City of Chicago, Illinois
Water Fund

Basic Financial Statements as of and for the Years Ended December 31, 2012 and 2011, Required Supplementary Information, Additional Information, Statistical Data, and Independent Auditors' Report

CITY OF CHICAGO, ILLINOIS WATER FUND

TABLE OF CONTENTS

Deloitte.

Deloitte & Touche LLP
111 S. Wacker Drive
Chicago, IL 60606-4301
USA

Tel: +1 312 486 1000
Fax: +1 312 486 1486
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

The Honorable Rahm Emanuel, Mayor
and Members of the City Council
City of Chicago, Illinois

We have audited the accompanying basic financial statements of the Water Fund ("Water Fund"), an enterprise fund of the City of Chicago, Illinois (the "City") as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Water Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Basic Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Water Fund as of December 31, 2012 and 2011, and the changes in its financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

As discussed in Note 1 to the basic financial statements, the basic financial statements referred to above present only the Water Fund, an enterprise fund of the City, and do not purport to, and do not, present the financial position of the City as of December 31, 2012 and 2011, changes in its financial position, or where applicable, its cash flows, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic financial statements that collectively comprise the Water Fund's basic financial statements. The additional supplementary information and statistical data, as listed in the foregoing table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The additional supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the additional supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The statistical data has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Deloitte & Touche LLP

June 29, 2013

The following discussion and analysis of the City of Chicago, Illinois (the "City"), Water Fund's ("Water Fund") financial performance provides an introduction and overview of the Water Fund's financial activities for the years ended December 31, 2012 and 2011. Please read this discussion in conjunction with the Water Fund's basic financial statements and the notes to basic financial statements following this section.

FINANCIAL HIGHLIGHTS

2012

- Operating revenues for 2012 increased by $122.1 million compared to 2011 operating revenues. This increase is primarily due to a water rate increase of 25% and increase in usage during the drought summer of 2012.

- Operating expenses before depreciation and amortization for 2012 increased by $7.3 million compared to 2011 mainly due to increase in costs of fringe benefits to employees, Water Fund's share of indirect costs, and diesel and gasoline costs offset by decrease in costs of sediment disposals.

- The Water Fund's net position at December 31, 2012, was $1,262.4 million. This is an increase of $160.2 million over net position at December 31, 2011.

- Utility plant additions in 2012 were $318.9 million due to the continuing capital improvement program.

2011

- Operating revenues for 2011 decreased by $4.2 million compared to 2010 operating revenues. This decrease is primarily due to a decrease in pumpage. There was no water rate increase in 2011.

- Operating expenses before depreciation and amortization for 2011 increased by $3.1 million compared to 2010 mainly due to increase in costs of sediment disposals offset by decreases in costs of natural gas and electricity, medical premiums, and workmen's compensation costs.

- The Water Fund's net position at December 31, 2011, was $1,102.2 million. This is an increase of $42.1 million over net position at December 31, 2010.

Utility plant increased in 2011 by $152 million due to the continuing capital improvement program.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Water Fund's basic financial statements. The Water Fund's basic financial statements comprise the financial statements and the notes to basic financial statements. In addition to the basic financial statements, this report also presents additional information after the notes to basic financial statements.

The statements of net position present all of the Water Fund's assets, deferred outflows, liabilities, and deferred inflows using the accrual basis of accounting, which is similar to the basis of accounting used by private-sector companies. The difference between assets, deferred outflows, liabilities, and deferred inflows is reported as net position. The increase or decrease in net position may serve as an indicator, over time, as to whether the Water Fund's financial position is improving or deteriorating.

The statements of revenues, expenses, and changes in net position present all current-year revenues and expenses, regardless of when cash is received or paid, and the ensuing change in net position.

The statements of cash flows report how cash and cash equivalents are provided and used by the Water Fund's operating, capital financing, and investing activities. These statements present the cash received and disbursed, the net increase or decrease in cash and cash equivalents for the year, and the cash and cash equivalents balance at year-end.

The notes to basic financial statements are an integral part of the basic financial statements; accordingly, such disclosures are essential for a full understanding of the information provided in the basic financial statements.

In addition to the basic financial statements, this report includes statistical data. The statistical data section presents unaudited debt service coverage calculation and includes certain unaudited information related to the Water Fund's historical financial and nonfinancial operating results and capital activities.

FINANCIAL ANALYSIS

At December 31, 2012, the Water Fund's financial position continued to be strong with total assets and deferred outflows of $3,734.1 million, total liabilities of $2,471.6 million, and net position of $1,262.4 million. A comparative condensed summary of the Water Fund's net position at December 31, 2012, 2011 and 2010, is as follows:

	Net Assets		
(In thousands)	**2012**	**2011**	**2010**
Current assets	$ 294,077	$ 196,738	$ 177,985
Restricted and other assets	452,295	238,549	348,724
Utility plant — net	2,861,340	2,594,391	2,492,738
Deferred outflows	126,371	128,386	77,367
Total assets and deferred outflows	$ 3,734,083	$ 3,158,064	$ 3,096,814
Current liabilities	$ 147,844	$ 132,903	$ 134,538
Long-term liabilities and payable from restricted assets	2,323,790	1,922,929	1,902,139
Total liabilities	$ 2,471,634	$ 2,055,832	$ 2,036,677
Net position:			
Net investment in capital assets	$ 1,073,309	$ 1,055,054	$ 974,328
Restricted for capital projects	1,308	209	447
Unrestricted	187,832	46,969	85,362
Total net position	$ 1,262,449	$ 1,102,232	$ 1,060,137

2012

Current assets of $294.1 million at December 31, 2012, increased by $97.3 million (49.5%) over 2011 as a result of increases in cash and cash equivalents of $56.6 million, investments of $10.2 million, and accounts receivable of $26.5 million resulting from an increase in water rates. Restricted and other assets increased by $213.7 million (89.6%) primarily due to the funding of the capital improvement program through the issuance of long-term debt and utility plant — net increased by $266.9 million (10.3%) due to the ongoing capital improvement.

The increase in current liabilities of $14.9 million (11.2%) during 2012 is directly related to the timing of payments of accounts payable and increases in accrued liabilities and deferred revenue offset by decrease in due to other city funds. Long-term liabilities and payable from restricted assets increased by $400.9 million (20.8%) mainly due to debt issuances in 2012.

Net position may serve as a useful indicator, over a period of time, of the Water Fund's basic financial position. At December 31, 2012, net position was $1,262.4 million, an increase of $160.2 million (14.5%) over 2011.

2011

Current assets of $196.7 million at December 31, 2011, increased by $18.8 million (10.5%) over 2010 as a result of an increase in investments of $30.2 million. Restricted and other assets decreased by $110.2 million (31.6%) primarily due to the funding of the capital improvement program and utility plant — net increased by $101.6 million (4.1%).

The decrease in current liabilities of $1.6 million (0.1%) during 2011 is directly related to the timing of payments of accounts payable and increases in accounts payable offset by decreases in due to other city funds and deferred revenue. Long-term liabilities and payable from restricted assets increased by $20.8 million (1.1%) mainly due to the Illinois Environmental Protection Agency debt issuances in 2011.

Net position may serve as a useful indicator, over a period of time, of the Water Fund's basic financial position. At December 31, 2011, total net position was $1,102.2 million, an increase of $42.1 million (4.1%) over 2010.

The primary sources of the Water Fund's operating revenues are water usage fees. These revenues fund all Water Fund operating expenses, fund deposits, capital construction, and debt service requirements. A comparative condensed summary of the Water Fund's revenues, expenses, and changes in net position for the years ended December 31, 2012, 2011, and 2010, is as follows:

	Revenues, Expenses, and Changes in Net Position		
(In thousands)	**2012**	**2011**	**2010**
Revenues:			
Operating revenues			
Water sales	$ 562,572	$ 441,769	$ 445,504
Other operating revenues	13,715	12,452	12,891
Total operating revenues	576,287	454,221	458,395
Nonoperating revenues	1,429	4,163	3,582
Total revenues	577,716	458,384	461,977
Expenses:			
Operating expenses	289,465	282,164	279,090
Depreciation and amortization	48,887	47,603	44,519
Interest expense	79,147	86,522	75,738
Total expenses	417,499	416,289	399,347
Change in net position	160,217	42,095	62,630
Net position — beginning of year	1,102,232	1,060,137	997,507
Net position — end of year	$ 1,262,449	$ 1,102,232	$ 1,060,137

2012

Water sales and other operating revenues comprise the Water Fund's $576.3 million operating revenues. Water sales and other operating revenues for 2012 were $562.6 million and $13.7 million, respectively. The increase in 2012 operating revenues of $122.1 million (26.9%) from 2011 was primarily due to a 25% increase in water rates and increase in usage resulting from a drought summer in 2012.

In 2012, net nonoperating revenues of $1.4 million were composed mainly of federal grants received for water mains replacement and net forced account totaling $1.2 million.

2011

Water sales and other operating revenues comprise the Water Fund's $454.2 million operating revenues. Water sales and other operating revenues for 2011 were $441.8 million and $12.4 million, respectively. The decrease in 2011 operating revenues of $4.2 million (0.9%) from 2010 was primarily due to a decrease in water pumpage. There was no water rate increase in 2011.

In 2011, net nonoperating revenues of $4.2 million were composed mainly of federal grants received for water mains replacement of $2.6 million and net interest income of $2.0 million. The increase in interest expense of $10.8 million (14.2%) is primarily due to the issuance of the Series 2010 A, B, and C Second Lien Water Revenue Bonds in 2010.

A comparative summary of the Water Fund's operating expenses, as classified in the basic financial statements, for the years ended December 31, 2012, 2011, and 2010, is as follows:

	Operating Expenses		
(In thousands)	**2012**	**2011**	**2010**
Source of supply	$ 168	$ 185	$ 100
Power and pumping	41,728	38,182	42,857
Purification	56,136	66,471	49,725
Transmission and distribution	36,494	38,985	38,671
Provision for doubtful accounts	15,714	13,947	15,862
Customer accounting and collection	10,004	10,663	10,305
Administrative and general	21,861	17,143	18,562
Central services and General Fund reimbursements	107,360	96,588	103,008
Operating expenses before depreciation and amortization	289,465	282,164	279,090
Depreciation and amortization	48,887	47,603	44,519
Total operating expenses	$ 338,352	$ 329,767	$ 323,609

2012

Operating expenses before depreciation and amortization for the year ended 2012 increased by $7.3 million (2.6%) from the year ended 2011 due to an increase in central services and General Fund reimbursements of $10.8 million (11.2%) primarily due to an increase in fringe benefits to employees of about $6.3 million, increase in the Water Fund's share of indirect costs of about $4.7 million, increase in power and pumping of about $3.5 million (9.3%) and increase in administrative and general of about $4.7 million (27.5%) this was offset by a decrease in purification of about $10.3 million (15.5%) resulting from a decrease in costs of sediment disposals of about $11.7 million.

2011

Operating expenses before depreciation and amortization for the year ended 2011 increased by $3.1 million (1.1%) from the year ended 2010 due to an increase in purification of $16.7 million (33.7%) primarily due to an increase in costs of sediment disposals of about $13.3 million, offset by a decrease in power and pumping of $4.7 million (10.9%) resulting from a decrease in costs of natural gas and electrical charges and a decrease in central services and General Fund reimbursements of $6.4 million (6.2%) resulting from a decrease in workmen's compensation costs.

A comparative summary of the Water Fund's cash flows for the years ended December 31, 2012, 2011, and 2010, is as follows:

	Cash Flows		
(In thousands of dollars)	**2012**	**2011**	**2010**
Cash from activities:			
Operating	$ 270,821	$ 176,651	$ 156,098
Capital and related financing	4,282	(265,251)	70,179
Investing	(209,656)	(33,168)	(101,076)
Net change in cash and cash equivalents	65,447	(121,768)	125,201
Cash and cash equivalents:			
Beginning of year	58,084	179,852	54,651
End of year	$ 123,531	$ 58,084	$ 179,852

2012

As of December 31, 2012, the Water Fund's cash and cash equivalents of $123.5 million increased from December 31, 2011, by $65.4 million mainly due to the cash provided of $270.8 from operating activities, cash provided by issuance of bonds and notes of $447.5 million offset by cash used in acquisition and construction of capital assets of $254.8 million and net cash used in investing activities of $209.7 million. Total cash and cash equivalents at December 31, 2012, are composed of unrestricted and restricted cash and cash equivalents of $84.4 million and $39.1 million, respectively.

2011

As of December 31, 2011, the Water Fund's cash and cash equivalents of $58.1 million decreased from December 31, 2010, by $121.8 million mainly due to the cash used in acquisition and construction of capital assets of $139.1 and cash used for debt service of $142.9, offset by cash provided by operating activities of $176.7 million and cash provided by the issuance of loans of $14.6 million. Total cash and cash equivalents at December 31, 2011, are composed of unrestricted and restricted cash and cash equivalents of $27.8 million and $30.3 million, respectively.

UTILITY PLANT AND DEBT ADMINISTRATION

2012

At the end of 2012 and 2011, the Water Fund had $2,861.3 million and $2,594.4 million, respectively, invested in utility plant, net of accumulated depreciation. During 2012, the Water Fund expended $318.9 million on capital activities. This included $2.2 million for structures and improvements, $133.9 million for distribution plant, $5.8 million for equipment, and $177.2 million for construction in progress.

During 2012, net completed projects totaling $63.7 million were transferred from construction in progress to applicable capital accounts. The major completed projects were related to installation and replacements of water mains ($63.4 million).

2011

At the end of 2011 and 2010, the Water Fund had $2,594.4 million and $2,492.7 million, respectively, invested in utility plant, net of accumulated depreciation. During 2011, the Water Fund expended $152 million on capital activities. This included $2.1 million for structures and improvements, $78 million for distribution plant, $6.9 million for equipment, and $65 million for construction in progress.

During 2011, net completed projects totaling $39.5 million were transferred from construction in progress to applicable capital accounts. The major completed projects were related to installation and replacements of water mains ($29.8 million) and Thomas Jefferson pumping station's electrical and control improvements ($4.8 million).

The Water Fund's utility plant at December 31, 2012, 2011, and 2010, is summarized as follows:

	Net Utility Plant at Year-End		
(In thousands)	**2012**	**2011**	**2010**
Utility plant not depreciated:			
Land and land rights	$ 5,083	$ 5,083	$ 5,083
Construction in progress	262,280	148,871	123,416
Total utility plant not depreciated	267,363	153,954	128,499
Utility plant being depreciated:			
Structures and improvements	535,710	534,472	532,758
Distribution plant	2,305,803	2,111,790	2,004,119
Equipment	620,775	617,159	605,477
Total utility plant being depreciated	3,462,288	3,263,421	3,142,354
Less accumulated depreciation:			
Structures and improvements	(190,278)	(182,537)	(175,294)
Distribution plant	(372,090)	(351,343)	(331,211)
Equipment	(305,943)	(289,104)	(271,610)
Total accumulated depreciation	(868,311)	(822,984)	(778,115)
Total utility plant being depreciated — net	2,593,977	2,440,437	2,364,239
Total utility plant — net	$2,861,340	$2,594,391	$2,492,738

The Water Fund's capital activities are funded through Water Fund revenue bonds and Water Fund revenue. Additional information on the Water Fund's capital assets is presented in Note 5 of the notes to basic financial statements.

The Water Fund's long-term liabilities at December 31, 2012, 2011, and 2010, are summarized as follows:

	Long-Term Liabilities at Year-End		
(In thousands)	**2012**	**2011**	**2010**
Revenue bonds and notes payable	$2,030,177	$1,721,188	$1,753,832
Add:			
Accretion of Capital Appreciation Bonds	47,658	46,946	45,900
Bond discount/premium	71,041	30,498	31,704
Less unamortized deferred loss on bond refunding	(36,199)	(38,678)	(41,215)
Total revenue bonds/notes payable — net	2,112,677	1,759,954	1,790,221
Less current portion of accretion	(8,749)	(4,493)	(4,271)
Less current bonds/notes payable	(42,232)	(44,448)	(42,218)
Total long-term revenue bonds/notes payable — net	2,061,696	1,711,013	1,743,732
Derivative instrument liability	126,371	128,386	77,367
Long-term purchase obligations	1,027	3,290	8,529
Water pipe extension certificates	1,576	1,590	1,590
Total long-term liabilities	$2,190,670	$1,844,279	$1,831,218

Additional information on the Water Fund's long-term debt is presented in Note 4 of the notes to basic financial statements.

The Water Fund's revenue bonds at December 31, 2012, have underlying credit ratings with each of the three major rating agencies as follows:

	Moody's Investor Services	Standard & Poor's	Fitch Ratings
Senior Lien Water Revenue Bonds	Aa2	AA	AA+
Junior Lien Water Revenue Bonds	Aa3	AA-	AA

At December 31, 2012, the Water Fund was in compliance with the debt covenants as stated within the bond ordinances. Additional information on certain of the Water Fund's debt covenants is presented in Note 4 of the notes to the basic financial statements.

Requests for Information

This financial report is designed to provide the reader with a general overview of the Water Fund's finances. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the City Comptroller's Office.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATEMENTS OF NET POSITION
AS OF DECEMBER 31, 2012 AND 2011
(In thousands)

ASSETS	2012	2011
CURRENT ASSETS:		
Cash and cash equivalents (Note 2)	$ 84,429	$ 27,796
Investments (Note 2)	44,188	34,019
Accounts receivable — net of allowance for doubtful accounts of approximately $64,161 in 2012 and $51,796 in 2011	127,390	100,933
Interest receivable	107	138
Due from other City funds	20,607	17,507
Inventories	17,356	16,345
Current unrestricted assets	294,077	196,738
Restricted assets (Notes 2 and 3):		
Cash and cash equivalents	39,102	30,288
Investments	395,439	193,495
Interest receivable	1,308	209
Total restricted assets	435,849	223,992
NONCURRENT ASSETS:		
Other assets	16,446	14,557
Utility plant (Note 5):		
Land and land rights	5,083	5,083
Structures and improvements	535,710	534,472
Distribution plant	2,305,803	2,111,790
Equipment	620,775	617,159
Construction in progress	262,280	148,871
Total utility plant	3,729,651	3,417,375
Less accumulated depreciation	(868,311)	(822,984)
Utility plant — net	2,861,340	2,594,391
Total noncurrent assets	2,877,786	2,608,948
Total assets	3,607,712	3,029,678
DEFERRED OUTFLOWS	126,371	128,386
TOTAL	$3,734,083	$3,158,064

LIABILITIES	2012	2011
CURRENT LIABILITIES:		
Accounts payable	$ 30,299	$ 29,139
Due to other City funds	8,503	18,212
Accrued liabilities	82,296	71,158
Deferred revenue	26,746	14,394
Total current liabilities	147,844	132,903
Liabilities payable from restricted assets:		
Accounts payable	63,094	13,975
Due to other City funds	2,693	1,554
Interest payable	16,352	14,180
Current portion of long-term debt (Note 4)	50,981	48,941
Total liabilities payable from restricted assets	133,120	78,650
NONCURRENT LIABILITIES:		
Long-term debt — net of current maturities (Note 4)	2,061,696	1,711,013
Derivative instrument liability	126,371	128,386
Long-term purchase obligation (Note 4)	1,027	3,290
Water pipe extension certificates	1,576	1,590
Total noncurrent liabilities	2,190,670	1,844,279
Total liabilities	2,471,634	2,055,832
NET POSITION (Note 1):		
Net investment in capital assets	1,073,309	1,055,054
Restricted for capital projects	1,308	209
Unrestricted	187,832	46,969
Total net position	1,262,449	1,102,232
TOTAL	$3,734,083	$3,158,064

See notes to basic financial statements.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
OPERATING REVENUES:		
Water sales	$ 562,572	$ 441,769
Other operating revenues	13,715	12,452
Total operating revenues	576,287	454,221
OPERATING EXPENSES:		
Source of supply	168	185
Power and pumping	41,728	38,182
Purification	56,136	66,471
Transmission and distribution	36,494	38,985
Provision for doubtful accounts	15,714	13,947
Customer accounting and collection	10,004	10,663
Administrative and general	21,861	17,143
Central services and General Fund reimbursements	107,360	96,588
Total operating expenses before depreciation and amortization	289,465	282,164
OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION	286,822	172,057
DEPRECIATION AND AMORTIZATION	48,887	47,603
OPERATING INCOME	237,935	124,454
NONOPERATING REVENUES (EXPENSES):		
Interest income	270	2,008
Interest expense	(79,147)	(86,522)
Other	1,159	2,155
Total nonoperating expenses — net	(77,718)	(82,359)
CHANGE IN NET POSITION	160,217	42,095
TOTAL NET POSITION — Beginning of year	1,102,232	1,060,137
TOTAL NET POSITION — End of year	$ 1,262,449	$ 1,102,232

See notes to basic financial statements.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Received from customers	$ 546,056	$ 440,408
Transactions with other City funds	(80,972)	(66,535)
Payments to vendors	(84,738)	(89,215)
Payments to employees	(109,525)	(108,007)
Net cash provided by operating activities	270,821	176,651
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition and construction of capital assets	(254,843)	(139,057)
Interest paid	(91,514)	(86,434)
Proceeds from issuance of bonds and notes	447,538	14,573
Principal paid on bonds	(59,859)	(56,488)
Payments of refunded bonds	(35,595)	
Payments of bonds issuance costs	(2,604)	
Construction reimbursements	1,159	2,155
Net cash provided by (used in) capital and related financing activities	4,282	(265,251)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Sales and purchases of investments — net	(212,113)	(37,663)
Investment interest	2,457	4,495
Net cash used in investing activities	(209,656)	(33,168)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	65,447	(121,768)
CASH AND CASH EQUIVALENTS — Beginning of year	58,084	179,852
CASH AND CASH EQUIVALENTS — End of year	$ 123,531	$ 58,084
RECONCILIATION OF CASH AND CASH EQUIVALENTS REPORTED IN THE STATEMENTS OF NET POSITION:		
Unrestricted	$ 84,429	$ 27,796
Restricted	39,102	30,288
TOTAL	$ 123,531	$ 58,084

(Continued)

CITY OF CHICAGO, ILLINOIS WATER FUND

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$ 237,935	$ 124,454
Adjustments to reconcile:		
Depreciation and amortization	48,887	47,603
Provision for doubtful accounts	15,714	13,947
Changes in assets and liabilities:		
Increase in accounts receivable	(42,570)	(7,433)
Increase in inventories	(1,011)	(2,279)
(Increase) in due from other City funds	(3,100)	1,994
Increase in unrestricted accounts payable	1,160	14,556
Decrease in due to other City funds	(9,709)	(6,240)
Increase (decrease) in accrued liabilities	11,176	(3,571)
Decrease in water pipe extension certificate	(13)	
Increase (decrease) in deferred revenue	12,352	(6,380)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 270,821	$ 176,651

SUPPLEMENTAL DISCLOSURE OF NONCASH ITEMS — Property additions in 2012 and 2011 of $65,787 and $15,528, respectively, have outstanding accounts payable.

See notes to basic financial statements.

(Concluded)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization — The Water Fund ("Water Fund") purifies and provides Lake Michigan water for the City of Chicago, Illinois (the "City") and approximately 125 suburbs. The Water Fund is included in the City's reporting entity as an enterprise fund.

The accompanying basic financial statements present only the Water Fund and are not intended to present the financial position of the City, and the results of its operations and the cash flows of its proprietary-fund types.

Basis of Accounting — The accounting policies of the Water Fund are based upon accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The accounts of the Water Fund are reported using the flow of economic resources measurement focus.

The Water Fund uses the accrual basis of accounting under which revenues are recognized when earned and expenses are recognized when the liability is incurred.

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

Annual Appropriated Budget — The Water Fund has a legally adopted annual budget, which is not required to be reported.

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

Cash, Cash Equivalents, and Investments — Cash, cash equivalents, and investments generally are held with the City Treasurer as required by the Municipal Code of Chicago (the "Code"). Interest earned on pooled investments is allocated to participating funds based upon their average combined cash and investment balances. Due to contractual agreements or legal restrictions, the cash and investments of certain funds are segregated and earn and receive interest directly.

The Code permits deposits only to City Council-approved depositories, which must be organized state or national banks and federal and state savings and loan associations, located within the City, whose deposits are federally insured.

Investments authorized by the Code include interest-bearing general obligations of the City, State of Illinois (the "State"), and the U.S. government; U.S. Treasury bills and other non-interest-bearing general obligations of the U.S. government purchased in the open market below face value; domestic money market funds regulated by and in good standing with the Securities and Exchange Commission; and tax anticipation warrants issued by the City. The City is prohibited by ordinance from investing in derivatives, as defined, without City Council approval.

The Water Fund values its investments at fair value or amortized cost as applicable. U.S. government securities purchased at a price other than par with a maturity of less than one year are reported at amortized cost. The fair value of U.S. agency securities, corporate bonds, and municipal bonds are estimated using recently executed transactions, market price quotations (where observable), or bond spreads.

Repurchase agreements can be purchased only from banks and certain other institutions authorized to do business in the State. The City Treasurer requires that securities pledged to secure these agreements have a fair value equal to the cost of the repurchase agreements, plus accrued interest.

Investments generally may not have a maturity in excess of 10 years from the date of purchase. Certain other investment balances are held in accordance with the specific provisions of applicable bond ordinances.

Cash equivalents include certificates of deposit and other investments with maturities of three months or less when purchased.

Accounts Receivable Allowance — Management has provided an allowance for amounts recorded at year-end, which may be uncollectible.

Transactions with the City — The City's General Fund provides services to all other funds. The amounts allocated to other funds for these services are treated as operating expenses by the Water Fund and consist mainly of employee benefits, self-insured risks, and administrative expenses.

Inventories — Inventories, composed mainly of materials and supplies, are stated at cost, determined principally on the average cost method.

Utility Plant — Utility plant is recorded at cost or, for donated assets, at fair value at the date of acquisition. Utility plant is defined by the Water Fund as assets with an initial cost of more than $5 thousand and an estimated useful life in excess of two years. Such assets are recorded at historical cost. Depreciation is provided using the straight-line method and begins in the year following the year of acquisition or completion. Estimated useful lives are as follows:

Structures and improvements	50–100 years
Distribution plant	25–100 years
Equipment	6–33 years

Costs of repairs and maintenance that do not significantly extend the useful life of assets are charged to operations.

Net Position — Net position is composed of net earnings from operating and nonoperating revenues, expenses, and capital grants. Net position is displayed in three components — invested in capital assets, net of related debt; restricted for capital projects; and unrestricted. Invested in capital assets, net of related debt consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt, net of debt service reserve, and unspent bond proceeds. Restricted for capital projects consist of assets for which constraints are placed thereon by external parties (such as lenders and grantors) and laws, regulations, and enabling legislation reduced by liabilities and deferred inflows of resources related to those assets. Unrestricted consists of the net amount of all other assets, deferred outflows, liabilities, and deferred inflows not categorized as either of the above.

Employee Benefits — Employee benefits are granted for vacation and sick leave, workers' compensation, and health care. Unused vacation leave is accrued and may be carried over for one year. Sick leave is accumulated at the rate of one day for each month worked, up to a maximum of 200 days. Severance of employment terminates all rights to receive compensation for any unused sick leave. Sick leave pay is not accrued. Employee benefit claims outstanding, including claims incurred but not reported, are estimated and recorded as liabilities.

Employees are eligible to defer a portion of their salaries until future years under the City's deferred compensation plan created in accordance with Internal Revenue Code Section 457. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. The plan is administered by third-party administrators, who maintain the investment portfolio. The plan's assets have been placed in trust accounts with the plan administrators for the exclusive benefit of participants and their beneficiaries, and are not considered assets of the City.

The City is subject to the State Unemployment Compensation Act and has elected the reimbursing employer option for providing unemployment insurance benefits for eligible former employees. Under this option, the City reimburses the State for claims paid by the State.

Bond Issuance Costs, Bond Discounts, and Refunding Transactions — Bond issuance costs and bond discounts are deferred and amortized over the term of the related debt, except in the case of refunding debt transactions where the amortization period is over the term of the refunding or refunded debt, whichever is shorter.

Derivatives — The Water Fund enters into interest rate swap agreements to hedge interest rates on outstanding variable interest rate debt. For existing swaps, the net interest expenditures resulting from these arrangements are recorded as interest expense. The fair value of derivative instruments that are deemed to be effective is accounted for as deferred outflows. Derivative instruments that are deemed not effective are adjusted to fair value with the change in fair value recorded to investment earnings. All interest rate swaps are approved by City Council.

Capitalized Interest — Interest expense, net of interest income, on construction bond proceeds is capitalized during construction of those capital projects paid for from the bond proceeds and are being amortized over the depreciable life of the related assets on a straight-line basis.

Revenue Recognition — Revenue from water sales is recognized when the water is consumed by customers. Of the accounts receivable balances, $50.0 million and $46.2 million represent revenue recognized on water sales, which had not yet been billed to customers at December 31, 2012 and 2011, respectively. Deferred revenue represents amounts billed to nonmetered customers prior to usage.

Revenues and Expenses — The Water Fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Water Fund's principal ongoing operations. The principal operating revenues of the Water Fund are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation and amortization on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Adopted Accounting Standards — In December 2010, the GASB issued GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The Water Fund implemented GASB Statement No. 62 on January 1, 2012. This statement incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which do not conflict with or contradict GASB pronouncements:

- FASB Statements and Interpretations
- Accounting Principles Board Opinions
- Accounting Research Bulletins of the American Institute of Certified Public Accountants' Committee on Accounting Procedure

The statement also supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Propriety Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. Those entities who chose to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements can continue to apply those pronouncements as other accounting literature. The financial reporting impact resulting from the implementation of GASB Statement No. 62 was not material.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows or Resources, and Net Position.* The Water Fund implemented GASB Statement No. 63 on January 1, 2012. GASB Statement No. 63 standardizes the presentation of deferred outflows of resources and deferred inflows of resources and their effect on a government's net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. The financial reporting impact resulting from the implementation of GASB Statement No. 63 is the change in terminology from net assets to net position.

In June 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions — An Amendment to GASB Statement No. 53.* The Water Fund implemented GASB Statement No. 64 on January 1, 2012. GASB Statement No. 64 clarifies whether an effective hedge relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. There was no impact on the City's financial statements as a result of the implementation of GASB Statement No. 64.

Upcoming Accounting Standards — Other accounting standards that the Water Fund is currently reviewing for applicability and potential impact on the financial statements include:

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, will be effective for the Water Fund beginning with its year ending December 31, 2013. The objective of this statement is to establish accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

GASB Statement No. 66, *Technical Corrections -2012- an amendment of GASB Statements No. 10 and No. 62*, will be effective for the Water Fund beginning with its year ending December 31, 2013. The objective of this statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, establishes new financial reporting requirements for most governments that provide their employees with pension benefits through these types of plans. Statement No. 68 will be effective for the Water Fund beginning with its year ending December 31, 2015. GASB Statement No. 68 replaces the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and GASB Statement No. 50, *Pension Disclosures*, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. GASB Statement No. 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. The Statement also enhances accountability and transparency through revised and new note disclosures and required supplementary information.

GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, establishes accounting and financial reporting standards related to government combinations and disposals of government operations. Statement No. 69 will be effective for the Water Fund beginning with its year ending December 31, 2014. GASB Statement No. 69 requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions.

GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, establishes accounting and financial reporting standards for financial guarantees that are nonexchange transactions (nonexchange financial guarantees) extended or received by a state or local government. Statement No. 70 will be effective for the Water Fund beginning with its year ending December 31, 2014. GASB Statement No. 70 requires a government that has issued an obligation guaranteed in a nonexchange transaction to report the obligation until legally released as an obligor. This Statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. This Statement also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units. Requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions.

2. RESTRICTED AND UNRESTRICTED CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash Equivalents and Investments — The Water Fund's cash equivalents and investments as of December 31, 2012, are as follows (in thousands):

	Investment Maturities (in Years)				
	Less Than 1	1–5	6–10	More Than 10	Fair Value
U.S. agencies	$ 11,519	$ 186,844	$ 157,329	$ -	$ 355,692
Certificates of deposit and **other short-term**	39,559				39,559
Commercial paper	1,300				1,300
Corporate bonds		12,507			12,507
Municipal bonds		19,212	8,029		27,241
Subtotal	$ 52,378	$ 218,563	$ 165,358	$ -	436,299
Share of City's pooled funds					60,431
Total					$ 496,730

Cash Equivalents and Investments — The Water Fund's cash equivalents and investments as of December 31, 2011, are as follows (in thousands):

	Investment Maturities (in Years)				
	Less Than 1	1–5	6–10	More Than 10	Fair Value
U.S. agencies	$ 4,001	$ 163,406	$ -	$ -	$ 167,407
Certificates of deposit and other short-term	31,385				31,385
Commercial paper	3,997				3,997
Corporate bonds	18,054				18,054
Municipal bonds		4,037			4,037
Subtotal	$ 57,437	$ 167,443	$ -	$ -	224,880
Share of City's pooled funds					43,307
Total					$ 268,187

U.S. agencies include investments in government-sponsored enterprises, such as Federal National Mortgage Association, Federal Home Loan Banks, and Federal Home Loan Mortgage Corp.

Interest Rate Risk — As a means of limiting its exposure to fair value losses arising from rising interest rates, the City's investment policy requires that investments generally may not have a maturity date in excess of 10 years from the date of purchase. Certain other investments are held in accordance with the specific provisions of applicable ordinances.

Credit Risk — The Code limits investments in commercial paper to banks whose senior obligations are rated in the top two rating categories by at least two national rating agencies and who are required to maintain such rating during the term of such investment. The Code also limits investments to domestic money market mutual funds regulated by, and in good standing with, the Securities and Exchange Commission. Certificates of deposit are also limited by the Code to national banks, which provide collateral of at least 105% by marketable U.S. government securities marked to market at least monthly; or secured by a corporate surety bond issued by an insurance company licensed to do business in the State and having a claims-paying rating in the top rating category, as rated by a nationally recognized statistical rating organization maintaining such rating during the term of such investment. A schedule summarizing the Water Fund's exposure to credit risk as of December 31, 2012 and 2011, is as follows (in thousands):

Quality Rating	2012	2011
Aaa/AAA	$ 8,018	$ 20,021
Aa/AA	373,085	189,498
A/A	4,417	
P1/A1	1,300	3,997
Not rated	49,479	11,364
Total	$ 436,299	$ 224,880

The Water Fund participates in the City's pooled cash and investments account, which includes amounts from other City funds and is maintained by the City Treasurer. Individual cash or investments are not specifically identifiable to any participant in the pool. The City Treasurer's pooled fund is included in the City's financial statements.

Custodial Credit Risk — Cash and Certificates of Deposit — This is the risk that in the event of a bank failure, the City's deposits may not be returned. The City's investment policy states that in order to protect the City's deposits, depository institutions are to maintain collateral pledges on City deposits during the term of the deposit of at least 102% of marketable U.S. government, or approved securities or surety bonds, issued by top-rated insurers. Collateral is required as security whenever deposits exceed the insured limits of the Federal Deposit Insurance Corporation. The bank balance of cash and certificates of deposit with the City's various municipal depositories was $532.3 million. Of the bank balance, 100% was either insured or collateralized with securities held by City agents in the City's name. Investments reported in the basic financial statements as of December 31, 2012 and 2011, are summarized as follows (in thousands):

	2012	2011
Per Note 2:		
Investments — Water Fund	$ 436,299	$ 224,880
Investments — City Treasurer Pooled Fund	60,431	43,307
	$ 496,730	$ 268,187
Per financial statements:		
Restricted investments	$ 395,439	$ 193,495
Unrestricted investments	44,188	34,019
Investments included as cash and cash equivalents on the statements of net assets	57,103	40,673
	$ 496,730	$ 268,187

3. RESTRICTED ASSETS AND ACCOUNTS

Water sales are pledged to pay outstanding Water Revenue Bonds. The ordinances authorizing the issuance of outstanding Water Revenue Bonds provide for the creation of separate accounts into which net revenues, as defined, or proceeds are to be credited, are as follows:

Water Revenue Bonds, Series 2001, 2000, 1997, and Refunding Bonds Series 1993 ("Senior Lien Revenue Bonds"):

Bond Principal and Interest Account — No later than 10 days prior to each principal or interest payment date, an amount sufficient to pay principal, redemption premium, if any, and interest becoming due, whether upon maturity, redemption, or otherwise.

Bond Debt Service Reserve Account — For each series, an amount equal to the least of (i) the maximum annual debt service requirement; (ii) 10% of the original principal amount less original issue discount; or (iii) 125% of the average annual debt service requirement. The required balance of the Series 2000, 1997, 1995, and 1993 bonds was met by the purchase of surety bonds. The required balance of the Series 2001 Second Lien Revenue Bonds is being met with a deposit of a portion of the proceeds of the Series 2001 Senior Lien Revenue Bonds.

Construction Account — Certain proceeds of the Senior Lien Revenue Bonds were deposited in this account for the purpose of paying construction costs of projects as defined in the ordinance.

Water Revenue Bonds, Series 2000, 2006A, 2008, 2010A, 2010B, 2010C, and Refunding Bonds, Series 2004 and 2001 (Second Lien Revenue Bonds):

Principal and Interest Account — Deposits are required to be transferred no later than the business day preceding each May 1 and November 1, in an amount sufficient to pay principal and interest as due on outstanding Second Lien Revenue Bonds.

Second Lien Bonds Account — On the date of issuance of any series of Second Lien Revenue Bonds that bear interest at a variable rate paying interest more than semiannually, an amount equal to the interest payable during a six-month period will be transferred to a restricted account. The amount transferred will be calculated based on the maximum rate payable on such bonds.

Construction Account — Certain proceeds of the Second Lien Revenue Bonds were deposited in this account for the purpose of paying construction costs of projects as defined in the ordinance.

Water Rate Stabilization Account — Any net revenues remaining after providing sufficient funds for all required deposits in the Water Revenue Bonds accounts may be transferred to the Water Rate Stabilization Account upon the direction of the City to be used for any lawful purpose of the Water Fund.

For accounts established by ordinances with balances, the amounts at December 31, 2012 and 2011, are as follows (in thousands):

	2012	2011
Senior lien debt service reserve	$ 3,563	$ 3,562
Second lien revenue bonds	30,472	28,241
Water rate stabilization	74,897	61,397
Construction	325,609	130,583
Total	$ 434,541	$ 223,783

At December 31, 2012 and 2011, management is not aware of any instances of noncompliance with the funding requirements and restrictions on assets as stated in the ordinances.

4. LONG-TERM DEBT

Long-term debt as of December 31, 2012 and 2011, consisted of the following (in thousands):

	2012	2011
$49,880 Series 1993 Water Revenue Refunding Bonds, issued October 1, 1993, due through 2016; interest at 4.125% to 6.5%	$ 20,635	$ 25,265
$277,911 Series 1997 Water Revenue Bonds, issued September 1, 1997, due through 2019; interest at 3.9% to 5.25%	17,389	20,976
$100,000 Series 2000 Second Lien Water Revenue Bonds, issued December 22, 1999, due 2030, variable floating interest rate; interest at 3.8694%	100,000	100,000
$156,819 Series 2000 Senior Lien Water Revenue Bonds, issued May 2, 2000, due 2030; interest at 4.375% to 5.875%	22,664	22,664
$81,500 Series 2001 Second Lien Water Revenue Refunding Bonds, issued December 13, 2001, due 2030; interest at 3.0% to 5.75%	80,945	80,990
$2,292 Illinois Environmental Protection Agency Loan Agreement, signed June 30, 2003, due 2025; interest at 2.57%	1,926	2,049
$3,605 Illinois Environmental Protection Agency Loan Agreement, signed October 16, 2003, due 2022; interest at 2.905%	2,095	2,273
$500,000 Series 2004 Second Lien Water Revenue Refunding Bonds, issued August 5, 2004, due through 2031, variable floating interest rate;	376,300	386,500
$215,400 Series 2006A Second Lien Water Revenue Bonds, issued July 26, 2006, due through 2036; interest at 4.5% to 5.0%	193,330	197,470
$549,915 Series 2008 Second Lien Water Revenue Bonds, issued April 2, 2008, due through 2038; interest at 4.0% to 5.25%	500,710	515,105
$313,580 Series 2010A-C Second Lien Water Revenue Bonds, issued November 10, 2010, due through 2040; interest at 2.0% to 6.742%	300,355	306,810
$6,000 Illinois Environmental Protection Agency Loan Agreement, signed January 21, 2011, due 2031; interest at 2.57%	5,734	6,000
$9,077 Illinois Environmental Protection Agency Loan Agreement, issued February 2, 2010, due 2031; noninterest bearing	8,649	8,573
$399,445 Series 2012 Second Lien Water Revenue Bonds, issued May 17, 2012, due through 2042; interest at 4.0% to 5.0%	399,445	
Commercial paper notes issued		46,513
	2,030,177	1,721,188
Add accretion of capital appreciation bonds	47,658	46,946
Less current portion of accretion	(8,749)	(4,493)
Less current portion of long-term debt	(42,232)	(44,448)
Add unamortized bond discount/premium — net	71,041	30,498
Less unamortized deferred loss on bond refunding	(36,199)	(38,678)
Long-term portion — net	$ 2,061,696	$ 1,711,013

Long-term debt changed during the years ended December 31, 2012 and 2011, is as follows (in thousands):

	Balance January 1, 2012	Additions	Reductions	Balance December 31, 2012	Due within One Year
Revenue bonds/notes payable	$ 1,721,188	399,950	$ (90,961)	$ 2,030,177	$ 42,232
Accretion of capital appreciation bonds	46,946	5,205	(4,493)	47,658	8,749
Unamortized bond discount/premium — net	30,498	47,588	(7,045)	71,041	
Unamortized deferred loss on bond refunding	(38,678)		2,479	(36,199)	
Total	$ 1,759,954	$452,743	$ (100,020)	$ 2,112,677	$ 50,981

	Balance January 1, 2011	Additions	Reductions	Balance December 31, 2011	Due within One Year
Revenue bonds/notes payable	$ 1,753,832	$ 14,573	$ (47,217)	$ 1,721,188	$ 44,448
Accretion of capital appreciation bonds	45,900	5,317	(4,271)	46,946	4,493
Unamortized bond discount/premium — net	31,704		(1,206)	30,498	
Unamortized deferred loss on bond refunding	(41,215)		2,537	(38,678)	
Total	$ 1,790,221	$ 19,890	$ (50,157)	$ 1,759,954	$ 48,941

Long-term purchase obligation relates to the City’s share of the cost for operation and maintenance of electrical generation facilities as described in Note 9, as follows:

	2012	2011
Non-interest-bearing obligation	$ 1,027	$ 3,290

Interest capitalized in 2012 and 2011 totaled $23.0 million and $14.8 million, respectively.

Interest expense includes amortization of the deferred loss on bond refunding for 2012 and 2011 of $2.5 million; amortization of bond discount of $7.0 million and $1.2 million, respectively; and accretion of Series 1997 and Series 2000 capital appreciation bonds of $8.7 million and $4.3 million, respectively.

As defined in the bond ordinances, net revenues are pledged for the payment of principal and interest on the bonds. Ordinances include covenants, which require that net revenues available for bonds, as adjusted, at least equal the greater of (i) 120% of the aggregate current annual debt service on the Senior Lien Revenue Bonds or (ii) the sum of the aggregate current annual debt service of the Senior Lien Revenue Bonds, plus 110% of the aggregate current annual Second Lien Revenue Bonds debt service, and that City management maintain all covenant reserve account balances at specified amounts. The above requirements were met in 2012 and 2011.

Rate Increase — Water rates are set by ordinance and established in an amount designed to pay the costs of Water Fund operations and capital improvements, including any related debt service. The water rate effective January 1, 2012, was $18.75 per 1,000 cubic feet.

Issuance of Debt — On January 21, 2011, a loan agreement was signed with the Illinois Environment Protection Agency to replace water mains and install water meters. In 2011, the Water Fund drew $6 million from this loan agreement. The loan has an interest rate of 2.57% with maturity dates from June 21, 2011 to December 21, 2031. On February 2, 2010, a loan agreement was signed with the Illinois Environment Protection Agency to replace undersized, leaking, and antiquated water mains. In 2012, the Water Fund drew $0.5 million from this loan agreement. The loan has no interest and has principal maturity dates from June 2, 2012 to December 2, 2031.

Second Lien Water Revenue Project Bonds, Series 2012 ($399.4 million) were sold at a premium in May 2012. The bonds have interest rates ranging from 4% to 5% and maturity dates from November 1, 2016 to November 1, 2042. Net proceeds of $444.4 million will be used to finance certain costs of improvements and extensions to the water system ($400.0 million), to retire water commercial paper notes outstanding ($35.9 million), and to fund certain capitalized interest ($8.5 million).

A schedule of bond and note debt service requirements to maturity at December 31, 2012, is as follows (in thousands):

Years Ending December 31	Principal	Interest	Total Debt Service
2013	$ 42,232	$ 106,633	$ 148,865
2014	43,428	105,482	148,910
2015	44,684	104,239	148,923
2016	53,879	102,777	156,656
2017	55,808	100,865	156,673
2018–2022	347,874	436,085	783,959
2023–2027	419,610	329,066	748,676
2028–2032	426,386	224,865	651,251
2033–2037	352,455	128,129	480,584
2038–2042	243,821	33,983	277,804
Total	$2,030,177	$1,672,124	$3,702,301

Debt service requirements above exclude commercial paper issues, as the timing of payments is not certain. There was no commercial paper outstanding at December 31, 2012.

The Water Fund's variable rate bonds may bear interest from time to time at a flexible rate, a daily rate, a weekly rate, an adjustable long rate, or the fixed rate as determined from time to time by the remarketing agent, in consultation with the City. At December 31, 2012, the variable rate bonds were in the weekly rate interest mode. For the requirements calculated above, interest on variable rate debt was calculated at the rate in effect at December 31, 2012, or the effective rate of a related swap agreement, if applicable. An irrevocable letter of credit provides for the timely payment of principal and interest on the Series 2000 until February 18, 2013. An irrevocable letter of credit provides for the timely payment of principal and interest on the Series 2004 bonds until July 12, 2014. At December 31, 2012, there were no outstanding letter of credit advances. In the event the bonds are put back to the bank and not successfully remarketed, or if the letter of credit expires without an extension or substitution, the bank bonds will convert to a term loan. There is no principal due on potential term loans within the next fiscal year.

Derivatives — Pay-Fixed, Receive — Variable Interest Rate Swaps

Objective of the Swaps — In order to protect against changes in cash flows, which includes the potential of rising interest rates, the Water Fund has entered into various separate pay-fixed, receive-variable interest rate swaps at a cost less than what the Water Fund would have paid to issue fixed-rate debt.

	Changes in Fair Value		Fair Value at December 31, 2012		
	Classification	**Amount**	**Classification**	**Amount**	**Notional**
Cash flow hedges — pay-fixed interest rate swaps	Deferred outflow of resources	$ (2,015)	Deferred outflow of resources	$126,371	$476,300

Terms, Fair Values, and Credit Risk — The terms, including the fair value and credit ratings of the outstanding swaps as of December 31, 2012, are as follows (in thousands). The notional amounts of the swaps match the principal amounts of the associated debt. The Water Fund's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled or anticipated reductions in the associated "bonds payable" category. Under the swap, the Water Fund pays the counterparty a fixed payment and receives a variable payment computed according to the London InterBank Offered Rate (LIBOR).

Associated Bond Issue	Notional Amounts	Effective Date	Terms	Fair Values	Maturity Date	Counterparty Credit Rating
Hedging instruments:						
Bonds (Series 2004)	$185,780	8/5/2004	Pay 3.8694%; receive 67% of 1-month LIBOR	$ (42,949)	11/1/2025	A2/A
Bonds (Series 2004)	190,520	8/5/2004	Pay 3.8669%; receive 67% of 1-month LIBOR	(49,862)	11/1/2031	Aa3/AA-
Bonds (Series 2000)	100,000	4/16/2008	Pay 3.8694%; receive 67% of 1-month LIBOR	(33,560)	11/1/2030	A2/A
Total	$476,300			$(126,371)		

Fair Value — As of December 31, 2012 and 2011, the swaps had a negative fair value of $126.4 million and $128.4 million, respectively. As per industry convention, the fair values of the Water Fund's outstanding swaps were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the forward rates implied by the yield curve correctly anticipate future spot rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap. Because interest rates declined subsequent to the date of execution, the Water Fund's swaps had negative values.

Credit Risk — The Water Fund is exposed to credit risk (counterparty risk) through the counterparties with which it enters into agreements. If minimum credit rating requirements are not maintained, the counterparty is required to post collateral to a third party. This protects the Water Fund by mitigating the credit risk and, therefore, the ability to pay a termination payment, inherent in a swap. Collateral on all swaps is to be in the form of cash or eligible collateral held by a third-party custodian. Upon credit events, the swaps also allow transfers, credit support, and termination if the counterparty is unable to meet the said credit requirements.

Basis Risk — Basis risk refers to the mismatch between the variable rate payments received on a swap contract and the interest payment actually owed on the bonds. The two significant components driving this risk are credit and LIBOR ratios. Credit may create basis risk because the Water Fund's bonds may trade differently from the swap index as a result of a credit change in the Water Fund. LIBOR ratios (or spreads) may create basis risk if LIBOR swaps of the Water Fund's bonds trade higher than the LIBOR received on the swap. This can occur due to many factors, including, without limitation, changes in marginal tax rates, tax-exempt status of bonds, and supply and demand for variable rate bonds. The Water Fund is exposed to basis risk on the swaps if the rate paid on the bonds is higher than the rate received. The Water Fund is liable for the difference. The difference would need to be available on the debt service payment date and would add additional underlying cost to the transaction.

Tax Risk — The swap exposes the Water Fund to tax risk or a permanent mismatch (shortfall) between the floating rate received on the swap and the variable rate paid on the underlying variable-rate bonds due to tax law changes such that the federal or state tax exception of municipal debt is eliminated or its value reduced. There have been no tax law changes since the execution of this swap agreement.

Termination Risk — The swap has the risk that it could be terminated as a result of certain events, including a ratings downgrade for the issuer or swap counterparty, covenant violation, bankruptcy, payment default, or other defined events of default. Termination of a swap may result in a payment made by the issuer or to the issuer depending upon the market at the time of termination.

Swap Payments and Associated Debt — Debt service requirements for the Water Fund's outstanding variable-rate debt and net swap payments, assuming current interest rates (December 31, 2012) remain the same for their term, are as follows (in thousands):

Years Ending December 31	Principal	Interest	Swaps — Net	Total
2013	$ 10,150	$ 611	$ 17,814	$ 28,575
2014	10,575	653	17,380	28,608
2015	11,000	638	16,986	28,624
2016	11,450	622	16,576	28,648
2017	11,925	606	16,149	28,680
2018–2022	136,400	2,658	70,782	209,840
2023–2027	158,080	1,472	39,193	198,745
2028–2032	126,720	377	10,036	137,133
Total	$ 476,300	$ 7,637	$ 204,916	$ 688,853

Defeased Bonds — Defeased bonds have been removed from the statements of net position because related assets have been placed in irrevocable trusts that, together with interest earned thereon, will provide amounts sufficient for payment of all principal and interest. There were no defeased bonds outstanding at December 31, 2012.

5. UTILITY PLANT

Utility plant changed during the years ended December 31, 2012 and 2011, as follows (in thousands):

	Balance — January 1, 2012	Additions	Disposals and Transfers	Balance — December 31, 2012
Utility plant not depreciated:				
Land and land rights	$ 5,083	$ -	$ -	$ 5,083
Construction in progress	148,871	177,152	(63,743)	262,280
Total utility plant not depreciated	153,954	177,152	(63,743)	267,363
Utility plant being depreciated:				
Structures and improvements	534,472	2,165	(927)	535,710
Distribution plant	2,111,790	133,871	60,142	2,305,803
Equipment	617,159	5,759	(2,143)	620,775
Total utility plant being depreciated	3,263,421	141,795	57,072	3,462,288
Less accumulated depreciation:				
Structures and improvements	(182,537)	(7,741)		(190,278)
Distribution plant	(351,343)	(21,804)	1,057	(372,090)
Equipment	(289,104)	(18,730)	1,891	(305,943)
Total accumulated depreciation	(822,984)	(48,275)	2,948	(868,311)
Utility plant being depreciated — net	2,440,437	93,520	60,020	2,593,977
Utility plant — net	$ 2,594,391	$ 270,672	$ (3,723)	$ 2,861,340

	Balance — January 1, 2011	Additions	Disposals and Transfers	Balance — December 31, 2011
Utility plant not depreciated:				
Land and land rights	$ 5,083	$ -	$ -	$ 5,083
Construction in progress	123,416	64,957	(39,502)	148,871
Total utility plant not depreciated	128,499	64,957	(39,502)	153,954
Utility plant being depreciated:				
Structures and improvements	532,758	2,103	(389)	534,472
Distribution plant	2,004,119	77,997	29,674	2,111,790
Equipment	605,477	6,908	4,774	617,159
Total utility plant being depreciated	3,142,354	87,008	34,059	3,263,421
Less accumulated depreciation:				
Structures and improvements	(175,294)	(7,243)		(182,537)
Distribution plant	(331,211)	(20,674)	542	(351,343)
Equipment	(271,610)	(18,797)	1,303	(289,104)
Total accumulated depreciation	(778,115)	(46,714)	1,845	(822,984)
Utility plant being depreciated — net	2,364,239	40,294	35,904	2,440,437
Utility plant — net	$ 2,492,738	$ 105,251	$ (3,598)	$ 2,594,391

6. PENSION PLANS

Eligible Water Fund employees participate in one of two of the City's single-employer defined benefit pension plans. These plans are the Municipal Employees' and the Laborers' and Retirement Board Employees' Annuity and Benefit Funds. These plans are administered by individual retirement boards represented by elected and appointed officials. Each plan issues publicly available financial statements for each of the pension plans, which may be obtained at the respective fund's office.

The funds provide retirement, death, and disability benefits as established by State law. Benefits generally vest after 20 years of credited service. Employees who retire at or after age 55 with at least 10 years of credited service qualify to receive a money purchase annuity and those with more than 20 years of credited service qualify to receive a minimum formula annuity. The annuity is computed by multiplying the final average salary by a minimum of 2.4% per year of credited service. The final average salary is the employee's highest average annual salary for any four consecutive years within the last 10 years of credited service.

Participating employees contribute 8.5% of their salary to these funds as required by State law. By law, the City's contributions are based on the amounts contributed by the employees. Financing of the City's contribution is through a separate property tax levy and the personal property replacement tax. The Water Fund reimburses the City's General Fund for the estimated pension cost applicable to the covered payroll of Water Fund employees. These reimbursements, recorded as expenses of the Water Fund, were $12.7 million in 2012 and $11.5 million in 2011. The annual pension costs are determined using the entry age normal actuarial cost method and the level dollar amortization method.

The funding policy mandated by State law requires City contributions at statutorily, not actuarially, determined rates. The rates are expressed as multiples of employee contributions. These contributions equal employee contributions made in the calendar year two years prior to the year for which the applicable tax is levied, multiplied by the statutory rates. The statutory rates in effect for the City's contributions made during the years ended December 31, 2012 and 2011, were 1.25 for the Municipal Employees' and 1.00 for the Laborers' and Retirement Board Employees' Annuity and Benefit Funds, respectively. The City has made the required contributions under State law.

The following table as of December 31, 2012, assists users in assessing each pension fund's progress in accumulating sufficient assets to pay benefits when due. The three-year historical information for each annuity and benefit fund, which includes all City employees within each respective annuity and benefit fund, is as follows (dollars in thousands):

	Annual Pension Cost	Percent of Annual Pension Cost Contributed	Annual Required Contribution	Percent of Required Contributions Contributed	Net Pension Obligation (Asset)
Municipal employees:					
2010	$ 482,421	32.10 %	483,948	32.00 %	$ 1,007,404
2011	609,491	24.10	611,756	24.00	1,469,886
2012	687,519	21.65	690,823	21.50	2,008,546
Laborers:					
2010	$ 47,129	32.60 %	46,665	32.90 %	$ (174,584)
2011	57,651	22.17	57,259	22.30	(129,712)
2012	77,858	15.22	77,566	15.30	(63,707)

The pension benefits information pertaining expressly to Water Fund employees is not available as the obligation is the responsibility of the general government. Accordingly, no amounts have been recorded in the accompanying basic financial statements for the net pension asset or obligation of these plans. Amounts for the City are recorded within the City's government-wide basic financial statements.

7. OTHER POSTEMPLOYMENT BENEFITS — CITY OBLIGATION

In addition to providing pension benefits, under State law, the City provides certain health benefits to employees who retire from the City based upon their participation in the City's pension plans. Substantially all employees who qualify as Municipal Employees' or Laborers' pension plan participants older than age 55, with at least 20 years of service may become eligible for postemployment benefits if they eventually become annuitants. Health benefits include basic benefits for annuitants and supplemental benefits for Medicare-eligible annuitants. Currently, the City does not segregate benefit payments to annuitants by fund. The cost of health benefits is recognized as claims are reported and are funded on a pay-as-you-go basis. The total cost to the City for providing health benefits to approximately 24,408 annuitants and their dependents was approximately $97.5 million and $99.1 million in 2012 and 2011, respectively.

The annuitants who retired prior to July 1, 2005, received a 55% subsidy from the City; and the annuitants who retired on or after July 1, 2005, received a 50%, 45%, 40%, and 0% subsidy from the City based on the annuitant's length of actual employment with the City for the gross cost of retiree health care under a court-approved settlement agreement. During 2012 and 2011, the pension funds contributed $65 for each Medicare-eligible annuitant and $95 for each Non-Medicare-eligible annuitant to their gross cost, respectively. The annuitants contributed a total of $67.8 million and $68.3 million in 2012 and 2011, respectively, to the gross cost of their retiree health care pursuant to premium amounts set forth in the above-referenced settlement agreement.

The City's net expense and the annuitants' contribution indicated above are preliminary and subject to the reconciliation per the court-approved settlement agreement.

Plan Description Summary — The City is party to a written legal settlement agreement outlining the provisions of the retiree health program, the Settlement Health Care Plans (the "Plans"), through June 30, 2013. The agreement does not require or extend continuation of the Plans after June 30, 2013. Pursuant to the Plans, the City administers a single-employer defined benefit health care plan (the "Health Plan"), for which the City pays a portion of the costs on a pay-as-you-go method. Under the Plans' agreement, the City sponsors health benefit plans for employees, former employees, and retired former employees. The provisions of the program provide, in general, that the City pay a percentage of the cost (based upon an employee's service) for hospital and medical coverage to eligible retired employees and their dependents for a specified period, until June 30, 2013.

In addition, Compiled Statutes authorize the four respective pension funds (Police, Fire, Municipal, and Laborers) to provide a fixed monthly dollar subsidy to each annuitant who has elected coverage under the Health Plan through June 30, 2013. After that date, no supplements are authorized.

The liabilities for the monthly dollar supplements paid to annuitants enrolled in the retiree medical plan by their respective pension funds are included in the liabilities and reports of the respective four pension funds.

Special Benefits under the Collective Bargaining Agreements (CBA) — Under the terms of the latest collective bargaining agreements for the Fraternal Order of Police and the International Association of Fire Fighters, certain employees who retire after attaining age 55 with the required years of service are permitted to enroll themselves and their dependents in the healthcare benefit program offered to actively employed members. They may keep this coverage until they reach the age of Medicare eligibility. These retirees do not contribute towards the cost of coverage, but the Police pension fund contributes $95 per month towards coverage for police officers (which is assumed to continue); the Fire Pension Fund does not contribute. Once CBA early retirees reach Medicare eligibility age, their healthcare benefits are provided under the provisions of the Settlement Plan.

No extension of the CBA has been negotiated as of the end of the governing contract period (June 30, 2012), and therefore this valuation assumes the expiration of the early retirement special benefits as of December 31, 2012, but includes the liabilities for continuation of payments to those members already retired under the CBA as of December 31, 2012.

Funding Policy — The City's retiree Health Plan is a single-employer plan, which operates on a pay-as-you-go funding basis. No assets are accumulated or dedicated to funding the retiree Health Plan benefits.

Annual OPEB Cost and Net OPEB Obligation — The City's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the employer. The ARC represents a level of funding that if paid on an ongoing basis, is projected to cover the normal cost each year and to amortize any unfunded actuarial liabilities over a period of one year (the remaining years of coverage under the settlement agreement).

The following table shows the components of the City's annual OPEB costs for the year for the Plans, the amount actually contributed to the Plans and changes in the City's net OPEB obligation to the retiree Health Plan. The net OPEB obligation is the amount entered upon the City's statement of net position as of year-end as the net liability for the other postemployment benefits — the retiree Health Plan. The amount of the annual cost for the retiree Health Plan, which is to be recorded in the statement of changes in net position for 2012 is the annual OPEB cost (expense).

	Annual OPEB Cost and Contributions Made (In thousands)	
	2012 Health Plan	**2011 Health Plan**
Contribution rates:		
City	Pay as you go	Pay as you go
Plan members	N/A	N/A
Annual required contribution	$ 252,747	$ 200,062
Interest on net OPEB obligation	3,816	4,567
Adjustment to annual required contribution	(179,586)	(155,675)
Annual OPEB cost	76,977	48,954
Contributions made	115,961	99,091
Decrease in net OPEB obligation	(38,984)	(50,137)
Net OPEB obligation — beginning of year	254,345	304,482
Net OPEB obligation — end of year	$ 215,361	$ 254,345

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the Plans, and the net OPEB obligation for fiscal years 2012, 2011, and 2010, are as follows (in thousands):

	Schedule of Contributions, OPEB Costs, and Net Obligations		
Fiscal Years Ended	**Annual OPEB Cost**	**Percentage of Annual OPEB Cost Contributed**	**Net OPEB Obligation**
December 31, 2012	$ 76,977	150.6 %	$ 215,361
December 31, 2011	48,954	202.4	254,345
December 31, 2010	82,874	129.6	304,483

Funded Status and Funding Progress — As of January 1, 2012, the most recent actuarial valuation date, the actuarial accrued liability for benefits was $191.4 million, all of which was unfunded. The covered payroll (annual payroll of active employees covered by the Plans) was approximately $2,518.8 million and the ratio of the unfunded actuarial accrued liability to the covered payroll was 7.6%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the health care cost trend. Amounts determined regarding the funded status of the Plans and the annual required contributions of the employer are subject to continual revisions as the results are compared with past expectations and new estimates are made about the future.

Actuarial Valuation Date	**Actuarial Value of Assets**	**Actuarial Accrued Liability (AAL)**	**Unfunded Actuarial Accrued Liability (UAAL)**	**Funded Ratio**	**Covered Payroll**
December 31, 2011	$ -	$ 470,952	$ 470,952	- %	$ 2,518,735
December 31, 2010		390,611	390,611		2,475,080

Actuarial Method and Assumptions — Projections of benefits for financial reporting purposes are based on the substantive plan (the plan understood by the employer and plan members) and included the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial method and assumptions used include techniques that are designed to reduce the effects of short-term volatility in AALs and the actuarial value of assets, consistent with the long-term perspective of the calculations.

For the Plans' benefits (not provided by the pension funds) in the actuarial valuation for the year ended December 31, 2012, the projected unit credit actuarial cost method was used. The actuarial assumptions included an annual health care cost trend rate of 10.5% initially, reduced by decrements to an ultimate rate of 5%. Both rates included a 3% inflation assumption. The Plans have not accumulated assets and does not hold assets in a segregated trust. However, the funds expected to be used to pay benefits are assumed to be invested for durations, which will yield an annual return rate of 1.5%. The UAAL is being amortized as a level dollar amount over one to five years.

Summary of Assumptions and Methods

	Health Plan	
Item	**2012**	**2011**
Actuarial valuation date	December 31, 2011	December 31, 2010
Actuarial cost method	Projected unit credit	Projected unit credit
Amortization method	Level dollar	Level dollar
Remaining amortization period	1 to 5 years	2 years
Asset valuation method	Market value	Market value
Actuarial assumptions:		
Investment rate of return	1.5%	1.5%
Projected salary increases	3.0%	2.5%
Healthcare inflation rate	10.5% initial to 5% ultimate	11.5% initial to 10.5% ultimate

The OPEB benefit information pertaining expressly to the Water Fund employees is not available as the obligation is the responsibility of the general government. Accordingly, no obligation has been recorded in the accompanying basic financial statements. Amounts for the City are recorded within the City's government-wide basic financial statements.

8. RELATED-PARTY TRANSACTIONS

Included in operating expenses are reimbursements to the General Fund of the City for services provided by other City departments, employee fringe benefits, and certain payments made on behalf of the Water Fund. Such reimbursements amounted to $68.2 million and $62.3 million in 2012 and 2011, respectively.

9. COMMITMENTS AND CONTINGENCIES

The Water Fund has certain contingent liabilities resulting from litigation, claims, or commitments incident to the ordinary course of business. Management expects that final resolution of these contingencies will not have a material adverse effect on the financial position or results of operations of the Water Fund.

The Water Fund provides workers' compensation benefits and employee health benefits under self-insurance programs administered by the City. Such claims outstanding, including claims incurred but not reported, are estimated and recorded as liabilities in the basic financial statements.

Uninsured claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. Changes in the claims liability amounts for the years ended December 31, 2012 and 2011, are as follows (in thousands):

	2012	**2011**
Balance — January 1	$ 33,172	$ 35,550
Claims incurred on current and prior-year events	33,458	30,375
Claims paid on current and prior-year events	(33,419)	(32,753)
Balance — December 31	$ 33,211	$ 33,172

The City purchases annuity contracts from commercial insurers to satisfy certain liabilities; accordingly, no liability is reported for those claims. Property and casualty risks for the Water Fund are transferred to commercial insurers. Claims have not exceeded the purchased insurance coverage in the past three years.

The City, who has a 40-year agreement with the DuPage Water Commission (DWC) to provide water service to the DWC and its 24 suburbs commencing on May 1, 1992, has signed an agreement with the DWC to share equally in the aggregate costs in the construction, operation, and maintenance of electrical generation facilities and other capital improvements at the Lexington Pumping station, of which neither party's share will exceed $15 million without an amendment to the agreement approved by both parties. Payments for the City's share will be in the form of credits against the charges for water supplied to the facility. Total cumulative credits as of December 31, 2012, amounted to $14 million.

At December 31, 2012 and 2011, the Water Fund entered into contracts with outstanding commitments of approximately $109.6 million and $291.9 million, respectively, for construction projects.

* * * * * *

CITY OF CHICAGO, ILLINOIS WATER FUND

ADDITIONAL SUPPLEMENTARY INFORMATION
SCHEDULE OF UTILITY PLANT
FOR THE YEAR ENDED DECEMBER 31, 2012
(In thousands)

	Assets					Accumulated Depreciation				
	Balance — January 1, 2012	Additions	Adjustments/ Disposals	Transfers	Balance — December 31, 2012	Balance — January 1, 2012	Provision	Adjustments/ Disposals	Balance — December 31, 2012	Net Balance — December 31, 2012
LAND AND LAND RIGHTS:										
Power and pumping	$ 2,367	$ -	$ -	$ -	$ 2,367	$ -	$ -	$ -	$ -	$ 2,367
Distribution reservoir	300				300				-	300
Purification	1,739				1,739				-	1,739
General and maintenance	677				677				-	677
Total land and land rights	5,083	-	-	-	5,083	-	-	-	-	5,083
STRUCTURES AND IMPROVEMENTS:										
Cribs	17,337				17,337	4,861	166		5,027	12,310
Lake and land tunnels	118,152	176		49	118,377	36,430	1,182		37,612	80,765
Intake structures	9,531				9,531	4,375	95		4,470	5,061
Power and pumping structures	127,188	354			127,542	30,948	1,612		32,560	94,982
Purification buildings	204,920	970			205,890	94,826	3,635		98,461	107,429
Distribution reservoirs	16,979				16,979	5,004	226		5,230	11,749
Offices, maintenance, and general	39,389	28			39,417	6,093	825		6,918	32,499
Contract retainage	976	637	(976)		637				-	637
Total structures and improvements	534,472	2,165	(976)	49	535,710	182,537	7,741	-	190,278	345,432
DISTRIBUTION PLANT:										
Mains and accessories	2,042,630	132,258	(876)	63,360	2,237,372	309,915	20,426	(857)	329,484	1,907,888
Meters and installations	49,572				49,572	31,052	1,114		32,166	17,406
Hydrants and valves	17,447		(200)		17,247	10,376	264	(200)	10,440	6,807
Contract retainage	2,141	1,613	(2,142)		1,612				-	1,612
Total distribution plant	2,111,790	133,871	(3,218)	63,360	2,305,803	351,343	21,804	(1,057)	372,090	1,933,713
EQUIPMENT:										
Power production	60,926	745			61,671	43,173	1,358		44,531	17,140
Pumping	197,611	375			197,986	79,747	6,038		85,785	112,201
Purification	311,308	673		334	312,315	133,754	9,045		142,799	169,516
Heavy machinery	21,935	2,833	(882)		23,886	13,323	1,441	(794)	13,970	9,916
Transportation	7,994	957	(1,219)		7,732	6,192	331	(1,097)	5,426	2,306
Miscellaneous	17,010				17,010	12,915	517		13,432	3,578
Contract retainage	375	175	(375)		175				-	175
Total equipment	617,159	5,758	(2,476)	334	620,775	289,104	18,730	(1,891)	305,943	314,832
Total structures and improvements, distribution plant, and equipment	3,263,421	141,794	(6,670)	63,743	3,462,288	822,984	48,275	(2,948)	868,311	2,593,977
CONSTRUCTION IN PROGRESS:										
Filtration plants	10,482	15,011		(473)	25,020				-	25,020
Pumping stations	23,731	26,756			50,487				-	50,487
Water mains	114,658	130,368		(63,270)	181,756				-	181,756
Contract retainage		5,017			5,017				-	5,017
Total construction in progress	148,871	177,152	-	(63,743)	262,280	-	-	-	-	262,280
TOTAL UTILITY PLANT	$3,417,375	$318,946	$(6,670)	$ -	$3,729,651	$822,984	$48,275	$(2,948)	$868,311	$2,861,340

STATISTICAL DATA

The statistical data section includes selected financial and operating information, generally presented on a multiyear basis. Statistical section information is presented in five categories — financial trends, revenue capacity, debt capacity, operating, and demographic and economic information. Schedules in the statistical section are the following:

Financial Trends Information

These schedules contain trend information to help the reader understand how the Water Fund's basic financial performance and well-being have changed over time.

Revenue Capacity Information

These schedules contain information to help the reader assess the Water Fund's most significant local revenue source and water sales charge.

Debt Capacity Information

These schedules present information to help the reader assess the affordability of the Water Fund's current levels of outstanding debt and the Water Fund's ability to issue additional debt in the future.

Operating Information

These schedules contain service and infrastructure data to help the reader understand how the information in the Water Fund's financial report relates to the services the Department of Water Management and the Water Fund and how it provides the activities it performs.

Demographic and Economic Information

These schedules offer demographic and economic indicators to help the reader understand where the environment within which the City's financial activities take place.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
CHANGES IN NET POSITION
THREE YEARS ENDED DECEMBER 31, 2010–2012
(In millions) (Unaudited)

	2010	2011	2012
OPERATING REVENUES:			
Water sales	$ 445.5	$ 441.8	$ 562.6
Other operating revenues	12.9	12.4	13.7
Total operating revenues	458.4	454.2	576.3
OPERATING EXPENSES:			
Source of supply	0.1	0.2	0.2
Power and pumping	42.9	38.2	41.7
Purification	49.7	66.5	56.1
Transmission and distribution	38.7	39.0	36.5
Provision for doubtful accounts	15.9	14.0	15.7
Customer accounting and collection	10.3	10.6	10.0
Administrative and general	18.5	17.1	21.9
Central services and General Fund reimbursements	103.0	96.6	107.4
Total operating expenses	279.1	282.2	289.5
OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION	179.3	172.0	286.8
DEPRECIATION AND AMORTIZATION	44.5	47.6	48.9
OPERATING INCOME	134.8	124.4	237.9
NONOPERATING REVENUES (EXPENSES):			
Interest income	(0.3)	2.0	0.3
Interest expenses	(75.8)	(86.5)	(79.1)
Other operating revenues	3.9	2.2	1.1
Total nonoperating expenses — net	(72.2)	(82.3)	(77.7)
CHANGE IN NET POSITION	62.6	42.1	160.2
TOTAL NET POSITION — Beginning of year	997.5	1,060.1	1,102.2
TOTAL NET POSITION — End of year	$ 1,060.1	$ 1,102.2	$ 1,262.4

Water Fund intends to provide ten-year information as it becomes available.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
NET POSITION BY COMPONENTS
THREE YEARS ENDED DECEMBER 31, 2010–2012
(In millions) (Unaudited)

	2010	2011	2012
NET POSITION:			
Net invested in capital assets	$ 974.3	$ 1,055.0	$ 1,073.3
Restricted net assets for capital projects	0.4	0.2	1.3
Unrestricted net assets	85.4	47.0	187.8
TOTAL NET POSITION	$ 1,060.1	$ 1,102.2	$ 1,262.4

Water Fund intends to provide ten year information as it becomes available.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
HISTORICAL FINANCIAL OPERATIONS
TEN YEARS ENDED DECEMBER 31, 2003–2012
(In millions) (Unaudited)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
OPERATING REVENUES:										
Water sales (1)	$ 296.9	$ 307.6	$ 333.7	$ 317.2	$ 323.6	$ 358.0	$ 396.9	$ 445.5	$ 441.8	$ 562.6
Other operating revenues	10.2	13.0	10.6	13.2	10.8	12.2	13.3	12.9	12.4	13.7
Total operating revenues	307.1	320.6	344.3	330.4	334.4	370.2	410.2	458.4	454.2	576.3
OPERATING EXPENSES:										
Source of supply	0.3	0.4	0.2	0.2	0.3	0.2	0.1	0.1	0.2	0.2
Power and pumping	43.8	42.1	50.6	49.8	52.2	54.7	47.5	42.9	38.2	41.7
Purification	44.2	40.6	43.3	41.9	44.2	48.4	49.4	49.7	66.5	56.1
Transmission and distribution	53.0	39.1	39.4	41.6	47.0	47.1	40.9	38.7	39.0	36.5
Provision for doubtful accounts	3.9	3.7	2.7	3.6	3.7	8.3	10.4	15.9	14.0	15.7
Customer accounting and collection	16.3	14.9	16.3	16.9	14.8	12.8	11.2	10.3	10.6	10.0
Administrative and general	13.8	11.5	13.2	15.1	14.9	18.1	16.1	18.5	17.1	21.9
Central services and General Fund reimbursements	72.6	72.3	80.2	74.0	83.7	87.2	98.5	103.0	96.6	107.4
Total operating expenses	247.9	224.6	245.9	243.1	260.8	276.8	274.1	279.1	282.2	289.5
INTEREST INCOME (Other than from constructional account)	1.8	1.0	2.6	3.8	4.9	3.7	1.0	(0.3)	2.0	0.3
NET REVENUES — As defined (Note 4)	$ 61.0	$ 97.0	$ 101.0	$ 91.1	$ 78.5	$ 97.1	$ 137.1	$ 179.0	$ 174.0	$ 287.1

(1) Operating revenues are net of credits to JAWA and DWC during years 2003 and 2004.

Source: City of Chicago Comptroller's Office.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
WATER SYSTEM ACCOUNTS
TEN YEARS ENDED DECEMBER 31, 2003–2012
(Unaudited)

Years Ended December 31	Nonmetered	Metered	Total
2003	325,789	165,440	491,229
2004	324,689	167,545	492,234
2005	323,740	169,664	493,404
2006	322,193	171,861	494,054
2007	320,579	175,256	495,835
2008	319,205	178,457	497,662
2009	318,088	179,649	497,737
2010	314,002	183,618	497,620
2011	304,519	192,304	496,823
2012	290,863	205,097	495,960

Source: City of Chicago Department of Water Management.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
TEN LARGEST SUBURBAN CUSTOMERS
FOR THE YEAR ENDED DECEMBER 31, 2012
(In thousands) (Unaudited)

Customer	Amount of Sales
Dupage Water Commission	$ 74,869
Oak Lawn, Illinois	29,750
Northwest Suburban Municipal Joint Action Water Agency	22,505
Bedford Park, Illinois	21,230
Harvey, Illinois	8,359
Melrose Park, Illinois	8,253
Cicero, Illinois	6,662
Alsip, Illinois	6,023
Niles, Illinois	4,980
McCook, Illinois	4,922
Total	$ 187,553

Source: City of Chicago Department of Water Management.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
REVENUE BOND COVERAGE
TEN YEARS ENDED DECEMBER 31, 2003–2012
(In millions) (Unaudited)

PRIOR BONDS COVERAGE CALCULATION

COMBINED PRIOR BONDS, SENIOR LIEN, AND SECOND LIEN DEBT SERVICE CALCULATION	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
REVENUES AVAILABLE FOR BONDS:										
Net revenues — as defined (Note 4)	$61.0	$97.0	$101.0	$91.1	$78.5	$97.1	$137.1	$179.0	$174.0	$287.1
Transfer from (to) Water Rate Stabilization account & PAYGO Fund	10.0			(7.0)	7.9			(10.0)		(61.1)
NET REVENUES AVAILABLE FOR BONDS	$71.0	$97.0	$101.0	$84.1	$86.4	$97.1	$137.1	$169.0	$174.0	$226.0
DEBT SERVICE REQUIREMENTS:										
Senior debt service requirements	$56.9	$45.8	$ 30.1	$29.7	$38.0	$27.5	$ 33.8	$ 29.1	$ 14.1	$ 13.9
Senior debt service coverage ratio	1.2	2.1	3.4	2.8	2.3	3.5	4.1	5.8	12.3	16.3
Second lien debt service requirements	$ 5.7	$10.3	$ 27.3	$30.5	$43.2	$62.5	$ 75.7	$ 82.1	$106.6	$116.5
Subordinate lien debt service requirements	0.1	0.2	0.2	0.3	0.4	0.4	0.4	0.4	0.4	1.2
TOTAL SECOND AND SUBORDINATE LIEN DEBT SERVICE REQUIREMENTS	$ 5.8	$10.5	$ 27.5	$30.8	$43.6	$62.9	$ 76.1	$ 82.5	$107.0	$117.7
TOTAL COMBINED SENIOR, SECOND, AND SUBORDINATE LIEN DEBT SERVICE REQUIREMENTS	$62.7	$56.3	$ 57.6	$60.5	$81.6	$90.4	$109.9	$111.6	$121.1	$134.0
TOTAL COMBINED SENIOR AND SECOND LIEN DEBT SERVICE COVERAGE RATIO	1.1	1.7	1.8	1.4	1.1	1.1	1.2	1.5	1.4	1.7
WATER RATE STABILIZATION ACCOUNT YEAR-END BALANCE	$52.3	$52.3	$ 52.3	$59.3	$51.4	$51.4	$ 51.4	$ 61.4	$ 61.4	$ 74.9

Source: City of Chicago Comptroller's Office.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
LONG-TERM DEBT
THREE YEARS ENDED DECEMBER 31, 2010–2012
(In millions) (Unaudited)

	2010	2011	2012
Senior lien bonds	$ 83.4	$ 68.9	$ 60.7
Second lien bonds	1,614.3	1,586.9	1,951.1
Commercial paper	51.5	46.5	
Subordinate lien — IEPA loan	4.6	18.9	18.4
Total long-term debt	$ 1,753.8	$ 1,721.2	$ 2,030.2

Water Fund intends to provide ten-year information as it becomes available.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
CAPITAL IMPROVEMENT PROGRAM
2013–2017
(In thousands) (Unaudited)

Years	Amount
2013	$ 388,707
2014	316,847
2015	376,734
2016	424,006
2017	425,854
Total	$ 1,932,148

Note: The information presented in the table above reflects the Water Fund's expected allocation of resources to various projects, but does not necessarily represent an expectation of actual cash expenditures for these projects.

Source: City of Chicago Department of Water Management.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
WATER SYSTEM PUMPAGE AND CAPACITY
TEN YEARS ENDED DECEMBER 31, 2003–2012
(Unaudited)

Years	Total Pumpage (MGD)	Average Daily Pumpage (MGD)	Maximum Daily Pumpage (MGD)	System's Rated Pumpage Capacity (MGD)	Maximum Daily Pumpage as % of Capacity
2003	326,743	895	1,234	2,160	57
2004	320,069	875	1,134	2,160	53
2005	337,682	925	1,377	2,160	64
2006	310,527	851	1,373	2,160	64
2007	315,916	866	1,200	2,160	56
2008	301,912	827	1,136	2,160	53
2009	295,121	809	1,112	2,160	51
2010	282,368	773	1,012	2,160	47
2011	281,506	771	1,317	2,160	61
2012	289,545	793	1,248	2,160	58

Note: Million Gallons Daily (MGD).

Source: City of Chicago Department of Water Management.

CITY OF CHICAGO, ILLINOIS WATER FUND

MISCELLANEOUS STATISTICAL DATA
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(Unaudited)

	2012	2011
AREA SERVED (IN SQUARE MILES):		
Chicago	228	228
125 suburbs	578	578
Total area served	806	806
WATER WORKS FACILITIES:		
Filtration plants	2	2
Continuous service capacity:		
South Water Filtration Plant (MGD)	720	720
Jardine Water Purification Plant (MGD)	1,440	1,440
Pumping stations — steam	4	4
Pumping stations — electric	8	8
Installed pumping capacity (MGD)	3,661	3,661
Crib intakes in service	2	2
Shore intakes (filtration plants)	2	2
Water supply tunnels (6 to 20 feet in diameter) — miles	64	64
DISTRIBUTION SYSTEM:		
Water mains (miles)	4,369	4,369
Fire hydrants	48,243	48,125
Valves	47,189	47,296

Note: Million Gallons Daily (MGD).

Source: City of Chicago Department of Water Management.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
OPERATING INFORMATION BY FUNCTION
THREE YEARS ENDED DECEMBER 31, 2010–2012
(Number of employees) (Unaudited)

Function	2010	2011	2012
Administration	65	63	62
Agency management	37	39	37
Safety and security	19	17	16
Capital design and construction services	10	10	8
Engineering services	4	4	4
Inspection services	32	32	30
Water quality	48	48	48
Water pumping	233	231	234
Water treatment	324	326	323
Systems installation	39	39	34
Systems maintenance	582	581	583
Billings and customer service	65	66	50
Water meter installation and repair	76	78	82
Total	1,534	1,534	1,511

Water Fund intends to provide ten year information as it becomes available.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
POPULATION OF SERVICE AREA
LAST FIVE CENSUS PERIODS
(Unaudited)

Years	Chicago		Suburban Customers		Total	Number of Suburbs Served
1970	3,369,357	(1)	1,127,446	(1)	4,496,803	72
1980	3,005,072	(1)	1,152,614	(1)	4,157,686	75
1990	2,783,726	(1)	1,589,557	(2)	4,373,283	95
2000	2,896,016	(1)	2,410,021		5,306,037	125
2010	2,695,598	(1)	2,600,496		5,296,094	125

(1) U.S. Department of Commerce — Census Bureau.
(2) 23 suburban customers not included (under the DWC contract; fully served May 1, 1992) with a population of 610,478, which increases total population to 4,983,761.

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
PRINCIPAL EMPLOYERS (NONGOVERNMENT)
FOR THE YEAR ENDED DECEMBER 31, 2012, AND NINE YEARS AGO
(Unaudited)

	2012 (1)			2003 (1)		
Employer	**Number of Employees**	**Rank**	**Percentage of Total City Employment**	**Number of Employees**	**Rank**	**Percentage of Total City Employment**
J.P. Morgan Chase (2)	8,168	1	0.76 %	10,192	1	0.95 %
United Airlines	7,521	2	0.70	7,634	2	0.71
Accenture LLP	5,590	3	0.52	3,862	6	0.36
Northern Trust	5,448	4	0.51	5,084	4	0.47
Jewel Food Stores, Inc.	4,572	5	0.43			
Ford Motor Company	4,187	6	0.39			
Bank of America NT & SA	3,811	7	0.36			
ABM Janitorial Services — North Central	3,398	8	0.32			
American Airlines	3,076	9	0.29	4,403	5	0.41
Walgreen's Co.	2,789	10	0.26			
SBC Ameritech (3)				5,240	3	0.49
Target Corporation				2,904	7	0.27
Harris Trus & Savings Bank				2,684	8	0.25
LaSalle Bank				2,668	9	0.25
United Parcel Service				2,649	10	0.25

(1) Source: City of Chicago, Department of Revenue, Employer's Expenses Tax Returns.
(2) J.P. Morgan Chase, formerly known as Banc One
(3) Ameritech currently known as SBC/AT&T

CITY OF CHICAGO, ILLINOIS WATER FUND

STATISTICAL DATA
POPULATION AND INCOME STATISTICS
TEN YEARS ENDED DECEMBER 31, 2003–2012
(Unaudited)

Year	Population (1)	Median Age (2)	Number of Households (2)	Unemployment Rate (3)	Per Capita Income (4)	Total Income (6)
2003	2,896,016	32.6	1,067,823	8.2	35,464	$ 102,704,311,424
2004	2,896,016	32.6	1,051,018	7.2	37,169	107,642,018,704
2005	2,896,016	33.0	1,045,282	7.0	38,439	111,319,959,024
2006	2,896,016	33.5	1,040,000	5.2	41,887	121,305,422,192
2007	2,896,016	33.7	1,033,328	5.7	43,714	126,596,443,424
2008	2,896,016	34.1	1,032,746	6.4	45,328	131,270,613,248
2009	2,896,016	34.5	1,037,069	10.0	43,727	126,634,091,632
2010	2,695,598	34.8	1,045,666	10.1	45,957	123,881,597,286
2011	2,695,598	33.2	1,048,222	9.3	N/A (5)	N/A (5)
2012	2,695,598	33.0	1,030,746	8.9	N/A (5)	N/A (5)

Notes:
(1) Source: U.S. Department of Commerce — Census Bureau.
(2) Source: World Business Chicago Website, Claritas date estimates; Cook County's website.
(3) Source: Bureau of Labor Statistics 2008, Unemployment rate for Chicago-Naperville-Illinois Metropolitan Area.
(4) Source: U.S. Department of Commerce, Bureau of Economic Analysis, Per Capita Personal Income for Chicago-Naperville-Illinois Metropolitan Area (in 2008 dollars).
(5) N/A means not available at time of publication
(6) Population multiplied by the Per Capita Income.