



[*future forward*]

TACOMA PUBLIC UTILITIES
Annual Report
2014

TACOMA PUBLIC UTILITIES
1893 - 2014

*Tacoma Public Utilities provides services
that are vital to our quality of life.*

FROM OUR MAYOR

For more than 120 years, Tacoma Public Utilities has provided vital services to our community. The work of dedicated employees can be seen in every household and every business – from the water that keeps us healthy to the electricity that keeps us warm to the products we use transported by rail.

I feel fortunate to lead a city where these are public-owned services; and I'm proud to support an organization that works hard to make them affordable and accessible to all.

Mayor Marilyn Strickland

FROM OUR PIERCE COUNTY EXECUTIVE

I have the opportunity to talk about the amazing work being done in Pierce County to people across the nation. My conversations often include Tacoma Public Utilities. We are fortunate to live in an area with renewable, low-cost hydropower and safe drinking water – all provided by a public organization that has served Pierce County for more than a century.

Pat McCarthy

FROM OUR BOARD CHAIR

The Tacoma Public Utility Board has a long record of good decisions that have resulted in some of the lowest power, water and rail rates in the country. We have a responsibility to the customers of Tacoma Public Utilities to continue to ensure good decisions on their behalf that continue the tradition of low rates and reliable service.

Woodrow Jones

FROM OUR DIRECTOR



William A. Gaines became the Director and CEO of Tacoma Public Utilities in 2007, after serving briefly as Tacoma Power superintendent. He has developed an exceptional record of success and accomplishment over the course of more than 30 years in the utility industry that has included senior executive roles at Seattle City Light and Puget Sound Energy.

His career has emphasized organizational leadership, strategic and energy supply planning, commercial transactions and policymaking. His educational background is in engineering and finance. Bill serves as a board member and leader with several regional and national electric utility industry organizations, including the Large Public Power Council (LPPC) and the American Public Power Association (APPA). He also serves on the Tacoma/Pierce County Chamber of Commerce Board, the Pierce County Economic Development Board, and on advisory boards at Washington State University and the University of Washington.

More than 120 years ago, Tacomans voted to own and operate their electric and water utilities. By doing so, they said they would trust policymakers, managers and employees to be financially responsible, provide services that meet their needs and be a part of the community.

I believe – and hope our customers would agree – that Tacoma Public Utilities has achieved those things. My job is to make sure that legacy continues.

I could give examples every day of Tacoma Public Utilities employees who impress me with a “customer value first” approach to their jobs. Employees doing what’s best on behalf of our customers can be seen nearly anywhere one looks – from employees who climb poles, maintain pipes and switch rail cars to those who answer phones, create system drawings and sell wholesale power. It’s a theme that is throughout this organization.

FINANCIAL RESPONSIBILITY

Tacoma Power made the most of high stream flows in 2014, selling \$82.5 million of wholesale power. The revenues exceeded budget projections by \$46.1 million – which will help offset rate increases in the next biennium.

Maximizing its excess supply, Tacoma Water secured an agreement with the City of Auburn this year to increase available wholesale water from 1 million gallons per day to 3.5 million gallons per day. Similar to Tacoma Power, these wholesale revenues will help offset future rate increases.

Both Tacoma Power and Tacoma Water kept rate increases to a minimum. Electric rates will increase by 3% in 2015 and will not increase in 2016. Water rates will increase by 4% in 2015 and 4% in 2016 – much less than originally projected.

Tacoma Rail also had a banner year: Each month’s revenues exceeded the preceding month’s revenues, and the railroad saw its highest annual revenue in history. Tacoma Rail accomplished that without raising rates and while weathering two months of slowdown at West Coast ports because of labor issues.

Power revenues
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MEETING CUSTOMERS' NEEDS

In 2014, we made great strides toward meeting our customers' needs.

Tacoma Power continued its aggressive approach to energy conservation to both meet the requirements of state law and to defer the need to acquire additional resources. In 2014, the utility helped customers save more than 6 average megawatts – enough to power about 4,700 homes for one year.

Customers highly value reliability when it comes to their electric service. Tacoma Power made several system improvements and lowered the average number of customers per outage from 87 to 84 and reduced the average duration of outages to 62 minutes – a minute less than last year.

As part of its relicensing agreement for the Cushman Hydroelectric Project, Tacoma Power continued construction of two fish passage facilities and two hatcheries. The facilities will be fully operational in 2015.

Tacoma Power continued its strategic planning efforts for Click! Network. Developments in the rapidly changing broadband and telecommunications marketplace require a new business plan for Click!.

TPU's biggest project of the year was completion of the \$187 million Green River Filtration Facility. This facility will ensure safe and healthy drinking water for Tacoma Water customers for many decades to come. Employees and contractors worked hard to deliver the project on time and \$30 million under original cost estimates.

Tacoma Water also celebrated the opening of the Niagara Bottling Company facility in 2014. The company opened one bottling line and plans to add another in the future. With both lines in operation, Niagara will be one of Tacoma Water's biggest customers.

Tacoma Rail set its future in stone when it sealed a 20-year operating agreement with the Port of Tacoma. Tacoma Rail will serve as the Port's sole rail service provider.

Construction on a unit train unloading facility began at U.S. Oil and Refining – Tacoma Rail's biggest customer – this year. Traffic grew as sourcing of crude oil expanded to Canada.

Service to residential retail customers greatly improved in 2014. Tacoma Public Utilities launched MyAccount, an online account management website. By the end of the year, nearly 50% of customers had registered to use the site.

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Tacoma Public Utilities won two awards from ESource, a national organization for power utilities. The utility took home the top award for large business customer satisfaction and the top award for small and medium business customer satisfaction.

TPU's customer call center showed dramatic improvements in performance this year, too. Customer service representatives answered 80% of calls within 60 seconds. They also reduced the time required to answer questions from six minutes to one minute, and achieved an attendance record of 95%, which is considered best-in-industry.

In 2014,
employees
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local nonprofit
organizations.



BEING PART OF THE COMMUNITY

Many employees live in the area served by Tacoma Public Utilities. Their commitment to the community reveals itself through the amount of time and money they donate. In 2014, employees gave and raised more than \$273,000 and volunteered 1,900 hours for local nonprofit organizations. That's not just being a part of the community – it is making a real difference.

It is a great honor to lead an organization that has a rich legacy in our community. We will do our best to not just continue the good work, but to do even better in the future.

A handwritten signature in black ink, appearing to read "M. Kaine".



PUBLIC UTILITY BOARD

Tacoma Public Utilities is governed by a Public Utility Board, whose five volunteer members are appointed by the City Council. The Board provides broad governance and policy guidance for Tacoma Public Utilities. Certain matters, such as budgets and rates, require City Council approval of Utility Board action. The Board appoints the director of utilities, Public Utilities' chief executive officer, to lead and manage the organization.

Woodrow Jones, chair, is retired from the City of Tacoma, where he worked in Human Resources for more than 20 years. He joined the Public Utility Board in 2009 and stays active in the community. He is president of the Sunrise Rotary, a board member for City Club of Tacoma and a member of the Tacoma-Pierce County Black Collective.

Bryan Flint, vice chair, is the executive director of the Greater Metro Parks Foundation. He is a member of both Rotary No. 8 and All Aboard Washington. He joined the Public Utility Board in 2011.

Mark Patterson, secretary, is an attorney with the local law firm Vandenberg, Johnson & Gandara. He is a board member of Franke Tobey Jones and on the personnel committee of Associated Ministries of Tacoma/Pierce County. He joined the Public Utility Board in 2012.

David Nelson, a local certified public accountant, joined the Public Utility Board in 2008. He is a member of several professional organizations, including the American Institute of Certified Public Accountants, American Society of IRS Problem Solvers and the Washington Society of Certified Public Accountants.

Monique Trudnowski is co-owner and operator of Adriatic Grill Italian Cuisine & Wine Bar. She is a founding member of the Washington Tourism Alliance and is the board chair for the Tacoma Regional Convention and Visitor Bureau. She also serves on the Board of Directors for the Broadway Center for the Performing Arts.

Pictured left to right: Woodrow Jones, David Nelson, Monique Trudnowski, Mark Patterson, Bryan Flint



MANAGEMENT TEAM

Theodore C. Coates was named superintendent and COO of Tacoma Power in 2009. Ted served previously as power manager and assistant power manager. He also served for 25 years at Seattle City Light, including five years as deputy superintendent of the wholesale branch.

Linda McCrea was named superintendent and COO of Tacoma Water in 2010. She has been with Tacoma Water since 1980, serving as deputy superintendent since 2006 and water distribution manager for 13 years before that.

Dale King was named superintendent and COO of Tacoma Rail in 2008. Dale served previously as the director of rail services for Weyerhaeuser Co. and has also served with Burlington Northern Railroad.

Robert Mack joined Tacoma Public Utilities in 2007 as the deputy director for Public Affairs. He oversees government relations, communications and customer research. Bob is a former principal in the Tacoma law firm Smith Alling and has also served in various offices of Washington state government.

Steven Hatcher has served as Tacoma Public Utilities' Customer Services manager since 2006. He is responsible for frontline customer service, meter reading, billing, key account management and low-income assistance. Steve has prior experience as a city administrator and as an officer in the United States Army.

Jim Sant was named deputy director for Administration in 2012. He is responsible for budgets and organizational performance, insurance and claims, records management, and financial oversight. Previously Jim served for 10 years as assistant treasurer at Puget Sound Energy where he directed the utility's financial planning and analysis, and as regional financial manager at Verizon Wireless.

Christine Gleason has served as Community & Media Services manager since 2006 and was a communicator for Tacoma Power for three years prior. Chris is responsible for internal and external communications, promotional marketing and community outreach.

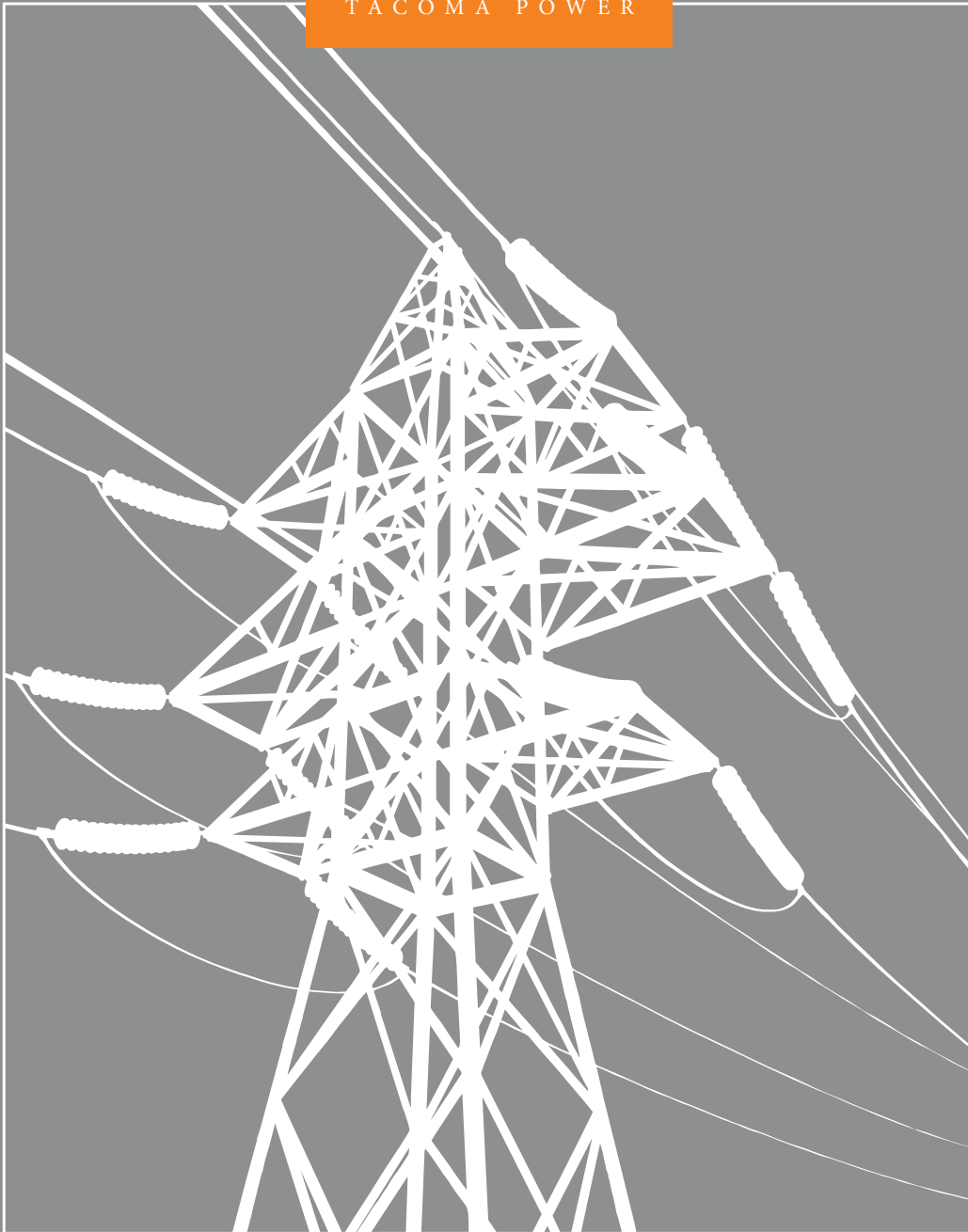
Pictured left to right: Linda McCrea, Robert Mack, Theodore C. Coates, Steven Hatcher, William A. Gaines, Dale King, Christine Gleason, Jim Sant



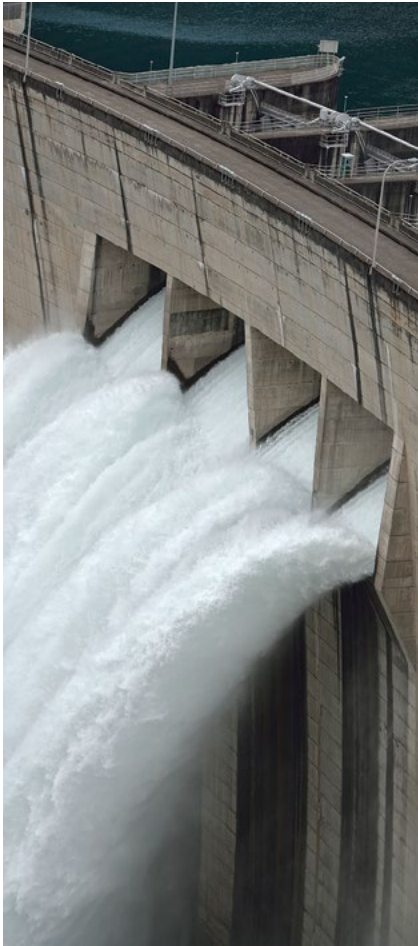
"TPU has been an instrumental partner to Pierce County by providing both technical and financial resources that support our energy and water conservation goals. They have worked with us to identify opportunities for cost-effective projects that have resulted in significant operational savings for the County. We look forward to continuing our partnership in the future and furthering our success in resource conservation."

JESSICA LUDWIG
*Resource Conservation Program Coordinator,
Pierce County*

TACOMA POWER



TACOMA POWER



Mossyrock Dam, Tacoma's highest energy-producing dam.

With its enduring commitment to the community, Tacoma Power can proudly report having spent another year running an organization that keeps finances strong, rates low and customer satisfaction high.

Our Public Utility Board and City Council passed Tacoma Power's \$1.27 billion biennial budget in 2014. The utility also gained approval for a 3% system-wide increase to electric rates starting April 1, 2015. The impact to a typical resident is \$2.25 a month. Good planning, along with strong reserves, means Tacoma Power will not need to raise electric rates in 2016. Even with the increases, Tacoma Power's rates are well below other local utilities, and even most in the region.

Several factors drove the utility's budget and rate increases, including increased Bonneville Power Administration (BPA) rates for purchased power, aging infrastructure and regulatory mandates including hydroelectric project license compliance and assessments.

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In 2014, wholesale power sales were very robust, due in part to higher than historic streamflow levels at our hydroelectric projects. There were 2.8 million megawatt-hours of wholesale power sales, which produced \$82.5 million in revenue. Both figures significantly exceeded budget estimates of 1.6 million megawatt-hours and \$36.4 million.

Tacoma Power continued to find new ways to monetize its power resource portfolio by participating in emerging markets for various ancillary energy products. Tacoma offered a dynamic scheduling service to a global wind developer to help integrate the variable output of its resources onto the Northwest power grid. That marketing activity brought in more than \$700,000. And, beginning in October, Tacoma Power began offering its clean hydro generation into new "specified source" markets, at premiums of \$1.50 to \$3 per megawatt-hour over standard wholesale power. That resulted in additional revenues of over \$80,000, with much greater expected potential in the future.

DOING THE MOST GOOD

In 2014, Tacoma Power continued its longstanding commitment of environmental stewardship.

Tacoma Power acquires energy conservation as a resource to defer the need for future, more costly generation resources. For residential and commercial customers, that means getting financial and technical help from the utility to make energy efficiency improvements. In 2014, we helped customers save about 6 average megawatts, making our biennial target of 8.1 average megawatts well within reach in 2015.

To allow us to apply “credit” for conservation that exceeds state-mandated goals, we worked with a regional group to modify Washington state’s conservation law in 2014.

The State Auditor’s Office completed its compliance audits, confirming Tacoma’s full compliance with the state law’s renewable and conservation acquisition mandates.

Meeting regulatory compliance and ensuring the dams at our four hydroelectric projects are safe is an enormous piece of Tacoma Power’s responsibility to its customers, to the communities where the dams are located and to the region. The utility submitted all dam safety and license compliance requirements to the Federal Energy Regulatory Commission (FERC) on time in 2014.

Part of our relicensing compliance includes improving fish runs and fish collection at our hydro projects. In 2014, we – along with Bonneville Power Administration (BPA) and Lewis County Public Utility District – signed a long-term agreement that will improve natural fish runs in western Washington’s Cowlitz River and help Tacoma Power meet its FERC license obligations. The agreement allows Tacoma Power to take ownership of BPA-owned existing fish collection facilities at Lewis County PUD’s Cowlitz Falls Dam and to install, operate and maintain improved fish collection structures at the dam to increase fish survival. The changes we’re making there and nearby are working: In 2014, we saw a record-breaking return for Coho salmon, a major accomplishment for the Pacific Northwest. We also began or continued work on a number of major fish-related capital projects at our Cushman Hydroelectric Project, including construction of both upstream and downstream fish passage systems and two fish hatcheries. Those projects will help restore the natural fisheries in the North Fork Skokomish River.



In 2014, we saw a record-breaking return for Coho salmon, a major accomplishment for the Pacific Northwest.

CUSTOMER - OWNED , CUSTOMER - FOCUSED

We keep customers happy when the lights stay on, and our performance in that arena was once again strong in 2014. The average number of customers without service per power outage was 84, compared with 87 the prior year. The average outage duration was 62 minutes per customer, beating the previous year by one minute.

We worked hard to improve our electric system's reliability by auditing our overhead system, which includes all poles and associated equipment. Changes like those are good for customers and good for system reliability.

Looking to the future, we completed the 10th year of our engineering intern program, through which we recruit and train young people with the hope that they'll consider employment at Tacoma Power. We also worked with military and veteran populations and fostered partnerships with schools to help ensure we have a pipeline of qualified applicants to fill jobs expected to become vacant through retirements in the next few years.

Strategic planning continued for Click! Network, as management prepared a draft business plan proposal to address declining cable television customer counts and higher programming costs. They will present the plan to policymakers in early 2015.



Click! focused heavily on retaining customers by offering new channels and features, including TV Everywhere, which allows customers to watch video content from more than 50 networks on their mobile devices.

One way we try to show how much we appreciate our customers is by providing them clean, beautiful, family-friendly parks near our hydro projects. In 2014, Tacoma Power's parks served over 311,000 people.

All said, Tacoma Power's year was solid and stable. The utility once again delivered reliable service with low rates, while maintaining a firm financial foundation. The utility is well positioned for the coming years.

FINANCIAL HIGHLIGHTS

In millions, for the years ended December 31	2014	2013	2012	2011	2010
Total Income	\$447.0	\$418.8	\$400.2	\$377.4	\$377.9
Operating Expenses	314.0	296.1	285.0	264.4	274.9
Income Available for Debt Service	\$133.0	\$122.7	\$115.2	\$113.0	\$102.7
Debt Service	\$58.7	\$52.4	\$ 56.5	\$ 56.5	\$ 50.3
Debt Service Coverage	2.26x	2.34x	2.04x	2.00x	2.04x
Plant Additions	\$122.9	\$146.3	\$134.4	\$125.5	\$162.1
Number of Customers	172,531	171,506	169,012	169,112	169,413
Average Rates (per kWh)					
Residential	\$0.081	\$0.078	\$0.074	\$0.070	\$0.068
Commercial	\$0.084	\$0.081	\$0.077	\$0.072	\$0.069
General/Industrial	\$0.053	\$0.051	\$0.049	\$0.047	\$0.046

Sales of Electric Energy (dollars in millions)	2014	2013
Residential	150.97	149.66
Commercial	26.59	25.11
General	114.72	109.05
Contract	21.15	19.8
Bulk	82.8	64.21
Others	1.61	1.56

Total Consumption (mwh in millions)	2014	2013
Residential	1.85	1.91
Commercial	0.32	0.31
General	2.04	2.00
Contract	0.52	0.54
Others	2.88	2.28

Power Sources (mwh in millions)	2014	2013
Nisqually	0.64	0.57
Cushman	0.36	0.24
Cowlitz	2.11	1.79
BPA	3.85	3.76
Others	0.31	0.32

Operating Expenses	2014	
Purchased Power	\$ 121,395,343	33%
Depreciation	59,156,228	16%
Distribution & Transmission	56,590,854	15%
Admin. & Pension	46,701,615	13%
Other Operating Expenses	41,707,150	11%
Hydraulic Power	24,054,773	6%
Click! Network	19,631,153	5%
Other Production Expenses	3,936,372	1%

REPORT OF INDEPENDENT AUDITORS

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

Report on the Financial Statements

We have audited the accompanying financial statements of City of Tacoma, Washington Department of Public Utilities, Power Division (the Division), which comprise the statements of net position as of December 31, 2014 and 2013, 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Division as of December 31, 2014 and 2013, 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

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the accompanying management's discussion and analysis on pages 5 through 13 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The statistical data presented on pages 44 through 60 and the superintendent's report presented on pages 61 through 72 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Miss Adams LLP

Tacoma, Washington

April 10, 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of Tacoma Power's financial performance provides an overview of the financial activities for the years ended December 31, 2014 and 2013. 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 generally accepted accounting principles (GAAP) in the United States of America applied on a consistent basis and include amounts that are based on management's best estimates and judgment.

The basic financial statements, presented on a comparative basis for the years ended December 31, 2014 and 2013, include the 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, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference being 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, non-capital financing, capital and related financing, and investing activities.

The Notes to 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

- Tacoma Power reported an increase in total net position of \$23.7 million (3.0% in 2014, compared to \$19.9 million (2.6%) in 2013.
- Operating revenues increased \$26.8 million (6.5%) in 2014. Operating revenues in 2013 increased \$26.6 million (6.9%).
- Utility Plant in Service increased \$43.7 million (2.5%) in 2014 and \$82.1 million (4.9%) in 2013.
- Construction work in progress increased \$31.4 million (134.1%) in 2014 and \$22.5 million (49.0%) in 2013.

Overview of Financial Statements

Tacoma Power reported net operating income of \$68.1, \$61.9 and \$45.1 million in 2014, 2013 and 2012 respectively. Operating revenues increased \$26.8 million during 2014 and operating expenses increased \$20.7 million. For 2013 operating revenues increased \$26.6 million and operating expenses increased \$9.7 million compared to 2012. Tacoma Power reported an increase in net position of \$23.7 million in 2014 compared to \$19.9 million in 2013 and \$16.3 million in 2012.

The following tables highlight Tacoma Power's past three years' operating results and megawatt-hours billed.

Operating Results (in thousands)

Category	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Operating Revenues	\$ 441,246	\$ 414,462	\$ 387,883	\$ 26,784	\$ 26,579
Operating Expenses	373,174	352,519	342,795	20,655	9,724
Net Operating Income	68,072	61,943	45,088	6,129	16,855
Net-Non Operating Expenses	(25,138)	(24,941)	(14,418)	(197)	(10,523)
Capital Contributions	4,120	5,200	5,525	(1,080)	(325)
BABs and CREBs subsidies	3,668	3,640	3,955	28	(315)
Transfers Out	(26,998)	(25,970)	(23,888)	(1,028)	(2,082)
Change in Net Position					
(Net Income)	\$ 23,724	\$ 19,872	\$ 16,262	\$ 3,852	\$ 3,610

Megawatt-Hours Billed (in thousands)

Type of Customer	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Residential	1,891	1,950	1,935	(59)	15
Commercial/General/Industrial	2,869	2,856	2,813	13	43
Wholesale	2,843	2,245	3,137	598	(892)
Total	7,603	7,051	7,885	552	(834)

Net Position

Net position may serve over time as a useful indicator of a company's financial position. The following analysis highlights net position for the last three years.

Statements of Net Position (in thousands)

Description	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Net Utility and Non-Utility Plant	\$ 979,067	\$ 960,067	\$ 954,323	\$ 19,000	\$ 5,744
Current Assets, Other Assets and Special Funds	525,770	541,985	488,259	(16,215)	53,726
Total Assets	1,504,837	1,502,052	1,442,582	2,785	59,470
Deferred Outflows	8,026	15,941	7,849	(7,915)	8,092
Total Assets and Deferred Outflows	\$ 1,512,863	\$ 1,517,993	\$ 1,450,431	\$ (5,130)	\$ 67,562

Net Position:

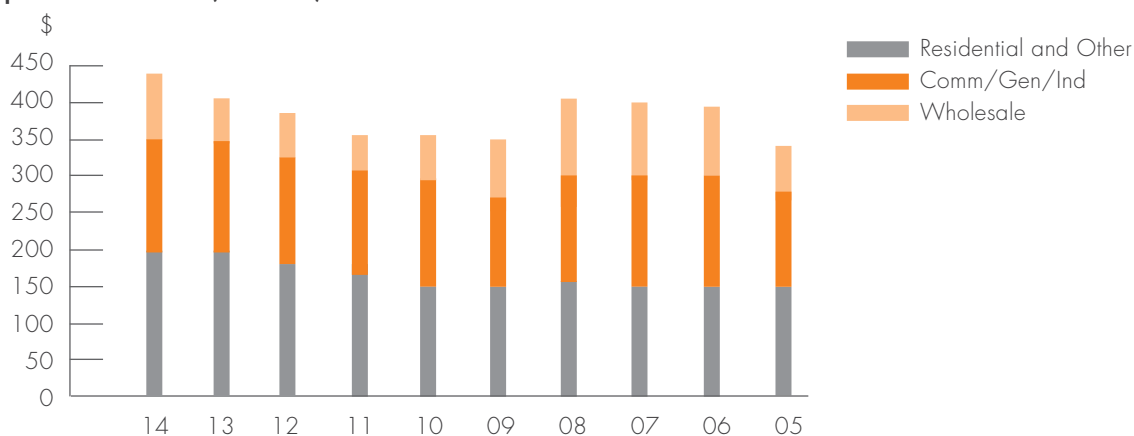
Net Invested in Capital Assets	\$ 499,659	\$ 541,804	\$ 498,336	\$ (42,145)	\$ 43,468
Restricted	34,666	30,794	31,560	3,872	(766)
Unrestricted	288,478	226,481	249,310	61,997	(22,829)
Total Net Position	822,803	799,079	779,206	23,724	19,873
Long-Term Debt	530,581	564,961	518,252	(34,380)	46,709
Other Liabilities	111,479	105,953	104,973	5,526	980
Total Liabilities	642,060	670,914	623,225	(28,854)	47,689
Deferred Inflows	48,000	48,000	48,000	–	–
Total Net Position, Liabilities and Deferred Inflows	\$ 1,512,863	\$ 1,517,993	\$ 1,450,431	\$ (5,130)	\$ 67,562

Revenues

2014 Compared to 2013

Operating revenues totaled \$441.2 million in 2014 compared to \$414.5 million in 2013, an increase of \$26.8 million (6.5%). Revenue from sales to residential and other customers decreased \$1.0 million. There was a 3.7% rate increase effective April 1, 2014 that was more than offset by a 60,000 decrease in MWh billed. Revenues from commercial, general, and industrial customers increased \$8.5 million primarily due to the rate increase effective April 1, 2014. The system average rate increase was 4.2%.

Operational Revenues (in millions)



Telecommunications revenue increased \$0.9 million primarily due to a 10% rate increase in July 2014. Also, there was an increase in customer count for wholesale internet services.

Wholesale revenues in 2014 increased \$18.6 million as compared to 2013. Streamflows in 2014 were 130% of 2013 streamflows, resulting in higher generation and therefore higher sales.

In 2014 residential sales accounted for 38.3% of electric revenues, commercial and industrial revenues accounted for 40.9% and wholesale power revenues accounted for 20.8%.

2013 Compared to 2012

Operating revenues totaled \$414.5 million in 2013 compared to \$387.9 million in 2012, an increase of \$26.6 million (6.9%). Revenue from sales to residential and other customers increased \$5.5 million primarily due to a residential rate increase of 3.7% effective April 1, 2013. Revenues from commercial, general, and industrial customers increased \$8.0 million also primarily due to the rate increase. The system average rate increase was 4.2%. Wheeling revenues increased \$1.1 million primarily due to a combination of contract changes and load growth.

Telecommunications revenue increased \$1.4 million primarily due to a 9% rate increase in January 2013 and an 8% rate increase in August 2013. Also, there was an increase in customer count for wholesale internet services.

Wholesale revenues in 2013 increased \$10.7 million as compared to 2012. Excluding the transfer of \$12.0 million to the Rate Stabilization Fund in 2012, the difference is a decrease of \$1.3 million. Average daily prices increased 61%, resulting in an increase of \$17.3 million. This was more than offset by a decrease in volume of 892,000 KWh (28.4%), resulting in a decrease of \$18.6 million.

In 2013 residential sales accounted for 41.2% of electric revenues, commercial and industrial revenues accounted for 41.5% and wholesale power revenues accounted for 17.3%.

Expenses

2014 Compared to 2013

Total operating expenses increased \$20.7 million or 5.9% compared to 2013.

Purchased power decreased \$1.4 million (1.2%). Bonneville Power Administration (BPA) purchases decreased \$1.5 million. The Slice and Block portions of the BPA contract increased \$1.9 million and credits for the Energy Conservation Agreement (ECA) increased \$3.4 million. Purchases from Grand Coulee Project Hydroelectric Authority increased \$0.8 million due to a combination of increased volume and a small price increase. Other portfolio purchases decreased \$0.5 million due to increased generation as a result of higher streamflows.

Generation operations expense increased \$1.9 million (18.1%) primarily due to increased labor costs.

Distribution operations expense increased \$3.0 million (27.3%). The Transmission and Distribution section began contributing to the Fleet Replacement Fund for the first time this biennium in July, which accounts for \$2.6 million of the increase. The remainder is primarily increased labor costs, which include back wages due to a labor contract settlement.

Other operations expense increased \$1.6 million (12.5%). This is made up of a \$1.3 million increase in conservation and other customer assistance programs and an increase in other production expense of \$0.3 million. These increases included \$1.1 million in amortization of deferred conservation costs.

Maintenance expense increased \$5.6 million (20.2%). Generation maintenance increased \$2.5 million primarily due to an increase of \$0.9 million for painting of the penstocks at Cushman #2 and \$0.9 million for painting the spillway gate at Mayfield. Distribution maintenance increased \$3.3 million. The contributions to the Fleet Replacement Fund beginning in July make up \$1.2 million of this increase. The remainder is primarily due to increased labor costs and a decrease in time charged to capital projects. Transmission maintenance expense decreased \$0.2 million.

Administrative and general expenses increased \$6.0 million (11.5%) in 2014. Maintenance of general plant increased \$1.0 million, the credit for capitalized and general expense decreased \$0.8 million, and labor costs increased \$1.8 million. Customer accounts expense increased \$2.2 million primarily due to an increase of \$1.5 million in customer records and collection expense and an increase of \$0.3 million in bad debt expense.

2013 Compared to 2012

Total operating expenses increased \$9.7 million or 2.8% compared to 2012.

Purchased power expense increased \$10.9 million (9.8%). Bonneville Power Administration (BPA) purchases increased \$1.1 million. The Slice and Block portions of the BPA contract decreased \$1.0 million and credits for the Energy Conservation Agreement (ECA) decreased \$2.1 million. Purchases from Priest Rapids decreased \$0.6 million due to the offset of proceeds from the sale of secondary power generated at the project. These proceeds were higher in 2013 than in 2012. Other portfolio purchases increased \$10.4 million due to decreased generation as a result of lower streamflows.

Distribution operations expense decreased \$3.2 million (22.6%) primarily because of costs in 2012 related to the January 2012 storm.

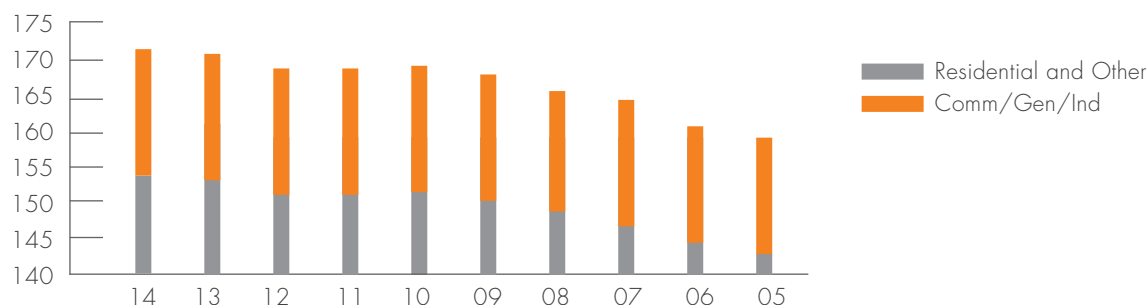
Other operations expense increased \$2.0 million (18.4%). This is made up of a \$1.6 million increase in conservation and other customer assistance programs and an increase in other production expense of \$0.4 million. These increases included \$1.5 million in amortization of deferred conservation costs. Maintenance expense decreased \$3.3 million primarily due to a shift from maintenance to capital work.

Administrative and general expenses increased \$2.2 million (4.3%) in 2013 primarily due to increased labor costs.

Customer Counts

Tacoma Power's overall customer growth during the past 10 years has been relatively steady averaging between less than 1% and 3% per year. The customer count for 2014 is 172,531 compared to 171,506 in 2013 and 169,012 in 2012.

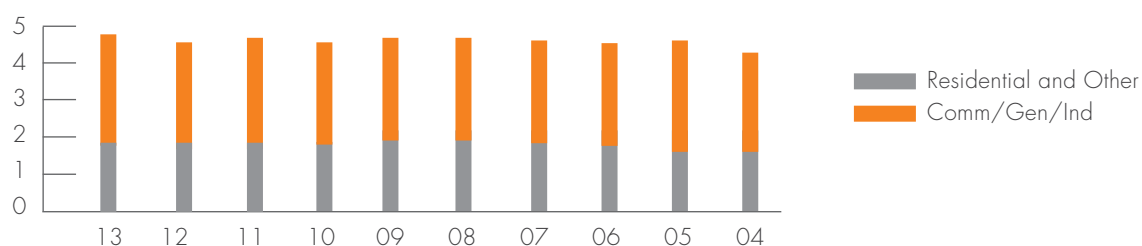
Number of Customers (in thousands)



Megawatt-hours Billed

Megawatt-hours billed to residential and other customers decreased 3.1% in 2014, while commercial/general/industrial billings increased 0.3%. Wholesale power billed in 2014 was 2,842,694 megawatt-hours compared to 2,244,963 in 2013, an increase of 597,731 megawatt-hours or 26.6%. During 2014 hydro generation increased 496 megawatt-hours compared to the previous year. Streamflows into Tacoma Power's system were 125% of average in 2014 compared to 96% of average in 2013.

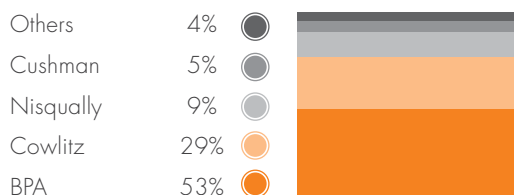
Megawatt Hours Billed (in millions)



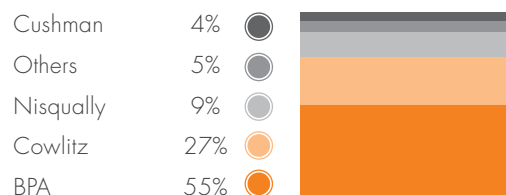
Sources of Power

Tacoma Power's total resources for power supply to serve its retail and wholesale customers for the last two years are shown in the following graphs.

Megawatt Hours Generated/Purchased - 2014



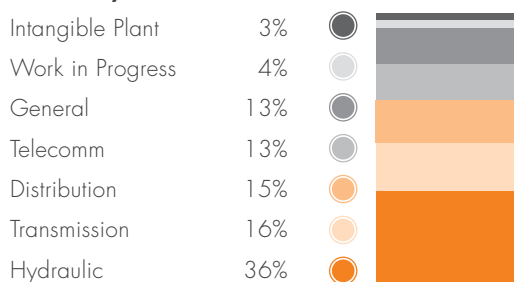
Megawatt Hours Generated/Purchased - 2013



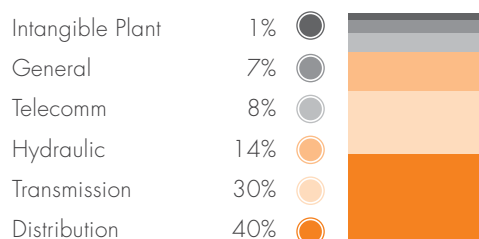
Utility Plant and Plant Additions

Tacoma Power has \$1.8 billion invested in its utility plant assets on a cost basis. The largest portion is for the combined distribution and transmission business unit, followed by its generation (hydroelectric) business unit. The following graphs show the allocation of plant additions and total investment in plant.

2014 Utility Plant

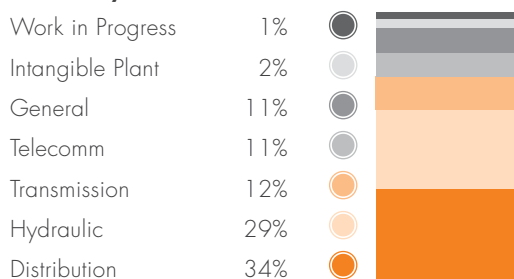


2014 Plant Additions

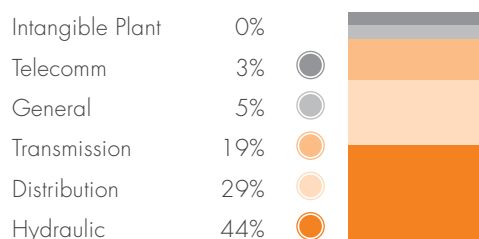


Additions in 2014 to distribution plant were \$18.3 million, which included addition and replacement programs for new services, pole replacements, and distribution transformers. Transmission plant additions were \$13.8 million, which included the North Bay Crossing Rehabilitation, system reliability improvements, and the salmon hatchery station upgrade. Hydraulic plant additions were \$6.4 million, which included the Cushman License Implementation and accessory electrical equipment at Alder and Wynoochee.

2013 Utility Plant



2013 Plant Additions



Additions in 2013 to hydraulic production plant were \$36.8 million, which included the North Fork Powerhouse and the Cowlitz License Implementation. Distribution plant additions were \$24.2 million, which included addition and replacement programs for new services, construction of Mountain Substation, and pole replacements. Transmission plant additions of \$15.9 million included the Backup Energy Control Center, Canyon Substation, and upgrades to transmission poles and towers.

The following table summarizes Tacoma Power's capital assets, net of accumulated depreciation, for the years ended December 31, 2014 through 2012.

Capital Assets, Net of Accumulated Depreciation (in thousands)

Net Utility Plant	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Intangible Plant	\$ 29,510	\$ 29,949	\$ 30,763	\$ (439)	\$ (814)
Hydraulic Plant	349,472	350,698	321,329	(1,226)	29,369
Transmission Facilities	122,213	117,981	109,866	4,232	8,115
Distribution Facilities	288,242	290,152	285,615	(1,910)	4,537
General Plant	81,443	85,198	88,158	(3,755)	(2,960)
Telecommunications Plant	53,216	62,500	72,472	(9,284)	(9,972)
Construction Work in Progress	54,789	23,407	45,938	31,382	(22,531)
Total Net Utility Plant	\$ 978,885	\$ 959,885	\$ 954,141	\$ 19,000	\$ 5,744

Additional information on Tacoma Power's capital assets can be found in Note 3 of the financial statements and also in the supplementary Statistical Data.

Debt Administration

At December 31, 2014 Tacoma Power had outstanding revenue bonds of \$540.1 million, a decrease of \$28.3 million compared to 2013. No new bonds were issued in 2014.

At December 31, 2013 Tacoma Power had outstanding revenue bonds of \$568.3 million, an increase of \$23.9 million compared to 2012. Tacoma power issued \$181.6 million of Electric System Revenue Refunding bonds, Series 2013A in May 2013 and \$35.6 million of Electric System Revenue Refunding bonds, Series 2013B in June 2013. Also, in May 2013 Tacoma Pwer defeased \$25.2 million of 2005 Series B Electric System Revenue Bonds and \$2.0 million of 2007 Electric System Refunding Bonds.

All bonds are rated Aa3 by Moody's Investor's Service, AA by Standard and Poor's and AA - by Fitch, Inc.

Additional information on Tacoma Power's long-term debt can be found in Note 6 of the financial statements.

Debt Service Coverage

Tacoma Power is required by its bond covenants to maintain a debt service coverage ration of 1.25. In 2014, principal and interest were covered 2.26 times compared to 2.34 times in 2012.

Summary


The management of the Finance Department of the City of Tacoma is responsible for preparing the accompanying financial statements and for their integrity. We prepared the financial statements according to GAAP in the United States of America and they fairly portray Tacoma Power's financial position and operating results. The Notes to Financial Statements are an integral part of the basic financial statements and provide additional financial information.

The financial statements have been audited by Moss Adams LLP. 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 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

2014

FINANCIAL REPORTS

Statements of Net Position

December 31,	2014	2013
Assets		
Utility Plant		
In Service, at Original Cost	\$ 1,817,897,475	\$ 1,774,187,522
Less - Accumulated Depreciation	(893,801,525)	(837,709,188)
Total	924,095,950	936,478,334
Construction Work in Progress	54,789,325	23,406,935
Net Utility Plant	978,885,275	959,885,269
Non-Utility Property	182,051	182,051
Special Funds		
Construction Funds	51,136,534	110,342,703
Debt Service Funds	45,458,725	42,745,393
Special Bond Reserve Funds	17,003,212	16,998,677
Wynoochee Reserve Funds	2,520,923	2,498,449
Total Special Funds	116,119,394	172,585,222
Current Assets		
Operating Funds Cash and Equity in Pooled Investments	287,949,952	257,668,097
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$1,079,721 in 2014 and \$2,975,222 in 2013)	35,210,149	29,026,642
Accrued Unbilled Revenue	28,750,681	29,416,868
Materials and Supplies	5,544,073	6,726,557
Interfund Receivables	2,509,436	1,858,982
Prepayments and Other	5,209,061	4,277,211
Total Current Assets	365,173,352	328,974,357
Other Assets		
Regulatory Asset - Conservation (Net of Amortization of \$13,063,221 in 2014 and \$8,319,523 in 2013)	42,599,246	39,117,460
Conservation Loans Receivable	1,877,469	1,307,849
Total Other Assets	44,476,715	40,425,309
Total Assets	1,504,836,787	1,502,052,208
Deferred Outflows Of Resources		
Unamortized Loss on Refunding Bonds	8,026,229	15,941,231
Total Assets and Deferred Outflows	\$ 1,512,863,016	\$ 1,517,993,439

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

Net Position And Liabilities

December 31,	2014	2013
Net Position		
Net Investment in Capital Assets	\$ 499,658,478	\$ 541,804,406
Restricted for:		
Wynoochee Reserve Funds	2,520,923	2,498,449
Debt Service Funds	32,145,520	28,295,000
Unrestricted	288,478,140	226,480,805
Total Net Position	822,803,061	799,078,660
Long-Term Debt		
	530,580,510	564,960,765
Current Liabilities		
Current Portion of Long-Term Debt	32,115,000	28,295,000
Taxes and Other Payables	18,321,909	18,903,478
Purchased Power Payable	11,560,184	12,106,562
Salaries, Wages and Compensated Absences Payable	5,598,198	5,109,119
Interest Payable	13,313,205	14,445,415
Customers' Deposits	2,897,268	2,781,069
Interfund Payables	2,970,410	1,264,489
Total Current Liabilities	86,776,174	82,905,132
Long-Term Liabilities		
Long Term Accrued Compensated Absences	9,434,785	9,238,488
Other Long Term Liabilities	15,268,486	13,810,394
Total Long Term Liabilities	24,703,271	23,048,882
Total Liabilities	642,059,955	670,914,779
Deferred Inflows of Resources		
Rate Stabilization	48,000,000	48,000,000
Total Net Position, Liabilities and Deferred Inflows	\$ 1,512,863,016	\$ 1,517,993,439

Statements of Revenues, Expenses and Changes In Net Position

Year Ended December 31,	2014	2013
Operating Revenues		
Sales of Electric Energy	\$ 397,175,394	\$ 371,048,970
Other Operating Revenue	16,920,147	17,127,746
Click! Network Operating Revenue	27,150,566	26,285,369
Total Operating Revenue	441,246,107	414,462,085
Operating Expenses		
Operations		
Purchased and Interchanged Power	121,395,343	122,832,529
Generation	12,273,808	10,389,822
Transmission	21,267,033	20,501,886
Distribution	13,806,687	10,844,246
Other	14,443,310	12,838,952
Maintenance	33,298,099	27,701,165
Telecommunications Expense	19,631,153	18,863,702
Administrative and General	58,625,611	52,586,421
Depreciation	59,156,228	56,397,306
Taxes	19,276,216	19,562,858
Total Operating Expenses	373,173,488	352,518,887
Net Operating Income	68,072,619	61,943,198
Non-Operating Revenues (Expenses)		
Interest Income	3,780,834	1,899,829
Contribution to Family Need	(900,000)	(900,000)
Other	(728,908)	(252,363)
Interest on Long-Term Debt	(24,621,702)	(24,172,778)
Loss on Defeasance or Refunding of Debt and Amortization of Debt Premium and Discount	(2,668,319)	(1,515,441)
Total Non-Operating Expenses	(25,138,095)	(24,940,753)
Net Income Before Capital Contributions and Transfers	42,934,524	37,002,445
Capital Contributions		
Cash	4,024,873	4,930,122
Donated Fixed Assets	95,492	269,593
BABs and CREBs Interest Subsidies	3,667,927	3,640,245
Transfers		
City of Tacoma Gross Earnings Tax	(26,860,649)	(25,441,619)
Transfers to/(from) Other Funds	(137,766)	(528,611)
Change in Net Position	23,724,401	19,872,175
Total Net Position - Beginning of Year	799,078,660	779,206,485
Total Net Position - End Of Year	\$ 822,803,061	\$ 799,078,660

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

Statements Of Cash Flows

Year to Date December 31,

2014

2013

Cash Flows From Operating Activities

Cash from Customers	\$ 435,728,792	\$ 414,885,400
Cash Paid to Suppliers	(188,794,275)	(184,106,433)
Cash Paid to Employees	(107,884,909)	(100,433,706)
Taxes Paid	(19,840,137)	(18,748,013)
Conservation Loans	(569,620)	187,527
Net Cash From Operating Activities	118,639,851	111,784,775

Cash Flows From Non-Capital Financing Activities

Transfer Out for Gross Earnings Tax	(26,860,649)	(25,441,619)
Transfer to/from Other Funds	(137,766)	(528,611)
Transfer to Family Need Fund	(900,000)	(900,000)
Net Cash From Non-Capital Financing Activities	(27,898,415)	(26,870,230)

Cash Flows From Capital and Related Financing Activities

Capital Expenditures	(76,056,034)	(59,455,167)
Proceeds from Issuance of Long-Term Debt	–	217,230,000
Debt Issuance Costs	–	(1,098,642)
Principal Payments on Long-Term Debt	(28,295,000)	(28,785,000)
Payments for Early Extinguishment of Debt	–	(164,535,000)
Loss on Refunding of Bonds	–	(12,327,835)
Premium on Sale of Bonds	–	25,028,879
Interest Paid	(27,758,620)	(25,657,345)
BABs and CREBs Interest Subsidies	3,667,927	3,640,245
Contributions in Aid of Construction	4,024,873	4,930,122
Other Long-Term Liabilities	1,458,092	1,610,510
Net Cash From Capital and Related Financing Activities	(122,958,762)	(39,419,233)

Cash Flows From Investing Activities

Interest Received	3,780,834	1,899,829
Termination of Repurchase Agreement	8,761,250	–
Other Net Non-Op Revenues and Deductions	2,252,519	846,281
Net Cash From Investing Activities	14,794,603	2,746,110

Net Change in Cash and Equity in Pooled Investments	(17,422,723)	48,241,422
Cash and Equity in Pooled Investments at January 1	421,492,069	373,250,647
Cash and Equity in Pooled Investments at December 31	\$ 404,069,346	\$ 421,492,069

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

Statements of Cash Flows

December 31,

2014

2013

**Reconciliation of Net Operating Income to
Net Cash Provided by Operating Activities:**

Net Operating Income	\$ 68,072,619	\$ 61,943,198
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation	59,156,228	56,397,306
Amortization of Regulatory Assets	4,743,698	3,705,526
Cash provided from changes in operating assets and liabilities:		
Accounts Receivable and Accrued Unbilled Revenue	(5,517,318)	423,316
Conservation Loans Receivable	(569,621)	187,527
Interfund Receivables	(650,454)	1,552,772
Materials and Supplies, and Other	250,634	(972,522)
Taxes and Other Payables	(581,569)	118,008
Purchased Power Payable	(546,378)	416,983
Salaries and Wages	467,268	564,470
Accrued Compensated Absences	218,108	596,538
Customers' Deposits	116,199	(55,851)
Regulatory Asset - Conservation	(8,225,484)	(10,381,723)
Interfund Payables	1,705,921	(2,710,773)
Total Adjustments	50,567,232	49,841,577
Net Cash From Operating Activities	\$ 118,639,851	\$ 111,784,775

Reconciliation of Cash and Equity in Pooled Investments to

Balance Sheet:

Cash and Equity in Pooled Investments in Special Funds	\$ 116,119,394	\$ 163,823,972
Cash and Equity in Pooled Investments in Operating Funds	287,949,952	257,668,097
Cash and Equity in Pooled Investments at December 31	\$ 404,069,346	\$ 421,492,069

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2014 AND 2013

NOTE 1 / OPERATIONS

Operations of Power - The Light Division, doing business as Tacoma Power (Tacoma Power or the Division), is a division of the City of Tacoma, Washington (the City), Department of Public Utilities (the Department) and is included in the Comprehensive Annual Financial Report (CAFR) of the City. 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 setting of utility rates and charges, are initiated and executed by the Board, but also require formal City Council approval. Tacoma Power owns and operates the City's electrical generation and distribution facilities and telecommunication infrastructure. Tacoma Power serves approximately 172,531 retail customers and has 939 employees. Tacoma Power is organized into six business units: Generation, Power Management, Transmission and Distribution, Rates, Planning and Analysis, Click! Network, and Utility Technology Services.

Generation operates four hydroelectric generating projects (Cowlitz, Cushman, Nisqually and Wynoochee) and the associated recreational facilities, fish hatcheries and other project lands.

Power Management manages the power supply portfolio, markets bulk and ancillary power supply services, schedules and dispatches division-owned generation and contract power supplies and performs power trading and risk management activities. Revenues and the cost of electric power purchases vary from year to year depending on the electric wholesale power market, which is affected by several factors including the availability of water for hydroelectric generation, marginal fuel prices and the demand for power in other areas of the country.

Transmission and Distribution plans, constructs, operates and maintains the transmission and distribution systems including substations, the underground network system, supervisory control and data acquisition (SCADA) systems, revenue metering facilities and all overhead transmission and distribution systems. Electricity use by retail customers varies from year to year primarily because of weather conditions, customer growth, the economy in Tacoma Power's service area, conservation efforts, appliance efficiency and other technology.

Rates, Planning and Analysis plans for and manages the retail rate process, financial planning, analysis and modeling, budget strategies, the capital program and risk management.

Click! Network plans, constructs, operates and maintains a hybrid fiber coaxial (HFC) telecommunications network that supports the operation of Tacoma Power's electrical transmission and distribution system, provides retail cable TV and wholesale high-speed Internet services to residential and business customers, and data transport services to retail customers.

Utility Technology Services (UTS) maintains communication networks, operational and informational technology systems, and related equipment and infrastructure to optimize utility operations and improve reliability and service quality. This includes a Project Management Office that establishes and leads Tacoma Public Utilities Information Systems project governance process and implements project portfolio management tools. UTS is responsible for all matters related to Tacoma Power's compliance with North American Electric Reliability Corporation (NERC) Reliability Standards, maintains overall responsibility for the NERC Reliability Standards and manages Tacoma Power's Internal Reliability and Compliance 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 generally accepted accounting principles (GAAP) issued by the Governmental Accounting Standards Board (GASB) applicable to governmental entities that use proprietary fund accounting. The financial statements use a flow of economic resources measurement focus to determine financial position and the change in financial position. The accounting principles used are similar to those applicable to businesses in the private sector and are maintained on the accrual basis of accounting. Revenues are recognized when earned, and costs and expenses are recognized when incurred.

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 accounts are maintained substantially in accordance with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission and the Division of Audits of the State Auditor's Office.

Cash, Special Funds 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.

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 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, 2014 and 2013 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 FDIC insurance up to \$250,000.

All deposits not covered by the FDIC are covered by the WSPDPC. The WSPDPC is a statutory authority established under RCW 39.58. It constitutes a fully insured or fully collateralized pool. The LGIP is authorized by RCW 43.250. The LGIP operated like a 2A7 fund and is collateralized by short-term legal investments.

Special Funds - 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 and customer deposits.

Receivables and 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 funds at year end are recorded as due to or due from other funds.

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

Bond Premium and Loss on Refunding - Bond premiums are amortized over the life of the bonds using a straight-line basis. Losses on refunding are amortized on a straight-line basis over the applicable bond period.

Regulatory Asset Conservation - The Division has deferred conservation costs to be charged to future periods matching the time when the revenues and expenses are included in rates. Conservation assets represent installation of savings measures at the properties of its customers. The deferred balance is reduced as costs are recovered and are amortized as other operating expense on the statements of revenues, expenses and changes in net position.

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 FERC recommended economic asset lives from 2 to 62 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.

The economic lives for plant in service are as follows:

Intangible Plant	2-37 years
Hydraulic Production Plant	62 years
Transmission Plant	29 years
Distribution Plant	27 years
Regional Transmission	5-27 years
General Plant	19 years
Telecommunications Plant	5-19 years

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.

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.

Capital Contributions - In accordance with GASB No. 33, Accounting and Financial Reporting for Nonexchange Transactions, capital grants and capital contributions are recorded as capital contributions.

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 personal time off (PTO) 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.

Rate Stabilization Account - 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 position in accordance with regulated operations. Revenue will be recognized in subsequent periods when it is withdrawn in accordance with rate decisions.

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 electricity. Utility revenue from power sales and power transmission is recognized when power is delivered to and received by the customer.

Non-Operating Revenues and Expenses - These are items that do not qualify as operating defined above.

Taxes - The City charges the Division a Gross Earnings Tax at the rate of 6.0% on electrical revenues and broadband revenues and 8.0% on cable television revenues. On Tacoma cable television revenues only, the City also charges the Division a franchise fee of 5.0% and a Public, Educational and Government access television (P.E.G.) fee of 1.0%. In addition, the Division pays a 3.8734% 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 1.5% on certain other non-utility revenues including cable television revenues, as well as 0.484% for Wholesaling and Broadcasting and 0.471% for Retailing. 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 and 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".

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 Division would record such a rebate as a liability. The Division had no liability in the current or prior year.

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.

Use of Estimates - The preparation of the financial statements in conformity with GAAP 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 Benefits (OPEB), self-insurance liabilities and other contingencies. Actual results may differ from these estimates.

Family Need - The Family Need program is Tacoma Power's low income bill assistance program. Contributions are received from customers, employees and Tacoma Power. The Family Need program is administered by the Metropolitan Development Council and Pierce County Community Services which identify and certify the eligibility of Tacoma Power customers for the program.

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 disasterrelated disruptions, collective bargaining labor disputes, fish and other endangered species act issues, Environmental Protection Agency regulations, federal government regulations or orders concerning the operation, maintenance and/or licensing of facilities.

NOTE 3 / UTILITY PLANT

A summary of the balances and changes in utility plant for 2014 and 2013 follows:

	Balance December 31, 2013	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2014
Intangible Plant	\$ 39,932,284	\$ 652,709	\$ (129)	\$ -	\$ 40,584,864
Hydraulic Production Plant	530,076,778	6,440,105	(91,980)	-	536,424,903
Transmission Plant	203,001,100	12,613,236	(575,049)	-	215,039,287
Distribution Plant	586,974,920	18,262,758	(1,208,323)	-	604,029,355
Regional Transmission	16,320,490	1,217,172	-	-	17,537,662
General Plant	194,039,551	2,996,886	-	-	197,036,437
Telecommunications Plant	203,842,399	3,727,992	(11,320)	(314,104)	207,244,967
Total Utility Plant In Service	1,774,187,522	45,910,858	(1,886,801)	(314,104)	1,817,897,475
Less Accumulated Depreciation	837,709,188	59,156,228	(1,794,691)	(1,269,200)	893,801,525
	936,478,334	(13,245,370)	(92,110)	955,096	924,095,950
Construction Work In Progress	23,406,935	76,979,144	-	(45,596,754)	54,789,325
Net Utility Plant	\$ 959,885,269	\$ 63,733,774	\$ (92,110)	\$ (44,641,658)	\$ 978,885,275

	Balance December 31, 2012	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2013
Intangible Plant	\$ 39,654,260	\$ 278,024	\$ –	\$ –	\$ 39,932,284
Hydraulic Production Plant	493,697,494	36,769,284	(390,000)	–	530,076,778
Transmission Plant	194,600,931	8,432,946	(32,777)	–	203,001,100
Distribution Plant	564,391,365	24,223,660	(1,640,105)	–	586,974,920
Regional Transmission	8,819,782	7,500,708	–	–	16,320,490
General Plant	190,021,574	4,546,587	–	(528,610)	194,039,551
Telecommunications Plant	200,922,038	2,925,768	(5,407)	–	203,842,399
Total Utility Plant In Service	1,692,107,444	84,676,977	(2,068,289)	(528,610)	1,774,187,522
Less Accumulated Depreciation	783,904,044	56,397,306	(1,964,385)	(627,777)	837,709,188
	908,203,400	28,279,671	(103,904)	99,167	936,478,334
Construction Work In Progress	45,938,023	61,617,279	–	(84,148,367)	23,406,935
Net Utility Plant	\$ 954,141,423	\$ 89,896,950	\$ (103,904)	\$ (84,049,200)	\$ 959,885,269

Total Utility Plant in Service includes non-depreciable assets of \$74,763,487 for 2014 and \$74,869,707 for 2013.

The total amount of interest cost incurred and capitalized is \$2,004,709 for 2014 and \$2,416,393 for 2013.

NOTE 4 / INVESTMENTS

Tacoma Power's investments are held in Special Funds by the Tacoma City Treasurer (Refer to Note 1). The investments held by the Tacoma City Treasurer outside of the general investment pool at December 31, 2014 and 2013 were as follows:

Investments at December 31, 2014

Investment Type	Carrying Value (Fair Value)	Maturity (in years)	% of Portfolio
Repurchase Agreements	\$ 0.00	0.00	100%
Total Investments	\$ 0.00		100%

Investments at December 31, 2013

Investment Type	Carrying Value (Fair Value)	Maturity (in years)	% of Portfolio
Repurchase Agreements	\$ 8,761,250	1.00	100%
Total Investments	\$ 8,761,250		100%

The repurchase agreement expired December 31, 2014 and was not renewed.

NOTE 5 / SPECIAL FUNDS

Cash and equity in pooled investments and investments included in Tacoma Power's Special Funds consist of:

Cash and Equity in Pooled Investments	2014	2013
Construction Funds	\$ 51,136,534	\$ 110,342,703
Debt Service Funds	45,458,725	42,745,393
Wynoochee Reserve	2,520,923	2,498,449
Special Bond Reserve	17,003,212	8,237,427
Total	116,119,394	163,823,972
Investments		
Special Bond Reserve	–	8,761,250
Total	\$ 116,119,394	\$ 172,585,222

NOTE 6 / LONG-TERM LIABILITIES

Tacoma Power's long-term liabilities are primarily for capital improvements. Long-term liability activity for the years ended December 31, 2014 and December 31, 2013 was as follows:

	Balance December 31, 2013		Additions	Reductions	Balance December 31, 2014	Due Within One Year
Revenue Bonds	\$ 568,345,000	\$	–	\$ (28,295,000)	\$ 540,050,000	\$ 32,115,000
Plus: Unamortized Premium	24,910,765		–	(2,265,255)	22,645,510	–
Total Long-Term Debt	\$ 593,255,765	\$	–	\$ (30,560,255)	\$ 562,695,510	\$ 32,115,000

	Balance December 31, 2012		Additions	Reductions	Balance December 31, 2013	Due Within One Year
Revenue Bonds	\$ 544,435,000	\$	217,230,000	\$ (193,320,000)	\$ 568,345,000	\$ 28,295,000
Plus: Unamortized Premium	2,843,676		25,056,314	(2,989,225)	24,910,765	–
Less: Unamortized Premium	(241,717)		–	241,717	–	–
Total Long-Term Debt	\$ 547,036,959	\$	242,286,314	\$ (196,067,508)	\$ 593,255,765	\$ 28,295,000

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

	2014	2013
2004 Revenue Bonds, with interest rates ranging from 5.0% to 5.25%, due in yearly installments of \$3,365,000 to \$20,690,000 through 2014. Original Issue: \$82,655,000 Current Portion: \$0	\$ –	\$ 3,365,000
2005A Revenue Bonds, with interest rates ranging from 3.5% to 4.3%, with the final payment of \$130,000 due in 2016. Original Issue: \$93,480,000 Current Portion: \$0	130,000	130,000
2005B Refunding Bonds, with interest rates ranging from 3.5% to 5.0%, due in yearly installments of \$1,050,000 to \$30,100,000 from 2016 to 2021. Original Issue: \$156,425,000 Current Portion: \$0	122,135,000	122,135,000
2007 Refunding Bonds, with interest rates ranging from 4.0% to 5.0%, due in yearly installments of \$10,485,000 to \$23,300,000 through 2015. Original Issue: \$81,130,000 Current Portion: \$21,300,000	21,300,000	38,230,000
2010A Revenue Bonds, with interest rates ranging from 2.0% to 5.0%, due in yearly installments of \$8,000,000 from 2014 to 2015. Original Issue: \$16,000,000 Current Portion: \$8,000,000	8,000,000	16,000,000

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	2014	2013
2010B Revenue Bonds, with interest rates ranging from 5.791% to 5.966%, with a Build America Bond (BAB) rebate ranging from 31.95% to 35% of interest, due in yearly installments of \$27,310,000 to \$31,630,000 from 2031 to 2035. Original Issue: \$147,070,000 Current Portion: \$0	147,070,000	147,070,000
2010C Revenue Bonds, with an interest rate of 5.641%, with Clean Renewal Energy Bond rebate at 67% of interest, due in one payment of \$24,185,000 in 2027. Original Issue: \$24,185,000 Current Portion: \$0	24,185,000	24,185,000
2013A Refunding Bonds, with interest rates ranging from 4.0% to 5.0%, due in yearly installments of \$2,815,000 to \$29,165,000 from 2015 to 2042. Original Issue: \$181,610,000 Current Portion: \$2,815,000	181,610,000	181,610,000
2013B Refunding Bonds, with interest rates ranging from 3.05% to 5.0%, due in yearly installments of \$3,795,000 to \$5,155,000 from 2022 to 2030. Original Issue: \$35,620,000 Current Portion: \$0	35,620,000	35,620,000
	540,050,000	568,345,000
Unamortized Premium	22,645,510	24,910,765
Current Portion	(32,115,000)	(28,295,000)
Long-term Portion of Revenue Bond Debt	\$ 530,580,510	\$ 564,960,765

Scheduled principal maturities on the bonds and interest payments are as follows:

	Principal	Interest
2015	\$ 32,115,000	\$ 26,037,611
2016	\$ 37,180,000	\$ 24,149,961
2017	\$ 36,185,000	\$ 22,419,101
2018	\$ 35,985,000	\$ 20,872,982
2019	\$ 35,145,000	\$ 19,369,185
2020-2024	\$ 79,875,000	\$ 79,913,767
2025-2029	\$ 42,685,000	\$ 70,513,064
2030-2034	\$ 120,595,000	\$ 53,244,529
2035-2039	\$ 78,990,000	\$ 16,821,896
2040-2042	\$ 41,295,000	\$ 2,520,900
	\$ 540,050,000	\$ 335,862,996

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

As of December 31, 2014, the following outstanding bonds were considered defeased:

Issue	Amount
1964 Light & Power Bonds	\$ 1,235,000
1965 Light & Power Bonds	3,360,000
1967 Light & Power Bonds - Series A & B	2,825,000
1969 Light & Power Bonds	2,260,000
1979 Light & Power Bonds	5,475,000
2005 Electric System Revenue Bonds - Series A	230,000
2005 Electric System Revenue Bonds - Series B	27,460,000
2007 Electric System Revenue Refunding Bonds	14,540,000
	<u>\$ 57,385,000</u>

These refunded bonds constitute a contingent liability of Tacoma Power only to the extent that cash and investments presently in the control of the refunding trustees are not sufficient to meet debt service requirements, and are therefore excluded from the financial statements because the likelihood of additional funding requirements is considered remote.

Conservation Project Revenue Bonds - On February 23, 1994, Tacoma Power and the Bonneville Power Administration (BPA) entered into a Conservation Project Agreement. The Conservation Project was created to develop cost-effective conservation resources within the service area of Tacoma Power. In the agreement, BPA is to acquire the conservation energy savings generated by the Conservation Project in return for paying all annual project costs.

In December 1994 to finance the Project, Tacoma Power and BPA joined in the sale of \$22.2 million of Conservation Project Revenue Bonds for which BPA is obligated to pay debt service. The bonds are not reflected in Tacoma Power's financial statements because they are only special limited obligations of Tacoma Power and are payable from and secured solely by Conservation Project Agreement conservation revenues that do not include any revenue derived from the electric system of Tacoma Power.

The 2003 Bonds are special limited obligations of Tacoma Power payable from the revenues derived from the Conservation Project and were issued to provide funds necessary to refund the 1994 Bonds and to pay costs of issuance of the bonds. Like the 1994 Bonds, the 2003 Bonds are not reflected in Tacoma Power's financial statements and BPA is obligated to pay debt service.

The final principal and interest payment was made on December 1, 2014.

NOTE 7 / PURCHASED POWER

Tacoma Power purchased electric power and energy from BPA under a long-term contract that expires on September 30, 2028. The contract consists of a base rate per kWh and certain cost-recovery adjustment clauses can be invoked under particular circumstances.

On December 1, 2008, the Board authorized the execution of a twenty-year Slice/Block Power Sales and Creditworthiness Agreement with BPA. The agreement allows Tacoma Power to purchase a Slice/Block power product from BPA which began October 1, 2011 and continues through September 30, 2028. In broad terms, the agreement requires Tacoma Power to purchase a firm amount (Block) and proportionate share (Slice) of power based on a number of criteria and calculations. This is a take or pay arrangement which allows Tacoma Power to remarket excess capacity. The related Creditworthiness Agreement provides for BPA to conduct a credit review of Tacoma Power. To determine if a letter of credit or cash deposit would be required, BPA completed this review and determined that as long as Tacoma Power's credit rating remains above BBB-, no Letter of Credit or cash deposit will be required.

The power received under this contract averaged approximately 439,003 and 428,854 kilowatts per hour for 2014 and 2013, respectively. Charges for the BPA purchased power were approximately \$104 million and \$106 million for 2014 and 2013, respectively, and are based on the total amount of energy delivered and the monthly peak power demand.

Under fixed contracts with other power suppliers, Tacoma Power has agreed to purchase portions of the output of certain generating facilities. Although Tacoma Power has no investment in such facilities, these contracts require Tacoma Power to pay minimum amounts (which are based at least in part on the debt service requirements of the supplier) whether or not the facility is operating. The cost of power obtained under the contracts, including payments made when a facility is not operating, is included in operations expense in the Statements of Revenues, Expenses and Changes in Net Position.

Tacoma Power entered into an Energy Conservation Agreement (ECA) with BPA in 2009. Under this agreement, funds are collected in wholesale power rates to support regional energy efficiency programs. As utilities implement conservation programs and activities, BPA reimburses these funds per program specifications. For the years 2014 and 2013, Tacoma Power recovered \$5,742,731 and \$2,344,001 respectively through the ECA.

Information for the year ended December 31, 2014 pertaining to these contracts is summarized as follows:

Tacoma Power's Current Share Of	Grand Coulee Project Hydro Authority	Grant County PUD- Priest Rapids Project
Energy Output	272,846 mWh	22,733 mWh
Megawatt Capacity	–	5 mW
Operating Costs	\$ 2,078,144	\$ (2,078,279)
Incentive Payments	\$ 3,866,460	–
R & R Repayment	\$ 102,666	–
Contract Expiration Date	5/9/2024	4/1/2052

On April 17, 2008, the FERC issued a new license to the Public Utility District No. 2 of Grant County (Grant PUD) for the continued operation of the Priest Rapids Hydroelectric Project which consists of the Priest Rapids Development and the Wanapum Development. The original license for the Priest Rapids Project was issued on November 4, 1955 and expired on October 31, 2005. Since then, the Project had operated under annual licenses. The renewed license issued by FERC allows Grant PUD a 44-year license for the continued operation of the Project. The term of Tacoma Power's contract with Grant PUD is for the term of the FERC license. Tacoma Power's purchase quantity and costs are tied to the actual costs of the Project.

Total expenses under the above contracts for the years 2014 and 2013 were \$6,047,270 and \$5,441,110, respectively, for Grand Coulee Project Hydro Authority, however, proceeds under the contract exceeded expenses in 2014 and 2013 for Grant County PUD - Priest Rapids resulting in a gain of \$2,078,279 and \$2,204,943, respectively.

In addition, Tacoma Power is required to pay its proportionate share of the variable operating expenses of these projects.

Other Power Transactions - Other power transactions include purchases under short-term agreements and interchanges of secondary power between utilities in response to seasonal resource and demand variations. Fluctuations in annual precipitation levels and other weather conditions materially affect the energy output from Tacoma Power's hydroelectric facilities. Accordingly, the net interchange of secondary power in and out may vary significantly from year to year. Tacoma Power's trading activities are limited to purchasing power to meet native loads, optimizing the value of Tacoma Power's power supply portfolio and selling energy during times of surplus.

Tacoma Power records applicable energy contracts using accrual accounting and recognizes the revenue or expense at the time of contract performance, settlement or termination. As of December 31, 2014 Tacoma Power had forward sales contracts totaling \$31.3 million dollars extending out to June 2016 with a fair market value of \$23.5 million. These contracts meet the normal purchase normal sales scope exception for derivative reporting under GASB 53.

Tacoma Power's net power purchases or sales and interchanged activities are reflected in the Statements of Revenues, Expenses and Changes in Net Position.

A breakdown of the net interchange in kilowatt-hours is as follows:

Interchange Summary	2014 (in kWh)	2013 (in kWh)
Secondary Sales	(2,842,694,000)	(2,244,963,000)
Portfolio Purchases	444,264,000	519,190,000
Miscellaneous Exchanges	(4,200,000)	(1,325,000)
Other	57,127,000	31,355,000
Net Interchange	(2,345,503,000)	(1,695,743,000)

NOTE 8 / FLEET SERVICES FUND

The Department of Public Utilities has established a Fleet Services Fund to perform scheduled maintenance, repair and replacement of Department vehicles and related equipment.

Tacoma Power pays the Fleet Services Fund for its use of the vehicles and equipment to cover fleet operating expenses. Payments made by Tacoma Power in 2014 and 2013 were \$7,475,002 and \$4,606,913, 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. The solvency of the Replacement Fund allowed Fleet Services to return a portion of interest earned on fund investments for the year to their customers. In 2014 and 2013, Fleet Services returned 75% of the interest earned to Tacoma Power's replacement fund. The amount of the refund was \$91,750 and \$118,896 for 2014 and 2013, 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 Power and other divisions within the Department for certain losses arising from personal and property damage claims by third parties. The major risks to Tacoma Power 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 Power is required to make payments to the Self-Insurance Fund to cover claims incurred by Tacoma Power and administrative expenses of the Fund. Tacoma Power's premium payments totaled \$810,000 in both 2014 and 2013. Assets in the Self-Insurance Fund total \$6.2 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 Power's investment in the Self-Insurance Fund is more than adequate to settle all its known or estimated claims.

The City purchased a \$15 million Fiduciary Liability Policy with a \$100,000 deductible that provides for wrongful acts arising out of the administration of the City's employee benefit programs and a \$1.0 million Crime policy for employee dishonesty and for fraudulent or dishonest act by employees against the City 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 Department's total liability limit is \$60 million any one occurrence and \$60 million annual aggregate. The general government comprehensive liability policies provide \$15 million of excess coverage with \$3.0 million retention. 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.

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 cost-sharing multiple employer, defined benefit retirement plan covering substantially all employees of the City of Tacoma, with the exception of police officers, firefighters, and Tacoma Rail employees who are covered by state or federal retirement plans. Employees of the Tacoma-Pierce County Health Department, as well as certain employees of the Pierce Transit and the Law Enforcement Support Agency who established membership in the System when these agencies were still City of Tacoma departments, are also members. It is administered in accordance with RCW Chapter 41.28 and Chapter 1.30 of the Tacoma Municipal Code. There are 2,166 retirees and beneficiaries currently receiving benefits, 459 vested terminated members entitled to future benefits and 2,884 active members of the System, as of December 31, 2014.

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 Municipal 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

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, 2014, 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.

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)
1/1/2012	\$ 1,068.3	\$ 1,185.5	\$ 117.2	90.1%	\$219.4	53.4%
1/1/2013	\$ 1,187.1	\$ 1,306.6	\$ 119.5	90.9%	\$210.6	56.7%
1/1/2014	\$ 1,297.0	\$ 1,400.0	\$ 103.0	92.6%	\$213.8	48.2%

Both the City and employees made 100% of the required contributions. The City's required contributions for the years ended December 31 were:

2012	\$20,919,787
2013	\$21,188,984
2014	\$22,149,246

Actuarial Methods and Significant Actuarial Assumptions:

Valuation Date	January 1, 2014
Actuarial Cost Method	Entry Age
Amortization Method	Level Percentage of the System's Projected Payroll
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	7.25%
Projected Salary Increases	4.00%
Includes Inflation at	3.00%
Postretirement Benefit Increases	2.125%

Schedule of Employer Contributions (Dollars in millions)

Year Ending December 31,	Covered Employee Payroll ⁽¹⁾	Actual Employer Contributions	Actual Employer Contribution Rate ⁽²⁾	Annual Required Contribution (ARC) ⁽²⁾	Percentage of ARC Contributed
2012	210.6	22.7	10.80%	10.80%	100%
2013	213.8	23.1	10.80%	11.06%	98%
2014	221.3	23.9	10.80%	11.77%	92%

(1) Computed as the dollar amount of the actual employer contribution made as a percentage of payroll divided by the contribution rate, expressed as a percentage of payroll.

(2) The actual and required employer contributions are expressed as a percentage of payroll.

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. GAAP requires 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 (3.75%).

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 is required to report as an expense for the year. The ARC is equal to the Normal Cost plus an amount to amortize the Unfunded Actuarial Accrued Liability (UAAL) on a closed basis of 30 years, beginning January 1, 2007. The amortization period for 2014 is 23 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 noncurrent liability (Net OPEB Obligation) on the statements of net position. The City has a Net OPEB Obligation as of December 31, 2014 as the City has not set aside funds for OPEB.

Excise Tax For High Cost or "Cadillac" Health Plans in 2018 and Beyond - An excise tax for high cost health coverage or "Cadillac" health plans was included in the Affordable Care Act (ACA) passed into law in March 2010. The provision levies a 40% tax on the value of health plan costs that exceed certain thresholds for single coverage or family coverage. The 2018 annual thresholds for qualified retirees aged 55-64 are \$11,850 for single coverage and \$30,950 for a family plan. If, between 2010 and 2018, the cost of health care insurance rises more than 55%, the threshold for the excise tax will be adjusted.

The City believes that the current provisions of ACA should be reflected in the projection of benefits and therefore, the value of the excise tax is included in the valuation. It is assumed that there will be no changes to the current law and that there will be no changes in plan design to help mitigate the impact of the tax.

GASB Statement No. 45 indicates that the projection of benefits should include all benefits to be provided to retirees in accordance with the current "substantive" plan. The substantive plan refers to the plan terms as understood by the employer and plan members at the time of the valuation. For this reason, the City believes that the current provisions of PPACA should be reflected in the projection of benefits and therefore, the value of the excise tax is included in this valuation. It is assumed that there will be no changes to the current law and that there will be no changes in plan design to help mitigate the impact of the tax.

Summary of Changes - As of the January 1, 2013 valuation, the total AAL was \$251,839,846, 3% lower than expected primarily due to lower than expected medical costs partially offset by the new excise tax for "Cadillac" health plans, demographic experience and assumptions, and economic assumptions.

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

	January 1, 2011	January 1, 2013
Total membership:		
Active employees	3,675	3,335
Terminated vested employees	363	394
Retired employees & Dependents	790	846
Total	4,828	4,575
Annual Benefit Payments	\$ 9,569,648	\$ 9,887,335
Discount rate	4.00%	3.75%
Present Value of Benefits (PVB)	\$ 319,550,419	\$ 326,742,538
Actuarial Accrued Liability (AAL)	\$ 248,571,791	\$ 251,839,846
Assets	\$ –	\$ –
Unfunded Actuarial Accrued Liability (UAAL)	\$ 248,571,791	\$ 251,839,846
Normal Cost	\$ 5,559,350	\$ 5,484,587
Annual Required Contribution (ARC)	\$ 19,734,040	\$ 20,058,760

The following table shows the total value of the benefits provided, the member paid premiums and the City paid benefits as of January 1, 2013.

Value of Subsidy at 3.75% Interest Rate	Total Value of Benefits	Member Paid Premiums	City Paid Benefits
Present Value of Benefits (PVB)	\$ 488,143,650	\$ 161,401,112	\$ 326,742,538
Actuarial Accrued Liability (AAL)	\$ 331,339,973	\$ 79,500,127	\$ 251,839,846
Normal Cost	\$ 11,227,919	\$ 5,743,332	\$ 5,484,587
Annual Benefit Payments	\$ 13,500,240	\$ 3,612,905	\$ 9,887,335

The following table shows the calculation of the Annual Required Contribution and Net OPEB Obligation for the City and for Tacoma Power as of December 31, 2014.

	City	Division
Determination of Annual Required Contribution:		
Normal Cost at Year-end	\$ 5,484,587	\$ 1,444,204
Amortization of UAAL	14,574,173	678,067
Annual Required Contribution (ARC)	\$ 20,058,760	\$ 2,122,271
Determination of Net OPEB Obligation:		
Annual Required Contribution (ARC)	\$ 20,058,760	\$ 2,122,271
Interest on prior year Net OPEB Obligation	2,104,155	292,751
Adjustments to ARC	(2,842,971)	(330,511)
Annual OPEB Cost	19,319,944	2,084,511
Actual benefits paid	(9,292,539)	(692,894)
Increase in Net OPEB Obligation	10,027,405	1,391,617
Net OPEB Obligation – beginning of year	56,110,801	7,806,683
Net OPEB Obligation – end of year	\$ 66,138,206	\$ 9,198,300

The Division has included the liability in the other long term liabilities on the Statement of Net Position.

Funded Status and Funding Progress - The following table shows the annual OPEB costs and net OPEB obligation for three years. This table is based upon a 4.00% interest rate for 2012 and 3.75% for 2013 and 2014.

Year Ended	<u>Annual OPEB Cost</u>		<u>Benefits Paid</u>		<u>Net OPEB Obligation</u>	
	City	Tacoma Power	City	Tacoma Power	City	Tacoma Power
12/31/2012	\$ 19,469,177	\$ 1,927,999	\$ 9,393,431	\$ 625,152	\$ 46,469,368	\$ 6,281,032
12/31/2013	\$ 19,528,767	\$ 2,103,280	\$ 9,887,334	\$ 577,629	\$ 56,110,801	\$ 7,806,683
12/31/2014	\$ 19,319,944	\$ 2,084,511	\$ 9,292,539	\$ 692,894	\$ 66,138,206	\$ 9,198,300

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

The portion of actuarial present value allocated to a valuation year is called the normal cost. The portion of this actuarial present value not provided for at a valuation date by the sum of (a) the actuarial value of the assets, and (b) the actuarial present value of future normal costs is called the Unfunded Actuarial Accrued Liability (UAAL). In determining the Annual Required Contribution, the UAAL is amortized as a level percentage of expected payrolls 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 is now 23 years.

Actuarial Methods and Significant Actuarial Assumptions

Valuation Date	January 1, 2013
Census Date	January 1, 2013
Actuarial Cost Method	Entry Age
Amortization Method	Combination of level percentage and level dollar amount, see note above.
Remaining Amortization Period	23 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	3.75% for pay-as-you-go funding
Medical Cost Trend	2013 8.9%
	2014 6.5%
	2015 5.8%
	2020 6.0%
	2030 5.9%
	2040 5.6%

The medical cost rate is assumed to continue grading downward until achieving the ultimate rate of 4.8% in 2083 and beyond. The first year trend reflects assumed increases based on ACA fees. These trend rates assume that, over time, deductibles and out-of-pocket maximums will be periodically increased as medical trends increase. The trends above do not reflect the increases in costs due to the excise tax.

Economic Assumptions –
Discount Rate (Liabilities)
Demographic Assumptions

3.75%

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 services

NOTE 12 / COMMITMENTS AND CONTINGENCIES

Capital Improvements - The financial requirement for Tacoma Power's 2013/2014 biennial Capital Improvement Program is approximately \$159.5 million. At December 31, 2014, the remaining financial requirement was approximately \$21.9 million. The remaining financial requirement for Capital Improvement Programs relating to prior biennium is approximately \$4.2 million.

General Legal Matters - Tacoma Public Utilities has received several other miscellaneous claims that either do not allege significant amounts or that the Legal Department has determined do not pose a risk to liability to the utilities.

TACOMA WATER



TACOMA WATER

Just one year after the centennial of establishing Tacoma's Green River water supply, we marked another major milestone: filtering our primary water source. The Green River has been a high-quality, low-cost supply source for a century, and with this new, enhanced treatment, it will continue to meet the needs of our customers for generations to come.

While certainly a large project, starting up the filtration plant was by no means the only progress Tacoma Water made in 2014. We continued to move ahead on initiatives in our Strategic Plan.

Our Public Utility Board unanimously approved the utility's 2015-2016 budget. We used new tools like strategic asset management planning and business case evaluations, as well as financial analysis, to identify the capital portion of the budget. As the utility transitions out of a decade of capital-intensive system improvements into a more operational mode, we will focus more on repairing and maintaining our capital infrastructure.

Financial results for Tacoma Water are healthy and strong as a result of updated policy direction, improved forecasting and comprehensive financial management. Our 2015-2016 budget effort reflected that fiscal discipline and resulted in proposed rate increases that are about half of what we'd previously projected for the biennium, despite large, required investments. A 4% overall rate increase was approved for both 2015 and 2016; the annual impact to a typical resident is about \$1.50 per month.

We marked
another major
milestone:
filtering our
primary water
source.



A once-in-a-lifetime view of the Green River Filtration Facility's 10-million-gallon water tank before it was filled.

N E X T S T E P S

For the past few years, Tacoma Water worked to make use of near-term surplus water supply to increase net revenues. In 2014, after several stages of review with policymakers and customers, the utility developed agreements with customer-specific terms for pricing, duration and seasonal characteristics to help Tacoma Water market that surplus. While the agreements will need to be approved by the Public Utility Board and City Council, the conceptual approach has been endorsed by both policymaking bodies.

Tacoma Water executed an agreement with the City of Auburn in 2014 to increase available wholesale capacity from 1 million gallons per day to 3.5 million gallons per day. The water purchased under this agreement is conventionally priced, but the execution of this agreement is aligned with our objective to increase net revenue from wholesale sales.

Tacoma Water updated short- and long-term demand forecasts in 2014, and we have already reaped the benefits. Ultimately, the utility will have a documented, repeatable and transparent process for forecasting on 10- and 60-year horizons, and we will be better able to account for uncertainty in our system planning and water supply agreement development.

Tacoma Water
updated short-
and long-term
demand forecasts
in 2014, and
we have already
reaped the
benefits.



NEW YEAR ,

NEW DEVELOPMENT

After a number of years of slow economic development activity in both the commercial and residential sectors, 2014 started tracking in the right direction. As new homes were built on the inventory of already developed lots, work on new plats started back up. The average number of new meter installations increased by 50% over 2013. With active engagement from Tacoma Water, economic development in downtown Tacoma – including an addition to a major medical center – is taking off. Tacoma Water also acquired a small new service area of about 150 service connections.

The premier recent accomplishment was the attraction of Niagara Bottling Company – the largest family-owned bottled water manufacturer in the United States – to Pierce County. The company began production in 2014 with one bottling line. As it brings on the planned addition of another bottling line, it will become one of Tacoma Water's largest customers. With the creation of good jobs and considerable capital investment, the success of attracting this company to the area was a win for both Tacoma Water's customers and the region in general.

The year proved to be a busy and fruitful one all around. We completed a leak survey on one of our major pipelines from the Green River. As a part of that survey, we conducted a pilot project to evaluate two different condition assessment technologies, focusing on an area of the pipeline with a history of leaks. The work required an unprecedented and lengthy – yet successful – shutdown of the pipeline. The success was attributed to excellent planning and coordination within the utility, and is an example of a willingness to try new approaches to deliver value to customers. With another nod toward planning

for the future, we made significant progress in assessing vulnerabilities to the water system.

The Green River Filtration Facility construction continued through the year, reaching substantial completion when filtered water entered the system on Dec. 16. With a competitive bidding climate and high-quality project management from the contractor, design team and the Tacoma Water team, overall project costs continued to be tightly controlled. At the close of the year, the total project cost – originally estimated to range from \$182 million to \$233 million – was at \$187 million. In addition to construction, we made some staffing changes to ensure reliable engineering, operation and maintenance support for this critical facility.

Our recent accomplishments are considerable, thanks to the dedication and efforts of the very capable Tacoma Water staff. From adopting and applying innovation to marketing surplus water, rehabilitation of infrastructure and technology implementation, Tacoma Water staff members have performed their work with pride and a commitment to our mission of providing clean, reliable water now and in the future.



FINANCIAL HIGHLIGHTS

In millions, for the years ended
December 31,

2014 2013 2012 2011 2010

Tacoma Water

Total Income	\$105.1	\$100.8	\$88.7	\$76.9	\$73.4
Operating Expenses	41.8	39.8	36.1	35.9	37.6
Income Available for Debt Service	\$63.3	\$61.0	\$52.6	\$41.0	\$35.8
Debt Service	\$26.7	\$28.0	\$26.0	\$25.9	\$21.8
Debt Service Coverage	2.37x	2.18x	2.02x	1.58x	1.64x
Plant Additions	\$95.2	\$138.0	\$106.7	\$87.0	\$66.3
Number of Customers	98,608	97,856	96,333	96,734	97,137
Average Rates (per 100 cubic feet)					
Residential	\$4.185	\$3.937	\$3.717	\$3.556	\$3.422
Commercial/Industrial	\$3.634	\$3.373	\$3.179	\$3.025	\$2.785

Water Sales (dollars in millions)

2014

2013

Residential	44.58	40.87
Commercial	12.81	11.40
Special	5.80	5.24
Other	6.39	6.13
Unbilled Revenue	0.12	0.47

Water Consumption (gallons in billions)

2014

2013

Residential	7.96	7.76
Commercial	2.63	2.53
Special	6.03	5.85
Other	2.19	1.72

Operating Expenses

2014

Depreciation	\$ 16,783,698	29%
Distribution	11,540,256	20%
Production	10,212,403	17%
Administration	8,536,393	15%
Other Operating Expenses	4,157,212	7%
Taxes	3,779,373	6%
Power & Transmission	3,547,299	6%

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 the 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, 2014 and 2013, 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Division as of December 31, 2014 and 2013, 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

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the accompanying management's discussion and analysis on pages 5 through 12 be presented to supplement the financial statements. Such information, although not a part of the 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 financial statements, and other knowledge we obtained during our

audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The statistical data presented on pages 42 through 61 and the superintendent's report presented on pages 62 through 71 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Miss Adams LLP

Tacoma, Washington
April 10, 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of Tacoma Water's financial performance provides an overview of the financial activities for the years ended December 31, 2014 and 2013. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues, provide an overview of the financial activities, and identify changes in the 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 generally accepted accounting principles (GAAP) in the United States of America, applied on a consistent basis, and include amounts that are based on management's best estimates and judgments.

The basic financial statements, presented on a comparative basis for the years ended December 31, 2014 and 2013, 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 Tacoma Water's assets, deferred outflows of resources, liabilities, and deferred inflows of resources with the difference being 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, non-capital financing, capital and related financing, and investing activities.

The Notes to 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 Tacoma Water's presentation of financial position, results of operations and changes in cash flows.

Financial Highlights

- The net position of Tacoma Water was \$516.7 million in 2014, \$480.3 million in 2013 and by \$449.9 million in 2012. Of these amounts, \$46.7 million in 2014, \$37.9 million in 2013, and \$42.5 million in 2012 were available to meet Tacoma Water's ongoing obligations to citizens and creditors.
- Tacoma Water's total net positions increased by \$36.4 (7.6%) million in 2014, \$30.4 (6.8%) million in 2013 and \$23.9 (5.5%) million in 2012.

- Operating revenues were \$98.3 million in 2014, an increase of \$2.2 million (2.3%) compared to 2013. Operating revenues were \$96.1 million in 2013, an increase of \$15.4 million (19.1%) compared to \$80.7 million in 2012. These increases are due to two average rate increases of 6.0% that went into effect January 1, 2014 and April 1, 2013. In 2013, the increase is also attributable to increases in other operating revenues and contract resource obligations.
- In 2014, Tacoma Water's net utility plant of \$872.1 million represented an increase of \$59.0 million (7.3%) over the 2013 \$813.1 million balance. In 2013, net utility plant was \$90.2 million (12.5%) more than 2012's \$722.9 million balance. Major projects contributing to the increases include the Green River Water Filtration Facility and Main Replacements Projects.

Overview of the Financial Statements

Tacoma Water reported net operating income of \$39.8, \$40.2 and \$29.3 million for 2014, 2013 and 2012 respectively. In 2014, operating revenues increased by \$2.2 million and operating expenses increased \$2.7 million. For 2013, operating revenues increased \$15.4 million and operating expenses increased \$4.5 million compared to 2012.

The following tables highlight Tacoma Water's past three years' operating results and gallons billed.

Operating Results (in thousands)

Category	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Operating Revenues	\$ 98,320	\$ 96,119	\$ 80,681	\$ 2,201	\$ 15,438
Operating Expenses	58,557	55,897	51,350	2,660	4,547
Net Operating Income	39,763	40,222	29,331	(459)	10,891
Net Non-Operating Income (Expense)	(9,657)	(14,580)	(11,854)	4,923	(2,726)
Capital Contributions	8,671	7,139	7,834	1,532	(695)
Federal BAB Subsidies and Grants	3,959	3,572	3,841	387	(269)
Transfers Out	(6,352)	(5,922)	(5,227)	(430)	(695)
Change in Net Position	\$ 36,384	\$ 30,431	\$ 23,925	\$ 5,953	\$ 6,506

Gallons Billed (in millions)

Type of Customer	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Residential	7,968.8	7,761.2	7,784.3	207.6	(23.1)
Commercial & Industrial	9,142.8	8,787.8	8,810.6	355.0	(22.8)
Municipal & Wholesale	1,255.7	1,278.8	787.6	(23.1)	491.2
Total	18,367.3	17,827.8	17,382.5	539.5	445.3

Net Position

Net position may serve over time as a useful indicator of a company's financial position. The analysis highlights net position for the last three years.

Statements of Net Position (in thousands)

Description	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Net Utility & Non-Utility Plant	\$ 872,576	\$ 813,543	\$ 723,400	\$ 59,033	\$ 90,143
Current & Other Assets	208,947	225,068	223,023	(16,121)	2,045
Total Assets	\$ 1,081,523	\$ 1,038,611	\$ 946,423	\$ 42,912	\$ 92,188
Deferred Outflows	1,588	1,814	1,764	(226)	50
Total Assets & Deferred Outflows	\$ 1,083,111	\$ 1,040,425	\$ 948,187	\$ 42,686	\$ 92,238
Net Position:					
Net Investment in Capital Assets	\$ 468,209	\$ 409,638	\$ 381,718	\$ 58,571	\$ 27,920
Restricted	1,797	32,703	25,634	(30,906)	7,069
Unrestricted	46,667	37,948	42,506	8,719	(4,558)
Total Net Position	516,673	480,289	449,858	36,384	30,431
Long-Term Debt	483,542	455,877	401,465	27,665	54,412
Current and Other LT Liabilities	47,321	68,684	61,289	(21,363)	7,395
Total Liabilities	530,863	524,561	462,754	6,302	61,807
Deferred Inflows	35,575	35,575	35,575	—	—
Total Net Position, Liabilities & Deferred Inflows	\$ 1,083,111	\$ 1,040,425	\$ 948,187	\$ 42,686	\$ 92,238

Revenues

Tacoma Water's operating revenues were \$98.3 million in 2014, an increase of \$2.2 million (2.3%) compared to 2013. This is primarily due to an increase in sales of water of \$5.6 million of which \$4.2 million is due an average rate increase of 6.0% effective January 1, 2014 and \$1.4 million is due to an increase in usage. However, this is offset by a decrease in contract resource obligations of \$3.6 million. As the construction of the Green River Filtration Facility approaches completion the partners were billed less accordingly. Operating revenues were \$96.1 million in 2013, an increase of \$15.4 million (19.1%) compared to 2012. This was largely due to an increase in contract resource obligations of \$12.6 million, an average rate increase of 6.0% effective April 1 and increased volume because of a warmer and drier summer than usual.

The following table highlights water sales by type of customer for 2014, 2013 and 2012.

Water Sales (in thousands)

Type of Customer	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Residential & Domestic	\$ 44,585	\$ 40,928	\$ 38,738	\$ 3,657	\$ 2,190
Commercial & Industrial	15,022	13,508	12,479	1,514	1,029
Special Rate	5,802	5,242	5,032	560	210
Municipal	455	446	383	9	63
Wholesale	3,718	3,520	2,090	198	1,430
Unbilled Revenue	121	468	417	(347)	51
Total	\$ 69,703	\$ 64,112	\$ 59,139	\$ 5,591	\$ 4,973

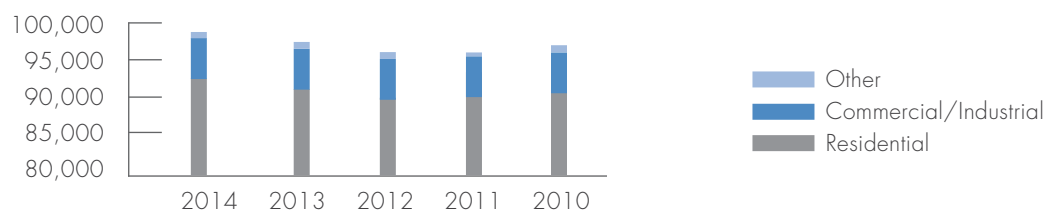
Approximately 64.0%, 63.8% and 65.5% of water sales were to residential and domestic customers in 2014, 2013 and 2012 respectively. Commercial and industrial sales were 21.6%, 21.1% and 21.1% of total sales for each year. Special rate sales were 8.3%, 8.2%, 8.5% of sales respectively.

Customers

Over the last five years, the overall number of customers has remained relatively stable. In 2014, 93.5% of all customers were residential compared to 93.6% in 2013 and 93.5% in 2012. Commercial and industrial customers were 6.2% of all customers in 2014, and 5.8% in 2013 and 2012. The remaining customer classes were 0.3% of all customers in 2014, 0.6% in 2013 and 0.7% in 2012.

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

Number of Customers

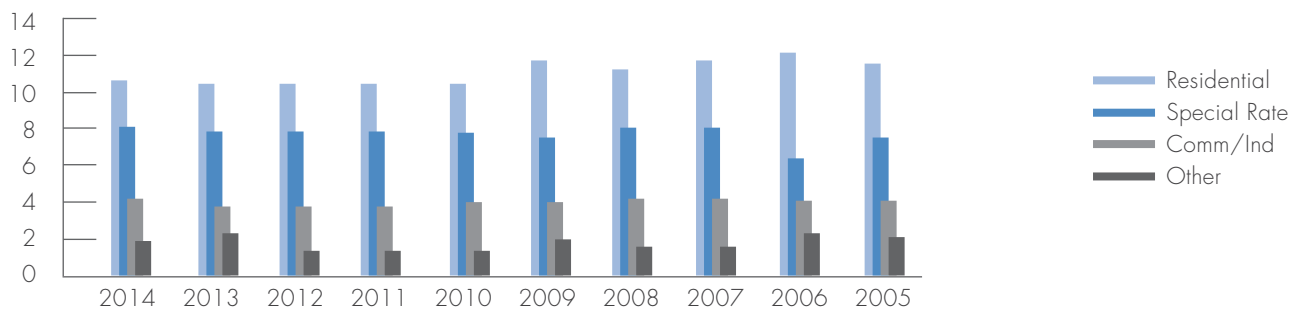


Water Users

Tacoma Water generates the majority of its revenues from its residential and domestic customer base. Consumption is measured in 100 cubic feet (CCF). In the years 2014, 2013 and 2012 residential customers used 10.7 million CCF (43.4%), 10.4 million CCF (43.5%) and 10.4 million CCF (44.9%) of total sales respectively. Special Rate customers used approximately 8.1 million CCF (33.0%), 7.8 million CCF (32.7%) and 7.8 million CCF (33.8%) respectively. Commercial and industrial customers used 4.1 million CCF (16.8%), 3.4 million CCF (14.2%) and 3.3 million CCF (14.4%) respectively. The remaining 1.7 million CCF (6.8%), 2.3 million CCF (9.6%) and 1.6 million CCF (6.9%) respectively was consumed by other customers.

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

Annual Water Usage (in millions of CCF)



Expenses

In 2014, operating expenses increased \$2.7 million (4.8%), compared to an increase of \$4.5 million in 2013. Source of Supply increased \$0.9 million compared to 2013 primarily due to less labor charged out to the Regional Water Supply System and capital projects. Water Treatment increased by \$0.2 million due to additional employees assigned to the Headworks that previously worked for Supply.

Depreciation expense increased by \$0.7 million (4.4%) in 2014 due to an increase in depreciable assets of \$28.3 million during 2013.

Administrative and General expense increased \$0.6 million (5.3%). Of this, \$0.2 million was related to Customer Accounting and Consumer Services expense. These increases are largely due to higher assessments for services provided by internal departments.

In 2013, operating expenses increased \$4.5 million (8.9%), compared to an increase of \$1.0 million in 2012. Source of Supply increased \$0.4 million compared to 2012 primarily due to a \$0.3 million increase in labor expense because of a shift in focus from capital to maintenance work and an increase in the number of full time employees. Source of Supply also had a \$0.2 million increase in electricity expense. This is partially offset by a \$0.1 million decrease in miscellaneous materials. Water Treatment increased \$0.3 million in labor expense primarily due to an increased number of employees. Transmission increased \$0.5 million due to \$0.2 million in increased labor expense because of increased maintenance work, \$0.2 in operating supplies and \$0.1 in external contract services. Distribution saw an increase of \$0.8 million largely due to \$0.4 million increase in labor expense for maintenance and \$0.3 million in equipment costs.

Depreciation expense increased by \$0.8 million (5.3%) in 2013 due to an increase in depreciable assets of \$26.4 million during 2012. The State Department of Revenue conducted a routine audit of revenues received and taxes paid by Tacoma Water for the years 2008 – 2011. As a result Tacoma Water owed an additional \$0.3 million. This was accrued in December 2013 and is a large part of the \$0.4 million increase in tax expense. An additional \$0.1 million was due to increased water sales.

Administrative and general expense increased \$0.9 million (12.8%) primarily due to an increase in overhead costs charged to capital projects of \$0.4 million. Tacoma Water incurred expenses of \$0.1 million from an internal department providing desktop PC support and \$0.2 million from the Customer Service IT department.

The following table highlights Tacoma Water's operating expenses for 2014 – 2012.

Operating Expenses (in thousands)

Category	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Production Expense					
Source of Supply	\$ 6,333	\$ 5,483	\$ 5,044	\$ 850	\$ 439
Water Treatment	3,879	3,674	3,335	205	339
Total Production Expense	10,212	9,157	8,379	1,055	778
Power Pumping Expense	568	426	280	142	146
Transmission & Storage Expense	2,979	2,793	2,273	186	520
Distribution Expense	11,540	11,476	10,633	64	843
Customer Accounting & Service	4,157	3,930	3,833	227	97
Taxes	3,779	3,919	3,485	(140)	434
Depreciation	16,784	16,072	15,263	712	809
Administrative & General	8,537	8,124	7,204	413	920
Total Operating Expenses	\$ 58,556	\$ 55,897	\$ 51,350	\$ 2,659	\$ 4,547

Capital Assets

Tacoma Water invests in a broad range of utility assets and at the end of 2014 had \$872.1 million in net utility plant, an increase of \$59.0 million from 2013. The largest increase was in construction work in progress of \$53.7 million. In 2013, Tacoma Water had \$813.1 million in net utility plant, an increase of \$90.2 million compared to 2012. Both increases were primarily due to the construction of Green River Water Filtration project. In 2014, 11.5 miles of water main were added or replaced compared to 12.8 miles in 2013, and 12.7 miles in 2012. Construction was completed on 18 private contracts in 2014, resulting in 7.55 miles; 14 private contracts in 2013, added 4.86 miles; and 12 private contracts in 2012, added 2.44 miles.

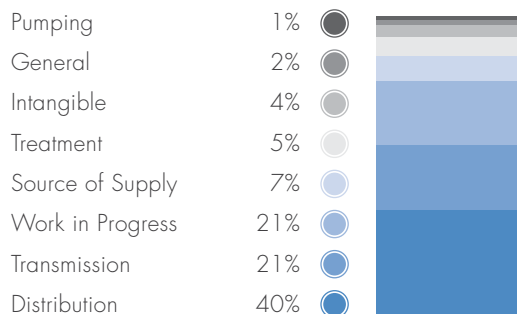
The following table summarizes Tacoma Water's capital assets, net of accumulated depreciation, for 2014 – 2012.

Capital Assets, Net of Accumulated Depreciation (in thousands)

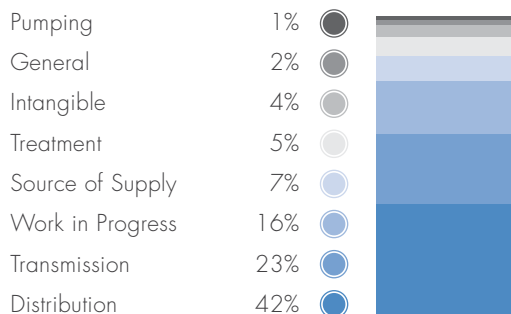
Net Utility Plant	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Intangible Plant	\$ 36,006	\$ 35,484	\$ 35,086	\$ 522	\$ 398
Source of Supply Plant	62,218	59,653	60,843	2,565	(1,190)
Pumping Plant	5,748	5,862	6,037	(114)	(175)
Water Treatment Plant	36,260	37,963	33,244	(1,703)	4,719
Transmission Plant	183,974	186,959	187,349	(2,985)	(390)
Distribution Plant	348,655	340,470	326,563	8,185	13,907
General Plant	12,868	13,987	14,189	(1,119)	(202)
Construction Work In Progress	186,354	132,673	59,541	53,681	73,132
Total	\$ 872,083	\$ 813,051	\$ 722,852	\$ 59,032	\$ 90,199

The following graphs provide a visual presentation of the allocation of Tacoma Water's capital investments in 2014 and 2013.

2014 Net Utility Plant



2013 Net Utility Plant



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

Debt Administration

At December 31, 2014 Tacoma Water had outstanding revenue bond obligations of \$407.3 million (net of unamortized bond premiums), a decrease of \$8.3 million compared to 2013. As of year-end 2013, the Utility had outstanding revenue bond obligations of \$415.6 million (net of unamortized bond premiums); an increase of \$46.1 million compared to \$369.5 million in 2012. Tacoma Water issued \$64.8 million in Regional Water Supply System Revenue Refunding Bonds in April 2013 and \$78.3 million of Water System Revenue and Refunding Bonds in May 2013.

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

Tacoma Water is required by bond covenants to maintain debt service coverage ratio 1.25 for principle and interest. Debt service coverage ratios were 2.40, 2.18, and 2.02 in 2014, 2013 and 2012 respectively.

At the end of 2014, Tacoma Water had an outstanding State loan balance of \$86.7 million compared to \$51.0 million in Drinking Water State Revolving Fund (DWSRF) Loans. Tacoma Water received \$2.4 million against the 2011 DWSRF Loan specifically for McMillin Reservoir. For the Green River Filtration Facility \$5.5 million was received against the 2010 DWSRF Loan, \$5.4 million was received against the 2011 DWSRF Loan, \$10.8 million was received against the 2012 DWSRF Loan, \$10.9 million was received against the 2013 DWSRF Loan, and \$4.6 million was received against the 2013 Fall DWSRF Loan.

Additional information on Tacoma Water'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 accompanying financial statements and for their integrity. We prepared the financial statements according to GAAP in the United States of America, and they fairly portray Tacoma Water's financial position and operating results. The Notes to Financial Statements are an integral part of the basic financial statements and provide additional financial information.

The financial statements have been audited by Moss Adams LLP. We have made available to them all pertinent information necessary to complete the audit.

Management considers and takes appropriate action on all 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

2014

FINANCIAL REPORTS

STATEMENTS OF NET POSITION

December 31,

ASSETS

2014

2013

UTILITY PLANT

In Service, at Original Cost	\$ 866,279,607	\$ 848,502,779
Less - Accumulated Depreciation	(180,549,889)	(168,125,255)
Total	685,729,718	680,377,524
Construction Work in Progress	186,353,639	132,672,994
Net Utility Plant	872,083,357	813,050,518

NON-UTILITY PROPERTY

492,963

492,963

RESTRICTED ASSETS

Construction Funds	39,509,127	46,470,902
Debt Service Funds	3,597,672	3,509,020
Bond Reserve Funds	22,110,124	22,095,502
System Development Charge Fund	53,255,060	53,719,777
Other Cash & Equity in Pooled Investments	27,968,224	31,023,815
Total Special Funds	146,440,207	156,819,016

CURRENT ASSETS

Operating Funds Cash and Equity in Pooled Investments	45,768,035	39,622,355
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$258,344 in 2014 and \$581,207 in 2013)	4,632,733	7,423,746
BABs Interest Subsidies Receivable	320,064	320,064
Accrued Unbilled Revenues	4,616,056	4,494,710
Materials and Supplies	2,401,523	2,336,648
Interfund Receivable	292,294	8,815,962
Prepayments	706,564	555,190
Total Current Assets	58,737,269	63,568,675

OTHER ASSETS

Regulatory Asset-Public Fire Protection Fees	2,940,674	3,756,025
Regulatory Asset-Hyada Surcharges	828,534	923,574
Total Other Assets	3,769,208	4,679,599
Total Assets	\$ 1,081,523,004	\$ 1,038,610,771

DEFERRED OUTFLOWS OF RESOURCES

Unamortized Losses on Refunding Bonds	1,587,851	1,813,858
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TOTAL ASSETS AND DEFERRED OUTFLOWS

\$ 1,083,110,855

\$ 1,040,424,629

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

NET POSITION AND LIABILITIES	December 31,	
	2014	2013
NET POSITION		
Invested in Capital Assets, Net of Related Debt	\$ 434,283,342	\$ 409,638,036
Restricted for:		
Water Capital and System Development Charge	33,925,829	30,986,617
Debt Service Funds	1,797,057	1,716,391
Unrestricted	46,667,017	37,947,929
Total Net Position	516,673,245	480,288,973
LONG-TERM DEBT		
Revenue Bonds	400,991,813	408,638,188
Public Works Trust Fund Loans	28,101,548	30,798,319
Drinking Water State Revolving Fund Loan	54,448,644	16,440,468
Total Long-Term Debt	483,542,005	455,876,975
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	10,442,544	10,693,020
Current Maturities of Long-Term Liabilities	195,299	200,182
Accrued Taxes	1,405,334	1,629,919
Accrued Expenses and Contracts Payable	4,015,959	16,911,220
Salaries, Wages and Fringe Benefits Payable	1,293,035	1,212,661
Interest Payable	1,800,615	1,792,629
Customers' Deposits	275,591	281,844
Interfund Payables	1,339,199	9,757,330
Total Current Liabilities	20,767,576	42,478,805
LONG-TERM LIABILITIES		
Muckleshoot Agreements	7,320,231	7,515,530
Customer Advances for Construction	4,338,242	3,970,932
Unearned Revenue	8,573,685	8,889,446
Long-Term Accrued Compensated Absences	2,300,497	2,245,968
Other Long-Term Liabilities	4,019,927	3,582,553
Total Long-Term Liabilities	26,552,582	26,204,429
TOTAL LIABILITIES	530,862,163	524,560,209
DEFERRED INFLOWS OF RESOURCES		
Rate Stabilization	35,575,447	35,575,447
TOTAL NET POSITION, LIABILITIES, AND DEFERRED INFLOWS	\$ 1,083,110,855	\$ 1,040,424,629

STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET POSITIONYear Ended December 31,
2014 2013**OPERATING REVENUES**

Sale of Water	\$ 69,702,657	\$ 64,111,896
Other Operating Revenues	9,454,498	9,242,674
Contract Resource Obligation Revenues	19,162,799	22,764,850
Total Operating Revenues	98,319,954	96,119,420

OPERATING EXPENSES

Operations	15,087,555	14,694,345
Production	10,212,403	9,156,746
Administrative and General	12,693,605	12,055,265
Depreciation	16,783,698	16,072,243
Taxes	3,779,373	3,918,944
Total Operating Expenses	58,556,634	55,897,543

Net Operating Income	39,763,320	40,221,877
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NON-OPERATING REVENUES (EXPENSES)

Interest Income	1,718,226	807,466
Other	537,052	(1,246,053)
Interest on Long-Term Debt	(20,363,130)	(20,195,198)
Amortization of Premium and Loss on Refunding	1,115,369	1,668,313
Interest Charged to Construction	7,335,911	4,385,849
Total Non-Operating Expenses	(9,656,572)	(14,579,623)

Net Income Before Capital Contributions and Transfers	30,106,748	25,642,254
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Capital Contributions

Cash	5,002,301	4,877,687
Donated Fixed Assets	3,668,338	2,261,651
Federal BAB Subsidies	3,562,311	3,535,426
Grants	397,135	36,237

Transfers

City of Tacoma Gross Earnings Tax	(6,274,494)	(5,838,335)
Transfers to/from Other Funds	(78,067)	(84,083)

CHANGE IN NET POSITION

	36,384,272	30,430,837
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TOTAL NET POSITION - BEGINNING OF YEAR

	480,288,973	449,858,136
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TOTAL NET POSITION - END OF YEAR

\$ 516,673,245	\$ 480,288,973
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The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CASH FLOWS

Year Ended December 31,
2014 **2013**

CASH FLOWS FROM OPERATING ACTIVITIES

Cash from Customers	\$ 101,860,957	\$ 99,105,625
Cash Paid to Suppliers	(28,273,532)	(14,790,800)
Cash Paid to Employees	(22,558,299)	(21,118,769)
Taxes Paid	(4,003,958)	(3,884,815)
Net Cash From Operating Activities	47,025,168	59,311,241

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES

Transfer to Other Funds	(78,067)	(84,083)
Transfer Out for Gross Earnings Tax	(6,274,494)	(5,838,335)
Net Cash From Non-Capital Financing Activities	(6,352,561)	(5,922,418)

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Capital Expenditures, net	(64,812,288)	(99,568,474)
Proceeds from PWTF Loan	–	10,000,000
Proceeds from State Drinking Water Loan	39,570,473	2,197,735
Proceeds from Sale of Bonds	–	143,100,000
Debt Issuance Costs	(299,999)	(1,574,009)
Premium on Sale of Bonds	–	12,889,179
Principal Payments on Long-Term Debt	(10,814,544)	(9,942,463)
Principal Payments on Muckleshoot LT Liability	(200,182)	(820,747)
Payments on Refunding of Bonds	–	(101,210,000)
Interest Paid	(20,355,144)	(20,351,944)
BABs Federal Interest Subsidies	3,562,311	3,535,426
Grants Received	397,135	36,237
System Development Charges, CIAC and Other	5,491,223	5,441,649
Net Cash From Capital and Related Financing Activities	(47,461,015)	(56,267,411)

CASH FLOWS FROM INVESTING ACTIVITIES

Interest Received on Investments	1,718,226	807,466
Other Net Non-Op Revenues and Expenses	837,053	(4,627)
Net Cash From Investing Activities	2,555,279	802,839

Net Change in Cash and Equity in Pooled Investments	(4,233,129)	(2,075,749)
Cash & Equity in Pooled Investments at January 1	196,441,371	198,517,120
Cash & Equity in Pooled Investments at December 31	\$ 192,208,242	\$ 196,441,371

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

STATEMENTS OF CASH FLOWS

	Year Ended December 31,	
	2014	2013
Reconciliation of Net Operating Income to Net Cash From Operating Activities:		
Net Operating Income	\$ 39,763,320	\$ 40,221,877
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation	16,783,698	16,072,243
Cash from changes in operating assets and liabilities:		
Accounts Receivable and Unbilled Revenue	2,669,667	2,611,384
Interfund Receivables	8,523,668	(7,868,582)
Regulatory Asset-Public Fire Protection Fees	815,351	518,567
Regulatory Asset-Hyada Surcharges	95,040	102,019
Materials and Supplies	(64,876)	4,526
Prepayments	(151,374)	47,416
Unearned Rental Revenues	(32,802)	(240,648)
Accrued Taxes	(224,585)	34,129
Salaries, Wages and Fringe Benefits Payable	74,315	135,315
Accrued Compensated Absences	60,588	137,454
Customers' Deposits	(6,253)	(6,117)
Accrued Expenses and Contracts Payable	(12,862,458)	(844,611)
Interfund Payables	(8,418,131)	8,386,269
Total Adjustments	\$ 7,261,848	\$ 19,089,364
Net Cash From Operating Activities	\$ 47,025,168	\$ 59,311,241
Reconciliation of Cash and Equity in Pooled Investments to Balance Sheet:		
Cash and Equity in Pooled Investments in Special Funds	\$ 146,440,207	\$ 156,819,016
Cash and Equity in Pooled Investments in Operating Funds	45,768,035	39,622,355
Cash and Equity in Pooled Investments at December 31	\$ 192,208,242	\$ 196,441,371

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2014 AND 2013

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 98,600 customers and had 240 employees as of December 31, 2014. 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 and multiple other cities. Tacoma Water is organized functionally as Water Distribution Engineering, Water Distribution Operations, Water Quality, Water Supply, Asset and Information Management, and Water Rates and Financial Planning.

Water Distribution Engineering - To engineer, design, inspect, and oversee 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; promote water conservation through outreach and customer programs.

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; to operate apprenticeship program to train and develop staff for positions in Distribution, Supply and Quality.

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 and assure regulatory compliance; to participate in shaping water quality legislation and regulations; to be aware of changes in water system security needs and to coordinate as needed; to support wholesale water customers.

Water Supply - To design, construct, 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; to oversee and manage Tacoma Water emergency preparedness and coordination with outside agencies.

Water Asset and Information Management - To prepare system and strategic plans for Tacoma Water, to support strategy and performance management; to provide GIS, SAP, Hydraulic Modeling and other technology support for Tacoma Water, and to manage strategic maintenance management, and incorporate risk and lifecycle costs into how Tacoma Water makes decisions.

Water Rates and Financial Planning - To construct financial planning scenarios, develop and implement rates and charges to recover utility costs, forecast demands, lead the development of capital and operating budgets, develop and ensure compliance with rate and financial policies, provide financial and customer statistic reporting to management team, policymakers, and RWSS Partners, develop and administer the financial features of water supply agreements, and maintain cost objects in SAP.

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) associated 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 ongoing 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 GAAP issued by the Governmental Accounting Standards Board (GASB) applicable to governmental entities that use proprietary fund accounting. The financial statements use a flow of economic resources measurement focus to determine financial position and the change in financial position. The accounting principles used are similar to those applicable to business in the private sector and are maintained on the accrual basis of accounting. Revenues are recognized when earned, and costs and expenses are recognized when incurred.

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.

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 issue 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 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, 2014 and 2013 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. 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.

Materials 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, system development charges funds, notes and contracts receivable, and customer deposits.

Bond Premium and Loss on Refunding - Bond premiums are amortized over the life of the bonds using the weighted average of the 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 position 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.

The economic lives for plant in service are as follows:

Source of Supply Plant	34 years
Pumping Plant	40 years
Water Treatment Plant	28 years
Transmission Plant	60 years
Distribution Plant	53 years
General Plant	13 years

Construction Work 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 System Development Charges - GASB Statement No. 33, which addresses accounting for contributed capital, requires that contributed capital be recognized as change in net position. 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 position. System development charges on uncompleted projects are recorded in other long term liabilities.

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.

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 Division had no liability in the current or prior year.

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.

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 the prior year account classifications as needed to conform to the current year presentation format. Included in these classifications are items resulting from the implementation of GASB 65, such as unamortized loss on refunding bonds and rate stabilization.

NOTE 3 / UTILITY PLANT

A summary of the balances and changes in utility plant for 2014 and 2013 follows:

	Balance December 31, 2013	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2014
Intangible Plant	\$ 35,484,224	\$ 739,974	\$ (217,820)	\$ -	\$ 36,006,378
Source of Supply Plant	79,208,344	4,432,850	(257,627)	-	83,383,567
Pumping Plant	9,278,296	118,293	(8,054)	-	9,388,535
Water Treatment Plant	50,663,085	73,173	-	-	50,736,258
Transmission Facilities	230,252,015	725,956	(13,162)	-	230,964,809
Distribution Facilities	409,827,797	14,379,945	(2,152,048)	-	422,055,694
General Plant	33,789,018	348,794	(315,379)	(78,067)	33,744,366
Total Water Plant In Service	848,502,779	20,818,985	(2,964,090)	(78,067)	866,279,607
Less Accumulated Depreciation	168,125,255	16,783,698	(2,746,082)	(1,612,982)	180,549,889
	680,377,524	4,035,287	(218,008)	1,534,915	685,729,718
Construction Work In Progress	132,672,994	74,421,563	-	(20,740,918)	186,353,639
Net Utility Plant	\$ 813,050,518	\$ 78,456,850	\$ (218,008)	\$ (19,206,003)	\$ 872,083,357

	Balance December 31, 2012	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2013
Intangible Plant	\$ 35,086,180	\$ 1,218,791	\$ (820,747)	\$ -	\$ 35,484,224
Source of Supply Plant	78,876,177	649,602	(317,435)	-	79,208,344
Pumping Plant	9,222,029	59,780	(3,513)	-	9,278,296
Water Treatment Plant	44,401,944	6,267,140	(5,999)	-	50,663,085
Transmission Facilities	226,940,853	3,311,162	-	-	230,252,015
Distribution Facilities	392,859,012	19,819,008	(2,850,223)	-	409,827,797
General Plant	32,800,989	1,136,867	(64,755)	(84,083)	33,789,018
Total Water Plant In Service	820,187,184	32,462,350	(4,062,672)	(84,083)	848,502,779
Less Accumulated Depreciation	156,876,447	16,072,243	(3,241,925)	(1,581,510)	168,125,255
	663,310,737	16,390,107	(820,747)	1,497,427	680,377,524
Construction Work In Progress	59,541,533	105,509,728	-	(32,378,267)	132,672,994
Net Utility Plant	\$ 722,852,270	\$ 121,899,835	\$ (820,747)	\$ (30,880,840)	\$ 813,050,518

Total Water Plant in Service includes non-depreciable assets of \$57,953,220 for 2014 and \$57,924,217 for 2013. The total amount of interest incurred and capitalized is \$7,335,911 for 2014 and \$4,385,849 for 2013.

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	2014	2013
Construction Funds	\$ 39,509,127	\$ 46,470,902
Debt Service Funds	3,597,672	3,509,020
Bond Reserve Funds	22,110,124	22,095,502
System Development Charge Fund	53,255,060	53,719,777
Other Cash and Equity in Pooled Investments	27,968,224	31,023,815
Total	\$ 146,440,207	\$ 156,819,016

NOTE 5 / LONG-TERM DEBT

The Division's Long-term Liabilities are primarily for the purpose of capital improvements. Long-term debt activities for 2014 and 2013 were as follows:

	Balance December 31, 2013	Additions	Reductions	Balance December 31, 2014	Due Within One Year
Revenue Bonds	\$ 400,015,000	\$ -	\$ (6,950,000)	\$ 393,065,000	\$ 6,305,000
Plus: Unamortized Premium	15,573,188	-	(1,341,375)	14,231,813	-
Net Revenue Bonds	415,588,188	-	(8,291,375)	407,296,813	6,305,000
Public Works Trust Fund Loans	33,495,090	-	(2,696,771)	30,798,319	2,696,771
Drinking Water State Revolving Fund Loans	17,486,717	39,570,473	(1,167,773)	55,889,417	1,440,773
Total Long-Term Debt	\$ 466,569,995	\$ 39,570,473	\$ (12,155,919)	\$ 493,984,549	\$ 10,442,544

	Balance December 31, 2012	Additions	Reductions	Balance December 31, 2013	Due Within One Year
Revenue Bonds	\$ 364,880,000	\$ 143,100,000	\$ (107,965,000)	\$ 400,015,000	\$ 6,950,000
Plus: Unamortized Premium	4,635,380	12,889,179	(1,951,371)	15,573,188	-
Net Revenue Bonds	369,515,380	155,989,179	(109,916,371)	415,588,188	6,950,000
Public Works Trust Fund Loans	25,636,305	10,000,000	(2,141,215)	33,495,090	2,696,771
Drinking Water State Revolving Fund Loans	16,335,230	2,197,735	(1,046,248)	17,486,717	1,046,249
Total Long-Term Debt	\$ 411,486,915	\$ 168,186,914	\$ (113,103,834)	\$ 466,569,995	\$ 10,693,020

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

SENIOR LIEN BONDS	2014	2013
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 Current Portion: \$4,295,000	\$ 29,365,000	\$ 33,450,000
2009 Water System Revenue Bonds, with interest rate at 5.751%, with Build America Bond (BAB) rebate ranging from 31.95% to 35.0%, due in yearly installments starting in 2033 ranging from \$9,800,000 to \$12,210,000 through 2039. Original Issue: \$76,775,000 Current Portion: \$0	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 ranging from \$550,000 to \$4,655,000 through 2023. Original Issue: \$29,100,000 Current Portion: \$555,000	27,505,000	28,055,000
2010B Water System Revenue Bonds, with interest rates ranging from 4.581% to 5.621%, with Build America Bond (BAB) Rebate ranging from 31.95% to 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 Current Portion: \$0	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 ranging from \$270,000 to to \$355,000 through 2024. (See Note 6) Original Issue: \$3,595,000 Current Portion: \$270,000	3,070,000	3,335,000
2010B Regional Water Supply System Revenue Bonds, with interest rates ranging from 5.371% to 5.621%, with Build America Bond (BAB) rebate ranging from 31.95% to 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 Current Portion: \$0	44,245,000	44,245,000
2013 Water System Revenue and Refunding Bonds, with interest rates ranging from 2.0% to 4.0%, due in installments of \$980,000 in 2014 and yearly installments starting in 2041 ranging from \$23,820,000 to \$25,765,000 through 2043. Original Issue: \$78,305,000 Current Portion: \$0	74,355,000	74,355,000
2013 Regional Water Supply System Revenue and Refunding Bonds, with interest rates ranging from 4.0% to 5.0%, due in yearly installments ranging from \$670,000 to \$6,425,000 through 2032. Original Issue: \$64,795,000 Current Portion: \$1,185,000	62,765,000	63,835,000
Subtotal Sr. Lien Debt	\$ 393,065,000	\$ 400,015,000
Unamortized Premium	14,231,813	15,573,188
Less Current Portion of Revenue Bond Debt	(6,305,000)	(6,950,000)
Long-term Portion of Revenue Bond Debt	\$ 400,991,813	\$ 408,638,188

Scheduled principal maturities on the bonds and interest payments are as follows:

Year	Principal	Interest
2015	\$ 6,305,000	\$ 19,622,925
2016	6,025,000	19,326,875
2017	6,355,000	19,042,225
2018	6,685,000	18,741,475
2019	7,855,000	18,467,207
2020-2024	44,180,000	86,706,314
2025-2029	54,045,000	74,973,533
2030-2034	71,085,000	60,116,118
2035-2039	95,010,000	37,455,215
2040-2043	95,520,000	10,190,085
	<u>\$ 393,065,000</u>	<u>\$ 364,641,972</u>

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

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

JUNIOR LIEN DEBT

Public Works Trust Fund Loans	2014	2013
2001 Public Works Trust Fund pre-construction loan for the Second Supply Project (SSP) Howard Hanson Dam Additional Storage Project, with interest of .5% per annum, due in yearly installments of \$52,632 through 2021.	\$ 368,421	\$ 421,053
2001 Public Works Trust Fund construction loan for the SSP, with interest of .5% per annum, due in yearly installments of \$533,334 through 2021.	3,733,333	4,266,667
2002 Public Works Trust Fund pre-construction loan for Middle and Headworks section of the SSP, with interest of .5% per annum, due in yearly installments of \$54,180 through 2022.	379,257	433,437
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 2021.	4,250,000	4,781,250
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 \$53,362 through 2024.	533,626	586,988
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.	4,447,059	4,817,647
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.	7,642,178	8,188,048
2012 Public Works Trust Fund construction loan for the Green River Filtration Facility, with interest of .5% per annum, due in yearly installments of \$555,555 through 2031.	9,444,445	10,000,000

JUNIOR LIEN DEBT (CONTINUED)

Drinking Water State Revolving Fund Loans	2014	2013
2002 construction loan for the Portland Avenue Reservoir, with interest of 2.5% per annum, due in yearly installments of \$161,052 through 2021.	\$ 1,127,369	\$ 1,288,421
2008 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.5% per annum, due in yearly installments of \$215,109 through 2028.	3,011,517	3,226,626
2009 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.0% per annum, due in yearly installments of \$367,088 through 2032.	6,607,582	6,974,670
2010 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.5% per annum, due in yearly installments of \$303,000 through 2032.	5,454,000	5,757,000
2010 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$273,000 through 2034.	5,460,000	—
2011 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.5% per annum, due in yearly installments of \$121,524 through 2033.	2,308,949	60,000
2011 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$273,000 from 2016 through 2035.	5,460,000	60,000
2012 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$546,000 from 2017 through 2036.	10,920,000	120,000
2013 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$546,000 from 2018 through 2037.	10,920,000	—
2013 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$231,000 from 2018 through 2037.	4,620,000	—
Subtotal Junior Lien Debt	86,687,736	50,981,807
Less Current Portion of Debt	(4,137,544)	(3,743,020)
Long-term Portion of Junior Lien Debt	\$ 82,550,192	\$ 47,238,787

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

Year	Principal	Interest
2015	\$ 4,137,544	\$ 491,767
2016	4,410,543	646,606
2017	4,956,543	663,633
2018	5,733,543	849,577
2019	5,733,543	790,767
2020-2024	25,201,625	3,096,011
2025-2029	19,865,926	1,843,440
2030-2034	12,952,469	773,583
2035-2037	3,696,000	98,595
	\$ 86,687,736	\$ 9,253,979

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

In May of 2014, Simpson Tacoma Kraft Company (Simpson) was sold to RockTenn CP LLC. Combined, these two customers accounted for 8.3% of Tacoma Water's total water sales in 2014. In 2013 Simpson accounted for 8.2% of Tacoma Water's total water sales. There were no outstanding accounts receivables from these customers at year-end 2014 or 2013.

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

NOTE 8 / FLEET SERVICES FUND

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 2014 and 2013 were \$2,453,302 and \$2,367,199, 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. The solvency of the Replacement Fund allowed Fleet Services to return a portion of interest earned on Fund investments for the year to their customers. In 2014 and 2013, Fleet Services returned 75% of the interest earned on the capital replacement reserve to Tacoma Water's replacement fund. The amounts refunded in 2014 and 2013 were \$32,345 and \$38,356, 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 \$180,000 in 2014 and \$180,000 in 2013. Assets in the Self-Insurance Fund total \$6.2 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 Liability Policy with a \$100,000 deductible that provides for wrongful acts arising out of the administration of the City's employee benefit programs and a \$1.0 million Crime policy for employee dishonesty and for fraudulent or dishonest acts by employees against the City 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 Department's total liability limit is \$60 million any one occurrence and \$60 million annual aggregate. The general government comprehensive liability policies provide \$15 million of excess coverage with \$3 million retention. 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.

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 cost-sharing multiple-employer, defined benefit retirement plan covering substantially all employees of the City of Tacoma, with the exception of police officers, firefighters, and Tacoma Rail employees who are covered by state or federal retirement plans. Employees of the Tacoma-Pierce County Health Department, as well as certain employees of the Pierce Transit and the South Sound 911 who established membership in the System when these agencies were still City of Tacoma departments, are also members. It is administered in accordance with RCW Chapter 41.28 and Chapter 1.30 of the Tacoma Municipal Code. There are 2,166 retirees and beneficiaries currently receiving benefits, 459 vested terminated members entitled to future benefits and 2,884 active members of the System, as of December 31, 2014.

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 Municipal 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

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, 2014, 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.

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)
1/1/2012	\$ 1,068.3	\$ 1,185.5	\$ 117.2	90.1%	\$ 219.4	53.4%
1/1/2013	\$ 1,187.1	\$ 1,306.6	\$ 119.5	90.9%	\$ 210.6	56.7%
1/1/2014	\$ 1,297.0	\$ 1,400.0	\$ 103.0	92.6%	\$ 213.8	48.2%

Both the City and employees made 100% of the required contributions. The City's required contributions for the years ended December 31 were:

2012	\$20,919,787
2013	\$21,188,984
2014	\$22,149,246

Actuarial Methods and Significant Actuarial Assumptions

Valuation Date	January 1, 2014
Actuarial Cost Method	Entry Age
Amortization Method	Level Percentage of the System's Projected Payroll
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	7.25%
Projected Salary Increases	4.00%
Includes Inflation at	3.00%
Postretirement Benefit Increases	2.125%

Schedule of Employer Contributions (\$ in millions):

Year Ending December 31,	Covered Employee Payroll ⁽¹⁾	Actual Employer Contributions	Actual Employer Contribution Rate ⁽²⁾	Annual Required Contribution (ARC) ⁽²⁾	Percentage of ARC Contributed
2012	210.6	22.7	10.80%	10.80%	100%
2013	213.8	23.1	10.80%	11.06%	98%
2014	221.3	23.9	10.80%	11.77%	92%

(1) Computed as the dollar amount of the actual employer contribution made as a percentage of payroll divided by the contributions rate, expressed as a percentage of payroll.

(2) The actual and required employer contributions are expressed as a percentage of payroll.

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. GAAP requires 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 (3.75%).

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 is 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 2014 is 23 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. The City has a Net OPEB Obligation as of December 31, 2014 as the City has not set aside funds for OPEB.

Excise Tax for High Cost or "Cadillac" Health Plans in 2018 and Beyond - An excise tax for high cost health coverage or "Cadillac" health plans was included in the Affordable Care Act (ACA) passed into law in March 2010. The provision levies a 40% tax on the value of health plan costs that exceed certain thresholds for single coverage or family coverage. The 2018 annual thresholds for qualified retirees aged 55-64 are \$11,580 for single coverage and \$30,950 for a family plan. If, between 2010 and 2018, the cost of health care insurance rises more than 55%, the threshold for the excise tax will be adjusted.

The City believes that the current provisions of ACA should be reflected in the projection of benefits and therefore, the value of the excise tax is included in the valuation. It is assumed that there will be no changes to the current law and that there will be no changes in plan design to help mitigate the impact of the tax.

GASB Statement No. 45 indicates that the projection of benefits should include all benefits to be provided to retirees in accordance with the "substantive" plan. The substantive plan refers to the plan terms as understood by the employer and plan members at the time of the valuation. For this reason, the City believes that the current provisions of the PPACA should be reflected in the projection of benefits and therefore, the value of the excise tax is included in this valuation. It is assumed that there will be no changes to the current law and that there will be no changes in plan design to help mitigate the impact of the tax.

Summary of Changes - As of January 1, 2013 valuation, the total AAL was \$251,839,846, 3% lower than expected primarily due to lower than expected medical costs partially offset by the new excise tax for "Cadillac" health plans, demographic experience and assumptions, and economic assumptions.

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

	January 1, 2011	January 1, 2013
Total membership:		
Active employees	3,675	3,335
Terminated vested employees	363	394
Retired employees & dependents	790	846
Total	4,828	4,575
Annual Benefit Payments	\$ 9,569,648	\$ 9,887,335
Discount Rate	4.00%	3.75%
Present Value of Benefits (PVB)	\$ 319,550,419	\$ 326,742,538
Actuarial Accrued Liability (AAL)	\$ 248,571,791	\$ 251,839,846
Assets	\$ -	\$ -
Unfunded Actuarial Accrued Liability (UAAL)	\$ 248,571,791	\$ 251,839,846
Normal Cost	\$ 5,559,350	\$ 5,484,587
Annual Required Contribution (ARC)	\$ 19,734,040	\$ 20,058,760

The following table shows the total value of the benefits provided, the member paid premiums and the City paid benefits as of January 1, 2013.

Value of Subsidy at 3.75% Interest Rate	Total Value of Benefits	Member Paid Premiums	City Paid Benefits
Present Value of Benefits (PVB)	\$ 488,143,650	\$ 161,401,112	\$ 326,742,538
Actuarial Accrued Liability (AAL)	\$ 331,339,973	\$ 79,500,127	\$ 251,839,846
Normal Cost	\$ 11,227,919	\$ 5,743,332	\$ 5,484,587
Annual Benefit Payments	\$ 13,500,240	\$ 3,612,905	\$ 9,887,335

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, 2014.

	City	Water
Determination of Annual Required Contribution:		
Normal Cost at Year-end	\$ 5,484,587	\$ 412,290
Amortization of UAAL	14,574,173	175,541
Annual Required Contribution (ARC)	\$ 20,058,760	\$ 587,831
Determination of Net OPEB Obligation:		
Annual Required Contribution (ARC)	\$ 20,058,760	\$ 587,831
Interest on prior year Net OPEB Obligation	2,104,155	93,664
Adjustments to ARC	(2,842,971)	(105,745)
Annual OPEB Cost	19,319,944	575,750
Actual benefits paid	(9,292,539)	(165,318)
Increase in Net OPEB Obligation	10,027,405	410,432
Net OPEB Obligation - beginning of year	56,110,801	2,497,707
Net OPEB Obligation - end of year	\$ 66,138,206	\$ 2,908,139

The Division has included the liability in the other long term liabilities on the Statement of Net Position.

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 for 2012 and 3.75% for 2013 and 2014.

Year Ended	Annual OPEB Cost		Benefits Paid		Net OPEB Obligation	
	City	Water	City	Water	City	Water
12/31/2012	\$ 19,469,178	\$ 540,137	\$ 9,393,431	\$ 138,439	\$ 46,469,368	\$ 2,055,309
12/31/2013	\$ 19,528,767	\$ 581,617	\$ 9,887,335	\$ 139,219	\$ 56,110,801	\$ 2,497,707
12/31/2014	\$ 19,319,944	\$ 575,750	\$ 9,292,539	\$ 165,318	\$ 66,138,206	\$ 2,908,139

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 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 23 years.

Actuarial Methods and Significant Actuarial Assumptions:

Valuation Date	January 1, 2013
Census Date	January 1, 2013
Actuarial Cost Method	Entry Age
Amortization Method	Combination of level percentage and level dollar amount, see note above.
Remaining Amortization Period	23 years, closed
Demographic Assumptions	Demographic assumptions regarding retirements, disability, and turnover are based upon pension valuations for the various pension plans.
Actuarial Assumptions:	
Discount Rate	3.75% for pay-as-you-go funding

(continued on next page)

Medical Cost Trend	2013	8.90%
	2014	6.50%
	2015	5.80%
	2020	6.00%
	2030	5.90%
	2040	5.60%

The medical cost rate is assumed to continue grading downward until achieving the ultimate rate of 4.8% in 2083 and beyond. The first year trend reflects assumed increases based on ACA fees. These trend rates assume that, over time, deductibles and out-of-pocket maximums will be periodically increased as medical trends increase. The trends above do not reflect increases in costs due to the excise tax.

Economic Assumptions:

Discount Rate (Liabilities) 3.75%

Demographic Assumptions:

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 2015-2016 biennial Capital Improvement program is approximately \$32.9 million and Tacoma Water has substantial contractual commitments relating to the program. At December 31, 2014 the remaining financial requirement for Capital Improvement Programs relating to all prior biennia is approximately \$4.5 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 has received several other miscellaneous claims or litigation that either do not allege material amounts or that the Legal Department has determined do not pose a risk of liability to the Utility.

TACOMA RAIL



TACOMA RAIL



Tacoma Rail is one of the busiest short-line railroads in the country in terms of volume and freight.

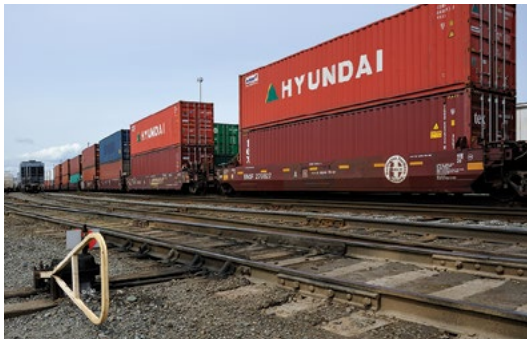
For Tacoma Rail, 2014 was an extraordinary year marked by its 100-year anniversary and business expansion all around. In particular, it was a time of remarkable revenue growth. For the second consecutive year, each succeeding month set an all-time revenue growth record. We achieved that without increasing rates, while also weathering labor issues at West Coast marine terminals in the last two months of 2014.

Tacoma Rail entered the third year of its 20-year operating agreement with the Port of Tacoma, establishing it as the Port's sole provider of rail service through 2033. We have established key performance indicators to gauge the progress of improved rail service, management oversight through increased communication and the maintenance of the combined organizations' exceptional rates and service. All of this is geared to secure Tacoma Rail's future through alignment, control and efficiency that will lead to traffic volume growth in highly competitive transportation markets.

Tacoma Rail continued to build on its longstanding relationship with U.S. Oil and Refining Company – the source of most of the railroad's growth, and its highest revenue source. In 2012, U.S. Oil shifted the sourcing of its refinery feedstock from ocean-transported Alaskan crude to the rail-served Bakken region of North Dakota. This year, construction started on the final phase of the multi-million dollar unit train unloading facility. Traffic volume steadily grew in 2014 as sourcing of crude oil expanded into Canada.

For the second consecutive year, each succeeding month set an all-time revenue growth record.

DIVISIONAL NEWS



For Tacoma Rail,
2014 was an
extraordinary year
marked by its 100-
year anniversary
and business
expansion.

Tacoma Rail continues to fund a volume incentive program to attract more intermodal business, as part of its operating agreement with the Port of Tacoma. We have also expanded our unit train rate structure for crude oil to allow U.S. Oil to source product on Union Pacific Railroad as well as BNSF Railway.

The Port of Olympia continued to move ceramic sand by transload from ships to railcars bound for the shale oil producing region in North Dakota. It surpassed the all-time record for cars handled at 3,171 for the Capital Division. Those increased volumes, coupled with the BNSF Railway's changes to its operating plan, have challenged Tacoma Rail's ability to efficiently service the Capital Division. The decline in crude oil prices caused a softening in the movement of ceramic sand in the last half of 2014, relieving some of the pressure on the division's infrastructure.

Tacoma Rail operates the Mountain Division for the City of Tacoma's Public Works Department. We continued to divest parts of the Mountain Division no longer needed for freight service. We added 10 miles to the existing operating lease with Western Washington Railroad, for a total of 30 miles between the end of the line in Chehalis to the northern junction with Tacoma Rail in Yelm. Mount Rainier Scenic Railroad (MRSR) continued to run its tourist steam train operations over a portion of its leased line between Eatonville and Morton. Tacoma Rail entered into a lease agreement with MRSR to lease Rail's passenger equipment, enabling them to run enhanced excursion train service. Finally, the sale of a 1.2-mile section of the Mountain Division to Sound Transit was approved. The Mountain Division operated at near-breakeven in 2014.

The future looks bright for Tacoma Rail. After quickly recovering from the economic slowdown on the West Coast because of a labor dispute, we are on track for steady operations and continued growth.

FINANCIAL HIGHLIGHTS

In Millions, For the Years Ended December 31,	2014	2013	2012	2011	2010
Total Income	\$30.5	\$27.9	\$24.1	\$20.1	\$16.3
Operating Expenses	25.5	22.8	19.4	16.5	14.2
Income Available for Debt Service	\$5.0	\$5.1	\$4.7	\$3.6	\$2.1
Debt Service	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3
Debt Service Coverage	19.16x	19.73x	18.14x	14.05x	8.15x
Plant Additions	\$7.9	\$4.8	\$7.4	\$10.7	\$0.6
Number of Cars Switched	108,137	99,366	92,117	68,953	73,175
Average Rates (per car)					
Line Haul Car	\$237.29	\$239.48	\$222.36	\$246.77	\$194.75
Local & Miscellaneous Car	\$510.59	\$662.72	\$343.33	\$340.07	\$321.60

Switching Revenues (in millions)	2014	2013
Line Hauls - Intermodal	11.32	11.32
Line Hauls - Commercial	12.21	10.86
Line Hauls - Capital Division	1.40	1.18
Miscellaneous	1.56	1.21

Switching Activities	2014	2013
Line Hauls - Intermodal	69,872	64,981
Line Hauls - Commercial	32,096	29,933
Line Hauls - Capital Division	3,111	2,622
Miscellaneous	3,058	1,830

Operating Expenses	2014	
Operations	10,810,206	41%
Administration	7,391,559	28%
Mechanical	4,116,105	15%
Construction	2,745,664	10%
Depreciation	1,069,265	4%
Taxes	429,875	2%

REPORT OF INDEPENDENT AUDITORS

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

Report on the Financial Statements

We have audited the accompanying financial statements of City of Tacoma, Washington Department of Public Utilities, Rail Division (the Division), which comprise the statements of net position as of December 31, 2014 and 2013, 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Division as of December 31, 2014 and 2013, 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 Matters

Required Supplementary Information

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 financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The statistical data presented on pages 36 through 46 and the superintendent's report presented on pages 47 through 48 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Miss Adams LLP

Tacoma, Washington
April 10, 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of Tacoma Rail's financial performance provides an overview of the financial activities for the years ended December 31, 2014 and 2013. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues, provide an overview of the financial activities, and identify changes in the 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 generally accepted accounting principles (GAAP) in the United States of America, applied on a consistent basis, and include amounts that are based on management's best estimates and judgments.

The basic financial statements, presented on a comparative basis for the years ended December 31, 2014 and 2013, 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 Tacoma Rail'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 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 Tacoma Rail's presentation of financial position, results of operations and changes in cash flow.

Financial Highlights

Tacoma Rail continued to meet its goal of providing efficient, cost-effective rail service to the Ports of Tacoma and Olympia as well as Tacoma's industrial areas. Doing so required adding operating staff, upgrading infrastructure and enforcing a disciplined tactical plan to respond to growth in local, national and world economies as they pertain to the rail industry.

The operating results for Tacoma Rail in 2014 indicate a slight decrease in intermodal traffic and a healthy increase in non-intermodal traffic. The intermodal decrease correlates to the negotiation conflicts between the Pacific Maritime Association and the International Longshore and Warehouse Union which slowed the flow of container traffic across the entire west coast. Non-intermodal traffic increased as customer facilities are expanded and new opportunities have arisen. This new traffic lends itself to higher crew utilization due to the increased amount of switching associated with the type of service.

Overview of the Financial Statements

Tacoma Rail is reporting a change in net position of \$2.0 million in 2014, compared to \$1.9 million in 2013, an increase of \$0.1 million. The increase in net position was due to an increase of \$2.5 million in operating revenues, an increase of \$2.8 million in operating expenses, an increase of \$0.9 million in contributions, and an increase of \$0.5 million in transfers out.

In 2013, Tacoma Rail realized a change in net position of \$1.9 million, compared to \$2.2 million in 2012, a decrease of \$0.3 million. The decrease in net position was due to an increase of \$3.9 million in operating revenues, an increase of \$3.6 million in operating expenses, a decrease of \$0.1 million in non-operating revenues, a decrease of \$0.3 million in contributions, and an increase of \$0.3 million in transfers out.

The following table highlights Tacoma Rail's past three years' operating results.

OPERATING RESULTS (in thousands)

Description	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Operating Revenues	\$ 29,457	\$ 26,943	\$ 23,044	\$ 2,514	\$ 3,899
Operating Expenses	26,563	23,782	20,191	2,781	3,591
Operating Income	2,894	3,161	2,853	(267)	308
Net Non-Operating Revenues	991	980	1,047	11	(67)
Contributions	878	—	255	878	(255)
Transfers Out	(2,751)	(2,273)	(1,952)	(478)	(321)
Net Operating Income	\$ 2,012	\$ 1,868	\$ 2,203	\$ 144	\$ (335)

Net position may serve over time as a useful indicator of a company's financial position. The following analysis highlights net position for the last three years.

STATEMENTS OF NET POSITION (in thousands)

Description	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Capital Assets (Net)	\$ 21,059	\$ 18,016	\$ 16,259	\$ 3,043	\$ 1,757
Current and Other Assets	\$ 16,029	\$ 13,027	\$ 11,795	\$ 3,002	\$ 1,232
Total Assets	\$ 37,088	\$ 31,043	\$ 28,054	\$ 6,045	\$ 2,989
Net Investments in Capital Assets	\$ 16,023	\$ 14,797	\$ 13,401	\$ 1,226	\$ 1,396
Restricted Net Position	65	65	397	—	(332)
Unrestricted Net Position	8,142	7,356	6,552	786	804
Total Net Position	24,230	22,218	20,350	2,012	1,868
Long-Term Debt, net of current maturities	4,483	2,765	2,167	1,718	598
Current and Long Term Liabilities	8,375	6,060	5,537	2,315	523
Total Liabilities	12,858	8,825	7,704	4,033	1,121
Total Net Position & Liabilities	\$ 37,088	\$ 31,043	\$ 28,054	\$ 6,045	\$ 2,989

Revenues

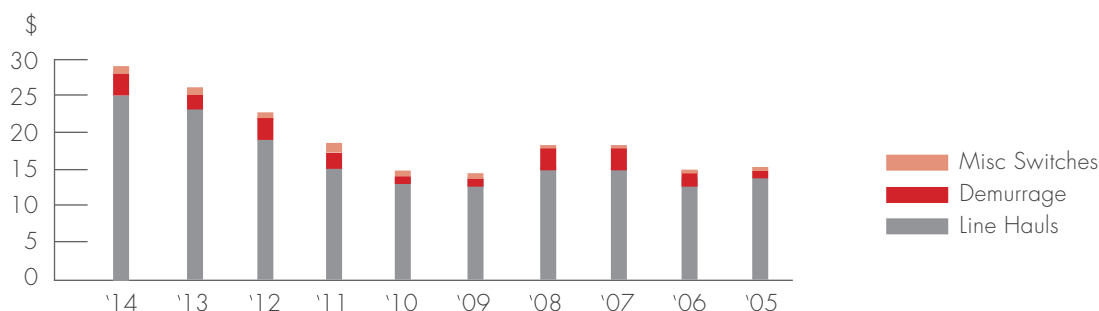
2014 Compared to 2013

In 2014, Tacoma Rail operating revenues of \$29.5 million were \$2.5 million higher than the \$26.9 million in 2013. Overall switching revenues increased \$1.9 million (7.8%), from 2013. The following table summarizes the switching revenues by activity type for the last two years.

Activity Types	Rail Cars				Switching Revenues (in thousands)			
	2014	2013	Var	% Chg	2014	2013	Var	% Chg
Intermodal Line Hauls	69,872	64,981	4,891	7.5%	\$ 11,324	\$ 11,317	\$ 7	0.1%
Commercial Line Hauls	32,096	29,933	2,163	7.2%	12,215	10,862	1,353	12.5%
Capital Div. Line Hauls	3,111	2,622	489	18.7%	1,395	1,179	216	18.3%
Miscellaneous Switches	3,058	1,830	1,228	67.1%	1,561	1,213	348	28.7%
Total Line Hauls	108,137	99,366	8,771	8.8%	\$ 26,495	\$ 24,571	\$ 1,924	7.8%

Demurrage and other operating revenues also increased \$590,000. Demurrage revenue increased by \$522,000 and locomotive servicing revenue and other revenue increased \$68,000. The increase in demurrage revenue was primarily due to the extended negotiations over a new labor contract between the Pacific Maritime Association and the International Longshore and Warehouse Union. This was a contributing factor in container movement and caused a delay in railcars being unloaded within the demurrage tariff's credited timeframes.

OPERATING REVENUES (in millions)



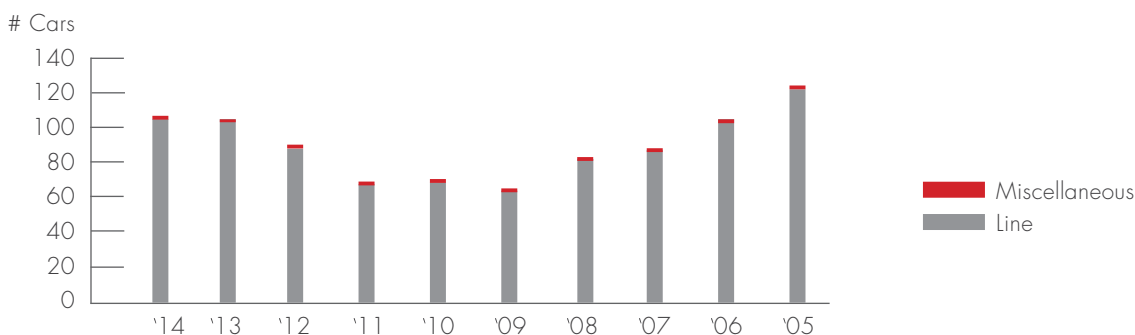
2013 Compared to 2012

In 2013, Tacoma Rail operating revenues of \$26.9 million were \$3.9 million higher than the \$23.0 million in 2012. This was the result of a \$3.8 million increase in switching revenues and a \$0.1 million increase in demurrage and other operating revenues.

Switching Activities

Switching activities increased in 2014 by 8,771 cars (8.8%) to 108,137, from 99,366 in 2013. The most significant increase in switching activity can be seen in intermodal line-hauls which were up by 4,891 cars (7.5%) due to an increase in intermodal rail traffic. The average number of cars switched over the last ten years is 88,183.

SWITCHING ACTIVITIES (in thousands)



During 2013, total switching activities increased by 7,249 cars (7.9%) from 2012. The increase in intermodal rail traffic was the dominant factor. Intermodal line-hauls were up by 7,982 cars (8.0%) in 2013. The table below shows the changes in switching volumes for the last three years.

SWITCHING ACTIVITIES

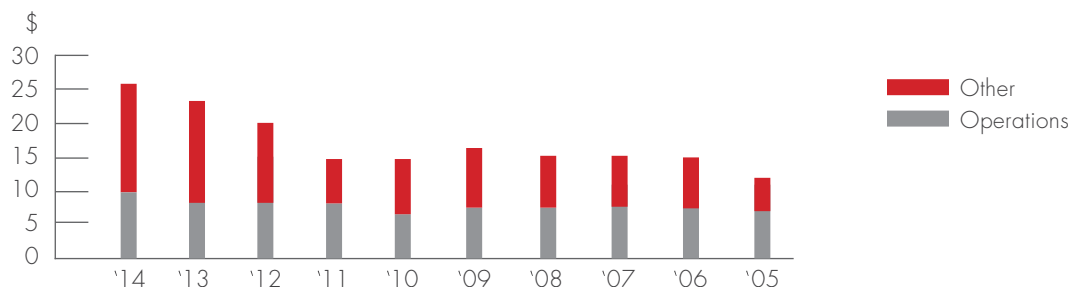
Description	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Line Hauls	105,079	97,536	89,554	7,543	7,982
Miscellaneous Switches	3,058	1,830	2,563	1,228	(733)
Total Cars Switched	108,137	99,366	92,117	8,771	7,249

Expenses

2014 Compared to 2013

In 2014, Tacoma Rail operating expenses of \$26.6 million were \$2.8 million higher than the \$23.8 million in 2013. This was primarily due to an increase of \$1.4 million in salaries and wages and increase of \$1.4 million in supplies and expenses. Salaries and wages were higher in 2014 due to 8 new personnel and an increase in overtime in response to increased traffic volume and for the new BNSF locomotive servicing agreement.

OPERATING EXPENSES (in millions)



The increase in supplies and expenses was mainly attributable to an increase in external services of \$.7 million and an increase of \$.4 million in equipment and supplies. Incurred but not reported (IBNR) claims increased \$.3 million in 2014 from \$1.1 million in 2013.

2013 Compared to 2012

In 2013, Tacoma Rail operating expenses of \$23.8 million were \$3.6 million higher than the \$20.2 million in 2012. This was primarily due to an increase of \$0.7 million in salaries and wages and increases of \$2.6 million in supplies and expenses. Salaries and wages were higher in 2013 due to 11 additional FTE's in response to increased traffic volume and the annual wage increase per labor contracts. The increase in supplies and expenses were mainly attributable to the volume incentive allowance and IBNR claims. Volume incentive allowance was \$2.1 million compared to \$1.2 million in 2012, a \$0.9 million increase in 2013. IBNR claims increased \$1.3 million in 2013 from (\$0.2) million in 2012. Capitalized A&G decreased \$0.4 million due to less spending on capital projects compared to 2012. Depreciation increased \$0.2 million due to an increase in depreciable assets of \$3.4 million compared to 2012.

Capital Assets

Total Capital Assets increased \$3.8 million during 2014. This increase was reflected primarily in road property plant which increased by \$3.7 million due to track upgrades, switch replacements and the installation of the U.S. Oil WYE track. Buildings increased \$0.1 million due to camera security system upgrade, lighting facility upgrade and parking lot asphalt relay.

During 2013, total Capital Assets increased \$2.1 million. This increase was reflected primarily in road property plant which increased by \$1.1 million mainly due to replacing rail and ties at various locations to improve up-keep and operational safety conditions. Machinery and equipment increased \$0.1 million mainly due to a locomotive simulator purchase.

The following table summarizes Tacoma Rail's capital assets, net of accumulated depreciation, for the last three years.

CAPITAL ASSETS, NET OF ACCUMULATED DEPRECIATION (in thousands)

Description	2014	2013	2012	13/12 Increase (Decrease)	13/12 Increase (Decrease)
Land	\$ 160	\$ 160	\$ 160	\$ –	\$ –
Road Property Plant	10,926	7,687	6,566	3,239	1,121
Building	1,711	1,754	1,757	(43)	(3)
Machinery Equipment	7,102	7,693	7,567	(591)	126
Office and Fixture	160	21	206	139	(185)
Construction Work in Progress	1,000	701	3	299	698
Total Net Plant and Properties	\$ 21,059	\$ 18,016	\$ 16,259	\$ 3,043	\$ 1,757

Additional information on Tacoma Rail's capital assets can be found in Note 3 to the Financial Statements.

Debt Administration

In 2014, Tacoma Rail obtained one new Washington State loan from the Department of Transportation for SR-509 Track Rebuild in the amount of \$1,037,012 from which no funds have been drawn. Draws were taken in 2014 on Yard Tracks 8 & 9, N. Intermodal Yard Lead Track, East Loop 17th St and Taylor Way in the amounts of \$618,626, \$366,387, \$773,070 and \$510,265 respectively.

In 2013, Tacoma Rail obtained one new Washington State loan from the Department of Transportation for Port Pass in the amount of \$247,500. In addition, Tacoma Rail entered into \$823,227, \$366,387, \$773,070, \$1,105,074 and \$515,789 of Washington State loans in 2013 to replace Yard Tracks 8 & 9, N. Intermodal Yard Lead Track, East Loop, Taylor Way and West Loop, respectively, from which no funds have been drawn. Draws were taken in 2013 on East 11th Street Crossing and Yard Tracks 5&6 in the amounts of \$347,320 and \$363,938 respectively.

The following table shows the outstanding long-term debt balances for the past three years. Additional information on Tacoma Rail's long-term debt can be found in Note 4 to the Financial Statements.

LONG-TERM DEBT (in thousands)

	2014	2013	2012	14/13 Increase (Decrease)	13/12 Increase (Decrease)
Long-Term Debt Balance, December 31	\$5,036	\$3,219	\$2,858	\$1,817	\$361

Debt Service Coverage

Tacoma Rail is required by its bond covenants to maintain a 1.25 times debt service coverage. In 2014, principal and interest were covered 19.16 times compared to 19.73 times in 2013 and 18.14 times in 2012.

Summary

The management of the Finance Department of the City of Tacoma is responsible for preparing the accompanying financial statements and for their integrity. We prepared the financial statements according to GAAP in the United States of America, and they fairly portray Tacoma Rail's financial position and operating results. The Notes to Financial Statements are an integral part of the basic financial statements and provide additional financial information. The financial statements have been audited by Moss Adams LLP. 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 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

2014

FINANCIAL REPORTS

STATEMENTS OF NET POSITION

December 31,

ASSETS	2014	2013
CAPITAL ASSETS		
Road and Equipment Property	\$ 36,412,953	\$ 32,599,709
Less Accumulated Depreciation	(16,354,584)	(15,285,319)
Total	20,058,369	17,314,390
Construction Work in Progress	1,000,440	701,285
Net Capital Assets	21,058,809	18,015,675
SPECIAL FUNDS		
Debt Service Funds	65,104	65,110
Total Special Funds	65,104	65,110
CURRENT ASSETS		
Cash and Equity in Pooled Investments	10,043,524	7,374,004
Customer Accounts Receivable (Net of Allowance for Doubtful Accounts of \$86,940 in 2014 and \$117,012 in 2013)	2,861,792	2,479,261
Grants Receivable	81,966	—
Interfund Receivable	103,243	81,455
Prepayments	1,988,311	2,187,428
Materials and Supplies Inventory	885,400	839,670
Total Current Assets	15,964,236	12,961,818
TOTAL ASSETS	\$ 37,088,149	\$ 31,042,603

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

NET POSITION AND LIABILITIES

	December 31,	
	2014	2013
NET POSITION		
Net Investment in Capital Assets	\$ 16,023,002	\$ 14,796,854
Restricted for:		
Debt Service	65,104	65,110
Unrestricted	8,142,084	7,356,215
TOTAL NET POSITION	24,230,190	22,218,179
LONG-TERM DEBT, NET OF CURRENT MATURITIES		
2006 Senior Lien Revenue Bond	312,763	548,332
State Loans	4,170,038	2,216,627
Total Long-Term Debt	4,482,801	2,764,959
CURRENT LIABILITIES		
Accounts Payable	1,244,449	1,106,566
Customer Deposits	45,900	54,300
Wages Payable and Compensated Absences	547,113	450,774
Unemployment and Other Tax Payables	281,435	230,058
Volume Incentive Payable	916,666	791,668
Current Portion of Long-Term Debt	553,006	453,862
Interest Payable	7,389	10,398
Interfund Payable	500,287	134,653
Total Current Liabilities	4,096,245	3,232,279
LONG-TERM LIABILITIES		
On the Job Injury Reserve	696,783	647,158
Long-Term Portion of Compensated Absences	912,353	697,546
Other Post Employment Benefits	363,064	261,551
Incurred but not Reported Claims	2,306,713	1,220,931
Total Long-Term Liabilities	4,278,913	2,827,186
TOTAL LIABILITIES	12,857,959	8,824,424
TOTAL NET POSITION AND LIABILITIES	\$ 37,088,149	\$ 31,042,603

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES
IN NET POSITION**

	Year Ended December 31,	
	2014	2013
OPERATING REVENUES		
Switching Revenues	\$ 26,495,108	\$ 24,570,867
Demurrage and Other Operating Revenues	2,962,289	2,372,435
Total Operating Revenues	29,457,397	26,943,302
OPERATING EXPENSES		
Maintenance of Way and Structures	2,745,664	2,291,652
Mechanical	4,116,105	3,510,327
Operations	10,810,206	9,630,427
Administration	7,391,559	6,915,862
Taxes - State	429,875	437,282
Depreciation	1,069,265	996,782
Total Operating Expenses	26,562,674	23,782,332
Net Operating Income	2,894,723	3,160,970
NON-OPERATING REVENUES (EXPENSES)		
Interest Income	72,535	21,155
Miscellaneous	952,326	1,004,957
Interest Expense	(34,122)	(45,941)
Total Non-Operating Revenues	990,739	980,171
Contributions - Grants	81,966	—
Contributions - Others	795,741	—
Total Contributions	877,707	—
Transfers		
City of Tacoma Gross Earnings Tax	(2,440,631)	(2,240,525)
Transfers to Other Funds	(310,527)	(32,407)
Total Transfers	(2,751,158)	(2,272,932)
CHANGE IN NET POSITION	2,012,011	1,868,209
TOTAL NET POSITION - BEGINNING OF YEAR	22,218,179	20,349,970
TOTAL NET POSITION - END OF YEAR	\$ 24,230,190	\$ 22,218,179

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

STATEMENTS OF CASH FLOWS**Year Ended December 31,
2014 2013****CASH FLOWS FROM OPERATING ACTIVITIES**

Cash from Customers	\$ 28,962,712	\$ 27,198,605
Cash Paid to Suppliers	(9,313,504)	(12,519,357)
Cash Paid to Employees	(13,420,062)	(9,111,300)
Taxes Paid	(378,498)	(620,398)
Net Cash Provided by Operating Activities	5,850,648	4,947,550

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES

Transfers to Other Funds	(2,751,158)	(2,272,932)
Net Cash Used in Non-Capital Financing Activities	(2,751,158)	(2,272,932)

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Capital Expenditures, Net	(4,112,399)	(2,753,531)
Principal Payments on Long-Term Debt	(453,862)	(702,097)
Interest Paid	(37,131)	(49,776)
Proceeds from Capital Contributions	877,707	–
Proceeds from Long-Term Debt	2,270,848	1,062,439
Proceeds from Other Non-Operating Revenues	952,326	1,004,957
Net Cash Used in Capital and Related Financing Activities	(502,511)	(1,438,008)

CASH FLOWS FROM INVESTING ACTIVITIES

Interest on Investments	72,535	21,155
Net Cash Provided by Investing Activities	72,535	21,155

Net Increase in Cash and Equity in Pooled Investments	2,669,514	1,257,765
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Cash and Equity in Pooled Investments at January 1	7,439,114	6,181,349
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Cash and Equity in Pooled Investments at December 31	\$ 10,108,628	\$ 7,439,114
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The accompanying notes are an integral part of these financial statements.

**Reconciliation of Operating Income to
Net Cash Provided by Operating Activities**

	Year Ended December 31,	
	2014	2013
Operating Income	\$ 2,894,723	\$ 3,160,970
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation	1,069,265	996,782
Cash provided from changes in operating assets and liabilities:		
Accounts and Grants Receivable	(464,497)	(90,909)
Interfund Receivable	(21,788)	353,411
Materials and Supplies Inventory	(45,730)	(222,734)
Prepayments	199,117	(13,635)
Accounts Payable	137,883	491,863
Customer Deposits	(8,400)	(7,200)
Unemployment and Other Tax Payables	51,377	(183,116)
Wages Payable	72,472	56,891
Volume Incentive Payable	124,998	(416,665)
Interfund Payable	365,634	(382,268)
Accrued Compensated Absences	238,674	(55,926)
Other Long-Term Liabilities & OJI Reserve	1,236,920	1,260,086
Total Adjustments	2,955,925	1,786,580
Net Cash Provided by Operating Activities	\$ 5,850,648	\$ 4,947,550

Reconciliation of Cash and Equity in Pooled Investments to Balance Sheet:

Cash and Equity in Pooled Investments in Special Funds	\$ 65,104	\$ 65,110
Cash and Equity in Pooled Investments in Operating Funds	10,043,524	7,374,004
Cash and Equity in Pooled Investments at December 31	\$ 10,108,628	\$ 7,439,114

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2014 AND 2013

NOTE 1 / OPERATIONS

Operations of Tacoma Rail - Tacoma Rail (the Division) is a division of the City of Tacoma, Department of Public Utilities, which also operates the Light and the Water Divisions and is included as an enterprise fund in the Comprehensive Annual Financial Report (CAFR) of the City. Tacoma Rail provides rail switching services to the Port of Tacoma and major Tacoma industries under its Tidelands Division. Tacoma Rail also provides rail service from its Capital Division. The Capital Division interchanges rail cars with BNSF in East Olympia. No traffic for the Capital Division enters Tacoma Rail's Tidelands infrastructure. In addition, Tacoma Rail manages the Mountain Division which is a reporting unit within Public Works and is included in the CAFR. Tacoma Rail is reimbursed for direct expenses. An operating agreement between Tacoma Rail and the Mountain Division is in place through 2016.

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 GAAP issued by the Governmental Accounting Standards Board (GASB) applicable to governmental entities that use proprietary fund accounting. The financial statements use a flow of economic resources measurement focus to determine financial position and the change in financial position. The accounting principles used are similar to those applicable to businesses in the private sector and are maintained on the accrual basis of accounting. Revenues are recognized when earned, and costs and expenses are recognized when incurred.

Cash and Equity in Pooled Investments - The Division's 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.

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 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 LGIP and/or a Municipal Investor interest bearing demand deposit account maintained with U.S. Bank.

The Division's equity in that portion of City Tacoma Investment Pool held in qualified public depositories at December 31, 2014 and 2013 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 FDIC insurance up to \$250,000. All deposits not covered by the FDIC are covered by the WSPDPC. The WSPDPC is a statutory authority established under RCW 39.58. It constitutes a fully insured or fully collateralized pool. The LGIP is authorized by RCW 43.250. The LGIP operated like a 2A7 fund and is collateralized by short-term legal investments.

Customer Accounts Receivable - 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.

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 funds at year-end are recorded as due to or due from other funds.

Materials 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.

Special Funds - 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.

Capital Assets and Depreciation - Capital assets are 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 the straight-line method at the beginning of the year and based on estimated economic lives of operating assets placed in service as follows:

Roads RR & bridges	7 – 20 years
Building	10 – 25 years
Machinery Equipment	10 – 25 years
Office and Fixture	5 – 20 years

Construction Work in Progress - Capitalizable costs incurred on projects which are not in service or ready for use are held in construction work 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.

Contributions - In accordance with GASB No. 33, Accounting and Financial Reporting for Non-exchange Transactions, grants and contributions are recorded as contribution revenue.

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 Revenues - Service rates are authorized by the Tacoma City Council. Revenues are recognized as earned and include an estimate of revenue earned but not billed to customers as of year-end. Revenues are based on services rendered through the end of the year.

Non-Operating Revenues and Expenses - These are items that do not qualify as operating defined above.

Taxes - The City charges the Division Gross Earnings Tax at the rate of 8.0%. In addition, the Division pays business and occupation tax to the State at the rate of 1.8% on service 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 and 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 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".

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.

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 allowance for doubtful accounts, accrued compensated absences, depreciation, Other Post-Employment Benefits (OPEB), self-insurance liabilities and other contingencies. Actual results may differ from these estimates.

On the Job Injury Reserve - Liabilities for claims are initially recorded when the expected loss is both probable and reasonably estimated. Subsequent adjustments to initial estimates are recorded as necessary based upon additional information developed in subsequent periods. Liabilities recorded for unasserted on the job injury claims are based on information currently available. Estimates of liabilities for on the job injury claims are undiscounted.

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, general economic conditions, fuel supply availability and rising fuel prices, weather and natural disaster-related disruptions, collective bargaining labor disputes, federal government regulations such as Federal Railroad Administration and Environmental Protection Agency or orders concerning the operation, maintenance and/or licensing of facilities, transportation of chemicals and other hazardous materials, acts of terrorism, war, or risk of war.

NOTE 3 / CAPITAL ASSETS

A summary of the balances and changes in capital assets for 2014 and 2013 follows:

	Balance December 31, 2013	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2013
Land	\$ 160,456	\$ –	\$ –	\$ –	\$ 160,456
Road Property Plant	17,433,535	3,706,335	–	–	21,139,870
Building	3,789,678	106,909	–	–	3,896,587
Machinery Equipment	10,353,086	–	–	–	10,353,086
Office and Fixture	862,954	–	–	–	862,954
Total Capital Assets In Service	32,599,709	3,813,244	–	–	36,412,953
Less Accumulated Depreciation	(15,285,319)	(1,069,265)	–	–	(16,354,584)
	17,314,390	2,743,979	–	–	20,058,369
Construction Work In Progress	701,285	4,112,398	–	(3,813,243)	1,000,440
Net Capital Assets	\$ 18,015,675	\$ 6,856,377	\$ –	\$ (3,813,243)	\$ 21,058,809

	Balance December 31, 2012	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2013
Land	\$ 160,456	\$ –	\$ –	\$ –	\$ 160,456
Road Property Plant	15,896,510	1,534,020	–	3,005	17,433,535
Building	3,654,376	135,302	–	–	3,789,678
Machinery Equipment	9,811,502	379,067	–	162,517	10,353,086
Office and Fixture	1,021,260	7,216	–	(165,522)	862,954
Total Capital Assets In Service	30,544,104	2,055,605	–	–	32,599,709
Less Accumulated Depreciation	(14,288,537)	(996,782)	–	–	(15,285,319)
	16,255,567	1,058,823	–	–	17,314,390
Construction Work In Progress	3,359	2,753,532	–	(2,055,606)	701,285
Net Capital Assets	\$ 16,258,926	\$ 3,812,355	\$ –	\$ (2,055,606)	\$ 18,015,675

NOTE 4 / LONG-TERM DEBT

Long-term debt activities for 2014 and 2013 were as follows:

	Balance December 31, 2013	Additions	Reductions	Balance December 31, 2014	Due Within One Year
Senior Lien Bond:					
2006 Revenue Bond	\$ 771,620	\$ –	\$ 223,288	\$ 548,332	\$ 235,569
Junior Lien Debts:					
Locomotive Idling Improvements State Loan	19,349	–	1,759	17,590	1,759
Locomotive Servicing Facility State Loan	199,562	–	16,630	182,932	16,630
Locomotive Repower State Loan	405,000	–	45,000	360,000	45,000
Annie 1 & 2 Tracks State Loan	550,800	–	61,200	489,600	61,200
Yard Tracks 2, 3, & 4 State Loan	313,732	–	34,859	278,873	34,859
Yard Tracks 5, & 6 State Loan	363,938	–	36,394	327,544	36,394
E 11th St Crossing State Loan	347,320	–	34,732	312,588	34,732
Port Pass West State Loan	247,500	2,500	–	250,000	25,000
Yard Tracks 8 & 9 State Loan	–	618,626	–	618,626	61,863
N. Intermodal Yard Lead Track State Loan	–	366,387	–	366,387	–
East Loop 17th St State Loan	–	773,070	–	773,070	–
Taylor Way Track Rehab & Ext. State Loan	–	510,265	–	510,265	–
Total Long-Term Debt	\$ 3,218,821	\$ 2,270,848	\$ 453,862	\$ 5,035,807	\$ 553,006

	Balance December 31, 2012	Additions	Reductions	Balance December 31, 2013	Due Within One Year
Senior Lien Bond:					
2006 Revenue Bond	\$ 983,268	\$ –	\$ 211,648	\$ 771,620	\$ 223,288
Junior Lien Debts:					
2003 Revenue Bond	331,000	–	331,000	–	–
Locomotive Idling Improvements State Loan	21,109	–	1,760	19,349	1,759
Locomotive Servicing Facility State Loan	216,192	–	16,630	199,562	16,630
Locomotive Repower State Loan	450,000	–	45,000	405,000	45,000
Annie 1 & 2 Tracks State Loan	612,000	–	61,200	550,800	61,200
Yard Tracks 2, 3, & 4 State Loan	244,910	103,681	34,859	313,732	34,859
Yard Tracks 5, & 6 State Loan	–	363,938	–	363,938	36,394
E 11th St Crossing State Loan	–	347,320	–	347,320	34,732
Port Pass West State Loan	–	247,500	–	247,500	–
Total Long-Term Debt	\$ 2,858,479	\$ 1,062,439	\$ 702,097	\$ 3,218,821	\$ 453,862

SENIOR LIEN BOND:

City Council Substitute Ordinance No. 27545, passed in November 2006, authorized the issuance of a Senior Lien Revenue Bond 2006 in the amount of \$2,000,000 to provide financing for capital projects included in the approved 2007-2008 Biennium budget for the Rail System. This Bond bears interest at the rate of 5.39% per annum (computed on the basis of a 360-day year of twelve 30-day months), with a maturity date of January 1, 2017. Equal installment payments of \$65,104 representing principal and interest on this Bond are payable quarterly on the first day of each January, April, July and October, commencing April 1, 2007, up to and including the Maturity Date of the Bond.

Scheduled principal maturities on bonds and interest payments are as follows:

	Principal	Interest
2015	\$ 235,569	\$ 24,847
2016	\$ 248,525	\$ 11,891
2017	\$ 64,238	\$ 866
	\$ 548,332	\$ 37,604

JUNIOR LIEN DEBTS:

In June 2003, City Council Resolution No. 27099 authorized the issuance of a Junior Lien Revenue Bond 2003 (Tacoma Rail Taxable Line of Credit) in the amount of \$3,310,000, with a maturity date of January 1, 2013.

During 2009, Tacoma Rail obtained two 15-year interest free Washington State loans from the Department of Transportation for locomotive idling improvements and locomotive servicing facility upgrades in the amounts of \$26,000 and \$249,000, respectively. The Idling Improvement loan will mature on July 1, 2024, with an annual principal payment of \$1,759, commencing July 1, 2010. The Facility Upgrade loan has a \$16,630 annual principal repayment schedule beginning in 2011 and matures on July 1, 2025.

During 2011, Tacoma Rail obtained 10-year interest free Washington State loan from the Department of Transportation for locomotive repower in the amount of \$450,000. The Locomotive Repower will mature on May 1, 2022, with an annual principal payment of \$45,000, commencing May 1, 2013.

During 2012, Tacoma Rail obtained two 10-year interest free Washington State loans from the Department of Transportation for replacement of Annie tracks 1 and 2 and yard tracks 2, 3, and 4 in the amounts of \$612,000 and \$244,910, respectively. The Annie 1 & 2 Tracks loan will mature on June 1, 2022, with annual principal payment of \$61,200, commencing June 1, 2013. The Yard Tracks 2, 3, & 4 loan has a \$34,859 annual principal repayment schedule beginning in 2013 and matures on July 1, 2022.

During 2013 an additional draw was made on 2012 yard tracks 2, 3 and 4 loan in the amount of \$103,681. Tacoma Rail obtained three additional 10-year interest free Washington State loans from Department of Transportation for East 11th Street Crossing, Yard Tracks 5&6 and Port Pass in the amounts of \$347,320, \$363,938 and \$247,500 respectively. The East 11th Street Crossing loan will mature on May 1, 2023, with annual principal payments of \$34,732, commencing May 1, 2014. The Yard Tracks 5 & 6 loan has a \$36,394 annual principal repayment schedule beginning in 2014 and matures on July 1, 2023. The Port Pass loan has a \$25,000 annual repayment schedule beginning in 2015 and matures on June 1, 2024.

Tacoma Rail obtained the following five additional 10-year interest free Washington State loans from Department of Transportation in 2014.

	Repayment Schedule	Loan Amount	Amount Drawn 2014	Annual Payment
Yard Tracks 8 & 9	4/2015 - 4/2024	\$ 618,626	\$ 618,626	\$ 61,863
N. Intermodal Yard Lead Track	5/2016 - 5/2025	366,387	366,387	36,639
East Loop 17th St	8/2016 - 8/2025	773,070	773,070	77,307
Taylor Way Track Rehab & Ext.	9/2016 - 9/2025	1,105,074	510,265	51,026
SR509 Track Improvement	11/2016 - 11/2025	1,037,012	—	—

Scheduled principal maturities on junior lien debts and interest payments are as follows:

	Principal	Interest
2015	\$ 317,437	\$ —
2016	482,409	—
2017	482,409	—
2018	482,409	—
2019	482,409	—
2020 - 2024	2,058,800	—
2025	181,602	—
	\$ 4,487,475	\$ —

Tacoma Rail's revenue bonds are secured by the net revenue of Tacoma Rail and all cash and investments held in the bond fund. The bonds as well as junior liens are subject to certain financial and non-financial covenants.

NOTE 5 / SIGNIFICANT CUSTOMER

Tacoma Rail's predominate sources of revenue are Union Pacific (UP) and Burlington Northern Santa Fe (BNSF). Revenue from UP and BNSF represented 26% and 48% of total revenues, respectively, in 2014. Revenue in 2013 was 26% and 60%, respectively. Accounts receivable from UP and BNSF in 2014 represented 21% and 45% of total customer accounts receivable, respectively. Accounts receivable in 2013 was 24% and 52%, respectively.

NOTE 6 / 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.

Tacoma Rail pays the Fleet Services Fund for the use of the vehicles and equipment to cover fleet operating expenses. Payments made by Tacoma Rail in 2014 and 2013 were \$502,723 and \$483,567, respectively.

NOTE 7 / SELF-INSURANCE FUND

Department of Public Utilities maintains a self-insurance program and insurance policies. The Department has established a self-insurance fund to insure Tacoma Rail and other divisions within the Department for certain losses arising from personal and property damage claims by third parties. The major risks to Tacoma Rail 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 Rail is required to make payments to the Self-Insurance Fund to cover claims incurred by Tacoma Rail and administrative expenses of the Fund. Tacoma Rail's premium payments totaled \$50,004 in 2014 and \$50,004 in 2013. Assets in the Self-Insurance Fund total \$6.2 million which exceeds accrued and incurred but not reported (IBNR) liabilities. Tacoma Rail's IBNR portion in the Self-Insurance Fund is \$2.3 million in 2014. Equity in the Self-Insurance Fund is transferred to the appropriate operating divisions in accordance with GASB 10. Management believes Tacoma Rail's investment in the Self-Insurance Fund is more than adequate to settle all its known or estimated claims.

The City purchased a \$15 million Fiduciary Liability Policy with a \$100,000 deductible that provides for wrongful acts arising out of the administration of the City's employee benefit programs and a \$1.0 million Crime policy for employee dishonesty and for fraudulent or dishonest act by employees against the City 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 Department's total liability limit is \$60 million any one occurrence and \$60 million annual aggregate. The general government comprehensive liability policies provide \$15 million of excess coverage with \$3.0 million retention. The City has a policy to cover extraordinary worker's compensation claims with a statutory limit (\$1 million self insured retention).

NOTE 8 / PENSION PLAN

Employees of Tacoma Rail are members of the United States Railroad Retirement System, in lieu of participating in Social Security and Tacoma Employees' Retirement System. The Railroad Retirement System is a payroll-based system. In 2014 and 2013, Tacoma Rail contributed \$1,859,639 and \$1,711,105, respectively, per structures set forth by the United States Railroad Retirement Board shown as follows:

Earnings Base

	2014	2013
Employer Tier I	\$ 117,000	\$ 113,700
Employer Tier II	87,000	84,300
Employer Medicare	No Limit	No Limit

Tax Rate

	2014	2013
Employer Tier I	6.20%	6.20%
Employer Tier II	12.60%	12.60%
Employer Medicare	1.45%	1.45%

Information was unavailable to determine if an actuarial liability exists for the City, but the entire Federal system has an unfunded actuarial liability of \$50.6 billion as of December 31, 2010. There is currently no schedule to amortize the unfunded liability and the system is currently functioning on a pay-as-you-go basis. Rates are determined based on actuarial valuations, which occur every three years. The City's obligation is to pay, in full, the payroll withholdings to the system.

NOTE 9 / 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. GAAP requires 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 (3.75%).

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 is required to report as an expense for the year. The ARC is equal to the Normal Cost plus an amount to amortize the Unfunded Actuarial Accrued Liability (UAAL) on a closed basis of 30 years, beginning January 1, 2007. The amortization period for 2014 is 23 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 noncurrent liability (Net OPEB Obligation) on the statements of net position. The City has a Net OPEB Obligation as of December 31, 2014 as the City has not set aside funds for OPEB.

Excise Tax for High Cost or "Cadillac" Health Plans in 2018 and Beyond - An excise tax for high cost health coverage or "Cadillac" health plans was included in the Affordable Care Act (ACA) passed into law in March 2010. The provision levies a 40% tax on the value of health plan costs that exceed certain thresholds for single coverage or family coverage. The 2018 annual thresholds for qualified retirees aged 55-64 are \$11,850 for single coverage and \$30,950 for a family plan. If, between 2010 and 2018, the cost of health care insurance rises more than 55%, the threshold for the excise tax will be adjusted.

The City believes that the current provisions of ACA should be reflected in the projection of benefits and therefore, the value of the excise tax is included in the valuation. It is assumed that there will be no changes to the current law and that there will be no changes in plan design to help mitigate the impact of the tax.

GASB Statement No. 45 indicates that the projection of benefits should include all benefits to be provided to retirees in accordance with the current "substantive" plan. The substantive plan refers to the plan terms as understood by the employer and plan members at the time of the valuation. For this reason, the City believes that the current provisions of PPACA should be reflected in the projection of benefits and therefore, the value of the excise tax is included in this valuation. It is assumed that there will be no changes to the current law and that there will be no changes in plan design to help mitigate the impact of the tax.

Summary of Changes - As of the January 1, 2013 valuation the total AAL was \$251,839,846, 3% lower than expected primarily due to lower than expected medical costs partially offset by the new excise tax for "Cadillac" health plans, demographic experience and assumptions, and economic assumptions.

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

	<u>January 1, 2011</u>	<u>January 1, 2013</u>
Total membership:		
Active employees	3,675	3,335
Terminated vested employees	363	394
Retired employees & dependents	790	846
Total	4,828	4,575
Annual Benefit Payments	\$ 9,569,648	\$ 9,887,335
Discount rate	4.00%	3.75%
Present Value of Benefits (PVB)	\$ 319,550,419	\$ 326,742,538
Actuarial Accrued Liability (AAL)	\$ 248,571,791	\$ 251,839,846
Assets	\$ -	\$ -
Unfunded Actuarial Accrued Liability (UAAL)	\$ 248,571,791	\$ 251,839,846
Normal Cost	\$ 5,559,350	\$ 5,484,587
Annual Required Contribution (ARC)	\$ 19,734,040	\$ 20,058,760

The following table shows the total value of the benefits provided, the member paid premiums and the City paid benefits as of January 1, 2013.

Value of Subsidy at 3.75% Interest Rate	Total Value of Benefits	Member Paid Premiums	City Paid Benefits
Present Value of Benefits (PVB)	\$ 488,143,650	\$ 161,401,112	\$ 326,742,538
Actuarial Accrued Liability (AAL)	\$ 331,339,973	\$ 79,500,127	\$ 251,839,846
Normal Cost	\$ 11,227,919	\$ 5,743,332	\$ 5,484,587
Annual Benefit Payments	\$ 13,500,240	\$ 3,612,905	\$ 9,887,335

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, 2014. This is recorded within Other Deferred Credits.

	City	Division
Determination of Annual Required Contribution		
Normal Cost at Year-end	\$ 5,484,587	\$ 93,944
Amortization of UAAL	14,574,173	60,446
Annual Required Contribution (ARC)	\$ 20,058,760	\$ 154,390
Determination of Net OPEB Obligation		
Annual Required Contribution (ARC)	\$ 20,058,760	\$ 154,390
Interest on prior year Net OPEB Obligation	2,104,155	9,808
Adjustments to ARC	(2,842,971)	(11,073)
Annual OPEB Cost	19,319,944	153,125
Actual benefits paid	(9,292,539)	(51,612)
Increase in Net OPEB Obligation	10,027,405	101,513
Net OPEB Obligation – beginning of year	56,110,801	261,551
Net OPEB Obligation – end of year	\$ 66,138,206	\$ 363,064

The Division has included the liability in other long-term liabilities on the statement of Net Position.

Funded 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 for 2012 and 3.75% for 2013 and 2014.

Year Ended	Annual OPEB Cost		Benefits Paid		Net OPEB Obligation	
	City	Division	City	Division	City	Division
12/31/2012	\$19,469,177	\$ 195,524	\$ 9,393,431	\$ 102,935	\$ 46,469,368	\$ 182,685
12/31/2013	\$19,528,767	\$ 153,838	\$ 9,887,334	\$ 74,972	\$ 56,110,801	\$ 261,551
12/31/2014	\$19,319,944	\$ 153,125	\$ 9,292,539	\$ 51,612	\$ 66,138,206	\$ 363,064

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 is now 23 years.

Actuarial Methods and Significant Actuarial Assumptions:

Valuation Date	January 1, 2013												
Census Date	January 1, 2013												
Actuarial Cost Method	Entry Age												
Amortization Method	Combination of level percentage and level dollar amount, see note above.												
Remaining Amortization Period	23 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	3.75% for pay-as-you-go funding												
Medical Cost Trend	<table> <tr> <td>2013</td><td>8.9%</td></tr> <tr> <td>2014</td><td>6.5%</td></tr> <tr> <td>2015</td><td>5.8%</td></tr> <tr> <td>2020</td><td>6.0%</td></tr> <tr> <td>2030</td><td>5.9%</td></tr> <tr> <td>2040</td><td>5.6%</td></tr> </table> <p>The medical cost rate is assumed to continue grading downward until achieving the ultimate rate of 4.8% in 2083 and beyond. The first year trend reflects assumed increases based on ACA fees. These trend rates assume that, over time, deductibles and out-of-pocket maximums will be periodically increased as medical trends increase. The trends above do not reflect increases in costs due to the excise tax.</p>	2013	8.9%	2014	6.5%	2015	5.8%	2020	6.0%	2030	5.9%	2040	5.6%
2013	8.9%												
2014	6.5%												
2015	5.8%												
2020	6.0%												
2030	5.9%												
2040	5.6%												
Economic Assumptions-Discount Rate (Liabilities)	3.75%												
Demographic Assumptions:	<p>Eligibility:</p> <p>Disability - Five years of service are required for non-service connected disability.</p> <p>Retirement - TERS members are eligible for retiree medical benefits after becoming eligible for service retirement pension benefits (either reduced or full pension benefits):</p> <ul style="list-style-type: none"> • Age 55 with 10 years of service • 20 years of service 												

NOTE 10 / COMMITMENTS AND CONTINGENCIES

Link Petroleum Project Customer Deposit and Refund Agreement - A contractual agreement was entered in 2009 between Tacoma Rail and Link Petroleum, Inc. Link Petroleum agreed to advance Tacoma Rail \$75,000 for track improvements on Tacoma Rail's property to efficiently and safely handle shipments leading to this customer's service facility. In return, Tacoma Rail agreed to refund the advance to the customer at a rate of \$150 per carload for each of the first 500 carloads handled at the facility, or through December 31, 2015, whichever event first occurs. As of December 31, 2014, the remaining deposit is \$45,900.

General Legal Matters - Tacoma Rail is involved in various litigations in the normal course of business. In the opinion of management, the ultimate outcome of these claims will not have a material effect on Tacoma Rail's financial position beyond amounts already accrued as of December 31, 2014.

Tacoma Rail Operation of City of Tacoma, Department of Public Works ("Public Works"), Mountain Division - Public Works owns approximately 143 miles of track, called Mountain Division, that connects to Tacoma Rail track in Tacoma, Washington. Tacoma Rail is under contract with Public Works to perform as its operator through 2016. The agreement states that Public Works would fund Tacoma Rail for any operations on the Mountain Division.



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