

**NEW ISSUE
FULL BOOK-ENTRY**

RATINGS: See “DESCRIPTION OF RATINGS” herein.

In the opinion of Bond Counsel, under existing federal law and assuming compliance with applicable requirements of the Internal Revenue Code of 1986, as amended (the “Code”), that must be satisfied subsequent to the issue date of the 2010A Bonds, interest on the 2010A Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals. However, while interest on the 2010A Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the 2010A Bonds received by corporations is taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations, interest on 2010A Bonds received by certain S corporations may be subject to tax, and interest on the 2010A Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. Receipt of interest on the 2010A Bonds may have other federal tax consequences for certain taxpayers. See “TAX MATTERS—The 2010A Bonds.” In the opinion of Bond Counsel, interest on the 2010B Bonds is not excludable from gross income under Section 103 of the Code. See “TAX MATTERS—The 2010B Bonds.”



**\$104,085,000
CITY OF TACOMA, WASHINGTON
Water System Revenue Bonds**

**\$29,100,000
Revenue Refunding Bonds,
Series 2010A**

**\$74,985,000
Revenue Bonds, Series 2010B
(Taxable Build America Bonds – Direct Payment)**

DATED: Date of Delivery

DUE: December 1, as shown on the inside cover

The City of Tacoma, Washington (the “City”), Water System Revenue Refunding Bonds, 2010A (the “2010A Bonds”) and Water System Revenue Bonds, 2010B (Taxable Build America Bonds – Direct Payment) (the “2010B Bonds,” and, together with the 2010A Bonds, the “Bonds”), will be issued only as fully registered bonds under a book-entry system, initially registered in the name of Cede & Co., as nominee for The Depository Trust Company (“DTC”), New York, New York, which will act as securities depository for the Bonds. Individual purchases of the Bonds may be made in the denominations of \$5,000 or any integral multiple thereof within a single maturity of a series. Purchasers of the Bonds will not receive certificates representing their interest in the Bonds.

Both principal of and interest on the Bonds shall be payable in lawful money of the United States of America. Interest on the Bonds, payable each June 1 and December 1, commencing June 1, 2011, and principal of the Bonds are payable by the Bond Registrar (currently The Bank of New York Mellon, New York, New York) to DTC, which is obligated to remit such principal and interest to its broker-dealer Participants for subsequent disbursement to beneficial owners of the Bonds. See Appendix B—“BOOK-ENTRY SYSTEM.”

Maturity Dates, Principal Amounts, Interest Rates, Yields or Prices and CUSIP Numbers on Inside Cover

The Bonds are subject to redemption by the City prior to their stated maturities as described herein under “DESCRIPTION OF THE BONDS—Optional Redemption,” “—Extraordinary Optional Redemption” and “—Mandatory Redemption.”

The Bonds are being issued to finance capital improvements to the Water System, to refund certain outstanding bonds, to fund the Reserve Account for the Bonds, and to pay costs of issuance. See “PURPOSE AND APPLICATION OF BOND PROCEEDS.”

The Bonds are payable solely from a special fund of the City known as the Water Revenue Bond Fund, and from the Net Revenue of the Water System pledged thereto, on a parity with \$182,795,000 of outstanding Water System revenue bonds, of which \$29,215,000 will be refunded with a portion of the Bonds, and bonds hereafter issued on a parity therewith. See “SECURITY FOR THE BONDS.” The City has outstanding \$78,350,000 principal amount of Regional Water Supply System Revenue Bonds, 2002, of which Tacoma Water is responsible for approximately \$43,600,000 of the remaining principal amount, and will issue \$47,840,000 of Regional Water Supply System Revenue Bonds, 2010 simultaneously with the issuance of the Bonds (collectively, the “Regional Supply System Bonds”), of which Tacoma Water will be responsible for paying approximately \$24,845,000 of the principal, plus interest, as a Contract Resource Obligation from Gross Revenue of the Water System as an Operation and Maintenance Expense of the Water System. See “THE WATER SYSTEM—The Second Supply System” and “SECURITY FOR THE BONDS.” The Bonds are not general obligations of the City, and neither the full faith and credit nor the taxing power of the City or of the State of Washington, nor any revenues of the City derived from sources other than the Water System, are pledged to the payment thereof.

This cover page includes certain information for reference only and is not a summary of matters set forth herein. Investors should read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Bonds are offered for delivery when, as, and if issued, subject to the approval of legality by Foster Pepper PLLC, Bond Counsel, Seattle, Washington. Certain legal matters will be passed upon for the Underwriter by K&L Gates LLP, Seattle, Washington. It is expected that the Bonds will be available for delivery at the facilities of The Depository Trust Company in New York, New York, by Fast Automated Securities Transfer (FAST) on or about August 24, 2010.

Citi

Dated: August 10, 2010

**MATURITY SCHEDULES, INTEREST RATES, YIELDS, PRICES
AND CUSIP NUMBERS**

\$29,100,000

WATER SYSTEM REVENUE REFUNDING BONDS, 2010A

<u>Due December 1</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>CUSIP No. *</u>
2012	\$ 515,000	2.00%	0.60%	873547GX5
2013	530,000	2.00	0.85	873547GY3
2014	550,000	2.00	1.05	873547GZ0
2015	555,000	3.00	1.52	873547HA4
2016	555,000	3.00	1.91	873547HB2
2017	570,000	3.00	2.20	873547HC0
2018	3,935,000	4.00	2.42	873547HD8
2019	4,100,000	4.00	2.63	873547HE6
2020	4,260,000	5.00	2.82**	873547HF3
2021	4,480,000	4.00	3.00**	873547HG1
2022	4,655,000	5.00	3.08**	873547HH9
2023	4,395,000	5.00	3.20**	873547HJ5

\$74,985,000

**WATER SYSTEM REVENUE BONDS, 2010B
(TAXABLE BUILD AMERICA BONDS – DIRECT PAYMENT)**

<u>Due December 1</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Price</u>	<u>CUSIP No. *</u>
2024	\$2,365,000	4.581%	100%	873547HK2
2025	2,435,000	4.681	100	873547HL0
2026	4,930,000	4.881	100	873547HM8

\$21,435,000 5.371% Term Bonds due December 1, 2030 @ 100%; CUSIP No.*: 873547HN6

\$43,820,000 5.621% Term Bonds due December 1, 2040 @ 100%; CUSIP No.*: 873547HP1

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** Priced to the June 1, 2020 par call date.

This Official Statement is provided by the City and not by the Underwriter of the Bonds. No dealer, broker, salesperson, or other person has been authorized to give any information or to make any representations other than those contained in this Official Statement in connection with the offering of the Bonds and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale.

Any statement made in this Official Statement involving any forecast or matter of estimates or opinion, whether or not expressly so stated, is intended solely as such and not as a representation of fact. The achievement of certain results or other expectations contained in such forward looking statements involves known and unknown risks, uncertainties, and other factors that may cause actual results, performance, or achievements described to be materially different from any future results, performance, or achievements expressed or implied by such forward looking statements. The City does not plan to issue any updates or revisions to those forward looking statements if and when its expectations or events, conditions, or circumstances on which such statements are based occur.

The information set forth herein has been obtained from the City and from other sources that the City believes to be reliable, but it is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale of the Bonds shall, under any circumstances, create any implication that there has been no change in the affairs of the City since the date hereof.

The CUSIP numbers provided in this Official Statement are included for convenience of the holders and potential holders of the Bonds. No assurance can be given that the CUSIP numbers for the Bonds will remain the same after the date of issuance and delivery of the Bonds.

The Underwriter has provided the following sentence for inclusion in this Official Statement. The Underwriter has reviewed the information in this Official Statement in accordance with, and as a part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does not guarantee the accuracy or completeness of such information.

This Official Statement is not to be construed as a contract or agreement between the City and purchasers or owners of any of the Bonds.

The initial public offering prices or yields set forth on the inside cover page hereof may be changed from time to time by the Underwriter. The Underwriter may offer and sell the Bonds to certain dealers, unit investment trusts or money market funds at prices lower than the public offering prices stated on the inside cover page hereof.

In connection with this offering, the Underwriter may overallocate or effect transactions that stabilize or maintain the market price of the Bonds at a level above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time.

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OFFICIAL STATEMENT

\$104,085,000

CITY OF TACOMA, WASHINGTON

\$29,100,000

**Water System Revenue Refunding
Bonds, 2010A**

\$74,985,000

**Water System Revenue Bonds, 2010B (Taxable
Build America Bonds – Direct Payment)**

INTRODUCTION

The City of Tacoma, Washington (the “City” or “Tacoma”) furnishes this Official Statement in connection with the offering of \$29,100,000 principal amount of its Water System Revenue Refunding Bonds, 2010A (the “2010A Bonds”) and \$74,985,000 principal amount of its Water System Revenue Bonds, 2010B (Taxable Build America Bonds – Direct Payment) (the “2010B Bonds,” and, together with the 2010A Bonds, the “Bonds”). This Official Statement, which includes the cover page, inside cover page and appendices, provides information concerning the City, the Bonds, the City’s Water System (the “Water System”), the Second Supply Project, and the City’s obligations with respect to the Second Supply Project.

The City is a municipal corporation under the constitution and laws of the State of Washington. The Water Division, doing business as Tacoma Water (“Tacoma Water”), of the City’s Department of Public Utilities (the “Department”) operates the Water System. Tacoma Water is one of the largest publicly owned water utilities in the Pacific Northwest and had 96,982 customers in 2009. See “THE WATER SYSTEM.”

The Bonds are issued pursuant to Ordinance No. 27902, passed by the City Council on July 20, 2010, and Substitute Resolution No. 38088, adopted by the City Council on August 10, 2010 (together, the “Bond Ordinance”), and under the authority of chapters 35.41, 39.46 and 39.53 of the Revised Code of Washington (“RCW”). Certain provisions of the Bond Ordinance are summarized in Appendix A.

As of June 30, 2010, the Water System had outstanding \$30,060,000 principal amount of Water System Revenue Bonds, 2001 (the “2001 Bonds”), a portion of which will be refunded by the 2010A Bonds, \$34,880,000 principal amount of Water System Revenue and Refunding Bonds, 2003 (the “2003 Bonds”), \$41,080,000 principal amount of Water System Revenue and Refunding Bonds, 2005 (the “2005 Bonds”), and \$76,775,000 principal amount of Water System Revenue Bonds, 2009 (Taxable Build America Bonds – Direct Payment) (the “2009 Bonds,” and, collectively with the 2001 Bonds, the 2003 Bonds and the 2005 Bonds, the “Outstanding Parity Bonds”). The Bonds are issued on a parity with the Outstanding Parity Bonds. The Bonds, the Outstanding Parity Bonds, and any Future Parity Bonds are referred to as the “Parity Bonds.”

The City has outstanding \$78,350,000 principal amount of Regional Water Supply System Revenue Bonds, 2002 (the “2002 RWSS Bonds”). Simultaneously with the issuance of the Bonds, the City will issue \$47,840,000 of Regional Water Supply System Revenue Bonds, 2010 (the “2010 RWSS Bonds,” and, together with the 2002 RWSS Bonds, the “RWSS Bonds”). Tacoma Water is responsible for paying debt service on approximately \$43,600,000 of the outstanding principal amount of the 2002 RWSS Bonds and is responsible for paying approximately \$24,845,000 of the principal on the 2010 RWSS Bonds, plus interest, each as a Contract Resource Obligation payable as an Operation and Maintenance Expense from Gross Revenue of the Water System senior to the payment of debt service on the Parity Bonds. See “THE WATER SYSTEM—The Second Supply System” and “SECURITY FOR THE BONDS—Additional Obligations—*Contract Resource Obligations*.”

The City has pledged in the Bond Ordinance that it will not issue any additional indebtedness which is secured by a lien on the Net Revenue of the Water System that is superior to the lien of the Parity Bonds. However, the City reserves the right under certain conditions to enter into additional Contract Resource Obligations, or issue additional

debt of the Second Supply Project, for which amounts due are payable as Operation and Maintenance Expenses of the Water System. See “SECURITY FOR THE BONDS—Additional Obligations—*Contract Resource Obligations*.” The City reserves the right in the Bond Ordinance to issue additional bonds on a parity with the Parity Bonds (“Future Parity Bonds”). See “SECURITY FOR THE BONDS—Additional Obligations—*Future Parity Bonds*.”

The Bonds are being issued to finance capital improvements to the Water System, to refund certain outstanding bonds, to fund the Reserve Account for the Bonds, and to pay costs of issuance of the Bonds, as more fully described under “PURPOSE AND APPLICATION OF BOND PROCEEDS.”

In the preparation of the projections in this Official Statement, the City has made certain assumptions with respect to conditions that may occur in the future. While the City believes these assumptions are reasonable for the purpose of the projections, they are dependent upon future events, and actual conditions may differ from those assumed. To the extent actual future factors differ from those assumed or provided to the City by others, the actual results will vary from those forecast.

Certain capitalized words and phrases used in this Official Statement not defined herein have the meanings given in the Bond Ordinance, unless the context shall clearly indicate that another meaning is intended. See Appendix A for certain definitions.

DESCRIPTION OF THE BONDS

General

The Bonds will be dated the date of their delivery and will be issued in the aggregate principal amount of \$29,100,000 for the 2010A Bonds and \$74,985,000 for the 2010B Bonds. The Bonds will bear interest at the rates and mature on the dates set forth on the inside cover page of this Official Statement. Interest on the Bonds shall be calculated on the basis of a 360-day year consisting of twelve 30-day months, and shall be payable each June 1 and December 1, commencing June 1, 2011.

The Bonds will be issued only as fully registered bonds under a book-entry system, initially registered in the name of Cede & Co., as nominee for DTC, which will act as securities depository for the Bonds. Individual purchases of the Bonds will be made in denominations of \$5,000 or any integral multiple thereof within a single maturity of each series. Both principal of and interest on the Bonds shall be payable in lawful money of the United States of America. The fiscal agent of the State of Washington in New York, New York (currently The Bank of New York Mellon) will act as Bond Registrar for the Bonds. Purchasers will not receive certificates representing their interest in the Bonds. See Appendix B—“BOOK-ENTRY SYSTEM.”

Designation of the 2010B Bonds as “Build America Bonds”

The City has made irrevocable elections to have Section 54AA of the Code apply to the 2010B Bonds so that the 2010B Bonds are treated as “Build America Bonds,” and further to have Subsection 54AA(g) of the Code apply to the 2010B Bonds so that the 2010B Bonds are treated as “qualified bonds” with respect to which the City will be allowed a credit payable by the United States Treasury to the City pursuant to Section 6431 of the Code in an amount equal to 35% of the interest payable on the 2010B Bonds on each interest payment date. As a result of these elections, interest on the 2010B Bonds is not excludable from gross income of owners of the 2010B Bonds under Section 103 of the Code, and owners of the 2010B Bonds will not be allowed any federal tax credits as a result of ownership of or receipt of interest payments on the 2010B Bonds. See “TAX MATTERS—The 2010B Bonds.” The obligation of the United States Treasury under Section 6431 of the Code to make direct payments to the City in respect of interest payments on the 2010B Bonds does not constitute a full faith and credit guarantee of the 2010B Bonds by the United States of America.

The City has authorized the Finance Director to take such actions as are necessary or appropriate for the City to receive from the United States Treasury the applicable federal direct payments in respect of the 2010B Bonds, such as the timely filing with the Internal Revenue Service of Form 8038-CP – “Return for Credit Payments to Issuers of

Qualified Bonds” in the manner prescribed by Internal Revenue Service Notice 2009-26. The City also has covenanted in the Bond Ordinance that it will not take or permit to be taken on its behalf any action that would adversely affect the entitlement of the City to receive from the United States Treasury the applicable federal direct payments in respect of any bonds, including the 2010B Bonds, sold and issued as Build America Bonds. Without limiting the generality of the foregoing, the City has covenanted to comply with the provisions of the Code compliance with which would result in the interest on such 2010B Bonds being excluded from gross income for federal tax purposes but for an irrevocable election to have Section 54AA of the Code apply to the 2010B Bonds.

Optional Redemption

2010A Bonds

The 2010A Bonds maturing in years 2012 through 2019, inclusive, are not subject to redemption prior to maturity. The 2010A Bonds maturing on and after December 1, 2020, are subject to redemption at the option of the City on and after June 1, 2020, in whole or in part at any time within one or more maturities selected by the City at a price of par plus accrued interest, if any, to the date of redemption. Notwithstanding the foregoing, for so long as the 2010A Bonds are registered in the name of DTC or its nominee, selection of the 2010A Bonds for redemption shall be in accordance with the operational procedures of DTC then in effect.

2010B Bonds

The 2010B Bonds are subject to optional redemption by the City prior to their stated maturity dates, in whole or in part, on any business day, at the “Make-Whole Redemption Price,” plus accrued and unpaid interest on the 2010B Bonds to be redeemed on the date fixed for redemption. Notwithstanding the foregoing, for so long as the 2010B Bonds are registered in the name of DTC or its nominee, selection of the 2010B Bonds for redemption shall be in accordance with the operational procedures of DTC then in effect.

The “Make-Whole Redemption Price” is the greater of (i) 100% of the principal amount of the 2010B Bonds to be redeemed and (ii) the sum of the present value of the remaining scheduled payments of principal and interest on the 2010B Bonds to be redeemed, not including any portion of those payments of interest accrued and unpaid as of the date on which such 2010B Bonds are to be redeemed, discounted to the date on which the 2010B Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the “Treasury Rate” (defined below) plus 25 basis points.

“Treasury Rate” means, with respect to any redemption date for a particular 2010B Bond, the rate per annum, expressed as a percentage of the principal amount, equal to the semi-annual equivalent yield to maturity or interpolated maturity of the Comparable Treasury Issue, assuming that the Comparable Treasury Issue is purchased on the redemption date for a price equal to the Comparable Treasury Price, as calculated by the Designated Investment Banker.

“Comparable Treasury Issue” means, with respect to any redemption date for a particular 2010B Bond, the United States Treasury security or securities selected by the Designated Investment Banker which has or have an actual or interpolated maturity comparable to the remaining average life of the 2010B Bond to be redeemed, and that would be utilized in accordance with customary financial practice in pricing new issues of debt securities of comparable maturity to the remaining average life of the 2010B Bond to be redeemed.

“Comparable Treasury Price” means, with respect to any redemption date for a particular 2010B Bond:

(1) the most recent yield data for the applicable U.S. Treasury maturity index from the Federal Reserve Statistical Release H.15 Daily Update (or any comparable or successor publication) reported, as of 11:00 a.m. New York City time, on the Valuation Date; or

(2) if the yield described in (1) above is not reported as of such time or the yield reported as of such time is not ascertainable, the average of four Reference Treasury Dealer Quotations for that redemption date, after excluding the highest and lowest of such Reference Treasury Dealer Quotations, or if the Designated Investment

Banker obtains fewer than four Reference Treasury Dealer Quotations, the average of all quotations obtained by the Designated Investment Banker.

“Designated Investment Banker” means one of the Reference Treasury Dealers appointed by the City.

“Reference Treasury Dealer” means each of four firms, specified by the City from time to time, that are primary United States Government securities dealers in the City of New York (each, a “Primary Treasury Dealer”); provided, that if any of them ceases to be a Primary Treasury Dealer, the City will substitute another Primary Treasury Dealer.

“Reference Treasury Dealer Quotations” means, with respect to each Reference Treasury Dealer and any redemption date for a particular 2010B Bond, the average, as determined by the Designated Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Designated Investment Banker by such Reference Treasury Dealer at 3:30 p.m., New York City time, on the Valuation Date.

“Valuation Date” means a date that is no earlier than four days prior to the date the redemption notice is to be mailed.

Extraordinary Optional Redemption

2010A Bonds

The 2010A Bonds are not subject to extraordinary optional redemption.

2010B Bonds

The 2010B Bonds are subject to redemption prior to their stated maturity dates at the option of the City, in whole or in part, upon the occurrence of an Extraordinary Event (defined below), at a redemption price (the “Extraordinary Redemption Price”) equal to the greater of: (i) the issue price set forth on the inside cover page of this Official Statement (but not less than 100%) of the principal amount of such 2010B Bonds to be redeemed; or (ii) the sum of the present value of the remaining scheduled payments of principal and interest to the maturity date of such 2010B Bonds to be redeemed, not including any portion of those payments of interest accrued and unpaid as of the date on which such 2010B Bonds are to be redeemed, discounted to the date on which such 2010B Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the Treasury Rate (described above) plus 100 basis points; plus, in each case, accrued interest on such 2010B Bonds to be redeemed to the redemption date.

An “Extraordinary Event” will have occurred if a material adverse change has occurred to Section 54AA or 6431 of the Internal Revenue Code of 1986, as amended (the “Code”) (as such Sections were added by Section 1531 of the Recovery Act, pertaining to “Build America Bonds”) pursuant to which the City’s 35% cash subsidy payment from the United States Treasury relating to the 2010B Bonds is reduced or eliminated.

Mandatory Redemption

The 2010B Bonds maturing in the years 2030 and 2040 are Term Bonds and, if not optionally redeemed, purchased or defeased in accordance with the Bond Ordinance, are subject to mandatory redemption at a redemption price equal to 100% of the principal amount thereof, plus accrued interest to the date fixed for redemption, and without premium, on December 1 in the years and principal amounts as follows:

2010B Bonds Maturing 2030

Year (December 1)	Principal Amount
2027	\$ 5,085,000
2028	5,265,000
2029	5,445,000
2030 ⁽¹⁾	5,640,000

(1) Maturity.

2010B Bonds Maturing 2040

Year (December 1)	Principal Amount
2031	\$ 5,835,000
2032	6,050,000
2033	2,115,000
2034	2,195,000
2035	2,275,000
2036	2,355,000
2037	2,445,000
2038	2,535,000
2039	2,625,000
2040 ⁽¹⁾	15,390,000

(1) Final maturity.

If the City optionally redeems, purchases or defeases 2010B Bonds that are Term Bonds, the par amount of the 2010B Bonds that are Term Bonds so redeemed, purchased or defeased shall be credited against the scheduled mandatory redemption amounts proportionately for those 2010B Bonds that are Term Bonds.

Partial Redemption

If less than all of the Bonds of a series are to be redeemed, the City may select the maturity or maturities of such Bonds to be redeemed. If less than all of the 2010A Bonds of any maturity are to be redeemed, the 2010A Bonds or portions thereof to be redeemed are to be selected by the Bond Registrar or DTC, as applicable, by lot, or in accordance with their respective standard procedures. The Bond Ordinance provides that the portion of any 2010A Bonds of a denomination of more than \$5,000 to be redeemed will be in the principal amount of \$5,000 or any integral multiple thereof and that in selecting portions of such 2010A Bonds for redemption, the Bond Registrar will treat each such 2010A Bond as representing that number of such 2010A Bonds of \$5,000 denomination that is obtained by dividing the principal amount of such 2010A Bonds to be redeemed in part by \$5,000.

If the 2010B Bonds are not registered in book-entry only form, any redemption of less than all of a maturity of 2010B Bonds shall be allocated among the registered owners of such 2010B Bonds as nearly as practicable in proportion to the principal amounts of such 2010B Bonds owned by each registered owner, subject to the authorized denominations applicable to the 2010B Bonds. This will be calculated based on the following formula:

$$\frac{(\text{principal amount to be redeemed}) \times (\text{principal amount owned by registered owner})}{(\text{principal amount outstanding})}$$

If the 2010B Bonds are registered in book-entry only form, and so long as DTC or a successor securities depository is the sole registered owner of the 2010B Bonds, partial redemptions will be done in accordance with DTC procedures. It is the City's intent that redemption allocations made by DTC, the DTC Participants or such other intermediaries that may exist between the City and the registered owners be made in accordance with these same proportional provisions, including pro rata pass-through distribution of principal. However, the City can provide no

assurance that DTC, the DTC Participants or any other intermediaries will allocate redemptions among registered owners on such a proportional basis.

Notice of Redemption

The City shall cause notice of any intended redemption of Bonds to be given not less than 30 nor more than 60 days prior to the date fixed for redemption by first class mail, postage prepaid, to the registered owner of any Bond to be redeemed at the address appearing on the Bond Register at the time the Bond Registrar prepares the notice, and this requirement shall be deemed to have been fulfilled when notice has been mailed, whether or not it is actually received by the owner of any Bond. Interest on Bonds called for redemption shall cease to accrue on the date fixed for redemption unless the Bond or Bonds called are not redeemed when presented pursuant to the call. Notwithstanding the foregoing, for so long as the Bonds are registered in the name of Cede & Co., as nominee of DTC, notice of redemption shall be given in accordance with the Letter of Representations (as it may be changed).

In the case of an optional redemption, the notice may state that the City retains the right to rescind the redemption notice and the related optional redemption of Bonds by giving a notice of rescission to the affected registered owners at any time prior to the scheduled optional redemption date. Any notice of optional redemption that is so rescinded shall be of no effect, and the Bonds for which the notice of optional redemption has been rescinded shall remain outstanding.

Purchase for Cancellation

The City reserves the right to purchase any of the Bonds for cancellation at any time at any price acceptable to the City.

Procedure in the Event of Discontinuation of Book-Entry Transfer System

If the City is unable to retain a qualified successor to DTC or the City has determined that it is in the best interest of the City not to continue the book-entry system of transfer or that interests of beneficial owners of the Bonds might be adversely affected if the book-entry system of transfer is continued, the City shall execute, authenticate, and deliver at no cost to the beneficial owners of the Bonds or their nominees, Bonds in fully registered form, in the denomination of \$5,000 or any integral multiple thereof within a single maturity of a series. Thereafter, the principal of the Bonds shall be payable upon due presentment and surrender thereof at the principal office of the Bond Registrar, currently The Bank of New York Mellon; interest on the Bonds will be payable by check or draft mailed to the persons in whose names such Bonds are registered, at the address appearing upon the Bond Register on the 15th day of the month preceding an interest payment date (the "record date"), or, at the request of an owner of \$1,000,000 or more in aggregate principal amount of Bonds, by wire transfer to an account in the United States designated in writing by such owner prior to the record date; and the Bonds will be transferable as provided in the Bond Ordinance.

Defeasance

In the event that the City, in order to effect the payment, retirement or redemption of any Bond, sets aside in the Bond Fund or in another special account, held in trust by the City or by a qualified trustee, advance refunding bond proceeds or other money lawfully available or Government Obligations or any combination of such proceeds, money and/or Government Obligations, in amounts which, together with known earned income from the investment thereof are sufficient to redeem, retire or pay such Bond in accordance with its terms and to pay when due the interest and redemption premium, if any, thereon, and such proceeds, money and/or Government Obligations are irrevocably set aside and pledged for such purpose, then no further payments need be made into the Bond Fund for the payment of the principal of and interest on such Bond, the Registered Owner of such Bond shall cease to be entitled to any lien, benefit or security of the Bond Ordinance except provisions regarding the transfer, exchange and replacement of Bonds, and the Registered Owner of such Bond shall be entitled to receive payment of principal, premium, if any, and interest only from such special account, and such Bond shall be deemed not otherwise to be outstanding under the Bond Ordinance.

The term “Government Obligations” has the meaning given in chapter 39.53 RCW, as amended, currently: (1) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by the United States of America and bank certificates of deposit secured by such obligations; (2) bonds, debentures, notes, participation certificates, or other obligations issued by the Banks for Cooperatives, the Federal Intermediate Credit Bank, the Federal Home Loan Bank system, the Export-Import Bank of the United States, Federal Land Banks, or the Federal National Mortgage Association; (3) public housing bonds and project notes fully secured by contracts with the United States; and (4) obligations of financial institutions insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, to the extent insured or to the extent guaranteed as permitted under any other provision of State law.

If the City defeases any 2010B Bonds, such 2010B Bonds may be deemed to be retired and “reissued” for federal income tax purposes as a result of the defeasance. See “TAX MATTERS—The 2010B Bonds—*Disposition or Retirement of 2010B Bonds.*”

PURPOSE AND APPLICATION OF BOND PROCEEDS

The Bonds are being issued to provide funds to pay for certain capital improvements to the Water System, to fund a debt service reserve for the Bonds, to refund the 2001 Bonds, and to pay the costs of issuance of the Bonds. For a description of the Water System’s capital improvement program, see “CAPITAL IMPROVEMENT PROGRAM.”

Refunding Plan

The bonds to be refunded with the proceeds of certain of the Bonds are identified below (“Refunded Bonds”).

Refunded Bonds						
<u>Bond</u>	<u>Maturity Date</u>	<u>Par Amount (\$)</u>	<u>Interest Rate (%)</u>	<u>Redemption Date</u>	<u>Redemption Price (%)</u>	<u>CUSIP Numbers</u>
<i>Water System Revenue Bonds, 2001</i>						
Serials	12/1/2012	\$ 445,000	4.00%	12/1/2011	100%	873547EQ2
	12/1/2013	465,000	4.00	12/1/2011	100	873547ER0
	12/1/2014	495,000	4.20	12/1/2011	100	873547ES8
	12/1/2015	510,000	4.30	12/1/2011	100	873547ET6
	12/1/2016	515,000	4.375	12/1/2011	100	873547EU3
	12/1/2017	535,000	4.50	12/1/2011	100	873547EV1
	12/1/2018	3,910,000	5.125	12/1/2011	100	873547EW9
	12/1/2019	4,115,000	5.125	12/1/2011	100	873547EX7
	12/1/2020	4,325,000	5.25	12/1/2011	100	873547EY5
	12/1/2021	4,555,000	5.25	12/1/2011	100	873547EZ2
	12/1/2022	4,795,000	5.25	12/1/2011	100	873547FA6
	12/1/2023	4,550,000	5.25	12/1/2011	100	873547FB4
Total		\$29,215,000				

A portion of the net proceeds from the sale of the 2010A Bonds will be deposited in the 2010 Refunding Account (the “Refunding Account”) and used to purchase Escrow Obligations (as defined below) to be held by The Bank of New York Mellon, New York, New York (the “Escrow Agent”) under an escrow agreement (the “Escrow Agreement”), dated the date of delivery of the Bonds, between the City and the Escrow Agent. Funds will be irrevocably deposited in the Refunding Account and will be used to purchase direct, noncallable, obligations of the United States of America (the “Escrow Obligations”). The Escrow Obligations will mature at such times and pay interest in such amounts so that, with other available funds held by the Escrow Agent under the Escrow Agreement, sufficient money will be available to pay the interest on the Refunded Bonds coming due on and prior to their redemption date and to redeem and retire the Refunded Bonds on the redemption date set forth above. Since all payments of principal of and interest on the Refunded Bonds will thereafter be provided for from money and securities on deposit with the Escrow Agent under the Escrow Agreement, the liens, pledges and covenants securing the Refunded Bonds will terminate and be discharged and released.

An independent verification shall be obtained from Causey Demgen & Moore Inc., Denver, Colorado, stating that the Escrow Obligations held by the Escrow Agent and the interest to be earned thereon, together with any money held by the Escrow Agent, will be sufficient to make all such interest payments to the redemption date for the Refunded Bonds and to pay the principal, of the Refunded Bonds on the date fixed for redemption. The verification will also confirm the correctness of the mathematical computations supporting the conclusion of Bond Counsel that the 2010A Bonds are not “arbitrage bonds” as defined by Section 148 of the Code.

Sources and Uses

The following table shows the estimated sources and uses of the Bond proceeds:

<u>Sources of Funds</u>	<u>2010A Bonds</u>	<u>2010B Bonds</u>
Par Amount of the Bonds	\$ 29,100,000	\$ 74,985,000
Original Issue Premium	<u>3,660,214</u>	<u>0</u>
Total	\$ 32,760,214	\$ 74,985,000
<u>Uses of Funds</u>		
Project Costs	\$ 0	\$ 70,583,000
Reserve Account Deposit	1,457,596	3,755,940
Refunding Account	31,087,587	0
Issuance Expenses(1)	<u>215,031</u>	<u>646,060</u>
Total	\$ 32,760,214	\$ 74,985,000

(1) Issuance expenses include underwriter’s discount, legal fees, financial advisor’s fees, rating agency fees, and other costs incurred in connection with the issuance of the Bonds.

SECURITY FOR THE BONDS

Pledge of Revenues

Under the Bond Ordinance and subject to its terms and conditions, the Bonds are special limited obligations of the City, payable from and secured solely by Net Revenue of the Water System and all money and investments held in the Bond Fund, the Rate Stabilization Account, and the Construction Fund (except for money or investments held for the purpose of compliance with rebate requirements under the Code). Net Revenue includes the payments from the federal government for a portion of the interest on the 2010B Bonds and the 2009 Bonds.

THE BONDS ARE NOT GENERAL OBLIGATIONS OF THE CITY, AND NEITHER THE FULL FAITH AND CREDIT NOR THE TAXING POWER OF THE CITY OR OF THE STATE OF WASHINGTON, NOR ANY REVENUES OF THE CITY DERIVED FROM SOURCES OTHER THAN THE WATER SYSTEM OF THE CITY, ARE PLEDGED TO THE PAYMENT THEREOF.

The Bonds are being issued on a parity of lien with the \$182,795,000 of Outstanding Parity Bonds, of which \$29,215,000 will be refunded with a portion of the Bonds. The City has obligated itself to set aside and pay into the Bond Fund certain amounts out of the Net Revenue of the Water System sufficient to pay the principal of and interest on the Bonds, the Outstanding Parity Bonds, and any Future Parity Bonds.

The City has outstanding \$78,350,000 principal amount of 2002 RWSS Bonds, of which Tacoma Water is responsible for paying approximately \$43,600,000 of the outstanding principal amount on such 2002 RWSS Bonds as a Contract Resource Obligation. The City further will issue \$47,840,000 of 2010 RWSS Bonds concurrent with the issuance of the Bonds, of which Tacoma Water will be responsible for approximately \$24,845,000 of the principal amount. The City also has certain step-up obligations in the event of a default by any other Participant in the Second Supply Project. See “Additional Obligations—*Contract Resource Obligations*” and “THE WATER SYSTEM—The Second Supply System.” As a Contract Resource Obligation, Tacoma Water’s share of debt service on the RWSS Bonds is payable as an Operation and Maintenance Expense of the Water System with a lien on Gross Revenue of the Water System prior to the lien thereon of the Bonds, Outstanding Parity Bonds, and Future Parity Bonds.

Washington State law provides that the owner of a bond, such as the Bonds, the payment of which is pledged from a special fund, such as the Bond Fund, has a claim only against that fund and proportionate amounts of revenue pledged to that fund. Under Washington State law, any bondowner may bring an action to compel a city to set aside and pay into the special fund the amount that a city is obligated to set aside and pay therein. See Appendix A—“SUMMARY OF THE BOND ORDINANCE—DEFAULTS AND REMEDIES.”

See Appendix A—“SUMMARY OF THE BOND ORDINANCE—PAYMENT OF AND SECURITY FOR THE BONDS.”

Flow of Funds

The Bond Ordinance provides that the Gross Revenue of the Water System shall be used for the following purposes only, and shall be applied in the following order of priority:

- (1) To pay the Operation and Maintenance Expenses, including payments for Contract Resource Obligations;
- (2) To pay interest on Parity Bonds and net payments on Parity Payment Agreements when due;
- (3) To pay the principal of Parity Bonds as it comes due at maturity or as the principal is required to be paid pursuant to mandatory redemption requirements applicable to Term Bonds, and to make payments due under any reimbursement agreement with a Bond Insurer for a series of Parity Bonds, which agreement requires those payments to be treated on a parity of lien with the Parity Bonds;
- (4) To make all payments required to be made into the Reserve Account, all payments required to be made under any agreement relating to the provision of Reserve Insurance, and payments due under any reimbursement agreement with a Bond Insurer, which agreement requires those payments to be treated on a parity of lien with the payments required to be made into the Reserve Account;
- (5) To make all payments required to be made into any revenue bond, note, warrant, or other revenue obligation redemption fund, debt service account, or reserve account created to pay or secure the payment of the principal of and interest on any revenue bonds, notes, warrants, or other obligations of the City having a lien upon the revenue of the Water System junior and inferior to the lien thereon for the payment of the principal of and interest on the Parity Bonds, including the State of Washington Public Works Trust Fund loans and the State Revolving Fund loans; and
- (6) To retire by redemption or purchase in the open market any outstanding revenue bonds or other revenue obligations of the Water System, to make necessary additional betterments, improvements, and repairs to or extensions and replacements of the Water System, to make deposits into the Rate Stabilization Account, or for any other lawful Water System purposes, including payment of gross earnings taxes to the City’s General Fund.

The City may transfer any money from any funds or accounts of the Water System legally available therefor, except bond redemption funds, refunding escrow funds, or defeasance funds, to meet the required payments to be made into the Bond Fund.

Rate Covenant

The City has pledged in the Bond Ordinance that it will establish, maintain, and collect rates and charges for services and facilities provided by the Water System which will be fair and equitable, and will adjust those rates and charges from time to time so that:

- (1) The Gross Revenue will be sufficient to (i) pay all Operation and Maintenance Expenses, (ii) pay when due all amounts that the City is obligated to pay into the Bond Fund and the accounts therein, and (iii) pay all taxes, assessments, or other governmental charges lawfully imposed on the Water System or the revenue

therefrom or payments in lieu thereof and any and all other amounts that the City may now or hereafter become obligated to pay from the Gross Revenue by law or contract; and

- (2) The Net Revenue of the Water System in each fiscal year will be at least equal to 1.25 times the Annual Debt Service that year on all Parity Bonds (the “Coverage Requirement”).

For purposes of the rate covenants, Tacoma Water’s share of costs of the Second Supply Project are Operation and Maintenance Expenses and are not part of Annual Debt Service. The failure of the City to comply with paragraphs (1) and (2) above will not be an Event of Default as defined in the Bond Ordinance if the City promptly retains an Independent Consulting Engineer or, once the Outstanding Parity Bonds are no longer Outstanding, an independent certified public accountant, to recommend to the City Council adjustments in the rates of the Water System necessary to meet the requirements of those subparagraphs and if the City Council adopts the recommended modifications within 180 days of the date the failure became known to the City Council.

Reserve Account

The Bond Ordinance obligates the City to fund the Reserve Account. The Reserve Requirement, as of any date, is an amount equal to the lesser of Maximum Annual Debt Service or 125% of Average Annual Debt Service on all outstanding Parity Bonds. Once the 2001 Bonds are no longer outstanding, the Reserve Requirement for a series of Parity Bonds shall not exceed 10% of the original net proceeds of such Parity Bonds. Upon the issuance of the Bonds, the City will use Bond proceeds in an amount that, together with the cash and Reserve Insurance policies for the Outstanding Parity Bonds, will satisfy the Reserve Requirement for the Bonds.

Any deficiency created in the Reserve Account by reason of any withdrawal therefrom for payment into the Principal and Interest Account must be made up within 12 months from money in the Water Division Fund after payment of Operation and Maintenance Expenses and deposits to the Principal and Interest Account.

The City has retained the right under the Bond Ordinance to obtain Reserve Insurance in lieu of specific amounts required to be on deposit in the Reserve Account, which Reserve Insurance may not be subject to cancellation on less than three years’ notice. Upon notice of cancellation, the City is obligated to fund the Reserve Account over a 36 month period from transfers from the Water Division Fund after making provision for payment of Operation and Maintenance Expenses and for required payments into the Bond Fund.

Once the 2001 Bonds, 2003 Bonds and 2005 Bonds are no longer outstanding, a supplemental ordinance may establish a separate reserve account for a series of Future Parity Bonds, in which case the Reserve Account shall not secure such Future Parity Bonds.

See Appendix A—“SUMMARY OF THE BOND ORDINANCE—PAYMENT OF AND SECURITY FOR THE BONDS.”

The Reserve Insurance Policies and Reserve Account Balance

Financial Guaranty Insurance Company (“Financial Guaranty”) issued municipal bond debt service reserve fund policies relating to the City’s Water System Revenue Bonds, 1997 (the “1997 Bonds”) (which were refunded by the 2005 Bonds), the 2001 Bonds and the 2005 Bonds. Such Financial Guaranty policies are reinsured by MBIA Illinois effective January 1, 2009. The maximum amount of the reserve policy relating to the 2005 Bonds is \$3,675,596 and is \$4,030,821 for the 1997 and 2001 Bonds. A reserve policy was obtained from Financial Security Assurance Inc., which is now known as Assured Guaranty Municipal Corp. (“FSA”) in the maximum amount of \$2,778,351.56 to satisfy the Reserve Requirement of the 2003 Bonds. Moody’s Investors Service (“Moody’s”), Standard & Poor’s Ratings Services (“S&P”) and Fitch Ratings (“Fitch”) have all withdrawn their ratings for Financial Guaranty. FSA is currently rated Aa3 and AAA by Moody’s and S&P, respectively. Fitch has withdrawn its rating for FSA. The ordinances authorizing the Outstanding Parity Bonds do not require that the Reserve Account be funded when the providers of reserve insurance are downgraded.

The surety policies issued by Financial Guaranty and FSA provide that upon the later of (i) one business day after the receipt by the applicable surety of a demand for payment executed by the Bond Registrar certifying that provision for the payment of principal of or interest on the Parity Bonds when due has not been made or (ii) the interest payment date specified in the demand for payment submitted to the applicable surety, the applicable surety provider will promptly deposit funds with the Bond Registrar sufficient to enable the Bond Registrar to make such payments due on the Parity Bonds, but in no event exceeding the policy limit of the surety policy so drawn on.

Pursuant to the terms of the surety policies, the policy limits of each are automatically reduced to the extent of each payment made by the insurer under the terms of the surety policies, and the City is required to reimburse the insurer for any draws under the surety policies with interest at a market rate. Upon such reimbursement, the surety policies are reinstated to the extent of each reimbursement up to but not exceeding the applicable policy limits. The reimbursement obligation of the City under the surety policies is subordinate to the City's obligations with respect to the Parity Bonds.

In the event the amount on deposit in, or credited to, the Reserve Account exceeds the amount of the surety policies, any draw on the surety policies shall be made only after all the funds in the Reserve Account have been expended. In the event that the amount on deposit in, or credited to, the Reserve Account, in addition to the amount available under the surety policies, including amounts available under a Reserve Account Instrument, draws on the surety policies and additional Reserve Account Instrument shall be made on a pro rata basis to fund the insufficiency. The surety policies do not insure against nonpayment caused by the insolvency or negligence of the Bond Registrar.

Financial Guaranty and FSA are subject to the informational requirements of the Exchange Act and in accordance therewith files reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). Certain SEC filings of Financial Guaranty are available on the company's website, www.fgic.com (which is not incorporated herein by this reference). Certain SEC filings of FSA are available on the company's website, www.assuredguaranty.com (which is not incorporated herein by this reference). Such reports, proxy statements and other information may also be inspected and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549.

In connection with the issuance of the 2009 Bonds, \$4,419,509 of 2009 Bond proceeds were deposited into the Reserve Account. The balance in the Reserve Account as of May 31, 2010 was \$4,479,016.

Rate Stabilization Account

The Bond Ordinance authorizes a Rate Stabilization Account in the Water Division Fund. The City has created a Rate Stabilization Account and deposited money into such account in 2009. The balance of the account was \$35,463,689 as of May 31, 2010. For purposes of calculating the Coverage Requirement described under "Rate Covenant," Net Revenue excludes deposits into the Rate Stabilization Account and includes withdrawals from the Rate Stabilization Account. See Appendix A—"SUMMARY OF THE BOND ORDINANCE—PAYMENT OF AND SECURITY FOR THE BONDS."

Additional Obligations

Future Parity Bonds. Pursuant to the Bond Ordinance, the City has reserved the right to issue Future Parity Bonds or to enter into Parity Payment Agreements for purposes related to the Water System or to refund a portion of the Parity Bonds upon satisfaction of certain conditions set forth in the Bond Ordinance. Before issuing Future Parity Bonds, among other things, there must be on file with the City either:

- (1) A certificate of the Finance Director demonstrating that during any 12 consecutive calendar months out of the immediately preceding 24 calendar months Net Revenue was at least equal to 1.25 times the projected Maximum Annual Debt Service for all Parity Bonds then outstanding plus the Future Parity Bonds proposed to be issued; or
- (2) A certificate of an Independent Consulting Engineer or certified public accountant that in his or her opinion the Net Revenue will be at least equal to 1.25 times the projected Average Annual Debt Service for all

Parity Bonds then outstanding plus the Future Parity Bonds proposed to be issued. In providing that certificate, the Independent Consulting Engineer or certified public accountant may take into account certain adjustments to Net Revenue as permitted by the Bond Ordinance.

If the Future Parity Bonds proposed to be issued are for the sole purpose of refunding outstanding bonds payable from the Bond Fund, no such coverage certification shall be required if the Annual Debt Service on the Parity Bonds after the issuance of the Future Parity Bonds is not, for any year in which Parity Bonds are outstanding, more than \$5,000 over the Annual Debt Service on the Parity Bonds prior to the issuance of those Future Parity Bonds.

See Appendix A—“SUMMARY OF THE BOND ORDINANCE—PROVISIONS FOR FUTURE PARITY BONDS.”

Parity Payment Agreements and Reimbursement Obligations. The Bond Ordinance permits the City to enter into a Payment Agreement for the purpose of managing or reducing the City’s exposure to fluctuations or levels of interest rates, currencies or commodities or other interest rate, investment, asset or liability management purposes. Upon satisfaction of the requirements for the issuance of Future Parity Bonds, a Payment Agreement may constitute a charge and lien on the Net Revenue of the Water System equal in rank with the charge and the lien of Parity Bonds. The City has not entered into any such Parity Payment Agreements and has no plans to do so at this time. See Appendix A—“SUMMARY OF THE BOND ORDINANCE—PAYMENT AGREEMENT AND PARITY PAYMENT AGREEMENTS.”

If the City elects to meet the Reserve Requirement or any portion thereof through the use of Reserve Insurance, the City may contract that payments to reimburse the provider of the Reserve Insurance shall be on a parity of lien with the payments required to be made into the Reserve Account. The reimbursement obligations for the debt service reserve fund policies for the Outstanding Parity Bonds are on a parity with the obligation to make payments into the Reserve Account. See “—The Reserve Insurance Policies and Reserve Account Balance.”

Contract Resource Obligations. Pursuant to the Bond Ordinance, the City may at any time enter into one or more obligations for the acquisition, from facilities to be constructed, of water supply, transmission, treatment, or other commodity or service relating to the Water System. Upon compliance with certain requirements of the Bond Ordinance, the City may determine that such contract or obligation is a Contract Resource Obligation and may provide that all payments under that Contract Resource Obligation (including payments prior to the time that water supply, transmission, treatment, or other commodity or service is being provided, or during a suspension or after termination of supply or service) shall be Operation and Maintenance Expenses. The Regional System is a Contract Resource Obligation of the Water System. Before entering into a Contract Resource Obligation, among other things, there must be on file a certificate of an Independent Consulting Engineer stating that (i) the payments to be made by the City in connection with the Contract Resource Obligation are reasonable for the supply, transmission, treatment, or other service rendered; (ii) the source of any new supply, and any facilities to be constructed to provide the supply, transmission, treatment, or other service, are sound from a water or other commodity supply or transmission planning standpoint, are technically and economically feasible in accordance with prudent utility practice, and are likely to provide supply or transmission no later than a date set forth in the Independent Consulting Engineer’s Certification; and (iii) the Net Revenue (further adjusted by the Independent Consulting Engineer’s estimate of the payments to be made in accordance with the Contract Resource Obligation) for the five fiscal years following the year in which the Contract Resource Obligation is incurred, as such Net Revenue is estimated by the Independent Consulting Engineer (with such estimate based on such factors as he or she considers reasonable), will be at least equal to the Coverage Requirement. Payments required to be made under Contract Resource Obligations shall not be subject to acceleration. See Appendix A—“SUMMARY OF THE BOND ORDINANCE—SEPARATE UTILITY SYSTEMS; CONTRACT RESOURCE OBLIGATIONS.”

Junior Lien Obligations. Nothing in the Bond Ordinance prohibits the issuance of obligations of the Water System junior to the lien of the Parity Bonds. Tacoma Water currently has outstanding seven low-interest loans from the State of Washington Public Works Trust Fund totaling \$26,188,422 and three low-interest loans from the State Revolving Fund totaling \$11,032,632, which are junior to the Bonds in their lien on the revenues and funds of the Water System.

Additional Covenants

The Bond Ordinance also contains covenants regarding operation and maintenance of the Water System, sale, transfer, or disposition of the Water System, no free service, liens upon the Water System, books and accounts, collection of delinquent accounts, maintenance of insurance and condemnation awards and insurance proceeds. See Appendix A—“SUMMARY OF THE BOND ORDINANCE—COVENANTS WITH BONDOWNERS.”

Permitted Investments

Money held in the Bond Fund (and the accounts therein) and the Bond proceeds account may be invested in legal investments, and any earnings may be retained in such fund or account for the purpose of that fund or transferred to the Bond Fund. For a description of the funds and accounts created by the Bond Ordinance, see Appendix A—“SUMMARY OF THE BOND ORDINANCE—PAYMENT OF AND SECURITY FOR THE BONDS.”

No Acceleration

Neither a bondowner nor any bondowners’ trustee has the right under the Bond Ordinance to accelerate the payment of debt service on the Bonds upon the occurrence of an Event of Default.

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DEBT SERVICE REQUIREMENTS AND ADDITIONAL BORROWING

The following table shows Tacoma Water’s Contract Resource Obligation payments for its share of debt service on the Regional System Bonds, debt service on the Outstanding Parity Bonds and debt service on the Bonds. The table does not show \$37,221,054 in junior lien Tacoma Water loans. See “SECURITY FOR THE BONDS—Additional Obligations.”

Summary of Debt and Debt Service Requirements

Year	Contract Resource Obligation (1)	Outstanding Parity Bonds (2)(3)	The Bonds		Total Parity Bond Debt Service (4)
			Principal	Interest (2)	
2010	\$ 2,666,768	\$ 15,179,063	--	--	\$ 15,179,063
2011	4,430,767	13,357,068	--	\$ 6,760,747	20,117,815
2012	4,047,013	12,910,680	\$ 515,000	5,325,752	18,751,432
2013	4,052,427	12,906,680	530,000	5,315,452	18,752,132
2014	4,056,066	12,899,680	550,000	5,304,852	18,754,532
2015	4,085,425	12,904,274	555,000	5,293,852	18,753,126
2016	4,109,940	12,918,237	555,000	5,277,202	18,750,439
2017	4,113,813	12,925,174	570,000	5,260,552	18,755,726
2018	4,123,302	9,619,674	3,935,000	5,243,452	18,798,126
2019	4,593,706	9,617,393	4,100,000	5,086,052	18,803,445
2020	4,607,548	9,611,712	4,260,000	4,922,052	18,793,764
2021	4,617,456	9,607,368	4,480,000	4,709,052	18,796,420
2022	4,623,432	9,609,830	4,655,000	4,529,852	18,794,682
2023	4,643,523	10,105,580	4,395,000	4,297,102	18,797,682
2024	5,736,637	6,835,330	2,365,000	4,077,352	13,277,682
2025	5,744,014	6,835,580	2,435,000	3,969,012	13,239,592
2026	5,730,600	4,415,330	4,930,000	3,855,029	13,200,359
2027	5,737,307	4,415,330	5,085,000	3,614,396	13,114,726
2028	5,735,966	4,415,330	5,265,000	3,341,281	13,021,611
2029	5,753,404	4,415,330	5,445,000	3,058,498	12,918,828
2030	5,748,039	4,415,330	5,640,000	2,766,047	12,821,377
2031	5,760,782	4,415,330	5,835,000	2,463,122	12,713,452
2032	5,495,185	4,415,330	6,050,000	2,135,137	12,600,467
2033	4,126,537	14,215,330	2,115,000	1,795,066	18,125,396
2034	4,073,084	14,016,732	2,195,000	1,676,182	17,887,914
2035	4,019,010	13,812,143	2,275,000	1,552,801	17,639,944
2036	3,959,034	13,600,700	2,355,000	1,424,924	17,380,624
2037	3,898,155	13,376,541	2,445,000	1,292,549	17,114,090
2038	3,836,094	13,149,090	2,535,000	1,155,116	16,839,206
2039	3,772,568	12,912,197	2,625,000	1,012,623	16,549,820
2040	3,707,297	--	15,390,000	865,072	16,255,072
TOTAL (4)	\$ 141,604,908	\$ 303,833,368	\$ 104,085,000	\$ 107,380,181	\$ 515,298,549

- (1) Includes Tacoma Water’s share of debt service on the 2002 RWSS Bonds and the 2010 RWSS Bonds (before the federal credit payments), which are being issued simultaneously with the Bonds. Payable as an Operation and Maintenance Expense. See “THE WATER SYSTEM – The Second Supply System.”
- (2) Before 35% federal credit payments.
- (3) Excludes the 2001 Bonds refunded with the 2010A Bonds.
- (4) Totals may not foot due to rounding.

Additional Borrowing

The City does not plan to issue Future Parity Bonds in the next year. The City currently plans to issue additional RWSS Bonds, and may issue Tacoma Water bonds, between 2012 and 2014 to fund the remaining construction of the filtration project to meet Federal and State drinking water regulations. See “THE WATER SYSTEM—Water Quality and Treatment” for a discussion of the City’s water treatment project.

THE CITY

The City of Tacoma was incorporated in 1884 and utilizes the Council Manager form of government, which is administered by a City Council under the Constitution and laws of the State of Washington and the City Charter. The City Council is composed of a Mayor and eight Councilmembers, five of whom are elected from districts which have been apportioned according to population. The three remaining positions are “at large” positions, nominated and elected City-wide. The Councilmember positions are four year terms with overlapping terms to allow for the election of four new Councilmembers every two years. The Mayor is elected City-wide for a four year term and is the presiding officer of the City Council. Councilmembers, including the Mayor, can serve no more than ten consecutive years as a member of the City Council, Mayor or combination thereof.

The City Council appoints a City Manager who is the chief executive officer of the City and who serves at the pleasure of the City Council. The City Manager is responsible to the City Council for the administration of all departments of the City with the exception of the Department of Public Utilities. The City Manager has the power to appoint department heads.

The City Manager appoints a Finance Director who supervises the financial and purchasing functions of the City, including the City’s accounting system. The Finance Director is responsible for preparing the Comprehensive Annual Financial Report (“CAFR”) in accordance with generally accepted accounting principles and the instructions of the State Auditor’s Office. The Finance Director is responsible for the payment of principal and interest on all bonds issued by the City, including the Bonds. The Finance Director is responsible for the preparation and monitoring of the biennial budget, which provides for the servicing of debt and provides for anticipated revenues to meet the estimated costs of expenditures. The budget is presented to the City Council for its review and approval and final adoption.

The City Manager appoints a City Treasurer who is responsible for the receipt, custody and disbursement of all City funds, including funds of Tacoma Water. The City Treasurer receives all money due and belonging to the City, and keeps a detailed account of the same in the manner prescribed by the Finance Director. A Finance Committee composed of the Mayor, Finance Director and City Treasurer controls the investment of City funds.

THE DEPARTMENT OF PUBLIC UTILITIES—TACOMA WATER

Department of Public Utilities

The City Charter provides for a Department of Public Utilities (the “Department”) governed by a five member Public Utility Board (the “Board”). The Board is responsible for general utility policy, and its members are appointed by the Mayor and confirmed by the City Council. The Department’s budget is presented to the Board for review and approval and then forwarded to the City Council for approval and inclusion in the City’s budget. The Board meets bi-monthly.

The Department consists of the Light Division (“Tacoma Power”), Water Division (“Tacoma Water”), and Belt Line Railroad Division (“Tacoma Rail”). The Board serves as the sole policy board for the approval of most Department business. In the case of budgets, rates, bond issues, real property transactions, and system expansions, actions approved by the Board must also be approved by the City Council.

The Board appoints the Director of Utilities, who is chief executive officer of the Department and serves at the pleasure of the Board. The Director, with the concurrence of the Board, has the power to appoint division superintendents.

Utility rates and charges initiated by the Board and adopted by the City Council are not subject to review or approval by any other governmental agency.

The City Charter provides that, except for a reasonable gross earnings tax imposed by the City Council for the benefit of the City’s general fund, the revenues of utilities owned and operated by the City may not be used for any purposes other than the ongoing operations of the utilities and payment of debt service on utility debt. The funds of

any utility may not be used to make loans to or purchase the bonds of any other utility, department, or agency of the City.

Tacoma Water—General

Tacoma Water was formed in 1893 when the City purchased the water and light utility properties of the former Tacoma Water and Light Company. The City acquired rights for up to 73 million gallons per day (“MGD”) of water from the Green River and in 1910 began construction of the Green River gravity system, which includes the headworks dam facilities, 43 miles of pipeline and 110 million gallons (“MG”) of storage. Water from the Green River was first delivered to the City in 1913. The City was awarded a second water right on the Green River in 1986 for 65 MGD.

As the City grew, a system of wells was developed in south Tacoma and on the North Fork of the Green River to meet summer peak use periods as well as the City’s needs during periods of turbidity in the Green River. Today, the system of wells has a capacity of approximately 59 MGD and on an annual basis supplies approximately 5% of the City’s water needs.

Tacoma Water is one of the largest publicly owned water utilities in the State of Washington. The following table displays selected operating data regarding Tacoma Water as of December 31, 2009 and 2008.

Selected Operating and Financial Data Calendar Years 2009 and 2008

	2009	2008
Average Number of Metered Customers	96,982	95,858
Operating Revenue	\$ 63,994,000	\$ 57,025,000
Total Water Billed (Million Gallons)	18,541	18,252
Average Daily Use (Million Gallons)	54.6	54.4
Maximum Daily Use (Million Gallons)	100.4	86.6

Source: Water Division, 2009 and 2008 Financial Reports.

Service Area

Tacoma Water’s current service area consists of the City and the urbanized areas of Pierce and south King Counties. The area extends from the northerly boundary of Lakewood Water District and Parkland Light and Water Company in the south, northward to the City of Federal Way in King County. The eastern boundary is the foothills of the Cascade Mountains. The western boundary is Puget Sound. Water service outside the City limits is provided under franchises granted by both Pierce County and King County, and the cities of Puyallup, Federal Way, Lakewood, Fircrest and University Place. Approximately 39% of Tacoma Water’s residential service is outside of the City limits.

Tacoma Water’s service outside of the City limits began in 1912 when customers adjacent to the first transmission pipeline from the Green River were served from the transmission line and from distribution extensions from the pipeline. As a result, the Water System serves customers as far away as Palmer and Cumberland in King County.

Tacoma Water is the exclusive retail provider of water service within the City and is designated as a key provider of water service within Pierce County under the Pierce County Coordinated Water System Plan. Tacoma Water presently provides direct service to some customers within the city limits of several municipalities, including the cities of Federal Way, Puyallup, and University Place.

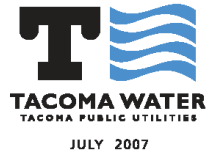
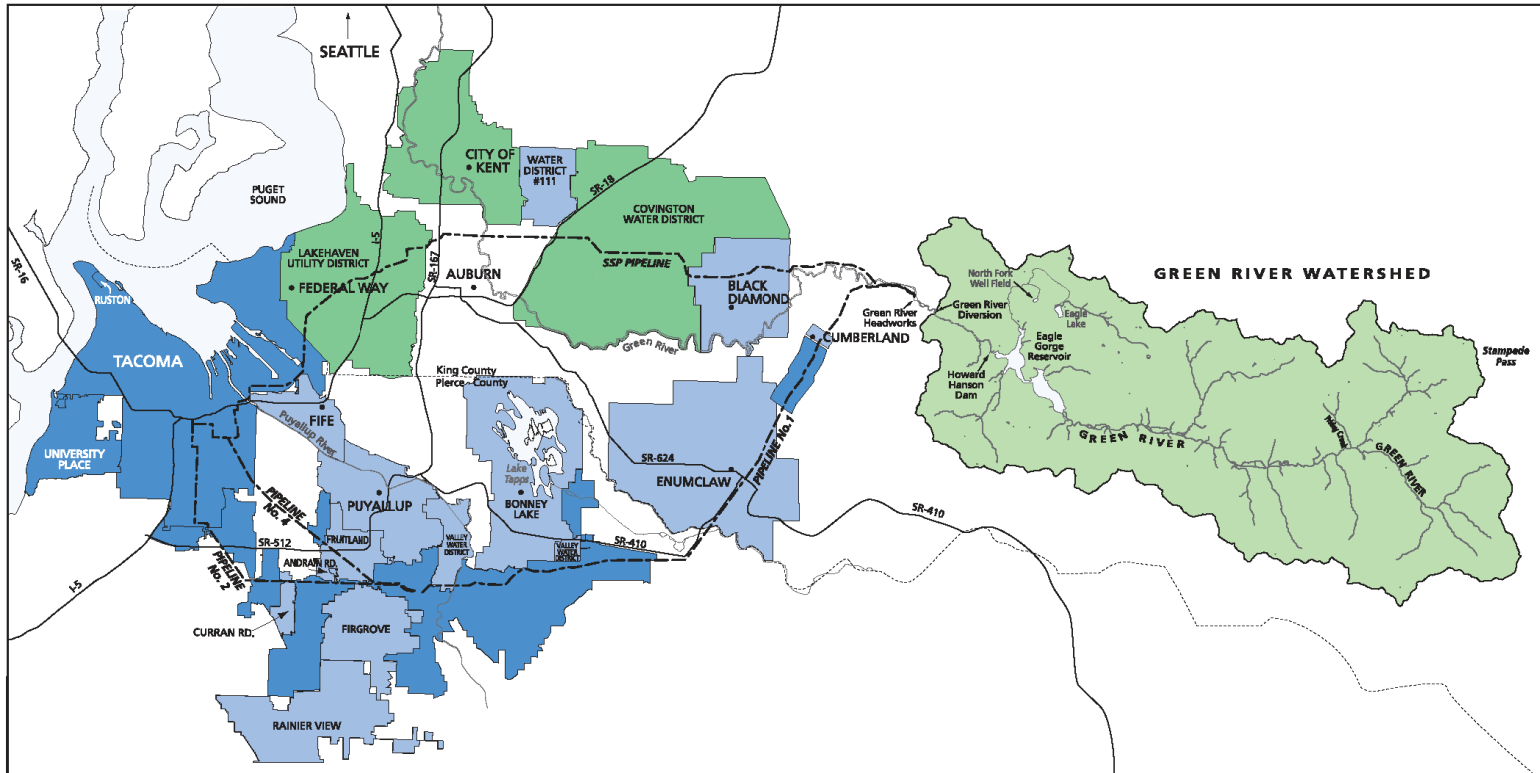
Historically, the Water System has expanded in order to meet City growth and to supply surrounding communities and water utilities. Over the years, the City has acquired water districts, water companies, and cooperatives as well as individual services outside the City limits. The City will continue such an acquisition program when requested, provided it is economically sound and consistent with growth management policy.

The State of Washington has a Growth Management Act which directs growth to the urbanizing areas. Dense development in rural areas is generally discouraged. It is anticipated that the direction of growth to the urbanizing areas will most likely result in an increase in the demand for water in the City's service area in coming years.

Currently, wholesale service is a small part of Tacoma Water's operations. Less than 5% of revenue is derived from that source but it is expected to grow substantially as additional water rights become more difficult to obtain by nearby growing communities that rely on limited ground water supplies.

The following map shows Tacoma Water's service area and the service areas of the participants of the Second Supply System Project.

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LEGEND	
■	Retail Service Area
■	Wholesale Service Area
■	Second Supply Project Partners

Management

Brief descriptions of the backgrounds of key officials of the City, the Department, and Tacoma Water follow.

William A. Gaines, Director of Utilities, assumed his position in October 2007, after serving as Superintendent/Chief Operating Officer of Tacoma Power for a year. Mr. Gaines, an experienced executive with approximately 30 years in the utility industry, came to Tacoma from Seattle City Light, where he served as Power Supply and Environmental Affairs Officer and as Power Management Executive. He spent much of his career as an executive officer at Puget Sound Energy, where he served as Vice President for Engineering and Contracting and as Vice President for Energy Supply. Mr. Gaines is active in regional industry groups including the Public Power Council, Pacific Northwest Utilities Conference Committee and Western Systems Power Pool, and sits on the Board of the Tacoma/Pierce County Chamber of Commerce and the Pierce County Economic Development Board. Mr. Gaines received a B.S. degree in electrical engineering from Washington State University and an M.B.A. from the University of Puget Sound. He also attended the executive development program at Stanford University.

Linda McCrea, P.E., Superintendent, Water Division, joined the City in 1980, became the Water Distribution Manager in 1993, became Deputy Water Superintendent in 2006 and was appointed Superintendent in January 2010. She has a B.S. in civil engineering from the University of Washington.

Jane Evancho, P.E., Rates and Financial Analysis Manager, joined the City in 1987, became the Water Resource Planning Manager in 1993 and became the Rates and Financial Analysis Manager in July 2009. She has a B.S. and M.S. in agricultural engineering from Oregon State University.

Steven Standley, P.E., Interim Water Distribution Engineering Manager, joined the City in 1992 with the Public Works Department. He joined Tacoma Water in 2000 and became interim Distribution Engineering Manager in April 2010. He holds a B.S. in Civil Engineering from Saint Martin's University, a B.A. in Business Administration and a B.S. in Mathematics from Washington State University.

Heather Pennington, P.E., Resource Planning Manager, joined Tacoma Water in 1994, and became Tacoma Water's interim Distribution Manager in 2006, Distribution Engineering Manager in 2007 and Resource Planning Manager in July 2009. She holds an M.B.A. from Pacific Lutheran University and a B.S. in environmental engineering from Northwestern University.

Chris McMeen, P.E., Water Quality Manager, joined the City in 2002. He has over 20 years experience in the drinking water industry, including work as an engineering consultant, drinking water regulator, utility engineer, and since 2004, Water Quality Manager for Tacoma Water. He has a B.S. and M.S. in civil engineering from the University of Washington.

Glen George, P.E., Water Supply Manager, joined the City in 1992 as a Civil Engineer and became the Water Supply Manager in March 2010. He has a B.S. in civil engineering from the University of Washington.

Raymond West, Water Distribution Operations Manager, joined Tacoma Water in 1975 and became Assistant Distribution Manager in 1998 and the Distribution Operations Manager in 2007. He has several certifications including electronics and a State of Washington Water Works Operator license.

Budgetary Policies

The Tacoma Water biennial budget is proposed by the Public Utility Board and adopted by the City Council with legal budgetary control at the fund level, i.e., expenditures may not exceed budgeted appropriations at the fund level. The City Manager or Director of Utilities, as appropriate, may authorize transfers within funds; however, the City Council must approve, by ordinance, any amendments that increase the total expenditures for the fund.

Auditing

Accounting systems and budgetary controls are prescribed by the Office of the State Auditor in accordance with RCW 43.09.200 and RCW 43.09.230. State statutes require audits for cities to be conducted by the Office of the State Auditor. The City complies with the systems and controls prescribed by the Office of the State Auditor and establishes procedures and records which reasonably assure safeguarding of assets and the reliability of financial reporting.

The State Auditor is required to examine the affairs of cities at least once every two years. The City is audited annually. The examination must include, among other things, the financial condition and resources of the City, whether the laws and constitution of the State are being complied with, and the methods and accuracy of the accounts and reports of the City. Reports of the auditor's examinations are required to be filed in the Office of the State Auditor and in the finance department of the City.

The City contracts with Moss Adams LLP to perform the annual audit of the financial statements of Tacoma Water. The audited financial statements of Tacoma Water for fiscal years 2008 and 2009 prepared by Tacoma Water and audited by Moss Adams LLP are contained in Appendix C. Moss Adams LLP, the City's independent auditor, has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. Moss Adams LLP also has not performed any procedures related to this Official Statement.

Retirement System

Substantially all employees of Tacoma Water are covered by a contributory retirement plan administered by the City's Employee Retirement System. The Retirement System covers employees of the City other than law enforcement officers, fire fighters, and railroad employees, who are covered by retirement plans operated by other entities. Contributions by Tacoma Water in 2009 totaled approximately \$1,518,000. The contribution rate for Tacoma Water's covered payroll is currently set at 18.0% of gross wages for 2010 (9.36% paid by Tacoma Water and 8.64% paid by employees). Tacoma Water is current in all payments to the Retirement System. Further details about the plan are provided in Note 9 in Appendix C—"2009 AND 2008 FINANCIAL STATEMENTS."

Milliman Inc., an actuarial firm, performed an actuarial valuation of the Retirement System as of January 1, 2009, which found that due to the rapid decline of the investment markets in 2008, based on the actuarial value of assets, the contribution rates in effect for 2009 and approved for 2010 are sufficient to meet the actuarial costs of the Retirement System. However, based on the market value of the assets as of January 1, 2009, and the assumptions in the actuarial valuation, additional contribution rate increases may be needed in future years. As of April 30, 2010, the funding status on a market basis for assets in the Retirement System was 87.6%. The City is actively monitoring the Retirement System.

Other Post-Employment Benefits

The City allows retirees to participate in medical, dental and vision programs from the time retirement begins until they qualify for Federal funded programs. The City uses pay as you go funding, and upon retirement the retiree is responsible for paying a blended premium, which prior to retirement was paid by the City. The benefit is an implicit subsidy to the retiree. As of December 31, 2009, the City's net OPEB obligation was \$18,872,723, of which \$878,592 was related to the Water System. Further details about OPEB are provided in Note 10 in Appendix C—"2009 AND 2008 FINANCIAL STATEMENTS."

Taxation

Under the City Charter and State law, the City Council may impose a gross earnings tax not exceeding 8.0% upon the revenues of Tacoma Water. The current tax rate is 8.0%. Under the Bond Ordinance, the gross earnings tax is subordinate to the payments required to be made into any fund or funds previously or subsequently created for the payment of the principal of and interest on water revenue bonds of the City.

Tacoma Water pays an excise tax imposed by the State of Washington presently at the rate of 5.029% of gross revenues, with certain exceptions. Tacoma Water also pays miscellaneous fees, licenses, and sales and use taxes. Certain of these taxes and payments are Operation and Maintenance Expenses of the Water System and Operating Expenses of the Regional System.

Program of Insurance

Tacoma Water currently maintains insurance policies and a self insurance program. The insurance policies presently in effect include coverage on the Department's buildings and fleet vehicles as well as general liability and public officials liability. The current insurance policies have deductibles or self insured retention of \$250,000 for buildings and vehicles, and \$1,000,000 for general comprehensive liability. The public officials policy has a deductible of \$200,000 for employee practices liability and \$100,000 for all other issues. The general comprehensive liability policies provide \$20 million of coverage. The City has a policy to cover extraordinary worker's compensation claims with a limit of \$25 million and \$1 million per occurrence. Earthquake coverage has a 3% per building self-insured retention.

Tacoma Water participates in the Department's self insurance claim fund (the "Self Insurance Fund") for payment of third party claims. As of December 31, 2009, assets in the Self Insurance Fund totaled \$4.6 million, which exceeds accrued and incurred but not reported liabilities. Tacoma Water's premium payments in both 2009 and 2008 totaled \$120,000. Contributions are routinely reviewed to determine their adequacy. The Self Insurance Fund is dedicated and requires a two thirds vote of the City Council before it can be used for anything except insurance or casualty losses. The City and the other Second Supply Project Participants separately insure or self insure the Second Supply Project and potential liabilities arising from or related to the Second Supply Project.

Performance and fidelity bonds covering all employees are provided in amounts up to \$1 million (subject to a \$50,000 deductible per occurrence).

The City maintains a separate self insurance fund for payment of third party claims against the general fund and certain utilities (not including the Water System).

Financial Policies

Tacoma Water has formally adopted certain goals as a guide to financial management and rate setting. These goals are included in the Water Rate Policies and are periodically reviewed and approved by the Board and City Council after any modification. These goals include rates based on cost of service within a customer class, restrictions on the term of debt, a minimum of 50% of routine capital financed with current revenues, that long term major projects be financed through debt, and maintenance of a minimum of 45 days of operating cash. The policies provide that water rates must be designed to adequately fund acquisition of new resources and conservation. The Board and City Council approved the amended Water Rate Policies in January 2003.

Tacoma Water operates under the guidance of a ten year business plan, which was most recently revised in 2010 to cover the period 2011 through 2020. This plan identifies key planning goals and customer, operational, and capital programs that the utility must address. The plan also addresses financing and rate requirements necessary to support the implementation of the operations and capital programs. This document serves as the basis for developing Tacoma Water's budget and is reviewed by the Board and City Council pursuant to budget and rate adjustment approval.

State law and City policies permit City utilities to borrow on a short-term basis from the General Fund. Tacoma Water has not borrowed from the General Fund and has no plans to do so.

Labor Relations

Tacoma Water has approximately 280 employees, many of which are represented by Local 483-International Brotherhood of Electrical Workers ("IBEW"), one of the 12 labor organizations that represent City employees. Other units representing Tacoma Water employees include Local 117-Teamsters, Local 17-Professional and

Technical Engineers, and Local 120-AFSCME. Negotiations with unions are conducted by a team chaired by a Human Resources Labor Relations staff member selected by the Human Resources Director, who reports directly to the City Manager. Management of Tacoma Water strives to promote sound labor relations policies that are beneficial both to its operations and to its employees. This cooperative effort has precluded a significant work stoppage among utility employees for the last several decades, although there was an 11 day work stoppage by clerical members of IBEW, Local 483, in 1992.

As provided by State law, matters that are delegated by the City Charter to the City's Civil Service Board are established by law and are not negotiated at the bargaining table. Such matters include issues relating to tenure of employment, hiring, recruitment, and termination. Additionally, retirement benefits through the Tacoma City Employees' Retirement System historically have been recommended by the Tacoma Retirement Board, which includes representatives of City employees and retirees, as well as City management, and approved by the City Council.

Investments

The investment of Tacoma Water's temporary excess funds is administered by the City Treasurer on behalf of the City's Finance Committee. The City has an investment policy that was last amended in August 2007 (the "Investment Policy"). The City Treasurer submits written reports of investment activity to the Finance Committee. The Finance Committee meets quarterly, and more often as needed.

In accordance with such Investment Policy, the City invests a portion of these excess funds in the Washington State Local Government Investment Pool (the "LGIP"). The Water System also currently invests its funds in the City's investment pool. The City Treasurer operates the investment portfolio as the Tacoma Treasury Investment Pool, where each fund has an undivided interest in the pool and earnings are allocated daily to each fund. The City may invest in the following securities in accordance with State law: U.S. Treasury and Agency Obligations, Certificates of Deposits with qualified Washington State Public Depositories, Bankers Acceptances, Commercial Paper, Repurchase and Reverse Repurchase Agreements, and any other future investment authorized by State statute. The Investment Policy, which has been awarded the Certification for Excellence by the Municipal Treasurers' Association of the United States and Canada, establishes diversification requirements for each security type. The maturity of any individual security is limited to five years for operating funds and the average maturity of the portfolio may not exceed three years. Bond reserve accounts may be invested for longer periods. Reverse repurchase transactions are limited to 5% of the portfolio. The City does not borrow money for the primary purpose of investing.

The State Treasurer's Office administers the LGIP, an \$8.7 billion fund that invests money on behalf of more than 460 participants (as of December 31, 2009). In its management of LGIP, the State Treasurer is required to adhere, at all times, to the principles appropriate for the prudent investment of public funds. These are, in priority order, (i) the safety of principal; (ii) the assurance of sufficient liquidity to meet cash flow demands; and (iii) to attain the highest possible yield within the constraints of the first two goals. Historically, the LGIP has had sufficient liquidity to meet all cash flow demands.

The LGIP, authorized by chapter 43.250 RCW, is a voluntary pool which provides its participants the opportunity to benefit from the economies of scale inherent in pooling. It is also intended to offer participants increased safety of principal and the ability to achieve a higher investment yield than would otherwise be available to them. The LGIP is restricted to investments with maturities of one year or less, and the average life typically is less than 90 days. Investments permitted under the guidelines of the LGIP include U.S. government and agency securities, bankers' acceptances, high quality commercial paper, repurchase and reverse repurchase agreements, motor vehicle fund warrants, and certificates of deposit issued by qualified Washington State depositories.

As of December 31, 2009, the City’s cash and investments, on a fair value basis, totaled \$951 million, of which a portion was Tacoma Water funds. The portfolio was distributed in various types of investment instruments in the following percentages:

**City Investments
(As of December 31, 2009)**

Bank Interest-Bearing Accounts	6.86%
LGIP	21.26
Municipal Securities	14.23
Federal Agricultural Mortgage Corp (Farmer Mac)	2.32
Federal Home Loan Mortgage Assn (Freddie Mac)	19.60
Federal Farm Credit Bank (Farm Credit)	4.11
Federal Home Loan Bank (Home Loan)	9.67
Federal National Mortgage Ass’n (Fannie Mae)	19.84
U.S. Treasuries	0.08
Secured Repurchase Agreements	0.92
Commercial Paper	1.11
Total	100.00%

THE WATER SYSTEM

Sources of Supply

The primary current source of supply for the Water System is a headworks diversion on the Green River approximately 30 miles east of the City, which is capable of supplying up to approximately 167 MGD to Tacoma Water and its Second Supply Project partners. Water withdrawn at the headworks is chlorinated, fluoridated, treated with ozone, and pH adjusted before being introduced into Pipeline No. 1 and the Second Supply pipeline. Pipeline No. 1 transports up to 72 MGD through or near the cities of Enumclaw, Buckley, Bonney Lake, Puyallup, and other urbanized areas before discharging it into McMillin Reservoir. The Second Supply pipeline transports up to 95 MGD through the cities of Black Diamond, Auburn, Federal Way, and Tacoma before discharging into Pipeline No. 4. The Green River diversion and Pipeline No. 1 were originally constructed in 1913. Over the years, nearly all of the original Pipeline No. 1 has been replaced and improvements to the diversion dam have occurred as a component of the Second Supply Project. The Second Supply pipeline itself began delivering water in October 2005.

The watershed, located above the diversion, consists of approximately 230 square miles of timbered and mountainous terrain. The U.S. Army Corps of Engineers (the “Army Corps”) constructed Howard Hanson Dam and Reservoir in 1961, forming the Eagle Gorge Reservoir, about three miles upstream from Tacoma Water’s headworks diversion dam. The primary authorized purpose of the dam is to provide flood control for the Green River valley during the winter. Secondary authorized purposes include augmentation of low summer flows downstream of the dam, irrigation and storing water for municipal water supply purposes by Tacoma Water and its Second Supply Project partners. The Army Corps is responsible for managing flood control and due to damage caused by a storm event in January 2009, is currently engaged in major rehabilitation of the Howard Hanson Dam to maintain the structural integrity of the dam and assure future flood control. The Army Corps is responsible for costs of this project. Tacoma Water has taken preemptive steps to protect the infrastructure in case of high river flows if the Army Corps is required to release larger than normal amounts of water.

In the 1970s, Tacoma Water drilled seven wells on the North Fork of the Green River (the “North Fork Wells”) approximately six miles upstream from the headworks. The North Fork Wells have been effective in maintaining the quality of Tacoma Water’s main water supply during high turbidity in the Green River source. The well water either blends with the river water or replaces the river water depending on the level of turbidity.

In addition to the North Fork Wells, Tacoma Water has a number of wells within its service area that can be used to meet peak summer water demands. During a typical year, approximately 95% of the Water System’s water supply is from the Green River and 5% is from these wells. The following table summarizes the water supplied by source

during 2009 to meet the peak and average water requirements for Tacoma Water only, it does not include capacity or production values for the Second Supply Participants (see the “The Second Supply System” below).

**Tacoma Water
2009 Sources of Supply of the Water System
(MGD)**

<u>Source</u>	<u>Peak Capacity</u>	<u>Peak Day Production**</u>	<u>Average Production**</u>
Surface Water Sources:			
Green River	111.58*	85.54	50.97
Groundwater Sources:			
Wells	52.16	17.10	3.40
Total Sources	163.74	102.64	54.37

* Tacoma’s Peak Green River capacity is limited by pipe/plant capacity (see “Water Rights” discussion below), which is 72 MGD for Pipeline No. 1 plus 15/36 of 95 MGD (39.58 MGD) for the Second Supply Pipeline.

** 2009 Tacoma water use (excludes Second Supply water use by Kent, Covington and Lakehaven).

Including Tacoma’s Participant Share in the Second Supply Project, the Water System has sufficient water supply to meet its current customers and expected growth until at least 2050.

Water Rights

Tacoma Water has water rights on the Green River in excess of its current needs, which include a water right claim for 73 MGD (the “First Diversion Water Right”) plus a Water Permit for the Second Diversion Water Right of up to 15/36 of 65 MGD and is the source of supply for the Second Supply System, as further described in “THE WATER SYSTEM—The Second Supply System.” Second Diversion Water is conditional based on Green River flow and is, therefore, only available approximately 60% of the time on an annual basis. However, Second Diversion Water may be stored behind Howard Hanson Dam in the spring, and as the water is being stored at a rate not to exceed the Second Diversion Water Right rate, it may be withdrawn at a later date, at any rate. Therefore, when needed in the peak season, water from the Green River source may be used at a rate that is limited only by pipe/plant capacity.

Water rights for the Water System’s 25 wells, most of which are located within its water service area, total 87 MGD, with an installed pumping capacity of 60 MGD.

During the last decade it has become increasingly difficult for Washington State water systems to obtain new water rights because of uncertainties in the administration of these rights. Major concerns include legal challenges to the Washington State Department of Ecology’s (“Ecology”) authority to administer water rights and concern that the additional appropriation of water in many areas might deplete limited resources. At this time, there is no foreseeable near term resolution of this issue. Some water systems in King and Pierce counties have had a water moratorium in the recent past, restricting development. These circumstances make Tacoma Water’s Second Diversion Water Right on the Green River for 65 MGD particularly valuable and attractive to the Participants in the Second Supply Project as well as potentially to other systems in the vicinity of Tacoma Water’s existing transmission pipelines. These other systems have experienced occasional water shortages due to increased demands resulting from customer growth.

The Second Supply System

The Second Supply System is a separate water supply and transmission system within Tacoma Water, formed by a partnership consisting of Tacoma, City of Kent (“Kent”), Covington Water District (“Covington”) and Lakehaven Utility District (“Lakehaven,” and collectively with Kent and Covington, the “Participants”). The Second Supply System was formed to permit, design, finance, construct, operate, maintain and receive delivery of water from the Second Supply Project. The Participants participate in the Second Supply Project under the terms of the Second

Supply Project Agreement, executed in 2002. Under the Second Supply Project Agreement, Tacoma is the owner and operator of the Second Supply Project.

The Second Supply Project Agreement allows each Participant to pay all or part of its Participant Share of the Second Supply Project capital costs either in cash or over time. Lakehaven has chosen to pay its entire share of the capital cost of Phase I of the Filtration Project (described below) in cash. Kent and Covington have chosen to have the City issue the 2010 RWSS Bonds to finance their Participant Shares. Consequently, Tacoma Water, Covington and Kent's water utility are obligated to pay amounts sufficient to provide for the payment of the principal of and interest on the 2010 RWSS Bonds. Under the Second Supply Project Agreement and the associated Repayment Agreement, Tacoma Water is responsible for payment of approximately \$43,600,000 of the outstanding principal amount on the 2002 RWSS Bonds and is responsible for approximately \$24,845,000 of the principal amount of the 2010 RWSS Bonds. Kent is responsible for paying debt service on approximately \$17,750,000 of the outstanding principal amount on the 2002 RWSS Bonds and is responsible for approximately \$11,400,000 of the principal amount of the 2010 RWSS Bonds. Covington is responsible for paying debt service on approximately \$17,000,000 of the outstanding principal amount on the 2002 RWSS Bonds and is responsible for approximately \$11,595,000 of the principal amount of the 2010 RWSS Bonds. Kent and Covington will pay their share to the City, which will pay the bond registrar for the RWSS Bonds. Those percentage shares are subject to change with the addition of a new participant, the payment default of a Participant, the issuance of additional RWSS Bonds or the optional prepayment by an obligated Participant. The payments by Tacoma Water and by Kent constitute "Contract Resource Obligations" payable as operation and maintenance expenses from the gross revenues of their respective water utilities. A portion of the payments by Covington to the City for debt service on the RWSS Bonds constitutes an operating expense so long as the Regional System is operating. The Repayment Agreement governs debt service payments on the RWSS Bonds and does not otherwise affect each Participant's rights and obligations under the Second Supply Project Agreement. The Repayment Agreement takes precedence over the debt repayment provisions of the Project Agreement.

Description of the Second Supply Project. To meet its own future water supply requirements as well as to increase regional supply, in 1968 Tacoma Water began developing the Second Supply Project, which includes a second supply pipeline from Tacoma Water's Green River resource (the "Second Supply Pipeline"). The Second Supply Project currently consists of the following components: (i) water from the exercise of Tacoma Water's Second Diversion Water Right (up to 100 cubic feet per second) ("cfs"); (ii) the Second Supply Pipeline; (iii) improvements made at the headworks diversion dam and intake; (iv) Second Supply Project fisheries and environmental enhancements; (v) the right to store water as a result of a Howard Hanson Dam additional storage project; and (vi) treatment facilities (disinfection, pH adjustment, fluoridation, and ozone). The Second Supply Pipeline is approximately 34 miles long and varies from 48 to 90 inches in diameter. Its route follows a more northerly route than Tacoma Water's Pipeline No. 1, traversing south King County and thereby making water available to the urbanized areas north and east of Tacoma. In addition to increasing water supply, the Second Supply Project increases flexibility and reliability of water delivery in both Tacoma Water's and the other Participants' service areas. The Second Supply Project became operational in October 2005.

Second Supply Project Agreement. The Second Supply Project Agreement defines the rights and obligations of the Participants with regard to the Second Supply Project. Tacoma has a 15/36 Participant Share and each of Kent, Covington and Lakehaven has a 7/36 Participant Share in the Second Supply Project. Generally, a Participant Share represents a Participant's proportional right to receive and obligation to pay for water delivered by the Second Supply Project.

The term of the Second Supply Project Agreement extends through the operating life of the Second Supply Project, including all renewals and replacements thereof and additions thereto. The Second Supply Project Agreement provides that all obligations incurred during its term will survive its termination or expiration, and will survive until such obligations are satisfied.

The Second Supply Project Agreement confers rights and imposes obligations on all four Participants, including Tacoma Water, and on Tacoma Water as operator of the Second Supply Project (the "Project Operator"). Each Participant has contractual rights under the Second Supply Project Agreement (i) to use an undivided share of the Second Supply Project equal to its project capacity share and to use available excess project capacity; (ii) to schedule for delivery and receive its Participant Share of Second Diversion Water at its points of delivery; (iii) to

schedule for delivery and receive additional water at its points of delivery; and (iv) to provide its Participant Share of storage. Each Participant has a contractual obligation (i) to receive Second Diversion Water and additional water scheduled for delivery by and delivered to it and (ii) to pay its Participant Share of Project Costs.

Decisions are made by a Project Committee, consisting of one representative of each Participant. For the Project Committee to take action, a quorum of not less than three Participants is required, with Tacoma Water's presence mandatory. For approval of certain matters, including approval of capital expenditures contained in an annual budget and approval or revision of any financing plan, an affirmative vote of 29/36ths of the Project Committee votes and three of the Participants is required. Further, in order to vote on a financing plan, the representative of each Participant must present to the Project Committee a resolution by its governing body indicating the nature of the vote to be cast by the representative. A financing plan sets forth the purpose, amount, repayment schedule and timing of any proposed Second Supply System bond issues.

Under the Second Supply Project Agreement, the Participant Share of a Participant that has been in default for a period of 60 days or more on any payment obligation under the Second Supply Project Agreement (if that payment obligation includes amounts necessary for the City to make payments on any RWSS Bonds) will be offered for assignment to the non-defaulting Participants. In the event that other non-defaulting Participants decline any or all of the defaulting Participant's Participant Share, Tacoma Water is required to increase its Participant Share in an amount equal to the defaulting Participant's Participant Share then remaining unassigned and will be responsible for the amount in default.

Initial Project Construction Financing. In October 2002, the City sold the 2002 RWSS Bonds in the principal amount of \$82,700,000. Tacoma Water is responsible for paying debt service on approximately \$43,600,000 of the outstanding principal amount of the 2002 RWSS Bonds. The Second Supply System is a separate utility system of the City. The City's obligation to pay its share of costs of the Second Supply System is a Contract Resource Obligation payable from Gross Revenues of the Water System as an Operation and Maintenance Expense of the Water System. The total project cost was approximately \$232 million, including financing costs. The remaining costs were paid for by the other Participants through a combination of cash contributions and low interest loans.

Annual Budgets. Under the Second Supply Project Agreement, the Second Supply System operates under an annual budget, which must include both the amounts necessary to operate and maintain the Second Supply Project and any proposed capital expenditures for any renewals, replacements, additional or improvements to the Second Supply Project.

Second Supply System Operations. As owner and operator of the Second Supply Project, Tacoma Water is responsible for the day-to-day operation of the Second Supply Project and is obligated, consistent with the approved annual budget then in effect, to operate and maintain the Second Supply Project in a manner that is consistent with prudent utility practice. Tacoma Water also is responsible as Project Operator for, among other things, (i) monitoring the delivery of Second Supply Project water to each Participant and (ii) calibrating and testing for accuracy no less than once each year the master meter and all delivery meters.

Water deliveries are scheduled on a weekly basis by an assigned Tacoma Water engineer. Tacoma Water tracks availability of run-of-the-river water for the Second Supply System and also tracks and coordinates delivery of stored water at Howard Hanson Dam. Tacoma Water maintains financial and water accounting records for the Second Supply System and provides reports to the Participants in accordance with the Second Supply Project Agreement. Daily flow records and other daily data are available to the Participants through a secure website. A monthly meeting is held by the Project Committee to discuss any issues or concerns related to the Second Supply Project. An operations subcommittee also meets bi-monthly to deal with operations issues.

The Second Supply Project began operations in October 2005. Water used by the Participants appears below.

Second Supply System Total Water Use (MG)					
	2005	2006	2007	2008	2009
Tacoma Water	679	3,757	6,881	9,461	8,700
City of Kent	0	22	6	35	271
Lakehaven Utility District	103	733	1,279	1,718	780
Covington Water District	0	48	352	446	422
Total Use	782	4,560	8,518	11,660	10,173

Filtration Project. The Green River is one of the few remaining major unfiltered surface water supplies in the country. In 2006, the U.S. Environmental Protection Agency promulgated the Long Term 2 Enhanced Surface Water Treatment Rule (“LT2”), establishing new requirements for all water utilities serving water from lakes or rivers to provide treatment for inactivation or removal of *Cryptosporidium*. *Cryptosporidium* is a naturally-occurring microorganism that can be found in open surface water sources such as the Green River, and has been responsible for waterborne disease outbreaks in some public water systems. While years of monthly testing from the Green River indicates that the presence of this organism is extremely rare, the LT2 regulation requires Tacoma Water to install additional treatment for *Cryptosporidium* by 2014. During 2009 and early 2010, the Participants worked with a consulting team to analyze potential strategies for LT2 compliance. A broad list of alternatives was narrowed to the two most feasible: (1) a hybrid winter/summer filtration alternative and (2) an ultraviolet light (UV) disinfection with clearwell storage alternative. Numerous aspects of these two alternatives were evaluated, including: water quality and public health protection; regulatory uncertainty, particularly the risk of violating criteria for remaining unfiltered; yield and reliability; operational flexibility and capital and life cycle costs. Following substantial analysis, significant public outreach and communication, and careful briefings and deliberation by the Tacoma Public Utility Board and City Council, the filtration option was selected as the best solution for the long-term benefit of the utility customers. The Project Committee determined that treatment facilities should be added to the Second Supply Project. The Tacoma Public Utility Board, the Covington and Lakehaven Boards and the Kent City Council have each adopted a resolution approving the installation of the Filtration Project.

The Second Supply Project Agreement defines the costs associated with additional or different treatments facilities to be Project Costs, apportioned to each of the Participants on the basis of their Participant Share.

In addition to increasing water supply, the Second Supply Project increases flexibility and reliability of water delivery in both Tacoma Water’s and the other Participants’ service areas. See “THE WATER SYSTEM—The Second Supply System.”

The total estimated cost for the Filtration Project is \$169 to \$217 million. Tacoma Water is responsible for an estimated \$73.4 to \$94.2 million of this total for its first diversion operations (the Tacoma Water system). The Second Supply System is responsible for an estimated \$95.6 to \$122.8 million of Filtration Project costs. Tacoma Water is responsible for \$40.2 to \$51.5 million of this portion.

Filtration Project Financing Plan and Repayment Agreement. The Participants have executed a Filtration Treatment Financing Plan and will also enter into the Repayment Agreement to set forth the terms under which Tacoma Water, Kent and Covington will pay to the City their proportionate shares of the amount necessary to pay the principal of and interest on the 2010 RWSS Bonds. Lakehaven will pay for its share from cash.

Under the Second Supply Project Agreement and the Repayment Agreement, the City is responsible for payment of approximately \$24,845,000 of the principal of the 2010 RWSS Bonds, Kent is responsible for paying approximately \$11,400,000 of the principal of the 2010 RWSS Bonds and Covington is responsible for paying approximately \$11,595,000 of the principal of the 2010 RWSS Bonds. The Second Supply Project Agreement permits Participants to elect to pay cash obtained from the issuance of their own bonds, from the proceeds of loans from private or public sources, or by any other lawful means for their Participant Share of a Project Cost to be otherwise financed with the

proceeds of RWSS Bonds. Lakehaven has elected to separately pay for its Participant Share of the costs of Phase I of the Filtration Project. Consequently, Lakehaven has no obligation to make debt service payments on the 2010 RWSS Bonds.

Agreement with Cascade Water Alliance

Tacoma Water entered into an agreement with the Cascade Water Alliance (“Cascade”), a regional wholesale water supplier, that entitles Cascade to a permanent supply of four MGD of water (average daily demand) each year, and an additional guaranteed reserved supply of six MGD (average daily demand) through 2026, declining to one MGD (average daily demand) in 2030 (the “Additional Supply”), and discontinuing thereafter. Increased deliveries are available during peak season. The agreement includes minimum purchase requirements from 2009 through 2025, and entitles Cascade to additional temporary water, based on availability. The agreement requires that Cascade pay system development charges and capacity reservation fees to Tacoma Water, in addition to paying for the metered water based on wholesale water rates. Cascade is obligated to provide Tacoma Water with a plan by December 1, 2015 that demonstrates Cascade’s ability to provide for the long term water needs of its members; if Cascade does not do so, Tacoma Water may terminate its obligation to provide the Additional Supply. Termination for the reasons described in the previous sentence applies only to Additional Supply, and not to the permanent supply of four MGD (average daily demand).

Tacoma Water is currently in discussions with Cascade regarding a new contract to provide for additional long-term wholesale water supply.

Endangered Species Act Compliance

In 1998, the National Marine Fisheries Service (“NMFS”) listed Puget Sound Chinook salmon as a threatened species. Subsequently, the U.S. Fisheries & Wildlife Service (“USFWS”) listed bull trout as a threatened species. Pursuant to regulations, NMFS and USFWS have extended to these threatened species the same level of protection the Endangered Species Act (“ESA”) provides for endangered species. This level of protection includes a prohibition on “taking” the species, which may include not only harm to members of the species, but also adverse effects or destruction of habitat. This caused water utilities throughout the region to assess their potential liability under the ESA. Tacoma Water has approached these issues within a multi faceted response strategy. First, it developed a Habitat Conservation Plan under Section 10 of the ESA, which was approved by the NMFS and USFWS in 2001, to protect its source of supply operations on the Green River. The Habitat Conservation Plan provides authorization under the ESA for Tacoma Water’s water supply operations on the Green River. Although the protection of the threatened Chinook salmon was the incentive for plan development, the Habitat Conservation Plan eventually was approved to provide coverage for 32 aquatic and terrestrial species. This significantly reduces the risk to Tacoma Water that future water supply operations may be disrupted due to ESA issues. Second, Tacoma Water has adopted a “take” avoidance strategy for its field operations on the water distribution system. Section 4(d) of the ESA allows certain categories of activities defined by federal rule to be conducted without “take” liability. In 2001, Tacoma Public Utilities obtained coverage under this provision for a wide variety of its utility maintenance activities by adopting and implementing the federally approved “Regional Road Maintenance Endangered Species Act Program Guidelines.” Tacoma Water has modified its operation to obtain coverage under this program for many of its day to day operations.

Water Quality and Treatment

Watershed monitoring and protection programs are critical to ensuring high water quality. Well managed, unpopulated watersheds minimize potential adverse effects on the water supply. Tacoma Water has a well organized watershed control program with inspectors who patrol the watershed to protect against any unauthorized entry. Tacoma Water owns approximately 10% of the watershed area including much of the land adjacent to the Green River and the Howard Hanson Reservoir located approximately three miles upstream from the Green River headworks. The land that is not owned by Tacoma Water is either U.S. Forest Service property or is owned by timber companies or the Washington State Department of Natural Resources. There are no permanent residents living within the watershed boundaries. Tacoma Water, the timber companies, and the State Department of Natural Resources work cooperatively to ensure that timber harvesting and other activities comply with watershed control best management practices, thereby minimizing any potential adverse impacts on water quality. Tacoma Water has

in place agreements with all of the timber companies to document their commitment to use these best management practices.

Tacoma Water's Watershed Control Program has been approved by the Washington State Department of Health ("WSDOH") and allows the Water System's Green River supply to remain unfiltered, provided that Tacoma Water implements this program, submits regular monitoring reports, and meets the established water quality standards at all times.

Tacoma Water adds chlorine, fluoride, ozone and sodium hydroxide (to raise the pH of the water) at the Green River headworks. As discussed under "—The Second Supply System—*Filtration Project*," new regulations require additional treatment of the Green River supply, and filtration has been selected to meet this requirement.

The water from Tacoma Water's wells is chlorinated before being introduced into the distribution system. The water quality is monitored on a regular basis in accordance with the requirements of the WSDOH and the U.S. Environmental Protection Agency ("U.S. EPA"). One of Tacoma Water's 30 wells is equipped with an air stripping tower to remove organic compound contamination, which was discovered during the early 1980s. This treatment maintains water quality by keeping contaminants in this water to levels that are below the detectable limits. Contaminant levels in this groundwater source have also decreased as a result of the cleanup of the pollution source, and significantly more rigorous land use controls within the City to protect groundwater.

Water System Security

Tacoma Water, along with many other major water utilities, is taking increased steps to protect its water supply facilities and to prevent contamination of the water supply. Tacoma Water has taken actions to secure the source of supply on the Green River through increased surveillance of watershed activities and closing additional areas to access. Security has been tightened regarding chemical deliveries to Tacoma Water facilities, additional monitoring of water quality has been initiated, and security provisions are reviewed on an ongoing basis to assure adaptive reaction to any changes in threat status. A system wide analysis was completed in early 2003 with the support of a U.S. EPA grant.

Water System Operations

Water Quality Section. The Water Quality Section of Tacoma Water is responsible for managing, operating and maintaining the Green River headworks and watershed; assuring security and natural resource management of Tacoma Water lands including the Watershed; providing for fish and wildlife habitat management, and installing, operating and maintaining water treatment equipment within the Water System. Water Quality personnel respond to all matters relating to water quality from the source to the customer, and monitor for contaminants as required by State and Federal regulations, and as required to meet customer needs and expectations. The section must assure compliance with the federal Safe Drinking Water Act, as implemented through WSDOH.

The Water Quality Section operates the Green River intake for both water supply and an adult salmon fish trap and sort facility. Major water quality and regulatory drivers have led to initiatives for significant investments in water treatment infrastructure. A new chemical treatment plant began operation in 2005, providing capacity for the Second Supply Project, and significantly improved safety and reliability for the addition of chlorine, fluoride, and sodium hydroxide. In 2007 ozone treatment was added to enhance system disinfection, eliminate seasonal poor taste and odor in the natural water, and reduce the levels of regulated chlorinated organic compounds that form after chlorine disinfection. The cost of this treatment was included in the Second Supply Project Agreement.

In addition to the watershed and treatment operations associated with the Green River supply, the Water Quality Section operates and maintains disinfection treatment equipment for the groundwater supplies at three reservoir locations, and at several smaller groundwater sites.

Water Supply Section. The Water Supply Section has responsibility for water supply resources, water transmission lines larger than 24 inches in diameter, reservoirs within the distribution system, pumping stations, and pressure reducing valves. The Water Supply Section also has responsibility for overall Water System operations and it

controls all elements of the Water System that are integral to Water System operations. Water System operations are managed from the Water Control Center, located in the Tacoma Water Distribution Center, which is staffed 24 hours a day.

Tacoma Water's water transmission and distribution system consists of 141 miles of transmission pipelines ranging in size from 28 to 96 inches in diameter, 23 booster pump stations, 181 million gallons of reservoir storage, and 1,198 miles of distribution pipeline ranging in size from two to 24 inches in diameter. The distribution system includes a number of pressure zones; most are supplied by reducing the pressure gradient from the McMillin Reservoir and the remainder require additional pumping of water to serve higher areas.

Tacoma Water's pipeline system delivers adequate supply for municipal use and fire protection throughout its service area. An independent evaluation conducted by the Washington Survey and Rating Bureau in 1997 found the condition of Tacoma Water's water facilities and the City's fire fighting capabilities to be very good. The Bureau makes the results of its evaluations available to the insurance industry which uses the information to determine, among other things, insurance rates for community water systems. The overall score of the most recent evaluation, which included a survey of the City's fire department, was Class 2 on a scale of 1 to 10, with Class 1 being the highest or best score. Also, the evaluation indicated a significant improvement in the water supply sections of the review as compared to the previous evaluation conducted in 1976. Only four cities in the state received a score of Class 2; no cities received a Class 1 designation.

The storage available in the Water System is capable of supplying approximately three days at the average daily usage rate. To maintain better water quality within the Water System, storage was reduced by approximately 100 MG when the Second Supply Pipeline was placed in service.

Tacoma Water also has approximately 22 interties with 11 wholesale purveyor systems. Some of these interties are used to supply wholesale water to the systems on a regular basis and others are available for peak or emergency demands of these systems. In several instances, these interties are capable of providing Tacoma Water with a limited amount of emergency water supply.

Water Distribution Operations Section. The Water Distribution Operations Section is responsible for the operation and maintenance of the distribution system, which includes all of the distribution mains, hydrants, valves, service connections, meters, and other distribution system features. Tacoma Water has made significant improvements during the last few years in its operations and maintenance programs.

Tacoma Water has implemented maintenance plans for all components of the water distribution system. Crews are scheduled to perform routine and preventive maintenance activities for the system based on various operational criteria and customer concerns. This assures that resources are allocated cost effectively and based on objective priorities.

Water Distribution Engineering Section. The Water Distribution Engineering Section engineering staff supports the operation and maintenance crews as well as engineering for distribution main projects for both private development and Tacoma Water's capital improvement program. This staff evaluates and approves permits for Water System extensions including developer installed systems. The section prepares the design of developer systems rather than simply approving a system designed by the developer's engineer, which is the more common approach taken by water utilities. Past benchmarking and cost analysis has shown that this approach not only assures a timely response and quality design for the developer but is less expensive than hiring a private engineering firm. The Water Distribution Engineering Section has implemented a major water main replacement program. Beginning in 1995, Tacoma Water formalized this program and has since ramped up project funding for its replacement priorities as well as replacement work conducted in conjunction with public road projects and work by other jurisdictions. Subsequent cycles of evaluation of the program continue to refine the criteria for main replacement based on an evolving asset management structure.

Washington State Department of Health/U.S. Environmental Protection Agency Requirements. Tacoma Water must comply with the requirements of the rules and regulations promulgated by the U.S. EPA pursuant to the Safe Drinking Water Act. WSDOH is delegated by U.S. EPA to administer these regulations in the State of Washington.

In addition, WSDOH has rules and regulations for the design and operation of water systems. WSDOH provides oversight of water systems including reviews, approvals, and monitoring of performance.

Tacoma Water has a Comprehensive Water Plan (the “Plan”), which was approved by WSDOH in 2006 and is required to be updated in 2012. The Plan includes projections of future water demand requirements for several scenarios and presents an Integrated Resource Development Strategy for meeting future water demands. The Plan sets forth Tacoma Water’s proposed program of supply development and system capital improvements. It also describes the financial plan for funding these improvements and includes required sections on emergency response and routine operations. This plan must be developed and resubmitted for approval every six years.

Customers, Water Sales, and Rates

Tacoma Water serves residential, commercial, and industrial customers, a special rate large industrial customer, municipal and other governmental customers, and wholesale customers. In 2009, revenues were attributed 66% to residential service, and 26% to commercial and industrial service, including the Simpson Tacoma Kraft Company (“Simpson”). The remaining approximately 8% was accounted for by service to municipal and other governmental customers and to wholesale customers.

Simpson is the largest customer of Tacoma Water and accounted for approximately 7.6% of total water sales revenue in 2009. In 2009 the 10 largest customers combined accounted for 16.4% of total water sales revenue.

Special Contract

The City and Simpson executed a 10 year contract in 2006, which expires in 2015. The contract currently provides that the City will furnish 15.9 MGD to Simpson on a uniform basis, 24 hours a day. Tacoma Water encouraged conservation at the Simpson facility, and the current use rate of 15.9 MGD represents a significant improvement in water use efficiency over the 30 MGD used by Simpson in previous years. Overall reduction in water use by Simpson has been supported by Tacoma Water through the development of a contract amendment to provide rate incentives for conservation. Pursuant to the contract, Simpson would not be required to take water if its paper mill operations shut down, but would be required to pay liquidated damages.

Water Rates

Washington State law provides that municipalities may establish water rates by action of the City Council, independent from review or approval by any state board or commission.

Tacoma Water’s rate structure consists of two basic components, a monthly minimum and a monthly consumption charge. In addition, the City charges a one time system development charge on new services to more equitably distribute the costs associated with growth. As described under “THE DEPARTMENT OF PUBLIC UTILITIES—TACOMA WATER—Financial Policies,” the Board has adopted a water rate policy that, among other provisions, provides that rates be set based on cost of service within a customer class.

The current water rates were implemented on January 1, 2010. The changes resulted in an average annual increase in water charges of approximately 3%. Rate increases since 2001 are summarized in the following table.

**Tacoma Water
Rate Increases**

Year	Average Annual Increase
2002	9.5%
2003	8.2
2004	8.2
2005	8.0
2006	8.0
2007	7.5
2008	7.5
2009	3.9
2010	2.9

The Board and the City Council have committed to increase rates to cover costs of the Filtration Project. A decision on the specific rate increases is expected in the latter half of 2010. As part of that process, the Board and the City Council may consider changes to rate policies.

Tacoma Water’s current water rates are summarized in the table below.

**Tacoma Water
Current Water Rates and Charges**

Size of Meter (inches)	Customer Charge Per Month	
	Inside City Limits	Outside City Limits
5/8	\$ 15.33	\$ 18.40
3/4	23.00	27.60
1	38.33	46.00
1-1/2	76.65	91.98
2	122.64	147.17
3	229.96	275.95
4	383.26	459.91
6	766.53	919.84
8	1,226.45	1,471.74
10	1,763.02	2,115.62
12	2,587.03	3,104.44

Consumption Up to and Including:	Charge for Water Used per Month (per ccf (1))	
	Inside City Limits	Outside City Limits
Residential		
Each 100 cubic feet of consumption		
October through May	\$ 1.251	\$ 1.502
First 500 cubic feet of consumption		
June through September	1.251	1.502
Each 100 cubic feet of consumption over 500 cubic feet June through September	1.564	1.878
Commercial and Industrial		
General.....	1.360	1.632
Large Volume (over 65,000 cubic feet annually)	1.206	1.447
Parks and Irrigation		
For each 100 cubic feet.....	1.698	2.038

(1) ccf = 100 cubic feet

Tacoma Water’s charges for water service are competitive with those of other major water utilities in the Pacific Northwest as well as other regional water utilities. The results of a comparison of Tacoma Water’s current rates with those of other water utilities located both in major metropolitan areas in the region and in the greater Pierce County area are set forth in the following table.

Comparison of Average Monthly Water Bills

UTILITY	5/8” RESIDENTIAL (10 ccf/month)	2” COMMERCIAL (150 ccf/month)
	Tacoma Water	\$ 27.84
Major Regional Water Systems:		
City of Bellevue, WA	39.79	466.10
City of Everett, WA	23.50	259.50
Portland, OR Water Bureau	31.78	373.38
Seattle Public Utilities	47.56	550.57
San Francisco, CA	37.59	523.20
Neighboring Water Systems:		
City of Kent, WA	42.28	595.66
City of Puyallup, WA	24.99	329.49
Covington Water District, WA	40.80	511.08
Lakehaven Utility District, WA	20.28	234.67

Source: Individual Utilities. Off-peak season 2010 rate (inside city where applicable).

In 1990, Tacoma Water implemented a system development charge (“SDC”), which is a one time charge on new services and primarily is collected on new construction. The charge is calculated for meters three inches or larger, based upon water use projections. The result of this new fee structure was an increase in SDC revenues. The SDC fees were designed to pay for approximately 50% of growth related capital costs. In addition, Tacoma Water periodically collects contributions from property owners that are restricted to specific capital projects. The table below does not include these contributions.

The following table shows annual funds recognized as revenues from SDCs from 2005 through 2009. In 2009, Tacoma Water deposited approximately \$35 million of SDCs into the Rate Stabilization Account, and consequently, these SDCs are not reflected in the table.

**Tacoma Water
Annual SDC Revenue**

<u>Year</u>	<u>SDC Recognized Revenue</u>
2005	\$ 5,769,592
2006	12,688,488
2007	2,953,984
2008	1,754,475
2009	404,451

CAPITAL IMPROVEMENT PROGRAM

Tacoma Water biennially prepares a ten-year business plan, which includes capital improvements, additions and renovations to the Water System necessary to address engineering recommendations, regulatory requirements and water quality standards and to provide for present and projected future customer needs. From this projection of need, Tacoma Water derives its Capital Improvement Program for the Water System. This program is an element of the City's Growth Management Act ("GMA") Comprehensive Plan, which contains a six-year projection of projects and is updated annually. The following table summarizes Tacoma Water's 2010-2015 Capital Improvement Program.

**Tacoma Water
2010-2015 Capital Improvement Program
(\$000)**

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Uses of Funds						
General Plant	\$ 1,343	\$ 1,972	\$ 1,972	\$ 669	\$ 669	\$ 669
Water Supply	22,066	3,422	6,804	4,080	3,921	5,246
Water Quality	1,940	680	280	1,456	690	1,180
Water Distribution	15,590	15,949	16,349	15,735	15,735	15,735
Second Supply System Projects(1)	3,073	8,412	4,353	30,586	30,028	13,998
Environ Stewardship/Conservation	<u>200</u>	<u>450</u>	<u>450</u>	<u>1,450</u>	<u>500</u>	<u>500</u>
Total Uses	\$ 44,212	\$ 30,885	\$ 30,209	\$ 53,800	\$ 51,573	\$ 37,358

(1) Includes Tacoma Water's First Diversion and Second Supply System Filtration Project funding obligations.

Source: DRAFT Tacoma Water Business Plan 2011-2020, Capital Projects, May 26, 2010

The Water System plans to fund these improvements with a combination of revenues from operations, Water System development funds, proceeds from the Bonds and Future Parity Bonds, RWSS Bonds and other miscellaneous revenue. See "Water Quality and Treatment."

HISTORICAL OPERATING RESULTS

The following table shows Tacoma Water's customer accounts and water sales for the years 2005 through 2009.

Tacoma Water Historical Number of Customers and Water Sales

	2005	2006	2007	2008	2009
Customer Accounts (Average)					
Residential	87,991	89,047	90,092	89,680	90,677
Commercial & Industrial Service	5,345	5,386	5,494	5,466	5,636
Simpson Tacoma Kraft ⁽¹⁾	1	1	1	1	1
Municipal	204	215	219	251	209
Other Public Buildings	472	437	454	442	441
Other Utilities	20	17	18	18	18
Total Customer Accounts	94,033	95,103	96,278	95,858	96,982
Water Sales (ccf)⁽²⁾					
Residential	11,351,952	12,140,488	11,409,873	11,018,505	11,566,425
Commercial & Industrial Service	4,049,305	4,097,122	4,043,797	3,963,159	3,806,353
Simpson Tacoma Kraft ⁽¹⁾	7,273,997	6,711,163	7,307,367	7,777,754	7,386,109
Municipal	120,495	129,879	134,007	97,056	102,179
Other Public Buildings	669,291	835,497	752,170	692,616	732,647
Other Utilities	1,464,800	1,379,466	1,112,968	851,377	1,127,243
Total Water Sales	24,929,840	25,293,615	24,760,182	24,400,467	24,720,956

(1) Simpson Tacoma Kraft is a pulp and paper mill with contracted annual usage of 15.9 MGD. See "THE WATER SYSTEM—Special Contract."

(2) ccf = 100 cubic feet.

Source: Annual Tacoma Water financial reports.

Historical Revenue and Expenses

The following table shows selected historical revenues and expenses for the years 2005 through 2009. The following table is based on consolidated financial statements that include Tacoma Water and the Second Supply System.

Tacoma Water Historical Operating Results

	2005	2006	2007	2008	2009
Operating Revenues (1)					
Residential and Domestic	\$ 27,611,024	\$ 31,216,429	\$ 32,645,594	\$ 34,592,712	\$ 36,643,366
Commercial & Industrial	7,174,647	7,751,215	8,298,263	8,978,703	9,659,078
Special Rate—Simpson	3,511,199	3,222,324	3,917,760	4,371,527	4,153,327
Municipal (2)	316,562	363,455	396,131	349,722	380,267
Other Public Bldgs. & Grounds (3)	1,409,107	1,596,360	1,644,166	1,680,603	1,861,111
Unbilled (4)	0	1,067,323	37,113	417,145	187,966
Sales to Other Water Utilities	1,599,919	1,640,803	1,433,705	1,251,815	1,776,686
Total Water Sales	\$ 41,622,458	\$ 46,857,909	\$ 48,372,732	\$ 51,642,227	\$ 54,661,801
Other Operating Revenues (5)	3,523,458	3,538,345	4,353,478	5,382,313	9,331,955
Total Operating Revenue	\$ 45,145,916	\$ 50,396,254	\$ 52,726,210	\$ 57,024,540	\$ 63,993,756
Operating Expenses (1)					
Operating & Maintenance	\$ 26,448,761	\$ 29,165,168	\$ 31,076,515	\$ 33,387,663	\$ 34,055,463
Depreciation	9,386,363	11,556,821	11,363,970	13,016,544	13,845,799
Taxes (6)	2,995,424	3,407,187	2,924,930	2,881,877	3,093,311
Total	\$ 38,830,548	\$ 44,129,176	\$ 45,365,415	\$ 49,286,084	\$ 50,994,573
Net Operating Income (Loss)	\$ 6,315,368	\$ 6,267,078	\$ 7,360,795	\$ 7,738,456	\$ 12,999,183
Non-Operating Revenue (Expenses) (1)					
Other Income	\$ 746,048	\$ 674,934	\$ 306,680	\$ 61,265	\$ 497,331
Interest Income	1,695,578	4,603,137	5,255,881	3,730,407	1,955,385
Gain from Disposition of Property	4,622,927	0	4,200,000	0	26,100
Interest Charges (Net)	(7,185,197)	(8,403,448)	(8,484,405)	(8,406,264)	(9,076,156)
Total Non-Operating Revenue (Expense)	\$ (120,644)	\$ (3,125,377)	\$ 1,278,156	\$ (4,614,592)	\$ (6,597,340)
Net Income (Loss) Before Capital Contributions (1)	\$ 6,194,724	\$ 3,141,701	\$ 8,638,951	\$ 3,123,864	\$ 6,401,843
Less: RWSS Net Income (Loss) Before Capital Contributions (7)	(484,221)	(3,302,056)	(2,928,541)	(2,576,589)	(4,701,178)
Net Tacoma Water Net Income (Loss) Before Capital Contributions	\$ 6,678,945	\$ 6,443,757	\$ 11,567,492	\$ 5,700,453	\$ 11,103,021
Debt Service Calculation Adjustments (8)					
Less: Restricted Income	\$ (138,874)	\$ (288,349)	\$ (784,445)	\$ (623,867)	\$ (273,694)
Less: Gain from Disposition of Property	(4,622,927)	0	(4,200,000)	0	(26,100)
Add: Depreciation	8,617,522	8,143,480	7,850,529	8,212,995	9,053,762
Add: Interest Charges (Net)	3,411,166	4,220,331	4,399,711	4,323,860	5,157,916
Add: SDC Revenues (9)	5,769,592	12,688,488	2,953,984	1,754,475	404,451
Net Tacoma Water Revenue Available for Debt Service	\$ 19,715,424	\$ 31,207,707	\$ 21,787,271	\$ 19,367,916	\$ 25,419,356
Debt Service on Outstanding Bonds (10)	\$ 7,513,003	\$ 10,433,270	\$ 10,433,970	\$ 10,438,208	\$ 10,432,133
Debt Service Coverage	2.62x	2.99x	2.09x	1.86x	2.44x

(1) Includes Second Supply System operating results.

(2) Retail sales to City facilities

(3) Retail sales to governmental entities other than the City

(4) Accrued revenue for water service provided and not billed in the current year

(5) Includes Kent, Covington and Lakehaven payments for Second Supply System, as well as Public Fire Protection fees and Cascade Water Alliance fees.

(6) Excludes City gross earnings tax, which is payable after debt service.

(7) Includes all Second Supply System revenues and expenses, including depreciation before Capital Contributions.

- (8) All adjustments exclude Second Supply System.
- (9) Excludes deferred SDC revenue and SDC revenue deposited to the Rate Stabilization Account. See “SECURITY FOR THE BONDS-Rate Stabilization Account”
- (10) Includes debt service on Tacoma Water Parity Bonds only.

The financial statements of Tacoma Water as of and for the years ended December 31, 2009 and 2008 are included as Appendix C to this Official Statement.

GENERAL AND ECONOMIC INFORMATION

Tacoma, the county seat of Pierce County (the “County”), is located in the west central part of Washington State near the southern tip of Puget Sound. It is the third largest city in the State with a 2010 estimated population of 204,200. The City is located 32 miles south of Seattle and 28 miles northeast of Olympia, the State capitol. The historical population of the City and Pierce County is shown in the following table.

POPULATION CITY OF TACOMA AND PIERCE COUNTY

Year	Tacoma	Pierce County
2010	204,200	814,600
2009	203,400	813,600
2008	202,700	805,400
2007	201,700	790,500
2006	199,600	773,500
2005	198,100	755,900
2004	196,800	744,000
2003	196,300	733,700
2002	194,900	724,998
2001	194,500	713,398
2000	193,556	700,818

Source: Washington State Office of Financial Management estimates; U.S. Census for 2000 figure.

Following are economic indicators for the City and Pierce County.

PIERCE COUNTY MAJOR EMPLOYERS

Employer	Type of Business	Number of Employees
Joint Base Lewis McChord	Military	49,674
Local Public School Districts (K-12)	Education	13,381
Washington State Employees	Public Sector	7,448
Multicare Health System	Health Services	6,410
US Army Madigan Hospital	Military Health Care	5,554
Franciscan Health System	Health Services	5,028
Pierce County Government	Government/Public Offices	3,059
Washington State Higher Education	Education	2,604
Washington State National Guard	Military	2,476
City of Tacoma (excluding Tacoma Public Utilities)	Government/Public Offices	2,383
Emerald Queen Casino	Casino Gambling	2,105
The Boeing Company (Frederickson Site)	Aerospace	1,440
Wal-Mart	Retail	1,406
Fred Meyer Stores (includes part time employees)	Retail Store	1,301
Tacoma Public Utilities	Public Utility	1,253
US Postal Service	Government/Public Offices	1,192
Costco	Wholesale	1,151
Safeway Stores, Inc.	Grocery	1,123
State Farm Insurance Companies	Insurance	1,117
Pierce Transit	Investment Management	971

Source: Economic Development Board of Tacoma-Pierce County, 2010.

CITY OF TACOMA BUILDING PERMIT ACTIVITY

Year	City of Tacoma	
	Total Number	Value
2010*	793	\$157,654,473
2009	1,796	214,530,401
2008	2,146	343,884,905
2007	2,628	519,576,251
2006	2,746	482,193,083
2005	2,586	345,444,070
2004	2,441	323,424,589
2003	2,339	376,871,561
2002	2,556	297,617,993
2001	2,399	284,359,070
2000	2,614	287,741,638

* Data through June 2010. Between January and June 2009, the City issued 785 permits for a total value of \$97,861,346.

Source: City of Tacoma Public Works Department, Building Division.

PIERCE COUNTY AND CITY OF TACOMA TAXABLE RETAIL SALES (\$000)

<u>Year</u>	<u>Pierce County</u>	<u>City of Tacoma</u>
2010 (1)	\$ 2,398,473	\$ 861,123
2009	10,359,977	3,803,604
2008	11,621,810	4,288,739
2007	12,449,284	4,665,527
2006	12,068,965	4,536,401
2005	11,177,879	4,218,012
2004	10,055,822	3,832,668
2003	9,448,120	3,708,718
2002	8,802,690	3,475,274
2001	8,510,487	3,527,642
2000	8,222,293	3,440,507

(1) Through the first quarter of 2010. The taxable retail sales for Pierce County for the first quarter of 2009 was \$2,487,751,934 and \$938,675,952 for the City of Tacoma.

Source: Washington State Department of Revenue.

**PIERCE COUNTY AND WASHINGTON STATE
MEDIAN HOUSEHOLD INCOME**

<u>Year</u>	<u>Pierce County</u>	<u>Washington State</u>
2009(1)	\$51,479	\$52,413
2008(2)	52,957	54,086
2007	55,531	55,771
2006	57,905	56,808
2005	55,785	54,618
2004	54,132	54,086
2003	51,662	51,104
2002	50,217	50,242
2001	49,348	49,598
2000	47,549	48,499

(1) Projected.

(2) Preliminary estimates.

Source: Washington State Office of Financial Management.

**PIERCE COUNTY AND STATE OF WASHINGTON
TOTAL PERSONAL AND PER CAPITA INCOME**

Year	Pierce County		State of Washington	
	Total Personal Income (\$000)	Per Capita Income	Total Personal Income (\$000)	Per Capita Income
2008(1)	\$ 31,046,350	\$ 39,444	\$280,677,561	\$ 42,747
2007	29,863,847	38,581	271,007,842	41,919
2006	27,915,671	36,527	252,022,976	39,550
2005	25,580,131	34,131	230,001,881	36,734
2004	23,906,049	32,248	222,378,678	35,959
2003	22,790,634	30,955	206,946,797	33,852
2002	21,934,934	30,107	200,482,327	33,104
2001	21,206,910	29,608	197,278,896	32,947
2000	19,823,801	28,159	191,561,542	32,407

(1) Last available data.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

TACOMA METROPOLITAN AREA (PIERCE COUNTY)
RESIDENT CIVILIAN LABOR FORCE AND EMPLOYMENT AND AVERAGE CIVILIAN
NONAGRICULTURAL WAGE AND SALARY EMPLOYMENT

Employment within the County is described in the following tables:

NAICS Industry Title	Annual Average				
	2010(1)	2009	2008	2007	2006
Resident Labor Force					
Employment	356,200	359,530	372,500	366,870	352,940
Unemployment	39,910	36,590	21,860	17,870	18,890
Total	396,150	396,120	394,360	384,740	371,830
Percent Of Labor Force	10.1%	9.2%	5.5%	4.6%	5.1%
Total Nonfarm	264,900	269,000	280,600	281,300	272,800
Total Private	206,200	211,200	223,700	226,300	218,100
Goods Producing	34,100	36,400	43,700	46,500	44,100
Mining and Logging	300	300	400	500	400
Construction	18,000	19,200	23,500	25,500	23,500
Specialty Trade Contractors	11,300	12,100	15,000	16,000	14,500
Manufacturing	15,800	16,900	19,800	20,500	20,200
Services Providing	230,700	232,700	236,900	234,800	228,700
Trade, Transportation And Utilities	51,600	53,100	55,600	56,400	54,200
Wholesale Trade	10,000	10,900	11,400	11,400	10,700
Retail Trade	30,700	31,200	32,900	33,400	32,000
Food And Beverage Stores	5,500	5,400	5,500	5,400	5,300
General Merchandise Stores	7,500	7,800	7,900	7,900	7,200
Transportation, Warehousing And Utilities	10,900	10,900	11,400	11,600	11,500
Information	3,100	3,100	3,700	3,700	3,600
Financial Activities	12,300	12,900	13,300	13,700	14,000
Professional And Business Services	23,000	23,700	24,900	25,500	24,300
Admin, Support, Waste Mgmt & Remed.	13,000	13,300	14,300	15,200	14,500
Administrative And Support Services	11,600	11,900	12,900	13,800	13,300
Education And Health Services	44,700	43,300	41,600	40,400	39,200
Ambulatory Health Care Services	14,400	14,000	13,600	13,300	12,900
Hospitals	10,600	10,100	9,600	9,100	8,800
Leisure And Hospitality	24,700	26,100	27,800	27,500	26,400
Food Services And Drinking Places	19,200	20,700	22,100	22,200	21,200
Other Services	12,700	12,800	13,000	12,700	12,500
Government	58,700	57,800	56,900	54,900	54,600
Federal Government	12,500	11,700	10,800	10,300	10,500
State Government	11,600	11,700	11,900	11,400	11,200
State Government Educational Services	4,000	3,700	3,800	3,600	3,700
Local Government	34,700	34,400	34,300	33,300	32,900
Local Government Educational Services	18,900	18,400	18,200	18,000	18,000

(1) Average through June 2010.

Source: Washington State Employment Security Department.

INITIATIVE AND REFERENDUM

Under the State Constitution, the voters of the State have the ability to initiate legislation and modify existing legislation through the powers of initiative and referendum, respectively. The initiative power in Washington may not be used to amend the State Constitution. Initiatives and referenda are submitted to the voters upon receipt of a petition signed by at least 8% (initiative) and 4% (referenda) of the number of voters registered and voting for the office of Governor at the preceding regular gubernatorial election. Any law approved in this manner by a majority of the voters may not be amended or repealed by the Legislature within a period of two years following enactment, except by a vote of two-thirds of all the members elected to each house of the Legislature. After two years, the law is subject to amendment or repeal by the Legislature in the same manner as other laws.

LITIGATION CONCERNING THE BONDS AND TACOMA WATER

There is no litigation pending or threatened in any court (local, state, or federal) to restrain or enjoin the issuance or delivery of the Bonds, or questioning the creation, organization, existence, or title to office of the officers of the Department, Tacoma Water or the City, the pledge of Net Revenue, the validity or enforceability of the Bond Ordinance, or the proceedings for the authorization, execution, sale, and delivery of the Bonds.

The City and Tacoma Water are parties to lawsuits in their normal course of business, but neither the City nor Tacoma Water believes that any of such litigation will have a significant adverse impact upon the financial condition of the City or Tacoma Water.

Public Fire Protection Cost Recovery. In response to an October 2008 Washington State Supreme Court ruling that public fire protection costs are the responsibility of general government, Tacoma Water removed these costs from the water rates effective January 19, 2009. Public fire protection costs were invoiced to the cities and counties served by Tacoma. Representatives from the larger entities (Pierce County and the cities of University Place and Federal Way) declined to pay these costs. Tacoma Water filed suit in Pierce County Superior Court to have its legal rights determined. The defendants moved the case to King County Superior Court, where a judge has entered an order on summary judgment ruling that the hydrant costs in areas with franchise agreements must be incorporated back into the utility rates. An appeal of this decision has been filed by the utility. This affects approximately \$2.28 million worth of unpaid hydrant costs for the 2009-2010 budget.

TAX MATTERS

The 2010A Bonds

Exclusion From Gross Income. In the opinion of Bond Counsel, under existing federal law and assuming compliance with applicable requirements of the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied subsequent to the issue date of the 2010A Bonds, interest on the 2010A Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals.

Continuing Requirements. The City is required to comply with certain requirements of the Code after the date of issuance of the 2010A Bonds in order to maintain the exclusion of the interest on the 2010A Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of 2010A Bond proceeds and the facilities financed or refinanced with 2010A Bond proceeds, limitations on investing gross proceeds of the 2010A Bonds in higher yielding investments in certain circumstances, and the requirement to comply with the arbitrage rebate requirement to the extent applicable to the 2010A Bonds. The City has covenanted in the Bond Ordinance to comply with those requirements, but if the City fails to comply with those requirements, interest on the 2010A Bonds could become taxable retroactive to the date of issuance of the 2010A Bonds. Bond Counsel has not undertaken and does not undertake to monitor the City's compliance with such requirements.

Corporate Alternative Minimum Tax. While interest on the 2010A Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, under Section 55 of the Code, certain tax exempt interest, including interest on the 2010A Bonds, received by corporations is taken into account in the

computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations (as defined for federal income tax purposes). Under the Code, alternative minimum taxable income of a corporation will be increased by 75% of the excess of the corporation's adjusted current earnings (including any certain tax exempt interest) over the corporation's alternative minimum taxable income determined without regard to such increase. A corporation's alternative minimum taxable income, so computed, that is in excess of an exemption of \$40,000, which exemption will be reduced (but not below zero) by 25% of the amount by which the corporation's alternative minimum taxable income exceeds \$150,000, is then subject to a 20% minimum tax.

A small business corporation is exempt from the corporate alternative minimum tax for any taxable year beginning after December 31, 1997, if its average annual gross receipts during the three-taxable-year period beginning after December 31, 1993, did not exceed \$5,000,000, and its average annual gross receipts during each successive three-taxable-year period thereafter ending before the relevant taxable year did not exceed \$7,500,000.

Tax on Certain Passive Investment Income of S Corporations. Under Section 1375 of the Code, certain excess net passive investment income, including interest on the 2010A Bonds, received by an S corporation (a corporation treated as a partnership for most federal tax purposes) that has Subchapter C earnings and profits at the close of the taxable year may be subject to federal income taxation at the highest rate applicable to corporations if more than 25% of the gross receipts of such S corporation is passive investment income.

Foreign Branch Profits Tax. Interest on the 2010A Bonds may be subject to the foreign branch profits tax imposed by Section 884 of the Code when the 2010A Bonds are owned by, and effectively connected with a trade or business of, a United States branch of a foreign corporation.

Possible Consequences of Tax Compliance Audit. The Internal Revenue Service (the "IRS") has established a general audit program to determine whether issuers of tax-exempt obligations, such as the 2010A Bonds, are in compliance with requirements of the Code that must be satisfied in order for interest on those obligations to be, and continue to be, excluded from gross income for federal income tax purposes. Bond Counsel cannot predict whether the IRS would commence an audit of the 2010A Bonds. Depending on all the facts and circumstances and the type of audit involved, it is possible that commencement of an audit of the 2010A Bonds could adversely affect the market value and liquidity of the 2010A Bonds until the audit is concluded, regardless of its ultimate outcome.

2010A Bonds Not "Qualified Tax Exempt Obligations" for Financial Institutions. Section 265 of the Code provides that 100% of any interest expense incurred by banks and other financial institutions for interest allocable to tax exempt obligations acquired after August 7, 1986, will be disallowed as a tax deduction. However, if the tax exempt obligations are obligations other than private activity bonds, are issued by a governmental unit that, together with all entities subordinate to it, does not reasonably anticipate issuing more than \$30,000,000 of tax exempt obligations (other than private activity bonds and other obligations not required to be included in such calculation) in the current calendar year, and are designated by the governmental unit as "qualified tax exempt obligations," only 20% of any interest expense deduction allocable to those obligations will be disallowed.

The City is a governmental unit that, together with all subordinate entities, reasonably anticipates issuing more than \$30,000,000 of tax exempt obligations (other than private activity bonds and other obligations not required to be included in such calculation) during the current calendar year and has **not** designated the 2010A Bonds as "qualified tax exempt obligations" for purposes of the 80% financial institution interest expense deduction. Therefore, no interest expense of a financial institution allocable to the 2010A Bonds is deductible for federal income tax purposes.

Original Issue Premium. The 2010A Bonds have been sold at prices reflecting original issue premium ("Premium Bonds"). An amount equal to the excess of the purchase price of a Premium Bond over its stated redemption price at maturity constitutes premium on such Premium Bond. A purchaser of a Premium Bond must amortize any premium over such Premium Bond's term using constant yield principles, based on the purchaser's yield to maturity. The amount of amortizable premium allocable to an interest accrual period for a Premium Bond will offset a like amount of qualified stated interest on such Premium Bond allocable to that accrual period, and may affect the calculation of alternative minimum tax liability described above. As premium is amortized, the purchaser's basis in such Premium Bond is reduced by a corresponding amount, resulting in an increase in the gain (or decrease in the loss) to be recognized for federal income tax purposes upon a sale or disposition of such Premium Bond prior to its

maturity. Even though the purchaser's basis is reduced, no federal income tax deduction is allowed. Purchasers of Premium Bonds, whether at the time of initial issuance or subsequent thereto, should consult with their own tax advisors with respect to the determination and treatment of premium for federal income tax purposes and with respect to state and local tax consequences of owning such Premium Bonds.

Reduction of Loss Reserve Deductions for Property and Casualty Insurance Companies. Under Section 832 of the Code, interest on the 2010A Bonds received by property and casualty insurance companies will reduce tax deductions for loss reserves otherwise available to such companies by an amount equal to 15% of tax exempt interest received during the taxable year.

Effect on Certain Social Security and Retirement Benefits. Section 86 of the Code requires recipients of certain Social Security and certain Railroad Retirement benefits to take receipts or accruals of interest on the 2010A Bonds into account in determining gross income.

Other Possible Federal Tax Consequences. Receipt of interest on the 2010A Bonds may have other federal tax consequences as to which prospective purchasers of the 2010A Bonds may wish to consult their own tax advisors.

The 2010B Bonds

This advice was written to support the promotion or marketing of the 2010B Bonds. This advice is not intended or written to be used, and may not be used, by any person or entity for the purpose of avoiding any penalties that may be imposed on any person or entity under the Code. Prospective purchasers of the 2010B Bonds should seek advice based on their particular circumstances from an independent tax advisor.

The following discussion generally describes certain aspects of the principal U.S. federal tax treatment of U.S. persons that are beneficial owners (“Owners”) of 2010B Bonds who have purchased 2010B Bonds in the initial offering and who hold the 2010B Bonds as capital assets within the meaning of Section 1221 of the Code. For purposes of this discussion, a “U.S. person” means an individual who, for U.S. federal income tax purposes, is (i) a citizen or resident of the United States, (ii) a corporation, partnership or other entity created or organized in or under the laws of the United States or any political subdivision thereof, (iii) an estate, the income of which is subject to U.S. federal income taxation regardless of its source of income, or (iv) a trust, if either: (A) a United States court is able to exercise primary supervision over the administration of the trust, and one or more United States persons have the authority to control all substantial decisions of the trust or (B) a trust has a valid election in effect to be treated as a United States person under the applicable treasury regulations.

This summary is based on the Code, published revenue rulings, administrative and judicial decisions, and existing and proposed Treasury regulations (all as of the date hereof and all of which are subject to change, possibly with retroactive effect). This summary does not discuss all of the tax consequences that may be relevant to an Owner in light of its particular circumstances, such as an Owner who may purchase 2010B Bonds in the secondary market, or to Owners subject to special rules, such as certain financial institutions, insurance companies, tax-exempt organizations, non-U.S. persons, taxpayers who may be subject to the alternative minimum tax or personal holding company provisions of the Code, or dealers in securities. Accordingly, before deciding whether to purchase any 2010B Bonds, prospective purchasers should consult their own tax advisors regarding the United States federal income tax consequences, as well as tax consequences under the laws of any state, local or foreign taxing jurisdiction or under any applicable tax treaty, of purchasing, holding, owning and disposing of the 2010B Bonds.

In General. As described herein under the heading “DESCRIPTION OF THE BONDS—Designation of the 2010B Bonds as ‘Build America Bonds,’” the City has made irrevocable elections to have the 2010B Bonds treated as “Build America Bonds” within the meaning of Section 54AA(d) of the Code that also are “qualified bonds” within the meaning of Subsection 54AA(g) of the Code. As a result of these elections, interest on the 2010B Bonds is not excludable from the gross income of the Owners for federal income tax purposes, and Owners of the 2010B Bonds will not be allowed any federal tax credits as a result of ownership of or receipt of interest payments on the 2010B Bonds.

Payments of Interest. Interest paid on the 2010B Bonds will generally be taxable to Owners as ordinary interest income at the time it accrues or is received, in accordance with the Owner's method of accounting for U.S. federal income tax purposes. Owners who are cash-method taxpayers will be required to include interest in income upon receipt of such interest payment; Owners who are accrual-method taxpayers will be required to include interest as it accrues, without regard to when interest payments are actually received.

Disposition or Retirement of 2010B Bonds. Upon the sale, exchange or other disposition of a 2010B Bond, or upon the retirement of a 2010B Bond (including by redemption), an Owner will recognize capital gain or loss equal to the difference, if any, between the amount realized upon the disposition or retirement (excluding any amounts attributable to accrued but unpaid interest, which will be taxable as such) and the Owner's adjusted tax basis in the 2010B Bond. Any such gain or loss will be United States source gain or loss for foreign tax credit purposes.

Defeasance of 2010B Bonds. If the City defeases any 2010B Bonds, such 2010B Bonds may be deemed to be retired and "reissued" for federal income tax purposes as a result of the defeasance. In such event, the Owner of a 2010B Bond would recognize a gain or loss on the 2010B Bond at the time of defeasance.

Backup Withholding. An Owner may, under certain circumstances, be subject to "backup withholding" (currently the rate of this withholding tax is 28%, but may change in the future) with respect to interest on the 2010B Bonds. This withholding generally applies if the owner of a 2010B Bond (a) fails to furnish the Bond Registrar or other payor with its taxpayer identification number; (b) furnishes the Bond Registrar or other payor an incorrect taxpayer identification number; (c) fails to report properly interest, dividends or other "reportable payments" as defined in the Code; or (d) under certain circumstances, fails to provide the Bond Registrar or other payor with a certified statement, signed under penalty of perjury, that the taxpayer identification number provided is its correct number and that the Owner is not subject to backup withholding. Any amount withheld may be creditable against the Owner's U.S. federal income tax liability and be refundable to the extent it exceeds the Owner's U.S. federal income tax liability.

The amount of "reportable payments" for each calendar year and the amount of tax withheld, if any, with respect to payments on the 2010B Bonds will be reported to the Owners and to the Internal Revenue Service.

Reporting of Interest Payments. Subject to certain exceptions, interest payments made to beneficial owners with respect to the 2010B Bonds will be reported to the IRS. Such information will be filed each year with the IRS on Form 1099, which will reflect the name, address and Taxpayer Identification Number of the beneficial owner. A copy of Form 1099 is required to be sent to each beneficial owner of a 2010B Bond.

ERISA CONSIDERATIONS

The Employees Retirement Income Security Act of 1974, as amended ("ERISA"), and the Code generally prohibit certain transactions between a qualified employee benefit plan under ERISA or tax-qualified retirement plans and individual retirement accounts under the Code (collectively, the "Plans") and persons who, with respect to a Plan, are fiduciaries or other "parties in interest" within the meaning of ERISA or "disqualified persons" within the meaning of the Code. All fiduciaries of Plans should consult their own tax advisors with respect to the consequences of any investment in the 2010B Bonds.

DESCRIPTION OF RATINGS

Moody's and S&P have assigned ratings of "Aa2" and "AA," respectively, to the Bonds. Ratings were applied for by the City and certain information was supplied by the City to the rating agencies to be considered in evaluating the Bonds. The ratings reflect only the views of the rating agencies and an explanation of the significance of the ratings may be obtained from the rating agencies. There is no assurance that the ratings will be retained for any given period of time or that the ratings will not be revised downward, suspended, or withdrawn entirely by the rating agencies if, in their judgment, circumstances so warrant. Any such downward revision, suspension, or withdrawal of the ratings would be likely to have an adverse effect on the market price of the Bonds.

UNDERWRITING

The 2010A Bonds are being purchased by Citigroup Global Markets Inc. (the "Underwriter") at an aggregate price of \$32,615,917, which represents the principal amount of the 2010A Bonds, plus an original issue premium of \$3,660,214, less an Underwriter's discount of \$144,297. The 2010B Bonds are being purchased by the Underwriter at an aggregate price of \$74,518,108, which represents the principal amount of the 2010B Bonds, less an Underwriter's discount of \$466,892. After the initial public offering, the public offering prices may be varied from time to time.

Citigroup Inc., the parent company of Citigroup Global Markets Inc., the Underwriter of the Bonds, has informed the City that it has entered into a retail brokerage joint venture with Morgan Stanley. As part of the joint venture, Citigroup Global Markets Inc. will distribute municipal securities to retail investors through the financial advisor network of its new broker-dealer, Morgan Stanley Smith Barney LLC. This distribution arrangement became effective on June 1, 2009. As part of this arrangement, Citigroup Global Markets Inc. will compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the Bonds.

FINANCIAL ADVISOR

DashenMusselman Inc. has acted as financial advisor to Tacoma Water in connection with the issuance of the Bonds. The financial advisor has not audited, authenticated, or otherwise verified the information set forth in this Official Statement or the other information available from Tacoma Water with respect to the appropriateness, accuracy, and completeness of the disclosure of such information, and the financial advisors make no guarantee, warranty, or other representation on any matter related to such information. DashenMusselman Inc. is an independent financial advisory and consulting organization and is not engaged in the business of underwriting, marketing, or trading of municipal securities or any other negotiable instruments.

APPROVAL OF COUNSEL

Legal matters incident to the authorization, issuance, and sale of the Bonds by the City are subject to the approving legal opinion of Foster Pepper PLLC, Seattle, Washington, Bond Counsel. The form of the opinion of Bond Counsel with respect to the Bonds is attached as Appendix D. The opinion of Bond Counsel is given based on factual representations made to Bond Counsel, and under existing law, as of the date of initial delivery of the Bonds, and Bond Counsel assumes no obligation to revise or supplement its opinion to reflect any facts or circumstances that may thereafter come to its attention, or any changes in law that may thereafter occur. The opinion of Bond Counsel is an expression of its professional judgment on the matters expressly addressed in its opinion and does not constitute a guarantee of result. Bond Counsel will be compensated only upon the issuance and sale of the Bonds.

Certain legal matters will be passed upon for the Underwriter by its counsel, K&L Gates LLP, Seattle, Washington, and any opinion of such counsel will be limited in scope, addressed solely to the Underwriter, and cannot be relied upon by investors.

LIMITATIONS ON REMEDIES

Any remedies available to the owners of the Bonds upon the occurrence of an event of default under the Bond Ordinance are in many respects dependent upon judicial actions, which are in turn often subject to discretion and delay and could be both expensive and time consuming to obtain. If the City fails to comply with its covenants under the Bond Ordinance or to pay principal of or interest on the Bonds, there can be no assurance that available remedies will be adequate to fully protect the interests of the owners of the Bonds.

In addition to the limitations on remedies contained in the Bond Ordinance, the rights and obligations under the Bonds and the Bond Ordinance may be limited by and are subject to bankruptcy, insolvency, reorganization, fraudulent conveyance, moratorium, and other laws relating to or affecting creditors' rights, to the application of equitable principles, and to the exercise of judicial discretion in appropriate cases. The opinion to be delivered by Foster Pepper PLLC, as Bond Counsel, concurrently with the issuance of the Bonds, will be subject to limitations regarding bankruptcy, insolvency, and other laws relating to or affecting creditors' rights. The various other legal

opinions to be delivered concurrently with the issuance of the Bonds will be similarly qualified. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix D.

CONTINUING DISCLOSURE UNDERTAKING

Basic Undertaking to Provide Annual Financial Information and Notice of Material Events. To assist the Underwriter in meeting the requirements of United States Securities and Exchange Commission (“SEC”) Rule 15c2-12(b)(5) (the “Rule”), as applicable to a participating underwriter for the Bonds, the City will undertake (the “Undertaking”) for the benefit of holders of the Bonds to provide or cause to be provided, either directly or through a designated agent, to the Municipal Securities Rulemaking Board (“MSRB”) in an electronic format as prescribed by the MSRB, accompanied by identifying information as prescribed by the MSRB, annual financial information and operating data of the type included in this Official Statement as generally described below (“annual financial information”); and to the MSRB timely notice of the occurrence of any of the following events with respect to the Bonds (as currently defined as follows or as redefined by MSRB in the future), if material: (i) principal and interest payment delinquencies; (ii) non payment related defaults; (iii) unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancements reflecting financial difficulties; (v) substitution of credit or liquidity providers, or their failure to perform; (vi) adverse tax opinions or events affecting the tax exempt status of the 2010A Bonds; (vii) modifications to rights of holders of the Bonds; (viii) Bond calls (other than scheduled mandatory redemptions of Term Bonds for which notice is given pursuant to Exchange Act Release 34-23856); (ix) defeasances; (x) release, substitution, or sale of property securing repayment of the Bonds; and (xi) rating changes. The City also will provide to the MSRB timely notice of a failure by the City to provide required annual financial information on or before the date specified below.

Type of Annual Financial Information Undertaken to be Provided. The annual financial information that the City undertakes to provide will consist of (i) annual financial statements of Tacoma Public Utilities Water Division, which statements will include the Water Division Fund, prepared (except as otherwise noted therein) in accordance with the Budget Accounting and Reporting System presented by the Washington State Auditor pursuant to RCW 43.09.200 (or any successor statute), which statements will not be audited, except that if and when audited financial statements are otherwise prepared and available to the City they will be provided; (ii) principal amount of outstanding Parity Bonds and debt service coverage; (iii) water rates; and (iv) numbers of customers and water sales; and will be provided to the MSRB not later than the last day of the ninth month after the end of each fiscal year of the City (currently, a fiscal year ending December 31 as such fiscal year may be changed as required or permitted by State law, commencing with the City’s fiscal year ending December 31, 2010).

The annual financial information may be provided in a single or multiple documents and may be incorporated by specific reference to documents available to the public on the Internet website of the MSRB or filed with the SEC.

Amendment of Undertaking. The Undertaking is subject to amendment after the primary offering of the Bonds without the consent of any holder of any Bond, or of any broker, dealer, municipal securities dealer, participating underwriter, rating agency, or the MSRB, under the circumstances and in the manner permitted by the Rule and with an opinion of bond counsel.

The City will give notice to the MSRB of the substance (or provide a copy) of any amendment to the Undertaking and a brief statement of the reasons for the amendment. If the amendment changes the type of annual financial information to be provided, the annual financial information containing the amended financial information will include a narrative explanation of the effect of that change on the type of information to be provided.

Termination of Undertaking. The City’s obligations under the Undertaking shall terminate upon the legal defeasance, prior redemption, or payment in full of all of the Bonds. In addition, the City’s obligations under the Undertaking shall terminate if those provisions of the Rule that require the City to comply with the Undertaking are invalid, have been repealed retroactively, or otherwise do not apply in respect of the Bonds for any reason, as confirmed by an opinion of nationally recognized bond counsel to the City, and the City provides timely notice of such termination to the MSRB.

Remedy for Failure to Comply with Undertaking. No failure by the City or other obligated person to comply with the Undertaking will constitute a default in respect of the Bonds. The sole remedy of any holder or beneficial owner

APPENDIX A

SUMMARY OF THE BOND ORDINANCE

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SUMMARY OF PRINCIPAL PROVISIONS OF THE BOND ORDINANCE

Following is a summary of the principal, substantive provisions of the Bond Ordinance, which summary is qualified in its entirety by reference to the complete text of the Bond Ordinance on file with the City Clerk of the City.

DEFINITIONS

As used in the Bond Ordinance, the following words have the following meanings:

“Accreted Value” means: (1) with respect to any Capital Appreciation Bonds, as of the time of calculation, the sum of the amount representing the initial principal amount of such Capital Appreciation Bonds as set forth in the applicable Parity Bond Authorizing Ordinance plus the interest accumulated, compounded and unpaid thereon as of the most recent compounding date, or (2) with respect to original issue discount bonds under the Code, as of the time of calculation, the amount representing the initial public offering price of such original issue discount bonds plus the amount of the discounted principal which has accreted since the date of issue, determined in accordance with the provisions of the applicable Parity Bond Authorizing Ordinance.

“Annual Debt Service” means, for any fiscal year of the Water System, all amounts required to be paid in respect of interest on and principal of Parity Bonds (excluding interest payments capitalized by Parity Bonds and excluding the accrued interest paid to the City upon the issuance of Parity Bonds) and Payment Agreement Payments in respect of Parity Payment Agreements, subject to the following:

Debt Service on Term Bonds. For purposes of calculating debt service on Term Bonds, only the scheduled mandatory redemption amounts payable in respect of principal of Term Bonds shall be taken into account in any fiscal year prior to the Term Bond Maturity Year, and only the principal amount scheduled to remain outstanding after payment of all prior mandatory redemption amounts shall be taken into account in the Term Bond Maturity Year;

Interest on Parity Bonds. For purposes of determining compliance with the Coverage Requirement, the Reserve Requirement and the conditions for the issuance of Future Parity Bonds or the creation of Contract Resource Obligations,

Generally. Except as otherwise provided with respect to Variable Interest Rate Bonds and with respect to Parity Bonds with respect to which a Payment Agreement is in force, interest on any issue of Parity Bonds payable in a fiscal year shall be calculated based on the actual amount of accrued, accreted or otherwise accumulated interest that is payable in that fiscal year in respect of that issue taken as a whole, at the rate or rates set forth in the Parity Bond Authorizing Ordinance;

Interest on Variable Interest Rate Bonds. The amount of interest deemed to be payable on any issue of Variable Interest Rate Bonds shall be calculated on the assumption that the interest rate on those bonds would be equal to the rate (the “assumed RBI-based rate”) that is 90% of the average Bond Buyer Revenue Bond Index or comparable index during the fiscal quarter preceding the quarter in which the calculation is made; except that, for purposes of determining actual compliance with the Coverage Requirement in any past fiscal year, the actual amount of interest paid on any issue of Variable Interest Rate Bonds shall be taken into account;

Interest on Parity Bonds With Respect to Which a Payment Agreement or Parity Payment Agreement is in Force. Debt service on Parity Bonds with respect to which a Payment Agreement or Parity Payment Agreement is in force shall be based on the net economic effect on the City expected to be produced by the terms of the Parity Bonds and the terms of the Payment Agreement.

Interest on Parity Bonds designated as “Build America Bonds.” Ordinances No. 26849, 27109 and 27405 are hereby amended to provide that the interest on Parity Bonds designated as Build America Bonds, including the Bonds, only for purposes of calculating the Reserve Requirement, shall be based on the net interest after the 35% federal direct payment or such other federal direct payment to be received for Future Parity Bonds. The owners of the Bonds shall be deemed to have consented to this subsection. This subsection shall be in effect

when 60% of the then current owners of Parity Bonds, including the Bonds, have consented to this amendment to the definition of Annual Debt Service.

“Average Annual Debt Service” means the sum of the Annual Debt Service for the remaining years to the last scheduled maturity of the applicable issue or issues of Parity Bonds divided by the number of those years.

“Bond Fund” means that special fund of the City known as the Water Revenue Bond Fund, created by Ordinance No. 25392 in the Water Division Fund of the City for the payment of the principal of, mandatory sinking fund payments and interest on the Parity Bonds.

“Bond Insurance” means any bond insurance, letter of credit, guaranty, surety bond or similar credit enhancement device providing for or securing the payment of all or part of the principal of and interest on any Parity Bonds.

“Bond Insurer” means any provider of Bond Insurance approved by the City Council by ordinance or resolution.

“Bond Register” means the books or records maintained by the Bond Registrar on which are recorded the names and addresses of the owners of each of the Bonds.

“Bond Registrar” means the Fiscal Agency.

“Build America Bonds” means any series of Parity Bonds to which the City irrevocably elects to have Section 54AA of the Code apply.

“Capital Appreciation Bonds” means any Parity Bonds, all or a portion of the interest on which is compounded and accumulated at the rates or in the manner, and on the dates, set forth in the applicable Parity Bond Authorizing Ordinance and is payable only upon redemption or on the maturity date of such Parity Bonds. Parity Bonds that are issued as Capital Appreciation Bonds, but later convert to obligations on which interest is paid periodically, shall be Capital Appreciation Bonds until the conversion date and thereafter shall no longer be Capital Appreciation Bonds, but shall be treated as having a principal amount equal to their Accreted Value on the conversion date.

“Code” means the Internal Revenue Code of 1986, as amended, together with corresponding final, temporary or proposed regulations and revenue rulings issued or amended with respect thereto by the U.S. Treasury Department or the Internal Revenue Service to the extent applicable to the Bonds.

“Contract Resource Obligation” means an obligation of the City, designated as a Contract Resource Obligation and entered into pursuant to the Bond Ordinance, to make payments for water supply, transmission or other commodity or service to another person or entity (including without limitation a separate utility system created pursuant to the Bond Ordinance). The Water System has designated the Regional System as a Contract Resource Obligation.

“Coverage Requirement” in any fiscal year of the Water System means an amount of Net Revenue of the Water System equal to at least 1.25 times the Annual Debt Service that year on all Parity Bonds.

“DTC” means The Depository Trust Company.

“Fiscal Agency” means the fiscal agency of the State of Washington, whose duties include registering and authenticating the Bonds, maintaining the Bond Register, transferring ownership of the Bonds, and paying principal and interest on the Bonds.

“Future Parity Bonds” means all revenue bonds and other obligations (including Parity Payment Agreements) of the City issued or entered into after the date of the issuance of the Bonds and then outstanding, the payment of which constitutes a charge and lien on the Net Revenue of the Water System equal in rank with the charge and lien upon such revenue required to be paid into the Bond Fund to pay and secure the payment of the principal of and interest on the Bonds and the Outstanding Parity Bonds.

“Gross Revenue of the Water System” or **“Gross Revenue”** means in any fiscal year of the Water System all of the revenues of the Water System, including but not limited to revenue from the sale or transmission of water; the sale, lease or furnishing of other commodities, services, properties or facilities; the imposition of connection, capital improvement or other charges; utility local improvement district assessments that are pledged to Parity Bonds; and earnings from the investment of money in the Water Division Fund. However, Gross Revenue shall not include earnings of the Regional System or any other separate utility system that may be acquired or constructed by the City pursuant to the Bond Ordinance; principal proceeds of Parity Bonds or other borrowing; grants for capital or other capital contributions; or earnings or proceeds from any investments in a trust, defeasance or escrow fund created to defease or refund Water System obligations (until commingled with other earnings and revenues of the Water System defined as Gross Revenue) or held in a special account for the purpose of paying a rebate to the United States government under the Code.

“Independent Consulting Engineer” means either (1) an independent licensed professional engineer experienced in the design, construction or operation or the development of rates and charges of municipal utilities of comparable size and character to the Water System, or (2) an independent certified public accountant or other professional consultant experienced in the development of rates and charges for municipal utilities of comparable size and character to the Water System.

“Letter of Representations” means the Blanket Letter of Representations from the City to DTC in the form on file with the Director of Finance.

“Maximum Annual Debt Service” means at the time of calculation, the maximum amount of Annual Debt Service that will mature or come due in the current year or any future year on the Parity Bonds.

“Net Revenue of the Water System” or **“Net Revenue”** means the Gross Revenue minus (1) Operation and Maintenance Expenses, (2) deposits into the Rate Stabilization Account and (3) proceeds from the sale of property of the Water System, and plus withdrawals from the Rate Stabilization Account.

“Operation and Maintenance Expenses” means all expenses incurred by the City in causing the Water System to be operated and maintained in good repair, working order and condition, including without limitation: deposits, premiums, assessments or other payments for insurance, if any, on the Water System; payments into pension funds; State-imposed taxes; amounts due under Contract Resource Obligations, including Regional Supply System costs, but only at the times described in the Bond Ordinance; payments made to any other person or entity for the receipt of water supply or transmission or other right, commodity or service; payments made to any other person or entity that are required in connection with the operation of the Water System or the acquisition or transmission of water and that are not subordinate to the lien of the Parity Bonds; and payments with respect to any other expenses of the Water System that are properly treated as operation and maintenance expenses under generally accepted accounting principles applicable to municipal corporations. Operation and Maintenance Expenses does not include any depreciation or taxes levied or imposed by the City, Payment Agreement Payments, or payments to the City in lieu of taxes, or capital additions or capital replacements to the Water System.

“Outstanding Parity Bonds” means the 2001 Bonds, the 2003 Bonds, the 2005 Bonds and the 2009 Bonds.

“Parity Bonds” means the Outstanding Parity Bonds, the Bonds and any Future Parity Bonds.

“Parity Bond Authorizing Ordinance” means the ordinance and/or resolution of the City that authorizes the issuance and sale and establishes the terms of a particular issue of Parity Bonds and other matters relating to the same plan of finance.

“Parity Payment Agreement” means a Payment Agreement under which the City’s payment obligations are expressly stated to constitute a charge and lien on the Net Revenue of the Water System equal in rank with the charge and lien upon such revenue required to be paid into the Bond Fund to pay and secure the payment of the principal of and interest on Parity Bonds.

“Payment Agreement” means a written agreement, for the purpose of managing or reducing the City’s exposure to fluctuations or levels of interest rates, currencies or commodities, or for other interest rate, investment, asset or liability management purposes, entered into on either a current or forward basis by the City and a Qualified Counterparty, all as authorized by any applicable laws of the State.

“Payment Agreement Payments” means the amounts periodically required to be paid by the City to the Qualified Counterparty pursuant to a Payment Agreement.

“Payment Agreement Receipts” means the amounts periodically required to be paid by the Qualified Counterparty to the City pursuant to a Payment Agreement.

“Plan of Additions” means the system or plan of additions to and betterments and extensions of the Water System described in the Bond Ordinance, as such plan of additions may be amended, updated, supplemented or replaced.

“Principal and Interest Account” means the account of that name created in the Bond Fund for the payment of the principal of and interest and mandatory redemption requirements, if any, on the Parity Bonds.

“Public Utility Board” means the board of that name created under the Tacoma City Charter.

“Qualified Counterparty” means a party (other than the City or a party related to the City) who is the other party to a Payment Agreement and (1)(a) whose senior debt obligations are rated in one of the three highest rating categories of each of the Rating Agencies (without regard to any gradations within a rating category) or (b) whose obligations under the Payment Agreement are guaranteed for the entire term of the Payment Agreement by a bond insurer or other institution which has been assigned a credit rating in one of the two highest rating categories of each of the Rating Agencies, and (2) who is otherwise qualified to act as the other party to a Payment Agreement under any applicable laws of the State.

“Rate Stabilization Account” means the fund of that name created in the Water Division Fund.

“Regional Supply System Costs” means with respect to each month all costs attributable to the Regional System, to the extent not paid from the proceeds of Parity Bonds or other sources, resulting from the ownership, operation, maintenance, and termination of, and repair, renewals, replacements, additions, improvements, betterments, and modifications to the Regional System, including, without limitation: (1) operating expenses; (2) the amount required to be paid into the bond fund for Regional System bonds; (3) any amount that the City may be required during such month to pay for the prevention or correction of any unusual loss or damage or for renewals, replacements, repairs, additions, improvements, betterments, and modifications that are necessary to keep the Regional System in good operating condition, to improve the operation thereof or to prevent a loss; and (4) all other charges or obligations against the revenues of the Regional System.

“Regional System” means the Regional Water Supply System, comprised of certain property and facilities to obtain and receive deliveries of water for the participants from the exercise by the City of the Second Diversion Water Right from the Green River and granted by the State of Washington Department of Ecology, which property and facilities include: (1) a Main Branch pipeline to Tacoma with a 72 MGD nominal capacity; (2) headworks improvements associated with the second diversion water right; (3) related fisheries and environmental enhancements; (4) improvements and additions to the Howard Hanson Dam to raise the summer storage pool to elevation of 1,167 feet in phase 1 to provide an additional 20,000 acre feet of water storage, together with improvements and additions related to accommodating fish passage; and (5) additional related water treatment facilities; and as the same will be added to, improved, and extended.

“Reserve Account” means the account of that name created in the Bond Fund for the purpose of securing the payment of the principal of and interest on the Parity Bonds.

“Reserve Insurance” means any bond insurance, letter of credit, guaranty, surety bond or similar credit enhancement device obtained by the City equal to part or all of the Reserve Requirement for any Parity Bonds which

is issued by an institution which has been assigned a credit rating at the time of issuance of the device in one of the two highest rating categories of each of the Rating Agencies.

“Reserve Requirement” means as of any date the lesser of Maximum Annual Debt Service or 125% of average Annual Debt Service on all the outstanding Parity Bonds. Once the 2001 Bonds are no longer outstanding, the Reserve Requirement for a series of Parity Bonds shall not exceed 10% of the net proceeds of such Bonds.

“Term Bond Maturity Year” means any calendar year in which Term Bonds are scheduled to mature.

“Term Bonds” means those Bonds designated as such in the Bond Sale Resolution and those Parity Bonds designated as such in the applicable Parity Bond Authorizing Ordinance.

“Variable Interest Rate” means any variable interest rate or rates to be borne by any Parity Bonds. The method of computing such a variable interest rate shall be as specified in the applicable Parity Bond Authorizing Ordinance, which ordinance or resolution also shall specify either (1) the particular period or periods of time or manner of determining such period or periods of time for which each value of such variable interest rate shall remain in effect or (2) the time or times upon which any change in such variable interest rate shall become effective. A Variable Interest Rate may, without limitation, be based on the interest rate on certain bonds or may be based on interest rate, currency, commodity or other indexes.

“Variable Interest Rate Bonds” means, for any period of time, any Parity Bonds that bear a Variable Interest Rate during that period, except that Parity Bonds shall not be treated as Variable Interest Rate Bonds if the net economic effect of interest rates on particular Parity Bonds of an issue and interest rates on other Parity Bonds of the same issue, as set forth in the applicable Parity Bond Authorizing Ordinance, or the net economic effect of a Payment Agreement with respect to particular Parity Bonds, in either case is to produce obligations that bear interest at a fixed interest rate; and Parity Bonds with respect to which a Payment Agreement is in force shall be treated as Variable Interest Rate Bonds if the net economic effect of the Payment Agreement is to produce obligations that bear interest at a Variable Interest Rate.

“Water Division Fund” means Fund No. 4600 of the City, or any successor fund or funds, into which is paid the Gross Revenue of the Water System.

“Water System” means the water system of the City as it now exists, and all additions thereto and betterments and extensions thereof at any time made for so long as any of the Parity Bonds are outstanding. The Water System shall not include the Regional System or any other water supply or service or other facilities that may be created, acquired or constructed by the City as a separate utility system as provided in the Bond Ordinance.

“2001 Bonds” means the City’s Water System Revenue Bonds, 2001, issued in the original principal amount of \$32,900,000 pursuant to Ordinance No. 26849.

“2003 Bonds” means the City’s Water System Revenue and Refunding Bonds, 2003, issued in the original principal amount of \$51,380,000 pursuant to Ordinance No. 27109.

“2005 Bonds” means the City’s Water System Revenue and Refunding Bonds, 2005, issued in the original principal amount of \$46,550,000 pursuant to Ordinance No. 24705.

“2009 Bonds” means the City’s Water System Revenue Bonds, 2009 (Taxable Build America Bonds – Direct Payment), issued in the original principal amount of \$76,775,000 pursuant to Ordinance No. 27837.

PAYMENT OF AND SECURITY FOR THE BONDS

Bond Fund. The Bond Fund has been created in the Water Division Fund and is divided into two accounts: the Principal and Interest Account and the Reserve Account. So long as any Parity Bonds are outstanding, the City is required to set aside and pay into the Bond Fund out of the Net Revenue, certain fixed amounts without regard to any fixed proportion, namely:

(a) Into the Principal and Interest Account on or before each interest or principal and interest payment date of any Parity Bonds at least an amount which, together with other money on deposit therein, will be sufficient to pay the interest, or principal and interest, to become due and payable on the Parity Bonds on that payment date, including any Parity Bonds subject to mandatory redemption on that date, and net payments due on Parity Payment Agreements; and

(b) Into the Reserve Account the Reserve Requirement for the Bonds. The City may at any time provide all or any part of the Reserve Requirement through Reserve Insurance, and the amount available to be drawn upon under that Reserve Insurance shall be credited against the Reserve Requirement, subject to the following:

Reserve Insurance shall not be cancelable on less than three years' notice. On receipt of a notice of cancellation of any Reserve Insurance or upon notice that the entity providing the Reserve Insurance no longer meets the requirements of the Bond Ordinance, the City shall substitute Reserve Insurance in the amount required to make up the deficiency created in the Reserve Account or in the alternative shall create a special account in the Water Division Fund and deposit therein, on or before the 25th day of each of the 36 succeeding calendar months (commencing with the 25th day of the calendar month next following the date of the notice) 1/36th of the amount sufficient, together with other money and investments on deposit in the Reserve Account, to equal the Reserve Requirement in effect as of the date the cancellation or disqualification of the entity becomes effective. Those amounts shall be deposited in the special account from money in the Water Division Fund after making provision for payment of Operation and Maintenance Expenses and for required payments into the Bond Fund. Amounts on deposit in that special account shall not be available to pay debt service on Parity Bonds or for any other purpose of the City, and shall be transferred to the Reserve Account on the effective date of any cancellation of a Reserve Insurance to make up all or part of the deficiency caused thereby. Amounts in that special account or in the Reserve Account may be transferred back to the Water Division Fund and used for any purpose if and when qualifying Reserve Insurance is obtained.

Except for withdrawals therefrom and payments over time as authorized by the Bond Ordinance, the Reserve Account is required to be maintained at the Reserve Requirement, as it is adjusted from time to time, at all times so long as any Parity Bonds are outstanding. For the purpose of determining the amount credited to the Reserve Account, obligations in which money in the Reserve Account has been invested shall be valued at the greater of cost or accreted value.

In the event that there shall be a deficiency in the Principal and Interest Account to meet maturing installments of either principal or interest or mandatory redemption requirements, as the case may be, that deficiency shall be made up from the Reserve Account by the withdrawal of cash or draws on the Reserve Insurance therefrom for that purpose. Any deficiency created in the Reserve Account by reason of any such withdrawal shall within 12 months be made up from Net Revenue available after making necessary provisions for the required payments into the Principal and Interest Account.

The money in the Reserve Account may be applied to the payment of the last outstanding Parity Bonds payable out of the Bond Fund, except that any money in the Reserve Account (including investment earnings) in excess of the Reserve Requirement may be withdrawn and deposited in the Principal and Interest Account and spent for the purpose of retiring Parity Bonds or may be deposited in any other fund or account and spent for any other lawful Water System purpose. When the total amount in the Bond Fund (including investment earnings) equals the total amount of principal and interest for all Parity Bonds to the last maturity thereof, no further payment need be made into the Bond Fund.

The City may provide for the purchase, redemption or defeasance of any Parity Bonds by the use of money on deposit in any account in the Bond Fund as long as the money remaining in those accounts is sufficient to satisfy the required deposits in those accounts for the remaining Parity Bonds.

All money in the Bond Fund may be kept in cash or invested in legal investments (including the City's investment pool) maturing, for investments in the Principal and Interest Account, not later than the dates when the funds are required for the payment of principal or interest on the Parity Bonds and, for investments in the Reserve Account, maturing (or subject to redemption, or repurchase and redemption, at the option of the City) on a date not later than 15 years from the date of investment.

Earnings from investments in the Principal and Interest Account shall be deposited in that account. Earnings from investments in the Reserve Account shall be deposited in that account if necessary to meet the Reserve Account Requirement. Notwithstanding the provisions for the deposit of earnings, any earnings that are subject to federal arbitrage rebate requirements may be withdrawn from the Bond Fund for deposit into a separate fund or account created for the purpose of compliance with those rebate requirements.

If the City provides for all or part of the Reserve Requirement by Reserve Insurance, excess amounts in the Reserve Account may be withdrawn from that account and deposited either in the Principal and Interest Account and/or in the Water Division Fund, subject to applicable state law and federal law.

FGIC Reserve Account Surety Policies. Debt service reserve fund policies issued by Financial Guaranty Insurance Company (“FGIC”) were obtained for the 1997 Bonds, 2001 Bonds and 2005 Bonds. See “SECURITY FOR THE BONDS – The Reserve Policies” in the Official Statement.

FSA Reserve Account Surety Policy. A debt service reserve fund policy issued by Financial Security Assurance Inc. (“FSA”) was obtained for the 2003. See “SECURITY FOR THE BONDS – The Reserve Policies” in the Official Statement.

Rate Stabilization Account. There has previously been established in the Water Division Fund a Rate Stabilization Account. The City may at any time, as determined by the City and as consistent with the Bond Ordinance, deposit in the Rate Stabilization Account Gross Revenue and any other money received by the Water System and available to be used therefor, excluding principal proceeds of Parity Bonds or other borrowing. Net Revenue for a fiscal year shall not include deposits into the Rate Stabilization Account. The City may withdraw money from the Rate Stabilization Account for inclusion in the Net Revenue for any fiscal year of the Water System, except that (a) the total amount withdrawn from the Rate Stabilization Account in any fiscal year of the Water System may not exceed the total debt service of the Water System in that year; and (b) the Net Revenue in that fiscal year, disregarding the amounts withdrawn from the Rate Stabilization Account, must equal at least 1.0 times the Annual Debt Service that year on all Parity Bonds. Such deposits or withdrawals may be made up to and including the date 90 days after the end of the fiscal year for which the deposit or withdrawal will be included as Net Revenue for that fiscal year. Earnings from investments in the Rate Stabilization Account shall be deposited in that fund or another Water System fund and shall not be included as Net Revenue unless and until withdrawn from that fund as provided by the Bond Ordinance. No deposit of Gross Revenue shall be made into the Rate Stabilization Account to the extent that such deposit would prevent the City from meeting the Coverage Requirement in the relevant fiscal year.

Pledge of Net Revenue and Lien Position. The Net Revenue of the Water System and all money and investments held in the Bond Fund, the Rate Stabilization Account, and the Construction Fund (except money and investments held in a separate fund or account created for the purpose of compliance with rebate requirements under the Code), is pledged to the payment of the Parity Bonds and to make payments into the Reserve Account required by the Bond Ordinance and the Parity Bond Authorizing Ordinances, and this pledge shall constitute a lien and charge upon the Net Revenue prior and superior to any other charges whatsoever.

COVENANTS WITH BONDOWNERS

The City covenants and agrees with the owner of each Bond at any time outstanding, as follows:

Operation and Maintenance. It will at all times maintain, preserve and keep the properties of the Water System in good repair, working order and condition, will make all necessary and proper additions, betterments, renewals and repairs thereto, and improvements, replacements and extensions thereof, and will at all times operate or cause to be operated the properties of the Water System and the business in connection therewith in an efficient manner and at a reasonable cost.

Rate Covenants. It will establish, maintain and collect rates and charges for services and facilities provided by the Water System that will be fair and equitable, and will adjust those rates and charges from time to time so that:

The Gross Revenue will be sufficient to (i) pay all Operation and Maintenance Expenses, (ii) pay when due all amounts that the City is obligated to pay into the Bond Fund and the accounts therein, and (iii) pay all taxes, assessments or other governmental charges lawfully imposed on the Water System or the revenue therefrom or payments in lieu thereof and any and all other amounts which the City may now or hereafter become obligated to pay from the Gross Revenue by law or contract; and

The Net Revenue of the Water System in each fiscal year of the Water System will be at least equal to the Coverage Requirement; and

Failure of the City to comply with the rate covenants described above shall not be an Event of Default as defined in the Bond Ordinance if the City promptly retains an Independent Consulting Engineer, or once the Outstanding Parity Bonds are no longer Outstanding, an independent certified public accountant, to recommend to the City Council adjustments in the rates of the Water System necessary to meet those covenants and if the City Council adopts the recommended modifications within 180 days of the date the failure becomes known to the City Council.

Sale, Transfer or Disposition of the Water System. It will sell, transfer or otherwise dispose of any of the works, plant, properties, facilities or other part of the Water System or any real or personal property comprising a part of the Water System only upon approval by ordinance and only consistent with one or more of the following:

The City may exchange any of the works, plant, properties, facilities or other part of the Water System for works, plant, properties or facilities of substantially the same type, use and value; or

The City in its discretion may carry out such a sale, transfer or disposition (each, as used in this subparagraph, a “transfer”) if the facilities or property transferred are not material to the operation of the Water System, or shall have become unserviceable, inadequate, obsolete or unfit to be used in the operation of the Water System or are no longer necessary, material or useful to the operation of the Water System; or

The City in its discretion may carry out such a transfer if the aggregate depreciated cost value of the facilities or property being transferred under this subparagraph (3) in any fiscal year of the Water System comprises no more than 3% of the total assets of the Water System; or

The City may sell, lease, mortgage or otherwise dispose of the Water System, including all additions to and betterments and extensions thereof at any time made, that are used, useful or material in the operation of the Water System, if provision is made for the replacement thereof or if the City receives from the purchaser or transferee an amount equal to or greater than the greatest of the following:

(a) An amount which will be in the same proportion to the net amount of Parity Bonds then outstanding (defined as the total amount of the Parity Bonds less the amount of cash and investments in the Bond Fund and accounts therein) that the Gross Revenue of the Water System from the portion of the Water System sold or disposed of for the preceding year bears to the total Gross Revenue of the Water System for that period; or

(b) An amount which will be in the same proportion to the net amount of Parity Bonds then outstanding (as defined above) that the Net Revenue from the portion of the Water System sold or disposed of for the preceding year bears to the total Net Revenue of the Water System for such period; or

(c) An amount which will be in the same proportion to the net amount of Parity Bonds then outstanding (as defined above) that the depreciated cost value of the portion of the Water System sold or disposed of bears to the depreciated cost value of the entire Water System immediately prior to such sale or disposition.

The amount required to be paid to the City under this section may be reduced by any “equity credits” or similar amounts based on prior capital contributions or other payments to the City which, under any contract between the City and the purchaser or transferee, are allowed as a setoff against the purchase or transfer price that would otherwise be payable to the City.

The City may accept from the purchaser or transferee the amount calculated as described above, payable, with interest, amortized over the number of years of remaining life of the portion of the Water System sold or disposed of or such shorter period of time as determined by the City. However, the contract of transfer or sale must provide that the payments to the City shall be either superior to or equal to the lien on the revenues of the purchaser or transferee of all other obligations of the purchaser or transferee.

No Free Service. Except to aid the poor or infirm and for fire-fighting purposes and if the City elects to provide free service for such purposes, it will not furnish or supply or permit the furnishing or supplying of any service or facility in connection with the operation of the Water System free of charge to any person, firm or corporation, public or private.

Liens Upon the Water System. Except as otherwise provided in the Bond Ordinance, it will not at any time create or permit to accrue or to exist any lien or other encumbrance or indebtedness upon the Gross Revenue or any part thereof, prior or superior to the lien thereon for the payment of the Parity Bonds, and will pay and discharge, or cause to be paid and discharged, any and all lawful claims for labor, materials or supplies which, if unpaid, might become a lien or charge upon the Gross Revenue or any part thereof, prior or superior to, or on a parity with, the lien of the Parity Bonds, or which might impair the security of the Parity Bonds.

Books and Accounts. It will keep proper books, records and accounts with respect to the operations, income and expenditures of the Water System in accordance with generally accepted accounting practices relating to municipal utilities and any applicable rules and regulations prescribed by the State, and will cause those books, records and accounts to be audited on an annual basis by the State Auditor (or, if such audit is not made by the State Auditor within 270 days after the close of any fiscal year of the Water System, by a certified public accountant selected by the City). It will prepare annual financial and operating statements as soon as practicable after the close of each fiscal year of the Water System showing in reasonable detail the financial condition of the Water System as of the close of the previous year, and the income and expenses for such year, including the amounts paid into the Bond Fund and into any and all special funds or accounts created pursuant to the provisions of the Bond Ordinance, the status of all funds and accounts as of the end of such year, and the amounts expended for maintenance, renewals, replacements and capital additions to the Water System. Such statements shall be sent to the owner of any Parity Bonds upon written request therefor being made to the City. The City may charge a reasonable cost for providing such financial statements.

Collection of Delinquent Accounts. On at least an annual basis, it will determine all accounts that are delinquent and will take such actions as the City determines are reasonably necessary to enforce payment of those delinquent accounts.

Maintenance of Insurance. It at all times will carry fire and extended coverage, public liability and property damage and such other forms of insurance with responsible insurers and with policies payable to the City on such of the buildings, equipment, works, plants, facilities and properties of the Water System as are ordinarily carried by municipal or privately owned utilities engaged in the operation of like systems, and against such claims for damages as are ordinarily carried by municipal or privately owned utilities engaged in the operation of like systems, or it will self-insure or will participate in an insurance pool or pools with reserves adequate, in the reasonable judgment of the City, to protect the Water System and the owners of the Parity Bonds against loss.

Condemnation Awards and Insurance Proceeds. If the City receives any condemnation awards or proceeds of an insurance policy in connection with any loss of or damage to any property of the Water System, it shall apply the condemnation award or insurance proceeds, in the City's sole discretion, either (i) to the cost of replacing or repairing the lost or damaged properties, (ii) to the payment, purchase or redemption of Parity Bonds, or (iii) to the cost of improvements to the Water System.

Tax Covenant. The City also will covenant in the Tax and Arbitrage Certification to be executed at closing that it will not take or permit to be taken on its behalf any action that would adversely affect the exclusion of the interest on the Bonds from the gross income of the recipients thereof for purposes of federal income taxation and will take or require to be taken such acts as may be permitted by State law and as may from time to time be required under applicable law to continue the exclusion of the interest on the Bonds from the gross income of the recipients thereof for purposes of federal income taxation.

PROVISIONS FOR FUTURE PARITY BONDS

The City reserves the right to issue Future Parity Bonds and to enter into Parity Payment Agreements for purposes of the Water System or to refund a portion of the Parity Bonds if the following conditions are met and complied with at the time of the issuance of those Future Parity Bonds or entering into the Parity Payment Agreement:

(a) There shall be no deficiency in the Bond Fund and no Event of Default shall have occurred and be continuing.

(b) The Parity Bond Authorizing Ordinance shall provide that all assessments and interest thereon that may be levied in any utility local improvement district created for the purpose of paying, in whole or in part, the principal of and interest on those Future Parity Bonds, shall be paid directly into the Bond Fund, except for any prepaid assessments permitted by law to be paid into a construction fund or account.

(c) The Parity Bond Authorizing Ordinance shall provide for the payment of the principal thereof and interest thereon out of the Bond Fund.

(d) The Parity Bond Authorizing Ordinance shall provide for the payment of amounts into the Bond Fund to meet mandatory redemption requirements applicable to any Term Bonds to be issued and for regular payments to be made for the payment of the principal of such Term Bonds on or before their maturity, or, as an alternative, the mandatory redemption of those Term Bonds prior to their maturity date from money in the Principal and Interest Account.

(e) The Parity Bond Authorizing Ordinance shall provide for the deposit into the Reserve Account of (i) an amount, if any, necessary to fund the Reserve Requirement upon the issuance of those Future Parity Bonds from Future Parity Bond proceeds or other money legally available, or (ii) Reserve Insurance or an amount plus Reserve Insurance necessary to fund the Reserve Requirement upon the issuance of those Future Parity Bonds, or (iii) amounts necessary to fund the Reserve Requirement from Net Revenue within five years from the date of issuance of those Future Parity Bonds, in five approximately equal annual payments.

(f) There shall be on file with the City either: a certificate of the Director of Finance demonstrating that during any 12 consecutive calendar months out of the immediately preceding 24 calendar months Net Revenue was at least equal to 1.25 times the projected Maximum Annual Debt Service for all Parity Bonds including the Future Parity Bonds proposed to be issued; or a certificate of an Independent Consulting Engineer or, once the Outstanding Parity Bonds are no longer Outstanding, an independent certified public accountant, that in his or her opinion the Net Revenue will be at least equal to 1.25 times the projected Average Annual Debt Service for all Parity Bonds plus the Future Parity Bonds proposed to be issued. In providing that certificate, the Independent Consulting Engineer, or independent certified public accountant, may take into account the following adjustments:

(i) Any changes in rates in effect and being charged, or rates expected to be charged in accordance with a program of specific rates, rate levels or increases in overall rate revenue approved by ordinance or resolution;

(ii) Net revenue from customers of the Water System who have become customers during the 12 consecutive month period or thereafter, and their estimate of net revenue from any customers to be connected to the Water System who have paid the required connection charges, adjusted to reflect one year's net revenue from those customers;

(iii) The Independent Consulting Engineer's, or independent certified public accountant's, estimate of customers anticipated to be served by facilities or improvements financed in substantial part by those Future Parity Bonds (or additional Parity Bonds expected to be issued during the five-year period); and

(iv) Net revenue from any person, firm, corporation or municipal corporation under any executed contract for water or other utility service, which revenue was not included in the historical Net Revenue of the Water System.

If the Future Parity Bonds proposed to be issued are for the sole purpose of refunding outstanding bonds payable from the Bond Fund, no such coverage certification shall be required if the Annual Debt Service on the Parity Bonds after the issuance of the Future Parity Bonds is not, for any year in which Parity Bonds are outstanding, more than \$5,000 over the Annual Debt Service on the Parity Bonds prior to the issuance of those Future Parity Bonds.

Nothing contained in the foregoing provisions relating to Future Parity Bonds shall prevent the City from issuing Future Parity Bonds to refund maturing Parity Bonds, money for the payment of which is not otherwise available, or revenue bonds that are a charge or lien upon the Gross Revenue subordinate to the charge or lien of the Parity Bonds, or from pledging the payment of utility local improvement district assessments into a bond redemption fund created for the payment of the principal of and interest on those junior lien bonds as long as such utility local improvement district assessments are levied for improvements constructed from the proceeds of those junior lien bonds.

SEPARATE UTILITY SYSTEMS; CONTRACT RESOURCE OBLIGATIONS

Separate Utility Systems. The City may create, acquire, construct, finance, own and operate one or more additional systems for water supply, transmission, treatment or other commodity or service. The Regional System has been created as a separate system. The revenue of any separate utility system shall not be included in the Gross Revenue of the Water System and may be pledged to the payment of revenue obligations issued to purchase, construct, condemn or otherwise acquire or expand the separate utility system. Neither the Gross Revenue nor the Net Revenue of the Water System shall be pledged by the City to the payment of any obligations of a separate utility system except (1) as a Contract Resource Obligation upon compliance with requirements of the Bond Ordinance relating thereto and/or (2), with respect to the Net Revenue, on a basis subordinate to the lien of the Parity Bonds on that Net Revenue.

Contract Resource Obligations. The City may at any time enter into one or more contracts or other obligations for the acquisition, from facilities to be constructed, of water supply, transmission, treatment or other commodity or service relating to the Water System. The City may determine that such contract or other obligation is a Contract Resource Obligation. The City's obligations with respect to the Regional System are a Contract Resolution Obligation. The City may provide that all payments under a Contract Resource Obligation (including payments prior to the time that water supply, transmission, treatment or other commodity or service is being provided, or during a suspension or after termination of supply or service) shall be Operation and Maintenance Expenses if the following requirements are met at the time such Contract source Obligation is entered into:

(a) No Event of Default under the Bond Ordinance has occurred and is continuing; and

(b) There shall be on file a certificate of an Independent Consulting Engineer or, once the Outstanding Parity Bonds are no longer Outstanding, an independent certified public accountant, stating that (i) the payments to be made by the City in connection with the Contract Resource Obligation are reasonable for the supply, transmission, treatment or other service rendered; (ii) the source of any new supply, and any facilities to be constructed to provide the supply, transmission, treatment or other service, are sound from a water or other commodity supply or transmission planning standpoint, are technically and economically feasible in accordance with prudent utility practice, and are likely to provide supply or transmission or other service no later than a date set forth in the Independent Consulting Engineer's or independent certified public accountant's, certification; and (iii) the Net Revenue (further adjusted by the Independent Consulting Engineer's or independent certified public accountant's estimate of the payments to be made in accordance with the Contract Resource Obligation) for the five fiscal years following the year in which the Contract Resource Obligation is incurred, as such Net Revenue is estimated by the Independent Consulting Engineer or independent certified public accountant (with such estimate based on such factors as he or she considers reasonable), will be at least equal to the Coverage Requirement.

Payments required to be made under Contract Resource Obligations shall not be subject to acceleration.

Nothing contained in the foregoing provisions relating to the Contract Resource Obligations shall be deemed to prevent the City from entering into other agreements for the acquisition of water supply, transmission, treatment or other commodity or service from existing facilities and from treating those payments as Operation and Maintenance Expenses of the Water System, or to prevent the City from entering into other agreements for the acquisition of

water supply, transmission, treatment or other commodity or service from facilities to be constructed and from agreeing to make payments with respect thereto, such payments constituting a lien and charge on Net Revenue subordinate to that of Parity Bonds.

REFUNDING OR DEFEASANCE OF BONDS

The City may issue refunding bonds pursuant to the laws of the State or use money available from any other lawful source to pay the principal of and interest on the Bonds, or such portion thereof included in a refunding or defeasance plan, as the same become due and payable and to redeem and retire, release, refund or defease the Bonds and to pay the costs of such refunding or defeasance. In the event that money and/or Government Obligations sufficient in amount, together with known earned income from the investments thereof, to redeem and retire, release, refund or defease the defeased Bonds in accordance with their terms, are set aside irrevocably in a special fund for and pledged irrevocably to such redemption, retirement or defeasance (the "trust account"), then all right and interest of the owners of the defeased Bonds in the covenants of the Bond Ordinance and in the Net Revenue and the funds and accounts pledged to the payment of such defeased Bonds, other than the right to receive the funds so set aside and pledged, thereafter shall cease and become void. Such owners thereafter shall have the right to receive payment of the principal of and interest or redemption price on the defeased Bonds from the trust account.

After the establishing and full funding of such a trust account, the City then may apply any money in any other fund or account established for the payment or redemption of the defeased Bonds to any lawful purposes as it shall determine, subject only to the rights of the owners of any other Parity Bonds.

If the refunding plan provides that the defeased Bonds to be issued be secured by money and/or Government Obligations pending the prior redemption of the defeased Bonds and if such refunding plan also provides that certain money and/or Government Obligations are pledged irrevocably for the prior redemption of the defeased Bonds included in that refunding plan, then only the debt service on the Bonds which are not defeased Bonds and the refunding bonds, the payment of which is not so secured by the refunding plan, shall be included in the computation of the Coverage Requirement for the issuance of Future Parity Bonds and the annual computation of the Coverage Requirement for determining compliance with the rate covenants.

AMENDATORY OR SUPPLEMENTAL ORDINANCES

The Bond Ordinance shall not be modified or amended in any respect subsequent to the initial issuance of the Bonds, except as provided in and in accordance with and subject to the provisions of the Bond Ordinance described in this section.

Without Bondowners' Consent. The City, from time to time, and at any time, without the consent of or notice to the registered owners of the Bonds, may pass supplemental or amendatory ordinances as follows:

- (1) To cure any formal defect, omission, inconsistency or ambiguity in the Bond Ordinance in a manner not adverse to the owner of any Parity Bond;
- (2) To impose upon the Bond Registrar (with its consent) for the benefit of the registered owners of the Bonds any additional rights, remedies, powers, authority, security, liabilities or duties which may lawfully be granted, conferred or imposed and which are not contrary to or inconsistent with the Bond Ordinance as theretofore in effect;
- (3) To add to the covenants and agreements of, and limitations and restrictions upon, the City in the Bond Ordinance, other covenants, agreements, limitations and restrictions to be observed by the City that are not contrary or inconsistent with the Bond Ordinance as theretofore in effect;
- (4) To confirm, as further assurance, any pledge under, and the subjection to any claim, lien or pledge created or to be created by the Bond Ordinance of any other money, securities or funds;

(5) To authorize different denominations of the Bonds and to make correlative amendments and modifications to the Bond Ordinance regarding exchangeability of Bonds of different authorized denominations, redemptions of portions of Bonds of particular authorized denominations and similar amendments and modifications of a technical nature;

(6) To modify, alter, amend or supplement the Bond Ordinance in any other respect that is not materially adverse to the registered owners of the Parity Bonds and that does not involve a change described under “With Bondowners’ Consent” below,

(7) Because of change in federal law or rulings, to maintain the exclusion from gross income of the interest on the Bonds from federal income taxation; and

(8) To add to the covenants and agreements of, and limitations and restrictions upon, the City in the Bond Ordinance, other covenants, agreements, limitations and restrictions to be observed by the City which are requested by a Bond Insurer or provider of Reserve Insurance and which are not materially adverse to the registered owners of the Parity Bonds.

Before the City shall adopt any such supplemental ordinance without Bondowners’ consent, there shall have been delivered to the City and the Bond Registrar an opinion of Bond Counsel, stating that such supplemental ordinance is authorized or permitted by the Bond Ordinance and, upon the execution and delivery thereof, will be valid and binding upon the City in accordance with its terms and will not adversely affect the exclusion from gross income for federal income tax purposes of interest on the tax-exempt Bonds.

With Bondowners’ Consent. Except for any supplemental ordinance entered into pursuant to the provisions described above, subject to the terms and provisions described below, registered owners of not less than 60% in aggregate principal amount of the Parity Bonds shall have the right from time to time to consent to and approve the passage by the City of any supplemental ordinance deemed necessary or desirable by the City for the purpose of modifying, altering, amending, supplementing or rescinding, in any particular, any of the terms or provisions contained in the Bond Ordinance; except that, unless approved in writing by the registered owners of all Parity Bonds, nothing contained in these provisions for amendatory or replacement ordinances shall permit, or be construed as permitting:

(i) A change in the times, amounts or currency of payment of the principal of or interest on any outstanding Parity Bond, or a reduction in the principal amount or redemption price of any outstanding Parity Bond or a change in the redemption price of any outstanding Parity Bond or a change in the method of determining the rate of interest thereon, or

(ii) A preference of priority of any Parity Bond or Bonds or any other bond or bonds, or

(iii) A reduction in the aggregate principal amount of Parity Bonds, the consent of the registered owners of Parity Bonds of which is required for any such supplemental ordinance.

If at any time the City shall pass any supplemental ordinance for any of the purposes described in this subsection, the Bond Registrar shall cause notice of the proposed supplemental ordinance to be given by first-class United States mail to all registered owners of the Parity Bonds, to any Bond Insurer, and to the Rating Agencies if the Bonds are rated by those agencies. Such notice shall briefly set forth the nature of the proposed supplemental ordinance and shall state that a copy thereof is on file at the office of the Bond Registrar for inspection by all registered owners of the Parity Bonds.

Within two years after the date of the mailing of such notice, the City may adopt such supplemental ordinance in substantially the form described in such notice, but only if there shall have first been delivered to the Bond Registrar (i) the required consents, in writing, of the registered owners of the Parity Bonds, and (ii) an opinion of bond counsel stating that such supplemental ordinance is authorized or permitted by the Bond Ordinance and, upon the execution and delivery thereof, will be valid and binding upon the City in accordance with its terms and will not adversely affect the exclusion from gross income for federal income tax purposes of interest on the Parity Bonds.

If registered owners of not less than 60% of the Parity Bonds shall have consented to and approved the execution and delivery thereof as provided by the Bond Ordinance, no owner of the Parity Bonds shall have any right to object to the passage of such supplemental ordinance, or to object to any of the terms and provisions contained therein or the operation thereof, or in any manner to question the propriety of the passage thereof, or to enjoin or restrain the City or the Bond Registrar from passing the same or from taking any action pursuant to the provisions thereof.

Upon the execution and delivery of any supplemental ordinance, the Bond Ordinance shall be, and be deemed to be, modified and amended in accordance therewith, and the respective rights, duties and obligations under the Bond Ordinance of the City, the Bond Registrar and all registered owners of Parity Bonds, shall thereafter be determined, exercised and enforced under the Bond Ordinance subject in all respects to such modifications and amendments.

DEFAULTS AND REMEDIES

Events of Default. The following shall constitute “Events of Default” with respect to the Bonds:

If a default is made in the payment of the principal of or interest on any of the Bonds when the same shall become due and payable.

If the City defaults in the observance and performance of any other of the covenants, conditions and agreements on the part of the City set forth in the Bond Ordinance or any covenants, conditions or agreements on the part of the City contained in any Parity Bond Authorizing Ordinance and such default or defaults have continued for a period of six months after the City has received from the Bondowners’ Trustee (as defined below) or from the registered owners of not less than 25% in principal amount of the Parity Bonds, a written notice specifying and demanding the cure of such default. However, if the default in the observance and performance of any other of the covenants, conditions and agreements is one which cannot be completely remedied within the six months after written notice has been given, it shall not be an Event of Default with respect to the Bonds as long as the City takes active steps within the 6 months after written notice has been given to remedy the default and is diligently pursuing such remedy.

If the City files a petition in bankruptcy or is placed in receivership under any state or federal bankruptcy or insolvency law.

Bondowners’ Trustee. So long as an Event of Default has not been remedied, a bondowners’ trustee (the “Bondowners’ Trustee”) may be appointed by the registered owners of 25% in principal amount of the Parity Bonds. That appointment shall become effective immediately upon acceptance thereof by the Bondowners’ Trustee. Any Bondowners’ Trustee shall be a bank or trust company organized under the laws of the State of Washington or the State of New York or a national banking association. The bank or trust company acting as Bondowners’ Trustee may be removed at any time, and a successor Bondowners’ Trustee may be appointed, by the registered owners of a majority in principal amount of the Parity Bonds. The Bondowners’ Trustee may require such security and indemnity as may be reasonable against the costs, expenses and liabilities that may be incurred in the performance of its duties.

In the event that any Event of Default in the sole judgment of the Bondowners’ Trustee is cured and the Bondowners’ Trustee furnishes to the City a certificate so stating, that Event of Default shall be conclusively deemed to be cured and the City, the Bondowners’ Trustee and the registered owners of the Parity Bonds shall be restored to the same rights and position they would have held if no Event of Default had occurred.

The Bondowners’ Trustee appointed in the manner provided by the Bond Ordinance, and each successor thereto, is declared to be a trustee for the registered owners of all the Parity Bonds and is empowered to exercise all the rights and powers conferred on the Bondowners’ Trustee by the Bond Ordinance.

Suits at Law or in Equity. Upon the happening of an Event of Default and during the continuance thereof, the Bondowners’ Trustee may, and upon the written request of the registered owners of not less than 25% in principal amount of the Parity Bonds outstanding shall, take such steps and institute such suits, actions or other proceedings, all as it may deem appropriate for the protection and enforcement of the rights of the registered owners of the Parity

Bonds, to collect any amounts due and owing to or from the City, or to obtain other appropriate relief, and may enforce the specific performance of any covenant, agreement or condition contained in the Bond Ordinance or in any of the Parity Bonds.

Nothing contained in the provisions of the Bond Ordinance relating to defaults and remedies shall, in any event or under any circumstance, be deemed to authorize the acceleration of maturity of principal on the Parity Bonds, and the remedy of acceleration is expressly denied to the registered owners of the Parity Bonds under any circumstances including, without limitation, upon the occurrence and continuance of an Event of Default.

Any action, suit or other proceedings instituted by the Bondowners' Trustee hereunder shall be brought in its name as trustee for the Bondowners for the ratable benefit of all of the registered owners of those Parity Bonds, subject to the provisions of the Bond Ordinance. The respective registered owners of the Parity Bonds, by taking and holding the same, shall be conclusively deemed irrevocably to appoint the Bondowners' Trustee the true and lawful trustee of the respective registered owners of those Parity Bonds, with authority to institute any such action, suit or proceeding; to receive as trustee and deposit in trust any sums becoming distributable on account of those Parity Bonds; to execute any paper or documents for the receipt of money; and to do all acts with respect thereto that the registered owner himself or herself might have done in person. Nothing in the Bond Ordinance shall be deemed to authorize or empower the Bondowners' Trustee to consent to accept or adopt, on behalf of any registered owner of the Parity Bonds, any plan of reorganization or adjustment affecting the Parity Bonds or any right of any registered owner thereof, or to authorize or empower the Bondowners' Trustee to vote the claims of the registered owners thereof in any receivership, insolvency, liquidation, bankruptcy, reorganization or other proceeding to which the City is a party.

Application of Money Collected by Bondowners' Trustee. Any money collected by the Bondowners' Trustee at any time shall be applied in the following order of priority:

first, to the payment of the charges, expenses, advances and compensation of the Bondowners' Trustee and the charges, expenses, counsel fees, disbursements and compensation of its agents and attorneys; and

second, to the payment to the persons entitled thereto of all installments of interest then due on the Parity Bonds in the order of maturity of such installments and, if the amount available shall not be sufficient to pay in full any installment or installments maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon to the persons entitled thereto, without any discrimination or preference; and

third, to the payment to the persons entitled thereto of the unpaid principal amounts of any Parity Bonds which shall have become due (other than Parity Bonds previously called for redemption for the payment of which money is held pursuant to the provisions hereto), whether at maturity or by proceedings for redemption or otherwise, in the order of their due dates and, if the amount available shall not be sufficient to pay in full the principal amounts due on the same date, then to the payment thereof ratably, according to the principal amounts due thereon to the persons entitled thereto, without any discrimination or preference.

Duties and Obligations of Bondowners' Trustee. The Bondowners' Trustee shall not be liable except for the performance of such duties as are specifically set forth in the Bond Ordinance. During an Event of Default, the Bondowners' Trustee shall exercise such of the rights and powers vested in it hereby, and shall use the same degree of care and skill in its exercise, as a prudent person would exercise or use under the circumstances in the conduct of his or her own affairs. The Bondowners' Trustee shall have no liability for any act or omission to act hereunder except for the Bondowners Trustee's own negligent action, its own negligent failure to act or its own willful misconduct. The duties and obligations of the Bondowners' Trustee shall be determined solely by the express provisions of the Bond Ordinance, and no implied powers, duties or obligations of the Bondowners' Trustee shall be read into the Bond Ordinance.

The Bondowners' Trustee shall not be required to expend or risk its own funds or otherwise incur individual liability in the performance of any of its duties or in the exercise of any of its rights or powers as the Bondowners' Trustee, except as may result from its own negligent action, its own negligent failure to act or its own willful misconduct.

The Bondowners' Trustee shall not be bound to recognize any person as a registered owner of any Bond until his title thereto, if disputed, has been established to its reasonable satisfaction.

The Bondowners' Trustee may consult with counsel and the opinion of such counsel shall be full and complete authorization and protection in respect of any action taken or suffered by it hereunder in good faith and in accordance with the opinion of such counsel. The Bondowners' Trustee shall not be answerable for any neglect or default of any person, firm or corporation employed and selected by it with reasonable care.

Suits by Individual Bondowners Restricted. Neither the registered owner nor the beneficial owner of any one or more of Parity Bonds shall have any right to institute any action, suit or proceeding at law or in equity for the enforcement of same unless:

an Event of Default has happened and is continuing; and

a Bondowners' Trustee has been appointed; and

such owner previously shall have given to the Bondowners' Trustee written notice of the Event of Default on account of which such suit, action or proceeding is to be instituted; and

the registered owners of 25% in principal amount of the Parity Bonds, after the occurrence of such Event of Default, has made written request of the Bondowners' Trustee and have afforded the Bondowners' Trustee a reasonable opportunity to institute such suit, action or proceeding; and

there have been offered to the Bondowners' Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby; and

the Bondowners' Trustee has refused or neglected to comply with such request within a reasonable time.

No registered owner or beneficial owner of any Parity Bond shall have any right in any manner whatever by his action to affect or impair the obligation of the City to pay from the Net Revenue the principal of and interest on such Parity Bonds to the respective owners thereof when due.

Payment Solely From Net Revenue and Certain Funds. Nothing in the provisions of the Bond Ordinance relating to defaults and remedies shall be deemed to require payment to Bondowners from any source other than the Net Revenue and money and investments in the funds pledged thereto by the Bond Ordinance.

PAYMENT AGREEMENTS AND PARITY PAYMENT AGREEMENTS

Calculation of Debt Service on Parity Bonds With Respect to Which a Payment Agreement Is in Force. Debt service on Parity Bonds with respect to which a Payment Agreement is in force shall be calculated based on the net economic effect on the City expected to be produced by the terms of the Parity Bonds and the terms of the Payment Agreement, including but not limited to the effects that (i) Parity Bonds that would, but for a Payment Agreement, be treated as obligations bearing interest at a Variable Interest Rate instead shall be treated as obligations bearing interest at a fixed interest rate, and (ii) Parity Bonds that would, but for a Payment Agreement, be treated as obligations bearing interest at a fixed interest rate instead shall be treated as obligations bearing interest at a Variable Interest Rate. Accordingly, the amount of interest deemed to be payable on any Parity Bonds with respect to which a Payment Agreement is in force shall be an amount equal to the amount of interest that would be payable at the rate or rates stated in those Parity Bonds plus Payment Agreement Payments minus Payment Agreement Receipts. For the purposes of calculating as nearly as practicable Payment Agreement Receipts and Payment Agreement Payments, under a Payment Agreement that includes a variable rate component determined by reference to a pricing mechanism or index that is not the same as the pricing mechanism or index used to determine the variable rate interest component on the Parity Bonds to which the Payment Agreement is related, it shall be assumed that the fixed rate used in calculating Payment Agreement Payments will be equal to 105% of the fixed rate specified by the Payment Agreement and that the pricing mechanism or index specified by the Payment Agreement is the same as the pricing mechanism or index specified by the Parity Bonds.

Debt Service on Parity Payment Agreements. No additional debt service shall be taken into account with respect to a Parity Payment Agreement for any period during which Payment Agreement Payments on that Parity Payment Agreement are taken into account in determining Annual Debt Service on related Parity Bonds. However, for any period during which Payment Agreement Payments are not taken into account in calculating Annual Debt Service on any outstanding Parity Bonds because the Parity Payment Agreement is not then related to any outstanding Parity Bonds, debt service on that Parity Payment Agreement shall be taken into account by assuming:

if the City is obligated to make Payment Agreement Payments based on a fixed rate and the Qualified Counterparty is obligated to make payments based on a variable rate index, that payments by the City will be based on the assumed fixed pay or rate, and that payments by the Qualified Counterparty will be based on a rate equal to the average rate determined by the variable rate index specified by the Parity Payment Agreement during the fiscal quarter preceding the quarter in which the calculation is made; and

if the City is obligated to make Payment Agreement Payments based on a variable rate index and the Qualified Counterparty is obligated to make payment based on a fixed rate, that payments by the City will be based on a rate equal to the average rate determined by the variable rate index specified by the Parity Payment Agreement during the fiscal quarter preceding the quarter in which the calculation is made, and that the Qualified Counterparty will make payments based on the fixed rate specified by the Parity Payment Agreement.

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APPENDIX B

BOOK-ENTRY SYSTEM

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BOOK-ENTRY SYSTEM

The following information has been provided by the Depository Trust Company, New York, New York (“DTC”). The City makes no representation regarding the accuracy or completeness thereof. Beneficial Owners (as hereinafter defined) should therefore confirm the following with DTC or the Participants (as hereinafter defined).

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered bonds registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of the Bonds in the principal amount of each such maturity and will be deposited with DTC.

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has Standard & Poor’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owners entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Bonds with DTC and their registration in the name of Cede & Co., or such other DTC nominee, do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

When notices are given, they shall be sent by the Bond Registrar to DTC only. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the City as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments on the Bonds will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the City or the Bond Registrar, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Bond Registrar, or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or any other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City or the Bond Registrar, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC or any successor (the "Depository") may determine not to continue to act as securities depository for the Bonds, and the City may advise the Depository of its determination to discontinue book-entry of the Bonds through such Depository. If the City is unable to retain a qualified successor to the Depository or the City has determined that it is in the best interest of the City not to continue the book-entry system of transfer or that the interests of Beneficial Owners might be adversely affected if the book-entry system is continued, Bond certificates will be delivered to the Beneficial Owners or their nominees in registered form, in the denomination of \$5,000 or any integral multiple of \$5,000. In the event the book-entry system is discontinued, the persons to whom Bond certificates are delivered and in whose names the Bonds are registered will be treated as "bondowners" for all purposes of the Bond Ordinance.

With respect to Bonds registered on the Bond Register in the name of Cede & Co., as nominee of DTC, the City and the Bond Registrar shall have no responsibility or obligation to any Participant or to any person on behalf of whom a Participant holds an interest in the Bonds with respect to (i) the accuracy of the records of DTC, Cede & Co. or any Participant with respect to any ownership interest in the Bonds; (ii) the delivery to any Participant or any other person, other than a bondowner as shown on the Bond Register, of any notice with respect to the Bonds, including any notice of redemption; (iii) the payment to any Participant or any other person, other than a bondowner as shown on the Bond Register, of any amount with respect to principal of, premium, if any, or interest on the Bonds; (iv) the selection by DTC or any Participant of any person to receive payment in the event of a partial redemption of the Bonds; (v) any consent given action taken by DTC as registered owner; or (vi) any other matter. The City and the Bond Registrar may treat and consider Cede & Co., in whose name each Bond is registered on the Bond Register, as the holder and absolute owner of such Bond for the purpose of payment of principal and interest with respect to such Bond, for the purpose of giving notices of redemption and other matters with respect to such Bond, for the purpose of registering transfers with respect to such Bond, and for all other purposes whatsoever. For the purposes of this Official Statement, the term "Beneficial Owner" shall include the person for whom the Participant acquires an interest in the Bonds.

APPENDIX C

2009 AND 2008 FINANCIAL STATEMENTS

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ANNUAL

TACOMA WATER

2009

**FINANCIAL
REPORT**



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Public Utility Board

LAURA FOX
Chair

PETER THEIN
Vice-Chair

ROBERT CASEY
Secretary

DAVID NELSON
Member

WOODROW JONES
Member

WILLIAM A. GAINES
Director of Utilities/CEO

LINDA MCCREA
Superintendent

ROBERT K. BILES
Finance Director

DEPARTMENT OF PUBLIC UTILITIES
CITY OF TACOMA

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CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES

TACOMA WATER

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FINANCIAL DATA

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INDEPENDENT AUDITOR'S REPORT

Chair and Members of the Public Utility Board
City of Tacoma, Washington Department of Public Utilities, Water Division
Tacoma, Washington

We have audited the accompanying balance sheets of City of Tacoma, Washington Department of Public Utilities, Water Division as of December 31, 2009 and 2008 and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Division's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of City of Tacoma, Washington Department of Public Utilities, Water Division as of December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis preceding the financial statements is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The statistical data and additional supplemental information following the financial statements and notes to the financial statements are also not a required part of the basic financial statements but are supplementary information provided for purposes of additional analysis. We did not audit or perform any other procedures on this information and express no opinion on it.

Moss Adams LLP

Portland, Oregon
April 28, 2010

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of Tacoma Water's (the Utility) financial performance provides an overview of the financial activities for the years ended December 31, 2009 and 2008. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues, provide an overview of the Utility's financial activities, and identify changes in the Utility's financial position. We encourage readers to consider the information presented here in conjunction with the financial statements and notes taken as a whole.

The management of the Finance Department of the City of Tacoma is responsible for preparing the accompanying financial statements and for their integrity. The statements were prepared in accordance with accounting principles generally accepted in the United States of America applied on a consistent basis and include amounts that are based on management's best estimates and judgments.

The basic financial statements, presented on a comparative basis for the years ended December 31, 2009 and 2008, include Balance Sheets, Statements of Revenues, Expenses and Changes in Net Assets and Statements of Cash Flows. The Balance Sheets present information on all of the Utility's assets and liabilities, with the difference between the two reported as net assets. The Statements of Revenues, Expenses and Changes in Net Assets report all of the revenues and expenses during the time periods indicated. The Statements of Cash Flows provide information on cash receipts and disbursements during the year and report changes in cash resulting from operating, investing and financing activities.

The notes to the financial statements provide additional disclosures that are essential to a full understanding of the data provided in the financial statements. They are an integral part of the Utility's presentation of financial position, results of operations and changes in cash flows.

Financial Highlights

- The assets of Tacoma Water exceeded its liabilities by \$412.6 million in 2009 and by \$404.0 million in 2008. Of these amounts, \$13.5 million in 2009 and \$8.2 million in 2008 may be used to meet Tacoma Water's ongoing obligation to citizens and creditors.
- Tacoma Water's total net assets increased by \$8.6 million in 2009 and \$12.2 million in 2008. The 2009 increase is largely attributed to a rate increase, Public Fire Protection fees for fire hydrants and unfilled positions resulting from the slowdown in development.
- Tacoma Water's operating revenues equaled \$64.0 million, an increase of \$7.0 million or 12.2% in 2009 compared to 2008 operating revenues of \$57.0 million. The increase is due to an average 4.0% rate increase and Public Fire Protection fees billed to other government agencies. Public Fire Protection fees are a new revenue source resulting from a 2008 Washington State Supreme Court ruling, which requires fire protection costs to be billed to local governments and not to the water utilities. There are approximately 9,840 hydrants at \$303.10 each annually.
- In 2009, Tacoma Water's net utility plant of \$604.7 million increased by \$14.1 million or 2.4% over 2008's \$590.6 million balance. Major projects contributing to the 2009 increase are construction of Howard Hanson Dam Additional Water Storage, replacement of Pipe No.1 at the Puyallup River and replacement of the In-take Bridge at the Headworks.

- Tacoma Water's Long-Term Liabilities increased by \$73.3 million during the current fiscal year and decreased by \$8.4 million during 2008. Tacoma Water issued new Build America Bonds for \$76.8 million and initiated draws from two State Public Trust Fund Loans for \$4.9 million in 2009. The Utility also secured a \$6.1 million loan from the Drinking Water State Revolving Fund during 2009.
- This year the Utility is reporting Rate Stabilization (deferred revenues) for \$35.5 million.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Utility's basic financial statements. Tacoma Water's basic financial statements are comprised of two components: 1) financial statements, 2) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

For 2009, the Utility is reporting operating income of \$13.0 million compared to \$7.7 million in 2008 and \$7.4 million in 2007. The Utility's 2009 operating revenue increased by 12.2% versus 3.5% increase in operating expenses. Net income for 2009 is \$8.6 million compared to \$12.2 million in 2008 and \$16.9 million in 2007. Of the net income, capital contributions for 2009 were \$7.1 million compared to \$14.1 million in 2008 and \$12.8 million in 2007. There were 450 new meters installed for 2009 compared to 859 new meters installed in 2008 and 1,093 new meters installed for 2007. This continuing decline in new meter installations is the result of the economic downturn in the housing market.

The following table highlights Tacoma Water's operating results for the years 2009 - 2007.

Operating Results					
(In thousands)					
	2009	2008	2007	09/08 Increase (Decrease)	08/07 Increase (Decrease)
Operating Revenues	\$ 63,994	\$ 57,025	\$ 52,726	\$ 6,969	\$ 4,299
Operating Expenses	50,995	49,286	45,365	1,709	3,921
Operating Income	12,999	7,739	7,361	5,260	378
Net Non-Operating Income (Expenses)	(6,597)	(4,615)	1,278	(1,982)	(5,893)
Capital Contributions	7,121	14,137	12,801	(7,016)	1,336
Federal BAB Subsidies	244	-	-	245	-
Transfers Out	(5,185)	(5,014)	(4,563)	(171)	(451)
Change in Net Assets (Net Income)	\$ 8,582	\$ 12,247	\$ 16,877	\$(3,664)	\$(4,630)

Net Assets

Net assets may serve over time as a useful indicator of the Utility's financial position. Assets exceeded liabilities by \$412.6 million for 2009, \$404.0 million for 2008 and \$391.8 million for 2007. Therefore, net assets increased by \$8.6 million or 2.1% in 2009 from 2008 and \$12.2 million or 3.1% in 2008 from 2007. The net increase in 2009 was due to an average 4.0% rate increase and Public Fire Protection fees. The changes in prior years were largely due to capital contributions. Capital contributions for 2009 were \$6.0 million for system development charges and \$1.2 million for donated fixed assets entirely from private contracts. In the year 2008, capital contributions were \$8.6 million for system development charges and \$5.6 million for donated fixed assets entirely from private contracts. In the year 2007, capital contributions were \$9.3 million for system development charges and \$3.5 million for donated assets all from private contracts.

The investment in capital assets net of related debt or the Utility's equity investment in capital assets for 2009 is \$369.6 million, a decrease of \$13.9 million or 3.6% compared to 2008. Investment in capital assets for 2008 was \$383.5 million, an increase of \$23.5 million or 6.5% compared to 2007's \$360.0 million.

Restricted net assets for 2009 were \$22.9 million, an increase of \$15.4 million from 2008. Restricted net assets for 2008 were \$7.5 million, reflecting a decrease of \$4.3 million from 2007. The majority of the increase in restricted net assets in 2009 was in System Development Charges (SDC). Capital projects financed with system development charges in 2008 were reimbursed with Build America Bonds in 2009 increasing restricted net assets in the SDC fund by \$13.1 million compared to 2008.

In 2009, unrestricted net assets were \$20.1 million, an increase of \$7.1 million over 2008. This was the result of increased operating revenues of \$7.0 million and increased operating expenses of \$1.7 million. Unrestricted net assets for 2008 were \$13.0 million, representing a decrease of \$6.9 million from 2007's balance of \$19.9 million.

The analysis below highlights changes in Tacoma Water's net assets for the years 2009, 2008 and 2007.

Tacoma Water's Net Assets
(In thousands)

Description	2009	2008	2007	09/08 Increase (Decrease)	08/07 Increase (Decrease)
Net Utility & Non-Utility Plant	\$ 605,205	\$ 591,141	\$ 569,041	\$ 14,064	\$ 22,100
Current and Other Assets	172,810	105,781	123,788	67,029	(18,007)
Total Assets	\$ 778,015	\$ 696,922	\$ 692,829	\$ 81,093	\$ 4,093
Net Assets:					
Invested in Capital Assets, Net of Related Debt	\$ 369,573	\$ 383,507	\$ 360,036	\$ (13,934)	\$ 23,471
Restricted	22,902	7,502	11,826	15,400	(4,324)
Unrestricted	20,118	13,001	19,901	7,117	(6,900)
Total Net Assets	412,593	404,010	391,763	8,583	12,247
Long-Term Liabilities	292,165	218,869	227,316	73,296	(8,447)
Current and Other Liabilities	73,257	74,043	73,750	(786)	293
Total Liabilities	365,422	292,912	301,066	72,510	(8,154)
Total Net Assets & Liabilities	\$ 778,015	\$ 696,922	\$ 692,829	\$ 81,093	\$ 4,093

Revenues

Total operating revenues increased to \$64.0 million in 2009 up \$7.0 million or 12.2% compared to 2008. Of this, \$3.0 million was related to water sales and \$4.0 was related to other operating revenues. The increase was \$4.3 million or 8.2% in 2008 to \$57.0 million compared to \$52.7 million in 2007.

Water sales increased by \$3.0 million, or 5.8% in 2009 to \$54.7 million compared to \$51.6 million in 2008. Water sales increased by \$3.3 million or 6.8% in 2008 compared to 2007's \$48.4 million. Effective January 19, 2009, the Public Utility Board approved an average 4.0% rate increase resulting in \$2.1 million additional revenues from residential and domestic customers, \$0.7 million from commercial and industrial customers and \$0.5 million from other customers. In 2008, an average 7.5% rate increase from 2007 resulted in \$1.9 million additional revenues from residential and domestic customers. Special rate revenue from

Simpson Tacoma Kraft in 2009 dropped due to approximately 4.8% lower consumption compared to 2008. As a result of a new contract with Simpson Tacoma Kraft, special rate revenue increased in 2008 compared to 2007.

The following table highlights Tacoma Water's water sales by type of customer for 2009, 2008 and 2007.

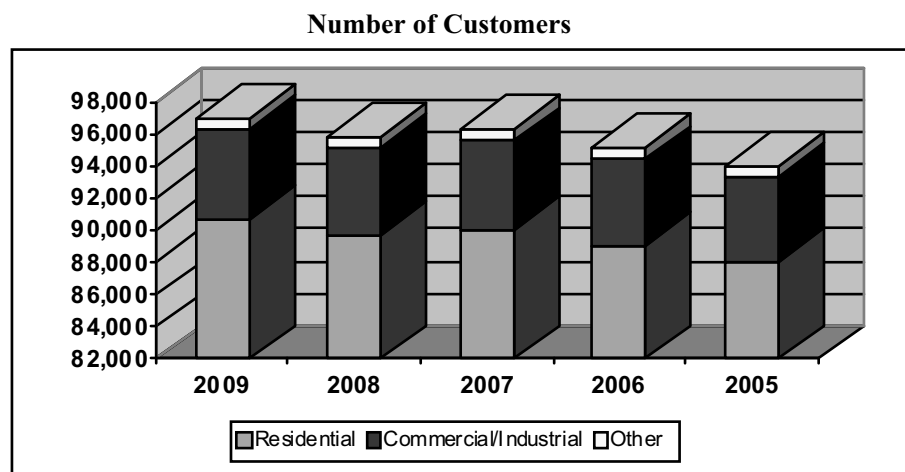
Type of Customer	Water Sales (In thousands)			09/08	08/07
	2009	2008	2007	Increase (Decrease)	Increase (Decrease)
Residential and Domestic	\$ 36,643	\$ 34,593	\$ 32,646	\$ 2,050	\$ 1,947
Commercial and Industrial	9,659	8,979	8,298	680	681
Special Rate – Simpson Tacoma	4,153	4,372	3,918	(219)	454
Municipal	381	349	396	31	(47)
Other Public Buildings and Grounds	1,861	1,680	1,644	181	36
Sale to Other Utilities	1,777	1,252	1,434	525	(182)
Unbilled Revenue	188	417	37	(229)	380
Total	\$ 54,662	\$ 51,642	\$ 48,373	\$ 3,019	\$ 3,269

The largest portion of the Utility's revenues was from sales to residential and domestic customers. Approximately 67.0% of water sales were to residential and domestic customers in both 2009 and 2008, and 67.5% in 2007. Residential sales are followed by commercial and industrial sales at 17.7% for 2009, 17.4% for 2008 and 17.2% for 2007. Special rate sales to Simpson Tacoma Kraft represent 7.6% of total sales for 2009, 8.5% in 2008 and 8.1% in 2007.

Customers

Over the last five years, the overall number of customers has grown at a steady rate of approximately 1.0% per year except 2008, which declined 0.4%. In 2009, there were 96,982 customers of which 90,677 or 93.5% were residential. The remaining 5,636 or 5.8% were commercial and industrial, and 669 or 0.7% were other rate classes combined.

Below is a graphical representation of the number of customers by customer type for the last 5 years.



Expenses

Operating expenses in 2009 increased \$1.7 million or 3.5% compared to 2008. Operating expenses in 2008 increased \$3.9 million or 8.6% compared to 2007. The largest increase was depreciation expense of \$0.8 million or 6.4% in 2009 and \$1.7 million or 14.5% in 2008 reflecting the increase in depreciable assets of \$23.9 million and \$34.0 million, respectively.

Other 2009 significant increases were in production expense by \$0.8 million or 11.7% and administrative and general expense of \$0.4 million or 5.7% compared to 2008. Of the \$0.8 million increase in production expense in 2009, \$0.6 million was source of supply and \$0.2 million was water treatment. Additional labor costs, relative to operations and maintenance have been incurred since the completion of several Second Supply Projects in 2008. In addition, Tacoma Water built a fish crowding facility and implemented environmental stewardship programs increasing source of supply expenses. The Utility also funded repairs for flood damages in January 2009. In addition, there were increased payroll related costs in 2009. Production expenses in 2008 increased \$0.9 million or 13.9 % and administrative and general expense increased \$0.4 million or 6.3 % compared to 2007.

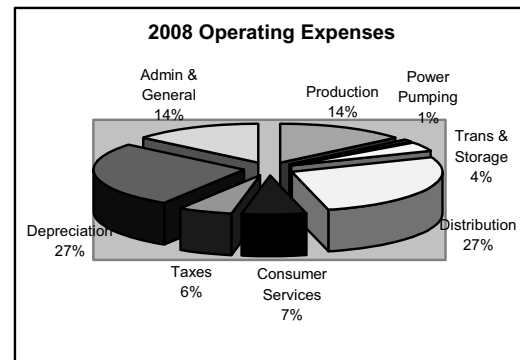
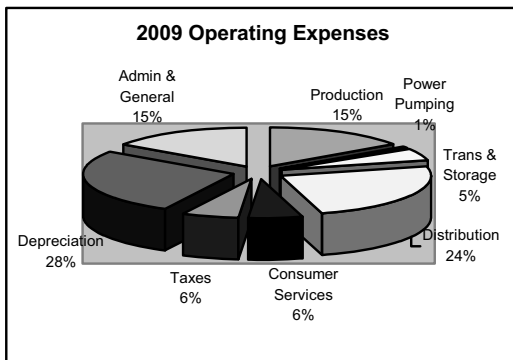
Distribution expense decreased by \$0.8 million or 5.8% in 2009 as a result of controlling expenses and not filling various positions in response to the economic downturn. In 2008, distribution expense increased by \$1.2 million or 10.3% due to an increase in labor and related benefit costs of \$0.8 million and fleet replacement fees of \$0.2 million.

The following table highlights Tacoma Water's operating expenses for 2009 – 2007.

Operating Expenses (in thousands)

Category	2009	2008	2007	09/08 Increase (Decrease)	08/07 Increase (Decrease)
Source of Supply	\$ 4,893	\$ 4,306	\$ 3,396	\$ 587	\$ 910
Water Treatment	2,984	2,743	2,793	241	(50)
Total Production Expense	7,877	7,049	6,189	828	860
Power Pumping Expense	395	343	361	52	(18)
Transmission and Storage Expense	2,529	2,151	2,615	378	(464)
Distribution Expense	12,452	13,223	11,990	(771)	1,233
Customer Accounting and Service	3,119	3,354	3,083	(235)	271
Taxes	3,093	2,882	2,925	211	(43)
Depreciation	13,846	13,016	11,364	830	1,652
Administrative and General	7,684	7,268	6,838	416	430
Total Operating Expenses	\$ 50,995	\$ 49,286	\$ 45,365	\$ 1,709	\$ 3,921

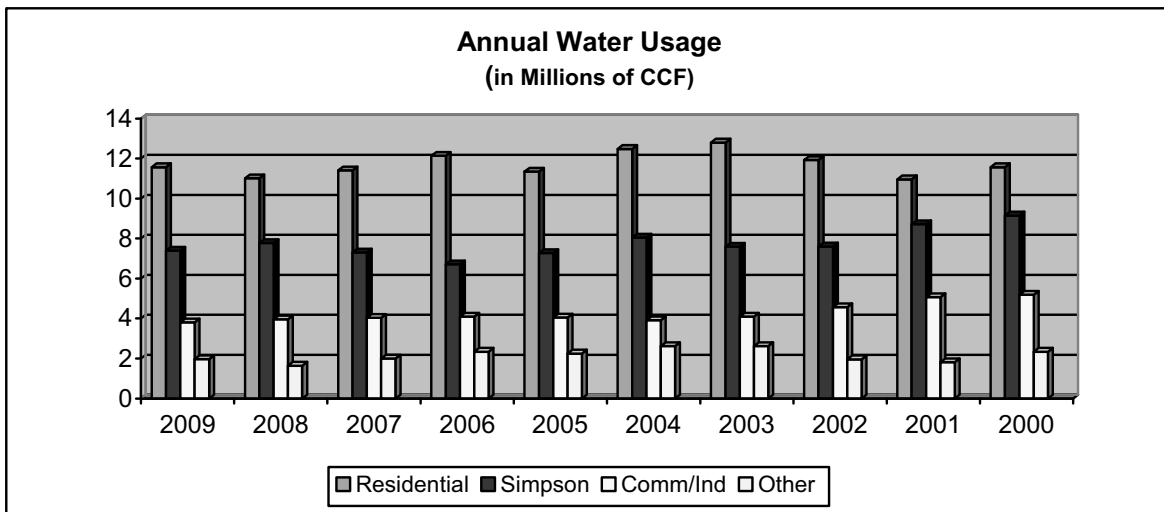
The following is a graphical presentation of Tacoma Water's operating expenses.



Water Users

The Utility generates the majority of its revenues from its residential and domestic customer base. Residential customers used 11.6 million CCF (100 cubic feet) or approximately 46.8% of the 24.7 million CCF of water consumed by the Utility's customers in 2009; Simpson Tacoma Kraft Company used approximately 7.4 million CCF or 29.9%; commercial and industrial customers used 3.8 million CCF or 15.4%. The remaining 2.0 million CCF or 7.9% was consumed by other customers.

Looking at the 10-year water usage trend, year 2000 was the highest with 28.25 million CCF, which declined over the next two years picking up in 2003 with 27.06 million CCF. However, the trend shows a decline in usage over the next six years to current year usage of 24.7 million CCF. This trend can be explained by plumbing code changes, conservation activities and reduction of use by the high water consuming commercial/industrial users.



Capital Assets—Utility Plant

Tacoma Water has invested in a broad range of utility assets. At the end of 2009, Tacoma Water had \$604.7 million in net utility plant, an increase of \$14.1 million or 2.4% from 2008. At the end of 2008, Tacoma Water had \$590.6 million in net utility plant, an increase of \$22.1 million or 3.9% from 2007. In the current year, the distribution crews installed 1,981 new water services.

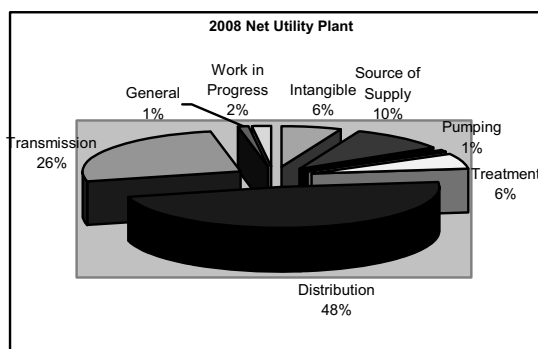
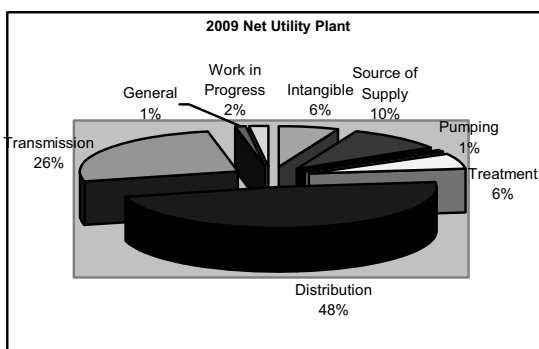
The Utility invests the majority of its capital in distribution facilities. In 2009, it invested \$292.2 million or 48.3%; in 2008, \$282.7 million or 47.9%; and in 2007, \$259.1 million or 45.6% of net utility plant. In addition, Tacoma Water added or replaced 7.7 miles of main in 2009; compared to 23.7 miles in 2008; and 19.9 miles in 2007. The decrease in main additions or replacements were due to delays in joint projects and lack of private contract developments with only 19 completed for 2009 compared to an average of 36 per year over the last 7 year period.

The following table summarizes Tacoma Water's capital assets, net of accumulated depreciation, for the years ended December 31, 2009, 2008 and 2007.

Capital Assets, Net of Accumulated Depreciation
(In thousands)

Net Utility Plant	2009	2008	2007	09/08 Increase (Decrease)	08/07 Increase (Decrease)
Intangible Plant	\$ 34,771	\$ 34,845	\$ 34,795	\$ (74)	\$ 50
Source of Supply Plant	60,243	57,207	57,877	3,036	(670)
Pumping Plant	6,489	6,363	5,267	126	1,096
Water Treatment Plant	37,761	37,635	39,155	126	(1,520)
Transmission Plant	156,919	155,412	154,112	1,507	1,300
Distribution Plant	292,211	282,746	259,120	9,465	23,626
General Plant	7,880	6,457	5,313	1,423	1,144
Construction Work In Progress	8,384	9,928	12,854	(1,544)	(2,926)
Total	<u>\$ 604,658</u>	<u>\$ 590,593</u>	<u>\$ 568,493</u>	<u>\$ 14,065</u>	<u>\$ 22,100</u>

The following graphs provide a visual presentation of the allocation of Tacoma Water's capital investment in 2009 and 2008.



Debt Administration

As of year end 2009, the Utility had outstanding revenue bond obligations of \$263.0 million (net of unamortized bond premiums and loss on refundings), an increase of \$70.7 million or 36.8% from 2008 amounts. The Utility issued new Build America Bonds in 2009 for \$76.8 million. As of year end 2008, Tacoma Water had outstanding revenue bond obligations of \$192.3 million (net of unamortized bond premiums and loss on refundings), a decrease of \$6.2 million or 3.2% from 2007 amounts. The Utility did not issue new bonds in 2008 or 2007.

All outstanding bonds are rated Aa2 by Moody's Investors Service on their Global Scale and AA by Standard & Poor's.

The Utility is required by its bond covenants to maintain a times debt service coverage of 1.25. In 2009, principal and interest were covered 1.87 times, in 2008, were covered 1.66 times, and in 2007, were covered 1.66 times.

At the end of 2009, the Utility had an outstanding State loan balance of \$28.1 million, an increase of \$3.1 million. At the end of 2008, Tacoma Water had an outstanding State loan balance of \$25.0 million, a decrease of \$1.7 million from the 2007 balance of \$26.7 million. During 2009, the Utility entered into a Drinking Water State Revolving Loan that is part of the American Recovery and Reinvestment Act (ARRA) for \$6.1 million but no draws were made in 2009. This loan is to comply with the State Drinking Water Act and Bilateral Compliance

Agreement with the Washington State Department of Health to reconstruct McMillin Reservoir. Also during 2009, Tacoma Water initiated draws of \$4.5 million from 2008 and \$0.4 million from 2006 agreements with Washington State Public Works Board.


Additional information on Tacoma Water's long-term debt can be found in Note 4 of the financial statements and in the supplementary Statistical Data.

Summary

The management of the Finance Department of the City of Tacoma is responsible for preparing the information in this annual report. We prepared the financial statements according to accounting principles generally accepted in the United States of America and they fairly portray Tacoma Water's financial position and operating results.

Moss Adams LLP has audited the financial statements. We have made available to them all pertinent information necessary to complete the audit. Management considers and takes appropriate action on audit recommendations.

Management has established and maintains a system of internal controls, which includes organizational, administrative and accounting processes. These controls provide reasonable assurance that records and reports are complete and reliable, that assets are used appropriately and that business transactions are carried out as authorized.



William A. Gaines
Director of Utilities/CEO



Robert K. Biles
Finance Director

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CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

BALANCE SHEETS

ASSETS	DECEMBER 31,	
	2009	2008
UTILITY PLANT		
In Service, at Original Cost	\$ 729,441,103	\$ 705,571,558
Less - Accumulated Depreciation	(133,167,004)	(124,906,754)
Total	596,274,099	580,664,804
Construction Work In Progress	8,383,676	9,928,454
Net Utility Plant	604,657,775	590,593,258
NON-UTILITY PROPERTY, NET	547,480	547,541
SPECIAL FUNDS		
Construction Funds	60,374,546	13,930,776
Debt Service Funds	2,873,339	2,092,216
Bond Reserve Funds	10,325,529	5,884,382
Other - Investments	56,165,823	53,318,912
Notes & Contracts Receivable - SDC & Other	3,662,577	5,084,574
Total Special Funds	133,401,814	80,310,860
CURRENT ASSETS		
Operating Funds Cash and Equity in		
Pooled Investments	20,541,247	9,035,906
Accounts Receivable	6,712,210	5,418,276
(Net of Allowance for Doubtful Accounts of \$364,083 in 2009 and \$335,032 in 2008)		
Accrued Unbilled Revenues	3,779,538	3,591,571
Materials and Supplies	2,523,703	2,617,021
Receivables from Affiliates	1,188,333	455,711
Prepayments.....	1,008,812	1,032,982
Total Current Assets	35,753,843	22,151,467
DEFERRED CHARGES		
Unamortized Debt Expense	2,307,813	1,865,740
Other Deferred Charges	1,346,681	1,453,416
Total Deferred Charges	3,654,494	3,319,156
TOTAL ASSETS	\$778,015,406	\$696,922,282

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

	DECEMBER 31,	
NET ASSETS AND LIABILITIES	2009	2008
NET ASSETS		
Invested in Capital Assets, Net of Related Debt ...	\$369,573,230	\$383,506,857
Restricted for:		
Regional Water Supply System Construction Fund .	8,466,341	2,644,292
Water Assurance and System Development Charges .	13,082,805	3,656,612
Debt Service Funds	1,352,909	1,201,618
Unrestricted	20,117,386	13,000,925
Total Net Assets	412,592,671	404,010,304
LONG-TERM LIABILITIES, NET OF CURRENT MATURITIES		
Revenue Bonds	256,923,578	186,406,888
Public Works Trust Fund Loans	24,593,077	21,338,420
Drinking Water State Revolving Fund Loan	1,771,579	1,932,632
Muckleshoot Agreements	8,877,172	9,191,075
Total Long-Term Liabilities.....	292,165,406	218,869,015
CURRENT LIABILITIES		
Current Maturities of Long-Term Liabilities	8,008,168	7,801,533
Accrued Taxes	1,088,676	1,221,907
Accrued Expenses and Contracts Payable	1,847,920	2,685,678
Salaries, Wages and Fringe Benefits Payable	682,764	573,350
Interest Payable	1,520,430	890,598
Accrued Compensated Absences	2,496,237	2,280,006
Customers' Deposits	266,231	246,805
Payables to Affiliates	1,753,749	588,428
Total Current Liabilities	17,664,175	16,288,305
DEFERRED CREDITS		
Retained on Contract Payments	31,491	34,650
Customer Advances for Construction	4,286,630	6,038,897
Rate Stabilization	35,463,689	-
Deferred Revenue - SDC & Other.....	14,200,293	50,058,137
Other Deferred Credits	1,611,051	1,622,974
Total Deferred Credits	55,593,154	57,754,658
Total Liabilities	365,422,735	292,911,978
TOTAL NET ASSETS AND LIABILITIES	\$778,015,406	\$696,922,282

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CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	YEAR ENDED DECEMBER 31,	
	2009	2008
OPERATING REVENUES		
Sale of Water	\$54,661,801	\$51,642,227
Other Operating Revenues	6,198,724	1,489,921
Contract Resource Obligation Revenues	3,133,231	3,892,392
Total Operating Revenues	<u>63,993,756</u>	<u>\$57,024,540</u>
OPERATING EXPENSES		
Operations	15,376,300	15,716,720
Production	7,876,564	7,048,696
Administrative and General	10,802,599	10,622,247
Depreciation	13,845,799	13,016,544
Other Taxes	3,093,311	2,881,877
Total Operating Expenses	<u>50,994,573</u>	<u>49,286,084</u>
Net Operating Income	12,999,183	7,738,456
NON-OPERATING REVENUES (EXPENSES)		
Interest Income	1,955,385	3,730,407
Proceeds from Disposition of Property	26,100	-
Other	497,331	61,265
Interest on Long-Term Debt	(10,027,675)	(9,428,638)
Amortization of Debt Expense, Premium and Loss on Refunding	6,509	29,855
Interest Charged to Construction	945,010	992,519
Total Non-Operating Revenues (Expenses)	<u>(6,597,340)</u>	<u>(4,614,592)</u>
Net Income Before Capital Contributions and Transfers	6,401,843	3,123,864
Capital Contributions		
Cash	5,954,544	8,554,112
Donated Fixed Assets	1,166,449	5,583,493
Federal BAB Subsidies	244,683	-
Transfers		
City of Tacoma Gross Earnings Tax	(4,998,197)	(4,500,155)
Transfer to Other Funds	<u>(186,955)</u>	<u>(514,327)</u>
CHANGE IN NET ASSETS (NET INCOME)	8,582,367	12,246,987
TOTAL NET ASSETS - BEGINNING OF YEAR	<u>404,010,304</u>	<u>391,763,317</u>
TOTAL NET ASSETS - END OF YEAR	<u><u>\$412,592,671</u></u>	<u><u>\$404,010,304</u></u>

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

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATEMENTS OF CASH FLOWS

	YEAR ENDED DECEMBER 31,	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash from Customers	\$62,756,537	\$56,262,503
Cash Paid to Suppliers	(14,832,501)	(14,693,692)
Cash Paid to Employees	(19,165,463)	(18,116,480)
Taxes Paid	(3,226,542)	(2,584,749)
Net Cash From		
Operating Activities	25,532,031	20,867,582
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Transfer to Other Funds	(186,955)	(514,327)
Transfer Out for Gross Earnings Tax	(4,998,197)	(4,500,155)
Net Cash From Non-Capital		
Financing Activities	(5,185,152)	(5,014,482)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital Expenditures, net.....	(25,798,794)	(27,515,917)
Proceeds from Disposition of Property	26,100	-
Proceeds from PWTF Loan	4,850,000	-
Proceeds from Sale of Bonds	76,775,000	-
Debt Issuance Costs	(618,875)	-
Principal Payments on Long-Term Debt	(7,938,664)	(8,440,371)
Interest Paid	(9,397,843)	(9,422,709)
System Development Charges, CIAC and Other	5,215,037	7,728,561
Net Cash From Capital and		
Related Financing Activities	43,111,961	(37,650,436)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received on Investments	1,955,385	3,730,407
Other Net Non-Op Revenues and Expenses	497,331	61,265
Net Change in Deferred Charges	106,736	(1,366,647)
Net Cash From Investing Activities	2,559,452	2,425,025
Net Change in Cash and Equity in		
Pooled Investments	66,018,292	(19,372,311)
Cash & Equity in Pooled Investments at January 1 ...	84,262,192	103,634,503
Cash & Equity in Pooled Investments at December 31 .	\$150,280,484	\$84,262,192

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

	<u>YEAR ENDED DECEMBER 31,</u>	
	<u>2009</u>	<u>2008</u>
Reconciliation of Net Operating Income to Net Cash From Operating Activities:		
Net Operating Income	\$12,999,183	\$7,738,456
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation	13,845,799	13,016,544
Cash from changes in operating assets and liabilities:		
Accounts Receivable and Unbilled Revenue	(1,237,218)	(762,037)
Receivables from Affiliates	(732,622)	(360,688)
Materials and Supplies	93,318	(267,966)
Prepayments	24,168	196,303
Accrued Taxes	(133,231)	297,128
Salaries, Wages and Fringe Benefits Payable	109,414	182,629
Accrued Compensated Absences	216,231	240,788
Customers' Deposits	19,426	20,086
Accrued Expenses and Contracts Payable	(837,758)	713,056
Payables to Affiliates	1,165,321	(146,717)
Total Adjustments	<u>12,532,848</u>	<u>13,129,126</u>
Net Cash From Operating Activities	<u>\$25,532,031</u>	<u>\$20,867,582</u>
Reconciliation of Cash and Equity in Pooled Investments to Balance Sheet:		
Cash and Equity in Pooled Investments in Special Funds	\$129,739,237	\$75,226,286
Cash and Equity in Pooled Investments in Operating Funds	<u>20,541,247</u>	<u>9,035,906</u>
Cash and Equity in Pooled Investments at December 31	<u>\$150,280,484</u>	<u>\$84,262,192</u>

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2009 AND 2008

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Operations of Tacoma Water. The Water Division, doing business as Tacoma Water, is a division of the City of Tacoma, Washington (the City), Department of Public Utilities (the Department). The Department consists of Tacoma Power, Tacoma Water and Tacoma Rail and is governed by a five-member Public Utility Board (the Board) appointed by the City Council. Certain matters relating to utility operations such as system expansion, issuance of bonds and fixing of utility rates and charges are initiated and executed by the Board, but also require formal City Council approval.

Tacoma Water owns and operates the City's Water System which includes a surface water supply source (the Watershed); several extensive well fields; a water transmission system consisting of several pipelines, water treatment and quality facilities; various reservoirs, standpipes and pump stations; and an extensive distribution system. Tacoma Water supplies water to approximately 97,000 customers and has approximately 280 employees. Tacoma Water's service area includes the City of Tacoma and urbanized areas of Pierce and South King Counties. Water service outside the City limits is provided under franchises granted by both Pierce and King Counties. Tacoma Water is organized functionally as Water Supply, Water Quality, Water Distribution, Second Supply Project and Water Resource Planning.

Water Supply designs, constructs, maintains and operates the water supply structures, wells, pumping stations, reservoirs, standpipes, transmission mains and associated property. Water use by retail customers varies from year to year primarily because of weather conditions, customer growth, economic conditions in Tacoma Water's service area and conservation efforts.

Water Quality operates and maintains the Green River Watershed and Headworks, operates and maintains water treatment equipment and monitors water quality.

Water Distribution engineers, designs, constructs, operates and maintains all distribution system facilities including mains, hydrants, valves, service connections and metering.

Water Resource Planning provides planning for cost-effective resources to meet future needs, including water supply projects and conservation activities. Resource Planning manages watershed lands to provide for fisheries and wildlife populations, manages real estate property acquisitions and dispositions, and acquires and grants right-of-way easements.

Second Supply Project was developed to meet Tacoma Water's own future water supply requirements as well as to increase regional supply. The Second Supply Project Pipeline is approximately 34 miles long. Its route follows a more northerly route than Tacoma Water's existing Pipeline No. 1, traversing south King County and thereby making water available to the urbanized areas north and east of the City. Tacoma Water owns and operates the Second Supply Project. (See Note 5)

Shared Services. Tacoma Water receives certain services from other departments and agencies of the City, including those normally considered to be general and administrative. Tacoma Water is charged for services received from other City departments and agencies and additionally, must pay gross earnings tax to the City.

Basis of Accounting and Presentation. The financial statements of Tacoma Water are prepared under the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP) issued by the Governmental Accounting Standards Board (GASB) applicable to governmental entities that use proprietary

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

fund accounting. Revenues are recognized when earned, and expenses are recognized when incurred.

Tacoma Water follows the provisions set forth in regulatory accounting guidance. In general, regulatory accounting permits an entity with cost-based rates to defer certain costs or income that would otherwise be recognized when incurred to the extent that the rate-regulated entity is recovering or expects to recover such amounts in rates charged to its customers.

Tacoma Water generally follows the uniform system of accounts prescribed by the National Association of Regulatory Utility Commissioners and the Division of Audits of the State Auditor's Office. Tacoma Water is exempt from payment of Federal income tax.

Utility Plant and Depreciation. Utility plant is stated at original cost (See Note 2), which includes both direct costs of construction or acquisition and indirect costs, including an allowance for funds used during construction. Assets are capitalized when the cost exceeds \$5,000 and the useful life exceeds one year.

Provision for depreciation is made using the straight-line method, based on estimated economic lives of related operating assets placed in service at the beginning of the year. The composite depreciation rates for 2009 and 2008 were 2.27% and 2.26%, respectively. When utility plant assets are retired, their original cost together with removal cost, less salvage, is charged to accumulated depreciation. The cost of maintenance and repairs is charged to expense as incurred, while the cost of replacements and betterments is capitalized.

Allowance for Funds Used During Construction (AFUDC). AFUDC represents the cost of borrowed funds used for the construction of utility plant, net of interest earned on unspent construction funds. Capitalized AFUDC is shown as part of the cost of utility plant and as a reduction of interest income and expense. Net interest expenses in 2009 and 2008 of \$.32 million and \$.48 million, respectively, was capitalized.

Asset Valuation. Tacoma Water periodically reviews the carrying amount of its long-lived assets for impairment. An asset is considered impaired when estimated future cash flows are less than the carrying amount of the asset. In the event the carrying amount of such asset is not deemed recoverable, the asset is adjusted to its estimated fair value. Fair value is generally determined based on discounted future cash flow. Tacoma Water has no impaired assets.

Special Funds. (See Note 3) In accordance with bond resolutions, agreements and laws, separate restricted funds have been established. These funds, which consist of cash and investments, are restricted for specific uses including capital additions, debt service and extraordinary operations and maintenance costs.

Materials and Supplies. Materials and supplies consist primarily of items for construction and maintenance of utility plant and are valued at the lower of average cost or market.

Accounts Receivable. Accounts receivable are recorded when invoices are issued and are written off when they are determined to be uncollectible. The allowance for doubtful accounts is estimated based on Tacoma Water's historical losses, review of specific problem accounts, the existing economic conditions and the financial stability of its customers. Generally, Tacoma Water considers accounts receivable past due after 30 days.

Bond Premium, Issuance Costs and Loss on Refunding. Bond premium and issuance costs are amortized using the bonds outstanding method over the terms of the issues to which they pertain. Loss on refunding is amortized on the straight-line basis over the remaining life of the old debt or the life of the new debt, whichever is shorter. Bond issuance costs are included in deferred charges with other components recorded in long-term debt.

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

Compensated Absences. The City has two different policies for compensated absences. The City's original policy allows employees to accrue vacation based on the number of years worked with a maximum accrual equal to the amount earned in a two-year period. These employees also accrue one day of sick leave per month without any ceiling on the maximum accrued. The City implemented a new policy in 1998 allowing employees to earn PTO (personal time off) without distinction between vacation and sick leave. Employees who worked for the City prior to the change could choose to stay with the original policy or opt to convert to the new policy. The amount of PTO earned is based on years of service. The maximum accrual for PTO is 960 hours, and upon termination, employees are entitled to compensation for unused PTO at 100%. Vacation pay and PTO are recorded as a liability and expense in the year earned.

Employees in the original policy who accumulate sick leave will receive 25% of the value at retirement or 10% upon termination for any other reason. In the event of death, beneficiaries receive 25% of the value. The accrued liability is computed at 10%, which is considered the amount vested. Sick leave pay is recorded as an expense in the year earned.

Contributions in Aid of Construction and System Development Charges. GASB Statement No. 33, which addresses accounting for contributed capital, requires that contributed capital be recognized as revenue. Capital contributions include new service connections and system development charges. System development charges are collected on all new services prior to installation to ensure required new source, transmission and storage facilities needed to meet new demands are funded. The charge was developed using a cost-of-service approach and includes a share of historical plant investment and projected future outlays that will increase system capacity. Because the funds collected for this charge can only be used for system expansion projects, the balance is reflected as restricted in Tacoma Water's net assets. System development charges on uncompleted projects are recorded in deferred credits.

Revenues. Service rates are authorized by the Tacoma City Council. Revenues are recognized as earned and include an estimate of revenue earned but not billed to customers as of year-end. Utility revenues are derived primarily from the sale and transmission of water. Utility revenue from water sales is recognized when the water is delivered to and received by the customer.

Tacoma Water receives contract resource obligation revenue and debt service payments from our partners in the Second Supply Project Agreement which are recorded as operating revenue.

Environmental Remediation Costs. The Utility recognizes environmental obligations according to GASB Statement No. 49 "Accounting and Financial Reporting for Pollution Remediation Obligations". Accruals for expected pollution remediation outlays are recorded when one of five obligating events occurs and adjusted as further information develops or circumstances change. The five obligating events are applied when the Division is: 1) compelled to take action because of an imminent endangerment, 2) the Division is in violation of a pollution prevention-related permit or license, 3) the Division is named or evidence indicates that it will be named by a regulator as a responsible party or potentially responsible party, 4) named in a lawsuit to compel participation in pollution remediation or 5) the Division commences or legally obligates itself to commence pollution remediation. Tacoma Water does not have any environmental obligations at this time.

Costs related to environmental remediation are charged to expense when the liability is recognized; outlays are capitalized when goods and services are acquired under specific circumstances as described in Statement No. 49. Measurement is based on the current value of the outlays for the individual remediation components using the expected cash flow technique, adjusted for recoveries from other parties and insurance.

Cash and Equity in Pooled Investments and Policies. Tacoma Water's cash is deposited with the City Treasurer in the City's general investment pool for the purpose of maximizing interest earnings through pooled investment activities. Cash and equity in pooled investments in the

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

City's general investment pool are reported at fair value and changes in unrealized gains and losses are recorded in the Statements of Revenues, Expenses and Changes in Net Assets. Interest earned on such pooled investments is allocated to the participating funds based on each fund's average daily cash balance during the allocation period.

The general investment pool operates like a demand deposit account in that all City departments, including Tacoma Water, may deposit cash into the pool at any time and can also withdraw cash out of the pool without prior notice or penalty. Accordingly, balances are considered to be cash equivalents.

The City of Tacoma Investment Policy permits investments in Certificates of Deposit with qualified public depositories (as defined in RCW 39.58), obligations of the U.S. Treasury, Government Sponsored Agencies and Instrumentalities, bonds issued by any State or Local Government, Bankers' Acceptances, Commercial Paper, Repurchase and Reverse Repurchase agreements, and the Washington State Local Government Investment Pool (LGIP). Liquidity required to meet the City's daily obligations is maintained by investing a portion of the City's Investment Pool in the WA State LGIP and/or a Municipal Investor demand deposit account maintained with U.S. Bank.

Tacoma Water's equity in that portion of the City of Tacoma Investment Pool held in qualified public depositories at December 31, 2009 and 2008 is entirely covered by the Federal Deposit Insurance Corporation (FDIC) and the Washington State Public Deposit Protection Commission (PDPC).

Use of Estimates. The preparation of the financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Tacoma Water used estimates in determining reported unbilled revenues, allowance for doubtful accounts, accrued compensated absences, depreciation, OPEB, self-insurance liabilities and other contingencies. Actual results may differ from these estimates.

Significant Risks and Uncertainty. Tacoma Water is subject to certain business risks that could have a material impact on future operations and financial performance. These risks include water conditions, weather and natural disaster-related disruptions, collective bargaining labor disputes, fish and other endangered species act issues, Environmental Protection Agency regulations, and federal government regulations or orders concerning the operation, maintenance and/or licensing of facilities.

Net Assets. Net assets consist of the following components:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation and outstanding balances of any bonds and other borrowings that are attributable to the acquisition, construction, or improvement of capital assets.
- Restricted – This component consists of net assets on which constraints are placed. Constraints include those imposed by creditors, contributors, enabling legislation or by law.
- Unrestricted – This component of net assets consists of net assets that are available for use.

Reclassifications. Changes have been made to prior year account classifications as needed to conform to the current year presentation format.

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

Rate Stabilization Account. The Utility has established a rate stabilization account to reduce year-to-year variations in rates. Amounts deposited into the account are excluded from the statement of revenues, expenses and changes in net assets in accordance with regulated operations. Revenue will be recognized in subsequent periods in accordance with rate decisions.

NOTE 2 UTILITY PLANT. A summary of the balances and changes in utility plant follows:

	Balance December 31, 2008	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2009
Intangible Plant	\$ 34,882,081	\$ 439,179	\$ (512,624)	\$ -	\$ 34,808,636
Source of Supply Plant	68,588,758	4,649,084	(88,981)	-	73,148,861
Pumping Plant	8,698,417	314,031	(7,032)	-	9,005,416
Water Treatment Plant	43,467,416	1,639,732	(4,586)	-	45,102,562
Transmission Facilities	184,130,846	4,492,744	(7,285)	-	188,616,305
Distribution Facilities	342,635,738	13,485,840	(2,130,187)	-	353,991,391
General Plant	<u>23,168,302</u>	<u>2,632,072</u>	<u>(845,487)</u>	<u>(186,955)</u>	<u>24,767,932</u>
Total Water Plant In Service	705,571,558	27,652,682	(3,596,182)	(186,955)	729,441,103
Less Accumulated Depreciation	<u>124,906,754</u>	<u>13,845,799</u>	<u>(3,083,558)</u>	<u>(2,501,991)</u>	<u>133,167,004</u>
	580,664,804	13,806,883	(512,624)	2,315,036	596,274,099
Construction Work In Progress	<u>9,928,454</u>	<u>25,920,949</u>	<u>-</u>	<u>(27,465,727)</u>	<u>8,383,676</u>
Net Utility Plant	<u>\$ 590,593,258</u>	<u>\$ 39,727,832</u>	<u>\$ (512,624)</u>	<u>\$(25,150,691)</u>	<u>\$ 604,657,775</u>

NOTE 3 SPECIAL FUNDS. Cash and equity in pooled investments included in Tacoma Water's Special Funds consist of:

Cash and Equity in Pooled Investments	<u>2009</u>	<u>2008</u>
Construction Funds	\$ 60,374,546	\$ 13,930,776
Other	<u>69,364,691</u>	<u>61,295,510</u>
Total	<u>\$129,739,237</u>	<u>\$ 75,226,286</u>

NOTE 4 LONG-TERM DEBT. Long-term debt activity for the year ended December 31, 2009 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Revenue Bonds	\$190,250,000	\$76,775,000	\$(5,880,000)	\$261,145,000	\$6,075,000
Plus: Unamortized Premium	3,267,239	-	(361,921)	2,905,318	-
Less: Unamortized Loss on Refundings	<u>(1,230,351)</u>	<u>-</u>	<u>178,611</u>	<u>(1,051,740)</u>	<u>-</u>
Net Revenue Bonds	192,286,888	76,775,000	(6,063,310)	262,998,578	6,075,000
Public Works Trust Fund Loans	22,913,182	4,850,000	(1,574,760)	26,188,422	1,595,345
Drinking Water State Revolving Fund Loan	<u>2,093,684</u>	<u>-</u>	<u>(161,053)</u>	<u>1,932,631</u>	<u>161,052</u>
Total Long-Term Debt	217,293,754	81,625,000	(7,799,123)	291,119,631	7,831,397
Muckleshoot Liability (See Note 11)	<u>9,376,794</u>	<u>-</u>	<u>(322,851)</u>	<u>9,053,943</u>	<u>176,771</u>
Total Long-Term Liabilities	<u>\$226,670,548</u>	<u>\$81,625,000</u>	<u>\$(8,121,974)</u>	<u>\$300,173,574</u>	<u>\$8,008,168</u>

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

Tacoma Water's long-term debt at December 31 consists of the following payable from revenues of Tacoma Water:

SENIOR LIEN BONDS

	<u>2009</u>	<u>2008</u>
2001 Water System Revenue Bonds, with interest rates ranging from 4.0% to 5.25%, due in yearly installments ranging from \$415,000 to \$4,795,000 through 2023.	\$30,060,000	\$30,460,000
2002 Regional Water Supply System Revenue Bonds, with interest rates ranging from 4.0% to 5.50%, due in yearly installments ranging from \$800,000 to \$1,025,000 and term bonds due in installments ranging from \$1,100,000 to \$7,400,000 through 2032.	78,350,000	79,150,000
2003 Water System Revenue and Refunding Bonds, with interest rates ranging from 4.0% to 5.25%, due in yearly installments ranging from \$1,725,000 to \$3,505,000 through 2023.	34,880,000	37,830,000
2005 Water System Revenue and Refunding Bonds, with interest rates ranging from 3.5% to 5.0%, due in yearly installments ranging from \$1,695,000 to \$4,760,000 through 2025.	41,080,000	42,810,000
2009 Water System Revenue Bonds, with interest rate at 5.751%, with Build America Bond (BAB) rebate at 35% of interest, yield rate at 3.738%, due in yearly installments starting in 2033 ranging from \$9,800,000 to \$12,210,000 through 2039.	<u>76,775,000</u>	<u>-</u>
Subtotal Sr. Lien Debt	261,145,000	190,250,000
Unamortized premium	2,905,318	3,267,239
Unamortized loss on refunding	(1,051,740)	(1,230,351)
Less Current Portion of Revenue Bond Debt	<u>(6,075,000)</u>	<u>(5,880,000)</u>
Long-term Portion of Revenue Bond Debt	<u>\$256,923,578</u>	<u>\$186,406,888</u>

Scheduled principal maturities on the bonds and interest payments (BAB interest rebates are included in the Total Interest) are as follows:

<u>Year</u>	<u>Principal</u>	<u>Total Interest</u>	<u>BAB Interest Rebate</u>
2010	\$6,075,000	\$13,785,375	\$1,661,268
2011	\$6,280,000	\$13,220,200	\$1,545,366
2012	\$6,550,000	\$12,941,813	\$1,545,365
2013	\$6,880,000	\$12,627,013	\$1,545,366
2014	\$7,230,000	\$12,295,319	\$1,545,365
2015-2019	\$43,210,000	\$55,914,113	\$7,726,828
2020-2024	\$53,790,000	\$43,532,120	\$7,726,828
2025-2029	\$32,655,000	\$32,319,401	\$7,726,828
2030-2034	\$41,665,000	\$23,695,553	\$7,529,569
2035-2039	\$56,810,000	\$10,040,671	\$3,514,235

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

The fair value of Tacoma Water's long-term debt is based on quoted market prices. The fair market value of the Water System Revenue Bonds at December 31, 2009 and 2008 was \$181,195,852 and \$113,010,415, respectively. The fair market value of the Regional Water Supply System Revenue Bonds at December 31, 2009 and 2008 was \$81,919,789 and \$66,957,498, respectively.

The carrying amounts of the Washington State Public Works Board Loans and Drinking Water State Revolving Fund Loan approximate the fair value since such loans are exclusive and have no market.

Tacoma Water's revenue bonds are secured by the net revenue of Tacoma Water and all cash and investments held in the bond funds and construction funds. The bonds are also subject to certain financial and non-financial covenants.

JUNIOR LIEN DEBT

	<u>2009</u>	<u>2008</u>
Public Works Trust Fund Loans		
2001 Public Works Trust Fund construction loan for the Second Supply Project (SSP), with interest of .5% per annum, due in yearly installments of \$533,333 through 2021.	\$6,400,000	\$6,933,333
2001 Public Works Trust Fund pre-construction loan for the SSP Howard Hanson Dam Additional Storage Project, with interest of .5% per annum, due in yearly installments of \$52,632 through 2021.	631,579	684,212
2002 Public Works Trust Fund construction loan for the Middle and Headworks section of the SSP, with interest of .5% per annum, due in yearly installments of \$531,250 through 2022.	6,906,250	7,437,500
2002 Public Works Trust Fund pre-construction loan for the Middle and Headworks section of the SSP, with interest of .5% per annum, due in yearly installments of \$54,180 through 2021.	650,155	704,335
2004 Public Works Trust Fund pre-construction loan for the design of the Green River Ozone Facility with interest of .5% per annum, due in yearly installments of \$53,363 through 2024.	800,438	853,802
2006 Public Works Trust Fund construction loan for the Green River Ozone Treatment Plant, with interest of .5% per annum, due in yearly installments of \$370,588 through 2026.	6,300,000	6,300,000
2008 Public Works Trust Fund construction loan for the McMillin Reservoir Reconstruction, with interest of .5% per annum, due in yearly installments of \$236,842 from 2011 through 2029.	4,500,000	-

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

JUNIOR LIEN DEBT (CONTINUED)

	<u>2009</u>	<u>2008</u>
Drinking Water State Revolving Fund Loan		
2002 construction loan for the Portland Avenue Reservoir, with interest of 2.5% per annum, due in yearly installments of \$161,053 through 2021.	1,932,631	2,093,684
Subtotal Junior Lien Debt	28,121,053	25,006,866
Less current portion of debt	(1,756,397)	(1,735,814)
Long-Term portion of Junior Lien Debt	\$26,364,656	\$23,271,052

Scheduled principal maturities of junior lien debt and interest payments are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>
2010	\$1,756,397	\$169,991
2011	\$1,993,240	\$167,255
2012	\$1,993,240	\$154,068
2013	\$1,993,240	\$140,880
2014	\$1,993,240	\$127,693
2015-2019	\$9,966,200	\$440,657
2020-2024	\$6,500,109	\$135,313
2025-2029	\$1,925,387	\$ 23,322

NOTE 5 SECOND SUPPLY PROJECT AGREEMENT. Four Washington municipalities are the Participants in the Second Supply Project under the terms of the Second Supply Project Agreement, which defines their rights and obligations with regard to the Second Supply Project. Tacoma Water has a 15/36 Participant Share and each of the City of Kent, Covington Water District and Lakehaven Utility District has a 7/36 Participant Share in the Second Supply Project. Each Participant has contractual rights under the Second Supply Project Agreement (i) to use an undivided share of the Project equal to its project capacity share and to use available excess project capacity; (ii) to schedule for delivery and receive its Participant Share of Second Diversion Water at its points of delivery; (iii) to schedule for delivery and receive additional water at its points of delivery; and (iv) to its Participant Share of storage. Each Participant has a contractual obligation (i) to receive Second Diversion Water and additional water scheduled for delivery and delivered to it and (ii) to pay its Participant Share of Project Costs, including but not limited to Fixed and Variable O & M Costs, Initial Project Construction Costs and Capital Expenditures. Kent and Covington, in the "Repayment Agreement", pledge to pay Tacoma Water a defined share of the principal and interest debt service on the Regional Water Supply System Bonds. The term of the Second Supply Project Agreement extends through the operating life of the Second Supply Project including all renewals and replacements thereof and additions thereto. The Second Supply Project Agreement provides that all obligations incurred during its term will survive its termination or expiration and will survive until satisfied.

NOTE 6 SIGNIFICANT CUSTOMER. Contracted sales to Simpson Tacoma Kraft Company (Simpson) accounted for 7.6% and 8.5% of Tacoma Water's total water sales in 2009 and 2008, respectively.

Tacoma Water has contracted with Simpson to supply certain quantities of water under a take-or-pay arrangement at a specified rate through July 31, 2015.

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

NOTE 7 FLEET SERVICES FUND. The Department of Public Utilities has established a Fleet Services Fund to perform scheduled maintenance, repair and replacement of the Department vehicles and related equipment. Transfers of vehicles and equipment from Tacoma Water to the Fleet Services Fund are accounted for as transfers.

Tacoma Water pays the Fleet Services Fund for the use of the vehicles and equipment to cover fleet operating expenses. Payments made by Tacoma Water in 2009 and 2008 were \$3,120,417 and \$3,396,652, respectively.

Fleet Services' management makes an annual assessment of the capital replacement reserve balance for appropriate funding levels. It is the Fund's policy to maintain the Fund's maximum balance at a level that will provide adequate purchasing power for a three-year cycle and to return any excess funds to customers based on their scheduled monthly payments. The solvency of the Replacement Fund also allowed Fleet Services to return a portion of interest earned on Fund investments for the year to their customers. In 2009 and 2008, Fleet Services returned 75% of the interest earned on the capital replacement reserve to Tacoma Water's replacement fund. The amounts refunded in 2009 and 2008 were \$104,897 and \$154,246, respectively, which was used to offset the corresponding year's fleet expenses.

NOTE 8 SELF-INSURANCE FUND. The Department of Public Utilities maintains a self-insurance program and insurance policies. The Department has established a self-insurance fund to insure Tacoma Water and other divisions within the Department for certain losses arising from personal and property damage claims by third parties. The major risks to Tacoma Water are flooding, wind damage, chemical spills and earthquakes. Mitigating controls and emergency and business resumption plans are in place. To the extent damage or claims exceed insured values, rates may be impacted.

Tacoma Water is required to make payments to the Self-Insurance Fund to cover claims incurred by Tacoma Water and administrative expenses of the Fund. Tacoma Water's premium payments totaled \$120,000 in both 2009 and 2008. Assets in the Self-Insurance Fund total \$4.6 million which exceeds accrued and incurred but not reported liabilities. Equity in the Self-Insurance Fund is transferred to the appropriate operating divisions in accordance with GASB 10. Management believes Tacoma Water's investment in the Self-Insurance Fund is more than adequate to settle all its known or estimated claims.

Performance and fidelity bonds covering all employees are provided in amounts up to \$1 million (subject to a \$50,000 deductible per occurrence). The insurance policies presently in effect include coverage on the Department's buildings and fleet vehicles as well as general liability and public official's liability. The current insurance policies have deductibles or self insured retentions of \$250,000 for buildings and vehicles and \$1 million for general comprehensive liability. The public officials policy has a \$200,000 deductible for employee practices liability and \$100,000 deductible for all other issues. The general comprehensive liability policies provide \$20 million of coverage. The City has a policy to cover extraordinary worker's compensation claims with a limit of \$25 million (\$1 million deductible).

TACOMA WATER
 NOTES TO FINANCIAL STATEMENTS
 (continued)

NOTE 9 TACOMA EMPLOYEES' RETIREMENT SYSTEM FUND (TERS). Pursuant to GASB Statement No. 50, "Pension Disclosures", this note disclosure emphasizes the employer disclosures and detailed information presented in an independent Comprehensive Annual Financial Report (CAFR) issued by the Retirement System. Further detailed information regarding these disclosures can be found in that report which may be obtained by writing to Tacoma Employees' Retirement System, 747 Market Street, Room 1544, Tacoma, Washington 98402.

1. **Plan Description and Contribution Information:** The System is a single employer, defined benefit retirement plan covering employees of the City of Tacoma and is administered in accordance with Revised Code of Washington (RCW) Chapter 41.28 and Chapter 1.30 of the Tacoma Municipal Code. There are 1,846 vested retirees and beneficiaries of deceased retirees currently receiving benefits and 366 vested terminated employees entitled to future benefits and 3,142 active members of the Tacoma Employees' Retirement System, as of December 31, 2009.
2. **Basis of Accounting:** The financial statements are prepared using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period in which employee services are performed and expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made. The employer contribution rate is determined by the actuarial funding method identified as the "entry age cost method".
3. **Investments:** Equity securities, fixed income securities, real estate and short-term investments are all reported at fair market value. Fair market value was determined by the custodian bank utilizing standard industry practices and verified by the performance consultant. No investment in any one corporation or organization exceeded 5% of net assets available for benefits.
4. **Contracts:** The System has no securities of the employer or related parties included in the plan assets. The System has not made any loans to the employer in the form of notes, bonds or other instruments.
5. **Contribution Rates:** Covered employees are required by Chapter 1.30 of the Tacoma City Code to contribute a percentage of their gross wages to the System, and the employer contributes an additional percentage. The contribution rates are provided in the following table:

<u>Applicable Period</u>	<u>City Rate</u>	<u>Member Rate</u>	<u>Total Rate</u>
1/1/2001 to 2/1/2009	7.56%	6.44%	14.00%
2/2/2009 to 12/31/2009	8.64%	7.36%	16.00%
1/1/2010 Forward	9.72%	8.28%	18.00%

Contributions city-wide totaled \$33.6 million in 2009 (\$17.9 million employer contributions and \$15.7 million employee contributions); contributions totaled \$28 million in 2008 (\$14.9 million employer contributions and \$13.1 million employee contributions).

6. **Funding Status and Progress:** Historical trend information about TERS is presented herewith as supplementary information. This information is based on the most recent actuarial valuation performed, dated January 1, 2009, and is intended to help assess TERS funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employee retirement systems.

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

7. Actuarial Methods and Significant Actuarial Assumptions:

Valuation Date:	January 1, 2009
Actuarial Cost Method:	Entry Age
Amortization Method:	Level Percentage of the System's Projected Payroll
Remaining Amortization Period:	30 years; open
Asset Valuation Method:	Assets are valued at market value, with a four-year smoothing of all market value gains and losses.
Actuarial Assumptions:	
Investment Rate of Return	7.75%
Projected Salary Increases	4.25%
Includes Inflation at	3.25%
Post-Retirement Benefit Increases	2.125%

SCHEDULE OF FUNDING PROGRESS: (\$ in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b-a/c)
1/1/05	\$807.3	\$754.3	(\$53.0)	107.0%	\$172.5	(30.7%)
1/1/07	\$1,021.3	\$895.8	(\$125.5)	114.0%	\$175.0	(71.7%)
1/1/09	\$1,097.3	\$1,002.3	(\$95.0)	109.5%	\$197.4	(48.1%)

ANNUAL PENSION COST AND NET PENSION OBLIGATION:

The City's annual pension cost and net pension obligation to the Retirement System for 2009 were as follows:

	(\$ in millions)
Annual Required Contribution (ARC)	\$15.2
Interest on Net Pension Obligation	(0.1)
Adjustment to ARC	<u>0.1</u>
Annual Pension Cost (APC)	15.2
Contributions made	<u>18.0</u>
Increase (Decrease) in Pension Obligation	(2.8)
Net Pension Obligation at beginning of year	<u>(1.0)</u>
Net Pension Obligation at end of year	<u><u>\$(3.8)</u></u>

TREND INFORMATION
(\$ in millions)

Year Ending	Annual Pension Cost (APC)	% of APC Contributed	Net Pension Obligation
12/31/07	\$13.6	100%	\$(0.4)
12/31/08	\$14.3	104%	\$(1.0)
12/31/09	\$15.2	118%	\$(3.8)

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

NOTE 10 OTHER POST EMPLOYMENT BENEFITS (OPEB)

Plan Description. The City charges some early retirees not yet eligible for Medicare a health premium based on the claims experience of active employees and retirees rather than based on the claims experience of retirees only. This difference is a benefit to the retirees, since health claims costs generally increase with age. Generally accepted accounting principles require that the portion of age-adjusted expected retiree health claims costs that exceed the premium charged to retirees be recognized as a liability for accounting purposes. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and are subject to continual revision as results are compared to past expectation and new estimates are made about the future.

Funding Policy. The City uses pay-as-you go funding; contributions to a separate trust are not required.

Annual OPEB Cost and Net OPEB Obligation. The Present Value of Benefits (PVB) is the present value of projected benefits discounted at the valuation interest rate (4.00%).

The Actuarial Accrued Liability (AAL) is the portion of the present value of benefits attributed to past service only. The portion attributed to future employee service is excluded. For inactive employees, the AAL is equal to the present value of benefits. For active employees, the actuarial present value of the projected benefits of each individual is allocated as a level percentage of expected salary for each year of employment between entry age (defined as age at hire) and assumed exit (until maximum retirement age). The portion attributed to service between entry age and the valuation date is the actuarial accrued liability.

The Normal Cost is that portion of the City provided benefit attributable to employee service in the current year.

The Annual Required Contribution (ARC) is the amount the City would be required to report as an expense for the year. The ARC is equal to the Normal Cost plus an amount to amortize the Unfunded Actuarial Accrued Liability (UAAL) on a closed basis of 30 years, beginning January 1, 2007. The amortization period for 2009 is 28 years.

The ARC represents an accounting expense, but the City is not required to contribute the ARC to a separate trust. If the City does not set aside funds equal to the ARC (less current year benefit payments) each year, then the ARC (less benefit payments) will accumulate as a liability or Net OPEB Obligation on the City's balance sheet.

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

The following table is a summary of actuarial valuation results as of January 1, 2009 with a comparison to the results from the January 1, 2007 valuation.

	<u>January 1, 2007</u>	<u>January 1, 2009</u>
Total membership:		
Active employees	3,674	3,633
Terminated vested employees	247	355
Retired employees	729	677
Dependents	184	138
Total	<u>4,834</u>	<u>4,803</u>
Annual Benefit Payments	\$ 8,527,863	\$ 8,319,788
Discount rate	4.00%	4.00%
Present Value of Benefits (PVB)	\$ 236,595,810	\$ 266,167,781
Actuarial Accrued Liability (AAL)	\$ 178,137,499	\$ 205,168,072
Assets	\$ -	\$ -
Unfunded Actuarial Accrued Liability (UAAL)	<u>\$ 178,137,499</u>	<u>\$ 205,168,072</u>
Normal Cost	\$ 4,949,734	\$ 5,615,626
Annual Required Contribution (ARC)	\$ 14,159,338	\$ 16,761,978

The following table shows the total value of the benefits provided, the member paid premiums and the City paid benefits as of December 31, 2009.

<u>Value of Subsidy at 4.00% Interest Rate</u>	<u>Total Value of Benefits</u>	<u>Member Paid Premiums</u>	<u>City Paid Benefits</u>
Present Value of Benefits (PVB)	\$ 381,316,670	\$ 115,148,889	\$ 266,167,781
Actuarial Accrued Liability (AAL)	\$ 256,534,861	\$ 51,366,789	\$ 205,168,072
Normal Cost	\$ 10,222,755	\$ 4,607,129	\$ 5,615,626
Annual Benefit Payments	\$ 10,601,879	\$ 2,282,091	\$ 8,319,788

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

The following table shows the calculation of the Annual Required Contribution and Net OPEB Obligation for the City and for Tacoma Water as of December 31, 2009.

	<u>City</u>	<u>Tacoma Water</u>
Determination of Annual Required Contribution		
Normal Cost at Year-end	\$ 5,615,626	\$ 342,040
Amortization of UAAL	11,146,352	122,319
Annual Required Contribution (ARC)	<u>\$ 16,761,978</u>	<u>\$ 464,359</u>
Determination of Net OPEB Obligation		
Annual Required Contribution (ARC)	\$ 16,761,978	\$ 464,359
Interest on prior year Net OPEB Obligation	417,211	19,820
Adjustments to ARC	<u>(416,955)</u>	<u>(17,129)</u>
Annual OPEB Cost	16,762,234	467,050
Actual benefits paid	<u>8,319,788</u>	<u>83,965</u>
Increase in Net OPEB Obligation	8,442,446	383,085
Net OPEB Obligation - 1/1/09	10,430,277	495,507
Net OPEB Obligation - 12/31/09	<u>\$ 18,872,723</u>	<u>\$ 878,592</u>

Funded Status and Funding Progress.

The following table shows the annual OPEB costs and net OPEB obligation for three years.

Year Ended	<u>Annual OPEB Cost</u>		<u>Benefits Paid</u>		<u>Net OPEB Obligation</u>	
	City	Tacoma Water	City	Tacoma Water	City	Tacoma Water
12/31/2007	\$ 14,159,338	\$ 378,274	\$ 8,527,863	\$ 115,133	\$ 5,631,475	\$ 263,141
12/31/2008	\$ 14,065,769	\$ 373,902	\$ 9,266,967	\$ 141,536	\$ 10,430,277	\$ 495,507
12/31/2009	\$ 16,762,234	\$ 467,050	\$ 8,319,788	\$ 83,965	\$ 18,872,723	\$ 878,592

As of January 1, 2009, the most recent actuarial valuation date, the Plan was zero percent funded. Based upon a 4% interest rate, the actuarial accrued liability for benefits was \$205.2 million, and the actuarial value of assets was zero, resulting in an Unfunded Actuarial Accrued Liability of \$205.2 million.

Actuarial Methods and Assumptions. The actuarial cost method used for determining the benefit obligations is the Entry Age Normal Cost Method. Under the principles of this method, the actuarial present value of the projected benefits of each individual included in the valuation is allocated as a level percentage of expected salary for each year of employment between entry age (defined as age at hire) and assumed exit (until maximum retirement age).

The portion of actuarial present value allocated to a valuation year is called the normal cost. The portion of this actuarial present value not provided for at a valuation date by the sum of (a) the actuarial value of the assets, and (b) the actuarial present value of future normal costs is called the Unfunded Actuarial Accrued Liability (UAAL). In determining the Annual Required Contribution, the UAAL is amortized as a level percentage of expected payrolls over 30 years for non-Law Enforcement Officers and Fire Fighter Retirement Pension System 1 (LEOFF 1) groups; for LEOFF 1, the UAAL is amortized as a level dollar amount over 30 years.

TACOMA WATER
 NOTES TO FINANCIAL STATEMENTS
 (continued)

Actuarial Methods and Significant Actuarial Assumptions:

Valuation Date	January 1, 2009
Census Date	January 1, 2009
Actuarial Cost Method:	Entry Age
Amortization Method:	Combination of level percentage and level dollar amount, see note above.
Remaining Amortization Period:	28 years, closed
Demographic Assumptions:	Demographic assumptions regarding retirement, disability and turnover are based upon pension valuations for the various pension plans.

Actuarial Assumptions:

Discount Rate	4.0% for pay-as-you-go funding	
Medical Cost Trend	2008	10.0%
	2009	8.7%
	2010	7.9%
	2011	7.0%
	2012-2015	6.5%
	2016-2020	6.4%
	2059	5.3%
Projected Payroll Increases	4.25%	

Eligibility:

Disability - Five years of service are required for non-service connected disability.

TERS members are eligible for retiree medical benefits after becoming eligible for service retirement pension benefits (either reduced or full pension benefits):

- Age 55 with 10 years of service
- 20 years of service

NOTE 11 COMMITMENTS AND CONTINGENCIES

Capital Improvements. The financial requirement for Tacoma Water's 2009/2010 biennial Capital Improvement Program is approximately \$105 million and Tacoma Water has substantial contractual commitments relating to the program. At December 31, 2009, the remaining financial requirement was approximately \$84.2 million. The remaining financial requirement for Capital Improvement Programs relating to prior bienniums is approximately \$12.8 million.

Muckleshoot Indian Tribe Settlement. A mutually beneficial settlement agreement was reached with the Muckleshoot Indian Tribe in 1995. The settlement package has a cost of approximately \$30 million and includes five basic elements: 1) building a fish restoration facility and annual operation and maintenance of that facility, or in the alternative, providing \$12 million (indexed at 1995 dollars) into a fish restoration fund; 2) providing for enhanced flows in the Green River; 3) transferring certain lands; 4) establishing a trust fund payable over 40 years which is intended to provide for the general welfare, educational and other needs of the Tribe; and 5) limited access into the Green River Watershed. The settlement resolved past damage claims by the Tribe for Tacoma Water's historical operations on the river, gain the Tribe's support for the Second Supply Project and provide the basis for a long-term, cooperative working relationship on the Green River. Tacoma Water has been implementing this agreement.

TACOMA WATER
NOTES TO FINANCIAL STATEMENTS
(continued)

Robison Construction Inc. The Contractor has filed suit related to two “additional work” claims arising out of work done by its subcontractor Northwest Boring, in boring tunnels for the I-5 and Green River crossings related to Tacoma Water’s Second Supply Pipeline construction project. The contractor alleges damages in the amount of \$3,478,416. Tacoma Water disputes these claims, and the parties are engaging in settlement discussions.

City of Federal Way, City of University Place, and Pierce County. The Washington State Supreme Court ruled that the local governments are required to pay for local fire hydrant services, not water utilities. Three local governments have failed to pay Tacoma Water for local fire hydrant services totaling \$2.4 million for the 2009-2010 biennium. The City has filed a declaratory judgment suit to determine who is liable for paying for such services. The Utility has recorded operating revenues and accounts receivable for the services.

General Legal Matters. The Utility is involved in various litigation in the normal course of business. In the opinion of management, the ultimate outcome of these claims will not have a material effect on the Utility’s financial position beyond amounts already accrued as of December 31, 2009.

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STATISTICAL DATA (Unaudited)

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

TEN-YEAR FINANCIAL REVIEW

BALANCE SHEET	2009	2008	2007	2006
ASSETS				
Utility Plant - Net	\$604,657,775	\$590,593,258	\$568,493,015	\$542,837,619
Special Funds & Non-Util Prop	133,949,294	80,858,401	99,062,414	111,884,788
Current Assets	35,753,843	22,151,467	23,150,235	20,256,759
Deferred Charges	3,654,494	3,319,156	2,123,339	2,622,731
Total Assets	<u>\$778,015,406</u>	<u>696,922,282</u>	<u>692,829,003</u>	<u>677,601,897</u>
NET ASSETS	412,592,671	404,010,304	391,763,317	374,885,816
LIABILITIES AND EQUITY				
Long-Term Debt	292,165,406	218,869,015	227,315,790	231,066,402
Current Liabilities	17,664,175	16,288,305	15,169,687	21,418,548
Deferred Credits	55,593,154	57,754,658	58,580,209	50,231,131
Equity	-	-	-	-
Total Liabilities and Equity ...	-	-	-	-
Total Liabilities	<u>365,422,735</u>	<u>292,911,978</u>	<u>301,065,686</u>	<u>302,716,081</u>
TOTAL NET ASSETS AND LIABILITIES ...	<u>778,015,406</u>	<u>\$696,922,282</u>	<u>\$692,829,003</u>	<u>\$677,601,897</u>
STATEMENT OF INCOME				
OPERATING REVENUES				
Residential and Domestic	\$36,643,366	\$34,592,712	\$32,645,594	\$31,216,429
Commercial and Industrial	9,659,078	8,978,703	8,298,263	7,751,215
Special Rate--Simpson/Other	4,153,327	4,371,527	3,917,760	3,222,324
Municipal	380,267	349,722	396,131	363,455
Other Public Bldgs and Grounds ...	1,861,111	1,680,603	1,644,166	1,596,360
Unbilled	187,966	417,145	37,113	1,067,323
Sales to Other Water Utilities ...	1,776,686	1,251,815	1,433,705	1,640,803
Total Water Sales	<u>54,661,801</u>	<u>51,642,227</u>	<u>48,372,732</u>	<u>46,857,909</u>
Other Operating Revenues	9,331,955	5,382,313	4,353,478	1,919,802
Total Operating Revenues	<u>63,993,756</u>	<u>57,024,540</u>	<u>52,726,210</u>	<u>48,777,711</u>
OPERATING EXPENSES				
Operation and Maintenance	34,055,463	33,387,663	31,076,515	29,165,168
Taxes	3,093,311	2,881,877	2,924,930	3,407,187
Depreciation	13,845,799	13,016,544	11,363,970	11,556,821
Total Operating Expenses	<u>50,994,573</u>	<u>49,286,084</u>	<u>45,365,415</u>	<u>44,129,176</u>
NET OPERATING INCOME (LOSS)	12,999,183	7,738,456	7,360,795	4,648,535
NON-OPERATING REVENUES (EXPENSES)				
Other Income	497,331	61,265	306,680	2,293,477
Interest Income	1,955,385	3,730,407	5,255,881	4,603,137
Gain from Disposition of Property	26,100	-	4,199,382	-
Interest Charges (Net)	<u>(9,076,156)</u>	<u>(8,406,264)</u>	<u>(8,484,405)</u>	<u>(8,403,448)</u>
Net Income (Loss) Before	6,401,843	3,123,864	8,638,333	3,141,701
Contributions & Transfers	6,401,843	3,123,864	8,638,333	3,141,701
Total Capital Contributions	7,120,993	14,137,605	12,801,825	30,462,788
Grants & Federal BAB Subsidies	244,683	-	-	-
Transfers Out **	<u>(5,185,152)</u>	<u>(5,014,482)</u>	<u>(4,562,657)</u>	<u>(4,302,274)</u>
NET INCOME (LOSS)	<u>\$8,582,367</u>	<u>\$12,246,987</u>	<u>\$16,877,501</u>	<u>\$29,302,215</u>

* Beginning in 2001, results have been reclassified to conform to the new GASB No. 34, Financial Reporting Model for Local Governments.

** Beginning in 2001, City Gross Earnings Tax is reported as a transfer out rather than an operating expense in accordance with GASB No. 34.

2005 (As Restated)	2004	2003 (As Restated)	2002 * (As Restated)	2001 * (As Restated)	2000 (As Restated)
\$515,240,672	\$449,792,203	\$391,992,687	\$328,497,886	\$258,090,234	\$239,797,425
124,884,569	86,235,235	128,107,319	111,051,760	45,226,731	22,993,841
15,880,090	21,804,006	19,223,128	16,097,870	9,791,934	7,492,155
<u>2,938,485</u>	<u>2,954,978</u>	<u>3,380,733</u>	<u>2,957,394</u>	<u>1,202,418</u>	<u>1,759,241</u>
658,943,816	560,786,422	542,703,867	458,604,910	314,311,317	272,042,662
345,583,601	327,326,910	305,678,001	273,351,382	225,440,687	-
224,760,581	199,174,091	203,913,661	170,542,535	77,292,631	43,110,621
12,820,700	14,542,631	12,150,879	11,896,274	7,567,108	6,173,108
75,778,934	19,742,790	20,961,326	2,814,719	4,010,891	3,779,256
-	-	-	-	-	218,979,677
-	-	-	-	-	\$272,042,662
<u>313,360,215</u>	<u>233,459,512</u>	<u>237,025,866</u>	<u>185,253,528</u>	<u>88,870,630</u>	
\$658,943,816	\$560,786,422	\$542,703,867	\$458,604,910	\$314,311,317	
\$27,611,024	\$26,589,163	\$24,497,359	\$21,277,778	\$18,033,215	\$16,799,076
7,174,647	6,619,432	5,809,774	5,442,100	5,329,293	5,259,844
3,511,199	3,293,335	3,044,266	2,726,194	2,514,362	2,436,500
316,562	308,884	218,852	206,254	275,146	265,789
1,409,107	1,523,562	1,353,062	1,190,054	1,014,132	1,023,816
-	(903,969)	680,497	194,702	312,477	(69,633)
<u>1,599,919</u>	<u>1,622,206</u>	<u>1,531,004</u>	<u>876,610</u>	<u>712,813</u>	<u>877,672</u>
41,622,458	39,052,613	37,134,814	31,913,692	28,191,438	26,593,064
<u>1,428,135</u>	<u>792,302</u>	<u>871,547</u>	<u>858,133</u>	<u>823,504</u>	<u>876,559</u>
43,050,593	39,844,915	38,006,361	32,771,825	29,014,942	27,469,623
26,448,761	25,590,407	23,675,319	20,931,027	20,873,670	19,660,327
2,995,424	2,480,667	2,276,909	1,802,616	1,708,422	3,903,305
<u>9,386,363</u>	<u>8,934,860</u>	<u>7,469,798</u>	<u>6,810,105</u>	<u>5,948,292</u>	<u>5,353,022</u>
38,830,548	37,005,934	33,422,026	29,543,748	28,530,384	28,916,654
4,220,045	2,838,981	4,584,335	3,228,077	484,558	(1,447,031)
2,841,371	1,190,100	1,108,555	1,100,448	160,164	2,576,530
1,695,578	1,484,779	1,586,825	1,047,376	1,477,894	1,515,542
4,622,927	4,500	2,872,246	793,002	-	-
<u>(7,185,197)</u>	<u>(6,253,392)</u>	<u>(3,655,291)</u>	<u>(2,787,024)</u>	<u>(1,613,155)</u>	<u>(1,542,018)</u>
6,194,724	(735,032)	6,496,670	3,381,879	509,461	1,103,023
24,453,875	25,597,104	28,892,401	47,599,106	9,166,126	-
-	803,224	344,857	-	-	-
<u>(3,951,776)</u>	<u>(4,016,387)</u>	<u>(3,407,309)</u>	<u>(3,070,290)</u>	<u>(3,214,577)</u>	<u>-</u>
<u>\$26,696,823</u>	<u>\$21,648,909</u>	<u>\$32,326,619</u>	<u>\$47,910,695</u>	<u>\$6,461,010</u>	<u>\$1,103,023</u>

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

BOND DEBT SERVICE REQUIREMENTS
DECEMBER 31, 2009

<u>YEAR</u>	<u>PRINCIPAL</u>	<u>INTEREST</u>	<u>TOTAL</u>
2010	\$ 6,075,000	\$ 13,785,375	\$ 19,860,375
2011	6,280,000	13,220,200	19,500,200
2012	6,550,000	12,941,813	19,491,813
2013	6,880,000	12,627,013	19,507,013
2014	7,230,000	12,295,319	19,525,319
2015	7,625,000	11,960,967	19,585,967
2016	8,010,000	11,604,437	19,614,437
2017	8,445,000	11,213,343	19,658,343
2018	8,900,000	10,787,768	19,687,768
2019	10,230,000	10,347,599	20,577,599
2020	10,745,000	9,841,024	20,586,024
2021	11,290,000	9,303,368	20,593,368
2022	11,855,000	8,744,193	20,599,193
2023	12,480,000	8,139,455	20,619,455
2024	7,420,000	7,504,080	14,924,080
2025	7,805,000	7,133,080	14,938,080
2026	5,750,000	6,742,830	12,492,830
2027	6,050,000	6,455,330	12,505,330
2028	6,350,000	6,152,830	12,502,830
2029	6,700,000	5,835,330	12,535,330
2030	7,025,000	5,500,330	12,525,330
2031	7,400,000	5,149,080	12,549,080
2032	7,275,000	4,779,080	12,054,080
2033	9,800,000	4,415,330	14,215,330
2034	10,165,000	3,851,732	14,016,732
2035	10,545,000	3,267,143	13,812,143
2036	10,940,000	2,660,700	13,600,700
2037	11,345,000	2,031,541	13,376,541
2038	11,770,000	1,379,090	13,149,090
2039	12,210,000	702,197	12,912,197
	<u>\$261,145,000</u>	<u>\$230,371,577</u>	<u>\$491,516,577</u>

The amounts above reflect debt service requirements, and do not include the portion funded in the current year of \$506,000.

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

FUNDS AVAILABLE FOR DEBT SERVICE

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Total Income	\$66,821,912	\$61,944,933	\$59,690,011	\$67,902,294	\$49,402,606
Less: Operating Exp .	<u>37,148,774</u>	<u>36,269,540</u>	<u>34,001,445</u>	<u>32,572,355</u>	<u>29,444,185</u>
Income Available for Debt Service	<u>\$29,673,138</u>	<u>\$25,675,393</u>	<u>\$25,688,566</u>	<u>\$35,329,939</u>	<u>\$19,958,421</u>
Bond Redemption	5,896,250	6,046,250	5,739,167	5,352,500	4,200,000
Bond Interest	<u>9,941,993</u>	<u>9,465,014</u>	<u>9,699,636</u>	<u>9,867,600</u>	<u>8,635,950</u>
Debt Service Payable	<u>\$15,838,243</u>	<u>\$15,511,264</u>	<u>\$15,438,803</u>	<u>\$15,220,100</u>	<u>\$12,835,950</u>
Times Debt Service Covered.....	1.87	1.66	1.66	2.32	1.55

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

WATER PLANT IN SERVICE - YEAR 2009

PLANT ACCOUNTS

	Book Cost 1/1/09	Additions 2009
INTANGIBLE PLANT	\$ 34,882,081	\$ 439,179
SOURCE OF SUPPLY	68,588,758	4,649,084
PUMPING PLANT	8,698,417	314,031
WATER TREATMENT PLANT	43,467,416	1,639,732
TRANSMISSION PLANT	184,130,846	4,492,744
DISTRIBUTION PLANT	342,635,738	13,485,840
GENERAL PLANT	23,168,302	2,632,072
TOTAL WATER PLANT IN SERVICE	705,571,558	27,652,682
CONSTRUCTION WORK IN PROGRESS	9,928,454	25,920,949
TOTAL	<u>\$ 715,500,012</u>	<u>\$ 53,573,631</u>

DEPRECIATION ACCOUNTS

	Depreciation Rate %	Accumulated Depreciation 1/1/09	Annual Accrual Cr.
INTANGIBLE PLANT	-	\$ 37,500	\$ -
SOURCE OF SUPPLY PLANT	2.957	11,382,207	1,612,720
PUMPING PLANT	2.513	2,335,845	224,636
WATER TREATMENT PLANT	3.620	5,831,965	1,513,922
TRANSMISSION PLANT	1.668	28,718,430	3,004,159
DISTRIBUTION PLANT	1.876	59,889,719	6,468,116
GENERAL PLANT	7.915	16,711,088	1,022,246
TOTAL PLANT DEPRECIATION		<u>\$ 124,906,754</u>	<u>\$ 13,845,799</u>

1. Total Water Plant in Service includes non-depreciable land and land rights of \$ 19,692,192
2. Total Book Cost of Plant Retired \$ (3,596,182)
Add: Cost of Water Rights Sold: 512,624
Total Retirements \$ (3,083,558)

Retirements 2009	Transfers & Adjustments	Book Cost 12/31/09
\$ (512,624)	\$ -	\$ 34,808,636
(88,981)	-	73,148,861
(7,032)	-	9,005,416
(4,586)	-	45,102,562
(7,285)	-	188,616,305
(2,130,187)	-	353,991,391
(845,487)	(186,955)	24,767,932
(3,596,182)	(186,955)	729,441,103
-	(27,465,727)	8,383,676
<u>\$ (3,596,182)</u>	<u>\$ (27,652,682)</u>	<u>\$ 737,824,779</u>

Book Cost of Plant Retired	Cost of Removal	Salvage, Transfers and Adjustments	Accumulated Depreciation 12/31/09
\$ -	\$ -	\$ -	\$ 37,500
(88,981)	-	-	12,905,946
(7,032)	(36,554)	-	2,516,895
(4,586)	-	-	7,341,301
(7,285)	(18,581)	-	31,696,723
(2,130,187)	(2,446,856)	-	61,780,792
(845,487)	-	-	16,887,847
<u>\$ (3,083,558)</u>	<u>\$ (2,501,991)</u>	<u>\$ -</u>	<u>\$ 133,167,004</u>

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

SUMMARY OF WATER BILLED
DECEMBER 31, 2009

	<u>MILLION GALLONS, TOTAL</u>		<u>MILLION GALLONS, AVG DAILY</u>	
	<u>YEAR 2009</u>	<u>YEAR 2008</u>	<u>YEAR 2009</u>	<u>YEAR 2008</u>
WATER BILLED				
Residential and Domestic	8,668.93	8,241.84	23.75	22.58
Commercial and Industrial	2,857.36	2,964.44	7.83	8.12
Special Rate - Simpson ...	5,540.04	5,817.76	15.18	15.94
Municipal	78.81	72.60	0.22	0.20
Other Public Bldgs and Grounds	548.75	518.08	1.50	1.42
Sales to Other Utilities	847.60	636.84	2.32	1.74
	<u>18,541.49</u>	<u>18,251.56</u>	<u>50.80</u>	<u>50.00</u>

NOTE: For conversion purposes, there are approximately 748 gallons in every 100 cubic feet of water.

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

SUMMARY OF WATER SALES - 2009

WATER SALES	AVERAGE MONTHS BILLED	C. CU. FT.	AMOUNT
RESIDENTIAL AND DOMESTIC SERVICE			
Single and Multiple Houses - Inside City	54,089	5,064,471	\$16,298,502
Multiple Unit Dwellings - Inside City	3,200	1,662,002	3,859,125
Sprinkling Services (Inside and Outside)	404	211,525	559,979
Fire Services (Inside and Outside)	123	1,048	48,752
Single and Multiple Houses - Outside City	31,108	3,624,350	12,878,836
Multiple Unit Dwellings - Outside City	1,753	1,003,029	2,998,172
Total Residential and Domestic Service	90,677	11,566,425	36,643,366
COMMERCIAL AND INDUSTRIAL SERVICE			
High Use Commercial (Inside and Outside)	11	1,190,924	1,476,530
Single and Multiple Buildings - Inside City	3,559	2,059,380	4,777,461
Sprinkling Services (Inside and Outside)	240	184,097	500,226
Fire Services (Inside and Outside)	1,036	12,765	1,828,482
Single and Multiple Buildings - Outside City ...	790	359,187	1,076,379
Total Commercial and Industrial Service	5,636	3,806,353	9,659,078
SERVICES WITH SPECIAL RATE			
Simpson Tacoma Kraft Company	1	7,386,109	4,153,327
MUNICIPAL WATER SERVICES			
Fountains, Buildings and Grounds	175	101,106	322,918
Fire Services	34	1,073	57,349
Total Municipal Water Service	209	102,179	380,267
OTHER PUBLIC BUILDINGS AND GROUNDS			
Single and Multiple Buildings - Inside	178	357,476	797,894
Single and Multiple Buildings - Outside	58	99,663	271,184
Fire Services	81	273,656	578,251
Sprinkling Services	124	1,852	213,782
Total Other Public Buildings and Grounds	441	732,647	1,861,111
SALES TO OTHER UTILITIES - Total	18	1,127,243	1,776,686
Unbilled Revenue			187,966
TOTAL WATER SALES	96,982	24,720,956	\$54,661,801

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATISTICS
AS OF DECEMBER 31, 2009

2009 average daily consumption exclusive of pulp mills . . .	39,390,000	gallons
Average daily consumption--pulp mills	15,220,000	gallons
Total average daily consumption	54,610,000	gallons
2009 maximum daily consumption . . . July 27, 2009	114,200,000	gallons
2009 minimum daily consumption . . . January 15, 2009	33,210,000	gallons
Total water produced in 2009 *	21.3 billion	gallons
Average daily consumption per single family		
residential service	208	
Miles of transmission and wells supply mains -		
28" to 96" diameter (includes North Fork wells system) . . .	141	
Miles of distribution mains - 2" to 24" in diameter	1,198	
Active services	96,983	
Fire hydrants (within the City limits including Ruston) . . .	5,938	

The primary source of Tacoma's water supply is the Green River with replacement from the North Fork wells during periods of excessive river turbidity. The Green River source consists of a 72 MGD water right plus a 27 MGD share of an interruptable, junior water right. A secondary supply, during peak-use periods, of 55 MGD is available from wells in the Tacoma area.

Tacoma's water supply has an excellent record for unsurpassed quality, meeting all the standards of the U.S. Environmental Protection Agency and the Washington State Department of Health.

There are 1,339 miles of mains in the system ranging in size from 2 inches to 96 inches in diameter. Storage facilities are provided at 14 different locations having a total of 10 separate concrete basins or reservoirs and 12 steel standpipes or reservoirs with a combined storage capacity of approximately 181,559,600 gallons. Of this storage capacity, 108,440,100 gallons are located at McMillin Reservoir approximately 14 miles southeast of Tacoma. The amount of water available from this location on demand is limited by the established design capacity of the transmission lines interconnecting it and the City distribution system. Water pressure in the distribution mains ranges from 30 to 125 pounds per square inch.

* Includes water for losses and self-consumption.

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

TAXES AND EMPLOYEE WELFARE CONTRIBUTIONS
FOR THE YEAR 2009

FEDERAL

Social Security (FICA)		\$1,406,217
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STATE OF WASHINGTON

Retail Sales	255,711	
Utilities and Business Activities Tax	2,679,147	
Total		2,934,858

COUNTY

Real Property	10,160	
Total		10,160

MUNICIPALITIES

City of Tacoma Gross Earnings Tax	4,998,197	
City of Lakewood Administrative Fee	4,685	
City of Puyallup Administrative Fee	9,940	
City of University Place Administrative Fee	406,489	
City of Fircrest Administrative Fee	4,923	
		5,424,234

TOTAL TAXES		\$9,775,469
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Taxes as a % of Total Revenues of \$65,949,141		14.82%
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EMPLOYEE WELFARE CONTRIBUTIONS

Industrial Insurance and Medical Aid	\$427,124	
Pensions	1,518,463	
Medical Insurance	2,701,256	
Dental Insurance	367,488	

TOTAL EMPLOYEE WELFARE CONTRIBUTIONS		\$5,014,331
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CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

2009 WATER RATES

METER SIZE		READY TO SERVE CHARGE PER MONTH	
		INSIDE TACOMA	OUTSIDE TACOMA
5/8	inch	\$15.07	\$18.08
3/4	inch	\$21.61	\$27.13
1	inch	\$37.68	\$45.22
1-1/2	inch	\$75.35	\$90.42
2	inch	\$120.56	\$144.67
3	inch	\$226.05	\$271.26
4	inch	\$376.75	\$452.10
6	inch	\$753.50	\$904.20
8	inch	\$1,205.60	\$1,446.72
10	inch	\$1,733.05	\$2,079.66
12	inch	\$2,543.06	\$3,051.67

		CHARGE FOR WATER USED PER MONTH PER 100 CUBIC FEET	
		INSIDE TACOMA	OUTSIDE TACOMA
<u>Residential Service</u>			
Each 100 cubic ft. of water consumption during the winter months of October through May		\$1.230	\$1.476
First 500 cubic ft. of water consumption per month during the summer months of June through September		\$1.230	\$1.476
Each 100 cubic ft. of water consumption over 500 cubic ft. during the summer months of June through September		\$1.538	\$1.878
<u>Commercial and Industrial</u>			
General Service		\$1.275	\$1.530
Large Volume Service (over 65,000 cubic feet annually)		\$1.094	\$1.313
<u>Parks and Irrigation Service</u>			
Each 100 cubic feet of water consumption		\$1.547	\$1.856

City of Tacoma water services are 100% metered.

Where service conditions are considered extraordinary, the Water Division may, with City Council approval, enter into contracts for periods up to 20 years.

Water rates were established by Ordinance No. 27778 and were effective January 19, 2009.

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

2009 FIRE PROTECTION RATES

RATES FOR FIRE PROTECTION SERVICE ON A SEPARATE METER ARE AS FOLLOWS:

METER SIZE	MONTHLY CHARGE	WATER INCLUDED FOR MONTHLY LEAKAGE AND TESTING PURPOSES (100 Cubic Feet)
2 inch	\$16.40	2.99
3 inch	\$23.88	2.99
4 inch	\$39.89	2.99
6 inch	\$89.49	2.99
8 inch	\$159.31	2.99
10 inch	\$249.19	2.99
12 inch	\$398.58	2.99

No charge is made for water used through a fire service in extinguishing fires of incendiary or accidental origin if the customer, at the location where the use occurs, gives written notice to the Division within ten days from the time of such fire. Use of water through a fire service for purposes other than extinguishing fires of incendiary or accidental origin is charged as follows:

MONTHLY CHARGE

12 times the monthly service charge (minimum).

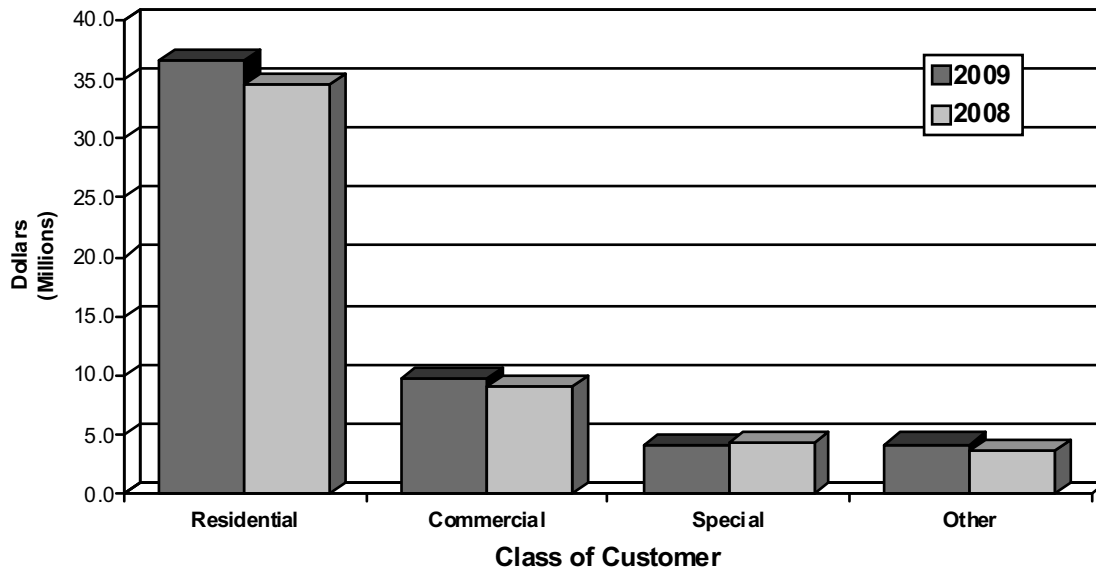
CONSUMPTION

Rates per 100 cubic feet per month \$2.501

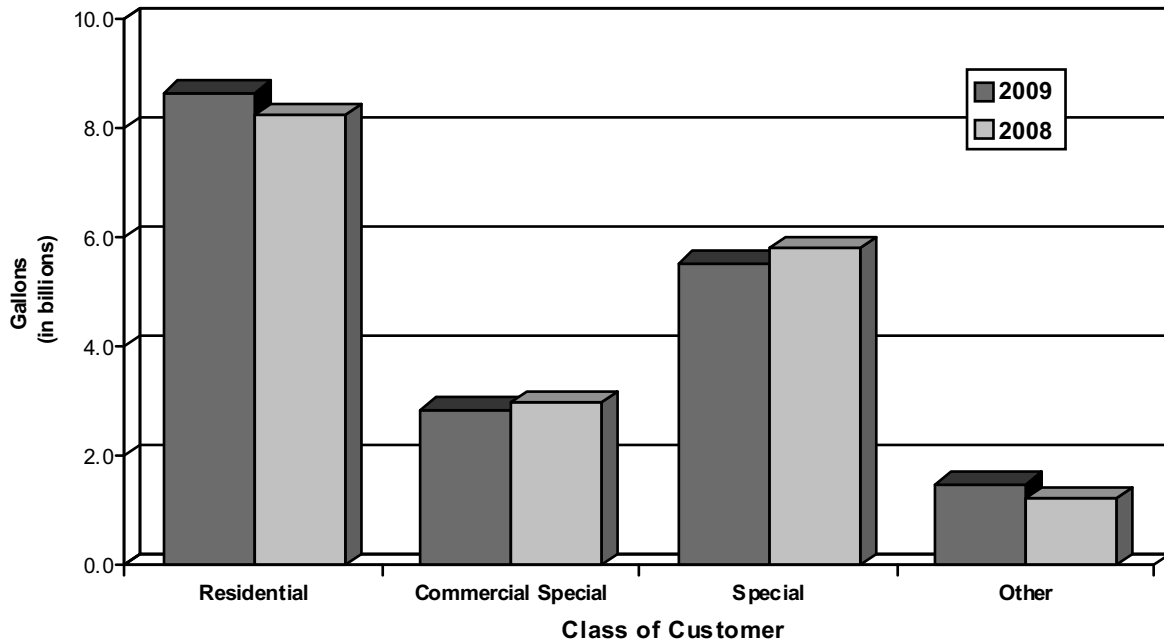
The above rates for fire service shall apply where City water is used for all purposes on such premises exclusive of that amount allowed for testing and leakage.

The Fire Protection Rates were established by Ordinance No. 27778 and were effective January 19, 2009.

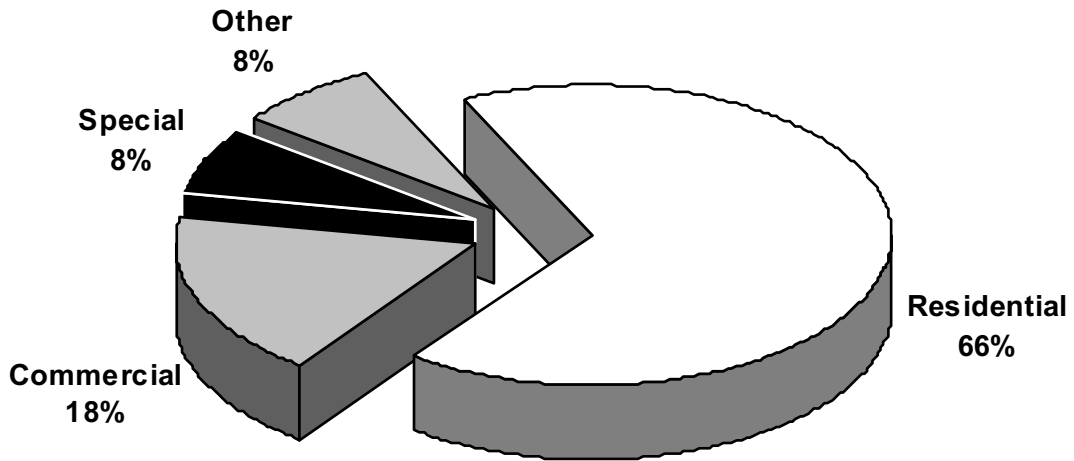
WATER SALES
Year to Date - December 2009 & 2008



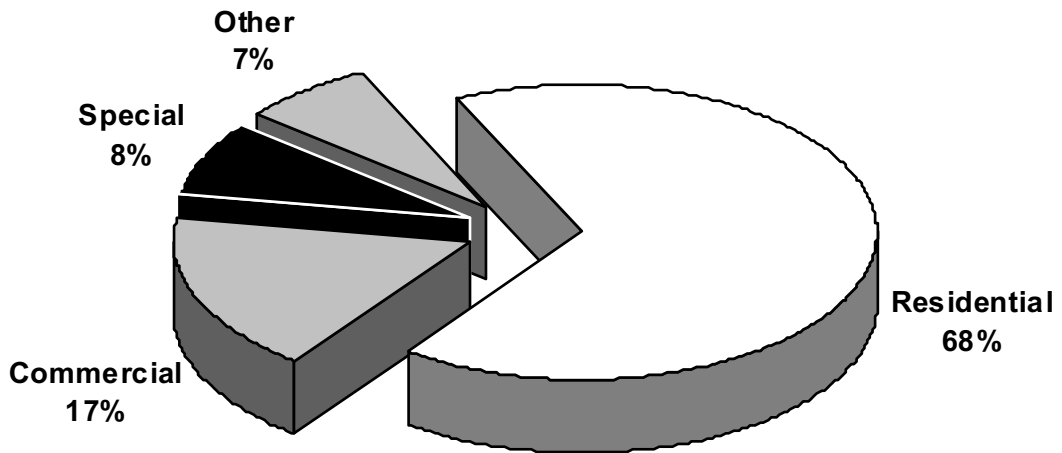
WATER CONSUMPTION
Year to Date - December 2009 & 2008



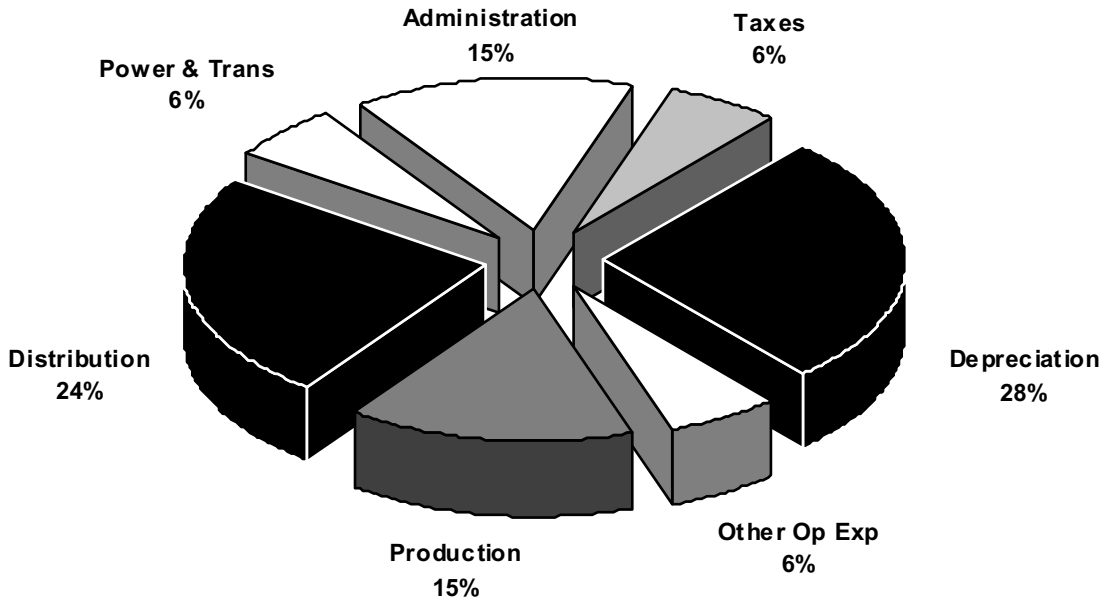
WATER SALES
Year to Date - December 2009
(\$54,661,801)



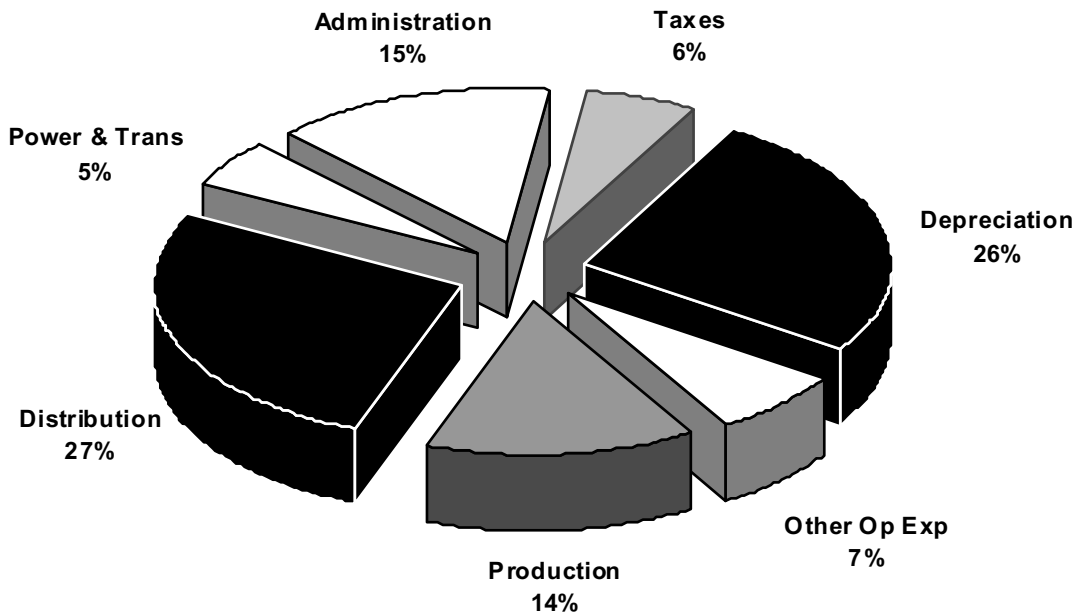
WATER SALES
Year to Date - December 2008
(\$51,642,227)



TOTAL OPERATING EXPENSES *
Year to Date - December 2009
(\$50,994,573)

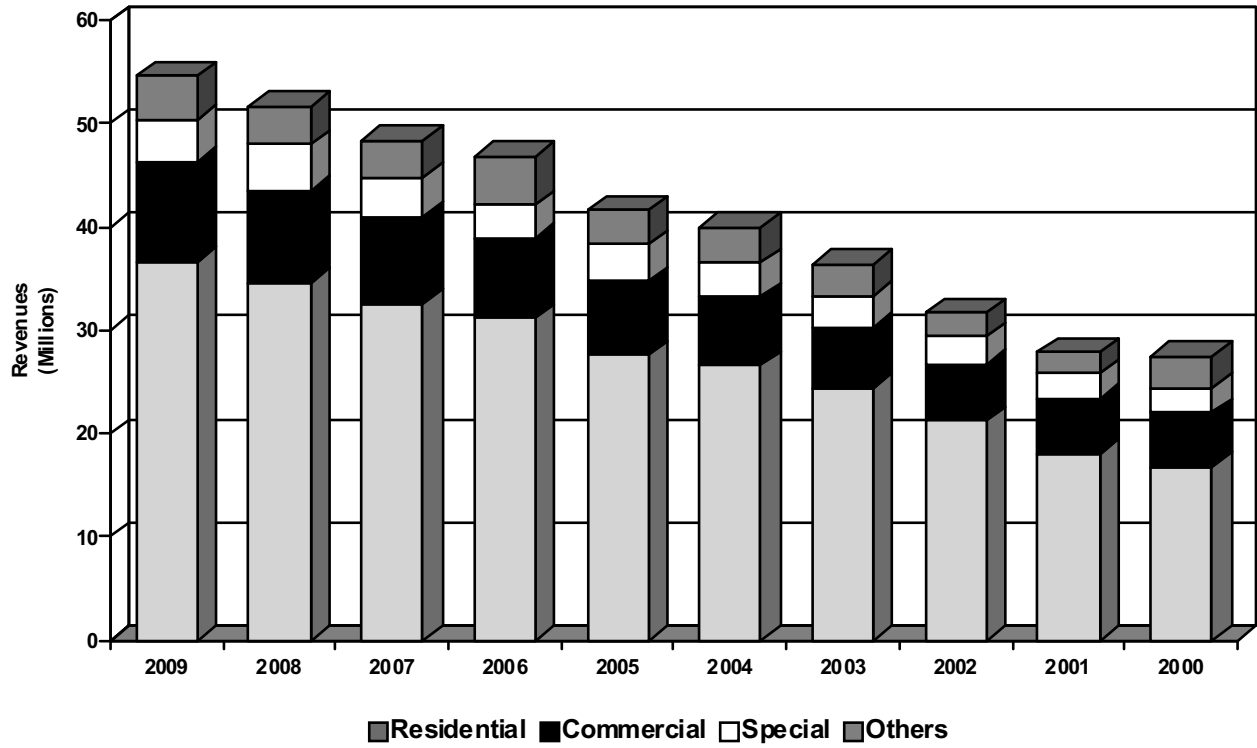


TOTAL OPERATING EXPENSES *
Year to Date - December 2008
(\$49,286,084)

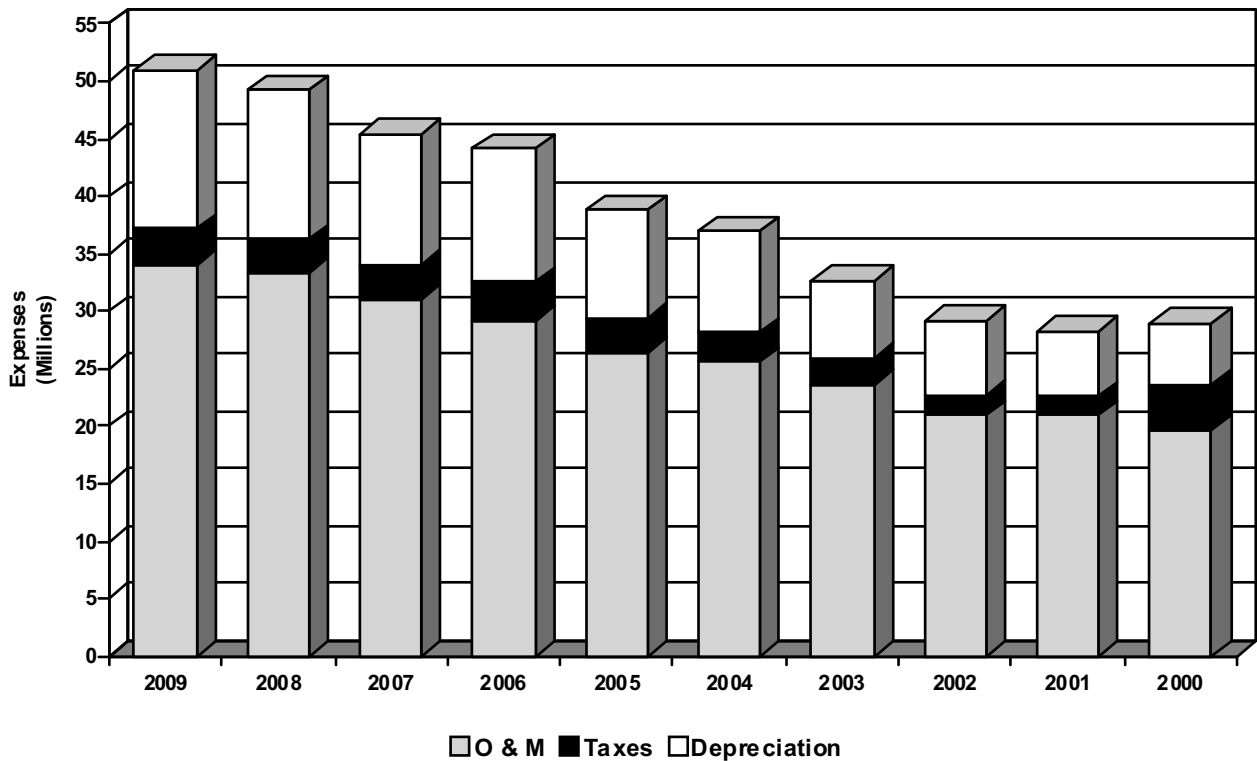


* City Gross Earnings Taxes are not included in Total Operating Expenses.

TEN-YEAR SUMMARY OF WATER SALES



TEN-YEAR SUMMARY OF OPERATING EXPENSES



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SUPERINTENDENT'S REPORT 2009

During 2009, Tacoma Water continued to focus on its mission to protect public health, support the economy of the region, enhance the quality of life of our customers and fulfill our role as an environmental steward of the substantial natural resources entrusted to our use. Progress was made in many areas in spite of revenue issues such as a significant downturn in development resulting in fewer hookup fees and system development charges and lower water sales than were projected.

Protecting public health by providing safe drinking water was advanced by planning for future treatment of the Green River and in-town groundwater sources as required by federal and state regulations. Support of the economy throughout the region was accomplished through the delivery of reliable supply at a competitive rate and by participation in numerous infrastructure projects including Sound Transit and urban redevelopment projects in various locations in Tacoma. Quality of life of our customers was furthered through the development of an Asset Management Program designed to protect their water system infrastructure investment along with providing a level of service they expect. Pursuit of our environmental commitments in 2009 included participation in multi-jurisdictional and multi-stakeholder committees working to restore habitat for threatened salmon populations in the Green/Duwamish watershed.

Water sales revenue in 2009 was down approximately 3% from the forecast, but would have been considerably worse if not for a heat wave in July that resulted in higher than expected sales. Of more significance this year was the slowdown in development. As a result Tacoma Water staff assigned to respond to development projects were reassigned to needed system renewal and replacement work. Additionally, many positions were left vacant and expenses monitored and limited to assure expenditures were less than revenues for the year.

Employees performed exceptionally well in 2009. Even though staffing was down, considerable accomplishments were achieved. The year started with a storm and record flooding in the area. An extraordinary response from staff kept water flowing to customers. The year ended with a freeze that caused frozen pipes and plumbing resulting in hundreds of calls for service. Tacoma Water staff worked around the clock to respond quickly and efficiently. Mid-2009, a reorganization was adopted throughout the division to better align key functions and provide a more focused attention on financial management within Tacoma Water. Tacoma Water's Pipe Tapping Team became the national champions at the American Water Works Association National Conference with the first ever flawless performance and fastest time. Finally, a Quality Team of Water employees researched and developed an employee recognition program. The awards program is focused on advancing Tacoma Water's Leadership Principles. The program will begin implementation in 2010.

Tacoma Water entered into an agreement to wheel water between Lakewood Water District and Rainier View Water Company. This wheeling arrangement assures Rainier View, an existing wholesale customer

of Tacoma Water, will purchase wholesale water from Tacoma before purchasing water from Lakewood. Additionally, it generates revenue from existing infrastructure without having any detrimental service impacts to Tacoma customers. Other policy issues addressed during the year include further discussion of take or pay rate for wholesale customers and the opportunity to partner with Tacoma Public Works Environmental Services Division on reuse.

Water Resource Planning

The Resource Planning section structure was revised in July 2009 in support of the larger Tacoma Water reorganization to provide improved alignment and focus in key areas. The section, restructured to include resource planning, water conservation, and engineering planning units, implemented programs in 2009 which further the mission and goals of Tacoma Water as generally described below.

Planning for the Future

Water Resource Planning staff participated in the County's effort to update the Pierce County Coordinated Water System Plan: a state required plan. Tacoma Water updated the water demand forecast extending it from 2040 to 2060 to facilitate conversations with the Cascade Water Alliance regarding long range supply options. Tacoma Water's 2009-2018 Business Plan and Performance Management Program were formally communicated with staff in 2009. Finally, Tacoma Water took significant steps in 2009 with our Asset Management Program. Through an engagement with CH2M Hill, Tacoma Water participated in a Blue Ribbon panel of top asset management practitioners, trained staff on advanced asset management concepts, participated in an operations survey at our headworks treatment facilities, and completed a framework and roadmap for program implementation.

Ensuring Future Supplies

In 2009, Tacoma Water continued its partnership with Tacoma Power to implement the clothes washer rebate program and the conservation leave behind kit associated with the refrigerator-recycling program. Tacoma Water partnered with TPU grounds maintenance to install weather-based irrigation controllers on TPU properties to study and determine the water saving potential of this technology. In 2009, Tacoma Water implemented its annual summer water conservation public awareness campaign "Watering too much?" The campaign included general advertising as well as a mailed conservation packages to the top 10% of residential summer water users.

Additional educational efforts included public events, presentations, workshops, youth education, the creation of new brochures, and further development of the EnviroHouse. An educational sign was developed and installed at the new Ben Gilbert Park north of the Tacoma Municipal Building to promote water wise landscaping. Through public events and workshops over 6,000 customers were reached. Approximately 4,000 conservation related items such as water conservation kits and shower timers were given away. Tacoma Water continues to work with Community/Media Services to provide articles

about water conservation in the quarterly U* newsletter, and to redevelop webpage content for the TPU website.

Engineering Planning

Water's SAP group has supported, as well as participated in, the successful implementation of Phase I of the Mobile Solution 2009 technical software upgrade. Phase II of the Mobile Solution upgrade will be completed by March 2010. This upgrade covers the reformatting and consolidation of existing work order completion forms. In addition, Phase II will clean up job codes by deletion or deactivation of the unused codes.

Tactical recommendations regarding acquiring King and Pierce County data presented in the 2008 GIS analysis by Enspira Solutions, Inc., were implemented in 2009. The King County GIS data was acquired in 2009 and Tacoma Water has started mapping our distribution infrastructure in SW King County. In addition, Pierce County GIS data conversion issues in place since 2007 have been resolved and Pierce County GIS data is being updated.

The Planning group supported Tacoma Water in 2009 with infrastructure replacement analysis in response to the economic downturn. The group additionally supported City of Tacoma economic development efforts in 2009 including the McMenamins-Elks Building, Frank Russell Sites, LeMay Car Museum, Port of Tacoma YTTI Terminal, Andersen High Rise, Beacon Senior Center, SSA/Puyallup Terminal, and Point Ruston Development. The planning group also provided hydraulic modeling support for not only planned capital work but as a tool to analyze developing situations with existing infrastructure such as the chlorine residual issue in the McKinley area.

Regional Water Supply System

Although the Regional Water Supply System was established as a separate system from Tacoma Water, year 2009 marks the first time since operations began in 2005 that the Regional Water Supply System had a separate budget, making the preparation of monthly budget to actual reports possible. A rating review on the Regional Water Supply System was conducted by Standard & Poor's during 2009 which resulted in a rating increase to AA from AA-.

To address the Department of Revenue's decision that capital contributions received by Tacoma from our Project Partners are subject to a 1.5% business and operations tax, Tacoma filed a Complaint for Tax Refund and Notice of Appeal with the Thurston County Superior Court. A trial date of October 2010 has been established for the Appeal.

Relationships with our Project Partners remain strong. Monthly Project Committee meetings continued, with the Project Committee approving two amendments to the Partnership Agreement and the 2010 O&M and capital budget during 2009. Monthly meetings with the Army Corps of Engineers and the Partners began in 2009 to improve the lines of communication on capital project and financial issues associated with the Howard Hanson Dam Additional Water Storage Project. The Operations Committee

continued to meet during 2009 to coordinate and communicate on Regional Water Supply System operations issues and our Project Partners were actively engaged in Tacoma's Water Treatment decision-making process.

The Partners used water stored with the Hanson Dam Additional Water Storage project during the 2009 peak demand time. Only half of the stored water was available in 2009 due to dam safety issues.

Water Supply

The Water Supply section made progress in 2009 on its mission of operating, maintaining and improving the infrastructure that forms Tacoma's water supply system.

Infrastructure construction

The construction contract for the McMillin Reservoir Replacement Project was awarded and construction began in the latter part of 2009. This major project will replace the last of our open reservoir basins with two large covered concrete tanks. The construction of Phase 1 of the replacement of Pipeline 1 at the Puyallup River was completed and the pipeline placed in service. Extensive Supervisory Control and Data Acquisition (SCADA) system improvements were completed at several key facilities as was the installation of several new external corrosion control facilities.

Infrastructure design

Design and permit work continued on Phase 2 of the Pipeline 1 replacement project at the Puyallup River. This phase replaces the bridge crossing with a pipeline under the river, and also replaces a long section of pipeline located on piers over a wetland. Several other major projects were at various stages of design during 2009. These include the relocation of Pipelines 2 and 4 where they cross Sound Transit right-of-way, a new well facility, modifications to Pipelines 1 and 2 to accommodate McMillin Reservoir replacement and a new 1.5 MW generator installation to serve as standby power for the North Fork well field. We also continued with planning for new microwave and radio communications facilities to strengthen the reliability and redundancy of communications within our service area and between our outlying facilities.

Operations & maintenance

Due to dam safety issues at the Corps of Engineers' Howard Hanson Dam, Tacoma was only able to store about half as much water as would normally be stored for summer supply needs. This required additional use of the South Tacoma and other wellfields, in particular during the unusually hot weather that occurred during July and August. Even with the reduced storage at Hanson Dam and the higher than usual summer demands, Tacoma was able to satisfactorily provide its customers with the water they needed.

Supply staff actively participated in the initial development phase of the Division's asset management program. Staff also successfully responded to emergency conditions created by the January flood and maintained service to customers during this challenging event.

In addition to operating and maintaining Tacoma Water's transmission and supply system, the section also coordinates operation and maintenance of the transmission system supplying the Regional Water Supply System partnership. Success in these activities requires close interaction with a wide variety of stakeholders including regulators, resource agencies, tribes, project partners, interest groups and the general public.

Financial Management and Rates

Bonds to finance a portion of the capital projects in the 2007/2008 and 2009/2010 biennial budgets were sold in the fall of 2009. The bonds were sold through a negotiated sale process in order to take advantage of the federal government's Build American Bonds program, which provided a very low net cost of 3.78%. The review by bond rating agencies conducted as part of that bond sale confirmed Tacoma Water's Standard & Poor's rating of AA and the Moody's rating of Aa3. These are considered excellent bond ratings for a Washington utility.

Financial performance measures were identified as part of the financial dashboard development. These measures will be updated quarterly on a Water SharePoint site.

Standardized financial reporting was implemented for the water management team on a monthly basis. Quarterly financial updates were provided to the TPU management and the Public Utility Board.

A financial management effectiveness Quality Action Team was formed in early 2009. Recommendations to management upon completion of the first phase were the identification of top priority financial topics, with documentation and a training plan for each subject matter area.

In response to the 2008 Washington State Supreme Court ruling Tacoma Water removed public fire protection costs from its rate structure and billed nine various government agencies for these services. Six of the agencies have objected to the billing and have not paid for the services. In June 2009, a lawsuit was filed in Pierce County Superior Court to have Tacoma Water's legal rights determined.

Distribution Operations

Due to the economic downturn and subsequent dramatic slowdown in developer paid for work, 2009 was a year of changes for the Distribution Operations Section. As a result of the revenue shortfall from development, crews were reassigned to perform renewal and replacement work in the distribution system. Significant upgrades to hydrants, water services and mains of poor condition and inadequate

capacity were made. Additionally, expenses were controlled through not filling vacant positions, resulting in a reduction of 12.5 FTE's, including one construction crew and various other positions.

Fleet

Distribution Operations undertook a comprehensive vehicle review with the assistance of Fleet. Replacement funding was cancelled for 11 vehicles that were determined to be fully funded for a savings of \$45,000 in 2009 and more in 2010. Additionally, eight vehicles were determined to be excess and were decommissioned saving further administrative and maintenance costs.

The process for purchasing step vans for crews was reevaluated and changed to standardize the process and require less customization. The new step vans run on bio-diesel and have an upgraded load capacity. Previous step vans were overloaded for their engine size resulting in more wear and tear and a shorter life. The new step vans have back-up cameras for increased safety. Standardized configurations were created for the type of work being done. This eliminated costly customization after the vehicles were received.

The office pool Ford Expedition was replaced with a Ford Escape Hybrid.

Operations and Maintenance

The meter group kept pace with previous years periodic meter replacements and testing program. Meter staff aided the Automated Meter Reading pilot by trouble shooting non-reporting transmitters and optimizing signal strength. New meter technology was tested including a new turbine meter brand from Sensus, as well as a fire rated meter from Hersey.

The fire hydrant maintenance program has increased production from 3,700 hydrants checked and maintained in 2008, to over 4,800 in 2009. Notifications tracked through SAP are used to verify the performance of fire hydrants, as well as report unaccounted for water in the Distribution System. The increased maintenance activities are making a significant impact on the number of needed hydrant repairs in the water system. In 2009, the section completed 17 repairs, half as many performed the previous year. Water Distribution Operations is very committed to maintaining a high level of reliability for fire hydrants.

Systematic flushing, a program of opening hydrants under controlled, high velocity flows, is an essential maintenance program that provides improved water quality throughout the system. This marks the third consecutive year of increased productivity since adding a second crew. In addition to flushing, these crews provided support for water main shutdowns and projects. A considerable improvement in reliability of valve function has occurred due to the flushing crews exercising valves and identifying operational issues they find.

Water Quality

The Water Quality section moved forward on several fronts in 2009 to enhance the protection of public health, and further support Tacoma Water's mission. These are briefly discussed in the following sections.

Our major decision

A significant effort in 2009 was the development of technical material and community outreach to enable a decision on how best to further treat the Green River supply to meet new drinking water regulations. Working together with TPU Community & Media Services, and an external consultant team, this project involved scoping alternatives, developing costs and rate impacts, and communicating the important risks and tradeoffs inherent in the decision. Key stakeholder groups were involved, and a diverse range of public feedback was gathered. This work has positioned the Public Utility Board to make a challenging decision in 2010 – one that has generational implications.

Our other major water resource

Planning for groundwater treatment continued in 2009, with predesign work for the in-town groundwater facilities at the Hood St. Reservoir and at the South Tacoma Pump Station completed. Methods of improving fluoridation, corrosion control at both sites, and additionally chlorination at Hood St. have been identified. Conceptual layouts of solutions have been provided, along with cost estimates. Decisions on proceeding with implementation will be made in 2010.

Aligning the Section

Section organization changed significantly with the movement of the Environmental Stewardship group into the Water Quality Section, allowing improved coordination with Watershed Management. The Water Quality Section now has five defined groups along functional lines: Engineering & In-town Operations and Maintenance, Regulatory Compliance, Watershed Management, Environmental Stewardship and Green River Headworks Treatment. These groups support each other, and ensure we meet our multiple objectives.

Meeting expectations

Our staff is ever-aware that the confidence of our customers in their water supply is hard-won, and easily lost, and that professionalism and timeliness of response when they have a concern is critical. In 2009 we implemented a new way of measuring our success – ensuring that our customers who call with a concern about their water quality get a very rapid response. We exceeded our established goal of responding to at least 98% of all Water Quality calls on the same day.

We continued our strong record of active system surveillance through water quality testing, and uninterrupted regulatory compliance. Treatment plant maintenance continued and improved, utilizing SAP based maintenance work orders for the first time, helping us along the path of better documenting the historically excellent care we have invested in our operating infrastructure.

Preserving Our Natural Environment

Environmental Stewardship staff implemented or completed a number of projects to protect and improve fish and wildlife habitat, and protect water quality in the Green River watershed. The group completed the replacement of key fish blockage culverts through the construction of new bridges. The group focused on meeting the Water Division's aggressive environmental obligations embodied in our Habitat Conservation Plan (HCP). Through direct efforts or cooperative agreements, research on the fate of large woody debris in the middle Green River was completed – this represents important habitat enhancement in the Green River system. A study documenting the impacts of the Tacoma Water Headworks Dam reconstruction on downstream juvenile fish passage was completed, and successfully demonstrated that key design parameters used for the dam are safe for fish. Monitoring and maintenance continued for wetlands established as part of the Second Supply project, and a milestone Five Year report for the HCP was completed for review.

Distribution Engineering

Infrastructure

The Capital Engineering group worked on many large replacement projects in 2009 including completion of the Broadway LID, the final phase of Salishan, and Phase 2 of our Galvanized Main Replacement project. Distribution Engineering's capital replacement projects, a combination of main replacement and public road projects, included 5.2 miles of new pipe in 2009. Several municipal projects containing distribution main were delayed resulting in a reduction of main constructed in 2009 compared to 12 miles in 2008. We anticipate a significant amount of main construction in 2010. In addition to replacement activities, construction was completed on 21 private contracts in 2009, resulting in 2.7 miles of new main added to Tacoma Water's distribution system paid for by private development. A direct reflection of the recession is the reduction in private contracts which is 42 percent below our five year average of 36 and 73 percent below the 11.45 miles of new main constructed in 2008.

Private Development Support

In 2009 the Customer Support group completed design on 19 private contracts, down from 36 in 2008. Pierce County water availability requests for service fell to 227, 22 percent below the previous year and 48 percent below the five year average. Plan checks, including tenant improvements and new commercial and industrial development, dropped to 66. This is 56 percent below the previous year and 72 percent below the 5 year average.

Total Quality

Distribution Engineering sponsored and participated in two Total Quality teams in 2009. The first team reviewed our drafting standards to look for ways to improve efficiency consistency, reducing revisions and omissions. The second team was a continuation of the review of combination fire services in light of changing requirements and liability.

APPENDIX D

FORM OF OPINION OF BOND COUNSEL

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[FORM OF APPROVING LEGAL OPINION]

City of Tacoma, Washington

Re: City of Tacoma, Washington,
\$29,100,000 Water System Revenue Refunding Bonds, 2010A and
\$74,985,000 Water System Revenue Bonds, 2010B (Taxable Build America Bonds – Direct
Payment)

We have served as bond counsel to the City of Tacoma, Washington (the “City”), in connection with the issuance of the above-referenced Water System Revenue Refunding Bonds, 2010A (the “2010A Bonds”) and Water System Revenue Bonds, 2010B (Taxable Build America Bonds – Direct Payment) (the “2010B Bonds,” and together with the 2010A Bonds, the “Bonds”), and in that capacity have examined such law and such certified proceedings and other documents as we have deemed necessary to render this opinion. As to matters of fact material to this opinion, we have relied upon representations contained in the certified proceedings and other certifications of public officials furnished to us, without undertaking to verify the same by independent investigation.

The Bonds are issued by the City pursuant to Ordinance No. 27902 and Substitute Resolution No. 38088 (together, the “Bond Ordinance”) to provide the funds to (a) pay part of the cost of constructing capital improvements to the Water System; (b) refund certain outstanding bonds; (c) provide for a reserve for the Bonds; and (d) pay the costs of issuance of the Bonds, all as set forth in the Bond Ordinance.

For as long as any of the Bonds are outstanding, the City irrevocably has pledged to set aside from the Gross Revenue of the Water System and to pay into the “Water Revenue Bond Fund of the Water Division Fund” (the “Bond Fund”) the various amounts required by the Bond Ordinance to be paid into and maintained in such Bond Fund within the times provided by the Bond Ordinance. The Bonds are special limited obligations of the City and are not obligations of the State of Washington or any political subdivision thereof other than the City, and neither the full faith and credit nor the taxing power of the City or the State of Washington is pledged to the payment of the Bonds.

Reference is made to the Bonds and the Bond Ordinance for the definitions of capitalized terms used and not otherwise defined herein.

We express no opinion herein concerning the completeness or accuracy of any official statement, offering circular or other sales or disclosure material relating to the issuance of the Bonds or otherwise used in connection with the Bonds.

Under the Internal Revenue Code of 1986, as amended (the “Code”), the City is required to comply with certain requirements after the date of issuance of the 2010A Bonds in order to maintain the exclusion of the interest on the 2010A Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of 2010A Bond proceeds and the facilities financed or refinanced with 2010A Bond proceeds, limitations on investing gross proceeds of the 2010A Bonds in higher yielding investments in certain circumstances and the arbitrage rebate requirement to the extent applicable to the 2010A Bonds. The City has covenanted in the Bond Ordinance to comply with those requirements, but if the City fails to comply with those requirements, interest on the 2010A Bonds could become taxable retroactive to the date of issuance of the 2010A Bonds. We have not undertaken and do not undertake to monitor the City’s compliance with such requirements.

Based upon the foregoing, as of the date of initial delivery of the Bonds to the purchaser thereof and full payment therefor, it is our opinion that under existing law:

1. The City is a duly organized and legally existing first-class city under the laws of the State of Washington;

2. The Bonds have been duly authorized and executed by the City and are issued in full compliance with the provisions of the Constitution and laws of the State of Washington and the ordinances of the City relating thereto;

3. The City has irrevocably bound itself to set aside and pay into the Bond Fund and the Reserve Account therein out of Net Revenue of the Water System, amounts necessary to pay the principal of and interest on the Bonds as the same become due.

4. The City has pledged that the payments to be made into the Bond Fund and the Reserve Account out of Gross Revenue of the Water System shall be a lien and charge thereon equal in rank to the lien and charge upon such Revenue of the amounts required to pay and secure the payment of the Outstanding Parity Bonds and any water system revenue bonds of the City hereafter issued on a parity with the Bonds, and superior to all other liens and charges except the Cost of Operation and Maintenance of the Water System and payments pursuant to Contract Resource Obligations. The City has reserved the right to issue Future Parity Bonds on the terms set forth in the Bond Ordinance.

5. Assuming compliance by the City after the date of issuance of the 2010A Bonds with applicable requirements of the Code, the interest on the 2010A Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals; however, while interest on the 2010A Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the 2010A Bonds received by corporations is to be taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations, interest on the 2010A Bonds received by certain S corporations may be subject to tax, and interest on the 2010A Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. We express no opinion regarding any other federal tax consequences of receipt of interest on the 2010A Bonds.

6. Interest on the 2010B Bonds is not excludable from gross income for federal tax purposes.

This opinion is given as of the date hereof, and we assume no obligation to revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention, or any changes in law that may hereafter occur.

We bring to your attention the fact that the foregoing opinions are expressions of our professional judgment on the matters expressly addressed and do not constitute guarantees of result.

Respectfully submitted,

FOSTER PEPPER PLLC

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