

**NEW ISSUE
FULL BOOK-ENTRY**

**RATINGS: Moody's: Aa2
S&P: AA
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 Bonds, interest on the 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 Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the 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 the Bonds received by certain S corporations may be subject to tax, and interest on the Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. Receipt of interest on the Bonds may have other federal tax consequences for certain taxpayers. See "TAX MATTERS."



**\$78,305,000
CITY OF TACOMA, WASHINGTON
Water System Revenue and Refunding Bonds, 2013**

DATED: Date of Delivery

DUE: December 1, as shown on the inside cover

The City of Tacoma, Washington (the "City"), Water System Revenue and Refunding Bonds, 2013 (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 denominations of \$5,000 or any integral multiple thereof within a single maturity. 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 December 1, 2013, 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 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" 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 Parity 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 \$241,115,000 of outstanding Water System revenue bonds, of which \$25,285,000 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 \$47,840,000 Regional Water Supply System Revenue Bonds, 2010A and 2010B (Taxable Build America Bonds—Direct Payment), of which Tacoma Water is responsible for \$32,925,000 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), and \$64,795,000 Regional Water Supply System Revenue Refunding Bonds, 2013 (collectively, the "Regional Supply System Bonds"), of which Tacoma Water will be responsible for paying \$35,840,000 of the principal, plus interest. 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. 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 May 7, 2013.

Dated April 23, 2013

MATURITY SCHEDULE, INTEREST RATES, YIELDS AND CUSIP NUMBERS

\$78,305,000 **WATER SYSTEM REVENUE AND REFUNDING BONDS, 2013**

| <u>Due December 1</u> | <u>Amount</u> | <u>Interest Rate</u> | <u>Yield</u> | <u>CUSIP No. *</u> |
|---------------------------|---------------|--------------------------|--------------|------------------------|
| 2013 | \$ 2,970,000 | 2.00% | 0.20% | 873547HQ9 |
| 2014 | 980,000 | 2.00 | 0.35 | 873547HR7 |
| 2041 | 23,820,000 | 4.00 | 3.60** | 873547HS5 |

\$50,535,000 4.00% Term Bond due December 1, 2043, initial reoffering yield of 3.65%^{**}; CUSIP No. 873547HU0^{*}

* Copyright © 2013 CUSIP Global Services. The CUSIP numbers are included for convenience of the holders and potential holders of the Bonds. CUSIP is a registered trademark of the American Bankers Association. CUSIP Global Services (CGS) is managed on behalf of the American Bankers Association by Standard & Poor's. 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.

* Priced to the June 1, 2023 par call date.

No dealer, broker, salesperson, or other person has been authorized by the City to give any information or to make any representations with respect to the Bonds other than those contained in this Official Statement and, if given or made, such information or representations must not be relied upon. 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.

The information set forth herein has been obtained from sources that are believed to be current and reliable. The City, however, makes no representation regarding the accuracy or completeness of the information in Appendix B—“BOOK-ENTRY SYSTEM,” which has been obtained from DTC’s website. Estimates and opinions should not be interpreted as statements of fact. Summaries of documents do not purport to be complete statements of their provisions and such summaries are qualified by references to the entire contents of the summarized documents. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made by use of this Official Statement shall, under any circumstances, create any implication that there has been no change in the affairs of the City since the date hereof.

In connection with the offering of the Bonds, the purchaser may overallocate or effect transactions which stabilize or maintain the market price of the Bonds at levels above those which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued or recommenced at any time.

The presentation of certain information, including tables of receipts from revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of the City or Tacoma Water. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue to be repeated in the future.

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.

This Official Statement contains forecasts, projections and estimates that are based upon expectations and assumptions that existed at the time such forecasts, projections and estimates were prepared. In light of the important factors that may materially affect economic conditions in the City, the inclusion in this Official Statement of such forecasts, projections and estimates should not be regarded as a representation by the City that such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or as guarantees of results.

If and when included in this Official Statement, the words “plan,” “expect,” “forecast,” “estimate,” “budget,” “project,” “intends,” “anticipates” and similar words are intended to identify forward-looking statements, and any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those projected. These forward-looking statements speak only as of the date they were prepared.

The Bonds will not be registered under the Securities Act of 1933, as amended, in reliance upon an exception contained in such act.

TACOMA PUBLIC UTILITIES
3628 South 35th Street
Tacoma, Washington 98409
(253) 502-8512

MAYOR AND TACOMA CITY COUNCIL

Marilyn Strickland, Mayor

Marty Campbell, Deputy Mayor
David Arthur Boe
Anders Ibsen
Joe Lonergan

Ryan N. Mello
Robert Thoms
Lauren Walker
Victoria Woodards

PUBLIC UTILITY BOARD

Laura Fox, Chair
David Nelson, Vice Chair
Woodrow Jones, Secretary
Bryan Flint
Mark Patterson

DEPARTMENT OF PUBLIC UTILITIES, TACOMA WATER

William A. Gaines, Director of Utilities, Chief Executive Officer
Linda McCrea, Superintendent of Water Division
Heather Pennington, Deputy Water Superintendent, Asset and Information Manager
Chris McMeen, Deputy Water Superintendent, Water Quality Manager
Sean Senescall, Rates and Financial Planning Manager
Glen George, Water Supply Manager
Raymond West, Distribution Operations Manager
Tony Lindgren, Water Distribution Engineering Manager

CERTAIN CITY ADMINISTRATIVE STAFF

T.C. Broadnax, City Manager
Andrew Cherullo, Finance Director
Teresa Sedmak, City Treasurer
Elizabeth A. Pauli, City Attorney

BOND AND DISCLOSURE COUNSEL

Foster Pepper PLLC
Seattle, Washington

FINANCIAL ADVISORS

A. Dashen & Associates
Bellevue, Washington

SDM Advisors Inc.
Mount Vernon, Washington

INDEPENDENT AUDITORS

Moss Adams LLP
Portland, Oregon

TABLE OF CONTENTS

| <u>Page</u> | <u>Page</u> |
|---|-------------|
| INTRODUCTION..... | 1 |
| DESCRIPTION OF THE BONDS..... | 2 |
| General..... | 2 |
| Optional Redemption..... | 2 |
| Mandatory Redemption..... | 2 |
| Partial Redemption..... | 3 |
| Notice of Redemption..... | 3 |
| Purchase for Cancellation..... | 3 |
| Book-Entry System..... | 3 |
| Termination of Book-Entry System..... | 4 |
| Defeasance..... | 4 |
| PURPOSE AND APPLICATION OF BOND | |
| PROCEEDS..... | 4 |
| Refunding Plan..... | 5 |
| Sources and Uses..... | 5 |
| SECURITY FOR THE BONDS..... | 6 |
| Pledge of Revenues..... | 6 |
| Flow of Funds..... | 6 |
| Rate Covenant..... | 7 |
| Reserve Account..... | 7 |
| The Reserve Insurance Policies and Reserve | |
| Account Balance..... | 8 |
| Rate Stabilization Account..... | 9 |
| Additional Obligations..... | 9 |
| Additional Covenants..... | 10 |
| Permitted Investments..... | 10 |
| No Acceleration..... | 10 |
| DEBT SERVICE REQUIREMENTS AND | |
| ADDITIONAL BORROWING..... | 11 |
| Additional Borrowing..... | 12 |
| THE CITY..... | 12 |
| THE DEPARTMENT OF PUBLIC | |
| UTILITIES—TACOMA WATER..... | 12 |
| Overview..... | 12 |
| Tacoma Water—General..... | 13 |
| Service Area..... | 13 |
| Management..... | 16 |
| Budgetary Policies..... | 16 |
| Auditing..... | 17 |
| Retirement System..... | 17 |
| Other Post-Employment Benefits..... | 19 |
| Taxation..... | 19 |
| Program of Insurance..... | 19 |
| Financial Policies..... | 19 |
| Labor Relations..... | 20 |
| Investments..... | 20 |
| THE WATER SYSTEM..... | 21 |
| Sources of Supply..... | 21 |
| Water Rights..... | 22 |
| The Second Supply System..... | 23 |
| Endangered Species Act Compliance..... | 26 |
| Agreement with Muckleshoot Tribe..... | 26 |
| Water Quality and Treatment..... | 27 |
| Water System Security..... | 27 |
| Water System Operations..... | 28 |
| Customers, Water Sales, and Rates..... | 30 |
| Special Contracts and Wholesale | |
| Agreements..... | 30 |
| Agreement with Cascade Water Alliance..... | 30 |
| Water Rates..... | 30 |
| Public Fire Protection Costs..... | 33 |
| CAPITAL IMPROVEMENT PROGRAM..... | 33 |
| HISTORICAL OPERATING RESULTS - | |
| TACOMA WATER AND SECOND | |
| SUPPLY SYSTEM..... | 34 |
| Historical Revenue and Expenses..... | 34 |
| GENERAL AND ECONOMIC | |
| INFORMATION..... | 37 |
| LITIGATION CONCERNING THE BONDS | |
| AND TACOMA WATER..... | 41 |
| TAX MATTERS..... | 42 |
| Tax Exemption..... | 42 |
| Certain Other Federal Tax Consequences..... | 43 |
| DESCRIPTION OF RATINGS..... | 44 |
| UNDERWRITING..... | 44 |
| FINANCIAL ADVISORS..... | 44 |
| APPROVAL OF COUNSEL..... | 44 |
| CERTAIN INVESTMENT | |
| CONSIDERATIONS..... | 44 |
| Initiative and Referendum..... | 44 |
| Limitations on Remedies..... | 45 |
| Municipal Bankruptcies..... | 45 |
| Seismic and Other Considerations..... | 45 |
| CONTINUING DISCLOSURE | |
| UNDERTAKING..... | 45 |
| Prior Compliance with Continuing | |
| Disclosure Undertakings..... | 47 |
| MISCELLANEOUS..... | 47 |
| SUMMARY OF THE BOND | |
| ORDINANCE..... | Appendix A |
| BOOK-ENTRY SYSTEM..... | Appendix B |
| 2011 AND 2012 AUDITED FINANCIAL | |
| STATEMENTS..... | Appendix C |
| FORM OF OPINION OF BOND | |
| COUNSEL..... | Appendix D |

(THIS PAGE INTENTIONALLY LEFT BLANK)

OFFICIAL STATEMENT

CITY OF TACOMA, WASHINGTON

\$78,305,000

WATER SYSTEM REVENUE AND REFUNDING BONDS, 2013

INTRODUCTION

The City of Tacoma, Washington (the “City” or “Tacoma”) furnishes this Official Statement in connection with the offering of \$78,305,000 principal amount of its Water System Revenue and Refunding Bonds, 2013 (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 Tacoma Water’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 “State”). 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 96,333 customers in 2012. See “THE WATER SYSTEM.”

The Bonds are being issued pursuant to Substitute Ordinance No. 28138, passed by the City Council on March 19, 2013 (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 January 1, 2013, the Water System had outstanding \$25,285,000 principal amount of Water System Revenue and Refunding Bonds, 2003 (the “2003 Bonds”), all of which will be refunded with a portion of the Bonds, \$35,485,000 principal amount of Water System Revenue and Refunding Bonds, 2005 (the “2005 Bonds”), \$76,775,000 principal amount of Water System Revenue Bonds, 2009 (Taxable Build America Bonds – Direct Payment) (the “2009 Bonds”), \$28,585,000 principal amount of Water System Revenue Refunding Bonds, 2010A (the “2010A Bonds”), and \$74,985,000 principal amount of Water System Revenue Bonds, 2010B (Taxable Build America Bonds – Direct Payment) (the “2010B Bonds,” and, collectively with the 2003 Bonds, the 2005 Bonds, the 2009 Bonds and the 2010A 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 \$3,595,000 principal amount of Regional Water Supply System Revenue Bonds, 2010A (the “2010A RWSS Bonds”), \$44,245,000 principal amount of Regional Water Supply System Revenue Bonds, 2010B (Taxable Build America Bonds – Direct Payment) (the “2010B RWSS Bonds,” and together with the 2010A RWSS Bonds, the “2010 RWSS Bonds”) and \$64,795,000 principal amount of Regional Water Supply System Revenue Refunding Bonds, 2013 (the “2013 RWSS Bonds,” and, collectively with the 2010 RWSS Bonds, the “RWSS Bonds”). Tacoma Water is responsible for paying debt service on \$32,925,000 of the outstanding principal on the 2010 RWSS Bonds, and \$35,840,000 of the principal amount on the 2013 RWSS Bonds, plus interest, each as a Contract Resource Obligation payable as an Operation and Maintenance Expense from Gross Revenue of the Water System prior to the payment of debt service on the Parity Bonds. If another Participant in the Second Supply Project defaults, Tacoma Water is obligated to increase its Participant Share, including paying debt service on the RWSS 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 prior to the payment of debt service on the Parity Bonds. 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 Parity Bonds, and to pay costs of issuance of the Bonds, as more fully described under “PURPOSE AND APPLICATION OF BOND PROCEEDS.”

Federal sequestration, which became effective on March 1, 2013, is expected to reduce Tacoma Water’s federal subsidy for a portion of the interest on the 2009 Bonds, the 2010B Bonds and 2010B RWSS Bonds. There also could be indirect impacts to the economy of the area. The exact impact will depend on how various Federal agencies respond to mandated expenditure reductions and the duration of sequestration.

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 initial delivery and will be issued in the aggregate principal amount of \$78,305,000. 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 December 1, 2013.

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. 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 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.”

Optional Redemption

The Bonds maturing in years 2013 and 2014 are not subject to redemption prior to maturity. The Bonds maturing on and after December 1, 2041, are subject to redemption at the option of the City on and after June 1, 2023, 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.

Mandatory Redemption

The Bonds maturing in the year 2043 are Term Bonds and, if not optionally redeemed, defeased or purchased and surrendered for cancellation 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:

| Year (December 1) | Principal Amount |
|---------------------|------------------|
| 2042 | \$24,770,000 |
| 2043 ⁽¹⁾ | 25,765,000 |

(1) Final maturity.

If the City optionally redeems, defeases or purchases Bonds that are Term Bonds, the par amount of the Bonds that are Term Bonds so redeemed, defeased or purchased shall be credited against one or more scheduled mandatory redemption amounts for those Term Bonds, as determined by the City.

Partial Redemption

If less than all of the Bonds are to be redeemed, the City may select the maturity or maturities of such Bonds to be redeemed. If less than all of the Bonds of any maturity are to be redeemed, the Bonds or portions thereof to be redeemed are to be selected in a random manner by the Bond Registrar or DTC, as applicable, or in accordance with their respective standard procedures. Any Bond in the principal amount of greater than \$5,000 may be partially redeemed in any integral multiple of \$5,000.

Notice of Redemption

The City shall cause notice of any intended redemption of Bonds to be given not less than 20 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 notice of redemption is rescinded or money sufficient to effect the redemption is not on deposit in the Bond Fund or in any escrow account established to carry out a refunding or defeasance of the redeemed Bonds. 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 or all of the Bonds in the open market at any time at any price acceptable to the City plus accrued interest to the date of purchase.

Book-Entry System

When issued, the Bonds will be registered in the name of Cede & Co. (or such other name as may be requested by an authorized representative of DTC), as nominee of DTC. DTC will act as securities depository for the Bonds. Individual purchases will be made in book-entry form only through DTC, and purchasers will not receive physical certificates representing their interests in the Bonds purchased. For information about DTC and its book-entry system, see Appendix B—"BOOK-ENTRY SYSTEM."

Termination of Book-Entry System

If DTC resigns as the securities depository and no substitute can be obtained, or if the City has determined that it is in the best interest of the beneficial owners of the Bonds that they be able to obtain bond certificates, the ownership of the Bonds may be transferred to any person as described in the Bond Ordinance and the Bonds no longer will be held in fully immobilized form. New bond certificates then will be issued in appropriate denominations and registered in the names of the beneficial owners. Thereafter, interest on the Bonds will be paid by check or draft mailed (or by wire transfer to a registered owner) at the addresses for such Registered Owners appearing on the Bond Register on the 15th day of the month preceding the interest payment date. Principal of the Bonds will be payable upon presentation and surrender of such Bonds by the Registered Owners to the Bond Registrar. See Appendix B—"BOOK-ENTRY SYSTEM."

Defeasance

The Bond Ordinance provides that if money and/or "Government Obligations" (as defined in Chapter 39.53 RCW, as now in existence or hereafter amended) maturing at such time(s) and bearing such interest to be earned thereon (without any reinvestment thereof) as will provide a series of payments which shall be sufficient, together with any money initially deposited, to provide for the payment of the principal of and interest on all or a designated portion of the Bonds when due in accordance with their terms are set aside in a special fund (the "trust account") to effect such payment, and are pledged irrevocably in accordance with a refunding plan adopted by the City for the purpose of effecting such payment, then no further payments need be made into the Bond Fund for the payment of principal of and interest on such Bonds, the Registered Owners thereof shall cease to be entitled to any lien, benefit or security of the Bond Ordinance, except the right to receive payment of the principal of and interest on such Bonds when due in accordance with their terms from the money and the principal and interest proceeds on the Government Obligations set aside in the trust account, and such Bonds shall no longer be deemed 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.

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 the Reserve Account for the Parity Bonds, to refund all of the outstanding 2003 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 2003 Bonds to be refunded with the proceeds of certain of the Bonds are identified below (“Refunded Bonds”).

| Refunded Bonds | | | | | | |
|---|---------------|--------------|---------------|-----------------|------------------|---------------|
| Bond | Maturity Date | Par Amount | Interest Rate | Redemption Date | Redemption Price | CUSIP Numbers |
| <i>Water System Revenue and Refunding Bonds, 2003</i> | | | | | | |
| Serials | 12/1/2013 | \$ 3,505,000 | 5.000% | 06/06/2013 | 100% | 873547FP3 |
| | 12/1/2014 | 1,725,000 | 4.125 | 06/06/2013 | 100 | 873547FQ1 |
| | 12/1/2015 | 1,795,000 | 4.250 | 06/06/2013 | 100 | 873547FR9 |
| | 12/1/2016 | 1,870,000 | 4.375 | 06/06/2013 | 100 | 873547FS7 |
| | 12/1/2017 | 1,950,000 | 5.000 | 06/06/2013 | 100 | 873547FT5 |
| | 12/1/2018 | 2,045,000 | 5.250 | 06/06/2013 | 100 | 873547FU2 |
| | 12/1/2019 | 2,150,000 | 5.250 | 06/06/2013 | 100 | 873547FV0 |
| | 12/1/2020 | 2,260,000 | 5.250 | 06/06/2013 | 100 | 873547FW8 |
| | 12/1/2021 | 2,375,000 | 5.000 | 06/06/2013 | 100 | 873547FZ6 |
| | 12/1/2022 | 2,495,000 | 5.000 | 06/06/2013 | 100 | 873547FY4 |
| | 12/1/2023 | 3,115,000 | 5.000 | 06/06/2013 | 100 | 873547FZ1 |
| Total | | \$25,285,000 | | | | |

A portion of the net proceeds from the sale of the Bonds will be deposited in the Refunding Account (the “Refunding Account”) and used to purchase Acquired Obligations (as defined below) to be held by U.S. Bank National Association, Seattle, Washington (the “Refunding Trustee”) under a refunding trust agreement (the “Refunding Trust Agreement”), dated the date of delivery of the Bonds, between the City and the Refunding Trustee. 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 “Acquired Obligations”). The Acquired Obligations will mature at such times and pay interest in such amounts so that, with other available funds held by the Refunding Trustee under the Refunding Trust 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 Refunding Trustee under the Refunding Trust Agreement, the liens, pledges and covenants securing the Refunded Bonds will terminate and be discharged and released.

Sources and Uses

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

| Sources of Funds | |
|-------------------------|----------------|
| Par Amount of the Bonds | \$ 78,305,000 |
| Original Issue Premium | 2,331,083 |
| City Cash Contribution | <u>620,072</u> |
| Total | \$ 81,256,155 |
| Uses of Funds | |
| Project Costs | \$ 50,672,000 |
| Reserve Account Deposit | 3,932,457 |
| Refunding Account | 25,922,296 |
| Issuance Expenses(1) | <u>729,402</u> |
| Total | \$ 81,256,155 |

- (1) Issuance expenses include underwriter’s discount, legal fees, financial advisors’ fees, Refunding Trustee 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 2009 Bonds and the 2010B 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, 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 \$241,115,000 of Outstanding Parity Bonds, of which \$25,285,000 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 \$47,840,000 principal amount of 2010 RWSS Bonds, of which Tacoma Water is responsible for \$32,925,000 of the principal, plus interest, and \$64,795,000 of 2013 RWSS Bonds of which Tacoma Water is responsible for \$35,840,000 of the principal amount plus interest as a Contract Resource Obligation from Gross Revenue of the Water System as an Operation and Maintenance Expense of the Water System. 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.

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 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 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. 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 deposit \$3,932,457 of Bond proceeds into the Reserve Account, which together with the cash and Reserve Insurance policies for the Outstanding Parity Bonds, will satisfy the Reserve Requirement.

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 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

To meet the Reserve Requirement for the Outstanding Parity Bonds, the City deposited \$4,419,509 of 2009 Bond proceeds, \$1,457,596 of 2010A Bond proceeds and \$3,755,940 of 2010B Bond proceeds in the Reserve Account and obtained reserve account surety policies from Financial Guaranty Insurance Company ("Financial Guaranty") and Financial Security Assurance Inc., which is now known as Assured Guaranty Municipal Corp. ("FSA"). There was a cash balance of \$9,791,339 in the Reserve Account as of December 31, 2012.

Financial Guaranty issued a reserve account surety policy 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 policy is reinsured by National Public Finance Guarantee Corporation ("National"), a subsidiary of MBIA Inc. effective January 1, 2009. The maximum amount of the Financial Guaranty reserve policy is \$7,706,417 and is expected to terminate on December 1, 2025 (or when the 2005 Bonds are no longer outstanding). A reserve policy was obtained from FSA in the maximum amount of \$2,778,351.56 relating to the 2003 Bonds. Once the 2003 Bonds are no longer outstanding, the FSA reserve policy will terminate. The 2003 Bonds will be refunded with Bond proceeds. 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. National is currently rated "Baa2" and "BB" by Moody's and S&P, respectively. FSA is currently rated "A2" and "AA-" by Moody's and S&P, respectively. Fitch has withdrawn its rating for National and 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 file 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.

Rate Stabilization Account

The Bond Ordinance authorizes a Rate Stabilization Account in the Water Division Fund. The balance of the account was \$35,575,446 as of December 31, 2012. 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 Public Works Trust Fund totaling \$25,636,305 and four low-interest loans from the State Revolving Fund totaling \$16,335,230, 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 Construction Fund 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.

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 RWSS Bonds, debt service on the Outstanding Parity Bonds and debt service on the Bonds. The table does not show \$41,971,535 in junior lien Tacoma Water loans. See "SECURITY FOR THE BONDS—Additional Obligations." The City understands that a portion of the 35% federal subsidy it should receive for the 2009 Bonds, 2010B Bonds and 2010B RWSS Bonds will be reduced as a result of the Federal sequestration. The IRS has announced that the reduction will be 8.7% for payments made through September 2013 (at which time it is subject to change).

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 | |
| 2013 | \$ 3,286,032 | \$ 14,006,989 | \$ 2,970,000 | \$ 1,730,147 | \$ 18,707,136 |
| 2014 | 4,182,314 | 15,964,639 | 980,000 | 2,993,800 | 19,938,439 |
| 2015 | 4,213,814 | 15,964,389 | -- | 2,974,200 | 18,938,589 |
| 2016 | 3,897,064 | 15,962,989 | -- | 2,974,200 | 18,937,189 |
| 2017 | 3,899,314 | 15,970,089 | -- | 2,974,200 | 18,944,289 |
| 2018 | 3,915,314 | 16,014,989 | -- | 2,974,200 | 18,989,189 |
| 2019 | 4,384,314 | 16,022,670 | -- | 2,974,200 | 18,996,870 |
| 2020 | 4,393,564 | 16,015,864 | -- | 2,974,200 | 18,990,064 |
| 2021 | 4,409,814 | 16,022,170 | -- | 2,974,200 | 18,996,370 |
| 2022 | 4,412,564 | 16,019,183 | -- | 2,974,200 | 18,993,383 |
| 2023 | 4,437,314 | 15,526,933 | -- | 2,974,200 | 18,501,133 |
| 2024 | 5,522,814 | 13,277,682 | -- | 2,974,200 | 16,251,882 |
| 2025 | 5,530,814 | 13,239,592 | -- | 2,974,200 | 16,213,792 |
| 2026 | 5,517,314 | 13,200,359 | -- | 2,974,200 | 16,174,559 |
| 2027 | 5,528,064 | 13,114,726 | -- | 2,974,200 | 16,088,926 |
| 2028 | 5,526,564 | 13,021,611 | -- | 2,974,200 | 15,995,811 |
| 2029 | 5,543,064 | 12,918,828 | -- | 2,974,200 | 15,893,028 |
| 2030 | 5,536,314 | 12,821,377 | -- | 2,974,200 | 15,795,577 |
| 2031 | 5,549,914 | 12,713,452 | -- | 2,974,200 | 15,687,652 |
| 2032 | 5,282,714 | 12,600,467 | -- | 2,974,200 | 15,574,667 |
| 2033 | 5,470,714 | 18,125,396 | -- | 2,974,200 | 21,099,596 |
| 2034 | 5,397,234 | 17,887,914 | -- | 2,974,200 | 20,862,114 |
| 2035 | 5,326,447 | 17,639,944 | -- | 2,974,200 | 20,614,144 |
| 2036 | 5,247,790 | 17,380,624 | -- | 2,974,200 | 20,354,824 |
| 2037 | 5,166,263 | 17,114,090 | -- | 2,974,200 | 20,088,290 |
| 2038 | 5,081,587 | 16,839,206 | -- | 2,974,200 | 19,813,406 |
| 2039 | 4,998,478 | 16,549,820 | -- | 2,974,200 | 19,524,020 |
| 2040 | 4,911,377 | 16,255,072 | -- | 2,974,200 | 19,229,272 |
| 2041 | -- | -- | 23,820,000 | 2,974,200 | 26,794,200 |
| 2042 | -- | -- | 24,770,000 | 2,021,400 | 26,791,400 |
| 2043 | -- | -- | 25,765,000 | 1,030,600 | 26,795,600 |
| TOTAL (4) | \$ 136,568,892 | \$ 428,191,065 | \$ 78,305,000 | \$ 88,079,347 | \$ 594,575,412 |

- (1) Includes Tacoma Water's share of debt service on the 2010 RWSS Bonds (before the federal credit payments), including the amount expected to be transferred from Covington to Tacoma Water, and the 2013 RWSS Bonds, which were issued on April 16, 2013, and excluding the 2002 RWSS Bonds refunded by the 2013 RWSS 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 2003 Bonds refunded with the Bonds.
- (4) Totals may not foot due to rounding.

Additional Borrowing

The City does not plan to issue Future Parity Bonds or any bonds for the Second Supply Project in the next 24 months. The City periodically reviews its outstanding bonds for refunding opportunities and may issue Future Parity Bonds or bonds for the Second Supply Project for refunding purposes if market conditions warrant.

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 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 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 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 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

Overview

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 twice monthly.

The Department consists of the Light Division (“Tacoma Power”), Water Division (“Tacoma Water”), and Belt Line Railroad Division (“Tacoma Rail”). The Water Division consists of two separate systems: the Regional Water Supply System and Tacoma Water. The Board serves as the sole policy board for the approval of most Department business. In the case of budgets, rates, bond issues, 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 55 MGD and on an annual basis supplies approximately 4% of the City's water needs.

Tacoma Water is one of the largest publicly owned water utilities in the State. The following table displays selected operating data regarding Tacoma Water as of December 31, 2012 and 2011.

Selected Operating and Financial Data Calendar Years 2012 and 2011

| | 2012 | 2011 |
|-------------------------------------|---------------|---------------|
| Average Number of Metered Customers | 96,333 | 96,734 |
| Operating Revenue | \$ 80,680,731 | \$ 65,404,034 |
| Total Water Billed (MG) | 17,355 | 17,260 |
| Average Daily Use (MG) | 50.3 | 51.0 |
| Maximum Daily Use (MG) | 80.5 | 80.5 |

Source: Water Division, 2011 and 2012 Audited 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 36% 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.

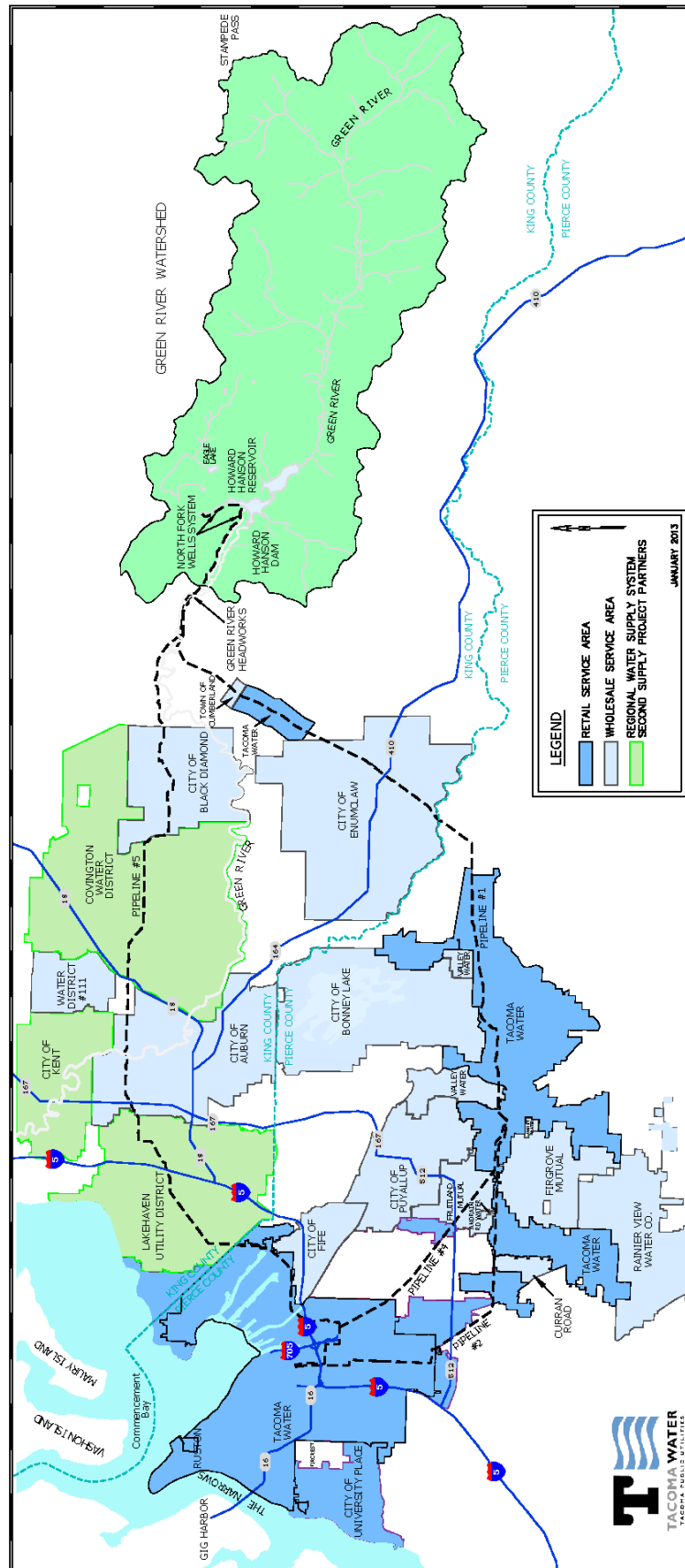
Tacoma Water is the exclusive retail provider of water service within the City and is designated as a key provider of water service within Pierce County under the Pierce County Coordinated Water System Plan. Tacoma Water presently provides direct service to some customers within the city limits of several 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 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 3.5% of billed revenue is derived from that source, but it is expected to grow 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.



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 32 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.

Heather Pennington, P.E., Deputy Water Superintendent, Asset and Information Manager, joined Tacoma Water in 1994, and became Tacoma Water's interim Distribution Manager in 2006, Distribution Engineering Manager in 2007, Resource Planning Manager in July 2009 and Resource Planning (now Asset and Information Management) Deputy Water Superintendent in 2011. She holds an M.B.A. from Pacific Lutheran University and a B.S. in environmental engineering from Northwestern University.

Chris McMeen, P.E., Deputy Water Superintendent, Water Quality Manager, joined the City in 2002. He has over 25 years experience in the drinking water industry, including work as an engineering consultant, drinking water regulator, utility engineer and manager. He has a B.S. and M.S. in civil engineering from the University of Washington.

Sean Senescall, Rates and Financial Planning Manager, joined the City in 2010 as the Rates and Financial Planning Assistant Division Manager, and became the Rates and Financial Planning Manager in 2013. He has 7 years of experience in government finance and rate development. He attended the U.S. Air Force Academy and has a B.S. in economics 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 Water Works Operator license.

Tony Lindgren, P.E., Water Distribution Engineering Manager, joined the City in 2002 and became the Resource Planning (now Asset and Information Management) Assistant Division Manager in 2010, and the Distribution Engineering Manager in January 2011. He has a B.S. in civil engineering from Washington State University.

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 has contracted with Moss Adams LLP to perform the annual audit of the financial statements of Tacoma Water for the 2012 fiscal year. The audited financial statements of Tacoma Water for fiscal years 2011 and 2012 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 ("TERS"). TERS is a local single employer defined benefit pension retirement plan covering City employees other than law enforcement officers, fire fighters, and railroad employees, who are covered by retirement plans operated by other entities. The Board of Administration of TERS administers the plan, and benefit provisions are established in accordance with chapter 41.28 RCW and Chapter 1.30 of the Tacoma City Code. The Board of Administration of TERS consists of nine members, including the Mayor, City Administrator, Finance Director, designee of the Director of Utilities, three employees and one retiree. As of December 31, 2012, there were 2,107 retirees and beneficiaries receiving benefits, 426 vested terminated employees entitled to future benefits, and 2,861 active members in TERS.

Tacoma Water is current in all payments to TERS. Further details about TERS are provided in Note 10 in Appendix C—"2011 AND 2012 AUDITED FINANCIAL STATEMENTS."

Contributions City-wide totaled \$42.4 million in 2011 (\$22.5 million employer contributions and \$19.9 million employee contributions) and totaled \$40.2 million in 2010 (\$21.3 million employer contributions and \$18.9 million employee contributions). The contribution rate for Tacoma Water's covered payroll is currently set at 20% of gross wages for 2013 (10.80% paid by Tacoma Water and 9.20% paid by employees). Tacoma Water contributed \$1,908,977 in 2011 and \$1,954,051 in 2012 into TERS.

The most recent actuarial valuation of TERS was completed as of January 1, 2012 by Milliman (the "Milliman Report"). Assumptions include investment earnings of 7.75%, wage growth of 4.25% and price inflation of 3.25%. TERS's 2011 market value investment return of 1.3% was less than the 7.75% investment earning assumption. According to the Milliman Report, due primarily to the continued recognition of a large asset loss in 2008, as of January 1, 2012 the Funding Ratio declined from 94.9% to 90.1% and the projected amortization period for the Unfunded Actuarial Accrued Liability ("UAAL") has increased from 12.8 years to 35.0 years. This is based on the Actuarial Value of Assets ("AVA") which smooth gains and losses over four years. As of January 1, 2012, the large 2008 loss was fully recognized in the AVA. Since the 2011 investment return of 1.3% was lower than the 7.75% assumption, measures based on the Market Value of Assets ("MVA") also declined. Specifically, based on MVA, the Funding Ratio declined from 95.4% to 91.3% and the projected amortization period of the UAAL increased from 11.4 years to 27.7 years. The asset losses were partially offset by salary increases that were less than assumed.

TERS Valuations
(Millions of \$)

| Actuarial Valuation Date | Actuarial Value of Assets | Accrued Liability (AAL) | Unfunded AAL (UAAL) | Funded Ratio | Covered Payroll | Percentage of Covered Payroll |
|---|--|--|------------------------------------|-------------------------|----------------------------|--|
| 01/01/2007 | \$1,021.3 | \$ 895.8 | \$(125.5) | 114.0% | \$175.0 | (71.7)% |
| 01/01/2009 | 1,097.3 | 1,002.3 | (95.0) | 109.5 | 197.4 | (48.1) |
| 01/01/2011 | 1,074.8 | 1,132.9 | 58.1 | 94.9 | 219.6 | 26.5 |
| 01/01/2012 | 1,068.3 | 1,185.5 | 117.2 | 90.1 | 219.4 | 53.4 |

The Milliman Report provides the following information regarding long-term funding projections: The baseline projection demonstrates that if experience in all future years matches the actuarial assumptions, including 7.75% investment returns, the Funding Ratio is projected to reach 100% by 2040. However, a downside scenario projection showing that adverse investment experience similar to what TERS experienced in 2006 – 2008 could require contribution rates to increase as high as 29.37% of pay to amortize the UAAL over 30 years. Future experience is expected to be both better and worse than the actuarial assumptions at different times and is likely to result in changes to TERS's funding status.

Although TERS is funded over a long period of time, the measurement of TERS's funding status can vary widely from year-to-year due to asset returns. The following table summarizes TERS's asset returns in recent years and compares the market value gains and losses to the AAL at the following valuation date. Returns greater than the 7.75% actuarial assumption are gains; returns less than the 7.75% actuarial assumption are losses. The AVA recognizes these market value gains and losses in four equal increments starting at the end of the year in which they occur. Gains in good years are needed to offset losses in bad years. The \$451 million market value loss in 2008, equal to 45% of TERS's AAL, and was fully recognized in the actuarial assets as of January 1, 2012.

TERS Asset Returns

| Year | Market Value % Return* | Market Value Gain/ (Loss) compared to expected | End of Year Actuarial Accrued Liability (AAL) | Gain / (Loss) as a % of next AAL |
|-------------|-----------------------------------|---|--|---|
| 2002 | (8.9)% | \$ (112,800,000) | \$ 686,800,000 | (16.4)% |
| 2003 | 29.4 | 131,400,000 | ** | 17.4 |
| 2004 | 15.5 | 60,100,000 | 754,300,000 | 8.0 |
| 2005 | 8.7 | 8,500,000 | ** | 0.9 |
| 2006 | 48.6 | 102,800,000 | 895,800,000 | 11.5 |
| 2007 | 3.9 | (42,200,000) | ** | (4.2) |
| 2008 | (32.0) | (451,000,000) | 1,002,300,000 | (45.0) |
| 2009 | 27.3 | 147,700,000 | ** | 13.0 |
| 2010 | 14.1 | 60,200,000 | 1,132,900,000 | 5.3 |
| 2011 | 1.3 | (69,900,000) | 1,185,500,000 | (5.9) |

* The market value returns shown above are net of investment expenses, but not administrative expenses. They are based on the TERS's annual financial statements, but may have some variance from calculations performed by other parties due to different methodology. The preliminary estimate of the market value in 2012 is 14.1%.

** Until 2011, valuations were performed every other year.

In August 2012, the Board of Administration of TERS changed the rate of return assumption from 7.75% to 7.5%. This changed assumption will be reflected in the valuation report for 2012 expected in May 2013.

In addition to TERS, City employees participate in the Federal social security program. The City withholds the employee contribution from City employee's wages.

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, 2012, the City's net OPEB obligation was \$46,469,368, of which \$2,055,309 was related to the Water System. Further details about OPEB are provided in Note 11 in Appendix C—“2011 AND 2012 AUDITED FINANCIAL STATEMENTS.”

Taxation

Under the City Charter, 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 a public utility tax imposed by the State 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 \$1,500,000 for general comprehensive liability. The public officials policy has a deductible of \$200,000 for employee practices liability. The general comprehensive liability policies provide \$40 million of coverage. The City has a policy to cover extraordinary worker's compensation claims with a statutory limit and \$1 million retention. Earthquake coverage has a 5% or \$250,000, whichever is greater, 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, 2012, assets in the Self Insurance Fund totaled \$5.4 million, which exceeds accrued and incurred but not reported liabilities. Tacoma Water's premium payments in both 2011 and 2010 totaled \$120,000. Tacoma Water's premium payment in 2012 was \$496,377 due to one large injury settlement. 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 \$25,000 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 policies that serve as a guide to financial management and rate setting. These are included in the “Water Rate and Financial Policy” document and are reviewed and approved by the Board and City Council when changes are recommended by staff. These policies include rates based on cost of service within a customer class, restrictions on the term of debt, and maintenance of a minimum of 60 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 Policy in February 2013, to formalize

debt service coverage minimums (at least 1.25 times on all debt including junior lien debt, and with taxes included as operating expenses) and an increase in the portion of rate revenues recoverable from the fixed component of the rate to 65%.

Tacoma Water operates under the guidance of its strategic plan, which was completed in 2012 to provide strategic focus for the utility for at least three to five years. This plan identifies eight initiatives, and progress towards the implementation of these initiatives will be closely monitored in the coming years. Financial forecasting scenarios were developed as a part of and incorporated into the strategic plan. These scenarios are meant to gauge the sensitivity of water rates to various contingencies. The plan also addresses financing and rate requirements necessary to support the implementation of the operations and capital programs. It served as the basis for developing Tacoma Water's 2013-2014 budget approved by the Board and City Council.

State law and City policies permit City utilities to borrow on a short-term basis from the General Fund. Tacoma Water has never borrowed from the General Fund and has no plans to do so.

Labor Relations

Tacoma Water has approximately 248 employees, many of whom 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 City's Investment Committee is composed of the Mayor, the Finance Director and the City Treasurer. Among the investments permitted by State law and the Investment Committee's policy are banker's acceptances of the top 50 world banks as published by American Banker; U.S. Treasury bills, certificates, notes and bonds; certain U.S. Government agency securities; commercial paper with the highest rating by at least two nationally recognized rating agencies; repurchase agreements with the market value of collateral exceeding the dollar amount of the repurchase agreement by 2% over the term of the agreement; reverse repurchase agreements; the State Local Investment Pool (described below) and municipal securities.

The City is authorized under State Law, primarily RCW 43.84.080, RCW 39.59.020 and by the City of Tacoma Investment Policy (Tacoma City Charter Section 7.4) to make security lending transactions. Securities lent are collateralized with cash or securities having 102% of market value.

As of December 31, 2012, the City's cash and investments, on a fair value basis, totaled \$954 million, not including City pension funds, 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, 2012)

| | |
|---|---------|
| Bank Interest-Bearing Accounts | 6.23% |
| LGIP | 7.65 |
| Municipal Securities | 27.33 |
| Federal Agricultural Mortgage Corp (Farmer Mac) | 1.51 |
| Federal Home Loan Mortgage Assn (Freddie Mac) | 17.66 |
| Federal Farm Credit Bank (Farm Credit) | 6.00 |
| Federal Home Loan Bank (Home Loan) | 7.56 |
| Federal National Mortgage Assn (Fannie Mae) | 23.58 |
| Tennessee Valley Authority (TVA) | 1.45 |
| U.S. Treasuries | 0.11 |
| Secured Repurchase Agreements | 0.92 |
| Total | 100.00% |

Source: City of Tacoma.

State Local Investment Pool. The State Treasurer's Office administers the Washington State Local Government Investment Pool (the "LGIP"), which invests over \$9 billion on behalf of more than 450 cities, counties and special taxing districts. 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 principles are, in order of priority, (i) the safety of principal; (ii) the assurance of sufficient liquidity to meet cash flow demands; and (iii) the attainment of 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 State depositories.

Authorized Investments for Bond Proceeds. In addition to the eligible investments discussed above, bond proceeds may also be invested in mutual funds with portfolios consisting of U.S. government and guaranteed agency securities with average maturities of less than four years; municipal securities rated in one of the four highest categories; and money market funds consisting of the same, so long as municipal securities held in the fund(s) are in one of the two highest rating categories of a nationally recognized rating agency. Bond proceeds may also be invested in shares of money market funds with portfolios of securities otherwise authorized by law for investment by local governments (RCW 39.59.030).

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 other Second Supply Project Participants. 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 City is constructing a filtration project on the Green River. See “—The Second Supply System.”

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. In 2012, the Army Corps completed the last dam safety rehabilitation project on the Howard Hanson Dam to mitigate damages from the January 2009 storm event and insure reliability of the dam in the future. The Army Corps was responsible for all dam safety costs. Projects implemented by the Army Corps include vertical and horizontal short path seepage dewatering wells, rock armoring and additional log booms.

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 96% of the Water System’s water supply is from the Green River and 4% is from these wells. The following table summarizes the water supplied by source during 2012 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
2012 Sources of Supply of the Water System
(MGD)**

| <u>Source</u> | <u>Peak Capacity</u> | <u>Peak Day Production(2)</u> | <u>Average Production(2)</u> |
|------------------------|--------------------------|-----------------------------------|----------------------------------|
| Surface Water Sources: | | | |
| Green River | 111.58(1) | 80.40 | 50.25 |
| Groundwater Sources: | | | |
| Wells | 53.30 | 14.89 | 0.49 |
| Total Sources | 164.88 | 95.29 | 50.74 |

(1) 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.

(2) 2012 Tacoma water use (excludes Second Supply System water use by Kent, Covington and Lakehaven).

Tacoma Water’s 2012 demand forecast indicates that the Water System has sufficient water supply to meet projected demands for at least the next 50 years.

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 115 MGD, with an installed pumping capacity of 67.2 MGD.

During the last decade it has become increasingly difficult for State water systems to obtain new water rights because of uncertainties in the administration of these rights. Major concerns include legal challenges to the 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 Tacoma, 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.

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.

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, additions or improvements to the Second Supply Project.

Financing of the Second Supply System. 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. Tacoma issued its 2002 RWSS Bonds to finance the construction of the Second Supply Project. Lakehaven used cash to finance its share of the initial project. The Participants entered into a Repayment Agreement and Financing Plan governing the payment of Second Supply Project costs and the obligation of Tacoma, Covington and Kent to pay debt service on the 2002 RWSS Bonds. Tacoma issued the 2013 RWSS Bonds to refund the 2002 RWSS Bonds on April 16, 2013. Pursuant to the Repayment Agreement, Tacoma, Covington and Kent will be obligated to pay their share of debt service on the 2013 RWSS Bonds in the same portion as the 2002 RWSS Bonds. The total original project cost was approximately \$232 million, including financing costs. In 2010, the Participants entered into a Financing Plan to install a filtration treatment system, and Kent and Covington chose to have Tacoma issue the 2010 RWSS Bonds to finance their Participant Shares. Lakehaven chose to pay its entire share of the capital cost of Phase I of the Filtration Project (described below) in cash. Tacoma issued \$47,840,000 of 2010 RWSS Bonds to finance a portion of the filtration project. Consequently, Tacoma Water, Covington and Kent are obligated to pay amounts sufficient to provide for the payment of the principal of and interest on the 2010 RWSS Bonds and 2013 RWSS Bonds.

Under the Second Supply Project Agreement and the associated Repayment Agreement, Tacoma Water is responsible for paying debt service on \$32,925,000 of the principal amount of the 2010 RWSS Bonds and \$35,840,000 of the principal amount on the 2013 RWSS Bonds. Kent is responsible for paying debt service on \$11,400,000 of the principal amount of the 2010 RWSS Bonds and \$14,790,000 of the principal amount on the 2013 RWSS Bonds. Covington is responsible for paying debt service on \$3,515,000 of the principal amount of the 2010 RWSS Bonds and \$14,165,000 of the principal amount on the 2013 RWSS Bonds. Covington has received State Revolving Fund loans for the Filtration Project and is expected to contribute \$8,080,000 of loan proceeds to finance a portion of its share of the project. Kent and Covington will pay their share to Tacoma, 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, Kent and Covington constitute "Contract Resource Obligations" payable as operation and maintenance expenses from the gross revenues of their respective water utilities. 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 Second Supply Project Agreement.

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 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 average daily water of the Second Supply System used by the Participants for the years 2008 through 2012 appear below. The Participants have other sources of water in addition to the Second Supply System.

**Second Supply System
Average Daily Total Water Use
(MGD)**

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|----------------------------|--------------|--------------|--------------|--------------|--------------|
| Tacoma Water | 25.85 | 23.84 | 15.57 | 15.53 | 19.57 |
| City of Kent | 0.10 | 0.74 | 0.54 | 0.47 | 0.64 |
| Lakehaven Utility District | 4.69 | 2.14 | 2.89 | 5.25 | 6.09 |
| Covington Water District | 1.22 | 1.16 | 1.90 | 1.96 | 2.60 |
| Total Use | 31.86 | 27.87 | 20.90 | 23.21 | 28.89 |

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 micro-organism 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 required Tacoma Water to install additional treatment for *Cryptosporidium* by 2014. The Participants worked with a consulting team to analyze potential strategies for LT2 compliance. Following substantial analysis, significant public outreach and communication, the filtration option was selected as the best solution for the long-term benefit of the utility customers. In 2010, the Tacoma Public Utility Board, the Covington and Lakehaven Boards and the Kent City Council 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.

Following Board and City Council approval, design was authorized in 2010, and continued through 2011 and early 2012. The Filtration Project is being delivered using an alternative delivery methodology allowed under State law (Chapter 39.10 RCW) called General Contractor/Construction Manager (GC/CM). This project delivery approach enables substantial risk control through the selection of a highly qualified general contractor, and close collaboration between Tacoma Water, the design engineer, and the contractor. To date, with over 85% of the work under contract, overall project costs are at approximately 80% of the upper bound budget approved by the Board. Underground work on facility foundations, where there are typically significant risks for major civil projects, is completed.

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 2010 RWSS Bonds were issued to finance the costs of Phase I of the Filtration Project except for Lakehaven's share (for which Lakehaven paid cash). Phase I work covers those portions of the Filtration Project completed between July 2010 and anticipated to be completed by approximately August 2013. This work includes completed design, permitting, and early stages of construction, including major earthwork and the early stages of major concrete placement. Phase II work will complete the concrete, major piping, and treatment process construction steps, leading toward an operational filtration plant by the end of 2014.

The total estimated cost for the Filtration Project is \$195 million. Tacoma Water is responsible for an estimated \$84.7 million of this total for its first diversion operations (the Tacoma Water System). The Second Supply System is responsible for an estimated \$110.3 million of Filtration Project costs; Tacoma Water is responsible for \$45.9 million of this portion.

Endangered Species Act Compliance

In 1999, the National Marine Fisheries Service ("NMFS") listed Puget Sound Chinook salmon as a threatened species. Subsequently, the U.S. Fish & Wildlife Service ("USFWS") listed Puget Sound bull trout and Puget Sound steelhead as threatened species in 1999 and 2007, respectively. Pursuant to regulations, NMFS and USFWS have extended to these threatened species certain protections under the Endangered Species Act ("ESA"). These protections include a prohibition on "take," which includes 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. Acceptance of the Habitat Conservation Plan led to the issuance of 50-year Incidental Take Permits from NMFS and the USFWS 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.

Agreement with Muckleshoot Tribe

An agreement was signed in August 1995 with the Muckleshoot Indian Tribe (the "Muckleshoots") that recognizes the importance of the Green River to the Muckleshoots' fisheries and cultural history. The settlement package had a cost of approximately \$30 million, of which \$25,213,000 has been paid to date, and includes five basic elements: (1) building a fish restoration facility and paying for annual operation and maintenance of that facility or, at the Muckleshoots' election, making an equivalent cash payment; (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 Muckleshoots; and (5) providing for limited access into the Green River watershed. With respect to item (1) above, the Muckleshoots have elected to accept an equivalent cash payment, relieving Tacoma Water of the annual operation and maintenance obligation. The Muckleshoots have until 2015 to determine if they would like to utilize the cash payment they have received for a fish restoration facility. The settlement resolves past damage claims by the Muckleshoots for Tacoma Water's historical operations on the river, gains the Muckleshoots' support for the Second Supply Project and provides a basis for a long-term cooperative working relationship on the Green River.

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 11% of the watershed area including much of the land adjacent to the Green River and the Eagle Gorge Reservoir, located approximately three miles upstream from the Green River Headworks behind Howard Hanson Dam. Most of the land that is not owned by Tacoma Water is either U.S. Forest Service property or is owned by timber companies or the 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 State Department of Health ("WSDOH") and has allowed 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 ozone, chlorine, fluoride 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, and construction is well underway.

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 water-borne contaminants 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. Tacoma Water is constructing a 40 million gallon per day groundwater treatment system at its Hood Street Reservoir to bolster compliance with regulations related to corrosivity of water to household plumbing, and to provide fluoridation of the groundwater. This work will be completed in 2013.

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 covered the last of its open basins in 2012. The basins were replaced with smaller covered reservoirs that will provide improved water quality as well as improved system security. The water quality leaving these new reservoirs has improved so much that a gas-rechlorination system has been eliminated, thus providing a decreased level of risk. Tacoma Water also 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. In 2013, Tacoma Water will be conducting a comprehensive all hazards vulnerability assessment. The intent is to identify Tacoma Water's vulnerabilities and develop remediation and resilience strategies to assure the continued safety and security of the Water System's assets. The assessment will include all of Tacoma Water's assets, including pump stations, wells, reservoirs, pressure reducing stations, interconnections, mains and appurtenances within its service area including the treatment facility and the new Filtration Project and in-town groundwater treatment facilities under construction. A separate cyber vulnerability assessment will be prepared under separate contract and incorporated into the all hazard analysis. The cyber assessment will evaluate the resilience of the corporate network, Supervisory Control And Data Acquisition (SCADA) system, and supporting infrastructure (telecommunications, microwave towers).

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 Section 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. The addition of filtration is a responsibility of the Water Quality Section, and its future operation (beginning in 2014) will also be incorporated into this section. Tacoma Water has positioned itself with experienced personnel capable of transitioning into filtration operation.

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. Tacoma is constructing a 40 million gallon per day groundwater treatment system at its Hood Street Reservoir to bolster treatment of groundwater at this location to assure future regulatory compliance. This work will be completed in 2013.

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, wells, 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, including a network of communication and telemetry systems. 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, 29 booster pump stations, 141 million gallons of reservoir storage, and 1,209 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 requires additional pumping of water to serve higher areas.

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 and as a result of other system changes, such as the construction of the Second Supply Project, storage was reduced by approximately 143 million gallons ("MG") from the historic storage amount to the amount of storage available in 2012.

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. Several of 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.

Asset and Information Management Section. The Asset and Information Management section oversees implementation of Tacoma Water's infrastructure and information management initiatives as detailed in the Strategic Plan as well as ensures that the Strategic Plan implementation uses a balanced scorecard throughout the organization. This staff manages Tacoma Water's asset management and performance management programs and provides hydraulic modeling, GIS, SAP and other technology support. Responsibilities also including system, strategic, and technology plan development for Tacoma Water.

Tacoma Water continues to prioritize its asset management program. The physical infrastructure that delivers water to customers is extensive and effective management is essential to get the most out of the investments and optimize operation, maintenance and capital expenditures. An economic model was developed and enhanced in 2012 to allow multiple assets to be brought together to analyze a capital project's benefit. This tool informed water main replacement decision making to support capital improvement program management. Tacoma Water also uses business case evaluations to evaluate and justify spending decisions. Comparing the lifecycle costs of alternatives, while considering the financial, social and environmental risks and benefits, provides Tacoma Water with optimal solutions. That process is used to make a variety of capital, operational and maintenance decisions, from vehicle replacements to work group relocations.

Rates and Financial Planning Section. The Rates and Financial Planning Section is responsible for managing financial risk through the development of financial policies, rates and charges, long-term financial plans, capital funding strategies, demand forecasts, and water supply agreements and strategies. This section is also responsible for managing the development of the utility's budget, and providing certain financial performance reporting to internal and external stakeholders. This section is expected to represent Tacoma Water in key financial matters, and make recommendations to the Superintendent and Director of Utilities with respect to agreements that have critical financial features.

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. 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 2008 and is required to be updated by January 23, 2014. 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. Because the Plan as a whole is only periodically updated, Tacoma Water updates

key components of the Plan more frequently. These updates include a renewed water demand forecast, an updated capital facilities plan, and the utility strategic plan.

Customers, Water Sales, and Rates

Tacoma Water serves residential, commercial, industrial and wholesale customers, and charges cost of service rates by customer class. In 2012, revenues were attributed 65.5% to residential service, and 27% to commercial and industrial service, including the Simpson Tacoma Kraft Company (“Simpson”). The remaining approximately 7.5% 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 8.5% of total water sales revenue in 2011 and in 2012. In 2012, the ten largest customers combined accounted for 14.9% of total water sales revenue.

Special Contracts and Wholesale Agreements

The City and Simpson executed a 10-year retail contract for industrial water supply in 2006, which includes options to extend or renegotiate upon its expiration in 2015. The parties have started negotiations on such extension. The contract currently provides that the City will furnish 15.9 MGD to Simpson on a uniform basis, 24 hours a day. 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.

Tacoma Water has agreements with a number of regional water purveyors to provide wholesale service, and most recently executed an agreement with the City of Auburn to provide one MGD of wholesale supply. A number of regional utilities, including the City of Auburn, have expressed an interest in increasing wholesale purchases, and Tacoma Water is actively engaged with these utilities in exploring options for expanded wholesale service.

Agreement with Cascade Water Alliance

In 2005, Tacoma Water entered into an agreement with the Cascade Water Alliance (“Cascade”), a regional wholesale water supplier, that entitled 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. Tacoma Water entered into an Amended and Restated Agreement for the Sale of Wholesale Water with Cascade effective December 31, 2012, that specifies a fixed payment stream from Cascade to Tacoma Water from 2012 through 2042. It also enables Cascade to transfer capacity that was previously purchased from Tacoma Water to the Cities of Auburn, Bonney Lake, Buckley, and Sumner (the “Four Cities”) over a period of five years, after which Tacoma Water will make such capacity available for direct purchase to the Four Cities until December 31, 2026. If such capacity transfer occurs, a wholesale water agreement will be negotiated between Tacoma Water and one or more of the Four Cities, and all water sales revenues will be received by Tacoma Water. Tacoma Water will receive a fixed payment stream, totaling \$119.7 million, from Cascade in amounts ranging from \$5,000,000 to \$6,863,929 between 2012 and 2029, inclusive, and ranging from \$1,000,000 to \$1,268,242 between 2030 and 2042, inclusive.

Water Rates

State law provides that cities 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 2013 and 2014 water rates were adopted by the City Council on February 26, 2013 and are scheduled to be implemented on April 1, 2013 and April 1, 2014. The changes resulted in an average annual increase in water charges of approximately 6% per year. Rate increases since 2005 are summarized in the following table.

**Tacoma Water
Rate Increases**

| Year | Average Annual Increase |
|-------------|--------------------------------|
| 2005 | 8.0% |
| 2006 | 8.0 |
| 2007 | 7.5 |
| 2008 | 7.5 |
| 2009 | 3.9 |
| 2010 | 2.9 |
| 2011 | 5.2 |
| 2012 | 5.2 |
| 2013 | 6.0 |
| 2014 | 6.0 |

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

**Tacoma Water
Current Water Rates and Charges
(as of April 1, 2013)**

| Size of Meter (inches) | Customer Charge Per Month | |
|-----------------------------------|----------------------------------|----------------------------|
| | Inside City Limits | Outside City Limits |
| 5/8 | \$ 17.78 | \$ 21.34 |
| 3/4 | 26.67 | 32.00 |
| 1 | 44.45 | 53.34 |
| 1-1/2 | 88.90 | 106.68 |
| 2 | 142.24 | 170.69 |
| 3 | 266.70 | 320.04 |
| 4 | 444.50 | 533.40 |
| 6 | 889.00 | 1,066.80 |
| 8 | 1,422.40 | 1,706.88 |
| 10 | 2,044.70 | 2,453.64 |
| 12 | 3,000.38 | 3,600.45 |

| Consumption Up to and Including: | Charge for Water Used (per ccf (1)) | |
|---|--|----------------------------|
| | Inside City Limits | Outside City Limits |
| Residential | | |
| Each 100 cubic feet of consumption | | |
| October through May..... | \$ 1.450 | \$ 1.740 |
| First 500 cubic feet of consumption June through | | |
| September | 1.450 | 1.740 |
| Each 100 cubic feet of consumption over 500 cubic | | |
| feet June through September..... | 1.813 | 2.176 |
| Commercial and Industrial | | |
| General | 1.600 | 1.920 |
| Large Volume (over 65,000 cubic feet annually) | 1.425 | 1.710 |
| Parks and Irrigation | | |
| For each 100 cubic feet..... | 2.200 | 2.640 |

(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 certain 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.

2013 Comparison of Average Monthly Water Bills

| UTILITY | 5/8" | 2" |
|--------------------------------------|---|---|
| | RESIDENTIAL (10 ccf/month) | COMMERCIAL (150 ccf/month) |
| Tacoma Water (1) | \$ 32.28 | \$ 382.24 |
| Major Regional Water Systems: | | |
| City of Everett, WA | 30.25 | 341.40 |
| Portland, OR Water Bureau(2) | 43.39 | 508.33 |
| Seattle Public Utilities | 58.50 | 698.75 |
| San Francisco, CA | 59.50 | 842.20 |
| Neighboring Water Systems: | | |
| City of Bellevue, WA | 55.96 | 654.34. |
| City of Kent, WA | 46.23 | 651.24 |
| City of Puyallup, WA | 29.27 | 329.49 |
| Covington Water District, WA | 55.85 | 595.98 |
| Lakehaven Utility District, WA | 25.60 | 307.86 |

(1) Tacoma rates effective as of April 1, 2013.

(2) Billed quarterly. Rates are greater if billed monthly or bimonthly.

Source: Individual Utilities. Off-peak season 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 2012. 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**

| Year | SDC Recognized Revenue |
|-------------|-------------------------------|
| 2005 | \$ 5,769,592 |
| 2006 | 12,688,488 |
| 2007 | 2,953,984 |
| 2008 | 1,754,475 |
| 2009 | 404,451 |
| 2010 | 5,772,945 |
| 2011 | 4,834,803 |
| 2012 | 1,810,178 |

Public Fire Protection Costs

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 the City. 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 entered an order on summary judgment ruling that the hydrant costs in areas with franchise agreements must be incorporated back into the utility rates. The City appealed the decision to the Washington State Supreme Court, which affirmed the outcome on January 23, 2012. Tacoma Water is now collecting these costs through fixed monthly charges to the ratepayers in these jurisdictions, both prospectively and retrospectively, and has refunded any funds received from local governments for these services. Tacoma Water bills the City, and not customers directly, for service provided within the City.

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 2013-2016 Capital Improvement Program.

**Tacoma Water
2013-2016 Capital Improvement Program
(\$000)**

| Uses of Funds | 2013 | 2014 | 2015 | 2016 |
|----------------------------------|------------------|------------------|------------------|------------------|
| General Plant | \$ 4,745 | \$ 1,193 | \$ 7,279 | \$ 5,679 |
| Water Supply | 8,107 | 8,939 | 4,422 | 8,791 |
| Water Quality | 3,373 | 605 | 520 | 520 |
| Water Distribution | 13,047 | 13,048 | 14,178 | 14,378 |
| Second Supply System Projects(1) | 52,954 | 41,326 | 1,508 | 255 |
| Environ Stewardship/Conservation | 1,000 | 250 | 250 | 2,375 |
| Total Uses | \$ 83,226 | \$ 65,361 | \$ 28,157 | \$ 31,998 |

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

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 "THE WATER SYSTEM—Water Quality and Treatment."

HISTORICAL OPERATING RESULTS - TACOMA WATER AND SECOND SUPPLY SYSTEM

The following table shows Tacoma Water's customer accounts and water sales for the years 2008 through 2012.

Tacoma Water Historical Number of Customers and Water Sales

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| Customer Accounts (Average) | | | | | |
| Residential | 89,680 | 90,677 | 90,818 | 90,447 | 90,090 |
| Commercial & Industrial Service | 5,466 | 5,636 | 5,663 | 5,646 | 5,612 |
| Simpson Tacoma Kraft ⁽¹⁾ | 1 | 1 | 1 | 1 | 1 |
| Municipal | 251 | 209 | 213 | 203 | 206 |
| Other Public Buildings | 442 | 441 | 425 | 420 | 406 |
| Other Utilities | 18 | 18 | 17 | 17 | 18 |
| Total Customer Accounts | 95,858 | 96,982 | 97,137 | 96,734 | 96,333 |
| Water Sales (ccf)⁽²⁾ | | | | | |
| Residential | 11,018,505 | 11,566,425 | 10,360,619 | 10,314,437 | 10,408,609 |
| Commercial & Industrial Service | 3,963,159 | 3,806,353 | 3,608,517 | 3,339,309 | 3,341,364 |
| Simpson Tacoma Kraft ⁽¹⁾ | 7,777,754 | 7,386,109 | 7,724,770 | 7,823,129 | 7,835,544 |
| Municipal | 97,056 | 102,179 | 88,948 | 105,286 | 94,432 |
| Other Public Buildings | 692,616 | 732,647 | 575,331 | 655,814 | 611,332 |
| Other Utilities | 851,377 | 1,127,243 | 871,563 | 836,657 | 910,332 |
| Total Water Sales | 24,400,467 | 24,720,956 | 23,229,748 | 23,074,632 | 23,201,613 |

(1) Simpson Tacoma Kraft is a pulp and paper mill with contracted annual usage of 15.9 MGD. See "THE WATER SYSTEM—Special Contracts and Wholesale Agreement 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 Tacoma Water for the years 2008 through 2012. The following table is based on consolidated audited financial statements that include Tacoma Water and the Second Supply System for the period between 2008 and 2012.

Tacoma Water Historical Operating Results

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|--------------------|--------------------|---------------------|---------------------|---------------------|
| Operating Revenues (1) | | | | | |
| Residential and Domestic | \$ 34,592,712 | \$ 36,643,366 | \$ 35,453,730 | \$ 36,682,278 | \$ 38,685,705 |
| Commercial & Industrial | 8,978,703 | 9,659,078 | 10,049,782 | 10,101,108 | 10,620,950 |
| Special Rate—Simpson | 4,371,527 | 4,153,327 | 3,798,922 | 4,774,237 | 5,031,760 |
| Municipal (2) | 349,722 | 380,267 | 364,357 | 400,322 | 383,385 |
| Other Public Bldgs. & Grounds (3) | 1,680,603 | 1,861,111 | 1,702,656 | 1,815,865 | 1,909,782 |
| Unbilled (4) | 417,145 | 187,966 | (648,438) | 478,594 | 416,986 |
| Sales to Other Water Utilities | <u>1,251,815</u> | <u>1,776,686</u> | <u>1,530,116</u> | <u>1,625,163</u> | <u>2,090,430</u> |
| Total Water Sales | \$ 51,642,227 | \$ 54,661,801 | \$ 52,251,125 | \$ 55,877,567 | \$ 59,138,998 |
| Other Operating Revenues (5) | <u>5,382,313</u> | <u>9,331,955</u> | <u>10,735,630</u> | <u>9,526,467</u> | <u>21,541,733</u> |
| Total Operating Revenue | \$ 57,024,540 | \$ 63,993,756 | \$ 62,986,755 | \$ 65,404,034 | \$ 80,680,731 |
| Operating Expenses (1) | | | | | |
| Operating & Maintenance | \$ 33,387,663 | \$ 34,055,463 | \$ 34,453,742 | \$ 32,821,611 | \$ 32,602,452 |
| Depreciation | 13,016,544 | 13,845,799 | 14,474,964 | 14,389,681 | 15,262,686 |
| Taxes (6) | <u>2,881,877</u> | <u>3,093,311</u> | <u>3,142,772</u> | <u>3,106,516</u> | <u>3,485,243</u> |
| Total | \$ 49,286,084 | \$ 50,994,573 | \$ 52,071,478 | \$ 50,317,808 | \$ 51,350,381 |
| Net Operating Income (Loss) | \$ 7,738,456 | \$ 12,999,183 | \$ 10,915,277 | \$ 15,086,226 | \$ 29,330,350 |
| Non-Operating Revenue (Expenses) (1) | | | | | |
| Other Income | \$ 61,265 | \$ 497,331 | \$ 33,795 | \$ (12,371) | \$ 288,183 |
| Interest Income | 3,730,407 | 1,955,385 | 2,370,993 | 3,141,374 | 2,320,753 |
| Gain from Disposition of Property | 0 | 26,100 | 0 | 0 | 0 |
| Interest Charges (Net) | <u>(8,406,264)</u> | <u>(9,076,156)</u> | <u>(15,175,660)</u> | <u>(15,018,374)</u> | <u>(14,696,096)</u> |
| Total Non-Operating Revenue (Expense) | \$ (4,614,592) | \$ (6,597,340) | \$ (12,770,872) | \$ (11,889,371) | \$ (12,087,160) |
| Net Income (Loss) Before Capital Contributions (1) | \$ 3,123,864 | \$ 6,401,843 | \$ (1,855,595) | \$ 3,196,855 | \$ 17,243,190 |
| Less: Regional System Net Income (Loss) Before Capital Contributions (7) | <u>(2,576,589)</u> | <u>(4,701,178)</u> | <u>(1,702,668)</u> | <u>(4,721,020)</u> | <u>2,849,378</u> |
| Net Tacoma Water Net Income (Loss) Before Capital Contributions | \$ 5,700,453 | \$ 11,103,021 | \$ (152,927) | \$ 7,917,875 | \$ 14,393,812 |
| Debt Service Calculation Adjustments (8) | | | | | |
| Less: Restricted Income | \$ (623,867) | \$ (273,694) | \$ (145,331) | \$ (341,378) | \$ (224,988) |
| Less: Gain from Disposition of Property | 0 | (26,100) | 0 | 0 | 0 |
| Add: Interest Subsidies on 2010B Bonds | 0 | 244,683 | 2,048,805 | 2,972,443 | 2,972,439 |
| Add: Depreciation | 8,212,995 | 9,053,762 | 10,048,851 | 9,906,861 | 10,766,715 |
| Add: Interest Charges (Net) | 4,323,860 | 5,157,916 | 10,342,360 | 8,577,696 | 9,727,637 |
| Add: SDC Revenues (9) | <u>1,754,475</u> | <u>404,451</u> | <u>5,772,945</u> | <u>4,834,803</u> | <u>1,810,178</u> |
| Net Tacoma Water Revenue Available for Debt Service | \$ 19,367,916 | \$ 25,664,039 | \$ 27,914,703 | \$ 33,868,300 | \$ 39,445,793 |
| Debt Service on Outstanding Bonds (10) | \$ 10,438,208 | \$ 10,432,133 | \$ 16,198,876 | \$ 18,689,644 | \$ 18,751,491 |
| Debt Service Coverage | 1.86x | 2.46x | 1.72x | 1.81x | 2.10x |

(1) Includes Second Supply System operating results. See "Regional Water Supply System Historical 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. See "Net Income (Loss) Before Capital Contributions" column in the "Regional Water Supply System Historical Operating Results" table.

(8) All adjustments exclude Second Supply System.

(9) Includes SDC revenue as recognized and excludes deferred SDC revenue. See "SECURITY FOR THE BONDS"

(10) Includes debt service on Tacoma Water Parity Bonds only.

Tacoma Water and the other Participants pay all costs of the Second Supply System on the same lien as operating costs of their respective utilities, prior to the payment of debt service and capital expenses. The other Participants are billed and pay monthly their share of capital and operating and maintenance expenses. Payments for debt service on the Outstanding Parity Bonds are paid by the other Participants monthly for the 2002 Bonds and the Bonds and semi-annually for the 2010 Bonds in advance when the debt service payments are due. Tacoma Water receives the payments from the other Participants and pays all operating costs and debt service of the Second Supply System.

The Second Supply System annual revenues are established to approximately equal annual operating costs and debt service. Variations from year to year primarily reflect the timing of payments received by Tacoma Water and payments made for capital projects. If another Participant defaults, Tacoma Water is obligated to increase its Participant's share, including paying debt service on the Bonds.

The following table shows selected historical revenues and expenses for the Second Supply System for the years 2008 through 2012.

**Regional Water Supply System
Historical Operating Results
(Year ending December 31)**

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|
| Operating Revenues | | | | | |
| Tacoma Water | \$ 3,738,462 | \$ 3,737,135 | \$ 4,500,707 | \$ 4,026,921 | \$ 4,709,244 |
| Kent | 1,630,416 | 1,211,628 | 1,890,066 | 1,677,415 | 1,869,737 |
| Covington | 1,601,782 | 1,177,764 | 1,879,914 | 1,671,137 | 1,859,353 |
| Lakehaven | <u>660,194</u> | <u>328,090</u> | <u>882,662</u> | <u>916,591</u> | <u>5,977,937</u> |
| Total Operating Revenue | \$ 7,630,854 | \$ 6,454,617 | \$ 9,153,349 | \$ 8,292,064 | \$ 14,416,271 |
| Operating Expenses | | | | | |
| Operating & Maintenance | \$ 2,300,026 | \$ 2,629,850 | \$ 2,458,379 | \$ 2,485,977 | \$ 2,510,085 |
| Depreciation | <u>4,803,549</u> | <u>4,792,037</u> | <u>4,426,113</u> | <u>4,482,820</u> | <u>4,495,971</u> |
| Total Operating Expenses | \$ 7,103,575 | \$ 7,421,887 | \$ 6,884,492 | \$ 6,968,797 | \$ 7,006,056 |
| Net Operating Income (Loss) | \$ 527,279 | \$ (967,270) | \$ 2,268,857 | \$ 1,323,267 | \$ 7,410,215 |
| Non-Operating Revenue (Expenses) | | | | | |
| Other Income | \$ 14,360 | \$ 0 | \$ 0 | \$ 0 | \$ 0 |
| Interest Income | 293,709 | 184,332 | 861,775 | 396,391 | 407,622 |
| Interest Charges (Net) | <u>(3,411,937)</u> | <u>(3,918,240)</u> | <u>(4,833,300)</u> | <u>(6,440,678)</u> | <u>(4,968,459)</u> |
| Total Non-Operating Revenue (Expense) | \$ (3,103,868) | \$ (3,733,908) | \$ (3,971,525) | \$ (6,044,287) | \$ (4,560,837) |
| Net Income (Loss) Before Capital Contributions | \$ (2,576,589) | \$ (4,701,178) | \$ (1,702,668) | \$ (4,721,020) | \$ 2,849,378 |
| Debt Service Calculation Adjustments | | | | | |
| Add: Capital Contributions from Participants | \$ 1,131,930 | \$ 0 | \$ 0 | \$ 0 | \$ 0 |
| Add: Interest Subsidies on 2010B RWSS Bonds | 0 | 0 | 306,327 | 868,328 | 868,328 |
| Add: Depreciation | 4,803,549 | 4,792,037 | 4,426,113 | 4,482,820 | 4,495,971 |
| Add: Interest Charges (Net) | 3,411,937 | 3,918,240 | 4,833,300 | 6,440,678 | 4,968,459 |
| Add: Use of Other Available Funds (1) | <u>0</u> | <u>1,096,214</u> | <u>0</u> | <u>0</u> | <u>0</u> |
| Net Regional Water Supply System Revenue Available for Debt Service | \$ 6,770,827 | \$ 5,105,313 | \$ 7,863,072 | \$ 7,070,806 | \$ 13,182,136 |
| Debt Service on Outstanding RWSS Bonds | \$ 4,995,313 | \$ 5,105,313 | \$ 5,593,852 | \$ 7,243,016 | \$ 7,259,682 |

- (1) The City maintains and collects rates that, together with amounts on deposit in the Revenue Fund, are sufficient to pay the cost of operation and maintenance of the Water System and debt service and other costs. See Appendix A—"SUMMARY OF THE BOND ORDINANCE – Covenants with Bondowners." The City currently bills the Second Supply System partners based on actual expenses so occasionally there are timing differences. When this occurs within the Second Supply System funds other Second Supply System funds are used to adjust for these differences, as occurred in 2009.

The audited financial statements of Tacoma Water as of and for the years ended December 31, 2012 and December 31, 2011 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 State near the southern tip of Puget Sound. It is the third largest city in the State with a 2012 estimated population of 199,600. The City is located 32 miles south of Seattle and 28 miles northeast of Olympia, the State capital. 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 |
|-------------|---------------|----------------------|
| 2012 | 199,600 | 808,200 |
| 2011 | 198,900 | 802,150 |
| 2010 | 198,397 | 795,225 |
| 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 |

Source: Washington State Office of Financial Management estimates; U.S. Census for 2010 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 | 56,624 |
| Local Public School Districts (K-12) | Education | 13,352 |
| Multicare Health System | Health Services | 6,547 |
| Washington State | Public Sector | 6,488 |
| Franciscan Health System | Health Services | 5,704 |
| Pierce County Government | Government/Public Offices | 2,872 |
| Washington State Higher Education | Education | 2,632 |
| City of Tacoma (excluding Tacoma Public Utilities) | Government/Public Offices | 2,222 |
| Emerald Queen Casino | Casino Gambling | 2,200 |
| Wal-Mart | Retail | 1,785 |
| The Boeing Company (Frederickson Site) | Aerospace | 1,700 |
| Tacoma Public Utilities | Public Utility | 1,332 |
| Costco | Wholesale | 1,185 |
| US Postal Service | Government/Public Offices | 1,100 |
| State Farm Insurance Companies | Insurance | 1,070 |
| Washington State National Guard | Military | 1,050 |
| Comcast Cable | Cable Televisions Services | 1,018 |

Source: Economic Development Board of Tacoma-Pierce County, 2012.

PIERCE COUNTY NEW RESIDENTIAL BUILDING PERMIT VALUES

| Year | Single-Family | | Multi-Family | |
|-------------|----------------------|--------------------|---------------------|--------------------|
| | Total Permits | Total Value | Total Units | Total Value |
| 2012 | 2,007 | \$513,727,095 | 472 | \$ 48,284,707 |
| 2011 | 1,487 | 358,523,919 | 1,072 | 119,788,982 |
| 2010 | 1,703 | 396,954,508 | 192 | 22,130,123 |
| 2009 | 1,240 | 242,118,582 | 804 | 79,995,681 |
| 2008 | 1,795 | 339,876,617 | 543 | 64,271,436 |
| 2007 | 3,537 | 718,169,188 | 1,490 | 176,217,591 |
| 2006 | 4,839 | 864,902,045 | 1,062 | 131,476,813 |
| 2005 | 5,402 | 928,758,256 | 1,204 | 141,101,681 |
| 2004 | 4,348 | 676,867,250 | 1,438 | 140,259,564 |
| 2003 | 4,400 | 643,284,106 | 752 | 60,428,746 |

Source: U.S. Census Bureau.

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

| Year | Pierce County | City of Tacoma |
|-------------|----------------------|-----------------------|
| 2012 (1) | \$ 2,484,930 | \$ 931,712 |
| 2011 | 10,428,907 | 3,826,546 |
| 2010 | 10,547,025 | 3,849,214 |
| 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 |

(1) Through the first quarter of 2012. The taxable retail sales for Pierce County for the first quarter of 2011 was \$2,432,448,662 and \$909,779,399 for the City of Tacoma.

Source: Washington State Department of Revenue.

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

| Year | Pierce County | Washington State |
|-------------|----------------------|-------------------------|
| 2012(1) | \$57,162 | \$56,444 |
| 2011(2) | 56,114 | 55,500 |
| 2010 | 55,531 | 54,888 |
| 2009 | 56,555 | 55,458 |
| 2008 | 57,674 | 57,858 |
| 2007 | 56,426 | 56,141 |
| 2006 | 55,506 | 53,522 |
| 2005 | 50,678 | 50,004 |
| 2004 | 49,151 | 49,585 |
| 2003 | 47,084 | 46,967 |

(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 |
| 2011(1) | \$ 33,117,849 | \$ 40,992 | \$299,685,263 | \$ 43,878 |
| 2010 | 31,625,073 | 39,761 | 283,367,864 | 42,024 |
| 2009 | 31,228,180 | 39,208 | 276,727,871 | 41,504 |
| 2008 | 32,198,440 | 40,996 | 289,433,693 | 44,106 |
| 2007 | 30,164,757 | 39,049 | 272,624,864 | 42,192 |
| 2006 | 27,915,787 | 36,567 | 252,091,288 | 39,570 |
| 2005 | 25,579,464 | 34,190 | 230,057,261 | 36,766 |
| 2004 | 23,905,533 | 32,299 | 222,421,768 | 35,998 |
| 2003 | 22,789,755 | 31,050 | 206,983,236 | 33,909 |
| 2002 | 21,933,684 | 30,125 | 200,492,998 | 33,126 |
| 2001 | 21,214,654 | 29,611 | 197,323,543 | 32,966 |

(1) Last available data.

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

Employment within the County is described in the following table:

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

| NAICS Industry Title | Annual Average | | | | |
|---------------------------------------|-----------------------|-------------|-------------|-------------|-------------|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| <u>Resident Labor Force</u> | | | | | |
| Employment | 357,010 | 349,310 | 352,260 | 356,550 | 370,570 |
| Unemployment | 34,530 | 37,940 | 40,180 | 38,140 | 22,510 |
| Total | 391,540 | 387,250 | 392,440 | 394,690 | 393,080 |
| Percent Of Labor Force | 8.8% | 9.8% | 10.2% | 9.7% | 5.7% |
| Total Nonfarm | 267,400 | 265,200 | 264,300 | 268,500 | 280,500 |
| Total Private | 210,400 | 207,400 | 205,900 | 210,700 | 223,500 |
| Goods Producing | 33,800 | 33,000 | 33,800 | 36,200 | 43,700 |
| Mining and Logging | 300 | 300 | 300 | 300 | 400 |
| Construction | 16,800 | 16,300 | 17,200 | 19,000 | 23,500 |
| Specialty Trade Contractors | 10,700 | 10,500 | 10,800 | 12,000 | 15,000 |
| Manufacturing | 16,700 | 16,400 | 16,300 | 16,900 | 19,800 |
| Services Providing | 233,600 | 232,100 | 230,500 | 232,200 | 236,700 |
| Trade, Transportation And Utilities | 55,100 | 54,300 | 53,000 | 53,100 | 55,600 |
| Wholesale Trade | 11,100 | 10,900 | 10,900 | 11,000 | 11,400 |
| Retail Trade | 31,800 | 31,700 | 31,200 | 31,200 | 32,900 |
| Food And Beverage Stores | 5,900 | 5,600 | 5,500 | 5,400 | 5,500 |
| General Merchandise Stores | 8,000 | 8,000 | 7,800 | 7,800 | 7,900 |
| Transportation and Utilities | 12,200 | 11,600 | 10,900 | 10,900 | 11,400 |
| Information | 2,700 | 2,800 | 3,000 | 3,100 | 3,700 |
| Financial Activities | 11,500 | 11,200 | 11,200 | 12,300 | 13,200 |
| Professional And Business Services | 23,900 | 23,900 | 23,500 | 23,900 | 24,900 |
| Admin, Support, Waste Mgmt & Remed. | 14,300 | 14,200 | 13,600 | 13,500 | 14,300 |
| Administrative And Support Services | 13,000 | 12,900 | 12,200 | 12,100 | 12,900 |
| Education And Health Services | 44,200 | 43,800 | 43,600 | 43,200 | 41,600 |
| Ambulatory Health Care Services | 14,500 | 14,300 | 14,000 | 14,000 | 13,600 |
| Hospitals | 11,000 | 10,900 | 10,600 | 10,200 | 9,600 |
| Leisure And Hospitality | 26,200 | 25,500 | 25,300 | 26,200 | 27,800 |
| Food Services And Drinking Places | 20,500 | 19,900 | 19,800 | 20,600 | 22,100 |
| Other Services | 13,000 | 12,900 | 12,600 | 12,700 | 13,000 |
| Government | 57,000 | 57,800 | 58,400 | 57,800 | 56,900 |
| Federal Government | 12,800 | 13,200 | 13,200 | 11,700 | 10,800 |
| State Government | 10,500 | 10,600 | 11,300 | 11,700 | 11,900 |
| State Government Educational Services | 3,700 | 3,700 | 3,700 | 3,600 | 3,800 |
| Local Government | 33,700 | 34,000 | 34,000 | 34,400 | 34,300 |
| Local Government Educational Services | 18,400 | 18,400 | 18,400 | 18,400 | 18,200 |

Source: Washington State Employment Security Department.

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.

TAX MATTERS

Tax Exemption

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 Bonds, interest on the 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 Bonds in order to maintain the exclusion of the interest on the Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of Bond proceeds and the facilities financed or refinanced with Bond proceeds, limitations on investing gross proceeds of the Bonds in higher yielding investments in certain circumstances, and the requirement to comply with the arbitrage rebate requirement to the extent applicable to the 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 Bonds could become taxable retroactive to the date of issuance of the 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 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, tax exempt interest, including interest on the 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 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 Bonds may be subject to the foreign branch profits tax imposed by Section 884 of the Code when the 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 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 Bonds. Depending on all the facts and circumstances and the type of audit

involved, it is possible that commencement of an audit of the Bonds could adversely affect the market value and liquidity of the Bonds until the audit is concluded, regardless of its ultimate outcome.

Certain Other Federal Tax Consequences

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 \$10,000,000 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 \$10,000,000 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 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 Bonds is deductible for federal income tax purposes.

Original Issue Premium. The 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 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 Bonds into account in determining gross income.

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

Potential Future Federal Tax Law Changes. From time to time, there are legislative proposals in Congress which, if enacted, could require changes in the description of federal tax matters relating to the Bonds set forth above or adversely affect the market value of the Bonds. It cannot be predicted whether future legislation may be proposed or enacted that would affect the federal tax treatment of interest received on the Bonds. Prospective purchasers of the Bonds should consult with their own tax advisors regarding any proposed or pending legislation that would change the federal tax treatment of interest on the Bonds.

DESCRIPTION OF RATINGS

Moody's Investors Service Inc. and Standard & Poor's Ratings Services, a business unit within Standard & Poor's Financial Services LLC, 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 Bonds are being purchased by Citigroup Global Markets Inc. at an aggregate price of \$80,173,300 which represents the principal amount of the Bonds, plus an original issue premium of \$2,331,083, less an underwriter's discount of \$462,783. After the initial public offering, the public offering prices may be varied from time to time.

FINANCIAL ADVISORS

SDM Advisors Inc., Mount Vernon, Washington and A. Dashen & Associates, Bellevue, Washington have acted as financial advisors to Tacoma Water in connection with the issuance of the Bonds. The financial advisors have 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. SDM Advisors Inc. and A. Dashen & Associates are independent financial advisory and consulting organizations and are 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 INVESTMENT CONSIDERATIONS

This section contains certain additional considerations and is not meant to be comprehensive or definitive.

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.

Local Measures. Under the City Charter, voters may initiate City Charter amendments and local legislation, including modifications to existing legislation, and through referendum may prevent legislation passed by the City

Council from becoming law; provided that ordinances authorizing bonds, adopting annual budgets, or making appropriations are not subject to referendum as well as ordinances not subject to referendum under state law (including rate ordinances).

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.

Municipal Bankruptcies

A municipality such as the City must be specifically authorized under State law in order to seek relief under Chapter 9 of the U.S. Bankruptcy Code (the "Bankruptcy Code"). A creditor, however, cannot bring an involuntarily bankruptcy proceeding against a municipality, including the City. The Federal bankruptcy courts have broad discretionary powers under the Bankruptcy Code. Chapter 39.64 RCW, entitled the "Taxing District Relief Act," permits any "taxing district" (defined to include cities) to voluntarily petition for relief under the Bankruptcy Code.

The legal opinion of Bond Counsel regarding the validity of the Bonds will be qualified by reference to bankruptcy, reorganization, insolvency, fraudulent conveyance, moratorium and other similar laws affecting the rights of creditors generally, and by general principles of equity. See Appendix D.

Seismic and Other Considerations

Tacoma Water's facilities are in an area of seismic activity, with frequent small earthquakes and occasional moderate and larger earthquakes. The City can give no assurance regarding the effect of an earthquake, a tsunami from seismic activity in the State or in other areas, a volcano or other natural disaster or that proceeds of insurance carried by the Department would be sufficient, if available, to rebuild and reopen Tacoma Water's facilities or that Tacoma Water facilities or surrounding facilities and infrastructure could or would be rebuilt and reopened in a timely manner following a major earthquake or other natural disaster.

CONTINUING DISCLOSURE UNDERTAKING

Basic Undertaking to Provide Annual Financial Information and Notice of Listed Events. To meet the requirements of paragraph (b)(5) of United States Securities and Exchange Commission ("SEC") Rule 15c2-12 ("Rule 15c2-12"), 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: (a) annual financial information and operating data of the type included in this Official Statement as generally described below ("annual financial information"); and (b) timely notice (not in excess of ten business days after the occurrence of the event) of the occurrence of any of the following events with respect to the Bonds: (i) principal and interest payment delinquencies; (ii) non payment related defaults, if material; (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, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notice of Proposed Issue (IRS Form 5701 – TEB) or other material notices or determinations with respect to the tax status of the Bonds; (vii) modifications to rights of holders of the Bonds, if material; (viii) Bond calls (other than scheduled mandatory redemptions of Term Bonds), if material, and tender offers; (ix) defeasances; (x) release, substitution, or sale of property securing repayment of the Bonds, if material; (xi) rating changes; (xii) bankruptcy, insolvency, receivership or similar event of the City, as such “Bankruptcy Events” are defined in Rule 15c2-12; (xiii) the consummation of a merger, consolidation, or acquisition involving the City or the sale of all or substantially all of the assets of the City, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (xiv) appointment of a successor or additional trustee or the change of name of a trustee, if material.

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 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, 2013).

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 Rule 15c2-12.

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 of all of the Bonds. In addition, the City’s obligations under the Undertaking shall terminate if those provisions of Rule 15c2-12 which require the City to comply with the Undertaking become legally inapplicable in respect of the Bonds for any reason, as confirmed by an opinion of nationally recognized bond counsel or other counsel familiar with federal securities laws delivered to the City, and the City provides timely notice of such termination to the MSRB.

Remedy for Failure to Comply with Undertaking. If the City or any other obligated person fails to comply with the Undertaking, the City will proceed with due diligence to cause such noncompliance to be corrected as soon as practicable after the City learns of that failure. 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 beneficial owner of a Bond will be to take such actions as that holder deems necessary, including seeking an order of specific performance from an appropriate court, to compel the City or other obligated person to comply with the Undertaking.

Prior Compliance with Continuing Disclosure Undertakings

The City has entered into previous continuing disclosure undertakings under Rule 15c2-12. On February 17, 2013, the City filed missing information regarding assessments levied, collected and uncollected for the years 2007 through 2011 in connection with its Consolidated Local Improvement District No. 60 Bonds. The City believes it is currently in compliance with its previous undertakings.

MISCELLANEOUS

Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and are not a representation of fact. This Official Statement is not to be construed as an agreement or contract between the City and the purchasers or owners of any Bonds.

51290704.2

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX A

SUMMARY OF THE BOND ORDINANCE

(THIS PAGE INTENTIONALLY LEFT BLANK)

SUMMARY OF PRINCIPAL PROVISIONS OF THE BOND ORDINANCE

Following is a summary of certain of the 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 Nos. 27109 and 27405 have been 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 2009 Bonds, the 2010 Bonds and the Bonds, have consented to this amendment to the definition of Annual Debt Service. This provision is expected to be in effect upon the issuance of the Bonds.

“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 for the purpose of identifying ownership of the Bonds.

“Bond Registrar” means the Fiscal Agent, or any successor bond registrar selected by the City.

“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 Agent” means the fiscal agent of the State of Washington, as the same may be designated from time to time.

“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 2003 Bonds, the 2005 Bonds, the 2009 Bonds and the 2010 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. 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 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.

“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.

“2010 Bonds” means the 2010A Bonds and 2010B Bonds.

“2010A Bonds” means the City’s Water System Revenue Refunding Bonds, 2010A, issued in the original principal amount of \$29,100,000 pursuant to Ordinance No. 27902.

“2010B Bonds” means the City’s Water System Revenue Bonds, 2010B (Taxable Build America Bonds – Direct Payment), issued in the original principal amount of \$74,985,000 pursuant to Ordinance No. 27902.

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 of 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, which are reinsured by National Public Finance Guarantee Corporation, a subsidiary of MBIA Inc. effective January 1, 2009 ("FGIC"), were obtained for the 1997 Bonds, 2001 Bonds and 2005 Bonds. See "SECURITY FOR THE BONDS – The Reserve Insurance Policies and Reserve Account Balance" 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 Bonds. See "SECURITY FOR THE BONDS – The Reserve Insurance Policies and Reserve Account Balance" 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 2003 Bonds, 2005 Bonds and 2009 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 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 2003 Bonds, 2005 Bonds and 2009 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:

(1) 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

(2) 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.

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX B

BOOK-ENTRY SYSTEM

(THIS PAGE INTENTIONALLY LEFT BLANK)

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, or for the absence of material changes in such information subsequent to the date hereof. 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 a Standard & Poor’s rating of AA+. 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 (which website is not incorporated by reference).

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 MMI 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. Payments to Cede & Co. (or any other nominee as may be requested by an authorized representative of DTC) are 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

2011 AND 2012 AUDITED FINANCIAL STATEMENTS

(THIS PAGE INTENTIONALLY LEFT BLANK)

ANNUAL

TACOMA WATER

2012

**FINANCIAL
REPORT**



Public Utility Board

LAURA FOX

Chair

DAVID NELSON

Vice-Chair

WOODROW JONES

Secretary

BRYAN FLINT

Member

MARK PATTERSON

Member

WILLIAM A. GAINES
Director of Utilities/CEO

LINDA MCCREA
Superintendent

ANDREW CHERULLO
Finance Director

DEPARTMENT OF PUBLIC UTILITIES
CITY OF TACOMA

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES

TACOMA WATER

TABLE OF CONTENTS

FINANCIAL DATA

| | |
|---|---------|
| INDEPENDENT AUDITOR'S REPORT | 3 - 4 |
| MANAGEMENT'S DISCUSSION AND ANALYSIS | 5 - 11 |
| STATEMENTS OF NET POSITION | 14 - 15 |
| STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION | 17 |
| STATEMENTS OF CASH FLOWS | 18 - 19 |
| NOTES TO FINANCIAL STATEMENTS | 20 - 37 |

STATISTICAL DATA (UNAUDITED)

| | |
|--|----------------|
| TEN-YEAR FINANCIAL REVIEW | 40 - 41 |
| TEN-YEAR FINANCIAL REVIEW RWSS | 42 - 43 |
| DEBT SERVICE REQUIREMENTS BY YEAR | 44 |
| FUNDS AVAILABLE FOR DEBT SERVICE | 45 |
| WATER PLANT IN SERVICE | 46 - 47 |
| SUMMARY OF WATER BILLED | 48 |
| SUMMARY OF WATER SALES | 49 |
| 2012 STATISTICAL INFORMATION | 50 |
| TAXES AND EMPLOYEE WELFARE CONTRIBUTIONS | 51 |
| WATER RATES | 52 |
| FIRE PROTECTION RATES | 53 |
| GRAPHS | 54 - 57 |
| SUPERINTENDENT'S REPORT | 59 - 67 |

FINANCIAL DATA

This page has been left blank intentionally.

REPORT OF INDEPENDENT AUDITORS

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

Report on Financial Statements

We have audited the accompanying financial statements of City of Tacoma, Washington Department of Public Utilities, Water Division (the Division), which comprise the Statements of Net Position as of December 31, 2012 and 2011, and the related statements of revenue, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Other Matter

Accounting principles generally accepted in the United States of America require that the accompanying management's discussion and analysis on pages 5 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules presented on pages 40 through 67 are not a required part of the basic financial statements, but are supplemental information presented for the purposes of additional analysis. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

A handwritten signature in blue ink that reads "Miss Adams LLP". The signature is written in a cursive, flowing style.

Portland, Oregon
April 3, 2013

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, 2012 and 2011. 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 includes 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, 2012 and 2011, include Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position, and Statements of Cash Flows. The Statements of Net Position present information on all of the Utility's assets and liabilities, with the difference between the two reported as net position. The Statements of Revenues, Expenses and Changes in Net Position 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, capital and related financing, non-capital financing and investing 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 \$452.9 million in 2012, \$429.2 million in 2011 and by \$417.7 million in 2010. Of these amounts, \$42.5 million in 2012, \$22.0 million in 2011, and \$13.7 million in 2010 were available to meet Tacoma Water's ongoing obligations to citizens and creditors.
- Tacoma Water's total net positions increased by \$23.7 million in 2012, \$11.5 million in 2011 and \$5.1 million in 2010.
- Tacoma Water's operating revenues were \$80.7 million, an increase of \$15.3 million, compared to \$65.4 million in 2011 due to an average water rate increase of 5.2% and other operating revenues and contract resource obligations. Operating revenues increased \$2.4 million in 2011 compared to 2010 operating revenues of \$63.0 million.
- In 2012, Tacoma Water's net utility plant of \$722.9 million represented an increase of \$61.7 million over the 2011 \$661.2 million balance. Major projects contributing to the increase include the Green River Water Filtration Facility and Main Replacement Projects. Utility plant increased \$24.6 million over the 2010 \$636.6 million balance.
- Tacoma Water's current assets increased by \$25.0 million during 2012 and increased \$1.2 million during 2011. The increases in 2012 are primarily in operating fund cash and accounts receivable. Current assets decreased by \$5.6 million during 2010.

- Tacoma Water's Long-Term Debt decreased by \$10.6 million during 2012, decreased \$3.5 million during 2011 and increased \$129.1 million during 2010. The increase in 2010 are due to the bond issuances for the Green River Water Filtration Facility.
- The Utility transferred \$5.0 million of revenues into the Rate Stabilization account.

Overview of the Financial Statements

The Utility reported operating income of \$29.3, \$15.1 and \$10.9 million for 2012, 2011 and 2010 respectively. In 2012, operating revenues increased by \$15.3 million while operating expenses increased \$1.0 million.

Net income was \$23.7, \$11.5 and \$5.1 million in 2012, 2011 and 2010 respectively. Non-operating revenues net of expenses decreased \$0.2 million. Capital contributions for 2012 decreased \$1.4 million compared to a decrease of \$0.5 million in 2011. The decrease in 2012 reflects a \$5.0 million transfer to the rate stabilization fund.

The following table highlights Tacoma Water's operating results for the years 2012 - 2010.

Operating Results (In thousands)

| | 2012 | 2011 | 2010 | 12/11 Increase (Decrease) | 11/10 Increase (Decrease) |
|---------------------------------------|-----------|-----------|-----------|---------------------------------|---------------------------------|
| Operating Revenues | \$ 80,681 | \$ 65,404 | \$ 62,987 | \$ 15,277 | \$ 2,417 |
| Operating Expenses | 51,350 | 50,318 | 52,072 | 1,032 | (1,754) |
| Operating Income | 29,331 | 15,086 | 10,915 | 14,245 | 4,171 |
| Net Non-Operating Income (Expense) | (12,087) | (11,889) | (12,771) | (198) | 882 |
| Capital Contributions | 7,834 | 9,251 | 9,714 | (1,417) | (463) |
| Federal BAB Subsidies and Grants | 3,841 | 4,006 | 2,355 | (165) | 1,651 |
| Transfers Out | (5,227) | (4,961) | (5,111) | (266) | 150 |
| Change in Net Position | \$ 23,692 | \$ 11,493 | \$ 5,102 | \$ 12,199 | \$ 6,391 |

Net Position

Net position may serve over time as a useful indicator of the Utility's financial position. Assets exceeded liabilities by \$452.9, \$429.2 and \$417.7 million for 2012, 2011 and 2010 respectively. Net position increased \$23.7 million in 2012 mainly due to increased operating revenues of \$15.3 million partially offset by increased operating and non-operating expense of \$0.7 million. In addition, contributions decreased \$1.4 million and transfers increased \$0.3 million.

Net investment in capital assets represents the Utility's equity investment in capital assets. In 2012, this amounted to \$384.7 million, an increase of \$2.3 million compared to 2011. Investment in capital assets in 2011 was \$382.4 million representing an increase of \$1.1 million compared to 2010.

Restricted net position for 2012 was \$25.6 million, an increase of \$0.9 million from 2011. Restricted net position for 2011 was \$24.7 million, reflecting an increase of \$2.0 million from 2010.

In 2012, unrestricted net position increased \$20.5 million to \$42.5 million. Unrestricted net position for 2011 was \$22.0 million, representing an increase of \$8.4 million from 2010 balance of \$13.7 million.

The analysis below highlights changes in Tacoma Water's net position for the years 2012, 2011 and 2010.

Tacoma Water's Net Position

(In thousands)

| Description | 2012 | 2011 | 2010 | 12/11 Increase (Decrease) | 11/10 Increase (Decrease) |
|------------------------------------|-------------------|-------------------|-------------------|---------------------------------|---------------------------------|
| Net Utility & Non-Utility Plant | \$ 723,400 | \$ 661,701 | \$ 637,140 | \$ 61,699 | \$ 24,561 |
| Current and Other Assets | 227,809 | 255,451 | 276,789 | (27,642) | (21,338) |
| Total Assets | <u>\$ 951,209</u> | <u>\$ 917,152</u> | <u>\$ 913,929</u> | <u>\$ 34,057</u> | <u>\$ 3,223</u> |
| Net Position: | | | | | |
| Net Investment in Capital | | | | | |
| Assets | \$ 384,739 | \$ 382,444 | \$ 381,316 | \$ 2,295 | \$ 1,128 |
| Restricted | 25,635 | 24,727 | 22,728 | 908 | 1,999 |
| Unrestricted | 42,506 | 22,017 | 13,651 | 20,489 | 8,366 |
| Total Net Position | <u>452,880</u> | <u>429,188</u> | <u>417,695</u> | <u>23,692</u> | <u>11,493</u> |
| Long-Term Debt | 409,181 | 419,801 | 423,577 | (10,620) | (3,776) |
| Current and Other LT Liabilities | 89,148 | 68,163 | 72,657 | 20,985 | (4,494) |
| Total Liabilities | <u>498,329</u> | <u>487,964</u> | <u>496,234</u> | <u>10,365</u> | <u>(8,270)</u> |
| Total Net Position and Liabilities | <u>\$ 951,209</u> | <u>\$ 917,152</u> | <u>\$ 913,929</u> | <u>\$ 34,057</u> | <u>\$ 3,223</u> |

Revenues

Total operating revenues in 2012 were \$80.7 million an increase of \$15.3 million (23.4%) compared to 2011. Total operating revenues increased \$2.4 million (3.8%) in 2011 compared to 2010. In 2012 an average rate increase of 5.2% effective January 1, 2012 and higher usage resulted in increased water sales of \$3.3 million (5.8%). In addition, other operating revenue increased \$5.6 million largely due to a \$5.0 million minimum daily purchase agreement restructuring and finally, contract obligations for the Regional Water Supply System (RWSS) partners increased \$6.4 million.

The following table highlights water sales by type of customer for 2012, 2011 and 2010.

Water Sales

(In thousands)

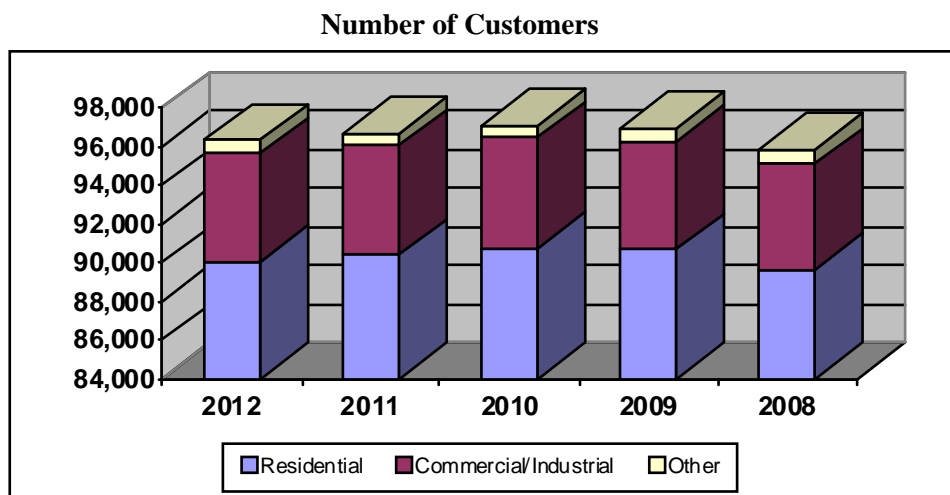
| Type of Customer | 2012 | 2011 | 2010 | 12/11 Increase (Decrease) | 11/10 Increase (Decrease) |
|------------------------------------|------------------|------------------|------------------|---------------------------------|---------------------------------|
| Residential and Domestic | \$ 38,686 | \$ 36,682 | \$ 35,454 | \$ 2,004 | \$ 1,228 |
| Commercial and Industrial | 10,621 | 10,101 | 10,050 | 520 | 51 |
| Special Rate – Simpson Tacoma | 5,032 | 4,774 | 3,799 | 258 | 975 |
| Municipal | 383 | 400 | 364 | (17) | 36 |
| Other Public Buildings and Grounds | 1,910 | 1,816 | 1,702 | 94 | 114 |
| Sale to Other Utilities | 2,090 | 1,625 | 1,530 | 465 | 95 |
| Unbilled Revenue | 417 | 479 | (648) | (62) | 1,127 |
| Total | <u>\$ 59,139</u> | <u>\$ 55,877</u> | <u>\$ 52,251</u> | <u>\$ 3,262</u> | <u>\$ 3,626</u> |

In 2012, approximately 65.4% of water sales were to residential and domestic customers compared to 65.6% in 2011 and 67.9% in 2010. In 2012, commercial and industrial sales were 18.0% compared to 18.1% in 2011 and 19.2% in 2010. Special rate sales to Simpson Tacoma Kraft were 8.5% of total sales in 2012 and 2011 compared to 7.3% in 2010.

Customers

Over the last five years, the overall number of customers has remained relatively stable. In 2012, 93.5% of all customers were residential, 5.8% were commercial and industrial, with 0.7% in the other customer classes.

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

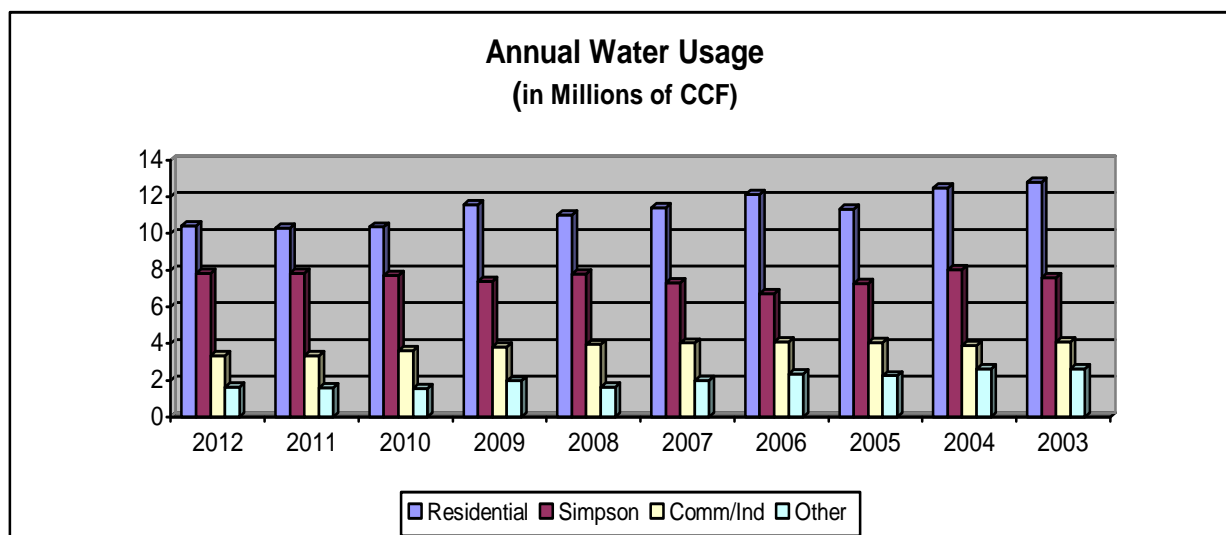


Water Users

The Utility generates the majority of its revenues from its residential and domestic customer base. Residential customers used 10.4 million CCF (100 cubic feet) (44.9%) of the 23.2 million CCF consumed by the Utility's customers in 2012; Simpson Tacoma Kraft Company used approximately 7.8 million CCF (33.8%); commercial and industrial customers used 3.3 million CCF (14.4%); the remaining 1.6 million CCF (6.9%) consumed by other customers.

Looking at the 10-year water usage trend, 2003 was the highest year with 27.11 million CCF, and 2011 was the lowest year with 23.0 million CCF. The trend indicates a general decline in usage since 2003 which reflects the result of plumbing code changes, conservation activities and reduced wholesale consumption.

Below is a graphical representation of the annual water usage by customer type for the last 10 years.



Expenses

In 2012, operating expenses increased \$1.0 million (2.1%), compared to a decrease of \$1.8 million in 2011.

Source of Supply expense decreased by \$0.4 million (8.0%) because the Utility implemented a new work schedule that allowed downsizing of the workforce during 2012, in addition to regulatory work ending in 2011. Transmission and Storage expense decreased by \$0.3 million (13.2%) largely due to a onetime adjustment for electricity expense in 2012.

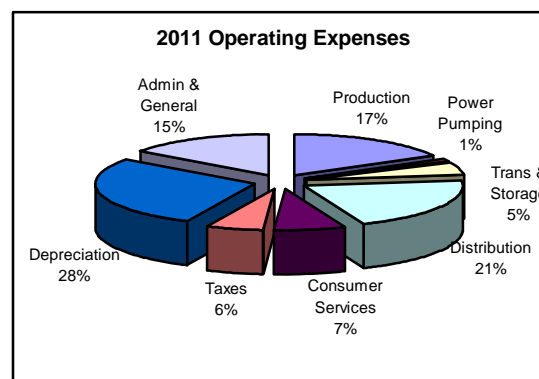
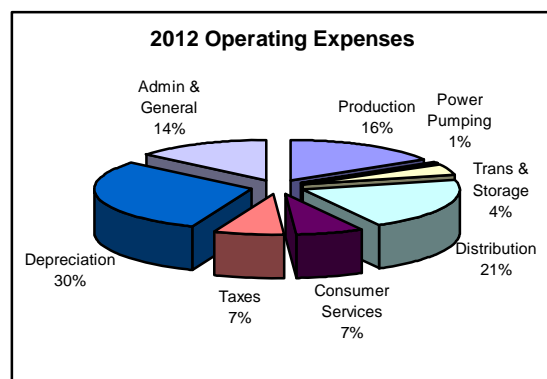
Depreciation expenses increased by \$0.9 million (6.1%) in 2012 mainly due to increase in depreciable asset by \$46.4 million during 2011. Tax expenses increased by \$0.4 million (12.2%) in 2012 largely due to increased water revenues. Customer Accounting and Consumer Services expense increased \$0.2 million (6.6%) in 2012 largely due to computer upgrades and SAP software related expenses.

The following table highlights Tacoma Water's operating expenses for 2012 – 2010.

Operating Expenses (In thousands)

| Category | 2012 | 2011 | 2010 | 12/10 Increase (Decrease) | 11/10 Increase (Decrease) |
|----------------------------------|-----------|-----------|-----------|---------------------------------|---------------------------------|
| Source of Supply | \$ 5,044 | \$ 5,485 | \$ 5,310 | \$ (441) | \$ 175 |
| Water Treatment | 3,335 | 3,119 | 3,400 | 216 | (281) |
| Total Production Expense | 8,379 | 8,604 | 8,710 | (225) | (106) |
| Power Pumping Expense | 280 | 306 | 282 | (26) | 24 |
| Transmission and Storage Expense | 2,273 | 2,619 | 2,525 | (346) | 94 |
| Distribution Expense | 10,633 | 10,367 | 12,232 | 266 | (1,865) |
| Customer Accounting and Service | 3,833 | 3,594 | 3,460 | 239 | 134 |
| Taxes | 3,485 | 3,107 | 3,143 | 378 | (36) |
| Depreciation | 15,263 | 14,390 | 14,475 | 873 | (85) |
| Administrative and General | 7,204 | 7,331 | 7,244 | (127) | 87 |
| Total Operating Expenses | \$ 51,350 | \$ 50,318 | \$ 52,071 | \$ 1,032 | \$ (1,753) |

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



Capital Assets–Utility Plant

Tacoma Water invests in a broad range of utility assets and at the end of 2012 had \$722.9 million in net utility plant, an increase of \$61.7 million from 2011. The largest increase was in construction work in progress of \$43.1 million largely from the Green River Water Filtration construction project. In 2011, Tacoma Water had \$661.2 million in net utility plant, an increase of \$24.6 million compared to 2010. In 2012, 12.7 miles of water main were added or replaced compared to 11.4 miles in 2011; and 6.9 miles in 2010. The effect of the economic turnaround continues to be slow for private development activity. Construction was completed on 12

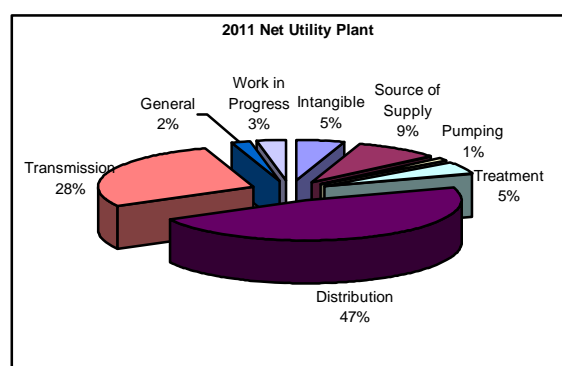
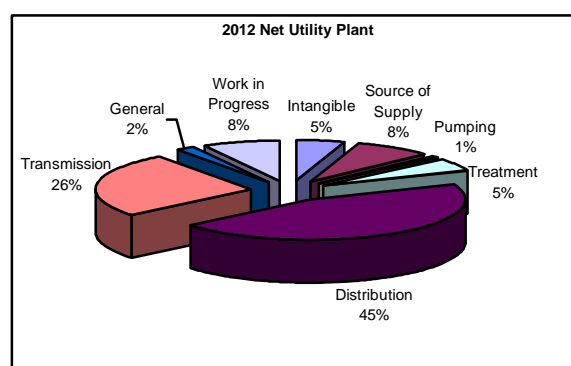
private contracts in 2012, resulting in 2.44 miles; 8 private contracts in 2011, added 2.0 miles; and 8 private contracts in 2010, added 0.9 miles.

The following table summarizes Tacoma Water's capital assets, net of accumulated depreciation, for the years ended December 31, 2012, 2011 and 2010.

Capital Assets, Net of Accumulated Depreciation
(In thousands)

| Net Utility Plant | 2012 | 2011 | 2010 | 12/10 Increase (Decrease) | 11/10 Increase (Decrease) |
|-------------------------------|-------------------|-------------------|-------------------|---------------------------------|---------------------------------|
| Intangible Plant | \$ 35,086 | \$ 34,865 | \$ 34,818 | \$ 221 | \$ 47 |
| Source of Supply Plant | 60,843 | 60,174 | 61,534 | 669 | (1,360) |
| Pumping Plant | 6,037 | 6,180 | 6,385 | (143) | (205) |
| Water Treatment Plant | 33,244 | 34,744 | 36,328 | (1,500) | (1,584) |
| Transmission Plant | 187,349 | 186,002 | 157,878 | 1,347 | 28,124 |
| Distribution Plant | 326,563 | 312,427 | 298,735 | 14,136 | 13,692 |
| General Plant | 14,189 | 10,334 | 9,584 | 3,855 | 750 |
| Construction Work In Progress | 59,541 | 16,427 | 31,331 | 43,114 | (14,904) |
| Total | <u>\$ 722,852</u> | <u>\$ 661,153</u> | <u>\$ 636,593</u> | <u>\$ 61,699</u> | <u>\$ 24,560</u> |

The following graphs provide a visual presentation of the allocation of Tacoma Water's capital investment in 2012 and 2011.



Additional information on capital assets can be found in Note 3 of the financial statements and in the supplementary statistical data.

Debt Administration

As of year-end 2012, the Utility had outstanding revenue bond obligations of \$369.5 million (net of unamortized bond premiums); a decrease of \$7.3 million (1.9%) from 2011. In 2011, Tacoma Water had outstanding revenue bond obligations of \$376.8 million (net of unamortized bond premiums); a decrease of \$6.8 million (1.8%) from 2010.

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

The Utility is required by bond covenants to maintain debt service coverage ratio of 1.25 for principle and interest. Debt service coverage ratios were 2.02, 1.58, 1.64 in 2012, 2011 and 2010 respectively.

At the end of 2012, the Utility had an outstanding State loan balance of \$42.0 million compared to \$43.6 million in 2011 and \$40.0 million in 2010. During 2012, the Utility received an additional \$0.5 million against the 2008 Public Works Trust Fund Loan and \$0.4 million against the 2008 Drinking Water State Revolving Fund Loan. The Utility entered into three more

Drinking Water State Revolving Loan agreements for McMillin Reservoir and the Water Treatment Facility in 2012 totaling \$24.2 million for which no funds have been drawn.

Additional information on the Utility's long-term debt can be found in Note 5 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



Andrew Cherullo
Finance Director

This page has been left blank intentionally.

This page has been left blank intentionally.

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATEMENTS OF NET POSITION

| | DECEMBER 31, | |
|--|----------------------|----------------------|
| ASSETS | 2012 | 2011 |
| UTILITY PLANT | | |
| In Service, at Original Cost | \$820,187,184 | \$793,903,858 |
| Less - Accumulated Depreciation | (156,876,447) | (149,177,559) |
| Total | 663,310,737 | 644,726,299 |
| Construction Work In Progress | 59,541,533 | 16,426,998 |
| Net Utility Plant | 722,852,270 | 661,153,297 |
| NON-UTILITY PROPERTY | 547,480 | 547,480 |
| RESTRICTED ASSETS | | |
| Construction Funds | 58,833,459 | 125,330,650 |
| Debt Service Funds | 3,318,052 | 3,091,834 |
| Bond Reserve Funds | 19,507,744 | 19,512,184 |
| System Development Charge Fund | 53,626,384 | 47,111,039 |
| Other Cash and Equity in Pooled Investments | 25,564,985 | 17,495,079 |
| Notes & Contracts Receivable - SDC & Other | 464,971 | 1,530,840 |
| Total Special Funds | 161,315,595 | 214,071,626 |
| CURRENT ASSETS | | |
| Operating Funds Cash and Equity in | | |
| Pooled Investments | 37,666,496 | 18,958,145 |
| Accounts Receivable | 10,503,161 | 5,693,200 |
| (Net of Allowance for Doubtful Accounts | | |
| of \$453,928 in 2012 and \$516,177 in 2011) | | |
| BABs Interest Subsidies Receivable | 320,064 | 320,064 |
| Accrued Unbilled Revenues | 4,026,679 | 3,609,693 |
| Materials and Supplies | 2,341,174 | 2,503,854 |
| Interfund Receivable | 947,380 | 68,381 |
| Prepayments..... | 602,606 | 250,184 |
| Total Current Assets | 56,407,560 | 31,403,521 |
| OTHER ASSETS | | |
| Unamortized Issuance Costs | 3,021,623 | 3,255,278 |
| Regulatory Asset-Public Fire Protection Fees ... | 4,274,592 | 3,514,579 |
| Regulatory Asset-Hyada Surcharges | 1,025,593 | 1,149,511 |
| Unamortized Losses on Refunding Bonds | 1,764,332 | 2,056,555 |
| Total Other Assets | 10,086,140 | 9,975,923 |
| TOTAL ASSETS | <u>\$951,209,045</u> | <u>\$917,151,847</u> |

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

| | DECEMBER 31, | |
|---|---------------|---------------|
| NET POSITION AND LIABILITIES | 2012 | 2011 |
| NET POSITION | | |
| Net Investment in Capital Assets | \$384,739,201 | \$382,443,716 |
| Restricted for: | | |
| Regional Water Supply System Construction Fund . | - | 360,122 |
| Water Assurance and System Development Charge .. | 24,265,546 | 23,113,760 |
| Debt Service Funds | 1,368,679 | 1,253,432 |
| Unrestricted | 42,506,333 | 22,017,058 |
| Total Net Position | 452,879,759 | 429,188,088 |
| LONG-TERM DEBT, NET OF CURRENT MATURITIES | | |
| Revenue Bonds | 362,310,380 | 370,169,234 |
| Public Works Trust Fund Loans | 23,495,090 | 25,136,305 |
| Drinking Water State Revolving Fund Loan | 15,659,868 | 15,958,759 |
| Muckleshoot Agreements | 7,715,713 | 8,536,459 |
| Total Long-Term Debt | 409,181,051 | 419,800,757 |
| CURRENT LIABILITIES | | |
| Current Maturities of Long-Term Liabilities | 10,842,324 | 9,250,850 |
| Accrued Taxes | 1,595,790 | 1,174,893 |
| Accrued Expenses and Contracts Payable | 17,996,478 | 3,801,668 |
| Salaries, Wages and Fringe Benefits Payable | 1,063,601 | 1,019,509 |
| Interest Payable | 1,949,375 | 1,838,402 |
| Customers' Deposits | 265,961 | 269,732 |
| Interfund Payables | 1,371,061 | 819,643 |
| Total Current Liabilities | 35,084,590 | 18,174,697 |
| LONG-TERM LIABILITIES | | |
| Retained on Contract Payments | 22,000 | 27,000 |
| Customer Advances for Construction | 4,356,297 | 4,563,137 |
| Deferred Revenue | 8,968,764 | 9,967,221 |
| Rate Stabilization | 35,575,447 | 30,575,447 |
| Long-Term Accrued Compensated Absences | 2,122,259 | 2,201,281 |
| Other Long-Term Liabilities | 3,018,878 | 2,654,219 |
| Total Long-Term Liabilities | 54,063,645 | 49,988,305 |
| TOTAL LIABILITIES | 498,329,286 | 487,963,759 |
| TOTAL NET POSITION AND LIABILITIES | \$951,209,045 | \$917,151,847 |

This page has been left blank intentionally.

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

| | YEAR ENDED DECEMBER 31, | |
|--|-------------------------|---------------|
| | 2012 | 2011 |
| OPERATING REVENUES | | |
| Sale of Water | \$59,138,998 | \$55,877,567 |
| Other Operating Revenues | 11,381,473 | 5,748,678 |
| Contract Resource Obligation Revenues | 10,160,260 | 3,777,789 |
| Total Operating Revenues | 80,680,731 | 65,404,034 |
| OPERATING EXPENSES | | |
| Operations | 13,186,350 | 13,292,512 |
| Production | 8,379,807 | 8,603,834 |
| Administrative and General | 11,036,295 | 10,925,265 |
| Depreciation | 15,262,686 | 14,389,681 |
| Other Taxes | 3,485,243 | 3,106,516 |
| Total Operating Expenses | 51,350,381 | 50,317,808 |
| Net Operating Income | 29,330,350 | 15,086,226 |
| NON-OPERATING REVENUES (EXPENSES) | | |
| Interest Income | 2,320,753 | 3,141,374 |
| Other | 288,182 | (12,371) |
| Interest on Long-Term Debt | (19,706,065) | (19,997,829) |
| Amortization of Debt Expense, Premium and Loss on Refunding | 127,976 | 1,605 |
| Interest Charged to Construction | 4,881,993 | 4,977,850 |
| Total Non-Operating Expenses | (12,087,161) | (11,889,371) |
| Net Income Before Capital Contributions and Transfers | 17,243,189 | 3,196,855 |
| Capital Contributions | | |
| Cash | 4,571,007 | 8,134,128 |
| Donated Fixed Assets | 3,263,338 | 1,116,549 |
| Federal BAB Subsidies | 3,840,767 | 3,840,771 |
| Grants | - | 165,438 |
| Transfers | | |
| City of Tacoma Gross Earnings Tax | (5,081,191) | (4,931,504) |
| Transfer to/from Other Funds | (145,439) | (29,232) |
| CHANGE IN NET POSITION | 23,691,671 | 11,493,005 |
| TOTAL NET POSITION - BEGINNING OF YEAR | 429,188,088 | 417,695,083 |
| TOTAL NET POSITION - END OF YEAR | \$452,879,759 | \$429,188,088 |

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, | |
|---|-------------------------|----------------------|
| | 2012 | 2011 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Cash from Customers | \$74,829,339 | \$64,773,377 |
| Cash Paid to Suppliers | 1,127,154 | (12,715,293) |
| Cash Paid to Employees | (20,102,470) | (19,863,291) |
| Taxes Paid | (3,064,346) | (3,059,275) |
| Net Cash From Operating Activities | 52,789,677 | 29,135,518 |
| CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES | | |
| Transfer to Other Funds | (145,439) | (29,232) |
| Transfer Out for Gross Earnings Tax | (5,081,191) | (4,931,504) |
| Net Cash From Non-Capital Financing Activities | (5,226,630) | (4,960,736) |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Capital Expenditures, net..... | (68,816,329) | (32,855,808) |
| Proceeds from PWTF Loan | 900,000 | 5,984,023 |
| Debt Issuance Costs | - | (64,808) |
| Principal Payments on Long-Term Debt | (9,274,378) | (8,915,056) |
| Interest Paid | (19,595,092) | (22,055,215) |
| BABs Federal Interest Subsidies | 3,840,767 | 4,459,254 |
| Grants Received | - | 165,438 |
| System Development Charges, CIAC and Other | 9,791,238 | 7,022,698 |
| Net Cash From Capital and Related Financing Activities | (83,153,794) | (46,259,474) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Interest Received on Investments | 2,320,753 | 3,141,374 |
| Other Net Non-Op Revenues and Expenses | 288,183 | (12,371) |
| Net Cash From Investing Activities | 2,608,936 | 3,129,003 |
| Net Change in Cash and Equity in Pooled Investments | (32,981,811) | (18,955,689) |
| Cash & Equity in Pooled Investments at January 1 ... | 231,498,931 | 250,454,620 |
| Cash & Equity in Pooled Investments at December 31 . | <u>\$198,517,120</u> | <u>\$231,498,931</u> |

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

| | YEAR ENDED DECEMBER 31, | |
|--|-------------------------|----------------------|
| | 2012 | 2011 |
| Reconciliation of Net Operating Income to Net Cash From Operating Activities: | | |
| Net Operating Income | \$29,330,350 | \$15,086,226 |
| Adjustments to reconcile net operating income to net cash provided by operating activities: | | |
| Depreciation | 15,262,686 | 14,389,681 |
| Cash from changes in operating assets and liabilities: | | |
| Accounts Receivable and Unbilled Revenue | (5,226,947) | 2,523,414 |
| Interfund Receivables | (878,999) | 271,927 |
| Regulatory Asset-Public Fire Protection Fees | (760,013) | (3,514,579) |
| Regulatory Asset-Hyada Surcharges..... | 123,918 | 98,708 |
| Materials and Supplies | 162,680 | 105,337 |
| Prepayments | (352,422) | 769,853 |
| Deferred Rental Revenues | 11,650 | 261,800 |
| Accrued Taxes | 420,897 | 47,241 |
| Salaries, Wages and Fringe Benefits Payable | 52,872 | (38,353) |
| Accrued Compensated Absences | (87,802) | 63,459 |
| Customers' Deposits | (3,771) | 10,679 |
| Accrued Expenses and Contracts Payable | 14,183,160 | (407,465) |
| Interfund Payables | 551,418 | (532,410) |
| Total Adjustments | 23,459,327 | 14,049,292 |
| Net Cash From Operating Activities | <u>\$52,789,677</u> | <u>\$29,135,518</u> |
| Reconciliation of Cash and Equity in Pooled Investments to Balance Sheet: | | |
| Cash and Equity in Pooled Investments | | |
| in Special Funds | \$160,850,624 | \$212,540,786 |
| Cash and Equity in Pooled Investments | | |
| in Operating Funds | 37,666,496 | 18,958,145 |
| Cash and Equity in Pooled Investments | | |
| at December 31 | <u>\$198,517,120</u> | <u>\$231,498,931</u> |

**CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER**

**NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2012 AND 2011**

NOTE 1 OPERATIONS

OPERATIONS OF TACOMA WATER – The 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 96,000 customers and had approximately 256 employees as of December 31, 2012. 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 Distribution Engineering and Operations, Water Quality, Water Supply, Water Resource Planning, and Water Rates and Financial Planning.

WATER DISTRIBUTION ENGINEERING - To engineer, design, construct, inspect, and oversee the construction of the distribution system and its facilities; to provide engineering and construction supervision for mains, hydrants, services, meters, pressure reducing valves and pressure zones; to provide efficient customer service and support for development.

WATER DISTRIBUTION OPERATIONS - To effectively manage, construct, inspect, operate and maintain the distribution system and its facilities including mains, hydrants, valves, services and meters in an environmentally responsible manner; to provide efficient customer service and support for development.

WATER QUALITY - To manage, operate and maintain the Green River Headworks and Watershed; to assure natural resource management of Water utility lands including the Watershed; to provide for fish and wildlife habitat management; to install, operate and maintain water treatment equipment within the system; to respond to all matters relating to water quality from the source to the customer; to monitor for contaminants; to participate in shaping water quality legislation and regulations; to be aware of changes in water system security needs and to coordinate as directed.

WATER SUPPLY - To design, construct, inspect, operate and maintain the City's water supply structures, wells, pump stations, reservoirs, standpipes, transmission mains, Tacoma Water buildings and associated property, and electrical and mechanical equipment; to maintain pressure reducing stations and pipeline rights-of-way; to administer water rights; to track water system security issues and coordinate as needed.

WATER RESOURCE PLANNING - To plan for resources to meet future needs including conservation; to prepare system, strategic, and business plans for Tacoma Water; to support wholesale customers; to provide planning support for growth; to provide hydraulic modeling, GIS, maps and records, computer, SAP, and other technology support for Tacoma Water; and to manage Tacoma Water's asset management program.

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

WATER RATES AND FINANCIAL PLANNING - To develop and maintain necessary tools and reports to assess the utility's financial health, identify issues, opportunities and recommend actions to maintain solid financial rating for the water utility and the Regional Water Supply System.

REGIONAL WATER SUPPLY SYSTEM - The Regional Water Supply System (RWSS) is a partnership formed by Tacoma, the City of Kent, Covington Water District and Lakehaven Utility District (the "Participants") to permit, design, finance, construct, operate, maintain and receive delivery of water from the Second Supply Project. The Second Supply Project consists of the following components: (i) water from the exercise of Tacoma Water's Second Diversion Water Right, (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 the Howard Hanson Dam Additional Storage Project, and (vi) construction of new Treatment Facilities. Participants' rights and obligations with regard to the Second Supply Project are called out in the Second Supply Project Agreement. Tacoma has a 15/36 Participant Share and each of the others have a 7/36 Participant Share. A Participant Share represents a Participant's proportional right to receive water delivered by the Second Supply Project and represents a Participant's obligation to pay project costs, including Fixed and Variable Operation & Maintenance Costs, Initial Project Construction Costs and Capital Expenditures. Tacoma, consistent with the Project Agreement, is the owner and operator of the Second Supply Project.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF ACCOUNTING AND PRESENTATION - The financial statements of the Division 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 fund accounting. Revenues are recognized when earned, and costs and expenses are recognized when incurred.

In June 2011, the GASB issued Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position effective for financial statements for periods beginning after December 15, 2011. The Division implemented this new pronouncement in the current year. The effect of the implementation of this statement to the Division is limited to renaming of "Net Assets" to "Net Position".

The Division 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.

The Division 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.

CASH AND EQUITY IN POOLED INVESTMENTS - The Division's fund cash balances are a "deposit" with the City Treasurer's Tacoma Investment Pool (TIP) for the purpose of maximizing interest earnings through pooled investment activities. Cash and equity in pooled investments in the TIP are reported at fair value and changes in unrealized gains and losses are recorded in the Statements of Revenues, Expenses and Changes in Net Position. Interest earned on such pooled investments is allocated daily to the participating funds based on each fund's daily equity in the TIP.

The TIP operates like a demand deposit account in that all City departments, including the Division, have fund balances which are their equity in the TIP. Accordingly, balances are considered to be cash equivalents.

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

The City of Tacoma Investment Policy permits legal investments as authorized by state law including Certificates of Deposit with qualified public depositories (as defined in Chapter 39.58 of the Revised Code of Washington (RCW)), obligations of the U.S. Treasury, Government Sponsored Agencies and Instrumentalities, bonds issued by Washington State and its Local Governments with an A or better rating, general obligation bonds issued by any State or Local Government with an A or better rating, Bankers' Acceptances, Commercial Paper, Repurchase and Reverse Repurchase agreements, and the Washington State Local Government Investment Pool (LGIP). Daily liquidity requirement 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 interest bearing demand deposit account maintained with U.S. Bank.

The Division's equity in that portion of the City of Tacoma Investment Pool held in qualified public depositories at December 31, 2012 and 2011 is entirely covered by the Federal Deposit Insurance Corporation (FDIC) and the Washington State Public Deposit Protection Commission (WSPDPC).

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, longer term investments have greater exposure to changes in market interest rates. The City of Tacoma investment policy allows for authorized investments up to 60 months to maturity. One way the City manages its exposure to interest rate risk is by timing cash flows from maturities so that portions of the portfolio are maturing over time to provide cash flow and liquidity needed for operations.

Credit risk is generally the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Repurchase agreements and commercial paper are protected by the Federal Deposit Insurance Corporation (FDIC) insurance up to \$250,000. All deposits not covered by the FDIC are covered by the WSPDPC of the State of Washington. The WSPDPC is a statutory authority established under RCW 39.58. It constitutes a fully insured or fully collateralized pool. The WA State Treasures LGIP is authorized by RCW 43.250. The LGIP operated like a 2A7 fund and is collateralized by short-term legal investments.

ACCOUNTS RECEIVABLE AND ACCRUED UNBILLED REVENUES - Accounts receivable consist of amounts owed by private individuals and organizations for goods delivered or services rendered in the regular course of business operations. Receivables are shown net of allowances for doubtful accounts. The Division accrues an estimated amount for services that have been provided but not billed.

ALLOWANCE FOR DOUBTFUL ACCOUNTS - A reserve has been established for uncollectible accounts receivable based on historical write-off trends and knowledge of specific circumstances that indicate collection of an account may be unlikely. Generally accounts receivable are considered past due after 30 days.

INTERFUND TRANSACTIONS - Unsettled transactions between City funds at year end are recorded as due to or due from other funds.

MATERIAL AND SUPPLIES INVENTORY - Materials and supplies consist primarily of items for maintenance of Division assets and are valued at the lower of average cost or fair market value.

RESTRICTED ASSETS - In accordance with bond resolutions, agreements and laws, separate restricted funds have been established. These funds consist of cash and investments in pooled investments with restrictions externally imposed and legally enforceable, established by the City Council. Generally, restricted assets include bond construction, reserve and debt service funds, extraordinary operations, notes and contracts receivable, and customer deposits.

BOND PREMIUM, ISSUANCE COSTS AND LOSS ON REFUNDING - Bond premium, discount and issuance costs are amortized over the life of the bonds using the weighted average of the

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

bonds outstanding. Losses on refunding are amortized on a straight-line basis over the applicable bond period.

RATE STABILIZATION - The Division has established a rate stabilization account to reduce significant 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 when it is withdrawn in accordance with rate decisions and debt service covenants.

UTILITY PLANT AND DEPRECIATION - Utility plant is stated at original cost, which includes both direct costs of construction or acquisition and indirect costs. The cost of maintenance and repairs is charged to expense as incurred, while the cost of replacements and betterments is capitalized. Assets are capitalized when costs exceed \$5,000 and the useful life exceeds one year.

Depreciation is recorded using a straight-line composite method based on National Association of Regulatory Utility Commissioners recommended economic asset lives from 13 to 60 years for related operating assets placed in service at the beginning of the year. The original cost of property together with removal cost, less salvage, is charged to accumulated depreciation at such time as property is retired and removed from service.

CONSTRUCTION IN PROGRESS - Capitalizable costs incurred on projects which are not in service or ready for use are held in construction in progress. When the asset is ready for service, related costs are transferred to capital assets. Upon determining that a project will be abandoned, the related costs are charged to expense.

ASSET VALUATION - The Division 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 flows.

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.

CONTRIBUTIONS IN AID OF CONSTRUCTION AND SYTEM 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 the Division's net assets. System development charges on uncompleted projects are recorded in deferred credits.

REGULATORY ASSETS - The Division has deferred Public Fire Protection Fees and Hyada Surcharges to future periods matching the time when the revenues and expenses are included in rates. The deferred balance is reduced as fees and surcharges are recovered and amortized as expenses on the statements of revenues, expenses and changes in net position.

INTANGIBLE ASSETS - In accordance with GASB No. 51, "Accounting and Financial Reporting for Intangible Assets", land use rights such as easements and right-of-ways are recorded as intangible assets.

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. Based on historical information, 10% of compensated absences are considered short term.

Employees in the original policy accumulate sick leave at the rate of one day per month with no maximum accumulation specified. Employees 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.

OPERATING REVENUE - 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.

NON-OPERATING REVENUES AND EXPENSES – These are items that do not qualify as operating defined above such as interest and gain (loss) on disposition of property.

TAXES - The City charges the Division a Gross Earnings Tax at the rate of 8.0%. In addition, the Division pays a 5.029% public utility tax to the State on a certain portion of revenues identified as utility revenues. The Division also pays business and occupation tax to the State at the rate of 1.8% on certain other non-utility revenues. The Division is exempt from payment of federal income tax.

NET POSITION - The statement of Net Position reports all financial and capital resources. The difference between assets and liabilities is net position. There are three components of net position: net investment in capital assets, restricted or unrestricted.

Net investment in capital assets consists of capital assets, less accumulated depreciation, reduced by the outstanding balances of any bonds, loans or other borrowings, less outstanding construction funds that are attributable to the acquisition, construction, or improvements of those assets.

Net position components are restricted when constraints placed on net position use are either (1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or (2) imposed by law through constitutional provisions or enabling legislation.

Unrestricted net position components are those that are not “net investment in capital assets” or “restricted” so that it can be used for daily operation of the Water Utility.

ARBITRAGE REBATE REQUIREMENT - The Division is subject to the Internal Revenue Code (“IRC”), Section 148(f), related to its tax-exempt revenue bonds. The IRC requires that earnings on gross proceeds of any revenue bonds that are in excess of the amount prescribed will be surrendered to the Internal Revenue Service. As such, the fund would record such a rebate as a liability. The fund had no liability in the current or prior year.

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

SHARED SERVICES - The Division receives certain services from other departments and agencies of the City, including those normally considered to be general and administrative. The Division is charged for services received from other City departments and agencies and additionally, must pay a gross earnings tax to the City.

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

SIGNIFICANT RISKS AND UNCERTAINTIES - The Division is subject to certain business risks that could have a material impact on future operations and financial performance. These risks include, but are not limited to, 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.

RECLASSIFICATIONS - Changes have been made to prior year account classifications as needed to conform to the current year presentation format. Such changes did not affect net position for this year.

NOTE 3 UTILITY PLANT - A summary of the balances and changes in utility plant follows:

| | Balance December 31, 2011 | Additions | Retirements | Transfers & Adjustments | Balance December 31, 2012 |
|-------------------------------|---------------------------------|---------------|--------------|----------------------------|---------------------------------|
| Intangible Plant | \$ 34,902,822 | \$ 389,111 | \$ (205,753) | \$ - | \$ 35,086,180 |
| Source of Supply Plant | 76,455,691 | 2,483,372 | (62,886) | - | 78,876,177 |
| Pumping Plant | 9,142,701 | 85,249 | (5,921) | - | 9,222,029 |
| Water Treatment Plant | 45,097,165 | 59,680 | (754,901) | - | 44,401,944 |
| Transmission Facilities | 222,241,072 | 4,790,118 | (90,337) | - | 226,940,853 |
| Distribution Facilities | 377,190,175 | 19,174,736 | (3,505,899) | - | 392,859,012 |
| General Plant | 28,874,232 | 4,859,197 | (787,001) | (145,439) | 32,800,989 |
| Total Water Plant In Service | 793,903,858 | 31,841,463 | (5,412,698) | (145,439) | 820,187,184 |
| Less Accumulated Depreciation | 149,177,559 | 15,262,686 | (5,244,445) | (2,319,353) | 156,876,447 |
| | 644,726,299 | 16,578,777 | (168,253) | 2,173,914 | 663,310,737 |
| Construction Work In Progress | 16,426,998 | 74,810,559 | - | (31,696,024) | 59,541,533 |
| Net Utility Plant | \$ 661,153,297 | \$ 91,389,336 | \$ (168,253) | \$ (29,522,110) | \$ 722,852,270 |

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

| | Balance December 31, 2010 | Additions | Retirements | Transfers & Adjustments | Balance December 31, 2011 |
|-------------------------------|---------------------------------|---------------|--------------|----------------------------|---------------------------------|
| Intangible Plant | \$ 34,854,971 | \$ 220,310 | \$ (172,459) | \$ - | \$ 34,902,822 |
| Source of Supply Plant | 76,057,618 | 434,423 | (36,350) | - | 76,455,691 |
| Pumping Plant | 9,121,209 | 25,492 | (4,000) | - | 9,142,701 |
| Water Treatment Plant | 45,124,694 | (27,529) | - | - | 45,097,165 |
| Transmission Facilities | 192,646,927 | 30,886,349 | (1,292,204) | - | 222,241,072 |
| Distribution Facilities | 362,138,047 | 17,936,010 | (2,883,882) | - | 377,190,175 |
| General Plant | 27,565,793 | 1,479,114 | (139,131) | (31,544) | 28,874,232 |
| Total Water Plant In Service | 747,509,259 | 50,954,169 | (4,528,026) | (31,544) | 793,903,858 |
| Less Accumulated Depreciation | 142,247,827 | 14,389,681 | (4,355,566) | (3,104,383) | 149,177,559 |
| | 605,261,432 | 36,564,488 | (172,460) | 3,072,839 | 644,726,299 |
| Construction Work In Progress | 31,331,339 | 36,018,284 | - | (50,922,625) | 16,426,998 |
| Net Utility Plant | \$ 636,592,771 | \$ 72,582,772 | \$ (172,460) | \$ (47,849,786) | \$ 661,153,297 |

Utility Plant includes non-depreciable assets of \$56,843,169 for 2012 and \$54,953,363 for 2011.

NOTE 4 SPECIAL FUNDS - Cash and equity in pooled investments included in Tacoma Water's Special Funds consist of:

| Cash and Equity in Pooled Investments | 2012 | 2011 |
|---|----------------|----------------|
| Construction Funds | \$ 58,833,459 | \$ 125,330,650 |
| Debt Service Funds | 3,318,052 | 3,091,834 |
| Bond Reserve Funds | 19,507,744 | 19,512,184 |
| System Development Charge Fund | 53,626,384 | 47,111,039 |
| Other Cash and Equity in Pooled Investments | 25,564,985 | 17,495,079 |
| Total | \$ 160,850,624 | \$ 212,540,786 |

NOTE 5 LONG-TERM LIABILITIES – The Division's Long-term Liabilities are primarily for the purpose of capital improvements with the exception of the Muckleshoot liability. Long-term debt activities for 2012 and 2011 were as follows:

| | Balance December 31, 2011 | Additions | Reductions | Balance December 31, 2012 | Due Within One Year |
|--|---------------------------------|------------|----------------|---------------------------------|------------------------|
| Revenue Bonds | \$ 371,500,000 | \$ - | \$ (6,620,000) | \$ 364,880,000 | \$ 7,205,000 |
| Plus: Unamortized Premium | 5,289,234 | - | (653,854) | 4,635,380 | - |
| Net Revenue Bonds | 376,789,234 | - | (7,273,854) | 369,515,380 | 7,205,000 |
| Public Works Trust Fund Loans | 27,246,270 | 500,000 | (2,109,965) | 25,636,305 | 2,141,215 |
| Drinking Water State Revolving Fund Loan | 16,311,391 | 400,000 | (376,161) | 16,335,230 | 675,362 |
| Total Long-Term Debt | 420,346,895 | 900,000 | (9,759,980) | 411,486,915 | 10,021,577 |
| Muckleshoot Liability | 8,704,712 | - | (168,252) | 8,536,460 | 820,747 |
| Total Long-Term Liabilities | \$ 429,051,607 | \$ 900,000 | \$ (9,928,232) | \$ 420,023,375 | \$ 10,842,324 |

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

| | Balance December 31, 2010 | Additions | Reductions | Balance December 31, 2011 | Due Within One Year |
|--|---------------------------------|---------------------|-----------------------|---------------------------------|------------------------|
| Revenue Bonds | \$377,780,000 | \$ - | \$ (6,280,000) | \$371,500,000 | \$6,620,000 |
| Plus: Unamortized Premium | 5,798,980 | - | (509,746) | 5,289,234 | - |
| Net Revenue Bonds | 383,578,980 | - | (6,789,746) | 376,789,234 | 6,620,000 |
| Public Works Trust Fund Loans | 29,356,235 | - | (2,109,965) | 27,246,270 | 2,109,965 |
| Drinking Water State Revolving Fund Loan | 10,680,000 | 5,984,023 | (352,632) | 16,311,391 | 352,632 |
| Total Long-Term Debt | 423,615,215 | 5,984,023 | (9,252,343) | 420,346,895 | 9,082,597 |
| Muckleshoot Liability | 8,877,171 | - | (172,459) | 8,704,712 | 168,253 |
| Total Long-Term Liabilities | <u>\$432,492,386</u> | <u>\$ 5,984,023</u> | <u>\$ (9,424,802)</u> | <u>\$429,051,607</u> | <u>\$9,250,850</u> |

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

SENIOR LIEN BONDS

| | <u>2012</u> | <u>2011</u> |
|--|--------------|--------------|
| 2002 Regional Water Supply System Revenue Bonds, with interest rates ranging from 4.13% to 5.50%, due in yearly installments ranging from \$875,000 to \$7,400,000 through 2032. Original Issue: \$82,700,000 | \$75,925,000 | \$76,750,000 |
| 2003 Water System Revenue and Refunding Bonds, with interest rates ranging from 4.125% to 5.25%, due in yearly installments ranging from \$1,725,000 to \$3,505,000 through 2023. Original Issue: \$51,380,000 | 25,285,000 | 28,630,000 |
| 2005 Water System Revenue and Refunding Bonds, with interest rates ranging from 4.125% to 5.0%, due in yearly installments ranging from \$1,695,000 to \$4,760,000 through 2025. Original Issue: \$46,550,000 | 35,485,000 | 37,420,000 |
| 2009 Water System Revenue Bonds, with interest rate at 5.751%, with Build America Bond (BAB) rebate at 35% of interest, due in yearly installments starting in 2033 ranging from \$9,800,000 to \$12,210,000 through 2039. Original Issue: \$76,775,000 | 76,775,000 | 76,775,000 |
| 2010A Water System Revenue Refunding Bonds, with interest rates ranging from 2.0% to 5.0%, due in yearly installments starting in 2013 ranging from \$530,000 to \$4,655,000 through 2023. Original Issue: \$29,100,000 | 28,585,000 | 29,100,000 |

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

2010B Water System Revenue Bonds, with interest rates ranging from 4.581% to 5.621%, with Build America Bond (BAB) rebate at 35% of interest, due in yearly installments starting in 2024 ranging from \$2,115,000 to \$15,390,000 through 2040.

| | | |
|------------------------------|------------|------------|
| Original Issue: \$74,985,000 | 74,985,000 | 74,985,000 |
|------------------------------|------------|------------|

2010A Regional Water Supply System Revenue Bonds, with interest rates ranging from 2.0% to 4.0%, due in yearly installments starting in 2013 ranging from \$260,000 to \$355,000 through 2024. (See Note 6)

| | | |
|-----------------------------|-----------|-----------|
| Original Issue: \$3,595,000 | 3,595,000 | 3,595,000 |
|-----------------------------|-----------|-----------|

2010B Regional Water Supply System Revenue Bonds, with interest rates ranging from 5.371% to 5.621%, with Build America Bond (BAB) rebate at 35% of interest, due in yearly installments starting in 2025 ranging from \$370,000 to \$5,775,000 through 2040. (See Note 6)

| | | |
|------------------------------|------------|------------|
| Original Issue: \$44,245,000 | 44,245,000 | 44,245,000 |
|------------------------------|------------|------------|

| | | |
|---|---------------|---------------|
| Subtotal Sr. Lien Debt | 364,880,000 | 371,500,000 |
| Unamortized premium | 4,635,380 | 5,289,234 |
| Less Current Portion of Revenue Bond Debt | (7,205,000) | (6,620,000) |
| Long-term Portion of Revenue Bond Debt | \$362,310,380 | \$370,169,234 |

Scheduled principal maturities on the bonds, gross interest payments and BAB interest rebates are as follows:

| <u>Year</u> | <u>Principal</u> | <u>Total Interest</u> | <u>BAB Interest Rebate</u> |
|-------------|------------------|-----------------------|----------------------------|
| 2013 | \$7,205,000 | \$19,060,732 | \$3,840,767 |
| 2014 | \$7,550,000 | \$18,731,838 | \$3,840,767 |
| 2015 | \$7,940,000 | \$18,401,975 | \$3,840,767 |
| 2016 | \$8,325,000 | \$18,045,325 | \$3,840,767 |
| 2017 | \$8,760,000 | \$17,651,863 | \$3,840,767 |
| 2018-2022 | \$54,295,000 | \$81,517,121 | \$19,203,835 |
| 2023-2027 | \$56,020,000 | \$67,935,251 | \$18,904,918 |
| 2028-2032 | \$65,185,000 | \$53,045,837 | \$16,697,043 |
| 2033-2037 | \$88,350,000 | \$32,840,156 | \$11,494,053 |
| 2038-2040 | \$61,250,000 | \$7,016,245 | \$2,455,686 |

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, 2012 and 2011 was \$270,585,588 and \$290,255,249 respectively. The fair market value of the Regional Water Supply System Revenue Bonds at December 31, 2012 and 2011 was \$130,661,604 and \$137,410,245 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.

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

JUNIOR LIEN DEBT

| | <u>2012</u> | <u>2011</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. | \$4,800,000 | \$5,333,333 |
| 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. | 473,684 | 526,316 |
| 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. | 5,312,500 | 5,843,750 |
| 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. | 487,616 | 541,796 |
| 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. | 640,351 | 693,713 |
| 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. | 5,188,235 | 5,558,824 |
| 2008 Public Works Trust Fund construction loan for the McMillin Reservoir Reconstruction, with interest of .5% per annum, due in yearly installments of \$545,870 through 2028. | 8,733,918 | 8,748,538 |
| Drinking Water State Revolving Fund Loans | | |
| 2002 construction loan for the Portland Avenue Reservoir, with interest of 2.5% per annum, due in yearly installments of \$161,053 through 2021. | 1,449,474 | 1,610,526 |
| 2008 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.5% per annum, due in yearly installments of \$215,108 through 2028. | 3,441,734 | 3,256,842 |
| 2009 construction loan for the McMillin Reservoir Reconstruction, with interest of 1% per annum, due in yearly installments of \$299,201 from 2013 through 2032. | 5,984,023 | 5,984,023 |

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

2010 construction loan for the McMillin Reservoir
Reconstruction, with interest of 1.5% per annum, due in
yearly installments of \$273,000 from 2015 through 2034.

| | | |
|---------------------------------------|---------------------|---------------------|
| | 5,460,000 | 5,460,000 |
| Subtotal Junior Lien Debt | 41,971,535 | 43,557,661 |
| Less current portion of debt | (2,816,577) | (2,462,597) |
| Long-Term portion of Junior Lien Debt | <u>\$39,154,958</u> | <u>\$41,095,064</u> |

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

| <u>Year</u> | <u>Principal</u> | <u>Interest</u> |
|-------------|------------------|-----------------|
| 2013 | \$2,816,577 | \$409,848 |
| 2014 | \$2,816,577 | \$254,934 |
| 2015 | \$3,089,577 | \$585,245 |
| 2016 | \$3,089,577 | \$290,836 |
| 2017 | \$3,089,578 | \$265,790 |
| 2018-2022 | \$14,646,690 | \$953,262 |
| 2023-2027 | \$8,254,975 | \$462,880 |
| 2028-2032 | \$3,621,984 | \$153,211 |
| 2033-2034 | \$546,000 | \$12,285 |

NOTE 6 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 7 SIGNIFICANT CUSTOMER - Contracted sales to Simpson Tacoma Kraft Company (Simpson) accounted for 8.5% and 8.5% of Tacoma Water's total water sales in 2012 and 2011, respectively. There were no outstanding accounts receivables from Simpson at year-end 2012 or 2011.

Tacoma Water has contracted with Simpson to supply certain quantities of water at a specified rate through July 31, 2015.

NOTE 8 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 2012 and 2011 were \$2,226,924 and \$2,336,806, 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 2012 and 2011, Fleet Services returned 75% of the interest earned on the capital replacement reserve to Tacoma Water's replacement fund. The amounts refunded in 2012 and 2011 were \$62,242 and \$76,000, respectively, which was used to offset the corresponding year's fleet expenses.

NOTE 9 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 were \$496,377 in 2012 and \$120,000 in 2011. Assets in the Self-Insurance Fund total \$5.4 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.

The City purchases a \$15 million Fiduciary Policy with a \$25,000 deductible that provides for wrongful acts arising out of the administration of the City's employee benefits programs and a \$1 million crime Liability policy for employee dishonesty and for fraudulent or dishonest acts by employees for loss of money, securities and property. 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 \$1.5 million for general comprehensive liability. The public official's policy has a \$200,000 deductible. The general government comprehensive liability policies provide \$15 million of coverage. The City has a policy to cover extraordinary worker's compensation claims with a statutory limit (\$1 million self insured retention).

NOTE 10 TACOMA EMPLOYEES' RETIREMENT SYSTEM FUND (TERS) - Employees of the Division are covered by the Tacoma Employees' Retirement System (the System), an actuarially funded system operated by the City. The following information is provided on a city-wide basis.

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

This note emphasizes the employer disclosures and detailed information presented in an independent 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, 3628 South 35th Street, Tacoma, Washington 98409.

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 RCW Chapter 41.28 and Chapter 1.30 of the Tacoma Municipal Code. There are 2,107 retirees and beneficiaries currently receiving benefits, 426 vested terminated members entitled to future benefits and 2,861 active members of the System, as of December 31, 2012.

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. Benefit payments and refunds of contributions are recognized when due and payable in accordance with the terms of the plan.

Method Used to Value 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 our custodian bank utilizing standard industry practices. Private equity investments are reported by the managers subject to their fair market value policies. No investment in any one corporation or organization exceeded five percent of net position available for benefits.

Investments and Contracts - The System has no securities of the employer and 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.

Benefits – There are two formulas that are used for calculating retirement benefits. The benefit will be determined on the formula which provides the higher benefit. The most commonly applied formula, "service retirement", is a product of the member's average monthly salary for the highest consecutive 24-month period, the number of years of membership credit, and a percentage factor (2% maximum) that is determined based on the member's age and years of service. Several options are available for the retiree to provide for the beneficiaries. The System also provides death and disability retirement.

Contributions - 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:

| Applicable Period | Employer Rate | Member Rate | Total Rate |
|------------------------|---------------|-------------|------------|
| 1/1/2001 to 02/01/2009 | 7.56% | 6.44% | 14.00% |
| 2/2/2009 to 12/31/2009 | 8.64 | 7.36 | 16.00 |
| 1/1/2010 to 12/31/2010 | 9.72 | 8.28 | 18.00 |
| 1/1/2011 to 12/31/2011 | 10.26 | 8.74 | 19.00 |
| 1/1/2012 onward | 10.80 | 9.20 | 20.00 |

Contributions city-wide totaled \$43.1 million in 2012 (\$22.7 million employer contributions and \$20.4 million employee contributions) and totaled \$42.4 million in 2011 (\$22.5 million employer contributions and \$19.9 million employee contributions). Contributions made by the Division were \$2.0 million and \$1.9 million in 2012 and 2011 respectively.

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, 2012, 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)

Schedule of Funding Progress (\$ in millions):

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (c) = (b)-(a) | Funded Ratio (d) = (a) / (b) | Covered Payroll (e) | UAAL as of Percentage of Covered Payroll (f) = (c) / (e) |
|--------------------------------|--|---|--|------------------------------------|---------------------------|--|
| 1/1/2009 | \$ 1,097.3 | \$ 1,002.3 | \$ (95.0) | 109.5% | \$ 197.4 | (48.1%) |
| 1/1/2011 | \$ 1,074.8 | \$ 1,132.9 | \$ 58.1 | 94.9% | \$ 219.6 | 26.5% |
| 1/1/2012 | \$ 1,068.3 | \$ 1,185.5 | \$ 117.2 | 90.1% | \$ 219.4 | 53.4% |

Actuarial Methods and Significant Actuarial Assumptions:

| | |
|----------------------------------|---|
| Valuation Date | January 1, 2012 |
| Actuarial Cost Method | Entry Age |
| Amortization Method | Level Percentage of the System's Projected Payroll |
| Remaining Amortization Period | 30 years, Open, unless fixed rate amortizes less than 30 years |
| 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% |
| Postretirement Benefit Increases | 2.125% |

Annual Pension Cost and Net Pension Obligation - The City's annual pension cost and net pension obligation to the Retirement System for 2012 were as follows:

| | (\$ in millions) |
|--|------------------|
| Annual Required Contribution (ARC) | \$ 22.7 |
| Interest on Net Pension Obligation (NPO) | (1.1) |
| Adjustment to ARC | 1.3 |
| Annual Pension Cost (APC) | 22.9 |
| Employer Contributions made | 22.7 |
| Change in NPO | 0.2 |
| NPO at Beginning of Year | (13.7) |
| NPO at End of Year | \$ (13.5) |

| Trend Information (\$ in millions) | | | |
|---------------------------------------|---------------------------------|-------------------------|------------------------------|
| Year Ending December 31, | Annual Pension Cost (APC) | % of APC Contributed | Net Pension Obligation |
| 2010 | \$ 17.0 | 125% | \$ (8.1) |
| 2011 | \$ 16.9 | 133% | \$ (13.7) |
| 2012 | \$ 22.9 | 99% | \$ (13.5) |

NOTE 11 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 remaining amortization period for 2012 is 25 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 non-current liability (Net OPEB Obligation) on the balance sheet.

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

The following table is a summary of valuation results with a comparison to the results from our last valuation.

| | January 1, 2009 | January 1, 2011 |
|---|-----------------------|-----------------------|
| Total membership: | | |
| Active employees | 3,633 | 3,675 |
| Terminated vested employees | 355 | 363 |
| Retired employees & Dependents | 815 | 790 |
| Total | <u>4,803</u> | <u>4,828</u> |
| Annual Benefit Payments | \$ 8,319,788 | \$ 9,569,648 |
| Discount rate | 4.00% | 4.00% |
| Present Value of Benefits (PVB) | \$ 266,167,781 | \$ 319,550,419 |
| Actuarial Accrued Liability (AAL) | \$ 205,168,072 | \$ 248,571,791 |
| Assets | \$ - | \$ - |
| Unfunded Actuarial Accrued Liability (UAAL) | <u>\$ 205,168,072</u> | <u>\$ 248,571,791</u> |
| Normal Cost | \$ 5,615,626 | \$ 5,559,350 |
| Annual Required Contribution (ARC) | \$ 16,761,978 | \$ 19,734,040 |

The following table shows the total value of the benefits provided, the member paid premiums and the City paid benefits as of December 31, 2012.

| Value of Subsidy at 4.00% Interest Rate | Total Value of Benefits | Member Paid Premiums | City Paid Benefits |
|---|----------------------------|-------------------------|-----------------------|
| Present Value of Benefits (PVB) | \$ 445,647,729 | \$ 126,097,310 | \$ 319,550,419 |
| Actuarial Accrued Liability (AAL) | \$ 305,186,964 | \$ 56,615,173 | \$ 248,571,791 |
| Normal Cost | \$ 10,741,744 | \$ 5,182,394 | \$ 5,559,350 |
| Annual Benefit Payments | \$ 12,218,978 | \$ 2,649,330 | \$ 9,569,648 |

The following table shows the calculation of the Annual Required Contribution and Net OPEB Obligation for the City and for the Division as of December 31, 2012.

| | City | Water |
|--|----------------------|---------------------|
| Determination of Annual Required Contribution: | | |
| Normal Cost at Year-end | \$ 5,559,351 | \$ 393,824 |
| Amortization of UALL | 14,174,690 | 144,425 |
| Annual Required Contribution (ARC) | <u>\$ 19,734,041</u> | <u>\$ 538,249</u> |
| Determination of NET OPEB Obligation: | | |
| Annual Required Contribution (ARC) | \$ 19,734,041 | \$ 538,249 |
| Interest on prior year Net OPEB Obligation | 1,455,746 | 66,144 |
| Adjustments to ARC | (1,720,609) | (64,256) |
| Annual OPEB Cost | 19,469,178 | 540,137 |
| Actual benefits paid | 9,393,431 | 138,439 |
| Increase in Net OPEB Obligation | 10,075,747 | 401,698 |
| Net OPEB Obligation - beginning of year | 36,393,621 | 1,653,611 |
| Net OPEB Obligation - end of year | <u>\$ 46,469,368</u> | <u>\$ 2,055,309</u> |

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

Funding Status and Funding Progress - The following table shows the annual OPEB cost and net OPEB obligation for three years. This table is based upon a 4.00% interest rate.

| | Annual OPEB Cost | | Benefits Paid | | Net OPEB Obligation | |
|------------|------------------|------------|---------------|------------|---------------------|--------------|
| Year Ended | City | Water | City | Water | City | Water |
| 12/31/2010 | \$ 16,700,184 | \$ 467,968 | \$ 9,206,060 | \$ 120,660 | \$ 26,366,848 | \$ 1,225,900 |
| 12/31/2011 | \$ 19,596,420 | \$ 541,536 | \$ 9,569,648 | \$ 113,825 | \$ 36,393,620 | \$ 1,653,611 |
| 12/31/2012 | \$ 19,469,178 | \$ 540,137 | \$ 9,393,431 | \$ 138,439 | \$ 46,469,368 | \$ 2,055,309 |

As of January 1, 2011, 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 \$248.6 million, and the actuarial value of assets was zero, resulting in an Unfunded Actuarial Accrued Liability of \$248.6 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 the 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 for non-LEOFF 1 groups. For LEOFF 1, the UAAL is amortized as a level dollar amount. The amortization period was 30 years in 2007 and the remaining is now 25 years.

Actuarial Methods and Significant Actuarial Assumptions:

| | |
|--------------------------------------|---|
| Valuation Date | January 1, 2011 |
| Census Date | January 1, 2011 |
| Actuarial Cost Method: | Entry Age |
| Amortization Method: | Combination of level percentage and level dollar amount, see note above. |
| Remaining Amortization Period: | 25 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 | 4.00% for pay-as-you-go funding |
| Medical Cost Trend | 2011 8.1% |
| | 2012 7.3% |
| | 2013 6.6% |
| | 2014-2019 6.5% |
| | 2020-2027 6.4% |
| | Grading down to an ultimate of 5.2% in 2082 and beyond. |
| Projected Payroll Increases | 4.25% per year |

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

Eligibility:

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

Retirement - 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 12 COMMITMENTS AND CONTINGENCIES

Capital Improvements – The financial requirement for Tacoma Water's 2011-2012 biennial Capital Improvement program is approximately \$64.0 million and Tacoma Water has substantial contractual commitments relating to the program. At December 31, 2012, the remaining financial requirement for Capital Improvement Programs relating to all prior biennia is approximately \$15.0 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.

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, 2012.

This page has been left blank intentionally.

STATISTICAL DATA (Unaudited)

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

TEN-YEAR FINANCIAL REVIEW

| BALANCE SHEET | 2012 | 2011 | 2010 | 2009 |
|--|---------------|---------------|---------------|---------------|
| ASSETS | | | | |
| Utility Plant - Net | \$722,852,270 | \$661,153,297 | \$636,592,771 | \$604,657,775 |
| Special Funds & Non-Util Prop | 161,863,075 | 214,619,106 | 240,132,895 | 133,949,294 |
| Current Assets | 56,407,560 | 31,403,521 | 30,200,303 | 35,753,843 |
| Other Assets | 10,086,140 | 7,919,368 | 4,654,608 | 3,654,494 |
| Total Assets | 951,209,045 | 915,095,292 | 911,580,577 | 778,015,406 |
| NET ASSETS | 452,879,759 | 429,188,088 | 417,695,083 | 412,592,671 |
| LIABILITIES AND EQUITY | | | | |
| Long-Term Debt | 409,181,051 | 417,744,202 | 421,228,553 | 292,165,406 |
| Current Liabilities | 35,084,590 | 18,174,697 | 20,548,451 | 15,167,938 |
| Long-Term Liabilities | 54,063,645 | 49,988,305 | 52,108,490 | 58,089,391 |
| Total Liabilities | 498,329,286 | 485,907,204 | 493,885,494 | 365,422,735 |
| TOTAL NET ASSETS AND LIABILITIES ... | \$951,209,045 | \$915,095,292 | \$911,580,577 | \$778,015,406 |
| STATEMENT OF INCOME | | | | |
| OPERATING REVENUES | | | | |
| Residential and Domestic | \$38,685,705 | \$36,682,278 | \$35,453,730 | \$36,643,366 |
| Commercial and Industrial | 10,620,950 | 10,101,108 | 10,049,782 | 9,659,078 |
| Special Rate-Simpson/Other | 5,031,760 | 4,774,237 | 3,798,922 | 4,153,327 |
| Municipal | 383,385 | 400,322 | 364,357 | 380,267 |
| Other Public Bldgs and Grounds ... | 1,909,782 | 1,815,865 | 1,702,656 | 1,861,111 |
| Unbilled | 416,986 | 478,594 | (648,438) | 187,966 |
| Sales to Other Water Utilities ... | 2,090,430 | 1,625,163 | 1,530,116 | 1,776,686 |
| Total Water Sales | 59,138,998 | 55,877,567 | 52,251,125 | 54,661,801 |
| Other Operating Revenues | 21,541,733 | 9,526,467 | 10,735,630 | 9,331,955 |
| Total Operating Revenues | 80,680,731 | 65,404,034 | 62,986,755 | 63,993,756 |
| OPERATING EXPENSES | | | | |
| Operation and Maintenance | 32,602,452 | 32,821,611 | 34,453,742 | 34,055,463 |
| Taxes | 3,485,243 | 3,106,516 | 3,142,772 | 3,093,311 |
| Depreciation | 15,262,686 | 14,389,681 | 14,474,964 | 13,845,799 |
| Total Operating Expenses | 51,350,381 | 50,317,808 | 52,071,478 | 50,994,573 |
| NET OPERATING INCOME (LOSS) | 29,330,350 | 15,086,226 | 10,915,277 | 12,999,183 |
| NON-OPERATING REVENUES (EXPENSES) | | | | |
| Other Income | 288,183 | (12,371) | 33,795 | 497,331 |
| Interest Income | 2,320,753 | 3,141,374 | 2,370,993 | 1,955,385 |
| Gain from Disposition of Property | - | - | - | 26,100 |
| Interest Charges (Net) | (14,696,096) | (15,018,374) | (15,175,660) | (9,076,156) |
| Net Income (Loss) Before | | | | |
| Contributions & Transfers | 17,243,190 | 3,196,855 | (1,855,595) | 6,401,843 |
| Total Capital Contributions | 7,834,345 | 9,250,677 | 9,713,596 | 7,120,993 |
| Grants & Federal BAB Subsidies | 3,840,767 | 4,006,209 | 2,355,132 | 244,683 |
| Transfers Out | (5,226,630) | (4,960,736) | (5,110,721) | (5,185,152) |
| NET INCOME (LOSS) | \$23,691,672 | \$11,493,005 | \$5,102,412 | \$8,582,367 |

Certain reclassifications made in the current year have not been restated for the prior years.

| 2008 | 2007 | 2006 | 2005 (As Restated) | 2004 | 2003 (As Restated) |
|---------------|---------------|---------------|-----------------------|---------------|-----------------------|
| \$590,593,258 | \$568,493,015 | \$542,837,619 | \$515,240,672 | \$449,792,203 | \$391,992,687 |
| 80,858,401 | 99,062,414 | 111,884,788 | 124,884,569 | 86,235,235 | 128,107,319 |
| 22,151,467 | 23,150,235 | 20,256,759 | 15,880,090 | 21,804,006 | 19,223,128 |
| 3,319,156 | 2,123,339 | 2,622,731 | 2,938,485 | 2,954,978 | 3,380,733 |
| 696,922,282 | 692,829,003 | 677,601,897 | 658,943,816 | 560,786,422 | 542,703,867 |
| 404,010,304 | 391,763,317 | 374,885,816 | 345,583,601 | 327,326,910 | 305,678,001 |
| 218,869,015 | 227,315,790 | 231,066,402 | 224,760,581 | 199,174,091 | 203,913,661 |
| 16,288,305 | 15,169,687 | 21,418,548 | 12,820,700 | 14,542,631 | 12,150,879 |
| 57,754,658 | 58,580,209 | 50,231,131 | 75,778,934 | 19,742,790 | 20,961,326 |
| 292,911,978 | 301,065,686 | 302,716,081 | 313,360,215 | 233,459,512 | 237,025,866 |
| \$696,922,282 | \$692,829,003 | \$677,601,897 | \$658,943,816 | \$560,786,422 | \$542,703,867 |
| \$34,592,712 | \$32,645,594 | \$31,216,429 | \$27,611,024 | \$26,589,163 | \$24,497,359 |
| 8,978,703 | 8,298,263 | 7,751,215 | 7,174,647 | 6,619,432 | 5,809,774 |
| 4,371,527 | 3,917,760 | 3,222,324 | 3,511,199 | 3,293,335 | 3,044,266 |
| 349,722 | 396,131 | 363,455 | 316,562 | 308,884 | 218,852 |
| 1,680,603 | 1,644,166 | 1,596,360 | 1,409,107 | 1,523,562 | 1,353,062 |
| 417,145 | 37,113 | 1,067,323 | - | (903,969) | 680,497 |
| 1,251,815 | 1,433,705 | 1,640,803 | 1,599,919 | 1,622,206 | 1,531,004 |
| 51,642,227 | 48,372,732 | 46,857,909 | 41,622,458 | 39,052,613 | 37,134,814 |
| 5,382,313 | 4,353,478 | 1,919,802 | 1,428,135 | 792,302 | 871,547 |
| 57,024,540 | 52,726,210 | 48,777,711 | 43,050,593 | 39,844,915 | 38,006,361 |
| 33,387,663 | 31,076,515 | 29,165,168 | 26,448,761 | 25,590,407 | 23,675,319 |
| 2,881,877 | 2,924,930 | 3,407,187 | 2,995,424 | 2,480,667 | 2,276,909 |
| 13,016,544 | 11,363,970 | 11,556,821 | 9,386,363 | 8,934,860 | 7,469,798 |
| 49,286,084 | 45,365,415 | 44,129,176 | 38,830,548 | 37,005,934 | 33,422,026 |
| 7,738,456 | 7,360,795 | 4,648,535 | 4,220,045 | 2,838,981 | 4,584,335 |
| 61,265 | 306,680 | 2,293,477 | 2,841,371 | 1,190,100 | 1,108,555 |
| 3,730,407 | 5,255,881 | 4,603,137 | 1,695,578 | 1,484,779 | 1,586,825 |
| - | 4,199,382 | - | 4,622,927 | 4,500 | 2,872,246 |
| (8,406,264) | (8,484,405) | (8,403,448) | (7,185,197) | (6,253,392) | (3,655,291) |
| 3,123,864 | 8,638,333 | 3,141,701 | 6,194,724 | (735,032) | 6,496,670 |
| 14,137,605 | 12,801,825 | 30,462,788 | 24,453,875 | 25,597,104 | 28,892,401 |
| - | - | - | - | 803,224 | 344,857 |
| (5,014,482) | (4,562,657) | (4,302,274) | (3,951,776) | (4,016,387) | (3,407,309) |
| \$12,246,987 | \$16,877,501 | \$29,302,215 | \$26,696,823 | \$21,648,909 | \$32,326,619 |

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
REGIONAL WATER SUPPLY SYSTEM

TEN-YEAR FINANCIAL REVIEW

| BALANCE SHEET | 2012 | 2011 | 2010 |
|---|---------------------------|-----------------------------|-----------------------------|
| ASSETS | | | |
| Utility Plant - Net | \$223,896,711 | \$203,938,358 | \$207,242,527 |
| Current Assets | 41,256,611 | 55,640,447 | 59,811,400 |
| Other Assets | <u>1,067,595</u> | <u>1,134,270</u> | <u>1,194,533</u> |
| Total Assets | 266,220,917 | 260,713,075 | 268,248,460 |
| NET ASSETS | 137,267,801 | 133,964,359 | 138,246,799 |
| LIABILITIES AND EQUITY | | | |
| Long-Term Debt | 122,882,652 | 124,045,739 | 124,890,764 |
| Current Liabilities | 5,253,742 | 1,931,325 | 5,110,897 |
| Long-Term Liab. | <u>816,722</u> | <u>771,652</u> | <u>-</u> |
| Total Liabilities | <u>128,953,116</u> | <u>126,748,716</u> | <u>130,001,661</u> |
| TOTAL NET ASSETS AND LIABILITIES ... | \$266,220,917 | \$260,713,075 | \$268,248,460 |
| STATEMENT OF INCOME | | | |
| OPERATING REVENUES | | | |
| CRO - Debt Service | \$6,272,476 | \$6,239,797 | \$5,119,047 |
| CRO - O&M | 2,478,238 | 1,778,186 | 2,732,956 |
| CRO - Capital | <u>5,665,557</u> | <u>274,081</u> | <u>1,301,346</u> |
| Total Operating Revenues | 14,416,271 | 8,292,064 | 9,153,349 |
| OPERATING EXPENSES | | | |
| Operation and Maintenance | 2,510,085 | 2,485,977 | 2,458,379 |
| Depreciation | <u>4,495,971</u> | <u>4,482,820</u> | <u>4,426,113</u> |
| Total Operating Expenses | 7,006,056 | 6,968,797 | 6,884,492 |
| NET OPERATING INCOME (LOSS) | 7,410,215 | 1,323,267 | 2,268,857 |
| NON-OPERATING REVENUES (EXPENSES) | | | |
| Other Income | - | - | - |
| Interest Income | 407,622 | 396,391 | 861,775 |
| Interest Charges (Net) | <u>(4,968,459)</u> | <u>(6,440,678)</u> | <u>(4,833,300)</u> |
| Net Income (Loss) Before Contributions & Transfers | 2,849,378 | (4,721,020) | (1,702,668) |
| Total Capital Contributions | (414,376) | (508,791) | (4,593,787) |
| Grants & Federal BAB Subsidies | 868,328 | 868,328 | 306,327 |
| Transfers | <u>112</u> | <u>79,043</u> | <u>1,435,898</u> |
| NET INCOME (LOSS) | <u><u>\$3,303,442</u></u> | <u><u>(\$4,282,440)</u></u> | <u><u>(\$4,554,230)</u></u> |

Separate unaudited financial reporting for RWSS began with continuing disclosure requirements in 2004.

| 2009 | 2008 | 2007 | 2006 | 2005 | 2004 |
|---------------|---------------|---------------|---------------|---------------|---------------|
| \$206,708,069 | \$231,099,649 | \$234,373,114 | \$213,434,158 | \$203,311,344 | \$152,678,547 |
| 15,845,604 | 9,519,659 | 8,924,226 | 6,721,684 | 11,318,970 | 30,425,291 |
| 807,387 | 856,484 | 906,294 | 956,724 | 1,161,513 | 1,058,917 |
| 223,361,060 | 241,475,792 | 244,203,634 | 221,112,566 | 215,791,827 | 184,162,755 |
| 142,801,029 | 151,581,061 | 149,348,807 | 136,863,991 | 133,125,039 | 97,906,139 |
| 77,694,584 | 88,122,323 | 92,649,652 | 80,471,326 | 81,480,440 | 82,239,626 |
| 2,865,447 | 1,772,408 | 2,205,175 | 3,588,936 | 1,032,453 | 4,010,341 |
| - | - | - | 188,313 | 153,895 | 6,649 |
| 80,560,031 | 89,894,731 | 94,854,827 | 84,248,575 | 82,666,788 | 86,256,616 |
| \$223,361,060 | \$241,475,792 | \$244,203,634 | \$221,112,566 | \$215,791,827 | \$184,162,755 |
| \$4,293,912 | \$2,016,804 | \$1,999,664 | \$2,095,323 | \$1,774,443 | \$2,312,368 |
| 2,517,129 | 6,074,980 | 4,646,715 | 4,162,516 | 2,415,213 | - |
| (339,930) | - | - | - | - | - |
| 6,471,111 | 8,091,784 | 6,646,379 | 6,257,839 | 4,189,656 | 2,312,368 |
| 2,629,850 | 2,300,026 | 2,377,499 | 2,130,748 | 314,507 | - |
| 4,792,037 | 4,803,549 | 3,513,441 | 3,413,341 | 768,841 | 765,663 |
| 7,421,887 | 7,103,575 | 5,890,940 | 5,544,089 | 1,083,348 | 765,663 |
| (950,776) | 988,209 | 755,439 | 713,750 | 3,106,308 | 1,546,705 |
| - | 14,360 | 43,532 | 56,160 | - | - |
| 184,332 | 293,709 | 355,782 | 282,278 | 185,041 | 145,994 |
| (3,918,240) | (3,411,937) | (4,083,294) | (4,354,244) | (3,775,570) | (2,948,229) |
| (4,684,684) | (2,115,659) | (2,928,541) | (3,302,056) | (484,221) | (1,255,530) |
| 8,085,876 | 1,287,306 | 10,186,209 | 7,041,008 | 35,703,146 | 10,525,051 |
| - | - | - | - | - | 99,751 |
| (12,181,224) | 3,060,607 | 5,227,148 | - | (25) | 1,153,815 |
| (\$8,780,032) | \$2,232,254 | \$12,484,816 | \$3,738,952 | \$35,218,900 | \$10,523,087 |

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

BOND DEBT SERVICE REQUIREMENTS
DECEMBER 31, 2012

| <u>YEAR</u> | <u>PRINCIPAL</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|----------------------|----------------------|----------------------|
| 2013 | 7,205,000 | 19,060,732 | 26,265,732 |
| 2014 | 7,550,000 | 18,731,838 | 26,281,838 |
| 2015 | 7,940,000 | 18,401,975 | 26,341,975 |
| 2016 | 8,325,000 | 18,045,325 | 26,370,325 |
| 2017 | 8,760,000 | 17,651,863 | 26,411,863 |
| 2018 | 9,215,000 | 17,224,863 | 26,439,863 |
| 2019 | 10,515,000 | 16,818,982 | 27,333,982 |
| 2020 | 10,990,000 | 16,350,300 | 27,340,300 |
| 2021 | 11,530,000 | 15,817,407 | 27,347,407 |
| 2022 | 12,045,000 | 15,305,569 | 27,350,569 |
| 2023 | 12,670,000 | 14,706,619 | 27,376,619 |
| 2024 | 10,140,000 | 14,076,569 | 24,216,569 |
| 2025 | 10,610,000 | 13,583,028 | 24,193,028 |
| 2026 | 11,065,000 | 13,058,923 | 24,123,923 |
| 2027 | 11,535,000 | 12,510,112 | 24,045,112 |
| 2028 | 12,025,000 | 11,913,012 | 23,938,012 |
| 2029 | 12,570,000 | 11,290,708 | 23,860,708 |
| 2030 | 13,105,000 | 10,640,430 | 23,745,430 |
| 2031 | 13,690,000 | 9,962,624 | 23,652,624 |
| 2032 | 13,795,000 | 9,239,063 | 23,034,063 |
| 2033 | 16,410,000 | 8,508,824 | 24,918,824 |
| 2034 | 17,015,000 | 7,573,677 | 24,588,677 |
| 2035 | 17,650,000 | 6,604,050 | 24,254,050 |
| 2036 | 18,300,000 | 5,598,235 | 23,898,235 |
| 2037 | 18,975,000 | 4,555,370 | 23,530,370 |
| 2038 | 19,680,000 | 3,474,037 | 23,154,037 |
| 2039 | 20,405,000 | 2,352,523 | 22,757,523 |
| 2040 | 21,165,000 | 1,189,685 | 22,354,685 |
| | <u>\$364,880,000</u> | <u>\$334,246,343</u> | <u>\$699,126,343</u> |

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

FUNDS AVAILABLE FOR DEBT SERVICE

| | <u>2012</u> | <u>2011</u> | <u>2010</u> | <u>2009</u> | <u>2008</u> |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|
| Total Income | \$88,715,624 | \$76,867,233 | \$73,374,289 | \$66,821,912 | \$61,944,933 |
| Less: Operating Exp . | <u>36,087,695</u> | <u>35,928,127</u> | <u>37,596,514</u> | <u>37,148,774</u> | <u>36,269,540</u> |
| Income Available for Debt Service | <u>\$52,627,929</u> | <u>\$40,939,106</u> | <u>\$35,777,775</u> | <u>\$29,673,138</u> | <u>\$25,675,393</u> |
| Bond Redemption | 6,668,750 | 6,308,333 | 6,092,083 | 5,896,250 | 6,046,250 |
| Bond Interest | <u>19,342,423</u> | <u>19,624,326</u> | <u>15,700,645</u> | <u>9,941,993</u> | <u>9,465,014</u> |
| Debt Service Payable | <u>\$26,011,174</u> | <u>\$25,932,659</u> | <u>\$21,792,728</u> | <u>\$15,838,243</u> | <u>\$15,511,264</u> |
| Times Debt Service Covered..... | 2.02 | 1.58 | 1.64 | 1.87 | 1.66 |

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

WATER PLANT IN SERVICE - YEAR 2012

PLANT ACCOUNTS

| | Book Cost 1/1/12 | Additions 2012 |
|-------------------------------------|-----------------------|-----------------------|
| INTANGIBLE PLANT | \$ 34,902,822 | \$ 389,111 |
| SOURCE OF SUPPLY | 76,455,691 | 2,483,372 |
| PUMPING PLANT | 9,142,701 | 85,249 |
| WATER TREATMENT PLANT | 45,097,165 | 59,680 |
| TRANSMISSION PLANT | 222,241,072 | 4,790,118 |
| DISTRIBUTION PLANT | 377,190,175 | 19,174,736 |
| GENERAL PLANT | 28,874,232 | 4,859,197 |
| TOTAL WATER PLANT IN SERVICE | 793,903,858 | 31,841,463 |
| CONSTRUCTION WORK IN PROGRESS | 16,426,998 | 74,810,559 |
| TOTAL | <u>\$ 810,330,856</u> | <u>\$ 106,652,022</u> |

DEPRECIATION ACCOUNTS

| | Depreciation Rate % | Accumulated Depreciation 1/1/12 | Annual Accrual Cr. |
|--------------------------------|---------------------------|---------------------------------------|--------------------------|
| INTANGIBLE PLANT | - | \$ 37,500 | \$ - |
| SOURCE OF SUPPLY PLANT | 2.957 | 16,281,893 | 1,821,895 |
| PUMPING PLANT | 2.513 | 2,962,906 | 232,101 |
| WATER TREATMENT PLANT | 3.620 | 10,352,658 | 1,573,225 |
| TRANSMISSION PLANT | 1.668 | 36,239,375 | 3,640,284 |
| DISTRIBUTION PLANT | 1.876 | 64,762,779 | 7,071,366 |
| GENERAL PLANT | 7.915 | 18,540,448 | 923,815 |
| TOTAL PLANT DEPRECIATION | | <u>\$ 149,177,559</u> | <u>\$ 15,262,686</u> |

1. Total Water Plant in Service includes non-depreciable land and land rights of \$56,843,169.
2. Total Book Cost of Plant Retired \$ (5,412,698)
Add: Cost of Land Sold: -
Intangible Plant: 168,253
Total Retirements \$ (5,244,445)

| Retirements 2012 | Transfers & Adjustments | Book Cost 12/31/12 |
|-----------------------------|--|-------------------------------|
| \$ (205,753) | \$ - | \$ 35,086,180 |
| (62,886) | - | 78,876,177 |
| (5,921) | - | 9,222,029 |
| (754,901) | - | 44,401,944 |
| (90,337) | - | 226,940,853 |
| (3,505,899) | - | 392,859,012 |
| (787,001) | (145,439) | 32,800,989 |
| (5,412,698) | (145,439) | 820,187,184 |
| - | (31,696,024) | 59,541,533 |
| <u>\$ (5,412,698)</u> | <u>\$ (31,841,463)</u> | <u>\$ 879,728,717</u> |

| Book Cost of Plant Retired | Cost of Removal | Salvage, Transfers and Adjustments | Accumulated Depreciation 12/31/12 |
|---|----------------------------|---|--|
| \$ (37,500) | \$ - | \$ - | \$ - |
| (62,886) | (7,543) | - | 18,033,359 |
| (5,921) | (3,962) | - | 3,185,124 |
| (754,901) | (12,981) | - | 11,158,001 |
| (90,337) | (197,084) | - | 39,592,238 |
| (3,505,899) | (2,032,455) | - | 66,295,791 |
| (787,001) | (65,328) | - | 18,611,934 |
| <u>\$ (5,244,445)</u> | <u>\$ (2,319,353)</u> | <u>\$ -</u> | <u>\$ 156,876,447</u> |

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

SUMMARY OF WATER BILLED
DECEMBER 31, 2012

| | MILLION GALLONS, TOTAL | | MILLION GALLONS, AVG DAILY | |
|---|------------------------|------------------|----------------------------|--------------|
| | YEAR 2012 | YEAR 2011 | YEAR 2012 | YEAR 2011 |
| WATER BILLED | | | | |
| Residential and Domestic | 7,785.64 | 7,715.15 | 21.33 | 21.14 |
| Commercial and Industrial | 2,499.33 | 2,497.80 | 6.85 | 6.84 |
| Special Rate--Simpson ... | 5,860.99 | 5,851.70 | 16.06 | 16.03 |
| Municipal | 70.63 | 78.76 | 0.19 | 0.22 |
| Other Public Bldgs and Grounds | 457.27 | 490.54 | 1.25 | 1.34 |
| Sales to Other Utilities | 632.32 | 625.83 | 1.73 | 1.71 |
| | <u>17,306.18</u> | <u>17,259.78</u> | <u>47.41</u> | <u>47.28</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 - 2012

| WATER SALES | AVERAGE MONTHS BILLED | C. CU. FT. | AMOUNT |
|--|-----------------------------|------------|--------------|
| RESIDENTIAL AND DOMESTIC SERVICE | | | |
| Single and Multiple Houses - Inside City | 53,772 | 4,490,938 | \$17,100,720 |
| Multiple Unit Dwellings - Inside City | 3,188 | 1,580,328 | 4,159,149 |
| Sprinkling Services (Inside and Outside) | 395 | 192,902 | 636,917 |
| Fire Services (Inside and Outside) | 146 | 491 | 71,444 |
| Single and Multiple Houses - Outside City | 30,806 | 3,188,216 | 13,439,771 |
| Multiple Unit Dwellings - Outside City | 1,783 | 955,734 | 3,277,704 |
| Total Residential and Domestic Service | 90,090 | 10,408,609 | 38,685,705 |
| COMMERCIAL AND INDUSTRIAL SERVICE | | | |
| High Use Commercial (Inside and Outside) | 8 | 820,998 | 1,290,964 |
| Single and Multiple Buildings - Inside City | 3,478 | 1,995,140 | 5,457,379 |
| Sprinkling Services (Inside and Outside) | 262 | 200,147 | 671,736 |
| Fire Services (Inside and Outside) | 1,075 | 6,948 | 2,029,035 |
| Single and Multiple Buildings - Outside City ... | 789 | 318,131 | 1,171,836 |
| Total Commercial and Industrial Service | 5,612 | 3,341,364 | 10,620,950 |
| SERVICES WITH SPECIAL RATE | | | |
| Simpson Tacoma Kraft Company | 1 | 7,835,544 | 5,031,760 |
| MUNICIPAL WATER SERVICES | | | |
| Fountains, Buildings and Grounds | 172 | 94,392 | 342,138 |
| Fire Services | 34 | 40 | 41,247 |
| Total Municipal Water Service | 206 | 94,432 | 383,385 |
| OTHER PUBLIC BUILDINGS AND GROUNDS | | | |
| Single and Multiple Buildings - Inside | 160 | 323,282 | 852,430 |
| Single and Multiple Buildings - Outside | 52 | 87,062 | 270,794 |
| Fire Services | 77 | 200,863 | 570,032 |
| Sprinkling Services | 117 | 125 | 216,526 |
| Total Other Public Buildings and Grounds | 406 | 611,332 | 1,909,782 |
| SALES TO OTHER UTILITIES - Total | 18 | 910,332 | 2,090,430 |
| Unbilled Revenue | | | 416,986 |
| TOTAL WATER SALES | 96,333 | 23,201,613 | \$59,138,998 |

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATISTICS
AS OF DECEMBER 31, 2012

Tacoma Water System:

| | | |
|---|--------|----|
| 2012 average daily delivery exclusive of pulp mill | 34.2 | MG |
| Average daily delivery pulp mill | 16.0 | MG |
| Total average daily delivery | 50.3 | MG |
| 2012 maximum daily production August 16, 2012 | 80.4 | MG |
| 2012 minimum daily production . . . February 8 2012 | 26.4 | MG |
| Total water produced in 2012*. | 18,393 | MG |

Regional Water Supply System (RWSS):

| | | |
|--|-----|----|
| Total average daily delivery | 9.3 | MG |
|--|-----|----|

Average daily consumption per single family

| | | |
|-------------------------------|-----|-----|
| residential service | 171 | GPD |
|-------------------------------|-----|-----|

Miles of transmission and wells supply mains -

| | | |
|---|-----|--|
| 28" to 96" diameter (includes North Fork wells system). . . . | 142 | |
|---|-----|--|

Miles of distribution mains - 2" to 24" in diameter.

| | | |
|------------------------|--------|--|
| Fire hydrants. | 10,225 | |
|------------------------|--------|--|

The primary source of Tacoma's water supply is the Green River. Additionally the North Fork well field provides blending options during periods of excessive river turbidity. The Green River source consists of a 73 MGD water right. Tacoma is also a partner in a Regional Water Supply System (RWSS) and holds a 27 MGD annual average share of that interruptible, junior water right on the Green River. Tacoma also has ground water rights totaling 87 MGD with an installed pumping capacity of 55 MGD.

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.

Storage facilities are provided at 15 locations. These facilities consist of 10 concrete basins or reservoirs and 12 steel standpipes. The combined storage capacity is equal to approximately 181 million gallons. Of this storage capacity 108 million gallons are located at McMillin Reservoir approximately 14 miles southeast of Tacoma.

* Includes losses and water for self-consumption.

MG equals million gallons.

GPD equals gallons per day.

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

TAXES AND EMPLOYEE WELFARE CONTRIBUTIONS
FOR THE YEAR 2012

FEDERAL

| | | |
|------------------------------|--|-------------|
| Social Security (FICA) | | \$1,444,114 |
|------------------------------|--|-------------|

STATE OF WASHINGTON

| | | |
|---|------------------|-----------|
| Retail Sales | \$298,592 | |
| Utilities and Business Activities Tax | <u>2,991,555</u> | |
| Total | | 3,290,147 |

COUNTY

| | | |
|---------------------|---------------|--------|
| Real Property | <u>27,866</u> | |
| Total | | 27,866 |

MUNICIPALITIES

| | | |
|--|--------------|------------------|
| City of Tacoma Gross Earnings Tax | 5,081,191 | |
| City of Lakewood Administrative Fee | 6,620 | |
| City of Puyallup Administrative Fee | 13,255 | |
| City of University Place Administrative Fee | 451,139 | |
| City of Fircrest Administrative Fee | <u>6,330</u> | |
| | | <u>5,558,535</u> |

| | | |
|-------------------|--|----------------------------|
| TOTAL TAXES | | <u><u>\$10,320,662</u></u> |
|-------------------|--|----------------------------|

| | | |
|---|--|--------|
| Taxes as a % of Total Revenues of \$83,001,484 | | 12.43% |
|---|--|--------|

EMPLOYEE WELFARE CONTRIBUTIONS

| | | |
|--|----------------|--|
| Industrial Insurance and Medical Aid | \$166,534 | |
| Pensions | 1,954,051 | |
| Medical Insurance | 3,599,426 | |
| Dental Insurance | <u>402,280</u> | |

| | | |
|--|--|---------------------------|
| TOTAL EMPLOYEE WELFARE CONTRIBUTIONS | | <u><u>\$6,122,291</u></u> |
|--|--|---------------------------|

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

2012 WATER RATES

| | | | READY TO SERVE CHARGE PER MONTH | |
|------------|------|-------|------------------------------------|-------------------|
| | | | INSIDE TACOMA | OUTSIDE TACOMA |
| METER SIZE | | | | |
| 5/8 | inch | ..... | \$16.76 | \$20.11 |
| 3/4 | inch | ..... | \$25.15 | \$30.17 |
| 1 | inch | ..... | \$41.91 | \$50.29 |
| 1-1/2 | inch | ..... | \$83.80 | \$100.56 |
| 2 | inch | ..... | \$134.08 | \$160.90 |
| 3 | inch | ..... | \$251.40 | \$301.68 |
| 4 | inch | ..... | \$419.00 | \$502.80 |
| 6 | inch | ..... | \$838.00 | \$1,005.60 |
| 8 | inch | ..... | \$1,340.80 | \$1,608.96 |
| 10 | inch | ..... | \$1,927.40 | \$2,312.88 |
| 12 | inch | ..... | \$2,828.25 | \$3,393.90 |

| | | | 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 | | | \$1.368 | \$1.642 |
| First 500 cubic ft. of water consumption per month during the summer months of June through September | | | \$1.368 | \$1.642 |
| Each 100 cubic ft. of water consumption over 500 cubic ft. during the summer months of June through September | | | \$1.710 | \$2.053 |
| <u>Commercial and Industrial</u> | | | | |
| General Service | | | \$1.497 | \$1.797 |
| Large Volume Service (over 65,000 cubic feet annually) | | | \$1.381 | \$1.658 |
| <u>Parks and Irrigation Service</u> | | | | |
| Each 100 cubic feet of water consumption | | | \$1.990 | \$2.388 |

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. 27970 and were effective January 1, 2012.

Residential service rate for outside Tacoma does not include Fircrest, Puyallup, University Place, and Lakewood.

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

2012 FIRE PROTECTION RATES

RATES FOR PRIVATE FIRE PROTECTION SERVICE ON A SEPARATE METER INSIDE THE CITY OF TACOMA ARE AS FOLLOWS:

| METER SIZE | | MONTHLY CHARGE | WATER INCLUDED FOR MONTHLY LEAKAGE AND TESTING PURPOSES (100 Cubic Feet) |
|------------|------------|-------------------|--|
| 2 | inch | \$21.29 | 2.99 |
| 3 | inch | \$31.00 | 2.99 |
| 4 | inch | \$51.79 | 2.99 |
| 6 | inch | \$116.17 | 2.99 |
| 8 | inch | \$206.81 | 2.99 |
| 10 | inch | \$323.48 | 2.99 |
| 12 | inch | \$517.40 | 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).

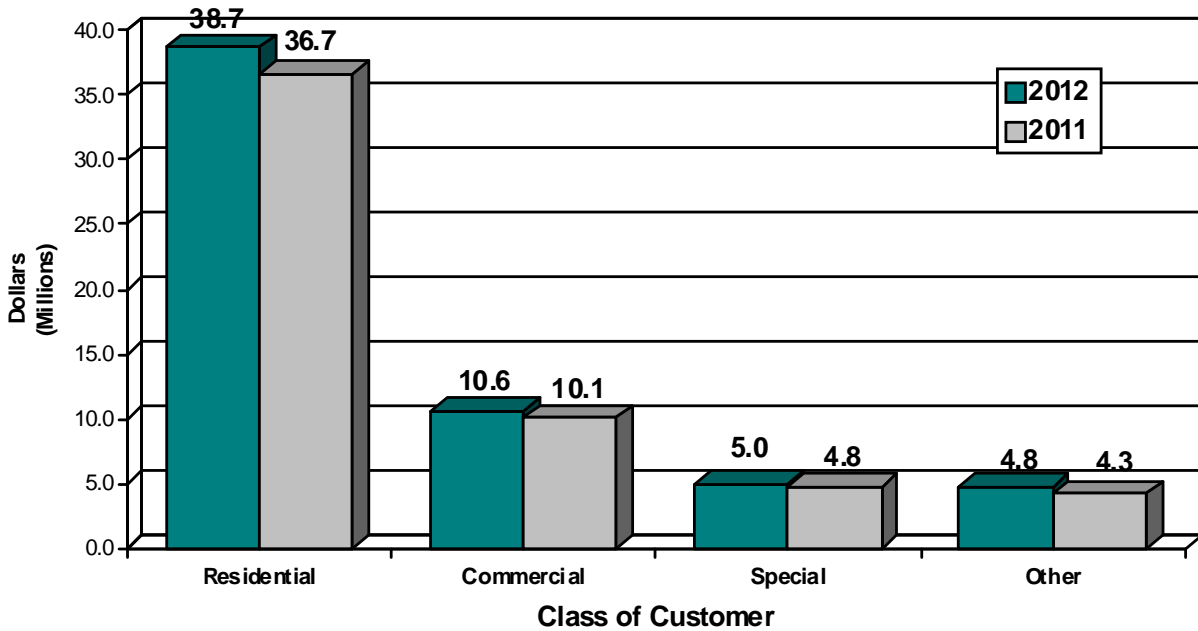
CONSUMPTION

Rates per 100 cubic feet per month \$3.726

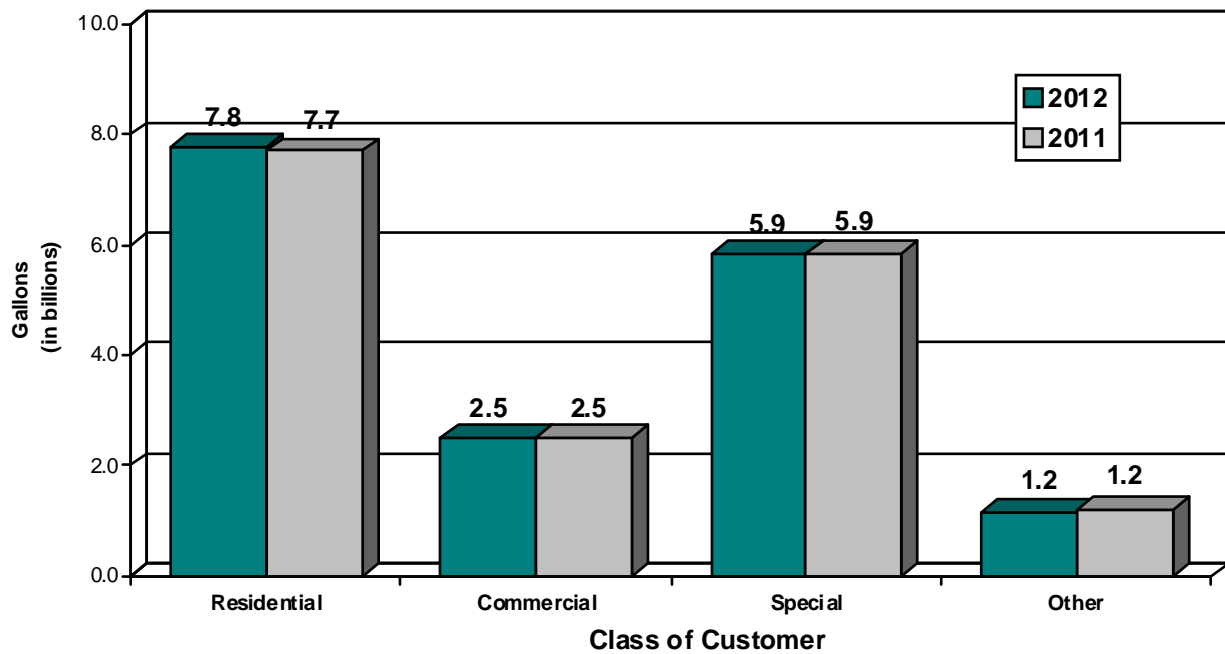
The above rates for fire service shall apply where City water is used for all purposes on such premises exclusive of that amount allowed for testing and leakage.

The Fire Protection Rates were established by Ordinance No. 27970 and were effective January 1, 2012.

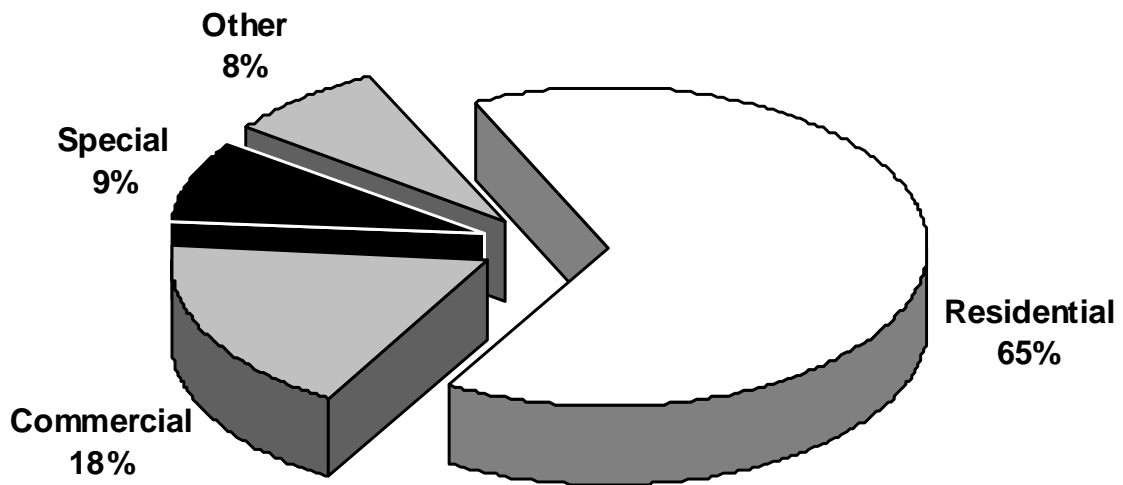
WATER SALES
Year to Date - December 2012 & 2011



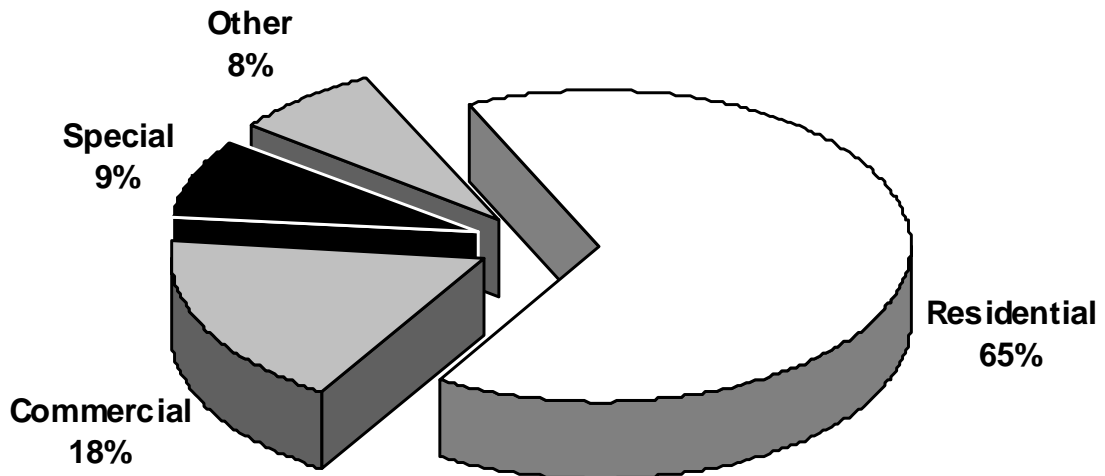
WATER CONSUMPTION
Year to Date - December 2012 & 2011



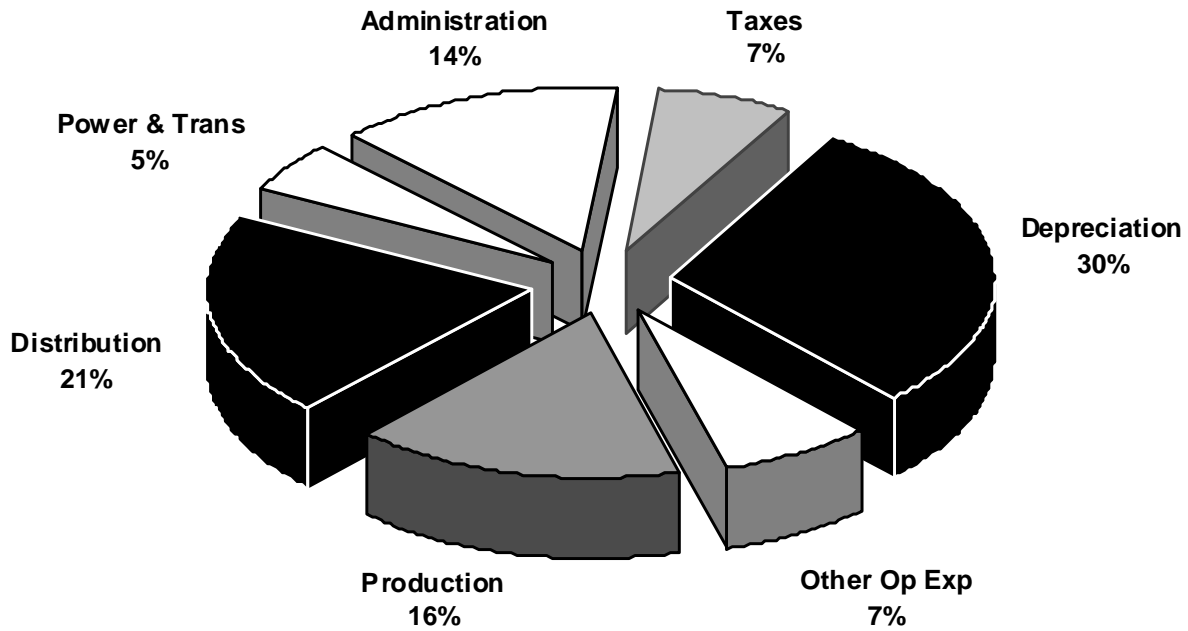
WATER SALES
Year to Date - December 2012
(\$59,138,998)



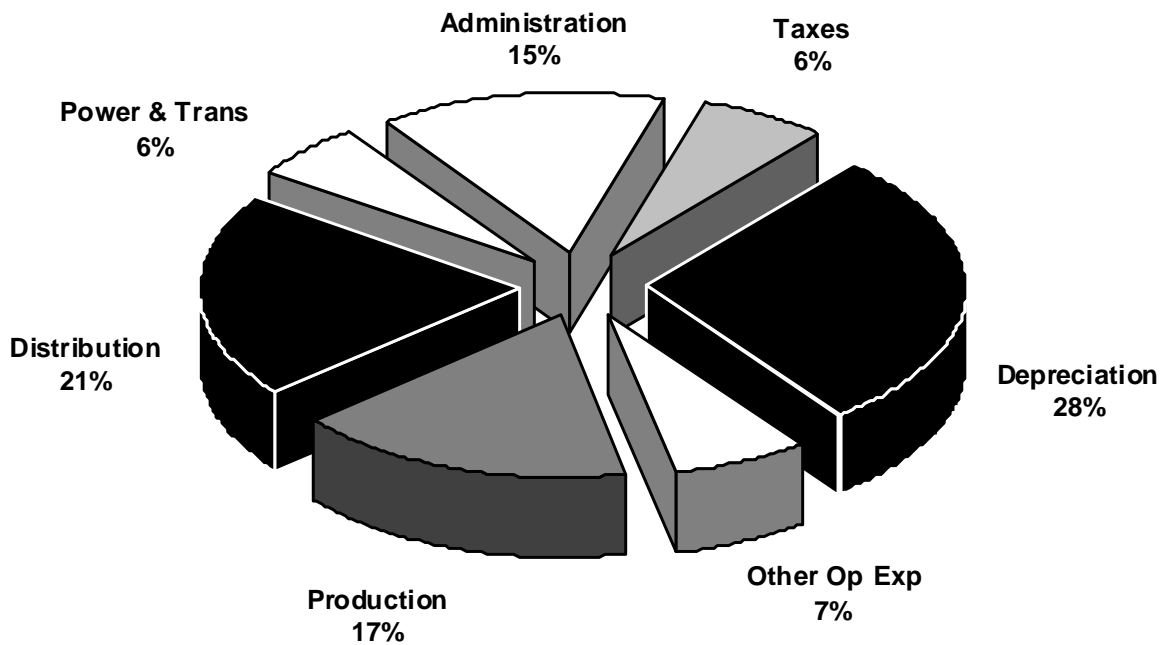
WATER SALES
Year to Date - December 2011
(\$55,877,567)



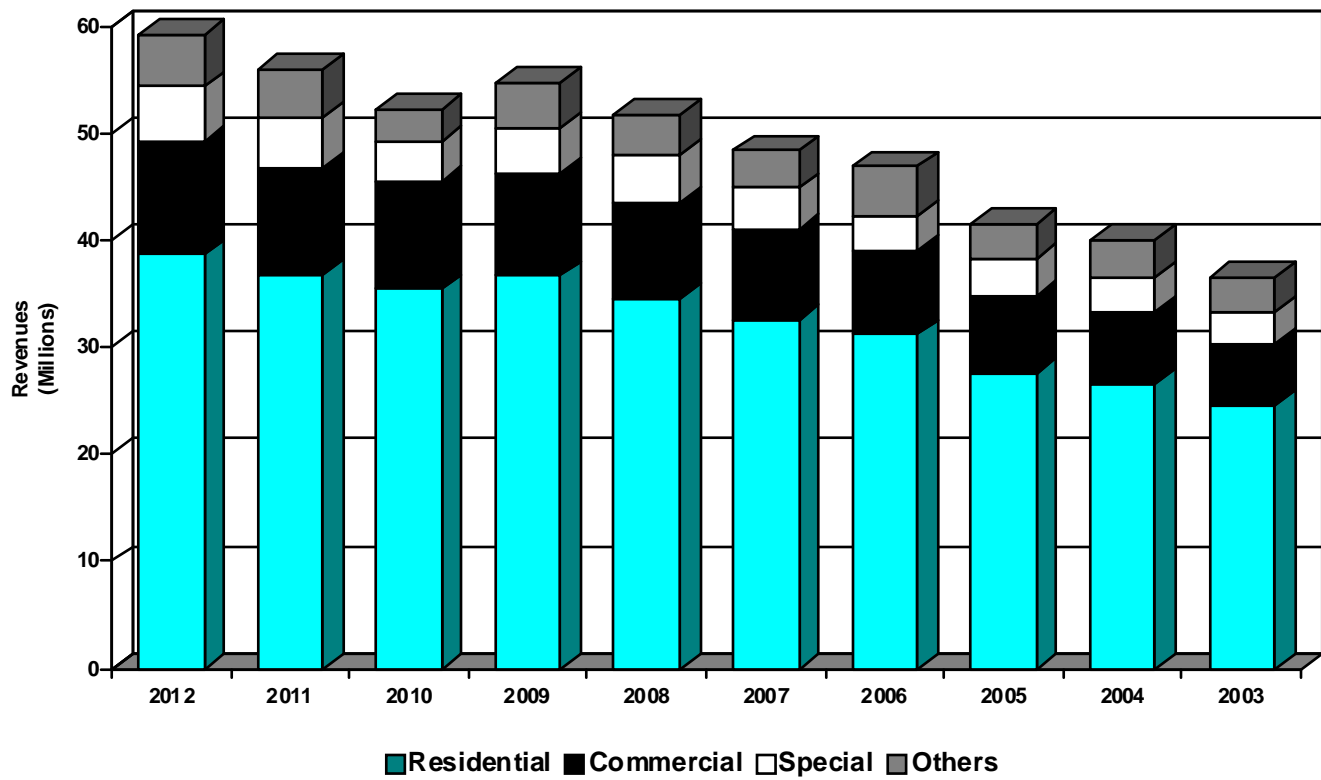
TOTAL OPERATING EXPENSES
Year to Date - December 2012
(\$51,350,381)



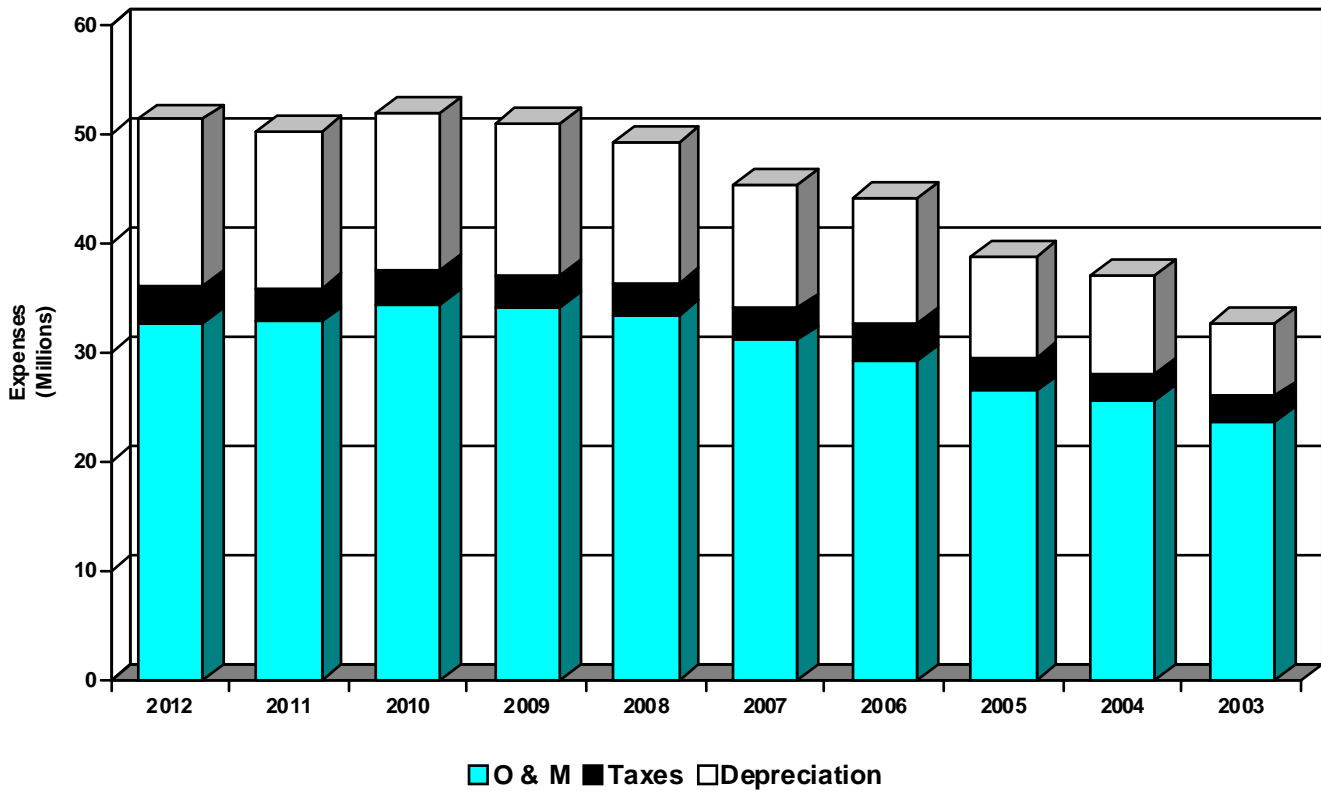
TOTAL OPERATING EXPENSES
Year to Date - December 2011
(\$50,317,808)



TEN-YEAR SUMMARY OF WATER SALES



TEN-YEAR SUMMARY OF OPERATING EXPENSES



This page has been left blank intentionally.

SUPERINTENDENT'S REPORT 2012 TACOMA WATER

Tacoma Water Management Team completed a strategic planning effort in early 2012. The adopted plan sets the direction and strategic focus for our Utility over the next many years. An updated mission and values were adopted along with a series of initiatives. The Tacoma Water Strategic Plan was presented to the Public Utility Board and provided to Tacoma Water staff during the second quarter. The plan provides us with a solid foundation by helping us understand and communicate the challenges we face. Eight initiatives were detailed to help us succeed in our mission of providing clean, reliable water now and in the future. Tacoma Water's management team also approved the approach we will use to track and report on Strategic Plan strategy and performance metric progress. A Balanced Scorecard Strategy Map was developed to provide structure for prioritization and measurement going forward. The Strategic Plan provided the basis for Tacoma Water's 2013/2014 budget request.

Summer weather in 2012 presented an interesting scenario; temperatures were similar to 2011 yet precipitation was, during late peak season, the lowest in years. Even with nice summer weather from mid July through early October, total water consumption in 2012 was similar to recent cool, wet summers. Water sales were lower than budgeted development activity, as indicated by new meter installs and residential System Development Charges, increased modestly due to construction of homes on developed lots.

Expenses were managed throughout all sections of Tacoma Water to respond to the reduced revenues resulting from poor water sales. Approximately 20 positions were held vacant, equipment was surplussed and not replaced and inventory turnover was improved and the economic recovery remained sluggish.

Four-year labor contracts for Tacoma Water's unionized staff were negotiated for the period of 2011 through 2014. The wage rates for the first two years will not increase implementation of the City's compensation policy regarding market rate wages will be implemented in the 2013/2014 timeframe.

In June, Tacoma Water entered into a water supply agreement with Auburn to provide 1 MGD of water supply. Auburn began purchasing water in late 2012; these sales are expected to generate in excess of \$1M annually.

Tacoma Water also renegotiated its agreement with the Cascade Water Alliance (Cascade), effective December 31, 2012. The new agreement restructures the payment obligations contained in the 2005 agreement from Cascade to Tacoma Water into a defined payment stream that totals \$119.7 million over the next 30 years. This agreement also contains provisions for the transfer of up to 10 million gallons per day of wholesale water supply capacity to Auburn, Buckley, Bonney Lake, and Sumner, which could result in significant additional water sales revenue for Tacoma reduce future water rates for all Tacoma Water customers.

In 2009, Tacoma Water removed the cost of public fire protection from rates and instead billed the applicable local governments pursuant to Washington State Supreme Court decision *Lane v. City of Seattle*. The Washington State Supreme Court decided on January 26 of 2012, in *City of Tacoma v. Bonney Lake*, that Tacoma Water should not have removed the cost of public fire protection from the 2009 – 2012 rates of customers outside City of Tacoma limits in jurisdictions where we have franchise agreements. Consistent with our understanding of the opinion, Tacoma Water did the following: continued to invoice the City of Tacoma for the cost of public fire protection inside City limits; deemed the invoices sent to the applicable outside City of Tacoma local governments for the period 2009 – 2012 uncollectable, eliminated invoice balances, and refunded as appropriate; and established a regulatory deferral per Financial Accounting Standard 71 for accounting years 2009 -2012 for recovery of uncollected costs related to outside City of Tacoma public fire protection services demonstrating intent to recover the lost revenue. Tacoma Water has proposed a “Franchise Fire Protection Rate” to recover these historical costs, as well as the ongoing costs of providing public fire protection, from those customers outside the city of Tacoma that receive the service. Tacoma Water is also actively participating in statewide efforts to accomplish additional clarity through a legislative fix.

WATER QUALITY

In 2012 the Water Quality section contributed to Tacoma Water’s continued commitment to protect public health, and to support Tacoma and the region with a high quality, reliable water supply. Highlights are briefly discussed in the following sections.

Green River Filtration Treatment

Design was completed and the Green River filtration plant moved into construction in 2012. The construction of this complex plant requires expert planning and project execution. The Tacoma Water construction management team, together with the selected General Contractor / Construction Manager, Hoffman Construction Company, are successfully delivering the project on schedule, and within budget. The project is targeted for substantial completion in December 2014, and the total project budget has reduced from \$211 million at the beginning of the year to \$195 million at year end, with over 85% of the project work under contract.

In 2012, Tacoma Water and its Regional Water Supply System (RWSS) Partners decided to incorporate Tacoma Water’s North Fork Well Field facilities into the design of the Green River Filtration Facility (GRFF) as a result of a business case evaluation (BCE) that was conducted by Tacoma Water staff and MWH Global, the design engineer for the GRFF. This is a significant decision from a treatment plant design perspective, in that it will significantly reduce expenses associated with the construction and operation of the solids handling components of the GRFF. Tacoma Water is actively engaged with Tacoma Power and Puget Sound Energy in developing a strategy to optimize energy use for these facilities once the GRFF is online.

Groundwater Treatment

Construction of groundwater treatment facilities at the Hood Street Reservoir and at the South Tacoma Pump Station began in 2012, and is well underway. This project will enhance Tacoma Water's ability to serve groundwater from the South Tacoma aquifer that meets requirements for treatment to reduce lead and copper exposure, and to provide fluoridation at the Hood Street Reservoir, in accordance with the expectations of Tacoma voters and the City's ordinance.

Meeting Expectations

Customer confidence is hard-won, and easily lost. Professionalism and timeliness of response when customers have a concern is critical. In 2012 we continued 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 percent 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.

Protecting and Preserving our Natural Environment

Our Watershed Management and Environmental Programs advanced the protection of critical assets in 2012 through the continued implementation of bridge and culvert evaluation and replacement projects on watershed lands, implementing additional surveillance and tracking, and improved maintenance procedures. There was continued progress meeting Tacoma Water's aggressive environmental obligations embodied in our Habitat Conservation Plan. Managing the lands and water resources with which we are entrusted is a cornerstone value at Tacoma Water, and one we share with our resource management partners.

Protection of our Green River water supply was improved in 2012 with the acquisition of 344 acres of forest land in the Sawmill Creek sub-basin. The land, which includes the largest piece of old growth timber remaining in private ownership in the Green River watershed, was purchased by an NGO (Forterra Northwest) using a Cooperative Endangered Species Conservation Fund grant administered by Washington Department of Natural Resources. The land was subsequently given to Tacoma Water in December 2012 to be managed under a conservation easement for the protection of ESA-listed species and water quality. These lands together with an adjacent parcel previously acquired from the Forterra (then Cascade Land Conservancy) and with the U.S. Forest Service's Kelly Butte Special Management Area represent a large block of contiguous habitat that provides ecological connectivity with similarly protected parcels in the I-90 Corridor and high quality ecosystem functions, such as water supply and quality to benefit Tacoma Water customers.

WATER SUPPLY

The Water Supply section made progress in 2012 on its mission of operating, maintaining and improving the infrastructure that forms Tacoma's water supply system to assure reliable supply to our customers.

Infrastructure Design and Construction

The construction of the McMillin Reservoir Replacement Project was completed. This major project represented the last of our open reservoir basins having been converted to enclosed tanks. The two new 33 million gallon covered concrete tanks, are the largest tanks of their kind in the world, and replace the three open basins that previously held up to 210 million gallons of storage. The old reservoirs had been in service for 50 to 100 years and were at the end of their useful lives. This is a significant improvement to Tacoma's supply system both from a maintenance perspective and water quality perspective. The conversion of these previously open basins to enclosed tanks has eliminated a safety hazard in that we no longer need to rechlorinate and have removed the gas chlorine from the site.

The replacement of a portion of Pipeline 1 across the Orting Valley wetlands was completed in 2012. This was phase 1 of the replacement project of the last original section of the Green River Pipeline and is located in an area vulnerable to flooding and volcanic eruption. The work to replace these remaining above ground sections of pipeline with buried sections will assure better reliability and safety of this critical line.

An extensive upgrade and modernization to the entire Supervisory Control and Data Acquisition (SCADA) system and the communication network (including 2 new microwave sites) was completed in 2012. This system-wide upgrade was the first since the system was installed in the late 1980's and will improve both the reliability and effectiveness of the operations of the water system.

Preliminary work needed to rehabilitate a section of Pipeline 2 at Woodland Avenue was completed in 2012. Several distribution mains were installed and customers originally connected to the pipeline were transferred to the new distribution mains. As a result, an extended shutdown of Pipeline 2, which is needed to accomplish the relining work, can occur without inconveniencing customers. Relining of the transmission main will occur in the 1st quarter of 2013.

Operations & Maintenance

Supply staff continued to actively participate in the development of the Division's Asset Management program.

A consolidation of reporting headquarters was accomplished in 2012. The consolidation will provide efficiencies to our operation by pooling resources at a single location, and will decrease expenses by shutting down a reporting headquarters and consolidating crews at an existing site.

A shift schedule similar to a schedule used at our Headworks facility was implemented in our Water Control Center. This allowed a downsizing of the workforce required to staff the Water Control Center from the historical 6 employees to a total of 4. This change will provide significant financial benefits to Tacoma Water, as well as provide significant benefits to the employees working the shifts.

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, and coordinates all activities with the US Army Corp of Engineers relating to Howard Hanson Dam. 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 & RATES

In 2012, Tacoma Water undertook an extensive financial modeling effort in support of the 2012 strategic planning process and 2013-2014 budget development. Additionally, we rebuilt our cost of service rate model. The rate model work required involvement across all Tacoma Water Sections along with support from a rate consultant. The preliminary findings of this analytical effort have been communicated to the Public Utility Board, with additional outreach to various customer groups and review by the City Council in early 2013.

The proposed rate adjustment is scheduled for City Council consideration in late February, and implementation April 1, 2013. Tacoma Water customers will see an overall average increase of 6.0%. Another 6.0% overall increase is scheduled for January 1, 2014. The rate increase varies by customer class, based on the cost of serving each customer class.

In 2012, Tacoma Water received clarification from the City of Tacoma Tax and License Department regarding applicability of gross earnings tax on Public Fire Protection revenues. Based on the Tacoma Municipal Code, the Utility is allowed a deduction from the gross earning tax for revenue received for inside and outside City Public Fire Protection Fees, fire hydrant rentals, damage reimbursements and interest earned in the RWSS Operating Fund on behalf of the RWSS Partners. However, the Department found that 'fire service, hydrant rental' as written in the Code does not include Private Fire Protection revenue and is not an allowed deduction. Tacoma Water received a refund of \$486,956 for inside Public Fire Protection Revenues, \$348,331 for outside City Public Fire Protection Revenues, \$1,436 for Fire Hydrant Rental Revenue, \$11,604 for Damage reimbursements and \$17,797 for RWSS Interest earned by the Partners. The Utility subsequently refunded the City \$486,956 for Gross Earnings Tax collected on inside City Public Fire Protection Fees. In addition, Tacoma Water was required to pay \$181,143 for unpaid tax on Private Fire Protection revenue. Including interest, Tacoma Water received a net refund of \$241,117 at the end of 2012.

DISTRIBUTION OPERATIONS

As the economic slowdown continued in 2012 Distribution Operations continued efforts to reduce costs. Working in collaboration with Distribution Engineering, galvanized water services and mains were targeted for replacement. Customer complaints due to low pressure, inadequate flow, service disruption due to main breaks, and discolored water were the basis for targeting galvanized mains. Some of the main replacement projects were assigned to Tacoma Water crews, rather than being contracted out.

Controlling expenses continued by exploring various options for accomplishing work, and evaluating vacancies as they become available. An extensive staffing review was conducted as part of the planning process for the 13/14 biennial budget with the goal of restructuring for our future needs. As a result, Distribution Operations reduced staffing by 2 construction crews and a supervisor position, a total reduction of nine FTE's by the end of 2012.

Planner/Scheduler

Distribution Operations initiated a planner/scheduler pilot program in June of 2012. The planner/scheduler pilot involves supervisors providing their work plan by 4:00 p.m. The following morning, staff availability is reaffirmed and resources allocated to the highest priority jobs. An immediate benefit was realized in the daily morning scheduling effort as a result of teamwork, collaboration and focusing on section wide work priorities.

Leadership Program

Six employees were selected to be part of a new Tacoma Water Leadership. The program included completing the Water Division Manager role profile assessment, management feedback session, and job shadowing. Additionally training was offered to all 25 staff who applied for the Leadership Program including the six who were selected. The training sessions covered accounting, budget, and rate setting.

Fleet Improvements

To be more efficient and environmentally aware, Tacoma Water's fleet was evaluated for improvement opportunities. Automatic Vehicle Location (AVL) system technology was installed in all Tacoma Water vehicles by the end of the first quarter 2012. Weekly reports on idle times and speeding events were tracked and followed up on. Monthly averages were compiled in 2012 with the potential of establishing specific goals for 2013.

Each piece of equipment in Distribution Operations was reviewed to determine what to surplus as a result of the crew downsizing. Using replacement and surplus funds to buy down future replacement costs, a savings of \$675,000 in fleet costs will be realized in 2013/2014 and another \$800,000 will be saved in the next two biennia.

Performance Management

Several performance metrics tracked by Distribution Operations were met or exceeded reflecting significant operational efficiencies:

Reduce Labor hours on fixed fee new service installs by 20% average as compared to 2010 average labor hours. Fixed fee service install include full service installs for 3/4 x 5/8 and 1x1. The average labor hours for 2010 fixed fee jobs was 38 hrs.. The average for 2012 was 27.14 hrs.

Complete EDPR's for each represented employee within 30 days of job classification anniversary date 95% of the time. Also, each EDPR will include 3 measurable personal goals, with one goal focused on efficient operations. For 2012 99% of EDPR's for 101 employees were turned in within 30 days and with 3 measurable personal goals.

Bill all time and materials orders within 60 days after final invoice or activity 90% of the time. As of third quarter the average time for billing is 29.76 days with 90% completed within 60 days.

Respond to all Distribution Operations high priority notifications on site within less than 2 hours average. The average as of third quarter is 90 minutes.

Systematic flushing

As we are an unfiltered, river water supply, it is critical that we regularly flush our water mains. In 2012 our Unidirectional flush crews completed 2,071,233 lineal feet or 392.3 miles of distribution mains, almost 100 miles more main than was flushed in 2011, making it the sixth consecutive year of increased main flushing productivity.

Fire Hydrant Maintenance

All fire hydrants receive comprehensive maintenance every other year. Efficient routing, improved record keeping, replacement of old scissor style hydrants and a mature hydrant maintenance program has resulted in high degree of hydrant reliability and low incidence of issues.

Meters

Changes in the availability of Compound, Turbine and Fire service meters, and new Federal Regulations relating to acceptable levels of lead in potable water products has lead Tacoma Water to investigate new meter technologies. A team of stakeholders identified metering options to respond to these changes and our business needs. The team used Asset Management principles considering life cycle costs in the evaluation process and started bench and field tests of several meters. A business case evaluation was been completed and meters will continue to be tested before a final decision is made.

ASSET AND INFORMATION MANAGEMENT (FORMERLY RESOURCE PLANNING)

Asset Management

Tacoma Water continued to make Asset Management progress in 2012. Some noteworthy accomplishments from the 2012 work plan include: initiating failure modes assessment for both the Treatment & Monitoring and Pump Station strategic asset management plans (SAMPs); holding a 2-day Asset Management workshop attended by 23 Tacoma Water employees; launching an Asset Management Forum to bring SAMP leads together; participating in development of the Balanced Scorecard strategy map; and enhancing our economic model by creating a multiple asset decision tool which allows multiple assets to be brought together to analyze the benefit of a project.

Information Management

Much work related to information management was conducted in 2012 to ready the organization for the future. The importance of Information Management was recognized by making it an initiative in our Strategic Plan. In addition, staff worked collaboratively across Tacoma Public Utilities and with Tacoma Power in particular to develop and support a new governance model for IT projects including the creation of a Project Management Office. Specific to Tacoma Water, an IT Roadmap was adopted as part on the Information Management initiative in our Strategic Plan with a supported budget

request for 13/14. We are well positioned to improve our GIS system in the coming years with a study completed in December 2012 along with completing the mapping of pipelines 1 and 5 and publishing them in our MapGuide System.

Federal Way Franchise

The Public Utility Board authorized acceptance of a new Tacoma Water franchise with the City of Federal Way. It is a 10 year franchise with the option of a 10 year extension to operate within its jurisdiction. Tacoma Water and the City of Federal Way began franchise negotiation in 2009 in anticipation of franchise expiration in June of that year. Following months of negotiation and given the uncertainty at that time regarding public fire protection we agreed to a one-year extension of the franchise to allow for resolution of public fire protection questions. The one-year extension was ultimately not enough and agreement was reached to continue to use the 1999 franchise until after resolution of the public fire protection matter in court. Negotiation of the proposed franchise picked up from where we left off in 2009 and contains a section providing public fire protection resolution for Tacoma Water in Federal Way. The terms of the franchise are generally favorable and will result in improved coordination and ability to serve our customers within City of Federal Way limits.

DISTRIBUTION ENGINEERING

Infrastructure

Distribution Engineering worked on many large water main replacement projects in 2012, throughout Tacoma and the greater service area. The Replacement Program constructed 10.3 miles of distribution main in 2012. Development of our strategic asset management plan for distribution mains has helped us with prioritization of replacements and identification of necessary funding levels to reliably sustain the distribution system and the work accomplished in 2012.

New Service/Development Support

Staffing at the Water Permit Counter was reduced in recognition of continuing slow development activity. Private development in 2012 shifted from primarily commercial over the past two years to over 90 percent residential. Residential meter installs on existing service stubs increased to 443, which is more than double 2011. Water main construction was completed on 12 private contracts in 2012, resulting in 2.44 miles of new main. Tacoma Water supported the area's economic development strategy and strengthened its partnership with Tacoma/Pierce County Economic Development Board with a successful effort to attract Carlisle Construction Materials to our service area. The Point Ruston development continued in 2012, with completion of all on-site water mains, as well as a signed Operations and Maintenance agreement.

Water Efficiency

The Water Conservation team was reassigned to Distribution Engineering midyear to consolidate customer program activities. Tacoma's Water Conservation Program had another busy year with great accomplishments and new endeavors. "Energy and Water Saving Kits" were direct mailed to 6,000 customers through a partnership with Tacoma Power. Included in the kits were items such as showerheads, faucet aerators, and water conservation literature. The "Know Your H2O" campaign continues to be a draw with customers and visible in the community with general advertising, vehicle wraps, an informational guidebook for customers, and 15-second TV spots. Tacoma Water chaired a committee through the Partnership for Water Conservation that produced a report "Cooperative Conservation: A Report of the Implementation of Washington's Water Use Efficiency Rule." The report demonstrates progress towards greater water efficiency among water suppliers in Washington since the adoption of the Water Use Efficiency Rule in 2007. A Home Water Use Review pilot project was offered to customers and provided a free residential water audit. Tacoma Water is a participant on the national Residential End Uses of Water study being led by the Water Research Foundation. The study will examine and quantify the "end uses" of water including all the places where water is used in a single-family home such as toilets, showers, clothes washers, faucets, lawn watering, etc.

Linda McCrea
Water Superintendent



The City of Tacoma does not discriminate on the basis of disability in any of its programs, activities, or services. To request this information in an alternative format or to request a reasonable accommodation, please contact the City Clerk's Office at (253) 591-5505. TTY or speech to speech users please dial 711 to connect to Washington Relay Services.

APPENDIX D

FORM OF OPINION OF BOND COUNSEL

(THIS PAGE INTENTIONALLY LEFT BLANK)

[FORM OF APPROVING LEGAL OPINION]

City of Tacoma, Washington

Re: City of Tacoma, Washington,
\$78,305,000 - Water System Revenue and Refunding Bonds, 2013

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 and Refunding Bonds, 2013 (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 Substitute Ordinance No. 28138 (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 Bonds in order to maintain the exclusion of the interest on the Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of Bond proceeds and the facilities financed or refinanced with Bond proceeds, limitations on investing gross proceeds of the Bonds in higher yielding investments in certain circumstances and the arbitrage rebate requirement to the extent applicable to the 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 Bonds could become taxable retroactive to the date of issuance of the 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 Bonds with applicable requirements of the Code, the interest on the 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 Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the 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 Bonds received by certain S corporations may be subject to tax, and interest on the 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 Bonds.

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

(THIS PAGE INTENTIONALLY LEFT BLANK)