projects, as well as refund \$56,670 of outstanding 2001 Series A and 2002 Series A revenue bonds, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated “AA-” and “Aa3” from S&P and Moody’s respectively. The bonds included serial and term bonds with interest rates varying from 3.0% to 5.0%.

The \$602,715 Sub-Series A bonds were issued as tax-exempt bonds to provide \$525,000 in new money for WSIP capital projects. The Sub-Series A bonds were issued as serial and term bonds with coupons ranging from 4.3% to 5.0% and have a final maturity of 2041. The Sub-Series A bonds have a true interest cost of 4.6%.

The \$28,975 Sub-Series B bonds were issued as tax-exempt bonds to provide \$27,710 to finance improvements to certain up-country water storage and transmission facilities under the jurisdiction of Hetch Hetchy Water and Power. The Sub-Series B bonds were issued as serial and term bonds with coupons ranging from 3.5% to 5.0% and have a final maturity of 2041. The Sub-Series B bonds have a true interest cost of 4.5%.

The \$33,595 Sub-Series C bonds were issued as tax-exempt bonds to provide \$33,772 to finance certain water main replacement projects within the City. The Sub-Series C bonds were issued as serial and term bonds with coupons ranging from 3.0% to 5.0% and have a final maturity of 2041. The Sub-Series C bonds have a true interest cost of 4.4%.

The \$55,465 Sub-Series D bonds were issued as tax-exempt bonds to provide \$59,381 to refund, on a current basis, a portion of the 2001 Series A bonds as well as refund, on an advance basis, a portion of the 2002 Series A bonds. The Sub-Series D bonds were issued as serial bonds with coupons ranging from 4.0% to 5.0% and have a final maturity of 2028. The Sub-Series D bonds have a true interest cost of 3.8%.

(n) Water Revenue Bonds Series 2012 ABC

In June 2012, the Enterprise issued revenue bonds, 2012 Series ABC in the combined principal amount of \$701,880. The purpose of the bonds was to provide \$530,000 of new money for WSIP capital projects, \$15,750 to reimburse the SFPUC for costs to settle litigation arising out of certain capital projects of benefit to the SFPUC’s Water Enterprise, and to refund \$99,180 of outstanding 2001 Series A and 2002 Series A revenue bonds, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated “AA-” and “Aa3” from S&P and Moody’s respectively. The bonds included serial and term bonds with interest rates varying from 4.0% to 5.0%.

The \$591,610 Sub-Series A bonds were issued as tax-exempt bonds to provide \$530,000 in new money for WSIP capital projects. The Sub-Series A bonds were issued as serial and term bonds with coupons ranging from 4.0% to 5.0% and have a final maturity of 2043. The Sub-Series A bonds have a true interest cost of 4.3%.

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The \$16,520 Sub-Series B bonds were issued as tax-exempt bonds to reimburse the SFPUC \$15,750 for costs to settle litigation arising out of certain capital projects of benefit to the SFPUC's Water Enterprise. The Sub-Series B bonds were issued as serial and term bonds with coupons ranging from 4.0% to 5.0% and have a final maturity of 2043. The Sub-Series B bonds have a true interest cost of 4.1%.

The \$93,750 Sub-Series C bonds were issued as tax-exempt bonds to provide \$101,147 to refund, on a current basis, a portion of the 2001 Series A bonds as well as refund, on an advance basis, a portion of the 2002 Series A bonds. The Sub-Series C bonds were issued as serial bonds with coupons ranging from 4.0% to 5.0% and have a final maturity of 2032. The Sub-Series C bonds have a true interest cost of 3.7%.

(o) Future Annual Debt Service of Revenue Bonds

The following table presents the future annual debt service relating to the revenue and refunding bonds outstanding as of June 30, 2012. The Federal interest subsidy amounts represent 35% of the interest for the revenue bond 2010 Sub-Series B, E, and G.

	<u>Principal</u>	<u>Interest before subsidy</u>	<u>Federal interest subsidy</u>	<u>Interest net of subsidy</u>
Years ending June 30:				
2013	\$ 45,965	218,795	(23,921)	194,874
2014	44,150	219,973	(23,921)	196,052
2015	50,995	217,741	(23,921)	193,820
2016	63,465	214,966	(23,921)	191,045
2017	68,220	211,756	(23,846)	187,910
2018 – 2022	445,350	1,003,482	(116,641)	886,841
2023 – 2027	620,240	872,190	(107,870)	764,320
2028 – 2032	781,100	694,911	(92,641)	602,270
2033 – 2037	984,245	467,083	(68,592)	398,491
2038 – 2042	908,315	205,489	(37,238)	168,251
2043 – 2047	226,085	58,260	(18,163)	40,097
2048 – 2051	97,680	13,961	(4,886)	9,075
	<u>4,335,810</u>	<u>4,398,607</u>	<u>(565,561)</u>	<u>3,833,046</u>
Less: Current portion	(45,965)			
Add: Unamortized bond premium, net of discount and refunding loss	<u>153,249</u>			
Long-term portion as of June 30, 2012	\$ <u>4,443,094</u>			

As defined in the Indentures, the principal and interest of the Enterprise's revenue and refunding bonds are payable from its revenues, as well as monies deposited in certain funds and accounts pledged thereto (note 5).

(p) Proposition A

On November 5, 2002, the San Francisco voters passed Proposition A, which provides for the issuance of revenue bonds and/or other forms of indebtedness by the Commission in a

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principal amount not to exceed \$1,628,000 to finance the acquisition and construction of improvements to the City's Water System. As of June 30, 2012, there was no commercial paper outstanding pursuant to this authorization and \$1,348,335 of bonds had been issued in fiscal years 2006, 2010, and 2012 against this authorization.

(q) Proposition E

On November 5, 2002, the San Francisco voters passed Proposition E, which authorizes the Board of Supervisors' approval of the issuance of revenue bonds and/or other forms of indebtedness by the Commission to finance costs for the Commission's capital programs, including WSIP. As of June 30, 2012, the Board of Supervisors has authorized the issuance of \$3,260,531 in revenue bonds with \$2,679,550 issued against this authorization. Additionally, \$174,000 in commercial paper was outstanding pursuant to this authorization as of June 30, 2012.

(8) Revenue Pledge

The Enterprise has pledged future revenues to repay various revenue bonds. Proceeds from the revenue bonds provided financing for various capital construction projects, and to refund previously issued bonds. The bonds are payable solely from revenues of the Enterprise and are payable through the year ending 2051.

The original amount of revenue bonds issued, total principal and interest remaining, principal and interest paid during 2012 and 2011, and applicable revenues for 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Bonds issued with revenue pledge	\$ 4,683,190	3,400,560
Principal and interest remaining due at the end of the year	8,734,417	6,270,611
Principal and interest paid during the year	122,289	86,554
Net revenue for the year ended June 30	159,183	125,747
Funds available for revenue bond debt service	186,656	169,877

(9) Certificates of Participation Issued for the 525 Golden Gate Avenue Headquarters Building

In October 2009, the City & County of San Francisco issued \$167,670 in certificates of participation to fund the future headquarters building of the San Francisco Public Utilities Commission (SFPUC) at 525 Golden Gate Avenue. The 2009 Series C were issued for \$38,120 and 2009 Series D for \$129,550 as "Build America Bonds" on a taxable basis under the 2009 American Recovery and Reinvestment Act. The 2009 Series C certificates carry interest rates ranging from 2.0% to 5.0% and mature on November 1, 2022. The 2009 Series D certificates carry interest rates ranging from 6.4% to 6.5% and mature on November 1, 2041, after adjusting for the Federal interest subsidy the true interest cost averages 3.4% and 4.3% for Series C & D, respectively.

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Under the terms of a memorandum of understanding between the City and the SFPUC dated October 1, 2009, the City conveyed the real property to the Trustee, the Bank of New York Mellon Trust Company, N.A., under a property lease in exchange for the proceeds of the sale of the certificates. The Trustee has leased the property back to the City for the City's use under a Project Lease. The City will be obligated under the Project Lease to pay base rental payments and other payments to the Trustee each year during the thirty-two year term of the Project Lease. The Commission will make annual base rental payments to the City for the building equal to annual debt service on the certificates. It is anticipated that these lease costs will be offset with reductions in costs associated with current office rental expense.

Each of the three Enterprises has an ownership interest in the building equal to their projected usage of space as follows: Water (73%), Wastewater (15%) and Power (12%). Similarly, each Enterprise is responsible for a portion of the annual Base Rental Payment based on their ownership percentages less contributed equity. The percentage share of Base Rental Payments for the Enterprises is as follows: Water (71.4%), Wastewater (18.9%), and Power (9.7%).

Certificates of Participation 2009 Series C (Tax-exempt)

	<u>Principal</u>	<u>Interest</u>
Years ending June 30:		
2013	\$ 1,971	1,231
2014	2,035	1,164
2015	2,106	1,092
2016	2,199	1,000
2017	2,313	888
2018 – 2022	13,470	2,532
2023	<u>3,124</u>	<u>78</u>
	27,218	<u>7,985</u>
Less: Current portion	(1,971)	
Add: Unamortized bond premium	<u>2,009</u>	
Long-term portion as of June 30, 2012	\$ <u>27,256</u>	

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Certificates of Participation 2009 Series D (Taxable)

	<u>Principal</u>	<u>Interest before subsidy</u>	<u>Federal interest subsidy</u>	<u>Interest net of subsidy</u>
Fiscal years ending June 30:				
2013	\$ —	5,968	(2,089)	3,879
2014	—	5,968	(2,089)	3,879
2015	—	5,968	(2,089)	3,879
2016	—	5,968	(2,089)	3,879
2017	—	5,968	(2,089)	3,879
2018 – 2022	—	29,839	(10,444)	19,395
2023 – 2027	13,909	28,116	(9,840)	18,276
2028 – 2032	20,949	22,183	(7,764)	14,419
2033 – 2037	25,811	14,651	(5,128)	9,523
2038 – 2042	31,830	5,335	(1,867)	3,468
	<u>92,499</u>	<u>129,964</u>	<u>(45,488)</u>	<u>84,476</u>
Less: Current portion	—			
Less: Unamortized bond premium	<u>—</u>			
Long-term portion as of June 30, 2012	\$ <u>92,499</u>			

(10) Wholesale Balancing Account

From 1984-2009, the Water Enterprise provided water service pursuant to the terms of the 1984 Settlement Agreement and Master Water Sales Contract, which established the basis for water rates to be charged to those customers (Wholesale Customers). The Master Water Sales Contract expired on June 30, 2009. The Commission and the Wholesale Customers approved a new Water Supply Agreement (“WSA”) of a twenty-five year term with two options for five-year extensions. The existing 184 millions of gallons per day (mgd) Supply Assurance continues under the WSA and no increase in the Supply Assurance will be considered before December 31, 2018. During the period from 2009 to 2018, the WSA limits the quantity of water delivered to Retail Customers and Wholesale Customers from the watersheds to 265 mgd. Under the WSA, annual operating expenses including debt service on bonds sold to finance regional system improvements and regional capital projects funded from revenues will be allocated between Retail Customers and Wholesale Customers on the basis of proportionate annual water use. The Wholesale Customers’ share of net book value of existing regional assets as of June 30, 2009 will be recovered on level annual payment over the twenty-five year term of the WSA at an interest rate of 5.13%. The WSA continues much of the rate setting, accounting, and dispute resolution provisions contained in the expired Contract, and has emergency and drought-pricing adjustment provisions.

Pursuant to the terms of the WSA, the City is required to establish water rates applicable to the Wholesale Customers annually. The wholesale water rates are based on an estimate of the level of revenues necessary to recoup the cost of distributing water to the Wholesale Customers in

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accordance with the methodology outlined in Article V of the WSA (the Wholesale Revenue Requirement (WRR), previously known as the Suburban Revenue Requirement). During fiscal years ending in 2012 and 2011, the WRR, net of adjustments, charged to such wholesale customers was \$160,423 and \$137,655, respectively. Such amounts are subject to final review by the Wholesale Customers, along with a trailing wholesale balancing account compliance audit of the Wholesale Revenue Requirement calculation.

Pursuant to Article VII, Section 7.02 of the WSA, the City is required to re-compute the WRR after the close of each fiscal year based on the actual costs incurred in the delivery of water to the Wholesale Customers. The difference between the wholesale revenues earned during the year and the "actual" WRR is recorded in a separate account (the Balancing Account) and represents the cumulative amount that is either owed to the Wholesale Customers (if the wholesale revenues exceed the WRR) or owed to the City (if the WRR exceeds the wholesale revenues paid). In accordance with Article VI of the WSA, the amount recorded in the Balancing Account shall earn interest at a rate equal to the average rate received by the City during the year on the invested pooled funds of the City Treasurer, and shall be taken into consideration in the determination of subsequent wholesale water rates. As of June 30, 2012 and 2011, the Wholesale Customers owed the Enterprise \$18,783 and \$41,026, respectively, under the terms of the WSA. Subsequently, the June 30, 2011 amount was revised to a total of \$40,254, including \$26,313 under the new WSA and \$13,941 related to the prior contract, based on the audited final balancing account statement dated March 14, 2012.

Pursuant to Section 5.03 of the Water Supply Agreement, the Wholesale Customers agree that SFPUC previously advanced funds to acquire or construct Existing Assets used and useful in the delivery of water to both Wholesale Customers and Retail Customers. As of the expiration of the 1984 Agreement on June 30, 2009, the Wholesale Customers collectively owed the SFPUC \$397,023 for the pre-2009 water-related capital costs that have been and will be used to deliver water services to the Wholesale Customers. The balance due was \$371,635 and \$380,535, respectively as of June 30, 2012 and 2011. The WSA requires a 25-year repayment term, with level annual payments of \$28,214 which includes both principal and interest calculated at 5.13% annually. Pursuant to Section 5.03(F) of the WSA, the Wholesale Customers also have the option to prepay the entire amount owed or make partial prepayments of at least equal to \$10,000 or greater at any time during the 25-year term. Additionally, the SFPUC has previously appropriated funds, advanced through rates charged to Retail Customers, for construction of capital projects that were not yet placed into service as of June 30, 2009. The Wholesale Customers' share of these Construction Work In Progress costs will be calculated in accordance with the provisions in the WSA including a 10-year repayment term, which is required to begin in fiscal year 2014-15. The WSA also requires level annual principal and annual interest calculated at 4.0%. The final balance due and the associated 10-year amortization schedule will be determined as part of the fiscal year 2012-13 Wholesale Revenue audit.

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(11) Employee Benefits

(a) Retirement Plan

Plan Description – The Enterprise participates in the City’s single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees’ Retirement System (the Retirement System). The Plan covers substantially all full-time employees of the Enterprise along with other employees of the City. The Plan provides basic service retirement, disability, and death benefits based on specified percentages of final average salary, and provides cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code are the authority which establishes and amends the benefit provisions and employer obligations of the Plan.

Funding Policy – Contributions to the basic plan are made by both the Enterprise and its employees. Employee contributions are mandatory. Employee contribution rates for fiscal years 2012, 2011, and 2010 varied from 7.5% to 8.0% as a percentage of covered payrolls. In addition, the Enterprise is required to contribute for 2012, 2011, and 2010 at an actuarially determined rate as a percentage of covered payroll of 18.1%, 13.6%, and 9.5%, respectively. The Enterprise’s required and actual contributions were approximately \$21,090 in 2012, \$16,453 in 2011, and \$12,283 in 2010.

Proposition B, a City Charter Amendment Changing Qualifications for Retiree Health and Pension Benefits and Establishing a Retiree Health Care Trust Fund, was passed by voters on June 3, 2008, and increased the years of service required to qualify for employer-funded retiree health benefits for City employees who retire under the San Francisco Employees Retirement System and were hired on or after January 10, 2009. Employees hired before January 10, 2009, became eligible to participate in the retirement health care system after 5 years of service and the employer paid 100% of the contribution. Proposition B also stated that a separate Retiree Health Care Trust Fund would be created to pay for the City’s future costs related to retiree health care. This trust fund will be funded by employer and employee contributions for employees hired on or after January 10, 2009. These new employees would contribute up to 2% of their pre-tax pay and employers would contribute 1%.

The Retirement System issues a publicly available financial report for Citywide level that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees’ Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, CA 94102, or by calling (415) 487-7020.

(b) Health Care Benefits

Health care benefits of the Enterprise employees, retired employees and surviving spouses are financed by beneficiaries and by the City through the City and County of San Francisco Health Service System (the Health Service System). The Enterprise’s annual contribution, which amounted to approximately \$24,356 and \$20,952 in fiscal years 2012, and 2011, respectively,

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is determined by a San Francisco Charter provision based on similar contributions made by the 10 most populous counties in California.

Included in these amounts are \$7,559 and \$5,214 for 2012 and 2011, respectively, to provide post-retirement benefits for retired employees, on a pay-as-you-go basis. There was no additional City allocation to the Enterprise's contribution allocation for payments made from the Health Service System for post-retirement health benefits in 2012 and 2011, respectively.

The City has determined a City-wide Annual Required Contribution (ARC), interest on net other post-employment benefits other than pensions (OPEB) obligation, ARC adjustment, and OPEB cost based upon an actuarial valuation performed in accordance with GASB 45, by the City's actuaries. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost of each year and any unfunded actuarial liabilities (or funding excess) amortized over thirty years. The City's allocation of the OPEB related costs to the Enterprise for the year ended June 30, 2012 based upon its percentage of City-wide payroll costs is presented below.

The following table shows the components of the City's annual OPEB allocations for the Enterprise for the years ended June 30, 2012 and 2011, for the amount contributed to the plan, and changes in the City's net OPEB obligation (dollar amount in thousands):

	<u>2012</u>	<u>2011</u>
Annual required contribution	\$ 19,856	19,533
Interest on net OPEB Obligation	2,331	1,842
Adjustment to ARC	<u>(1,933)</u>	<u>(1,445)</u>
Annual OPEB cost (expense)	20,254	19,930
Contribution made	<u>(7,559)</u>	<u>(5,214)</u>
Increase in net OPEB obligation	12,695	14,716
Net OPEB obligation – beginning of year	<u>60,314</u>	<u>45,598</u>
Net OPEB obligation – end of year	\$ <u><u>73,009</u></u>	<u><u>60,314</u></u>

The City issues a publicly available financial report for Citywide level that includes the complete note disclosures and required supplementary information related to the City's post retirement health care obligations. The report may be obtained by writing to the City and County of San Francisco, Office of the Controller, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, CA 94102, or by calling (415) 554-7500.

(12) Related Parties

Various common costs incurred by the Commission are allocated proratably between the Enterprise, Hetch Hetchy, and the Wastewater Enterprise. The allocations are based on the Commission management's best estimate and may change from year to year depending on the activities incurred

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by each Enterprise and the information available. The Commission allocated \$34,396 and \$35,912 in administrative costs to the Enterprise for the years ended June 30, 2012 and 2011, respectively.

The City performs certain administrative services such as maintenance of accounting records and investment of cash for all fund groups within the City. The various funds are charged for these services based on the City's indirect cost allocation plan. The overhead allocation paid to the General Fund of the City by the Enterprise was \$2,091 and \$2,122 for the years ended June 30, 2012 and 2011, respectively, and is included in other operating expenses in the accompanying financial statements.

The Enterprise purchases water from Hetch Hetchy Water. This amount, totaling \$30,639 and \$29,747 for June 30, 2012 and 2011, respectively, has been included in the services provided by other departments in the accompanying financial statements.

The Enterprise purchases electricity from Hetch Hetchy Power at market rates. This amount, totaling \$7,064 and \$6,591 for the years ended June 30, 2012 and 2011, respectively, has been included in services provided by other departments in the accompanying financial statements.

Since fiscal year 2008, the Enterprise has charged all City departments for water with the exception of fire hydrants for public safety purpose. In fiscal year 2012 and 2011, the Enterprise delivered water for fire hydrant purposes totaling \$6 and \$4, respectively, based on metered usage and applicable water rates, and the amount has been excluded from operating revenues in the accompanying financial statements.

A variety of City departments provide services such as engineering, purchasing, legal, data processing, telecommunications, and human resources to the Enterprise and charge amounts designed to recover those departments' costs. These charges, totaling \$11,692 and \$9,971 for the years ended June 30, 2012 and 2011, respectively, have been included in services provided by other departments in the accompanying financial statements.

During the fiscal year ending June 30, 2012, \$15,085 was transferred to other City departments, including \$14,073 to Hetch Hetchy Enterprise to finance improvements to certain up-country water storage and transmission facilities, \$943 to the Recreation and Park and Department of Public Works for landscape and irrigation project performed for the Water Enterprise, and \$10 transferred to special revenue fund for the City Surety Bond Program. The Enterprise received \$1,500 transfer in for the first installment of total \$6,272 purchase price by the City's General Fund for the 17th and Folsom property. The purchase will be completed in fiscal year 2013.

As of June 30, 2012, the Enterprise has \$1,701 payable due to the Hetch Hetchy Enterprise for information technology purchases for the SFPUC headquarters building, \$1,301 due to the Arts Commission for art work, and \$693 due to the Hetch Hetchy Enterprise for Water's allocable share of costs associated with the construction of the headquarters building.

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SFPUC entered into a seventy-five year lease agreement with the San Francisco Recreation and Park Commission for the use of parking spaces at the parking garage located at 355 McAllister Street beneath Civic Center Plaza which is in closer proximity to SFPUC’s new headquarters at 525 Golden Gate Avenue. The term of the agreement commenced on February 1, 2011, with 40 parking spaces allocated to SFPUC. As of April 1, 2012, SFPUC had the rights to an additional 20 parking spaces. As of June 30, 2012, SFPUC exercised four of the additional 20 parking spaces for a total of 44 parking spaces. The total payment under this agreement is \$6,274 and the first payment in the amount of \$1,500 was made in the fiscal year 2011. Of this \$1,500, SFPUC recognized \$40 as expenses for the 40 parking spaces rented between February and June, 2011. The remaining \$1,460 was recorded as prepaid. Of the second payment in the amount of \$1,500 made in the fiscal year ending June 30, 2012, SFPUC recognized \$84 as expenses and the remaining \$1,416 was recorded as prepaid. The expenses and prepayment were prorated and allocated among the three SFPUC Enterprises based on the use of parking spaces. The total remaining payments that will be allocated to the 3 enterprises will be made as follows:

	<u>Amount</u>
Fiscal years ending June 30:	
2013	\$ 1,500
2014	1,500
2015	<u>274</u>
Total	<u>\$ 3,274</u>

In fiscal year ending June 30, 2012, the Water Enterprise’s allocable share of expenses and prepayment was \$75 and \$647, respectively. In fiscal year ending June 30, 2011, the Water Enterprise’s allocable share of expenses and prepayment was \$39 and \$401, respectively.

(13) Risk Management

The Enterprise’s risk management program includes both self-insured and insured exposures at risk. Risk assessments and purchasing of insurance coverage are collaboratively coordinated by SFPUC Enterprise Risk Management and the City’s Office of Risk Management. With certain exceptions, the City and the Enterprise’s general policy is to first evaluate the exposure at risk for self-insurance. Based on this analysis, internal mitigation strategies and financing through a ‘self-retention’ mechanism is generally more economical as the SFPUC administers, adjusts, settles, defends, and pays claims from budgeted resources (i.e. pay-as-you-go fund). When economically more viable or when required by debt financing covenants, the Enterprise obtains commercial insurance. At least annually, the City actuarially determines general liability and workers’ compensation risk exposures. The Enterprise does not maintain commercial earthquake coverage, with certain minor exceptions, such as a sub-limit for fire-sprinkler leakage due to earthquake under the Property Insurance program.

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Primary risks	Typical coverage approach
General liability	Self-Insured
Property	Purchased Insurance and Self-Insured
Workers' compensation	Self-Insured through Citywide Pool
Other risks	Typical coverage approach
Surety bonds	Purchased and Contractually Transferred
Professional liability	Combination of Self-Insured, Purchased Insurance and Contractual Risk Transfer
Errors and omissions	Combination of Self-Insured, Purchased Insurance and Contractual Risk Transfer
Builders' risk	Purchased Insurance and Contractual Risk Transfer
Public Officials Liability	Purchased Insurance

(a) Damage Claims Liability

Through coordination with the Controller and the City Attorney's Office, the general liability risk exposure is actuarially determined and is addressed through pay-as-you-go funding as part of the budgetary process. Associated costs are also booked as expenses as required under Generally Accepted Accounting Principles (GAAP) for financial statement purposes for both the Enterprise and the City and County of San Francisco's Comprehensive Annual Financial Report (CAFR). The claim expense allocations are determined based on actuarially determined anticipated claim payments and the projected timing of disbursement.

The changes for the damage claims liabilities for the years ended June 30, 2012 and 2011 are as follows:

	Beginning of year	Claims and changes in estimates	Claims paid	End of year
2010 – 2011	\$ 29,740	6,815	(9,565)	26,990
2011 – 2012	26,990	2,565	(20,460)	9,095

(b) Property

The Enterprise's property risk management approach varies depending on whether the facility is currently under construction, or if the property is part of revenue-generating operations. For new construction projects, the Enterprise has utilized traditional insurance, or other alternative insurance programs. Under the latter approach, the insurance program usually provides coverage for the entire construction project, along with multiple risk coverage, such as for general liability, property damage and workers' compensation, for example. When a traditional insurance program is used for property risks, the Enterprise requires each contractor to provide its own insurance, while ensuring that the full scope of work be covered with satisfactory levels to limit the Enterprise's risk exposure. The majority of purchased insurance program is

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for either: 1) revenue-generating facilities, 2) debt-financed facilities, or 3) mandated coverage to meet statutory requirements for bonding of various public officials.

(c) Workers' Compensation

The City actuarially determines and allocates workers' compensation costs to the Enterprise according to a formula based on the following: (i) the dollar amount of claims; (ii) yearly projections of payments based on historical experience; and (iii) the size of the Enterprise's payroll. The administration of workers' compensation claims and payouts are handled by the Workers' Compensation Division of the City's Department of Human Resources. Statewide workers' compensation reforms have resulted in budgetary savings in recent years. The City continues to develop and implement improved programs, such as return-to-work programs, to lower or mitigate the growth of workers' compensation costs. Programs include: accident prevention, investigation and duty modification for injured employees with medical restrictions so return to work can occur as soon as possible.

The changes in the liabilities for workers' compensation for the years ended June 30, 2012 and 2011 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2010 – 2011	\$ 8,094	2,030	(2,449)	7,675
2011 – 2012	7,675	2,639	(2,350)	7,964

(d) Surety Bonds and Public Official Liability

Bonds are required in most phases of the public utilities construction contracting process for such phases as bid, performance, and payment or maintenance. Additionally, bonds may be required in other contracts where goods or services are provided to ensure compliance with applicable terms and conditions such as warranty. All SFPUC public officials with financial oversight responsibilities are provided coverage through a commercial Public Official Liability policy. The Enterprise also maintains a commercial crime policy in lieu of bonding its employees.

(e) Professional Liability, Errors and Omissions

Professional liability policies are either directly purchased insurance on behalf of the Enterprise, transferred through contract to the contracted professional, or retained through self-insurance on a case by case basis depending on the size, complexity or scope of construction or professional service contracts. Examples of contracts providing any form of the coverage described are engineers, architects, design professionals and other licensed or certified professional service providers.

SAN FRANCISCO WATER ENTERPRISE

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(f) Builders' Risk

Builder's risk policies of insurance are required to be provided by the contractor on all construction projects for the full value of construction.

(14) Commitments and Litigation

(a) Commitments

As of June 30, 2012 and 2011, the Enterprise has outstanding commitments with third parties of \$969,302 and \$1,168,888, respectively, for various capital projects and other purchase agreements for materials and services.

(b) Grants

Grants that the Enterprise receives are subject to audit and final acceptance by the granting agency. Current and prior year costs of such grants are subject to adjustment upon audit.

(c) Litigation

The Enterprise is a defendant in various legal actions and claims that arise during the normal course of business. The final disposition of those legal actions and claims is not determinable. However, in the opinion of management, the outcome of any litigation of these matters will not have a material effect on the financial position or changes in net assets of the Enterprise.

(15) Subsequent Events

(a) Water Revenue Bonds 2012 Series D

In August 2012, the Enterprise issued revenue bonds, 2012 Series D in the principal amount of \$24,040. The purpose of the bonds was to refund \$24,120 of outstanding 2002 Series B revenue bonds, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated "AA-" and "Aa3" from S&P and Moody's respectively. The bonds are serial bonds with interest rates varying from 1.8% to 5.0%. The 2012 Series D bonds have a true interest cost of 1.3%.

A portion of the proceeds of the 2012 Series D revenue bonds was deposited with the trustee, acting as escrow agent under the irrevocable Escrow Agreement, dated August 1, 2012, to refund and legally defease a portion of the outstanding 2002 Series B bonds. This deposit, together with certain other available moneys was held by the escrow agent under the Escrow Agreement and invested in non-callable Federal Securities consisting of United States Treasury Securities - State and Local Government Series. The principal and interest on monies held by the escrow agent will be sufficient to redeem the refunded 2002 Series B bonds on November 1, 2012 by optional redemption on that date.

SAN FRANCISCO WATER ENTERPRISE

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(b) *BAWSCA Payment Agreement*

On September 10, 2012, Governor Brown signed legislation authorizing BAWSCA to prepay the unpaid principal balance, approximately \$370 million, relating to existing SFPUC capital assets as of June 30, 2009, as provided in the Water Supply Agreement between the SFPUC and the BAWSCA members. This payment will be in lieu of the current Water Supply Agreement payment structure over 25 years at an interest rate of 5.13%. It is anticipated this prepayment may occur, at least in part, in 2013.



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**Report on Internal Control Over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Honorable Mayor and Board of Supervisors
City and County of San Francisco, California:

We have audited the financial statements of the San Francisco Water Enterprise (the Enterprise), an enterprise fund of the City and County of San Francisco, California (the City) as of and for the year ended June 30, 2012, and have issued our report thereon dated October 25, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Enterprise is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Enterprise's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Enterprise's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Enterprise's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Enterprise's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those



provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the City and County of San Francisco Government Audit and Oversight Committee, the Commission, and others within the entities, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 25, 2012