



READING AREA WATER AUTHORITY

A COMPONENT UNIT OF THE CITY OF READING

FINANCIAL REPORT

DECEMBER 31, 2011

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INDEPENDENT AUDITOR'S REPORT

**To the Members of the Board
Reading Area Water Authority
Reading, Pennsylvania**

We have audited the accompanying basic financial statements of the Reading Area Water Authority, a component unit of the City of Reading, Pennsylvania, as of and for the years ended December 31, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Reading Area Water Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As of December 31, 2011 and 2010, the Authority was unable to provide records that reflect accounts receivable balances due by customer.

In our opinion, except for the effects of such adjustments on the financial statements, if any, as might have been determined necessary had we been able to examine records reflecting accounts receivable balances due by customer, the financial statements referred to above present fairly, in all material respects, the financial position of the Reading Area Water Authority as of December 31, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America, require that the Management's Discussion and Analysis on pages 2-6 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.

Reinsel Kuntz Lesher LLP

**Wyomissing, Pennsylvania
October 17, 2012**

**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The Management of the Reading Area Water Authority (the "Authority") offers readers of our financial statements the following narrative overview and analysis of our financial activities for the year ended December 31, 2011.

Financial Highlights

- Unrestricted current assets exceed current liabilities by \$ 5,502,983 at the close of the year. This is compared to \$ 6,412,769 and \$ 8,369,835 at the close of the 2010 and 2009 years, respectively.
- Total net assets decreased by \$ 850,909 and \$ 1,145,295 at the close of the 2011 and 2010 years over the total net assets balance at the close of the 2011 and 2010 years, respectively. The 2011 decrease is largely due to an increase in salaries and payroll taxes due to the transfer of the City of Reading's water department employees to the Authority. The 2010 decrease is largely due to an increase in lease payments to the City of \$ 2,718,937 in addition to \$ 308,000 in expenses related to a rate study, ISO flow testing and dredging of Lake Ontelaunee.
- The Authority had net operating income of \$ 835,069 for 2011 compared to net operating income of \$ 606,164 and \$ 2,127,292 for the 2010 and 2009 years, respectively. This increase in net operating income is the result of an increase in water billings of \$ 2,782,525 combined with an increase in salaries and payroll taxes of \$ 1,431,808 and an increase in insurance related to employees of \$ 437,638.
- During 2011, the Authority issued \$ 50,000,000 in Water Revenue Bonds, Series of 2011 to provide funds for capital projects and pay costs of issuance.
- During 2011, the City of Reading transferred employment of water department employees to the Authority in accordance with the second addendum to the lease between the City of Reading and the Authority.

Basic Financial Statements

Our basic financial statements are prepared on the accrual basis of accounting using an economic resources measurement focus, which is basically the same as what is used in for profit businesses in the private sector. The basic financial statements include statements of net assets, statements of revenues, expenses and changes in net assets, statements of cash flows and notes to the financial statements.

The statements of net assets present information on the assets and liabilities, with the difference between assets and liabilities reported as net assets. The increases and decreases in net assets over time may be a useful indicator of the finances of the Authority as to whether it is improving or deteriorating.

The statements of revenues, expenses and changes in net assets of the Authority for the year show the detail of net income or loss being combined with the beginning net assets balance, resulting in the ending net assets for the year.

The statements of cash flows report cash activities for the year resulting from operating activities, noncapital financing activities, capital and related financing activities, and investing activities. The net result of these activities, added to the beginning of the year cash balance, reconciles to the cash balance at the end of the current year.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

Financial Information

Net Assets. The following schedule presents a summary of net assets comparison for the years ended December 31, 2011, 2010 and 2009:

	2011	2010	2009
Unrestricted current assets	\$ 10,025,119	\$ 10,983,068	\$ 10,962,104
Restricted current assets	57,562,261	16,610,866	20,246,512
Capital assets, net	35,551,858	28,439,474	20,734,347
Other assets, net	<u>2,638,694</u>	<u>3,286,527</u>	<u>3,653,376</u>
Total assets	<u>105,777,932</u>	<u>59,319,935</u>	<u>55,596,339</u>
Current liabilities	4,522,136	4,570,299	2,592,269
Other long-term liability, interest rate swap	124,391	332,995	226,475
Long-term debt, net	<u>96,264,787</u>	<u>48,699,114</u>	<u>45,914,773</u>
Total liabilities	<u>100,911,314</u>	<u>53,602,408</u>	<u>48,733,517</u>
Net assets:			
Invested in capital assets, net	-	-	-
Restricted for debt service	4,060,685	4,044,555	4,399,356
Unrestricted assets	<u>805,933</u>	<u>1,672,972</u>	<u>2,463,466</u>
Total net assets	<u>\$ 4,866,618</u>	<u>\$ 5,717,527</u>	<u>\$ 6,862,822</u>

Current liabilities decreased by 1.1% in 2011 compared to an increase of 76.3% in 2010. The 2010 increase was attributable to the increase in current maturities of long-term debt and an increase in trade accounts payable, specifically for a \$ 1,020,000 payment to the City of Reading for rights to leased land.

Revenues. The following schedule presents a summary of revenue for the years ended December 31, 2011, 2010 and 2009:

	2011	2010	2009
Water billings	\$ 22,770,457	\$ 19,987,932	\$ 18,237,476
Interest and penalty charges	491,790	395,410	415,319
Tampered meter and other charges	474,164	397,579	282,498
Tapping and connection fees	133,518	157,335	157,979
Abandonment fees	<u>23,531</u>	<u>51,519</u>	<u>21,419</u>
Total operating revenues	<u>\$ 23,893,460</u>	<u>\$ 20,989,775</u>	<u>\$ 19,114,691</u>

The 2011 fiscal year's total operating revenue increased by 13.8% compared to 2010 and increased by 9.8% in 2010 and 9.2% in 2009.

Expenses. The following schedule presents a summary of expenses for the years ended December 31, 2011, 2010 and 2009:

	2011	2010	2009
Operating expenses:			
Lease payments, City of Reading	\$ 16,875,521	\$ 16,790,137	\$ 14,071,200
Meter reading	523,137	498,226	474,501
Salaries and payroll taxes	1,629,458	197,650	116,393
Insurance	536,869	99,231	47,018
Other	<u>2,156,490</u>	<u>1,653,540</u>	<u>1,308,538</u>
Total operating expenses	<u>\$ 21,721,475</u>	<u>\$ 19,238,784</u>	<u>\$ 16,017,650</u>

The largest portion of the \$ 2,482,691 increase in expenses is the result of an increase in salaries, payroll taxes and insurance in the amount of \$ 1,869,446.

Changes in Net Assets. The following schedule presents a summary of changes in net assets for the years ended December 31, 2011, 2010 and 2009:

	2011	2010	2009
Operating revenues	\$ 23,893,460	\$ 20,989,775	\$ 19,114,691
Operating expenses	<u>21,721,475</u>	<u>19,238,784</u>	<u>16,017,650</u>
Operating income before depreciation and amortization	2,171,985	1,750,991	3,097,041
Depreciation and amortization	<u>1,336,916</u>	<u>1,144,827</u>	<u>969,749</u>
Operating income	835,069	606,164	2,127,292
Nonoperating revenues (expenses)	<u>(1,685,978)</u>	<u>(1,751,459)</u>	<u>(1,179,321)</u>
Increase (decrease) in net assets	<u>\$ (850,909)</u>	<u>\$ (1,145,295)</u>	<u>\$ 947,971</u>

**Statement of Changes in Net Assets
Year Ended December 31, 2011**

	Beginning Balance	Increase (Decrease)	Ending Balance
Invested in capital assets, net	\$ -	\$ -	\$ -
Restricted	4,044,555	16,130	4,060,685
Unrestricted	<u>1,672,972</u>	<u>(867,039)</u>	<u>805,933</u>
Total net assets	<u>\$ 5,717,527</u>	<u>\$ (850,909)</u>	<u>\$ 4,866,618</u>

**Statement of Changes in Net Assets
Year Ended December 31, 2010**

	Beginning Balance	Increase (Decrease)	Ending Balance
Invested in capital assets, net	\$ -	\$ -	\$ -
Restricted	4,399,356	(354,801)	4,044,555
Unrestricted	<u>2,463,466</u>	<u>(790,494)</u>	<u>1,672,972</u>
Total net assets	<u>\$ 6,862,822</u>	<u>\$ (1,145,295)</u>	<u>\$ 5,717,527</u>

**Statement of Changes in Net Assets
Year Ended December 31, 2009**

	Beginning Balance	Increase (Decrease)	Ending Balance
Invested in capital assets, net	\$ -	\$ -	\$ -
Restricted	5,442,317	(1,042,961)	4,399,356
Unrestricted	<u>472,534</u>	<u>1,990,932</u>	<u>2,463,466</u>
Total net assets	<u>\$ 5,914,851</u>	<u>\$ 947,971</u>	<u>\$ 6,862,822</u>

Capital Assets

The Authority's investment in capital assets includes leasehold improvements, equipment, vehicles, computers and software, and construction in progress. Major additions are funded by the issuance of water revenue bonds and notes or funds held in the Authority's construction accounts.

The Authority's capital assets as of December 31, 2011, 2010 and 2009, net of accumulated depreciation, amounted to \$ 35,551,858, \$ 28,439,474 and \$ 20,734,347, respectively. For the year ended December 31, 2011, this amount represents a net increase (including additions, deletions and depreciation) of \$ 7,112,384 from the prior year. See Note 4 for more information on capital assets.

**Capital Assets at December 31
(Net of Accumulated Depreciation)**

	2011	2010	2009
Leasehold improvements	\$ 20,824,547	\$ 15,730,869	\$ 13,259,803
Acquired systems	875,762	-	-
Equipment	4,870,530	2,427,454	1,511,080
Vehicles	400,574	559,299	561,427
Computers and software	95,974	120,237	73,282
Construction in progress	<u>8,484,471</u>	<u>9,601,615</u>	<u>5,328,755</u>
	<u>\$ 35,551,858</u>	<u>\$ 28,439,474</u>	<u>\$ 20,734,347</u>

Debt Administration

At December 31, 2011, the Authority had \$ 102,751,257 of Guaranteed Revenue Bonds and loans payable, compared to \$ 55,196,820 and \$ 52,331,047 at the end of the 2010 and 2009 years, respectively. The proceeds from these long-term borrowings are used for renovations and improvements to the water system. See Note 5 for additional information on the Authority's debt.

Economic Factors

The Reading Area Water Authority will continue to address the existing infrastructure by addressing the rehabilitation needs of the system, as well as pursue possible extension of the water system into new areas.

Future investments include relining of water mains throughout the existing system, cleaning of finished water reservoirs to uphold water quality, address PADEP requirements for the Lake Ontelaunee Dam and address sediment within Lake Ontelaunee.

Request for Information

This financial report is intended to provide an overview of the finances of the Reading Area Water Authority for those with an interest in the Authority. Questions concerning any information contained in the report may be directed to the Executive Director, Reading Area Water Authority, 1801 Kutztown Road, Reading, PA 19604.

**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING**

**STATEMENTS OF NET ASSETS
December 31, 2011 and 2010**

ASSETS	2011	2010
UNRESTRICTED CURRENT ASSETS		
Cash	\$ 5,466,860	\$ 5,876,463
Accounts receivable, billings, net of allowance 2011 \$ 3,720,853; 2010 \$ 2,761,231	3,044,335	2,366,265
Due from City of Reading	1,477,135	2,696,356
Accrued interest receivable	14,311	43,984
Prepaid expenses	<u>22,478</u>	<u>-</u>
Total unrestricted current assets	<u>10,025,119</u>	<u>10,983,068</u>
RESTRICTED CURRENT ASSETS		
Developer escrow deposits, cash	<u>57,061</u>	<u>96,376</u>
Trust accounts, cash and investments:		
Clearing Account	114,741	93,107
Construction Account	42,450,430	12,376,828
Debt Service Account	7,518,131	3
Debt Service Reserve Account	<u>7,421,898</u>	<u>4,044,552</u>
Total restricted current assets	<u>57,505,200</u>	<u>16,514,490</u>
	<u>57,562,261</u>	<u>16,610,866</u>
CAPITAL ASSETS		
Capital assets not being depreciated, construction in progress	<u>8,484,471</u>	<u>9,601,615</u>
Capital assets being depreciated:		
Leasehold improvements	24,901,942	19,167,334
Acquired systems	883,121	-
Equipment	6,681,536	3,808,904
Vehicles	1,654,792	1,654,792
Computers and software	<u>462,033</u>	<u>451,593</u>
	<u>34,583,424</u>	<u>25,082,623</u>
Less accumulated depreciation	<u>7,516,037</u>	<u>6,244,764</u>
	<u>27,067,387</u>	<u>18,837,859</u>
Capital assets, net	<u>35,551,858</u>	<u>28,439,474</u>
OTHER ASSETS		
Due from City of Reading, PENNVEST loan assumption	98,086	1,433,833
Unamortized bond issuance costs, net of accumulated amortization 2011 \$ 425,687; 2010 \$ 360,044	1,520,608	832,694
Leased land rights	<u>1,020,000</u>	<u>1,020,000</u>
	<u>2,638,694</u>	<u>3,286,527</u>
	<u><u>\$ 105,777,932</u></u>	<u><u>\$ 59,319,935</u></u>

See Notes to Financial Statements.

LIABILITIES AND NET ASSETS	2011	2010
CURRENT LIABILITIES		
Accounts payable, capital	\$ 1,236,034	\$ 708,084
Accounts payable, trade	124,999	1,176,028
Accrued payroll	54,579	-
Accrued interest payable	208,365	114,079
Escrow deposits	57,061	92,808
Current maturities of long-term debt	<u>2,841,098</u>	<u>2,479,300</u>
Total current liabilities	<u>4,522,136</u>	<u>4,570,299</u>
OTHER LONG-TERM LIABILITY, interest rate swap	<u>124,391</u>	<u>332,995</u>
LONG-TERM DEBT, less current maturities	<u>96,264,787</u>	<u>48,699,114</u>
COMMITMENTS AND CONTINGENCIES	<u>-</u>	<u>-</u>
NET ASSETS		
Invested in capital assets, net of related debt	-	-
Restricted for debt service	4,060,685	4,044,555
Unrestricted	<u>805,933</u>	<u>1,672,972</u>
	4,866,618	5,717,527
	<u><u>\$ 105,777,932</u></u>	<u><u>\$ 59,319,935</u></u>

**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING**

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended December 31, 2011 and 2010**

	2011	2010
Operating revenues:		
Water billings	\$ 22,770,457	\$ 19,987,932
Interest and penalty charges	491,790	395,410
Tampered meter and other charges	474,164	397,579
Tapping and connection fees	133,518	157,335
Abandonment fees	23,531	51,519
	23,893,460	20,989,775
 Total operating revenues		
 Operating expenses:		
Lease payments, City of Reading	16,875,521	16,790,137
Meter reading	523,137	498,226
Engineering	92,888	38,974
Legal fees	168,757	118,231
Salaries and payroll taxes	1,629,458	197,650
Collections expense	226,086	155,764
Insurance	536,869	99,231
Employee benefits	50,319	13,854
Grant expenditures	66,530	56,280
Telephone	11,851	11,066
Contracted services	183,813	136,990
Repairs and maintenance	33,714	49,801
Audit and accounting	87,681	64,309
Bank charges	10,507	5,778
Dues and subscriptions	28,629	-
Advertising	1,866	1,404
Education	7,499	2,255
Supplies	17,773	8,383
Bad debt expense	959,622	682,106
Other professional services, rate study	72,146	23,045
Lake Ontelaunee dredging	136,809	163,207
ISO flow testing	-	122,093
	21,721,475	19,238,784
 Total operating expenses		
 Operating income before depreciation and amortization	2,171,985	1,750,991

**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING**

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (CONTINUED)
Years Ended December 31, 2011 and 2010**

	2011	2010
Depreciation and amortization:		
Depreciation	\$ 1,271,273	\$ 1,080,440
Amortization of bond issuance costs	<u>65,643</u>	<u>64,387</u>
	<u>1,336,916</u>	<u>1,144,827</u>
 Operating income	 <u>835,069</u>	 <u>606,164</u>
 Nonoperating revenues (expenses):		
Investment income	194,323	220,419
Swap income, net	30,291	12,587
Miscellaneous income	22,777	26,587
Change in value of interest rate swap	208,604	(106,520)
Interest expense	(2,096,347)	(1,994,785)
Miscellaneous expense	(12,933)	(11,341)
Arbitrage rebate	(32,693)	-
Grant income	<u>-</u>	<u>101,594</u>
	<u>(1,685,978)</u>	<u>(1,751,459)</u>
 Decrease in net assets	 (850,909)	 (1,145,295)
 Net assets, beginning	 <u>5,717,527</u>	 <u>6,862,822</u>
 Net assets, ending	 <u>\$ 4,866,618</u>	 <u>\$ 5,717,527</u>

See Notes to Financial Statements.

**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING**

**STATEMENTS OF CASH FLOWS
Years Ended December 31, 2011 and 2010**

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers	\$ 22,255,768	\$ 20,228,630
Cash payments to suppliers for goods and services	(18,986,681)	(17,859,672)
Cash payments to employees for services	<u>(1,574,879)</u>	<u>(197,650)</u>
Net cash provided by operating activities	<u>1,694,208</u>	<u>2,171,308</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Increase (decrease) in escrow liability, net	(35,747)	(15,798)
Miscellaneous income received	22,777	26,587
Miscellaneous expenses paid	(12,933)	(11,341)
Cash receipts from grants	<u>-</u>	<u>101,594</u>
Net cash provided by (used in) noncapital financing activities	<u>(25,903)</u>	<u>101,042</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(7,796,014)	(8,620,505)
Proceeds from issuance of debt	51,733,833	6,069,642
Principal paid on long-term debt	(3,114,739)	(1,881,407)
Interest paid on long-term debt	(1,417,630)	(1,374,832)
Bond issuance costs paid	(753,557)	-
Arbitrage rebate paid	<u>(32,693)</u>	<u>-</u>
Net cash provided by (used in) capital and related financing activities	<u>38,619,200</u>	<u>(5,807,102)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
(Increase) decrease in restricted assets, net	(40,951,395)	3,635,646
Swap income received, net	30,291	12,587
Investment income received	<u>223,996</u>	<u>201,517</u>
Net cash provided by (used in) investing activities	<u>(40,697,108)</u>	<u>3,849,750</u>
Net increase (decrease) in cash	(409,603)	314,998
Cash:		
Beginning	<u>5,876,463</u>	<u>5,561,465</u>
Ending	<u>\$ 5,466,860</u>	<u>\$ 5,876,463</u>

**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING**

**STATEMENTS OF CASH FLOWS (CONTINUED)
Years Ended December 31, 2011 and 2010**

	2011	2010
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 835,069	\$ 606,164
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,271,273	1,080,440
Amortization	65,643	64,387
Changes in assets and liabilities:		
(Increase) in accounts receivable	(678,070)	(79,039)
Decrease in accounts receivable, other	-	153,874
Decrease in due from City of Reading	1,219,221	188,993
(Increase) decrease in prepaid expenses	(22,478)	49,108
Increase (decrease) in accounts payable	(1,051,029)	107,381
Increase in accrued payroll	54,579	-
	<u>\$ 1,694,208</u>	<u>\$ 2,171,308</u>
Net cash provided by operating activities		
NONCASH CAPITAL AND FINANCING ACTIVITIES		
Payment by City of Reading, PENNVEST loan assumption applied to PENNVEST note payable	\$ 1,335,747	\$ 1,322,462

See Notes to Financial Statements.

**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING**

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Activity and Significant Accounting Policies

Nature of activity:

The Reading Area Water Authority (the "Authority"), a component unit of the City of Reading, (the "City") was created as an operating authority in 1995 in compliance with the Pennsylvania Municipality Authorities Act. The Authority was formed to provide water services to residential, commercial and industrial users of the water system for the City of Reading and certain surrounding municipalities. The Authority is governed by a five-member board, each of whom is appointed by the City of Reading.

A summary of the Authority's significant accounting policies follows:

The accompanying financial statements conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant accounting policies used by the Authority.

A. THE FINANCIAL REPORTING ENTITY

Accounting principles generally accepted in the United States of America require that the reporting entity include the primary government, organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. There are no agencies or entities which should be presented with the Authority.

The Authority is a component unit of the City of Reading, Berks County, Pennsylvania.

B. MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION

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

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of timing of related cash flows.

Private-sector standards of accounting and financial reporting issued prior to December 31, 1989 are generally followed to the extent that these standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Authority has elected to follow subsequent private-sector guidance, subject to the same limitation.

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Activity and Significant Accounting Policies (Continued)

A summary of the Authority's significant accounting policies follows (continued):

B. MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION (CONTINUED)

Operating revenues and expenses are distinguished from nonoperating items in the statements of revenues, expenses and changes in net assets. Operating revenues and expenses generally result from providing services in connection with the Authority's principal ongoing operations. The principal operating revenues of the Authority are charges to customers for the sale of water. Operating expenses include the cost of providing services, administrative expenses, depreciation on capital assets and amortization on bond premium and issue costs. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal nonoperating revenues and expenses of the Authority are interest expense, investment income, change in value of interest rate swap and capital contributions.

When restricted and unrestricted resources are available for its use, it is the Authority's policy to use restricted resources first.

C. ASSETS, LIABILITIES AND NET ASSETS

In accordance with the terms of the trust indenture dated September 15, 2002, the first supplemental indenture dated July 1, 2003, the second supplemental indenture dated July 15, 2007 and the third supplemental indenture dated December 19, 2011 (hereinafter collectively referred to as the "indentures"), relating to the bonded debt, funds of the Authority are accounted for by separate trust accounts; segregated for specific use and held for the benefit of the bondholders. In accordance with the indentures, the trust accounts maintained by the independent trustee are accounted for, by the trustee, using the cash basis method of accounting. A brief description of the purposes of the several revenue bond trust restricted accounts follows:

Project accounts:

Clearing Account:

Funds are deposited herein to cover principal and interest payments due on the bonds. Transfers are made to the Debt Service Account to make these payments.

Construction Account:

The Construction Account consists of funds deposited from the Settlement Account for the purpose of paying costs of capital additions.

Debt Service Account:

Semiannual transfers from the Clearing Account are recorded in this account. Current debt service and sinking fund requirements of the bond issues are paid from this Account.

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Activity and Significant Accounting Policies (Continued)

A summary of the Authority's significant accounting policies follows (continued):

C. ASSETS, LIABILITIES AND NET ASSETS (CONTINUED)

Project accounts (continued):

Debt Service Reserve Account:

This Account was funded by the trust indentures. The aggregate balance provides additional collateral for the bondholders.

Cash:

For purposes of reporting cash flows, the Authority considers all cash accounts, which are not subject to withdrawal restrictions or penalties, and all highly-liquid debt investments purchased with a maturity of three months or less to be cash.

Accounts receivable:

Accounts receivable are shown net of an allowance for uncollectibles, as applicable. Accounts receivable are evaluated for collectibility and an allowance is established, as deemed necessary, based on the best information available and in an amount that management believes is adequate. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Investments:

The Board and trustee are permitted to invest the Authority's funds as defined in the Local Government Unit Debt Act, the Municipality Authorities Act and the related trust indentures. Authorized types of investments include the following:

- a. U. S. Treasury Bills.
- b. Short-term obligations of the U. S. Government and federal agencies.
- c. Insured savings and checking accounts and certificates of deposit in banks, savings and loan associations and credit unions.
- d. General obligation bonds of the federal government, the Commonwealth of Pennsylvania or any state agency, or of any Pennsylvania political subdivision.
- e. Shares of mutual funds whose investments are restricted to the above categories.

When making investments, the Board and trustee can combine funds from more than one fund under the Authority's control for the purchase of a single investment and join with other political subdivisions and municipal authorities in the purchase of a single investment.

Investments are carried at fair value.

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Activity and Significant Accounting Policies (Continued)

A summary of the Authority's significant accounting policies follows (continued):

C. ASSETS, LIABILITIES AND NET ASSETS (CONTINUED)

Capital assets:

Capital assets are stated at cost. Depreciation of capital assets is computed on the straight-line method over the following estimated useful lives:

	Years
Leasehold improvements	10-40
Acquired systems	40
Equipment	3-40
Vehicles	5-7
Computers and software	3-5

Maintenance and repairs of capital assets are charged to operations and major improvements are capitalized. Upon retirement, sale or other disposition of capital assets, the cost and accumulated depreciation are eliminated from the accounts and gain or loss is included in operations. Interest costs incurred during the construction period of major projects are capitalized and amortized over the life of the asset. The total interest expense incurred by the Authority for the years ending December 31, 2011 and 2010 was \$ 2,156,040 and \$ 2,025,979, respectively. Of these amounts, \$ 59,693 and \$ 31,194, respectively, was included as part of the cost of capital assets under construction.

Bond/note premiums/discounts and issuance costs:

Bond/note premiums/discounts and issuance costs are deferred and amortized over the term of the bonds/notes. Bond premiums/discounts are presented as an addition or deduction to the face amount of the revenue bonds payable, whereas issuance costs are recorded as an other asset.

Derivatives:

Changes in fair value for effective hedges that are achieved with derivative instruments are recognized in the reporting period to which they relate. Changes in fair value of these hedging derivative instruments do not affect the current period, but are instead reported as deferrals in the statement of net assets. Derivative instruments that either do not meet the criteria for an effective hedge or are associated with investments that are already reported at fair value are classified as investment derivative instruments for financial reporting purposes. Changes in fair value of those derivative instruments are reported in the current reporting period.

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Activity and Significant Accounting Policies (Continued)

A summary of the Authority's significant accounting policies follows (continued):

C. ASSETS, LIABILITIES AND NET ASSETS (CONTINUED)

Net assets:

Net assets are classified into three categories as follows:

Invested in capital assets consists of capital assets, net of accumulated depreciation and debt incurred for the acquisition of capital assets.

Restricted net assets are amounts that have externally imposed restrictions on how the funds can be spent.

Unrestricted net assets are amounts that do not meet the definitions of "invested in capital assets" or "restricted" and are available for Authority operations.

Note 2. Stewardship, Compliance and Accountability

Compliance with finance-related legal and contractual provisions:

The Authority had no material violations of finance-related legal and contractual provisions in regard to the terms, covenants, provisions or conditions contained in the trust indentures relating to the bond issues.

Note 3. Cash and Investments

The carrying amounts of cash and investments at December 31, 2011 and 2010 consist of the following:

	2011	2010
Petty cash	\$ 300	\$ 300
Demand deposit accounts	5,523,621	5,972,539
Investments	<u>57,505,200</u>	<u>16,514,490</u>
	<u>\$ 63,029,121</u>	<u>\$ 22,487,329</u>
Classification per statements of net assets:		
Unrestricted current assets, cash	\$ 5,466,860	\$ 5,876,463
Restricted current assets:		
Developer escrow deposits, cash	57,061	96,376
Trust accounts, cash and investments	<u>57,505,200</u>	<u>16,514,490</u>
	<u>\$ 63,029,121</u>	<u>\$ 22,487,329</u>

NOTES TO FINANCIAL STATEMENTS

Note 3. Cash and Investments (Continued)

Cash:

The Authority's available cash is invested in demand deposit accounts.

The Authority has custodial credit risk on cash deposits. This is the risk that in the event of a financial institution failure, the Authority's deposits may not be returned. The Authority has a deposit policy for custodial risk that requires depository institutions to pledge securities as collateral for deposits that exceed depository insurance.

At December 31, 2011 and 2010, the carrying amounts of the Authority's bank deposits were \$ 5,523,621 and \$ 5,972,539, respectively, and the bank balances were \$ 6,037,936 and \$ 5,792,059, respectively, of which \$ 500,000 was covered by Federal Depository Insurance each year. The remaining \$ 5,537,936 and \$ 5,292,059, respectively, of deposits were exposed to custodial risk because they were uninsured and collateralized with securities held by the pledging financial institution's trust department or agent, but not in the Authority's name.

Investments:

As of December 31, 2011 and 2010, the Authority has the following investments with M&T Bank:

	Investment Maturities	
	----- (in Years) -----	
December 31, 2011	Fair Value	Less than One Year
Federated Treasury Obligation Funds	\$ 53,771,200	\$ 53,771,200
Federal National Mortgage Association Notes	<u>3,734,000</u>	<u>3,734,000</u>
	<u>\$ 57,505,200</u>	<u>\$ 57,505,200</u>
December 31, 2010		
Federated Treasury Obligation Funds	\$ 5,772,210	\$ 5,772,210
Federal National Mortgage Association Note	3,742,280	3,742,280
Certificates of deposit	<u>7,000,000</u>	<u>7,000,000</u>
	<u>\$ 16,514,490</u>	<u>\$ 16,514,490</u>

Interest rate risk:

The Authority does not have a formal investment policy that limits maturities in certain investments as a means of managing its exposure to fair value losses arising from increasing interest rates.

NOTES TO FINANCIAL STATEMENTS

Note 3. Cash and Investments (Continued)

Credit risk:

The Authority does not have an investment policy that would limit its investment choices to certain credit ratings. However, the Authority limits the type of investments permitted as defined in the Local Government Unit Debt Act, the Municipality Authorities Act and the related trust indentures. Permitted investments are defined in Note 1.

Custodial credit risk:

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. As of December 31, 2011 and 2010, \$ 57,505,200 and \$ 16,514,490, respectively, is held by the investment's counterparty, not in the name of the Authority.

Note 4. Capital Assets

Capital asset activity for the years ended December 31, 2011 and 2010 was as follows:

	----- 2011 -----			
	Balance January 1,	Additions	Deletions	Balance December 31,
Capital assets not being depreciated, construction in progress	\$ 9,601,615	\$ 8,350,890	\$ 9,468,034	\$ 8,484,471
Capital assets being depreciated:				
Leasehold improvements	19,167,334	5,734,608	-	24,901,942
Acquired systems	-	883,121	-	883,121
Equipment	3,808,904	2,872,632	-	6,681,536
Vehicles	1,654,792	-	-	1,654,792
Computers and software	451,593	10,440	-	462,033
Total capital assets being depreciated	<u>25,082,623</u>	<u>9,500,801</u>	<u>-</u>	<u>34,583,424</u>
Less accumulated depreciation for:				
Leasehold improvements	3,436,465	640,930	-	4,077,395
Acquired systems	-	7,359	-	7,359
Equipment	1,381,450	429,556	-	1,811,006
Vehicles	1,095,493	158,725	-	1,254,218
Computers and software	331,356	34,703	-	366,059
Total accumulated depreciation	<u>6,244,764</u>	<u>1,271,273</u>	<u>-</u>	<u>7,516,037</u>
Total capital assets being depreciated, net	<u>18,837,859</u>	<u>8,229,528</u>	<u>-</u>	<u>27,067,387</u>
Total capital assets, net	<u>\$ 28,439,474</u>	<u>\$ 16,580,418</u>	<u>\$ 9,468,034</u>	<u>\$ 35,551,858</u>

NOTES TO FINANCIAL STATEMENTS

Note 4. Capital Assets (Continued)

	-----2010-----			
	Balance January 1,	Additions	Deletions	Balance December 31,
Capital assets not being depreciated, construction in progress	<u>\$ 5,328,755</u>	<u>\$ 8,361,436</u>	<u>\$ 4,088,576</u>	<u>\$ 9,601,615</u>
Capital assets being depreciated:				
Leasehold improvements	16,107,640	3,059,694	-	19,167,334
Equipment	2,588,931	1,219,973	-	3,808,904
Vehicles	1,491,011	163,781	-	1,654,792
Computers and software	<u>382,334</u>	<u>69,259</u>	<u>-</u>	<u>451,593</u>
Total capital assets being depreciated	<u>20,569,916</u>	<u>4,512,707</u>	<u>-</u>	<u>25,082,623</u>
Less accumulated depreciation for:				
Leasehold improvements	2,847,837	588,628	-	3,436,465
Equipment	1,077,851	303,599	-	1,381,450
Vehicles	929,584	165,909	-	1,095,493
Computers and software	<u>309,052</u>	<u>22,304</u>	<u>-</u>	<u>331,356</u>
Total accumulated depreciation	<u>5,164,324</u>	<u>1,080,440</u>	<u>-</u>	<u>6,244,764</u>
Total capital assets being depreciated, net	<u>15,405,592</u>	<u>3,432,267</u>	<u>-</u>	<u>18,837,859</u>
Total capital assets, net	<u>\$ 20,734,347</u>	<u>\$ 11,793,703</u>	<u>\$ 4,088,576</u>	<u>\$ 28,439,474</u>

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Debt

At December 31, 2011 and 2010, long-term debt consists of the following:

	----- 2011 -----		
	Balance Outstanding January 1,	Additions (Payments)	Balance Outstanding December 31,
Note payable to PENNVEST, due in monthly payments of \$ 18,405, including interest at 3.997% to December 2017, secured by a lien and security interest in substantially all Authority assets	\$ 1,346,641	\$ (170,130)	\$ 1,176,511
Note payable to PENNVEST, due in monthly payments of \$ 111,998, including interest at 1.000% through January 2012, guaranteed by the City of Reading	1,433,833	(1,335,747)	98,086
Guaranteed Water Revenue Bonds, Series of 2002, initial issue \$ 3,250,000, various interest rates ranging from 1.300% to 4.400%, maturing in amounts ranging from \$ 190,000 to \$ 265,000 through 2017	1,665,000	(215,000)	1,450,000
Guaranteed Water Revenue Bonds, Series of 2003 (Capital Appreciation Bonds), initial issue \$ 21,080,000, various interest rates ranging from 3.600% to 4.620%, maturing in amounts ranging from \$ 610,000 to \$ 2,690,000 through 2020	21,080,000	(610,000)	20,470,000
Guaranteed Water Revenue Bonds, Series of 2007, initial issue \$ 25,000,000, various interest rates ranging from 4.250% to 5.000%, maturing in amounts ranging from \$ 125,000 to \$ 3,860,000 through 2027	25,000,000	(125,000)	24,875,000
Note payable to PENNVEST, maximum drawdown of \$ 6,550,000, interest only for the first 36 months of the loan, principal and interest due monthly thereafter; interest at 1.274% for first 5 years and 2.547% thereafter through 2032. Guaranteed by the City of Reading	2,875,070	1,806,590	4,681,660
Water Revenue Note, Series of 2009, maximum drawdown of \$ 6,550,000, interest payable monthly at 3.150%, with principal due October 2012	1,772,854	(1,772,854)	-

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Debt (Continued)

	2011		
	Balance Outstanding January 1,	Additions (Payments)	Balance Outstanding December 31,
Water Revenue Bonds, Series of 2011, initial issue \$ 50,000,000, various interest rates ranging from 2.350% to 5.250%, maturing in amounts ranging from \$ 100,000 to \$ 6,975,000 through 2036	\$ -	\$ 50,000,000	\$ 50,000,000
Note payable to a bank in quarterly principal payments ranging from \$ 21,366 to \$ 23,300, plus monthly interest payments calculated at a variable rate through February 2011	<u>23,422</u>	<u>(23,422)</u>	<u>-</u>
	<u>\$ 55,196,820</u>	<u>\$ 47,554,437</u>	<u>\$ 102,751,257</u>
	2010		
	Balance Outstanding January 1,	Additions (Payments)	Balance Outstanding December 31,
Note payable to a bank in quarterly principal payments ranging from \$ 21,366 to \$ 23,300, plus monthly interest payments calculated at a variable rate through February 2011	\$ 114,636	\$ (91,214)	\$ 23,422
Note payable to PENNVEST, due in monthly payments of \$ 18,405, including interest at 3.997% to December 2017, secured by a lien and security interest in substantially all Authority assets	1,510,116	(163,475)	1,346,641
Note payable to PENNVEST, due in monthly payments of \$ 111,998, including interest at 1.000% through January 2012, guaranteed by the City of Reading	2,756,295	(1,322,462)	1,433,833
Guaranteed Water Revenue Bonds, Series of 2002, initial issue \$ 3,250,000, various interest rates ranging from 1.300% to 4.400%, maturing in amounts ranging from \$ 190,000 to \$ 265,000 through 2017	1,870,000	(205,000)	1,665,000
Guaranteed Water Revenue Bonds, Series of 2003 (Capital Appreciation Bonds), initial issue \$ 21,080,000, various interest rates ranging from 3.600% to 4.620%, maturing in amounts ranging from \$ 610,000 to \$ 2,690,000 through 2020	21,080,000	-	21,080,000

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Debt (Continued)

	-----2010-----		
	Balance Outstanding January 1,	Additions (Payments)	Balance Outstanding December 31,
Guaranteed Water Revenue Bonds, Series of 2007, initial issue \$ 25,000,000, various interest rates ranging from 4.250% to 5.000%, maturing in amounts ranging from \$ 125,000 to \$ 3,860,000 through 2027	\$ 25,000,000	\$ -	\$ 25,000,000
Note payable to PENNVEST, maximum drawdown of \$ 6,550,000, interest only for the first 36 months of the loan, principal and interest due monthly thereafter; interest at 1.274% for first 5 years and 2.547% thereafter through 2032. Guaranteed by the City of Reading	-	2,875,070	2,875,070
Water Revenue Note, Series of 2009, maximum drawdown of \$ 6,550,000, interest payable monthly at 3.150%, with principal due October 2012	-	1,772,854	1,772,854
	<u>\$ 52,331,047</u>	<u>\$ 2,865,773</u>	<u>\$ 55,196,820</u>

Aggregate maturities required on the long-term debt at December 31, 2011 are as follows:

Year Ending	Principal	Interest	Total
2012	\$ 2,841,098	\$ 3,896,849	\$ 6,737,947
2013	2,851,760	4,083,655	6,935,415
2014	2,877,754	4,136,425	7,014,179
2015	3,219,098	4,186,714	7,405,812
2016	3,238,557	4,299,488	7,538,045
2017-2021	16,342,616	22,009,388	38,352,004
2022-2026	18,989,553	16,380,385	35,369,938
2027-2031	21,820,821	11,344,779	33,165,600
2032-2036	<u>30,570,000</u>	<u>5,089,086</u>	<u>35,659,086</u>
	<u>\$ 102,751,257</u>	<u>\$ 75,426,769</u>	<u>\$ 178,178,026</u>

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Debt (Continued)

	2011	2010
Total long-term debt payable	\$ 102,751,257	\$ 55,196,820
Less current maturities	(2,841,098)	(2,479,300)
Less unamortized bond discount	(270,638)	-
Plus unamortized bond premium	713,880	758,731
Less unamortized interest on capital appreciation bonds	<u>(4,088,614)</u>	<u>(4,777,137)</u>
	<u>\$ 96,264,787</u>	<u>\$ 48,699,114</u>

Bonds payable:

The bonds are secured under the indentures by an assignment and pledge to the trustee of receipts and revenues from the water system.

Derivative financial instrument:

Interest rate swap - In July 2005, the Authority entered into a forward interest rate swap agreement with a financial institution in conjunction with its Guaranteed Water Revenue Bonds, Series of 2003. The agreement uses an underlying index of 67% of the 30-day LIBOR versus the BMA Municipal Bond Index.

The swap is a cash flow hedge – a pay-fixed interest rate swap. The classification of the interest rate swap is deferred outflow. The fair value liability as of December 31, 2011 and 2010 was as follows:

----- 2011 -----					
Original Notional Amount	Effective Date	Maturity Date	January 1, Beginning	Increase (Decrease)	December 31, Ending
\$ 20,470,000	July 1, 2005	November 1, 2020	\$ (332,995)	\$ 208,604	\$ (124,391)
----- 2010 -----					
\$ 21,080,000	July 1, 2005	November 1, 2020	\$ (226,475)	\$ (106,520)	\$ (332,995)

Note 6. Operating Lease

The Authority has entered into a 99-year operating lease, effective June 1, 1994, with the City of Reading for the operations of the water system. Lease payments are the sum of agreed-upon administrative expenses, operating expenses, debt service expenses and financing fees of the City of Reading. In addition, the Authority must provide water service free of charge to the City. Lease payments are made monthly based on an estimate of the anticipated lease payments for the year. At the end of the year, the Authority receives an annual reconciliation statement, which reflects a credit due to the Authority or a payment due to the City. Total lease expense for the years ended December 31, 2011 and 2010 was \$ 16,875,521 and \$ 16,790,137, respectively.

NOTES TO FINANCIAL STATEMENTS

Note 6. Operating Lease (Continued)

In December 2010, a Second Addendum to the lease was agreed upon by the City of Reading and the Authority. The Addendum authorizes the Authority to directly employ the City's Water Department employees at various dates beginning in January 2011, as defined therein. Upon employment by the Authority of each employee, the lease payment to the City of Reading is reduced by the operational expenses and administrative expenses directly attributed to the City's employment of such employees for the period following employment.

The Addendum also required the payment by the Authority to the City of \$ 1,020,000 for restriction on the City's Ontelaunee Township property. Under the Addendum, except in the exercise of its Take-Back Powers or with the Authority's prior written approval, the City cannot voluntarily convey or transfer any property interest in the approximately 120 acre parcel of land located in Ontelaunee Township.

In June 2012, a Third Addendum to the lease was agreed upon by the City of Reading and the Authority to facilitate additional payments to the City by the Authority to assist in the Act 47 recovery program of the City. In addition to the lease payment to the City for operational and administrative expenses, the Authority is to pay a financing fee and meter surcharge payment. The following is a schedule of the future minimum lease payments under the Third Addendum for the financing fee and meter surcharge payment:

Year Ending December 31:	
2012	\$ 7,620,000
2013	8,170,000
2014	8,370,000
2015	<u>1,700,000</u>
	<u>\$ 25,860,000</u>

Note 7. Retirement Plan

During 2011, the Authority adopted a retirement plan covering salary deferral for those employees who meet the eligibility requirements set forth in the plan. The amount of the contribution for salary deferral is at the discretion of the employee subject to the provisions of Section 457(b) of the Internal Revenue Code. Under terms of the plan, the Authority may make discretionary matching contributions.

The Authority reflects its contributions to the plan as an operating expense. For the year ended December 31, 2011, \$ 13,652 was contributed to the plan.

NOTES TO FINANCIAL STATEMENTS

Note 8. Commitments and Contingencies

Commitments:

Management agreement:

The Authority has entered into an agreement with Miller Environmental, Inc. for the services of a water filter plant manager, who is responsible for the management of all operational and maintenance activities of the water filter plant. The agreement is automatically renewable annually unless one of the parties gives written notice of their intent to terminate the agreement. Total expense under the agreement for the years ended December 31, 2011 and 2010 was \$ 183,813 and \$ 177,343, respectively.

Water reading services agreement:

The Authority has entered into an agreement with Miller Environmental, Inc. to perform water reading services in the Authority's service area. The agreement was amended in February 2012. Under the terms of the amended agreement, the Authority pays a monthly operating fee of \$ 44,957 beginning March 1, 2012 plus additional hourly charges for services performed outside the scope of the agreement. The monthly fee and hourly rates are subject to a 5% increase per year, effective March 1 of each year. The amended agreement expires February 28, 2015 and is automatically renewable for three-year terms unless one of the parties gives written notice of their intent to terminate the agreement. Total expense under the agreement for the years ended December 31, 2011 and 2010 was \$ 523,137 and \$ 498,226, respectively.

Capital improvements:

The Authority has entered into contracts for various capital improvements. Outstanding commitments on these contracts totaled approximately \$ 806,000 as of December 31, 2011.

Contingencies:

Litigation:

The Authority is a defendant in a lawsuit. While it is not feasible to determine the outcome of the matter, in the opinion of management, it would not have a material effect on the Authority's financial position.

Letter of credit:

The Authority has an unused letter of credit of \$ 800,000 at December 31, 2011.

Concentration of labor:

In July 2011, the Authority entered into a collective bargaining agreement with the employees who operate and maintain the Authority's facilities, effective through December 31, 2015. Of the Authority's total workforce, 89% is covered by the agreement.

NOTES TO FINANCIAL STATEMENTS

Note 9. Subsequent Events

The Authority has evaluated subsequent events through October 17, 2012. This date is the date the financial statements were available to be issued. The following subsequent events were noted:

Capital projects:

From January through August 2012, the Authority awarded various contracts for capital projects totaling approximately \$ 793,000.

Debt issuance:

In August 2012, the Authority issued a Water Revenue Notes, Series of 2012 in the amount of \$ 2,459,000 to currently refund the Authority's Guaranteed Water Revenue Bonds, Series of 2002, the 1997 PENNVEST Loan and to pay note issuance costs.

Swap termination:

In September 2012, the Authority terminated its interest rate swap relating to its Guaranteed Water Revenue Bonds, Series of 2003.