YORK WATER CO
Form 10-K
March 06, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
(Mark One)

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________to____________

Commission file number 001-34245
THE YORK WATER COMPANY
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	23-1242500
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
130 EAST MARKET STREET, YORK, PENNSYLVANIA	17401
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (717) 845-3601

Securities registered	None (Title of	The NASDAQ Global Select Market

pursuant to Section 12(b) of the Act:	Each Class)	(Name of Each Exchange on Which Registered)

Securities registered pursuant to Section 12(g) of the Act:	<u>COMMON STOCK, NO PAR VALUE</u> (Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES ýNO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES ýNO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
ý YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
ýYES NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer	Accelerated filer ý	Non-accelerated filer
		(Do not check if a smaller reporting company)
Small Reporting company	Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES ýNO
The aggregate market value of the Common Stock, no par value, held by nonaffiliates of the registrant on June 30, 2017 was $447,682,707.
As of March 6, 2018 there were 12,881,018 shares of Common Stock, no par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE
Portions of the Proxy Statement for the Company's 2018 Annual Meeting of Shareholders are incorporated by reference into Part I and Part III.

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FORWARD-LOOKING STATEMENTS

Certain statements contained in this annual report and in documents incorporated by reference constitute "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. Words such as "may," "should," "believe," "anticipate," "estimate," "expect," "intend," "plan" and similar expressions are intended to identify forward-looking statements. These forward-looking statements include certain information relating to the Company's business strategy; statements including, but not limited to:

- the amount and timing of rate increases and other regulatory matters including the recovery of costs recorded as regulatory assets;
- expected profitability and results of operations;
- trends;
- goals, priorities and plans for, and cost of, growth and expansion;
- strategic initiatives;
- availability of water supply;
- water usage by customers; and
- the ability to pay dividends on common stock and the rate of those dividends.

The forward-looking statements in this Annual Report reflect what the Company currently anticipates will happen. What actually happens could differ materially from what it currently anticipates will happen. The Company does not intend to make a public announcement when forward-looking statements in this Annual Report are no longer accurate, whether as a result of new information, what actually happens in the future or for any other reason. Important matters that may affect what will actually happen include, but are not limited to:

- changes in weather, including drought conditions or extended periods of heavy rainfall;
- levels of rate relief granted;
- the level of commercial and industrial business activity within the Company's service territory;
- construction of new housing within the Company's service territory and increases in population;
- changes in government policies or regulations, including the tax code;
- the ability to obtain permits for expansion projects;
- material changes in demand from customers, including the impact of conservation efforts which may impact the demand of customers for water;
- changes in economic and business conditions, including interest rates, which are less favorable than expected;
- loss of customers;
- changes in, or unanticipated, capital requirements;
- the impact of acquisitions;
- changes in accounting pronouncements;
- changes in the Company's credit rating or the market price of its common stock;
- the ability to obtain financing; and
- other matters set forth in Item 1A, "Risk Factors" of this Annual Report.

THE YORK WATER COMPANY

PART I

Item 1. Business.

The York Water Company (the "Company") is the oldest investor-owned water utility in the United States and is duly organized under the laws of the Commonwealth of Pennsylvania. The Company has operated continuously since 1816. The primary business of the Company is to impound, purify to meet or exceed safe drinking water standards and distribute water. The Company also owns and operates three wastewater collection systems and two wastewater treatment systems. The Company operates within its franchised water territory, which covers 39 municipalities within York County, Pennsylvania and nine municipalities within Adams County, Pennsylvania. The Company's wastewater operations include portions of four municipalities in York County, Pennsylvania. The Company is regulated by the Pennsylvania Public Utility Commission, or PPUC, for both water and wastewater in the areas of billing, payment procedures, dispute processing, terminations, service territory, debt and equity financing and rate setting. The Company must obtain PPUC approval before changing any practices associated with the aforementioned areas.

Water service is supplied through the Company's own distribution system. The Company obtains the bulk of its water supply from both the South Branch and East Branch of the Codorus Creek, which together have an average daily flow of 73.0 million gallons. This combined watershed area is approximately 117 square miles. The Company has two reservoirs, Lake Williams and Lake Redman, which together hold up to approximately 2.2 billion gallons of water. The Company supplements its reservoirs with a 15-mile pipeline from the Susquehanna River to Lake Redman which provides access to an additional supply of 12.0 million gallons of untreated water per day. The Company also owns seven wells which are capable of providing a safe yield of approximately 366,000 gallons per day to supply water to its customers in Carroll Valley Borough and Cumberland Township, Adams County. As of December 31, 2017, the Company's average daily availability was 35.4 million gallons, and average daily consumption was approximately 18.4 million gallons. The Company's service territory had an estimated population of 198,000 as of December 31, 2017. Industry within the Company's service territory is diversified, manufacturing such items as fixtures and furniture, electrical machinery, food products, paper, ordnance units, textile products, air conditioning systems, laundry detergent, barbells and motorcycles.

The Company's water business is somewhat dependent on weather conditions, particularly the amount and timing of rainfall. Revenues are particularly vulnerable to weather conditions in the summer months. Prolonged periods of hot and dry weather generally cause increased water usage for watering lawns, washing cars, and keeping golf courses and sports fields irrigated. Conversely, prolonged periods of dry weather could lead to drought restrictions from governmental authorities. Despite the Company's adequate water supply, customers may be required to cut back water usage under such drought restrictions which would negatively impact revenues. The Company has addressed some of this vulnerability by instituting minimum customer charges which are intended to cover fixed costs of operations under all likely weather conditions.

The Company's business does not require large amounts of working capital and is not dependent on any single customer or a very few customers for a material portion of its business. Increases in revenues are generally dependent on the Company's ability to obtain rate increases from the PPUC in a timely manner and in adequate amounts and to increase volumes of water sold through increased consumption and increases in the number of customers served. The Company continuously looks for water and wastewater acquisition and expansion opportunities both within and outside its current service territory as well as additional opportunities to enter into bulk water contracts with municipalities and other entities to supply water.

The Company has agreements with several municipalities to provide sewer billing and collection services. The Company also has a service line protection program on a targeted basis in order to further diversify its business. Under this optional program, customers pay a fixed monthly fee, and the Company will repair or replace damaged customer service lines, as needed, subject to an annual maximum dollar amount. The Company continues to review and consider opportunities to expand both initiatives.

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Competition

As a regulated utility, the Company operates within an exclusive franchised territory that is substantially free from direct competition with other public utilities, municipalities and other entities. Although the Company has been granted an exclusive franchise for each of its existing community water and wastewater systems, the ability of the Company to expand or acquire new service territories may be affected by currently unknown competitors obtaining franchises to surrounding systems by application or acquisition. These competitors may include other investor-owned utilities, nearby municipally-owned utilities and sometimes competition from strategic or financial purchasers seeking to enter or expand in the water and wastewater industry. The addition of new service territory and the acquisition of other utilities are generally subject to review and approval by the PPUC.

Water and Wastewater Quality and Environmental Regulations

Provisions of water and wastewater service are subject to regulation under the federal Safe Drinking Water Act, the Clean Water Act and related state laws, and under federal and state regulations issued under these laws. In addition, the Company is subject to federal and state laws and other regulations relating to solid waste disposal, dam safety and other aspects of its operations.

The federal Safe Drinking Water Act establishes criteria and procedures for the U.S. Environmental Protection Agency, or EPA, to develop national quality standards. Regulations issued under the Act, and its amendments, set standards on the amount of certain contaminants allowable in drinking water. Current requirements are not expected to have a material impact on the Company's operations or financial condition as it already meets or exceeds standards. In the future, the Company may be required to change its method of treating drinking water, and may incur additional capital investments if new regulations become effective.

Under the requirements of the Pennsylvania Safe Drinking Water Act, or SDWA, the Pennsylvania Department of Environmental Protection, or DEP, monitors the quality of the finished water supplied to customers. The DEP requires the Company to submit weekly reports showing the results of daily bacteriological and other chemical and physical analyses. As part of this requirement, the Company conducts over 70,000 laboratory tests annually. Management believes that the Company complies with the standards established by the agency under the SDWA. The DEP assists the Company by regulating discharges into the Company's watershed area to prevent and eliminate pollution.

The federal Groundwater Rule establishes rules for community water supplies serving between 100 and 500 customers. This rule requires additional testing of water from well sources, and under certain circumstances requires demonstration and maintenance of effective disinfection. The Company holds public water supply permits issued by the DEP, which establishes the groundwater source operating conditions for its wells, including demonstrated 4-log treatment of viruses. All of the satellite systems operated by the Company are in compliance with the federal Groundwater Rule.

The Clean Water Act regulates discharges from water and wastewater treatment facilities into lakes, rivers, streams and groundwater. The Company complies with this Act by obtaining and maintaining all required permits and approvals for discharges from its water and wastewater facilities and by satisfying all conditions and regulatory requirements associated with the permits.

The DEP monitors the quality of wastewater discharge effluent under the provisions of the National Pollutant Discharge Elimination System, or NPDES. The Company submits monthly reports to the DEP showing the results of its daily effluent monitoring and removal of sludge and biosolids. The Company is not aware of any significant environmental remediation costs necessary from the handling and disposal of waste material from its wastewater operations.

Lead and copper may enter drinking water primarily through plumbing materials. The Company is required to comply with the Lead and Copper Rule established by the EPA and administered by the DEP. The Company must monitor drinking water at customer taps for compliance with this rule. If lead concentrations exceed an action level, the Company must undertake a number of additional actions to control corrosion, inform the public about steps they should take to protect their health and may be required to replace lead service lines under its control. See "Management's Discussion and Analysis – Environmental Matters" for a discussion of the Company's most recently completed testing.

The DEP and the Susquehanna River Basin Commission, or SRBC, regulate the amount of water withdrawn from streams in the watershed to assure that sufficient quantities are available to meet the needs of the Company and other regulated users. Through its Division of Dam Safety, the DEP regulates the operation and maintenance of the Company's impounding dams. The Company routinely inspects its dams and prepares annual reports of their condition as required by DEP regulations. The DEP reviews these reports and inspects the Company's dams. The DEP most recently inspected the Company's dams in 2017 and noted no significant violations.

Since 1980, the DEP has required any new dam to have a spillway that is capable of passing the design flood without overtopping the dam. The design flood is either the Probable Maximum Flood, or PMF, or some fraction of it, depending on the size and location of the dam. PMF is very conservative and is calculated using the most severe combination of meteorological and hydrologic conditions reasonably possible in the watershed area of a dam.

The Company engaged a professional engineer to analyze the spillway capacities at the Lake Williams and Lake Redman dams and validate the DEP's recommended flood design for the dams. Management presented the results of the study to the DEP in December 2004, and DEP then requested that the Company submit a proposed schedule for the actions to address the spillway capacities. Thereafter, the Company retained an engineering firm to prepare preliminary designs for increasing the spillway capacities to pass the PMF through armoring the dams with roller compacted concrete. Management has met with the DEP on a regular basis to review the preliminary design and discuss scheduling, permitting, and construction requirements. The Company is currently completing preliminary work on the dams as well as the final design and the permitting process. The Company expects to finalize its plans in 2018 and begin armoring one of the dams in 2019. The second dam is expected to be armored in a year or two following the first dam armoring. The cost to armor each dam is expected to be approximately $5.5 million.

Capital expenditures and operating costs required as a result of water quality standards and environmental requirements have been traditionally recognized by state public utility commissions as appropriate for inclusion in establishing rates. The capital expenditures currently required as a result of water quality standards and environmental requirements have been budgeted in the Company's capital program and represent less than 10% of its expected total capital expenditures over the next five years. The Company is currently in compliance with wastewater environmental standards and does not anticipate any major capital expenditures for its current wastewater business.

Growth

During the five year period ended December 31, 2017, the Company continued to grow the number of customers and its distribution facilities.

The following table sets forth certain of the Company's summary statistical information.

(In thousands of dollars)	For the Years Ended December 31,				
	2017	2016	2015	2014	2013
Revenues:					
Residential	$31,184	$30,142	$29,682	$29,079	$26,796
Commercial and industrial	13,729	13,760	13,822	13,267	12,299
Other	3,676	3,682	3,585	3,554	3,288
Total	$48,589	$47,584	$47,089	$45,900	$42,383
Average daily water consumption (gallons per day)	18,378,000	18,798,000	18,507,000	18,327,000	19,094,000
Miles of water mains at year-end	973	967	958	951	945
Miles of wastewater mains at year-end	19	8	8	8	3
Additional water distribution mains installed/acquired (ft.)	31,709	46,368	40,873	28,523	28,051
Wastewater collection mains acquired (ft.)	57,386	-	-	28,250	-
Number of customers at year-end	69,604	67,052	66,087	65,102	64,118
Population served at year-end	198,000	196,000	194,000	192,000	190,000

Executive Officers of the Registrant

The Company presently has 102 full time employees including the officers detailed in the information set forth under the caption "Executive Officers of the Company" of the 2018 Proxy Statement incorporated herein by reference.

Available Information

The Company makes available free of charge, on or through its website (www.yorkwater.com), its annual report on Form 10-K, its quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC.

Shareholders may request, without charge, copies of the Company's financial reports. Such requests, as well as other investor relations inquiries, should be addressed to:

Molly E. Norton	The York Water Company	(717) 718-2942
Investor Relations &	130 East Market Street	(800) 750-5561
Communications Administrator	York, PA 17401	mollyn@yorkwater.com

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Item 1A. Risk Factors.

The rates we charge our customers are subject to regulation. If we are unable to obtain government approval of our requests for rate increases, or if approved rate increases are untimely or inadequate to cover our investments in utility plant and equipment and projected expenses, our results of operations may be adversely affected.

Our ability to maintain and meet our financial objectives is dependent upon the rates we charge our customers, which are subject to approval by the PPUC. We file rate increase requests with the PPUC, from time to time, to recover our investments in utility plant and equipment and projected expenses. Any rate increase or adjustment must first be justified through documented evidence and testimony. The PPUC determines whether the investments and expenses are recoverable, the length of time over which such costs are recoverable, or, because of changes in circumstances, whether a remaining balance of deferred investments and expenses is no longer recoverable in rates charged to customers. Once a rate increase application is filed with the PPUC, the ensuing administrative and hearing process may be lengthy and costly. The timing of our rate increase requests are therefore dependent upon the estimated cost of the administrative process in relation to the investments and expenses that we hope to recover through the rate increase. In addition, the amount or frequency of rate increases may be decreased or lengthened as a result of changes in income tax laws regarding tax-basis depreciation as it applies to our capital expenditures or qualifying repair tax deductible expenditures, and by the interpretation of the Tax Cuts and Jobs Act of 2017 by the PPUC.

We can provide no assurances that future requests will be approved by the PPUC; and, if approved, we cannot guarantee that these rate increases will be granted in a timely or sufficient manner to cover the investments and expenses for which we sought the rate increase. If we are unable to obtain PPUC approval of our requests for rate increases, or if approved rate increases are untimely or inadequate to cover our investments in utility plant and equipment and projected expenses, our results of operations may be adversely affected.

We are subject to federal, state and local regulation that may impose costly limitations and restrictions on the way we do business.

Various federal, state and local authorities regulate many aspects of our business. Among the most important of these regulations are those relating to the quality of water we supply our customers, water allocation rights and the quality of the effluent we discharge from our wastewater treatment facility. Government authorities continually review these regulations, particularly the drinking water quality regulations, and may propose new or more restrictive requirements in the future. We are required to perform water and wastewater quality tests that are monitored by the PPUC, the EPA, and the DEP, for the detection of certain chemicals and compounds in our water and effluent. If new or more restrictive limitations on permissible levels of substances and contaminants in our water and wastewater are imposed, we may not be able to adequately predict the costs necessary to meet regulatory standards. If we are unable to recover the cost of implementing new water and wastewater treatment procedures in response to more restrictive quality regulations through our rates that we charge our customers, or if we fail to comply with such regulations, it could have a material adverse effect on our financial condition and results of operations.

We are also subject to water allocation regulations that control the amount of water that we can draw from water sources. The SRBC and the DEP regulate the amount of water withdrawn from streams in the watershed for water supply purposes to assure that sufficient quantities are available to meet our needs and the needs of other regulated users. In addition, government drought restrictions could cause the SRBC or the DEP to temporarily reduce the amount of our allocations. If new or more restrictive water allocation regulations are implemented or our allocations are reduced due to weather conditions, it may have an adverse effect on our ability to supply the demands of our customers, and in turn, on our revenues and results of operations.

Our business is subject to seasonal fluctuations, which could affect demand for our water service and our revenues.

Demand for our water during the warmer months is generally greater than during cooler months due primarily to additional requirements for water in connection with cooling systems, swimming pools, irrigation systems and other outside water use. Throughout the year, and particularly during typically warmer months, demand will vary with temperature and rainfall levels. If temperatures during the typically warmer months are cooler than expected, or there is more rainfall than expected, the demand for our water may decrease and adversely affect our revenues.

Weather conditions and overuse may interfere with our sources of water, demand for water services, and our ability to supply water to our customers.

We depend on an adequate water supply to meet the present and future demands of our customers and to continue our expansion efforts. Unexpected conditions may interfere with our water supply sources. Drought and overuse may limit the availability of surface and ground water. These factors might adversely affect our ability to supply water in sufficient quantities to our customers and our revenues and earnings may be adversely affected. Additionally, cool and wet weather, as well as drought restrictions and our customers' conservation efforts, may reduce consumption demands, also adversely affecting our revenue and earnings. Furthermore, freezing weather may also contribute to water transmission interruptions caused by pipe and main breakage. If we experience an interruption in our water supply, it could have a material adverse effect on our financial condition and results of operations.

Some scientific experts are predicting a worsening of weather volatility in the future, possibly created by the climate change greenhouse gases. Changing severe weather patterns could require additional expenditures to reduce the risk associated with any increasing storm, flood and drought occurrences.

The issue of climate change continues to receive attention worldwide. Many climate change predictions, if true, present several potential challenges to water and wastewater utilities, such as increased frequency and duration of droughts, increased precipitation and flooding, potential degradation of water quality, and the resulting changes in demand for services. The changes may result in lower revenue, the need for additional capital expenditures, or increased costs. Because of the uncertainty of weather volatility related to climate change, we cannot predict its potential impact on our business, financial condition, or results of operations. Although any potential expenditures and costs may be recovered in the form of higher rates, there can be no assurance that the PPUC would approve rate increases to enable us to recover such expenditures and costs. We cannot assure you that our costs of complying with any climate change related measures will not harm our business, financial condition, or results of operations.

General economic conditions may affect our financial condition and results of operations.

A general economic downturn may lead to a number of impacts on our business that may affect our financial condition and results of operations. Such impacts may include: a reduction in discretionary and recreational water use by our residential water customers, particularly during the summer months when such discretionary usage is normally at its highest; a decline in usage by industrial and commercial customers as a result of decreased business activity; an increased incidence of customers' inability to pay or delays in paying their utility bills, or an increase in customer bankruptcies, which may lead to higher bad debt expense and reduced cash flow; a lower customer growth rate due to a decline in new housing starts; and a decline in the number of active customers due to housing vacancies or abandonments. A deterioration in general economic conditions may also lead to an investment market downturn, which may result in our pension plans' asset market values suffering a decline and significant volatility. A decline in our pension plans' asset market values could increase our required cash contributions to these plans and pension expense in subsequent years.

The current concentration of our business in central and southern Pennsylvania makes us particularly susceptible to adverse developments in local economic and demographic conditions.

Our service territory presently includes 39 municipalities within York County, Pennsylvania and nine municipalities within Adams County, Pennsylvania. Our revenues and operating results are therefore especially subject to local economic and demographic conditions in the area. A change in any of these conditions could make it more costly or difficult for us to conduct our business. In addition, any such change would have a disproportionate effect on us, compared to water and wastewater utility companies that do not have such a geographic concentration.

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Contamination of our water supply may cause disruption in our services and adversely affect our revenues.

Our water supply is subject to contamination from the migration of naturally-occurring substances in groundwater and surface systems and pollution resulting from man-made sources. In the event that our water supply is contaminated, we may have to interrupt the use of that water supply until we are able to substitute the flow of water from an uncontaminated water source through our interconnected transmission and distribution facilities. In addition, we may incur significant costs in order to treat the contaminated source through expansion of our current treatment facilities or development of new treatment methods. Our inability to substitute water supply from an uncontaminated water source, or to adequately treat the contaminated water source in a cost-effective manner, may have an adverse effect on our revenues.

If our sources of water or water at customer sites become contaminated, it could subject us to reduction in usage, regulatory actions, damage to our reputation and private litigation.

As described in "Management's Discussion and Analysis – Environmental Matters", during our triennial testing, completed in 2016, we determined that we exceeded the action level for lead in rules issued by the EPA. The Company is operating under a consent order agreement with the DEP to address the test results, including replacing all known company-owned lead service lines in the next three years. While we believe that our response has been appropriate, we may incur significant costs in responding to this incident and may not be able to recover such costs through rates or from insurers.

Our primary business is to impound, purify to meet or exceed safe drinking water standards and distribute water. Contamination of the water provided to our customers exposes us to risks, including regulatory or government action, customer exposure to contamination or hazardous substances in the water, and resulting private claims and litigation. Negative impacts to our reputation may occur even if we are not responsible for any contamination or its consequences. Pending or future claims against us and reputational damage could have a material adverse impact on our business, financial condition, and results of operations.

The necessity for increased security has and may continue to result in increased operating costs.

We have taken steps to increase security measures at our facilities and heighten employee awareness of threats to our water supply. We have also tightened our security measures regarding the delivery and handling of certain chemicals used in our business. We have and will continue to bear increased costs for security precautions to protect our facilities, operations and supplies. We are not aware of any specific threats to our facilities, operations or supplies. However, it is possible that we would not be in a position to control the outcome of such events should they occur.

The growing dependence on digital technology has increased the risks related to cybersecurity.

Computers and the Internet have led to increased productivity and improved customer service. Unfortunately, progress in this area has brought with it cybersecurity risks. Recently, the frequency and severity of cyber-attacks on companies has increased resulting in a disruption to business operations and the corruption or misappropriation of proprietary data. We have and will continue to bear increased costs for security precautions to protect our information technology. However, if such an attack was to occur and could not be prevented, customer information could be misappropriated, our networks may be down for an extended period of time disrupting our business, and it could require costly replacement of hardware and software. We carry cyber liability insurance, however, our limits may not be sufficient to cover all losses or liabilities.

We depend on the availability of capital for expansion, construction and maintenance.

Our ability to continue our expansion efforts and fund our construction and maintenance program depends on the availability of adequate capital. There is no guarantee that we will be able to obtain sufficient capital in the future or that the cost of capital will not be too high for future expansion and construction. In addition, approval from the PPUC must be obtained prior to our sale and issuance of securities. If we are unable to obtain approval from the PPUC on these matters, or to obtain approval in a timely manner, it may affect our ability to effect transactions that are beneficial to us or our shareholders. A single transaction may itself not be profitable but might still be necessary to continue providing service or to grow the business.

The failure to maintain our existing credit rating could affect our cost of funds and related liquidity.

Standard & Poor's Ratings Services rates our outstanding debt and has given a credit rating to us. Their evaluations are based on a number of factors, which include financial strength as well as transparency with rating agencies and timeliness of financial reporting. Failure to maintain our current credit rating could adversely affect our cost of funds and related liquidity.

We may face competition from other water suppliers or wastewater service providers that may hinder our growth and reduce our profitability.

We face competition from other water suppliers for acquisitions, which may limit our growth opportunities. Furthermore, even after we have been the successful bidder in an acquisition, competing water suppliers or wastewater service providers may challenge our application for extending our franchise territory to cover the target company's market. Finally, third parties either supplying water on a contract basis to municipalities or entering into agreements to operate municipal water or wastewater systems might adversely affect our business by winning contracts that may be beneficial to us. If we are unable to compete successfully with other water suppliers and wastewater service providers for these acquisitions, franchise territories and contracts, it may impede our expansion goals and adversely affect our profitability.

An important element of our growth strategy is the acquisition of water and wastewater systems. Any pending or future acquisitions we decide to undertake will involve risks.

The acquisition and integration of water and wastewater systems is an important element in our growth strategy. This strategy depends on identifying suitable acquisition opportunities and reaching mutually agreeable terms with acquisition candidates. The negotiation of potential acquisitions as well as the integration of acquired businesses could require us to incur significant costs. Further, acquisitions may result in dilution for the owners of our common stock, our incurrence of debt and contingent liabilities and fluctuations in quarterly results. In addition, the businesses and other assets we acquire may not achieve the financial results that we expect, which could adversely affect our profitability.

We have restrictions on our dividends. There can also be no assurance that we will continue to pay dividends in the future or, if dividends are paid, that they will be in amounts similar to past dividends.

The terms of our debt instruments impose conditions on our ability to pay dividends. We have paid dividends on our common stock each year since our inception in 1816 and have increased the amount of dividends paid each year since 1997. Our earnings, financial condition, capital requirements, applicable regulations and other factors, including the timeliness and adequacy of rate increases, will determine both our ability to pay dividends on our common stock and the amount of those dividends. There can be no assurance that we will continue to pay dividends in the future or, if dividends are paid, that they will be in amounts similar to past dividends.

If we are unable to pay the principal and interest on our indebtedness as it comes due or we default under certain other provisions of our loan documents, our indebtedness could be accelerated and our results of operations and financial condition could be adversely affected.

Our ability to pay the principal and interest on our indebtedness as it comes due will depend upon our current and future performance. Our performance is affected by many factors, some of which are beyond our control. We believe that our cash generated from operations, and, if necessary, borrowings under our existing credit facilities will be sufficient to enable us to make our debt payments as they become due. If, however, we do not generate sufficient cash, we may be required to refinance our obligations or sell additional equity, which may be on terms that are not as favorable to us. No assurance can be given that any refinancing or sale of equity will be possible when needed or that we will be able to negotiate acceptable terms. In addition, our failure to comply with certain provisions contained in our trust indentures and loan agreements relating to our outstanding indebtedness could lead to a default under these documents, which could result in an acceleration of our indebtedness.

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We depend significantly on the services of the members of our senior management team, and the departure of any of those persons could cause our operating results to suffer.

Our success depends significantly on the continued individual and collective contributions of our senior management team. If we lose the services of any member of our senior management or are unable to hire and retain experienced management personnel, our operating results could suffer.

Work stoppages and other labor relations matters could adversely affect our operating results.

Approximately one-third of our workforce is unionized under a contract with a labor union. In light of rising costs for healthcare and retirement benefits, contract negotiations in the future may be difficult. We are subject to a risk of work stoppages and other labor actions as we negotiate with the union to address these issues, which could affect our business, financial condition, and results of operations. Although we believe we have a good relationship with our union workforce and have a strike contingency plan, we cannot be assured that issues with our labor force will be resolved favorably to us in the future or that we will not experience work stoppages.

There is a limited trading market for our common stock; you may not be able to resell your shares at or above the price you pay for them.

Although our common stock is listed for trading on the NASDAQ Global Select Market, the trading in our common stock has substantially less liquidity than many other companies quoted on the NASDAQ Global Select Market. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the market of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Because of the limited volume of trading in our common stock, a sale of a significant number of shares of our common stock in the open market could cause our stock price to decline.

The failure of, or the requirement to repair, upgrade or dismantle, either of our dams may adversely affect our financial condition and results of operations.

Our water system includes two impounding dams. While we maintain active and robust dam maintenance and inspection programs, a failure of the dams could result in injuries and damage to residential and/or commercial property downstream for which we may be responsible, in whole or in part. The failure of a dam could also adversely affect our ability to supply water in sufficient quantities to our customers and could adversely affect our financial condition and results of operations. We carry liability insurance on our dams, however, our limits may not be sufficient to cover all losses or liabilities incurred due to the failure of one of our dams. The estimated costs to maintain and upgrade our dams are included in our capital budget. Although such costs have previously been recoverable in rates, there is no guarantee that these costs will continue to be recoverable and in what magnitude they will be recoverable.

Wastewater operations entail significant risks and may impose significant costs.

Wastewater collection and treatment and septage pumping and sludge hauling involve various unique risks. If collection or treatment systems fail or do not operate properly, or if there is a spill, untreated or partially treated wastewater could discharge onto property or into nearby streams and rivers, causing various damages and injuries, including environmental damage. These risks are most acute during periods of substantial rainfall or flooding, which are the main causes of sewer overflow and system failure. Liabilities resulting from such damages and injuries could materially and adversely affect our business, financial condition, and results of operations.

The final determination of our income tax liability may be materially different from our income tax provision.

Significant judgment is required in determining our provision for income taxes. The calculation of the provision for income taxes is subject to our interpretation of applicable business tax laws in the federal and state jurisdictions in which we file. In addition, our income tax returns are subject to periodic examination by the Internal Revenue Service, or IRS, and other taxing authorities.

In December 2014, we changed our tax method of accounting to permit the expensing of qualifying asset improvement costs that were previously being capitalized and depreciated for tax purposes. Our determination of what qualifies as a capital cost versus a repair expense tax deduction is subject to subsequent adjustment and may impact the income tax benefits that have been recognized. Although we believe our income tax estimates are appropriate, there is no assurance that the final determination of our income tax liability will not be materially different, either higher or lower, from what is reflected in our income tax provision. In the event we are assessed additional income taxes, our business, financial condition, and results of operations could be adversely affected.

In December 2017, the Tax Cuts and Jobs Act of 2017, or 2017 Tax Act, was signed into law. The 2017 Tax Act significantly changes how corporations are taxed. Significant judgments are required to be made in interpreting the provisions of the 2017 Tax Act and estimates may be required to comply with the provisions of the 2017 Tax Act. The U.S. Treasury Department, the IRS, and other standard-setting bodies could interpret or issue guidance on how provisions of the 2017 Tax Act will be applied or otherwise administered that is different from our interpretation. As additional regulatory guidance is issued by the applicable taxing authorities, as accounting treatment is clarified, as we perform additional analysis on the application of the law, and as we refine estimates in calculating the effect, our final analysis, which will be recorded in the period completed, may be different from our current provisional amounts, which could materially affect our tax obligations and effective tax rate.

We are subject to market and interest rate risk on our $12,000,000 variable interest rate debt issue.

We are subject to interest rate risk in conjunction with our $12,000,000 variable interest rate debt issue. This exposure, however, has been hedged with an interest rate swap. This hedge will protect the Company from the risk of changes in the benchmark interest rates, but does not protect the Company's exposure to the changes in the difference between its own variable funding rate and the benchmark rate. A breakdown of the historical relationships between the cost of funds of the Company and the benchmark rate underlying the interest rate swap could result in higher interest rates adversely affecting our financial results.

The holders of the $12,000,000 variable rate Pennsylvania Economic Development Financing Authority (PEDFA) Series A Bonds may tender their bonds at any time. When the bonds are tendered, they are subject to an annual remarketing agreement, pursuant to which a remarketing agent attempts to remarket the tendered bonds pursuant to the terms of the Indenture. In order to keep variable interest rates down and to enhance the marketability of the Series A Bonds, the Company entered into a Reimbursement, Credit and Security Agreement with PNC Bank, National Association ("the Bank") dated as of May 1, 2008. This agreement provides for a direct pay letter of credit issued by the Bank to the trustee for the Series A Bonds. The letter of credit expires June 30, 2019 and is reviewed annually for a potential extension of the expiration date. The Bank is responsible for providing the trustee with funds for the timely payment of the principal and interest on the Series A Bonds and for the purchase price of the Series A Bonds that have been tendered or deemed tendered for purchase and have not been remarketed. If the Bank is unable to meet its obligations, the Company would be required to buy any bonds which had been tendered.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Source of Water Supply

The Company owns two impounding dams located in York and Springfield Townships adjoining the Borough of Jacobus to the south. The lower dam, the Lake Williams Impounding Dam, creates a reservoir covering approximately 165 acres containing about 870 million gallons of water. The upper dam, the Lake Redman Impounding Dam, creates a reservoir covering approximately 290 acres containing about 1.3 billion gallons of water.

In addition to the two impounding dams, the Company owns a 15-mile pipeline from the Susquehanna River to Lake Redman that provides access to a supply of an additional 12.0 million gallons of water per day.

The Company also owns three satellite water systems in Adams County, Pennsylvania. The Carroll Valley Water System consists of two groundwater wells capable of providing a safe yield of approximately 100,000 gallons per day with a current average daily consumption of 16,000 gallons per day. The Western Cumberland Water System consists of three groundwater wells capable of providing a safe yield of 144,000 gallons per day with a current average daily consumption of 19,000 gallons per day. The Eastern Cumberland Water System (formerly The Meadows) consists of two groundwater wells capable of providing a safe yield of 122,000 gallons per day with a current average daily consumption of 28,000 gallons per day.

As of December 31, 2017, the Company's present average daily availability was 35.4 million gallons, and daily consumption was approximately 18.4 million gallons.

Pumping Stations

The Company's main pumping station is located in Spring Garden Township on the south branch of the Codorus Creek about four miles downstream from the Company's lower impounding dam. The pumping station presently houses pumping equipment consisting of three electrically driven centrifugal pumps and two diesel-engine driven centrifugal pumps with a combined pumping capacity of 68.0 million gallons per day. The pumping capacity is more than double peak requirements and is designed to provide an ample safety margin in the event of pump or power failure. A large diesel backup generator is installed to provide power to the pumps in the event of an emergency. The untreated water is pumped approximately two miles to the filtration plant through pipes owned by the Company.

The Susquehanna River Pumping Station is located on the western shore of the Susquehanna River several miles south of Wrightsville, PA. The pumping station is equipped with three Floway Vertical Turbine pumps rated at 6 million gallons per day each. The pumping station pumps water from the Susquehanna River approximately 15 miles through a combination of 30 inch and 36 inch ductile iron main to the Company's upper impounding dam, located at Lake Redman.

In 2018, the new Lake Redman Pumping Station, located in York Township adjacent to Lake Redman, was put into service. The pumping station is designed to provide a redundant source with the capacity to pump 20 million gallons per day of untreated water through a company-owned 36 inch force main approximately 3.5 miles to the filtration plant, meeting the Company's daily consumption needs.

Treatment Facilities

The Company's water filtration plant is located in Spring Garden Township about one-half mile south of the City of York. Water at this plant is filtered through twelve dual media filters having a rated capacity of 39.0 million gallons per day, or MGD, with a maximum supply of 42.0 MGD for short periods if necessary. Based on an average daily consumption in 2017 of approximately 18.4 million gallons, the Company believes the pumping and filtering facilities are adequate to meet present and anticipated demands.

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The Company's sediment recycling facility is located adjacent to its water filtration plant. This state of the art facility employs cutting edge technology to remove fine, suspended solids from untreated water. The Company estimates that through this energy-efficient, environmentally friendly process, approximately 600 tons of sediment will be removed annually, thereby improving the quality of the Codorus Creek watershed.

The Company's two wastewater treatment facilities are located in East Manchester and Lower Windsor Townships. The two wastewater treatment plants are each small, packaged, extended aeration activated sludge facilities with a combined average daily flow capacity of 167,000 gallons. With a projected maximum daily demand of 77,000 gallons, the plants' flow paths offer both capacity and operational redundancy for maintenance, high flow events, and potential growth.

Distribution and Collection

The distribution system of the Company has approximately 973 miles of water main lines which range in diameter from 2 inches to 36 inches. The distribution system includes 31 booster stations and 33 standpipes and reservoirs capable of storing approximately 58.0 million gallons of potable water. All booster stations are equipped with at least two pumps for protection in case of mechanical failure. Following a deliberate study of customer demand and pumping capacity, the Company installed standby generators at all critical booster stations to provide an alternate energy source or emergency power in the event of an electric utility interruption.

The three wastewater collection systems of the Company have a combined approximate 95,000 feet of 6 inch and 8 inch gravity collection mains and 5,000 feet of 6 inch pressure force main along with three sewage pumping stations each rated at 80 gallons per minute.

Other Properties

The Company's distribution center and material and supplies warehouse are located in Springettsbury Township, and are composed of three one-story concrete block buildings aggregating 30,680 square feet.

The administrative and executive offices of the Company are located in one three-story and one two-story brick and masonry buildings, containing a total of approximately 21,861 square feet, in the City of York, Pennsylvania.

All of the Company's properties described above are held in fee by the Company. There are no material encumbrances on such properties.

In 1976, the Company entered into a Joint Use and Park Management Agreement with York County under which the Company licensed use of certain of its lands and waters for public park purposes for a period of 50 years. Under the agreement, York County has agreed not to erect a dam upstream on the East Branch of the Codorus Creek or otherwise obstruct the flow of the creek.

Item 3. Legal Proceedings.

There are no material legal proceedings involving the Company.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market for Common Stock and Dividends

The common stock of The York Water Company is traded on the NASDAQ Global Select Market (Symbol "YORW"). Quarterly price ranges and cash dividends per share for the last two years follow:

	2017			2016		
	High	Low	Dividend*	High	Low	Dividend*
1st Quarter	$39.00	$33.10	$ 0.1602	$30.99	$23.79	$ 0.1555
2nd Quarter	39.86	31.70	0.1602	33.40	26.54	0.1555
3rd Quarter	36.77	31.90	0.1602	32.24	27.68	0.1555
4th Quarter	39.00	33.25	0.1666	39.85	28.61	0.1602

*Cash dividends per share reflect dividends declared at each dividend date.

Prices listed in the above table are sales prices as listed on the NASDAQ Global Select Market. Shareholders of record (excluding individual participants in securities positions listings) as of December 31, 2017 numbered approximately 2,011.

Dividend Policy

Dividends on the Company's common stock are declared by the Board of Directors and are normally paid in January, April, July and October. Dividends are paid based on shares outstanding as of the stated record date, which is ordinarily the last day of the calendar month immediately preceding the dividend payment.

The dividend paid on the Company's common stock on January 16, 2018 was the 588th consecutive dividend paid by the Company. The Company has paid consecutive dividends for its entire history, since 1816. The policy of the Company's Board of Directors is currently to pay cash dividends on a quarterly basis. The dividend rate has been increased annually for twenty-one consecutive years. The Company's Board of Directors declared dividend number 589 in the amount of $0.1666 per share at its January 2018 meeting. The dividend is payable on April 16, 2018 to shareholders of record as of February 28, 2018. Future cash dividends will be dependent upon the Company's earnings, financial condition, capital demands and other factors and will be determined by the Company's Board of Directors. See Note 4 to the Company's financial statements included herein for restrictions on dividend payments.

Purchases of Equity Securities by the Company

The Company did not repurchase any of its securities during the fourth quarter of 2017.

Performance Graph

The following line graph presents the annual and cumulative total shareholder return for The York Water Company Common Stock over a five-year period from 2012 through 2017, based on the market price of the Common Stock and assuming reinvestment of dividends, compared with the cumulative total shareholder return of companies in the S&P 500 Index and a peer group made up of publicly traded water utilities, also assuming reinvestment of dividends. The peer group companies include: American States, American Water, Aqua America, Artesian Resources, California Water Service, Connecticut Water, Middlesex Water and San Jose Water.

	2012	2013	2014	2015	2016	2017
The York Water Company	100.00	122.52	139.56	153.90	240.54	217.44
S&P 500 Index - Total Returns	100.00	132.39	150.51	152.59	170.84	208.14
Peer Group	100.00	118.03	144.80	163.55	199.92	256.47

Item 6. Selected Financial Data.

(All dollar amounts are stated in thousands of dollars.)

	Summary of Operations				
For the Year	2017	2016	2015	2014	2013
Operating revenues	$48,589	$47,584	$47,089	$45,900	$42,383
Operating expenses	26,116	24,696	24,428	23,823	21,622
Operating income	22,473	22,888	22,661	22,077	20,761
Interest expense	4,484	5,037	4,976	4,996	5,267
Gain on sale of land	-	36	-	316	-
Other income (expenses), net	(472)	(632)	(456)	(1,036)	(28)
Income before income taxes	17,517	17,255	17,229	16,361	15,466
Income taxes	4,543	5,409	4,740	4,877	5,812
Net income	$12,974	$11,846	$12,489	$11,484	$9,654
Per Share of Common Stock					
Book value	$9.28	$8.87	$8.51	$8.15	$7.98
Earnings per share:					
Basic	1.01	0.92	0.97	0.89	0.75
Diluted	1.01	0.92	0.97	0.89	0.75
Weighted average number of shares outstanding during the year:					
Basic	12,849,123	12,845,955	12,831,687	12,879,912	12,928,040
Diluted	12,849,171	12,845,973	12,831,687	12,879,912	12,928,040
Cash dividends declared per share	0.6472	0.6267	0.6040	0.5788	0.5580
Utility Plant					
Original cost, net of acquisition adjustments	$362,533	$339,745	$325,691	$313,003	$298,670
Construction expenditures	24,602	13,158	13,844	14,139	9,852
Other					
Total assets	$332,030	$320,494	$310,533	$300,708	$280,123
Long-term debt including current portion	90,142	84,653	84,562	82,312	82,741

For Management's Discussion and Analysis of Financial Condition and Results of Operations, please refer to Item 7 of this Annual Report.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(All dollar amounts are stated in thousands of dollars.)

Overview

The York Water Company (the "Company") is the oldest investor-owned water utility in the United States, operated continuously since 1816. The Company also operates three wastewater collection systems and two wastewater treatment systems. The Company is a purely regulated water and wastewater utility. Profitability is largely dependent on water revenues. Due to the size of the Company and the limited geographic diversity of its service territory, weather conditions, particularly rainfall, economic, and market conditions can have an adverse effect on revenues. Market conditions and the economy in general have been improving, albeit slowly. While there was little organic growth in the customer base, the Company increased revenues in 2017 compared to 2016 as a result of the distribution system improvement charge, or DSIC, and the West York Borough wastewater acquisition.

The Company's business does not require large amounts of working capital and is not dependent on any single customer or a very few customers for a material portion of its business. In 2017, operating revenue was derived from the following sources and in the following percentages: residential, 64%; commercial and industrial, 28%; and other, 8% which is primarily from the provision for fire service, but includes other water and wastewater service-related income. The diverse customer mix helps to reduce volatility in consumption.

The Company seeks to grow revenues by increasing the volume of water sold through increases in the number of customers served, making timely and prudent investments in infrastructure replacements, expansion and improvements, and timely filing for rate increases. The Company continuously looks for acquisition and expansion opportunities both within and outside its current service territory as well as through contractual services and bulk water supply. The Company's wastewater business provides additional opportunities to expand.

The Company has entered into agreements with several municipalities to provide sewer billing and collection services. The Company also has a service line protection program on a targeted basis. The Company continues to review and consider opportunities to expand both initiatives to further diversify the business.

In addition to increasing revenue, the Company consistently focuses on minimizing costs without sacrificing water quality or customer service. Paperless billing, expanding online services, negotiation of favorable electric, banking and other costs, as well as taking advantage of the 2017 Tax Act and the IRS tangible property regulations are examples of the Company's recent efforts to minimize costs.

Performance Measures

Company management uses financial measures including operating revenues, net income, earnings per share and return on equity to evaluate its financial performance. Additional statistical measures including number of customers, customer complaint rate, annual customer rates and the efficiency ratio are used to evaluate performance quality. These measures are calculated on a regular basis and compared with historical information, budget and the other publicly-traded water and wastewater companies.

The Company's performance in 2017 was strong under the above measures. The collection of a distribution system improvement charge, or DSIC, and increases in the number of customers primarily as a result of acquisitions resulted in higher revenue and offset the higher operating expenses recorded in 2017. Other net expenses were lower in 2017, mainly due to an increased allowance for funds used during construction. The Company incurred lower income taxes mainly due to a higher volume of assets improvements eligible for the tax benefit under the IRS tangible property regulations, or TPR. The overall effect was an increase in net income in 2017 over 2016 of 9.5% and a return on year end common equity of 10.9%, higher than the 2016 result of 10.4% and the five year historical average of 10.3%.

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The efficiency ratio, which is calculated as net income divided by revenues, is used by management to evaluate its ability to control expenses. Over the five previous years, the Company's ratio averaged 24.3%. In 2017, the ratio was higher than the average at 26.7% due primarily to lower income taxes than are included in the historical average. Management is confident that its ratio will compare favorably to that of its peers. Management continues to look for ways to decrease expenses and increase efficiency as well as to file for rate increases promptly when needed.

2017 Compared with 2016

Net income for 2017 was $12,974, an increase of $1,128, or 9.5%, over net income of $11,846 for 2016. The primary contributing factors to the increase in net income were higher operating revenues, lower income taxes, and an increased allowance for funds used during construction, which were partially offset by higher operating expenses.

Operating revenues for the year increased $1,005, or 2.1%, from $47,584 for 2016 to $48,589 for 2017. The primary reasons for the increase were $899 of revenues from the DSIC and $626 from the recent West York Borough wastewater acquisition. Growth in the water customer base also added to revenues. The average number of water customers served in 2017 increased as compared to 2016 by 1,061 customers, from 66,000 to 67,061 customers. The average number of wastewater customers served in 2017 increased as compared to 2016 by 1,371 customers, from 641 to 2,012 customers, due to the acquisition. The increase in revenue was partially offset by lower per capita consumption. Total per capita consumption for 2017 was approximately 4.6% lower than 2016. The Company expects revenues for 2018 to show a modest increase over 2017 due to the DSIC, and the continued increase in the number of water and wastewater customers from acquisitions and growth within the Company's service territory. Other regulatory actions, including the impact of the 2017 Tax Act, and weather patterns could impact results.

Operating expenses for the year increased $1,420, or 5.7%, from $24,696 for 2016 to $26,116 for 2017. The increase was primarily due to higher expenses of approximately $718 for West York Borough wastewater operating expenses and $347 for depreciation. Also adding to the increase were $120 for health insurance, $109 for maintenance, $101 for decreased wages and benefits that were able to be capitalized, and $75 for wages. Other expenses increased by a net of $55. The increase was partially offset by approximately $57 for the absence of rate case expenses and $48 for lower shareholder expenses. In 2018, the Company expects depreciation expense to continue to rise due to additional investment in utility plant, and other expenses to increase at a moderate rate as costs to treat water and to maintain and extend the distribution system continue to rise and the full cost to operate the West York Borough wastewater collection system are incurred. Overall, increases in operating expenses are expected to outpace growth in revenue in the short-term.

Interest on debt for the year increased $83, or 1.6%, from $5,265 for 2016 to $5,348 for 2017. The increase was due to interest on line of credit borrowings and higher short-term interest rates on the variable rate debt. The average debt outstanding under the lines of credit was $3,132 for 2017 and $0 for 2016. The weighted average interest rate on the lines of credit was 1.76% for 2017. Interest expense for 2018 is expected to be higher due to continued borrowings under lines of credit and increases in short-term interest rates.

Allowance for funds used during construction increased $636, from $228 in 2016 to $864 in 2017, due to a higher volume of eligible construction mainly related to the pumping station and force main project. Allowance for funds used during construction for 2018 is expected to decrease due to the completion of the project.

A non-recurring gain on the sale of land of $36 was recorded in 2016 as a result of the sale of nonoperating property from a recent acquisition. No additional land sales are anticipated at this time.

Other income (expenses), net for 2017 reflects decreased expenses of $160 as compared to 2016. Higher earnings on life insurance policies of approximately $159 and lower retirement expenses of $146 were the primary reasons for the decrease. Other expenses decreased by a net of $8. The decreased expenses were partially offset by additional charitable contributions of $153. For 2018, other income (expenses) will be largely determined by the change in market returns and discount rates for retirement programs and related assets.

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Income taxes for 2017 decreased $866, or 16.0%, compared to 2016 due primarily to a higher volume of asset improvements eligible for the tax benefit under the IRS TPR, including the replacement of company-owned lead service lines, partially offset by the effects of the 2017 Tax Act. (See the Income Taxes, Deferred Income Taxes and Uncertain Tax Positions section included herein for additional details.) The Company's effective tax rate was 25.9% for 2017 and 31.3% for 2016. The Company's effective tax rate for 2018 will largely be determined by the combination of the full implementation of the 2017 Tax Act and the level of eligible asset improvements expensed for tax purposes that would have been capitalized for tax purposes prior to the implementation of the TPR. The 2017 Tax Act should lower the effective tax rate, although the Company is awaiting direction from the PPUC on how to handle the benefit from lowering the federal statutory corporate tax rate. The Company expects the level of eligible asset improvements expensed for tax purposes to decrease in 2018 as a significant portion of the company-owned lead service lines have already been replaced.

2016 Compared with 2015

Net income for 2016 was $11,846, a decrease of $643, or 5.1%, from net income of $12,489 for 2015. The primary contributing factor to the decrease in net income was higher income taxes.

Operating revenues for the year increased $495, or 1.1%, from $47,089 for 2015 to $47,584 for 2016. The primary reasons for the increase in revenues were an increase in customers, and higher sewer billing and collection service revenue. The average number of customers served in 2016 increased as compared to 2015 by 974 customers, from 65,667 to 66,641 customers, due primarily to recent acquisitions. Lower per capita consumption due mainly to a prior year emergency interconnection partially offset the increase. Total per capita consumption for 2016 was 1.1% lower than 2015, but just 0.2% lower excluding the prior year benefit of the emergency interconnection.

Operating expenses for the year increased $268, or 1.1%, from $24,428 for 2015 to $24,696 for 2016. The increase was primarily due to higher expenses of approximately $271 for depreciation, $118 for wages, $60 for shareholder expenses and $54 for maintenance. The increased expenses were partially offset by approximately $149 for wages and benefits that were able to be capitalized, and reduced rate case expense of $80. Other expenses decreased by a net of $6.

Interest expense on debt for 2016 increased $83, or 1.6%, from $5,182 for 2015 to $5,265 for 2016. The increase was due to an increase in long-term debt outstanding resulting from the bond issuance in July 2015.

Allowance for funds used during construction increased $22, from $206 in 2015 to $228 in 2016, due to a higher volume of eligible construction.

A non-recurring gain on the sale of land of $36 was recorded in 2016 as a result of the sale of nonoperating property from a recent acquisition.

Other income (expenses), net for 2016 reflects increased expenses of $176 as compared to the same period of 2015. Higher retirement expenses of $256 were the primary reason for the increase. The increased expenses were partially offset by higher earnings on life insurance policies of $78. Other expenses decreased by a net of approximately $2 as compared to the same period of 2015.

Income taxes for 2016 increased $669, or 14.1%, compared to 2015 due to a lower volume of asset improvements eligible for the tax benefit of the IRS TPR. The Company's effective tax rate was 31.3% for 2016 and 27.5% for 2015.

Rate Matters

See Note 8 to the Company's financial statements included herein for a discussion of its rate matters.

Effective January 1, 2018 the Company's tariff included a DSIC on revenues of 4.51%.

The benefit from the implementation of the IRS TPR impacts the rate matters of the Company. Earnings in excess of the regulatory benchmark delayed the collection of a DSIC until June 2017, when the Company began recognizing DSIC for bills rendered after July 1, 2017 that included June consumption. The benefit of the IRS TPR may also lengthen the amount of time between rate increase requests. When the Company does file for its next rate increase, which it expects to do in 2018, the PPUC will take into account the lower income taxes which resulted from the implementation of the IRS TPR, as well as the lower income taxes that will result from the 2017 Tax Act, effectively reducing the amount of revenue required in future years and lowering the Company's rate increase request.

Acquisitions and Growth

See Note 2 to the Company's financial statements included herein for a discussion of completed acquisitions included in financial results.

On October 8, 2013, the Company signed an agreement to purchase the wastewater assets of SYC WWTP, L.P. in Shrewsbury and Springfield Townships, York County, Pennsylvania. Completion of the acquisition is contingent upon receiving approval from all required regulatory authorities. Closing is expected in 2018, at which time the Company will add approximately 30 commercial and industrial wastewater customers.

This acquisition is expected to be immaterial to Company results. The Company is also pursuing other bulk water contracts and acquisitions in and around its service territory to help offset any further declines in per capita water consumption and to grow its business.

On May 10, 2017, the Company signed an emergency interconnect agreement with Dallastown-Yoe Water Authority. The effectiveness of this agreement is contingent upon receiving approval from all required regulatory authorities. Approval is expected to be granted in 2018 at which time the Company will construct a water main extension to a single point of interconnection and supply an agreed upon amount of water to the authority at current tariff rates.

Capital Expenditures

During 2017, the Company invested $24,602 in construction expenditures for routine items and an additional untreated water pumping station and force main, as well as various replacements of infrastructure including company-owned lead service lines as discussed in Note 10 to the financial statements included herein. The Company replaced or relined approximately 42,500 feet of main in 2017. In addition, the Company invested $472 in the acquisition of water and wastewater systems during 2017. The Company was able to fund construction expenditures and acquisitions using internally-generated funds, line of credit borrowings, proceeds from its stock purchase plans, and customer advances and contributions from developers, municipalities, customers or builders. See Notes 1, 4 and 5 to the Company's financial statements included herein.

The Company anticipates construction and acquisition expenditures for 2018 and 2019 of approximately $22,564 and $19,755, respectively, exclusive of any acquisitions not yet approved. In addition to routine transmission and distribution projects, a portion of the anticipated 2018 and 2019 expenditures will be for additional main extensions, spillway improvements and the armoring of one of the dams, replacing a water storage tank, expansion of a wastewater treatment plant, and various replacements of infrastructure. The Company intends to use primarily internally-generated funds for its anticipated 2018 and 2019 construction and fund the remainder through line of credit borrowings, proceeds from its stock purchase plans and customer advances and contributions (see Note 1 to the

Company's financial statements included herein). Customer advances and contributions are expected to account for between 5% and 10% of funding requirements in 2018 and 2019. Potential debt and equity offerings may be utilized if required. The Company believes it will have adequate credit facilities and access to the capital markets, if necessary, during 2018 and 2019, to fund anticipated construction and acquisition expenditures.

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Liquidity and Capital Resources

Cash
The Company manages its cash through a cash management account that is directly connected to a line of credit. Excess cash generated automatically pays down outstanding borrowings under the line of credit arrangement. If there are no outstanding borrowings, the cash is used as an earnings credit to reduce banking fees. Likewise, if additional funds are needed beyond what is generated internally for payroll, to pay suppliers, or for debt service, funds are automatically borrowed under the line of credit. The Company fully utilized its cash on hand in 2017 primarily as a result of higher capital expenditures and repurchase of common stock, incurring a cash overdraft on its cash management account of $769 as of December 31, 2017. In addition, the Company borrowed $6,389 under its lines of credit in 2017. The cash management facility and the other lines of credit are expected to provide the necessary liquidity and funding for the Company's operations, capital expenditures, acquisitions and potential buybacks of stock for the foreseeable future.

Accounts Receivable
The accounts receivable balance tends to follow the change in revenues but is also affected by the timeliness of payments by customers and the level of the reserve for doubtful accounts. In 2017, the accounts receivable balance increased due to an increase in revenue from increased customer counts and the DSIC and a slight decrease in percentage of prior months billings paid by customers in December 2017 as compared to December 2016. Prior to December, the Company experienced an improvement in the timeliness of payments by its customers. A reserve is maintained at a level considered adequate to provide for losses that can be reasonably anticipated based on inactive accounts with outstanding balances. Management periodically evaluates the adequacy of the reserve based on past experience, agings of the receivables, adverse situations that may affect a customer's ability to pay, current economic conditions, and other relevant factors. If the status of these factors deteriorates, the Company may incur additional expenses for uncollectible accounts and experience a reduction in its internally-generated funds.

Internally-generated Funds
The amount of internally-generated funds available for operations and construction depends on the Company's ability to obtain timely and adequate rate relief, changes in regulations, customers' water usage, weather conditions, customer growth and controlled expenses. In 2017, the Company generated $20,110 internally as compared to $19,365 in 2016 and $20,710 in 2015. The increase from 2016 was primarily due to lower income taxes paid.

Credit Lines
Historically, the Company has borrowed $15,000 to $20,000 under its lines of credit before refinancing with long-term debt or equity capital. As of December 31, 2017, the Company maintained unsecured lines of credit aggregating $41,500 with four banks at interest rates ranging from LIBOR plus 1.20% to LIBOR plus 1.25%. The Company had $6,389 in outstanding borrowings under its lines of credit as of December 31, 2017. The weighted average interest rate on line of credit borrowings as of December 31, 2017 was 2.65%. The Company plans to renew a $7,500 line of credit that expires in June 2018 and a $10,000 line of credit that expires in September 2018 under similar terms and conditions.

The Company has taken steps to manage the risk of reduced credit availability. It has maintained committed lines of credit that cannot be called on demand and obtained a 2-year revolving maturity on its larger facilities. There is no guarantee that the Company will be able to obtain sufficient lines of credit with favorable terms in the future. If the Company is unable to obtain sufficient lines of credit or to refinance its line of credit borrowings with long-term debt or equity when necessary, it may have to eliminate or postpone capital expenditures. Management believes the Company will have adequate capacity under its current lines of credit to meet financing needs throughout 2018.

Long-term Debt
The Company's loan agreements contain various covenants and restrictions. Management believes it is currently in compliance with all of these restrictions. See Note 4 to the Company's financial statements included herein for

additional information regarding these restrictions.

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The Pennsylvania Economic Development Financing Authority Series 2014 bonds contain special redemption provisions. Under these provisions, representatives of deceased beneficial owners have the right to request redemption prior to the stated maturity of all or part of their holding in the bonds. The Company is not obligated to redeem any individual holding exceeding $25, or aggregate holdings exceeding $300 in any annual period. In 2017, no bonds were retired under these provisions. In 2016, the Company retired $10 of the bonds under these provisions. Currently, no additional bonds that meet the special provisions have been tendered for redemption.

The York County Industrial Development Authority Series 2006 bonds are subject to optional redemption provisions that allow the Company to redeem all or a portion of the bonds on or after October 1, 2016. The Company may refinance these bonds prior to maturity in 2036 to take advantage of lower interest rates.

The Company's total long-term debt as a percentage of the total capitalization, defined as total common stockholders' equity plus total long-term debt, was 43.7% as of December 31, 2017, compared with 43.4% as of December 31, 2016. The Company began using its lines of credit in 2017 due primarily to increased capital expenditures which increased the debt to total capitalization ratio. The Company expects to allow the debt percentage to trend upward until it approaches fifty percent before considering additional equity. A debt to total capitalization ratio between forty-six and fifty percent has historically been acceptable to the PPUC in rate filings. Due to its recent ability to generate more cash internally, the Company has been able to keep its ratio below fifty percent. See Note 4 to the Company's financial statements included herein for the details of its long-term debt outstanding as of December 31, 2017.

Income Taxes, Deferred Income Taxes and Uncertain Tax Positions

The Company has a substantial deferred income tax asset primarily due to the excess accumulated deferred income taxes on accelerated depreciation from the 2017 Tax Act detailed below and the differences between the book and tax balances of the pension and deferred compensation plans. The Company does not believe a valuation allowance is required due to the expected generation of future taxable income during the periods in which those temporary differences become deductible.

The Company has seen an increase in its deferred income tax liability amounts primarily as a result of the accelerated and bonus depreciation deduction available for federal tax purposes which creates differences between book and tax depreciation expense. In 2017, the recent increase was offset by the remeasurement of the deferred income tax liabilities upon enactment of the 2017 Tax Act detailed below. The Company expects this trend to continue as it makes significant investments in capital expenditures subject to accelerated depreciation or TPR, but at a more modest rate due to the elimination of bonus depreciation on qualified water and wastewater property.

The 2017 Tax Act, among other things, reduces the federal statutory corporate tax rate for tax years beginning in 2018 from 34% to 21%, eliminates certain deductions, and eliminates bonus depreciation on qualified water and wastewater property. This resulted in the remeasurement of the federal portion of the Company's deferred taxes as of December 31, 2017 to the 21% rate. The effect was recognized in income for the year ended December 31, 2017 for all deferred tax assets and liabilities except accelerated depreciation. Under normalization rules applicable to public utility property included in the 2017 Tax Act, the excess accumulated deferred income taxes on accelerated depreciation is recorded as a regulatory liability. The regulatory liability is a temporary difference so a deferred tax asset is recorded including the gross-up of revenue necessary to return, in rates, the effect of the temporary difference.

The Company filed for a change in accounting method under the IRS TPR effective in 2014. Under the change in accounting method, the Company is permitted to deduct the costs of certain asset improvements that were previously being capitalized and depreciated for tax purposes as an expense on its income tax return. The Company was permitted to make this deduction for prior years (the "catch-up deduction") and each year going forward (the "ongoing deduction"). As a result of the catch-up deduction, income tax benefits of $3,887 were deferred as a regulatory liability. The Company will seek approval from the PPUC in its next rate filing to amortize the catch-up deduction, recorded as a regulatory liability.

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As a result of the ongoing deduction, the net income tax benefits of $1,796, $962 and $1,438 for the years ended December 31, 2017, 2016 and 2015, respectively, reduced income tax expense and flowed-through to net income. The ongoing deduction results in a reduction in the effective income tax rate, a net reduction in income tax expense, and a reduction in the amount of income taxes currently payable. Both the ongoing and catch-up deductions result in increases to deferred tax liabilities and regulatory assets representing the appropriate book and tax basis difference on capital additions. The Company expects to continue to expense these asset improvements in the future.

The Company's effective tax rate will largely be determined by the combination of the full implementation of the 2017 Tax Act and the level of eligible asset improvements expensed for tax purposes that would have been capitalized for tax purposes prior to the implementation of the TPR.

The Company has determined there are no uncertain tax positions that require recognition as of December 31, 2017. See Note 3 to the Company's financial statements included herein for additional details regarding income taxes.

Common Stock

Common stockholders' equity as a percent of the total capitalization was 56.3% as of December 31, 2017, compared with 56.6% as of December 31, 2016. The ratio decreased in 2017 due to share repurchases and higher debt primarily from increased capital expenditures. Similar transactions, among other things, could reduce this percentage in the future. It is the Company's intent to target a ratio between fifty and fifty-four percent.

Credit Rating

On April 21, 2017, Standard & Poor's affirmed the Company's credit rating at A-, with a stable outlook. The Company's ability to maintain its credit rating depends, among other things, on adequate and timely rate relief, which it has been successful in obtaining, its ability to fund capital expenditures in a balanced manner using both debt and equity and its ability to generate cash flow. In 2018, the Company's objectives are to continue to maximize its funds provided by operations and maintain a strong capital structure in order to be able to attract capital.

Environmental Matters

During its triennial testing completed in 2016, the Company determined it exceeded the action level for lead as established by the Lead and Copper Rule, or LCR, issued by the U.S. Environmental Protection Agency. The rule allows the Company to have five samples of the 50 high-risk homes tested exceed the action level of 15 parts per billion, or PPB. The testing found that six properties with lead service lines, all built before 1935, exceeded the action level, and the reported exceedance amount was 1 PPB. The Company determined that only 3% of the company-owned service lines in the system were lead. The Company is required, per the LCR, to engage in more frequent testing for lead, public education, and annually replace 7% of the remaining company-owned lead service lines in its distribution system. The Company completed two rounds of compliance testing at the customer's tap in 2017 and the water samples did not exceed the action level either time. As a result, the Company will reduce its monitoring from semi-annual to annual beginning in 2018.

The Company is performing in excess of the required actions under the LCR. Specifically, the Company is providing the affected customers with a free water test and a 200 gallon per month credit to flush their line in order to reduce any lead content until their lead service line has been replaced. The cost of the water tests and flushing credits was $16 and $9 for the years ended December 31, 2017 and 2016, respectively. Additional amounts for water tests and flushing credits are not expected to have a material impact on the financial position of the Company over the remaining three years.

In addition, the Company entered into a consent order agreement with the Pennsylvania Department of Environmental Protection in December 2016. Under the agreement, the Company committed to exceed the LCR replacement schedule by replacing all of the remaining known company-owned lead service lines within four years from the agreement. The cost for these service line replacements was approximately $1,390 and $75 for the years ended

December 31, 2017 and 2016, respectively, and is included in utility plant. Additional costs of approximately $535 are expected until the replacements are complete, and will be integrated into the Company's annual capital budgets.

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Finally, the Company was granted approval by the PPUC to modify its tariff to include the cost of the replacement of lead customer-owned service lines that are discovered when the Company replaces its lead service lines over the remaining three years, and to include the cost of the annual replacement of up to 400 lead customer-owned service lines whenever they are discovered, regardless of the material used for the company-owned service line over nine years. The tariff modification allows the Company to replace customer-owned service lines at its own initial cost. The Company will record the costs as a regulatory asset to be recovered in future base rates to customers, over a reasonable period of at least four but not more than six years. The cost for the customer-owned lead service line replacements under the four-year tariff modification was approximately $191 through December 31, 2017 and is included as a regulatory asset. Additional replacements are expected to be approximately $75 under the four-year tariff modification, assuming the average percentage of customer-owned lead service lines that were replaced when company-owned lead service lines were replaced through December 31, 2017 remains consistent over the entire replacement period. The Company is unable to predict how many lead customer-owned service lines are in use, and, therefore, its current estimate of $1,040 for replacements under the nine-year tariff modification is subject to adjustment as more facts become available.

Dividends

During 2017, the Company's dividend payout ratios relative to net income and net cash provided by operating activities were 64.1% and 40.9%, respectively. During 2016, the Company's dividend payout ratios relative to net income and net cash provided by operating activities were 68.0% and 41.1%, respectively. During the fourth quarter of 2017, the Board of Directors increased the dividend by 4.0% from $0.1602 per share to $0.1666 per share per quarter.

The Company's Board of Directors declared a dividend in the amount of $0.1666 per share at its January 2018 meeting. The dividend is payable on April 16, 2018 to shareholders of record as of February 28, 2018. While the Company expects to maintain this dividend amount in 2018, future dividends will be dependent upon the Company's earnings, financial condition, capital demands and other factors and will be determined by the Company's Board of Directors. See Note 4 to the Company's financial statements included herein for restrictions on dividend payments.

Inflation

The Company is affected by inflation, most notably by the continually increasing costs incurred to maintain and expand its service capacity. The cumulative effect of inflation results in significantly higher facility replacement costs which must be recovered from future cash flows. The ability of the Company to recover this increased investment in facilities is dependent upon future rate increases, which are subject to approval by the PPUC. The Company can provide no assurances that its rate increases will be approved by the PPUC; and, if approved, the Company cannot guarantee that these rate increases will be granted in a timely or sufficient manner to cover the investments and expenses for which the rate increase was sought.

Contractual Obligations

The following summarizes the Company's contractual obligations by period as of December 31, 2017:

	Payments due by period				
	Total	Less than 1 Year	Years 2 and 3	Years 4 and 5	More than 5 Years
Long-term debt obligations (a)	$92,833	$44	$34,919	$7,500	$50,370
Interest on long-term debt (b)	54,776	4,719	7,184	5,924	36,949
Short-term Lines of Credit (c)	1,000	1,000	-	-	-
Purchase obligations (d)	1,380	1,380			