



CONNECTIONS

TPU **2016** ANNUAL REPORT





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PHOTO CREDITS

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GRAPHIC DESIGN

Andra Freet Creative

FROM THE DIRECTOR

WILLIAM A. GAINES

Connecting with the community and with stakeholders was a prominent theme for Tacoma Public Utilities in 2016.

We made some organizational enhancements to enable us to more strongly connect with our customers and other stakeholders. We also continued our focus on the stability of the financial foundation that has served us well for more than a century.

On a national scale, we built up and relied on connections in the industry to maintain a strong voice for public power on key issues like tax-exempt financing, wholesale electricity markets, hydropower relicensing, distributed generation and cyber security. As a member of the Board of the American Public Power Association, I participated in conversations with members of Congress to ensure agencies like ours can continue to operate under thoughtfully crafted regulations that avoid undue burden on public power customers.

We also focused on regional issues that have an impact on our operations, like the evolving West Coast energy imbalance markets, water quality regulations and oil train safety. We strengthened our government relations focus and hired two new employees to connect and represent our customers' best interests at a local and state level.



As an organization that provides vital services, it's important for us to be prepared for and adapt to whatever circumstances come our way. This year offered many opportunities to test and strengthen those capabilities.

We joined other public and private entities in a three-state emergency planning exercise called Cascadia Rising. Two days of drills helped us identify what we're doing well and how we can improve if a major earthquake were to affect our area. We developed Tacoma Public Utilities' first continuity of operations plan, which outlines the available resources and needed actions if a natural or other disaster impacted us. We will modify the plan as we continue to assess and identify areas of strength and opportunities for improvement.

We tested our response capabilities in April when we detected high levels of lead in water samples following certain new testing procedures. Although our water was, and still is, safe to drink, we experienced a short period of scrutiny in the public spotlight. Our deep relationships with the state and county departments of health, as well as a careful and fact-based response by the media, helped reduce public fear of our water supply at a time when water quality was in the national news on a daily basis. We passed the test of customer confidence: Just weeks after this incident, we conducted our annual customer satisfaction survey. Despite the publicity around the testing

results, our scores improved in three key areas: being well managed, being a company our customers trust and showing care and concern for our customers.

Other customer satisfaction results showed that we're headed in the right direction. When looking at 21 key components of customer satisfaction, Tacoma Public Utilities scored in the top 10 among 90 of the largest private and public utilities in the country. In fact, we earned the top spot for the value of the product delivered and came in second for reasonableness of electric rates, providing reliable service and promptly fixing customer problems.

As is true for all utilities, one of the most regularly available tools for connecting with customers is our bill. In 2016, we took on the challenge of redesigning it to help customers more easily understand the services they are paying for and how much they pay for them.

TPU SCORED IN THE
TOP 10 AMONG 90 OF
THE LARGEST PRIVATE
& PUBLIC UTILITIES IN
THE COUNTRY

We were pleasantly surprised by the successful opportunity to connect with customers through one of Tacoma Power's key projects in 2016: community solar. To make the most of Washington state solar incentives, we built four, 75-kilowatt solar projects on the roof of our warehouse building. Starting in February, we offered customers the opportunity to purchase individual solar units and sold about 75% of those available to 727 customers in just a few days. More than 250 people attended a celebration of the project in August.

Since 1893, Tacoma Public Utilities has played a vital role in the economic health of our community. While we may not be a primary driver of economic development, we play a key supporting role. This year, we hired an expert to ensure coordination and participation with local and regional economic development agencies – with a goal of growing business and jobs in the areas we serve. In just a short time, we identified new opportunities to review our policies and expand our support for economic development in the region. By increasing focus in this area, we project benefits for all of our business lines and for the community.

We closed out the year with many successes, including a dozen awards from local and national groups. Some of the most notable include:

- **Outstanding Performance Award from the U.S. Department of Energy**
- **2016 Platinum Award for Utility Excellence from the Association of Metropolitan Water Agencies**
- **Outstanding Stewards of America's Waters Award from the National Hydropower Association**
- **Energy Efficiency Award for Innovation from the Northwest Energy Efficiency Alliance**
- **Washington State Governor's Volunteer Service Award for Employer-based Programs**

All of the accomplishments outlined here can be attributed to one thing: Tacoma Public Utilities' outstanding workforce. From the employees in the field who work all hours of the day in every type of weather to the folks in the office who manage finances and projects, work on strategic initiatives and take care of customers, I am proud to lead such a fine group of people.

I look forward to many more successes in the future.



PUBLIC UTILITY BOARD



MARK PATTERSON,
CHAIR

Mark is an attorney with the local law firm Vandeberg, Johnson & Gandara. He is on the personnel committee of Associated Ministries of Tacoma/Pierce County and is a current Strategic Planning Committee member and former board chair of Franke Tobey Jones. He joined the Public Utility Board in 2012.



MONIQUE TRUDNOWSKI,
VICE CHAIR

Monique 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.



WOODROW JONES,
SECRETARY

Woodrow 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 past president and current member of the Sunrise Rotary and a member of the Tacoma-Pierce County Black Collective. He is a past board member for the City Club of Tacoma and Associated Ministries.





BRYAN FLINT

Bryan is the executive director of the Greater Metro Parks Foundation. He is a member of Rotary No. 8 and Citizens for a Healthy Bay, as well as an American Leadership Foundation Senior Fellow. With 15 years in energy and environmental policy, he joined the Public Utility Board in 2011.



KAREN LARKIN

Karen, a former City of Tacoma and State of Washington employee, joined the board in 2015. She has a long history of public service, having served 31 years in Tacoma's city government and her last five years prior to retirement as an assistant director at the Washington State Department of Commerce.



MANAGEMENT TEAM



WILLIAM A. GAINES

Bill became the Director and CEO of Tacoma Public Utilities in 2007, after serving briefly as Tacoma Power superintendent. Bill has developed an exceptional record of success and accomplishment over the course of a 30-plus year utility industry career that has included senior executive roles at Seattle City Light and Puget Sound Energy. He is a member of the Executive Committee of the board of the American Public Power Association and is immediate past chair of the Large Public Power Council.



CHRIS ROBINSON

Chris was named superintendent and COO of Tacoma Power in 2015. During his 16-year tenure with Tacoma Power, Chris has served as power manager and assistant power manager. Prior to Tacoma Power, Chris worked as a consultant with multiple electrical utilities. Chris serves on the boards of the Public Power Council, River Partners and the Pacific Northwest Utilities Conference Committee.

LINDA MCCREA

Linda 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 as the water distribution manager for 13 years before that. Linda represents the Pacific Northwest Section on the national American Water Works Association Water Utility Council. She is also a co-chair of the Utility Management Committee for the Association of Metropolitan Water Agencies.



DALE KING

Dale 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. Dale is a certified member of the American Society of Transportation & Logistics, now a part of APICS. He is also chairman of the board of the World Trade Center Tacoma, a member of the Tacoma/Pierce County Workforce Development Council and a board member of the Pierce Center for Arts & Technology.



STEVEN HATCHER

Steve has served as Tacoma Public Utilities' Customer Services manager since 2006. He is responsible for front-line customer service, field investigations and meter reading, billing, mail delivery services, and low-income assistance programs. Steve has prior experience as a city administrator and is a retired United States Army officer with 20 years of military service. He is a member of the E Source Customer Experience Executive Council and the Pierce County Black Collective, and he serves on the board of several Pierce County nonprofit organizations.

ROBERT MACK

Bob joined Tacoma Public Utilities in 2007. As deputy director for Public Affairs and Communications, he oversees government relations, communications and customer research. Bob is a founding member of the Tacoma law firm Smith Alling and has also served in various offices of Washington state government. He is a board member of the Tahoma Audubon Society and a former member of the boards of the Washington Environmental Council, Point Defiance Zoological Society, City Club of Tacoma and Washington Trust for Historic Preservation.



JIM SANT


Jim was named deputy director for administration in 2012. His previous experience includes over 10 years of service at Puget Sound Energy, where he served as assistant treasurer and directed the utility's financial planning and analysis. Prior to that, he was the regional director of finance at Verizon Wireless. Jim is a member of the Washington State Society of Certified Public Accountants.





The image shows a large concrete dam with a series of buttresses, situated on a river. The water is calm, reflecting the dam and the surrounding green forested hills. A white hexagonal grid is overlaid on the entire image. In the center-right, a white hexagon contains the text "TACOMA POWER".

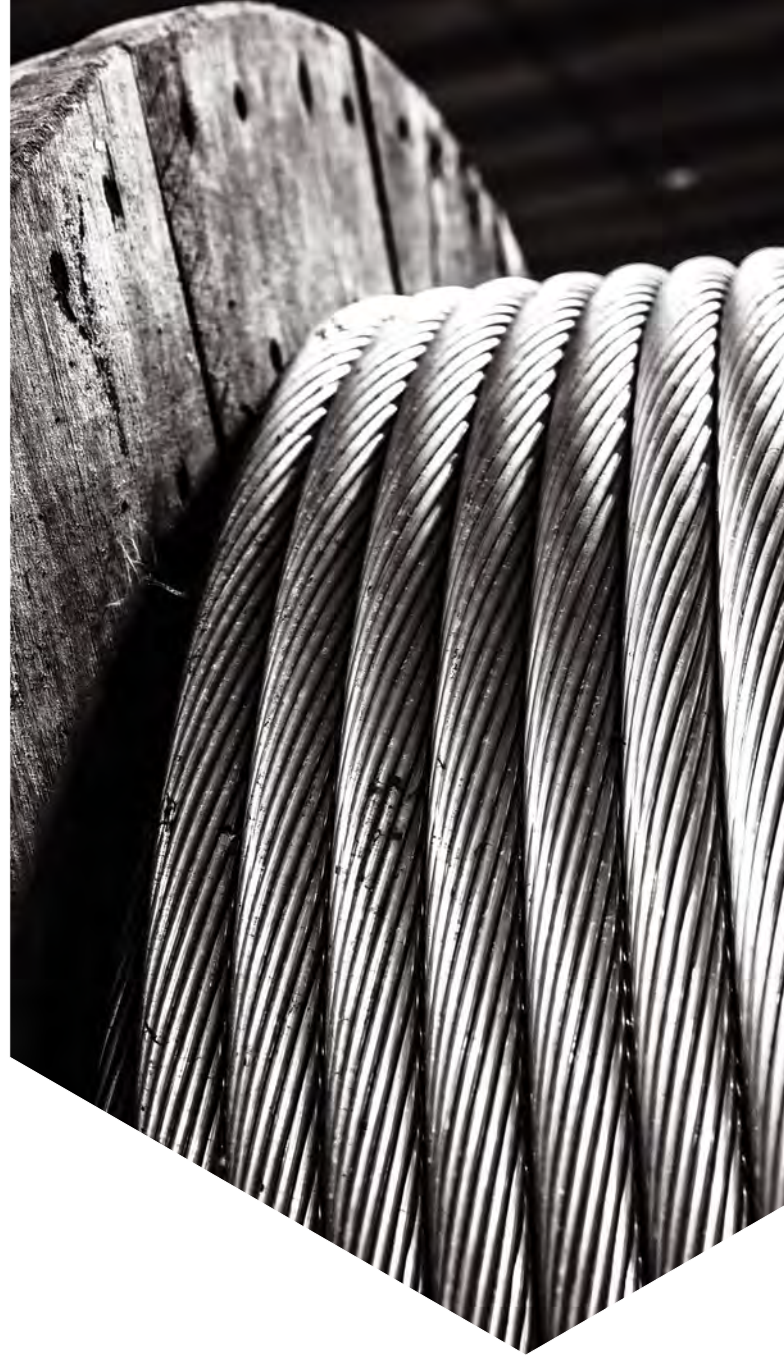
TACOMA POWER



Setting the stage for future success, Tacoma Power completed a new comprehensive strategic plan in 2016. The development of the plan incorporated an analysis of challenges and opportunities the utility faces, as well as feedback from customers, employees and key stakeholders. The plan will help the utility put a laser focus on a series of priority strategic objectives related to employees, customers, finances and environmental stewardship.

In its environmental stewardship, Tacoma Power made significant progress on several projects that support the successful life cycle of salmon in the Northwest. The utility will soon complete the \$35 million construction of a facility that will improve natural fish runs in the Cowlitz River and help Tacoma Power meet its Federal Energy Regulatory Commission license obligations. In addition, the utility completed construction of two new fish hatcheries, which began operating in 2016.

The utility continued to meet its dam safety and licensing requirements – a high priority with seven dams under its purview. Tacoma Power also furthered its strong regulatory compliance record with the North American Electric Reliability Corporation by meeting all compliance regulations and completing an audit with no adverse findings.



CUSTOMERS RANKED
TACOMA POWER FIRST
FOR THE VALUE
OF THE ELECTRIC
SERVICE PROVIDED.



THE FINANCIAL SIDE

Illustrating Tacoma Power's financial stability, Standard & Poor's confirmed the utility's credit ratings as part of the agency's regular monitoring and review cycle. Tacoma Power's existing credit ratings of Aa3/AA/AA- by Moody's, S&P, and Fitch, respectively, continue to allow Tacoma Power access to low-interest rates for future borrowing needs.

Tacoma Power serves six classes of retail electricity customers in the city of Tacoma and surrounding area. Its 10 largest customers accounted for approximately 17% of revenues in 2016, and no single customer represented more than 9% of Tacoma Power's supplied load. Tacoma Power's relatively low-cost hydropower resource base and its access to preference power from Bonneville Power Association permit the rates it charges to be low in comparison to state and national averages.

In 2016, Tacoma Power supplied electric energy to 176,000 retail customer accounts and received approximately \$320.6 million in revenue. Retail revenue comprised 75% of Tacoma Power's total revenue, with wholesale revenue making up just 12% of the total revenue in 2016.

Tacoma Power generates more electricity than is required to provide power to its retail customers. Any additional power produced is

sold into the wholesale power market. In 2016, wholesale activity was heavy with transactions and volume, but with lower prices compared to prior years. Net wholesale power sales were more than double budget estimates; the utility sold 2.5 million megawatt hours. The annual revenue, however, fell just below budget estimates at \$50.1 million, compared to a projected \$53.3 million.

Tacoma continued to make the most of its flexible power resource portfolio by selling power at a premium in emerging markets. The utility continued selling energy as a designated asset controlling supplier, one of only three in the Pacific Northwest. With this designation, any sales made from Tacoma's resource portfolio are deemed "low carbon" and can be sold at a premium. In 2016, those sales resulted in almost \$1.5 million in additional revenue.

Tacoma also brought in \$1 million in additional revenue by analyzing its resource portfolio and finding new sales opportunities.

Facing a \$48.6 million projected reduction in wholesale and retail revenue in the coming biennium, Tacoma Power focused its biennial budget planning on minimizing its operations and maintenance, personnel, and capital budgets expenses. The utility repurposed more than 30 unfilled positions during the budget process to align with the strategic needs of the utility, and it reduced its initial capital budget by \$29 million through a new review and development process. Those adjustments allowed the utility to hold rate increases to a system average 5.9% for each year in the next biennium despite the reduction in wholesale and retail revenue.

ALWAYS SEEKING IMPROVEMENT

Tacoma Power completed its first generation cash-flow-at-risk model, which will enable better analysis of wholesale market risks related to hedging decisions. Tacoma Power also examined a study that benchmarked wholesale risk management practices against industry standards; it resulted in staff developing and implementing new business processes for enhancing credit reporting and risk controls.

The utility also reached out to customers in a new and popular way when it developed its first community solar project. The 300-kilowatt solar project, located on site, enabled customers to connect with the utility – and each other – to support renewable energy and the benefits it brings. The solar units sold at a record-breaking pace and provided a lucrative state incentive to their buyers.

Furthering its work in renewables, Tacoma Power again exceeded its energy conservation target by completing over 1,000 residential and 200 commercial conservation projects. In addition to providing significant environmental benefits, conservation also provides thousands of homeowners and businesses technical and financial assistance to save energy and money through energy efficiency improvements. Tacoma Power acquires energy conservation as a resource to defer its need for future, more costly resources, making the benefit one that's shared with all ratepayers.

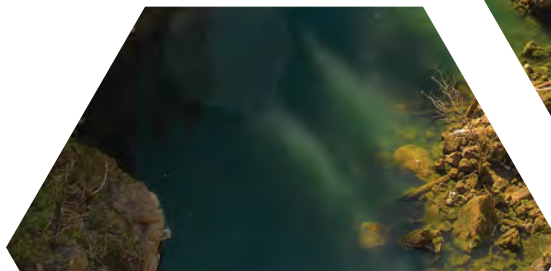
The utility continued to place high value on making the most of ratepayers' money by using the asset management philosophy to address the lifespan and replacement needs of electrical equipment. The utility achieved overall system improvements by rehabilitating one substation in a more modern configuration to address reliability and load growth. Tacoma Power

constantly evaluates its system with the customer in mind, and in 2016 made a number of changes that will improve power reliability.

Tacoma Power continued to excel in the area of training and development. The utility's Transmission & Distribution group completed the thirteenth year of its college engineering intern program. It has a proven track record of success, with approximately 50% of current Transmission & Distribution engineers coming from the program. The work group continued its outreach efforts by working with military and veteran populations and fostering partnerships with schools to ensure a pipeline of qualified applicants to fill jobs expected to become vacant through retirements in the next few years.

SERVICE CONNECTIONS

Last but not least in 2016, Tacoma Power proudly continued to make strong connections with people through outstanding service. For example, in a recent customer satisfaction survey comparing 96 utilities across the country, customers ranked Tacoma Power first for the value of the electric service provided. In addition, a separate survey of park customers showed that about 99% of them rated parks employees as helpful. The utility's cable TV service also earned solid customer satisfaction ratings from customers; in particular, they are pleased with both the services provided and the quality of the people who provide it.



FINANCIAL HIGHLIGHTS

In millions, for the years ended December 31,	2016	2015	2014	2013	2012	2011
Total Income	\$ 425.7	\$ 413.7	\$ 447.0	\$ 418.8	\$ 400.2	\$ 377.4
Operating Expenses	332.5	319.2	314.0	296.1	285.0	264.4
Income Available for Debt Service	\$ 93.2	\$ 94.5	\$ 133.0	\$ 122.7	\$ 115.2	\$ 113.0
Debt Service	\$ 31.8	\$ 37.2	\$ 58.7	\$ 52.4	\$ 56.5	\$ 56.5
Debt Service Coverage	2.94x	2.54x	2.26x	2.34x	2.04x	2.00x
Plant Additions	\$ 231.6	\$ 127.1	\$ 122.9	\$ 146.3	\$ 134.4	\$ 125.5
Number of Customers	176,784	174,562	172,531	171,506	169,012	169,112
Average Rates (per kWh)						
Residential	\$ 0.085	\$ 0.085	\$ 0.081	\$ 0.078	\$ 0.074	\$ 0.070
Commercial	\$ 0.087	\$ 0.087	\$ 0.084	\$ 0.081	\$ 0.077	\$ 0.072
General/Industrial	\$ 0.057	\$ 0.055	\$ 0.053	\$ 0.051	\$ 0.049	\$ 0.047

Sales of Electric Energy (dollars in millions)	2016	2015	2014
Residential	154.09	149.20	150.97
Commercial	27.7	26.96	26.59
General	115.6	116.05	114.72
Contract	21.46	21.36	21.15
Bulk	54.51	50.38	82.8
Others	1.72	1.64	1.61

Total Consumption (mwh in millions)	2016	2015	2014
Residential	1.82	1.76	1.85
Commercial	0.32	0.31	0.32
General	1.95	1.97	2.04
Contract	0.51	0.51	0.52
Others	2.77	1.95	2.88

Power Sources (mwh in millions)	2016	2015	2014
Nisqually	0.63	0.51	0.64
Cushman	0.51	0.27	0.36
Cowlitz	1.99	1.63	2.11
BPA	3.81	3.67	3.85
Others	0.32	0.30	0.31

Operating Expenses	2016	2015	
Purchased Power	\$ 126,835,928	\$ 126,315,151	33%
Depreciation	55,702,297	57,381,578	16%
Distribution & Transmission	68,056,825	47,400,006	15%
Admin. & Pension	26,668,314	45,977,299	13%
Other Operating Expenses	47,312,994	43,603,789	11%
Hydraulic Power	32,108,847	26,595,133	6%
Click! Network	26,059,166	25,304,001	5%
Other Production Expenses	5,475,627	3,999,158	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, 2016 and 2015, 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, 2016 and 2015, 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 13, schedule of proportionate share of net pension liability, and schedule of the city of Tacoma's contributions employer contributions on page 46 be presented to supplement the basic 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 47 through 64, and the superintendent's report presented on pages 65 through 82 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 basic financial statements, and, accordingly, we express no opinion on it.

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

Tacoma, Washington
April 19, 2017

MANAGEMENT DISCUSSION & 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, 2016 and 2015. 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, 2016 and 2015, 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.

The Division adopted GASB Statement No. 72, *Fair Value Measurement and Application*, during fiscal year 2016. The statement provides guidance for determining fair value to certain investments and disclosures related to all fair value measurements, and requires accounting for investments at fair value (See note 3).

Financial Highlights

- Tacoma Power reported a decrease in total net position of \$3.9 million (150.6%) in 2016, compared to a decrease of \$1.6 million (106.6%) in 2015.
- Operating revenues increased \$8.0 million (1.9%) in 2016. Operating revenues in 2015 decreased \$30.6 million (6.9%).
- Utility Plant in Service increased \$143.1 million (7.7%) in 2016 and \$43.2 million (2.4%) in 2015.
- Construction work in progress decreased \$61.5 million (70.0%) in 2016 and increased \$33.2 million (60.5%) in 2015.

Overview of Financial Statements

Tacoma Power reported net operating income of \$30.4, \$34.1 and \$68.1 million in 2016, 2015 and 2014 respectively. Operating revenues increased \$8.0 million during 2016 and operating expenses increased \$11.6 million. For 2015, operating revenues decreased \$30.6 million and operating expenses increased \$3.4 million compared to 2014. Tacoma Power reported a decrease in net position of \$3.9 million in 2016 compared to a decrease of \$1.6 million in 2015 and an increase of \$23.7 million in 2014.

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

Operating Results (in thousands)

Category	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Operating Revenues	\$ 418,614	\$ 410,626	\$ 441,246	\$ 7,988	\$ (30,620)
Operating Expenses	388,220	376,576	373,173	11,644	3,403
Net Operating Income	30,394	34,050	68,073	(3,656)	(34,023)
Net-Non Operating Expenses	(12,716)	(20,036)	(25,138)	7,320	5,102
Capital Contributions	5,162	5,708	4,120	(546)	1,588
BABs and CREBs subsidies	3,684	3,676	3,668	8	8
Transfers Out	(30,462)	(24,969)	(26,999)	(5,493)	2,030
Change in Net Position (Net Income)	\$ (3,938)	\$ (1,571)	\$ 23,724	\$ (2,367)	\$ (25,295)

Megawatt-Hours Billed (in thousands)

Type of Customer	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Residential	1,856	1,801	1,891	55	(90)
Commercial/General/Industrial	2,715	2,791	2,869	(76)	(78)
Wholesale	2,731	1,918	2,843	813	(925)
Total	7,302	6,510	7,603	792	(1,093)

Net Position

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

Statements of Net Position (in thousands)

Description	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Net Utility and Non-Utility Plant	\$ 1,033,591	\$ 1,002,993	\$ 979,067	\$ 30,598	\$ 23,926
Current Assets, Other Assets and Special Funds	384,884	392,482	525,770	(7,598)	(133,288)
Total Assets	1,418,475	1,395,475	1,504,837	23,000	(109,362)
Deferred Outflows	39,469	10,977	8,026	28,492	2,951
Total Assets and Deferred Outflows	\$ 1,457,944	\$ 1,406,452	\$ 1,512,863	\$ 51,492	\$ (106,411)
Net Position:					
Net Invested in Capital Assets	\$ 581,629	\$ 594,626	\$ 499,659	\$ (12,997)	\$ 94,967
Restricted	15,225	21,028	34,666	(5,803)	(13,638)
Unrestricted	225,142	210,279	288,478	14,863	(78,199)
Total Net Position	821,996	825,933	822,803	(3,937)	3,130
Long-Term Debt	457,602	441,928	530,581	15,674	(88,653)
Other Liabilities	128,058	86,555	111,479	41,503	(24,924)
Total Liabilities	585,660	528,483	642,060	57,177	(113,577)
Deferred Inflows	50,288	52,036	48,000	(1,748)	4,036
Total Net Position, Liabilities and Deferred Inflows	\$ 1,457,944	\$ 1,406,452	\$ 1,512,863	\$ 51,492	\$ (106,411)

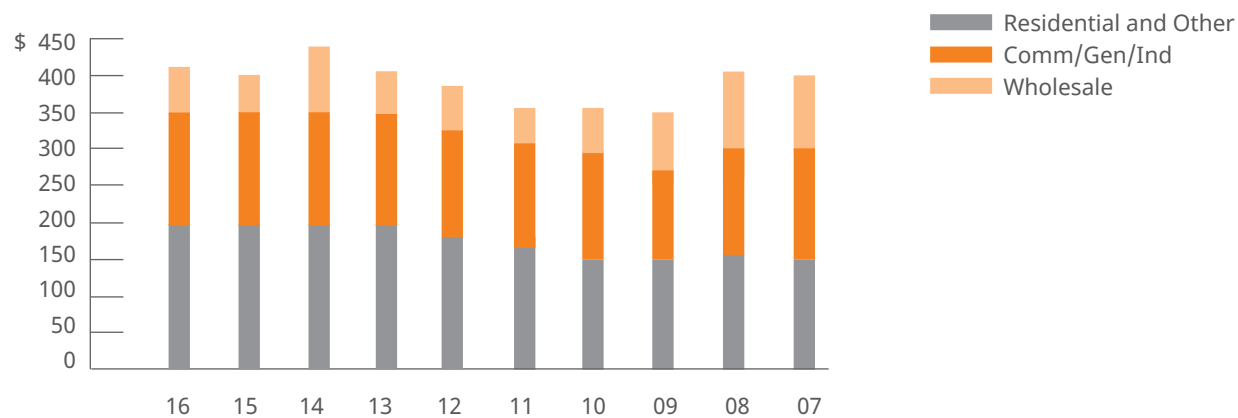
Revenues

2016 Compared to 2015

Operating revenues totaled \$418.6 million in 2016 compared to \$410.6 million in 2015, an increase of \$8.0 million (1.9%). Revenues from residential customers increased \$4.9 million (3.3%). Wholesale revenues increased \$4.1 million (8.2%) as compared to 2015. The majority of the increase was due to higher volume. Streamflows were up 116% over 2015, and were 113% of average for 2016. Generation was up 27%, while purchases were down, which left more to sell.

In 2016 residential sales accounted for 41.4% of electric revenues, commercial, general and industrial revenues accounted for 44.0% and wholesale power revenues accounted for 14.6%.

Operating Revenues (in millions)



2015 Compared to 2014

Operating revenues totaled \$410.6 million in 2015 compared to \$441.2 million in 2014, a decrease of \$30.6 million (6.9%). Revenues from general customers increased \$1.3 million (1.2%). There was a rate increase of 3.8% effective 2015, which was partially offset by a decrease of 62,000 MWh billed. Wholesale revenues in 2015 decreased \$32.4 million as compared to 2014. Streamflows in 2015 were 79% of 2014 streamflows, resulting in lower generation and therefore lower sales.

In 2015 residential sales accounted for 41.4% of electric revenues, commercial, general, and industrial revenues accounted for 44.8% and wholesale power revenues accounted for 13.8%.

Expenses

2016 Compared to 2015

Total operating expenses increased \$11.6 million or 3.1% compared to 2015.

GASB 68, *Accounting and Financial Reporting for Pensions*, resulted in an increase in expense of \$10.0 million in 2016. This expense was allocated across the Power sections as follows: Admin & General \$2.9 million, Distribution \$2.9 million, Maintenance \$1.4 million, Generation \$1.0 million, Telecommunications \$0.8 million, Other \$0.7 million, and Transmission \$0.4 million.

Purchased power increased \$0.5 million (0.4%). The increase was primarily due to increased contract costs and renewable energy credits purchased offset by increased credits and decreased purchased power.

Transmission expense increased \$6.1 million (28.0%) and distribution expense increased \$10.3 million (101.5%). In 2015 Tacoma Power conducted a review of expenses and determined that a large amount of costs that were assigned to administration and general expense should be reclassified to non-administrative groups. The increases in transmission and distribution expenses are primarily due to reclassifying these expenses effective January 1, 2016.

Generation expense increased \$5.1 million (35.7%), maintenance expense increased \$4.6 million (16.7%) and other production expenses increased \$3.7 million (24.3%) primarily due to the reclassification of expenses previously mentioned.

Administration and general expenses decreased \$17.5 million (29.9%) primarily due to the reclassification of expenses previously mentioned.

2015 Compared to 2014

Total operating expenses increased \$3.4 million or 0.9% compared to 2014.

Purchased power increased \$4.9 million (4.1%). Bonneville Power Administration (BPA) purchases increased \$8.1 million. The Slice and Block portions of the BPA contract increased \$3.1 million and credits for the Energy Conservation Agreement (ECA) decreased \$5.0 million. Purchases from Priest Rapids increased \$1.6 million. Part of the contract includes a credit for a portion of the proceeds of sale of the output from the project. Credits were less in 2015 than in 2014. Purchases from Grand Coulee Project Hydroelectric Authority increased \$0.3 million due to increased operating costs that were passed on to Tacoma Power. Other portfolio purchases decreased \$5.5 million primarily due to lower volume. Temperatures for most of the year were higher than normal and streamflows were lower.

Telecommunications expense increased \$5.7 million primarily due to an updated cost allocation between Power and Click!. Previously, allocated costs were approximately 75% Click! and 25% Power. The cost allocation has been updated to reflect shared costs of approximately 94% to Click! and 6% to Power. This change was effective January 1, 2015.

Maintenance expense decreased \$5.6 million (16.8%). Generation maintenance increased \$0.5 million primarily due to a mechanical overhaul at Wynoochee.

Distribution maintenance decreased \$2.6 million and Transmission maintenance expense decreased \$3.5 million. This is mostly due to the updated cost allocation between Power and Click!.

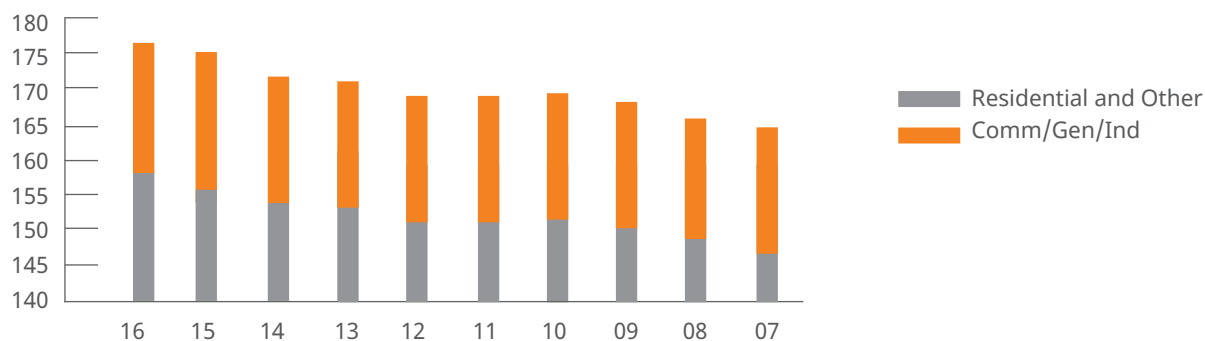
Distribution operations expense decreased \$3.6 million (26.4%) primarily due to the updated cost allocation between Power and Click! and the implementation of GASB 68, resulting in a \$1.3 million decrease in pension expense.

Generation operations expense increased \$1.9 million (15.7%). Natural Resources costs increased \$1.3 million due to testing and operations of new fish related facilities and to hiring new personnel. Contributions to the Fleet Replacement Fund increased \$0.7 million.

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 2016 is 176,784 compared to 174,562 in 2015 and 172,531 in 2014.

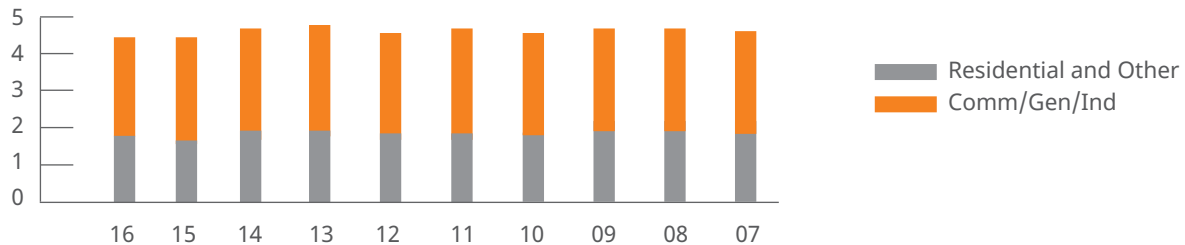
Number of Customers (in thousands)



Megawatt-hours Billed

Megawatt-hours billed to residential and other customers increased 3.3% in 2016, while commercial / general / industrial billings decreased 2.5%. Wholesale power billed in 2016 was 2,731,076 megawatt-hours compared to 1,917,685 in 2015, an increase of 813,391 megawatt-hours or 42.4%. During 2016 hydro generation increased 735,503 megawatt-hours compared to the previous year. Streamflows into Tacoma Power's system were 113% of average in 2016 compared to 97% of average in 2015.

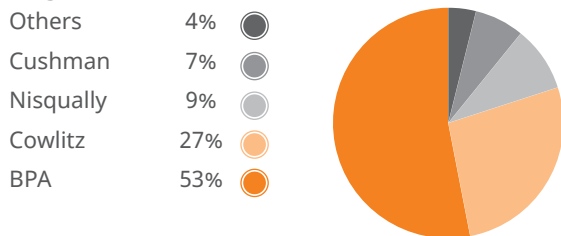
Megawatt-hours Billed (in millions)



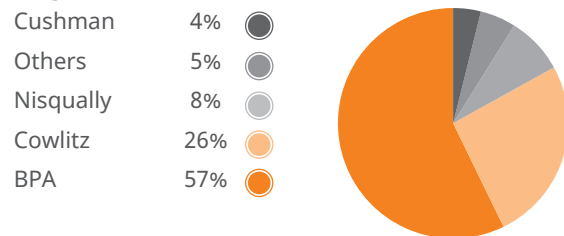
Sources of Power

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 - 2016



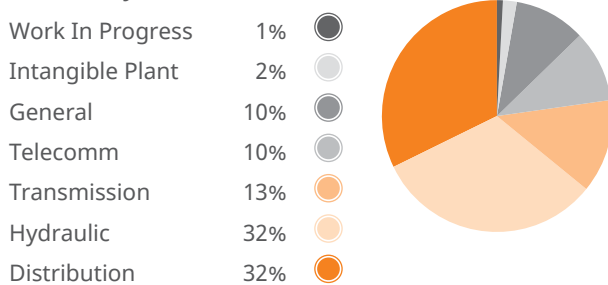
Megawatt Hours Generated/Purchased - 2015



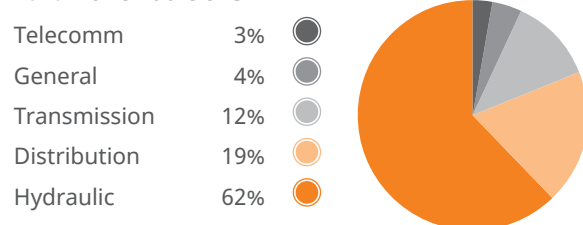
Utility Plant and Plant Additions

Tacoma Power has \$2.0 billion invested in its utility plant assets on a cost basis. The largest portion is for the generation (hydroelectric) business unit followed by the combined distribution and transmission business unit. The following graphs show the allocation of plant additions and total investment in plant.

2016 Utility Plant



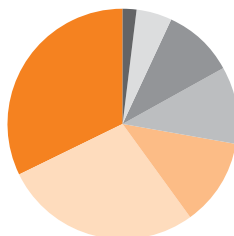
2016 Plant Additions



Additions to Hydraulic plant in 2016 were \$89.2 million, which included the Cowlitz Falls Downstream Fish Passage and the Cushman License Implementation. Distribution plant additions were \$27.2 million, which included addition and replacement programs for new services, pole replacements, and road related additions and replacements. Transmission plant additions were \$16.5 million, which included system reliability improvements and substation additions and replacements.

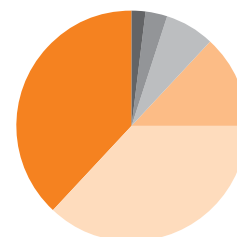
2015 Utility Plant

Intangible Plant	2%
Work in Progress	5%
General	10%
Telecomm	11%
Transmission	12%
Hydraulic	28%
Distribution	32%



2015 Plant Additions

Telecomm	2%
Intangible Plant	3%
General	7%
Transmission	13%
Distribution	37%
Hydraulic	38%



Additions to Hydraulic plant in 2015 were \$18.2 million, which included the Cushman fish hatcheries, Wynoochee modernization, and a hydro exciter replacement program. Distribution plant additions were \$17.3 million, which included addition and replacement programs for new services, pole replacements, and road related additions and replacements. Transmission plant additions were \$6.1 million, which included system reliability improvements and substation additions and replacements.

The following table summarizes Tacoma Power's capital assets, net of accumulated depreciation, for the years ended December 31, 2016 through 2014.

Capital Assets, Net of Accumulated Depreciation (in thousands)

Net Utility Plant	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Intangible Plant	\$ 32,030	\$ 29,404	\$ 29,510	\$ 2,626	\$ (106)
Hydraulic Plant	441,163	359,992	349,472	81,171	10,520
Transmission Facilities	125,357	118,765	122,213	6,592	(3,448)
Distribution Facilities	290,766	284,826	288,242	5,940	(3,416)
General Plant	77,081	78,190	81,443	(1,109)	(3,253)
Telecommunications Plant	40,600	43,682	53,216	(3,082)	(9,534)
Construction Work in Progress	26,412	87,952	54,789	(61,540)	33,163
Total Net Utility Plant	\$ 1,033,409	\$ 1,002,811	\$ 978,885	\$ 30,598	\$ 23,926

Additional information on Tacoma Power's capital assets can be found in Note 4 of the financial statements and also in the supplementary Statistical Data.

Debt Administration

At December 31, 2016 Tacoma Power had outstanding revenue bonds of \$371.1 million, a decrease of \$14.7 million compared to 2015. No new revenue bonds were issued in 2016. On March 10, 2016 and August 16, 2016 Tacoma Power took draws of \$15 million respectively on the line of credit agreement with Wells Fargo bringing the total drawn to \$80.3 million. No draws have been taken on the 3-year line of credit agreement with Key Bank.

At December 31, 2015 Tacoma Power had outstanding revenue bonds of \$385.8 million, a decrease of \$154.3 million compared to 2014. In July 2015, Tacoma Power called \$122.1 million of Series 2005 B Electric System Revenue Bonds. No new revenue bonds were issued in 2015. On May 15, 2015 Tacoma Power entered into a 3-year line of credit agreement with Wells Fargo in the amount of \$100 million, of which draws were taken in the amount of \$50.3 million.

Also, on May 1, 2015 Tacoma Power entered into a 3-year line of credit agreement with Key Bank in the amount of \$50 million, of which no draws were taken.

All bonds are rated Aa3 by Moody's Investors 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 5 of the financial statements.

Debt Service Coverage

Tacoma Power is required by its bond covenants to maintain a debt service coverage ratio of 1.25. In 2016, principal and interest were covered 2.94 times compared to 2.54 times in 2015 and 2.26 times in 2014.

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

2016 FINANCIAL REPORTS

STATEMENTS OF NET POSITION

Assets and Deferred Outflows

December 31,	2016	2015
Utility Plant		
In Service, at Original Cost	\$ 2,004,204,782	\$ 1,861,142,589
Less - Accumulated Depreciation	(997,207,625)	(946,283,353)
Total	1,006,997,157	914,859,236
Construction Work in Progress	26,411,907	87,951,638
Net Utility Plant	1,033,409,064	1,002,810,874
Non-Utility Property	182,051	182,051
Special Funds		
Construction Funds	13,387,867	41,412,285
Debt Service Funds	22,180,111	24,549,803
Special Bond Reserve Funds	4,981,885	4,984,302
Wynoochee Reserve Funds	2,557,943	2,534,915
Total Special Funds	43,107,806	73,481,305
Current Assets		
Operating Funds Cash and Equity in Pooled Investments	214,474,287	193,804,373
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$2,174,162 in 2016 and \$1,080,447 in 2015)	30,021,427	30,667,987
Accrued Unbilled Revenue	28,587,295	29,427,771
Materials and Supplies	7,468,481	6,318,431
Interfund Receivables	2,226,220	1,484,313
Prepayments and Other	6,384,609	5,757,216
Total Current Assets	289,162,319	267,460,091
Other Assets		
Regulatory Asset - Conservation (Net of Amortization of \$25,121,809 in 2016 and \$18,629,468 in 2015)	50,071,005	46,293,923
Net Pension Asset	—	3,823,476
Conservation Loans Receivable	2,542,470	1,423,037
Total Other Assets	52,613,475	51,540,436
Total Assets	1,418,474,715	1,395,474,757
Deferred Outflows Of Resources		
Deferred Outflow for Pensions	39,469,454	9,077,586
Unamortized Loss on Refunding Bonds	—	1,899,931
Total Deferred Outflows	39,469,454	10,977,517
Total Assets and Deferred Outflows	\$ 1,457,944,169	\$ 1,406,452,274

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

Net Position, Liabilities and Deferred Inflows

December 31,	2016	2015
Net Position		
Net Investment in Capital Assets	\$ 581,629,142	\$ 594,626,313
Restricted for:		
Wynoochee Reserve Funds	2,557,943	2,534,915
Debt Service Funds	12,667,207	14,669,173
Net Pension Asset	—	3,823,476
Unrestricted	225,141,401	210,279,420
Total Net Position	821,995,693	825,933,297
Long-Term Debt		
Revenue Bonds	377,351,726	391,678,130
Revolving Line of Credit	80,250,000	50,250,000
Total Long-Term Debt	457,601,726	441,928,130
Current Liabilities		
Current Portion of Long-Term Debt	12,730,000	14,735,000
Taxes and Other Payables	27,457,682	20,356,768
Purchased Power Payable	12,639,142	12,013,478
Salaries, Wages and Compensated Absences Payable	2,912,713	2,487,419
Interest Payable	9,512,905	9,880,630
Customers' Deposits	2,772,395	3,108,808
Interfund Payables	2,140,909	1,324,441
Total Current Liabilities	70,165,746	63,906,544
Long-Term Liabilities		
Long Term Accrued Compensated Absences	9,681,941	9,522,650
Net Pension Liability	34,177,293	—
Other Long Term Liabilities	14,033,787	13,125,264
Total Long Term Liabilities	57,893,021	22,647,914
Total Liabilities	585,660,493	528,482,588
Deferred Inflows of Resources		
Deferred Inflow for Pensions	2,287,983	4,036,389
Rate Stabilization	48,000,000	48,000,000
Total Deferred Inflows	50,287,983	52,036,389
Total Net Position, Liabilities and Deferred Inflows	\$ 1,457,944,169	\$ 1,406,452,274

Statements of Revenues, Expenses and Changes In Net Position

Year Ended December 31,	2016	2015
Operating Revenues		
Sales of Electric Energy	\$ 374,249,290	\$ 366,263,055
Other Operating Revenue	17,690,192	17,106,442
Click! Network Operating Revenue	26,674,906	27,256,718
Total Operating Revenue	418,614,388	410,626,215
Operating Expenses		
Operations		
Purchased and Interchanged Power	126,835,928	126,315,151
Generation	19,270,201	14,197,116
Transmission	28,075,318	21,928,763
Distribution	20,477,257	10,163,887
Other	18,677,827	15,025,954
Maintenance	32,342,896	27,705,373
Telecommunications Expense	26,059,166	25,304,001
Administrative and General	41,051,795	58,560,459
Depreciation	55,702,297	57,381,578
Taxes	19,727,313	19,993,833
Total Operating Expenses	388,219,998	376,576,115
Net Operating Income	30,394,390	34,050,100
Non-Operating Revenues (Expenses)		
Interest Income	2,405,144	1,796,071
Contribution to Family Need	(480,000)	(480,000)
Other	1,555,659	(1,923,329)
Interest on Long-Term Debt	(15,893,207)	(19,225,735)
Loss on Defeasance or Refunding of Debt and Amortization of Debt Premium	(303,527)	(202,938)
Total Non-Operating Expenses	(12,715,931)	(20,035,931)
Net Income Before Capital Contributions and Transfers	17,678,459	14,014,169
Capital Contributions		
Cash	4,741,136	5,183,295
Donated Fixed Assets	421,334	524,713
BABs and CREBs Interest Subsidies	3,683,746	3,675,836
Transfers		
City of Tacoma Gross Earnings Tax	(30,460,098)	(25,481,823)
Transfers to/(from) Other Funds	(2,181)	512,401
Change in Net Position	(3,937,604)	(1,571,409)
Total Net Position - Beginning of Year	825,933,297	822,803,061
Accumulated Adjustment for Change in Accounting Principle	—	4,701,645
Net Position, Beginning of Year, As Adjusted	825,933,297	827,504,706
Total Net Position - End Of Year	\$ 821,995,693	\$ 825,933,297

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

Statements Of Cash Flows

Year to Date December 31,

2016

2015

Cash Flows From Operating Activities

Cash from Customers	\$ 420,101,423	\$ 414,491,290
Cash Paid to Suppliers	(193,431,153)	(206,195,837)
Cash Paid to Employees	(111,575,956)	(106,153,040)
Taxes Paid	(19,155,309)	(19,876,260)
Conservation Loans	(1,119,433)	454,432
Net Cash From Operating Activities	94,819,572	82,720,585

Cash Flows From Non-Capital Financing Activities

Transfer Out for Gross Earnings Tax	(30,460,098)	(25,481,823)
Transfer to/from Other Funds	(2,181)	512,401
Transfer to Family Need Fund	(480,000)	(480,000)
Net Cash From Non-Capital Financing Activities	(30,942,279)	(25,449,422)

Cash Flows From Capital and Related Financing Activities

Capital Expenditures	(82,126,418)	(77,374,831)
Proceeds from Issuance of Long-Term Debt	30,000,000	50,250,000
Debt Issuance Costs	—	(114,250)
Principal Payments on Long-Term Debt	(14,735,000)	(32,115,000)
Payments for Early Extinguishment of Debt	—	(122,135,000)
Interest Paid	(20,013,668)	(26,065,944)
BABs and CREBs Interest Subsidies	3,683,746	3,675,836
Contributions in Aid of Construction	4,741,136	5,183,295
Other Long-Term Liabilities	908,523	763,091
Net Cash From Capital and Related Financing Activities	(77,541,681)	(197,932,803)

Cash Flows From Investing Activities

Interest Received	2,405,144	1,796,071
Other Non-Op Revenues and Deductions	1,555,659	2,081,901
Net Cash From Investing Activities	3,960,803	3,877,972

Net Change in Cash and Equity in Pooled Investments	(9,703,585)	(136,783,668)
Cash and Equity in Pooled Investments at January 1	267,285,678	404,069,346
Cash and Equity in Pooled Investments at December 31	\$ 257,582,093	\$ 267,285,678

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

Statements of Cash Flows

December 31,	2016	2015
Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:		
Net Operating Income	\$ 30,394,390	\$ 34,050,100
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation	55,702,297	57,381,578
Amortization of Regulatory Assets	6,492,341	5,566,247
Pension (Credits) Expenses	5,860,495	(4,163,028)
Cash provided from changes in operating assets and liabilities:		
Accounts Receivable and Accrued Unbilled Revenue	1,487,036	3,865,072
Conservation Loans Receivable	(1,119,433)	454,432
Interfund Receivables	(741,907)	1,025,123
Materials and Supplies, and Other	(1,777,443)	(1,322,513)
Taxes and Other Payables	7,100,914	(871,453)
Purchased Power Payable	625,664	453,294
Salaries, Wages and Compensated Absences Payable	425,294	(3,120,542)
Long Term Accrued Compensated Absences	159,291	97,628
Customers' Deposits	(336,413)	211,540
Regulatory Asset - Conservation	(10,269,422)	(9,260,924)
Interfund Payables	816,468	(1,645,969)
Total Adjustments	64,425,182	48,670,485
Net Cash From Operating Activities	\$ 94,819,572	\$ 82,720,585
Reconciliation of Cash and Equity in Pooled Investments to Balance Sheet:		
Cash and Equity in Pooled Investments in Special Funds	\$ 43,107,806	\$ 73,481,305
Cash and Equity in Pooled Investments in Operating Funds	214,474,287	193,804,373
Cash and Equity in Pooled Investments at December 31	\$ 257,582,093	\$ 267,285,678

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

NOTE 1 OPERATIONS

OPERATIONS OF TACOMA 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 as an enterprise fund 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 of 176,784 retail customers and has 838 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 in certificates of deposit with East West Bank and Opus Bank.

The Division's equity in that portion of the City of Tacoma Investment Pool held in qualified public depositories at December 31, 2016 and 2015 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 WA State Treasures LGIP is authorized by RCW 43.250. The LGIP is 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 as of December 31st.

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 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.

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 PTO (personal time off) without distinction between vacation and sick leave. Employees who worked for the City prior to the change could choose to stay with the original policy or opt to convert to the new policy. The amount of PTO earned is based on years of service. The maximum accrual for PTO is 960 hours, and upon termination, employees are entitled to compensation for unused PTO at 100%. Vacation pay and PTO are recorded as a liability and expense in the year earned.

Employees in the original policy 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. Sick leave pay is recorded as a liability and an expense in the year earned.

The accrued liability is computed at 100% vacation and PTO while sick leave is accrued at 10%, which is considered the amount vested or 25% if the employee meets retirement criteria. Based on historical information, 10% of compensated absences are considered short term.

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 7.5% 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), pension, 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 INVESTMENTS MEASURED AT FAIR VALUE

The City measures and records its investments within the fair value hierarchy established by generally accepted accounting principles.

The Hierarchy is based on the valuation inputs used to measure the fair value of the asset, where fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. These guidelines recognize a three-tiered fair value hierarchy, as follows:

- **Level 1** - Level 1 inputs are quoted (adjusted) prices in active markets for identical assets or liabilities that the government can access at the measurement data. Observable markets include exchange markets, dealer markets, brokered markets and principal-to-principal markets.
- **Level 2** - Level 2 inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These inputs are sourced from pricing vendors using models that are market-based and corroborated by observable market data including: quoted prices; nominal yield spreads; benchmark yield curves; and other corroborated inputs.

- **Level 3** - Level 3 inputs are unobservable inputs for the asset or liability and should only be used when relevant Level 1 or Level 2 inputs are unavailable.

The fair value evaluations are provided by Interactive Data. Interactive Data utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information and for structured securities, cash flow and, when available, loan performance data. Because many fixed income securities do not trade on a daily basis, Interactive Data's evaluated pricing applications apply available information as applicable through processes such as benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing, to prepare evaluations. In addition, Interactive Data uses model processes, such as the Option Adjusted Spread model to assess interest rate impact and development payment scenarios. Their models and processes take into account market convention. For each asset class, a team of evaluators gathers information from market sources and integrates relevant credit information, perceived market movements and sector news into the evaluated pricing applications and models.

Source: Interactive Data "Summary of Inputs by Asset Class Fixed Income Evaluations, Fair Value Information Service and Valuations of Certain Other Instruments" dated January 2016.

Cash and cash equivalents include highly liquid investments including short-term investment funds. Cash and cash equivalents are valued at cost and, therefore, excluded from the fair value schedule.

Data regarding the City's investments, valued and categorized according to the above outlined levels, is below:

Debt Securities	As of 12/31/2016	Level 1	Level 2	Level 3
U.S. Treasury Securities	\$ 146,824,628	\$ —	\$ 146,824,628	\$ —
U.S. Agency Securities	544,579,831	—	544,579,831	—
Municipal Bonds	61,450,051	—	61,450,051	—
Total	\$ 752,854,510	\$ —	\$ 752,854,510	\$ —

Debt Securities	As of 12/31/2015	Level 1	Level 2	Level 3
U.S. Treasury Securities	\$ 108,647,159	\$ —	\$ 108,647,159	\$ —
U.S. Agency Securities	541,730,184	—	541,730,184	—
Municipal Bonds	119,200,942	—	119,200,942	—
Total	\$ 769,578,285	\$ —	\$ 769,578,285	\$ —

Tacoma Power's share of the City investments shown in the table above is 33.84% and 33.19% for 2016 and 2015.

NOTE 4 UTILITY PLANT

A summary of the balances and changes in utility plant for 2016 and 2015 follows:

	Balance December 31, 2015	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2016
Intangible Plant	\$ 41,682,352	\$ 3,797,958	\$ (48,212)	\$ —	\$ 45,432,098
Hydraulic Production Plant	554,637,653	89,259,998	—	—	643,897,651
Transmission Plant	219,918,041	9,721,911	(259,570)	—	229,380,382
Distribution Plant	618,397,975	27,229,473	(3,189,896)	—	642,437,552
Regional Transmission	18,147,561	6,776,297	—	—	24,923,858
General Plant	200,160,423	5,391,442	—	—	205,551,865
Telecommunications Plant	208,198,584	4,382,792	—	—	212,581,376
Total Utility Plant In Service	1,861,142,589	146,559,871	(3,497,678)	—	2,004,204,782
Less Accumulated Depreciation	946,283,353	55,702,297	(3,449,466)	(1,328,559)	997,207,625
	914,859,236	90,857,574	(48,212)	1,328,559	1,006,997,157
Construction Work In Progress	87,951,638	85,011,567	—	(146,551,298)	26,411,907
Net Utility Plant	\$ 1,002,810,874	\$ 175,869,141	\$ (48,212)	\$ (145,222,739)	\$ 1,033,409,064

	Balance December 31, 2014	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2015
Intangible Plant	\$ 40,584,864	\$ 1,287,650	\$ (190,162)	\$ —	\$ 41,682,352
Hydraulic Production Plant	536,424,903	18,212,750	—	—	554,637,653
Transmission Plant	215,039,287	5,495,463	(616,709)	—	219,918,041
Distribution Plant	604,029,355	17,270,360	(2,901,740)	—	618,397,975
Regional Transmission	17,537,662	609,899	—	—	18,147,561
General Plant	197,036,437	3,204,314	—	(80,328)	200,160,423
Telecommunications Plant	207,244,967	953,617	—	—	208,198,584
Total Utility Plant In Service	1,817,897,475	47,034,053	(3,708,611)	(80,328)	1,861,142,589
Less Accumulated Depreciation	893,801,525	57,381,578	(3,518,449)	(1,381,301)	946,283,353
	924,095,950	(10,347,525)	(190,162)	1,300,973	914,859,236
Construction Work In Progress	54,789,325	80,107,465	—	(46,945,152)	87,951,638
Net Utility Plant	\$ 978,885,275	\$ 69,759,940	\$ (190,162)	\$ (45,644,179)	\$ 1,002,810,874

Total Utility Plant in Service includes non-depreciable assets of \$75,780,466 for 2016 and \$75,310,858 for 2015.

The total amount of interest cost incurred and capitalized is \$3,752,735 for 2016 and \$3,407,633 for 2015.

NOTE 5 LONG-TERM DEBT

Tacoma Power's long-term debt is primarily for capital improvements.

Long-term liability activity for the years ended December 31, 2016 and December 31, 2015 was as follows:

	Balance December 31, 2015	Additions	Reductions	Balance December 31, 2016	Due Within One Year
Revenue Bonds	\$ 385,800,000	\$ —	\$ (14,735,000)	\$ 371,065,000	\$ 12,730,000
Plus: Unamortized Premium	20,613,130	—	(1,596,404)	19,016,726	—
Net Revenue Bonds	406,413,130	—	(16,331,404)	390,081,726	12,730,000
Line of Credit	50,250,000	30,000,000	—	80,250,000	—
Total Long-Term Debt	\$ 456,663,130	\$ 30,000,000	\$ (16,331,404))	\$ 470,331,726	\$ 12,730,000

	Balance December 31, 2014	Additions	Reductions	Balance December 31, 2015	Due Within One Year
Revenue Bonds	\$ 540,050,000	\$ —	\$ (154,250,000)	\$ 385,800,000	\$ 14,735,000
Plus: Unamortized Premium	22,645,510	—	(2,032,380)	20,613,130	—
Net Revenue Bonds	562,695,510	—	(156,282,380)	406,413,130	14,735,000
Line of Credit	—	50,250,000	—	50,250,000	—
Total Long-Term Debt	\$ 562,695,510	\$ 50,250,000	\$ (156,282,380)	\$ 456,663,130	\$ 14,735,000

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

	2016	2015
2005A Revenue Bonds, with interest rates ranging from 3.5% to 4.3%, due in yearly installments of \$115,000 to \$13,275,000 paid in full in 2016. Original Issue: \$93,480,000	\$ —	\$ 130,000
2010B Revenue Bonds, with interest rates ranging from 5.791% to 5.966%, with a Build America Bond (BAB) rebate ranging from 32.45% to 32.62% 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 \$10,095,000 to \$29,165,000 through 2042. Original Issue: \$181,610,000 Current Portion: \$12,730,000	164,190,000	178,795,000
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 through 2030. Original Issue: \$35,620,000 Current Portion: \$0	35,620,000	35,620,000
	371,065,000	385,800,000
Unamortized Premium	19,016,726	20,613,130
Current Portion	(12,730,000)	(14,735,000)
Long-term Portion of Revenue Bond Debt	377,351,726	391,678,130
Revolving Line of Credit	80,250,000	50,250,000
Total Long Term Debt	\$ 457,601,726	\$ 441,928,130

In 2015, Tacoma Power entered into a \$100 million line-of-credit agreement with Wells Fargo for working capital. The line matures in May 2018, and each advance will bear interest at the London Interbank Offered Rate (LIBOR) of 1.64344% at December 31, 2016. Each advance is secured by Revenues as set forth in the Note Ordinance. The balance outstanding is \$80.3 million as of December 31, 2016.

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

	Principal	Interest
2017	\$ 12,730,000	\$ 18,707,560
2018	\$ 11,575,000	\$ 18,157,810
2019	\$ 10,095,000	\$ 17,698,935
2020	\$ 29,165,000	\$ 16,792,435
2021	\$ 11,970,000	\$ 15,839,060
2022-2026	\$ 20,885,000	\$ 75,475,070
2027-2031	\$ 66,230,000	\$ 66,152,269
2032-2036	\$ 130,750,000	\$ 37,344,302
2037-2041	\$ 63,355,000	\$ 9,659,100
2042	\$ 14,310,000	\$ 286,200
	<u>\$ 371,065,000</u>	<u>\$ 276,112,740</u>

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. The Division was in compliance with all loan covenants at December 31, 2016.

As of December 31, 2016, 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.

NOTE 6 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 433,427 and 419,422 kilowatts per hour for 2016 and 2015, respectively. Charges for the BPA purchased power were approximately \$114 million and \$112 million for 2016 and 2015, respectively, and are based on the total amount of energy delivered and the monthly peak power demand.

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 2016 and 2015, Tacoma Power recovered \$7,076,890 and \$763,356 respectively through the ECA.

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.

Information for the year ended December 31, 2016 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	253,625 mWh	26,975 mWh
Megawatt Capacity	-	5 mW
Operating Costs	\$ 2,227,828	\$80,802
Incentive Payments	\$ 3,538,658	-
R & R Repayment	\$ 399,836	-
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 2016 and 2015 were \$6,412,705 and \$6,395,201, respectively, for Grand Coulee Project Hydro Authority, however, proceeds under the contract exceeded expenses in 2016 and 2015 for Grant County PUD - Priest Rapids resulting in a gain of \$80,802 and \$659,731, 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, 2016 Tacoma Power had forward sales contracts totaling \$28.7 million dollars extending out to September 2018 with a fair market value of \$28.7 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	2016 (in kWh)	2015 (in kWh)
Secondary Sales	(2,731,083,000)	(1,917,685,000)
Portfolio Purchases	263,105,000	293,059,000
Miscellaneous Exchanges	(1,533,000)	(1,441,000)
Other	26,228,000	54,924,000
Net Interchange	(2,443,283,000)	(1,571,144,000)

NOTE 7 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 2016 and 2015 were \$6,733,591 and \$7,212,082, 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 2016 and 2015, Fleet Services returned 75% of the interest earned on Tacoma Power's replacement fund. The amount of the refund was \$106,192 and \$107,916 for 2016 and 2015, respectively, which was used to offset the corresponding year's fleet expenses.

NOTE 8 SELF-INSURANCE FUND

The Department of Public Utilities maintains a self-insurance program and insurance policies. The Department has established a Self-Insurance Fund to insure Tacoma 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 \$900,000 in both 2016 and 2015 respectively. Assets in the Self-Insurance Fund total \$7.6 million which exceeds accrued and incurred but not reported liabilities. Equity in the Self-Insurance Fund is transferred to the appropriate operating divisions in accordance with GASB 10. Management believes Tacoma 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 Crime policy with a \$1 million limit and \$75,000 deductible for employee dishonesty and for fraudulent or dishonest act by employees against the City for loss of money, securities and property.

Other 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 covering the buildings and fleet vehicles have deductibles or self-insured retentions of \$250,000 for buildings and property within buildings and \$10,000 per vehicle. There is a selfinsured retention of \$1.5 million for general liability. The public official liability 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 general liability and public official liability policies provide \$20 million of excess coverage with a \$3 million retention. The City has a policy to cover extraordinary worker's compensation claims with a statutory limit and a self-insured retention of \$1 million per occurrence and an additional \$250,000 for each 12 month policy period.

NOTE 9 TACOMA EMPLOYEES' RETIREMENT SYSTEM FUND (TERS)

The Tacoma Employees' Retirement System (TERS or System), a pension trust fund of the City of Tacoma, issues a publicly available CAFR that includes financial statements and required supplementary information may be obtained by writing to:

Tacoma Employee's Retirement System
3628 South 35th Street
Tacoma, WA 98409

Or the TERS CAFR may be downloaded from the TERS website at www.cityoftacoma.org/retirement.

Administration of The System - The "Tacoma Employees' Retirement System" is a costsharing, 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 and federal retirement plans. Employees of the Tacoma- Pierce County Health Department, as well as, certain employees of the Pierce Transit and Law Enforcement Support Agency who established membership in the System when these agencies were still City of Tacoma departments, are also members. The Board of Administration of the Tacoma Employees' Retirement System administers the plan and derives its authority in accordance with Chapter 41.28 RCW and Chapter 1.30 of the Tacoma City Code.

At the direction of the City Council, the System is administered by the Board of Administration (the Board) consisting of nine regular members and one alternate member. The members of the Board are: the Mayor, who serves as Chair; the Director of Finance; the City Manager (or designee); the Public Utilities Director (or designee); three elected employee representatives; one elected retired representative; and one City resident (not employed by the City) elected by the other eight members. The nine Board members appoint a TERS member, either active or retired, as an alternate Board member. The Board is required by the Tacoma Municipal Code to make annual reports to the City Council on the financial condition of the System. The Board, subject to City Council approval, appoints the Director who is responsible for managing the daily operations of the System.

The breakdown of membership as of December 31, 2015 is as follows:

Retirees and beneficiaries currently receiving benefits	2,234
Terminated vested and other terminated participants	644
Active members:	
City of Tacoma	2,654
South Sound 911	4
Pierce Transit	7
Tacoma-Pierce County Health Department	262
Total active members	2,927
Total membership	5,805

Membership - Substantially all employees of the City of Tacoma are members of the System, with the exception of police officers, firefighter, and Tacoma Rail employees, who are covered by state or federal retirement plans. Other members include employees of the Tacoma-Pierce County Health Department, and certain employees of the Pierce Transit and the South Sound 911 (formerly known as Law Enforcement Support Agency) who established membership in the System when these agencies were still City of Tacoma departments.

Benefits - There are two formulas to calculate the retirement benefits. The benefit paid will be issued 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 based on the member’s age and years of service. The other formula is an annuity based on member contributions. There are several options available for the retiree to provide for their beneficiaries. The System also provides death, disability and deferred retirement. Additionally, the System provides cost of living adjustment (COLA) increases up to 2.125% as of July 1st of each year; the actual COLA granted is dependent on the Consumer Price Index (Seattle Area – all items) over the preceding calendar year.

Any active member who has not retired, and has five or more years of service as a member may purchase up to five additional years of service at the time of retirement. Total service including service purchased cannot exceed 30 years.

The System participates in the portability of public retirement benefits in Washington State public retirement. As provided under Chapter 4154 of the RCW, this allows a member to use all years of service with qualified Washington systems to determine retirement eligibility and percentage factor for benefits under the System.

Contributions - The participating employers are responsible for funding the System at a level sufficient to pay obligations and ensure the actuarial and financial soundness of the System. Contribution rates for the employer and the employee are recommended by the Board of Administration and final approval rests with the Tacoma City Council.

Currently, the required contribution rate for employees is 9.20% of their regular gross pay; the employer contributes 10.80%, for a combined total of 20.00% which is sufficient to amortize the Unfunded Actuarial Accrued Liability (UAAL) of the System if future experience follows all actuarial assumptions. Changes to the contribution rate are subject to Sections 1.30.340 and 1.30.360 of the Tacoma Municipal Code.

Significant Assumptions - The following actuarial methods were used in the funding valuation.

Measurement Date	December 31, 2015
Valuation Date	January 1, 2016
Actuarial Cost Method	Entry Age Normal Funding is based on statutory contributions rate. This amount is compared to a 30-year amortization for the purposes of calculating the Actuarially Determined Contribution. The amortization method for the ADC is as follows:
Amortization Method	<ul style="list-style-type: none">• Level percent• Open periods• 30 year amortization period at 01/01/2016• 4% amortization growth rate
Asset Valuation Method	4 year smoothing period; Corridor - None
Inflation	3%
Salary Increases	4% general wage increase assumption
Investment Rate of Return	7.25%
Cost of Living Adjustment	2.13%
Retirement Age	Varies by age, gender, eligibility
Turnover	Varies by age, gender, eligibility
Mortality	RP-2000 mortality for healthy and disabled annuitants, with age adjustments

Benefit and Assumption Changes - The comparability of the data from year to year can be affected by changes in actuarial assumptions, benefit provisions, accounting policies, and other factors. Between January 1, 2015 and January 1, 2016 no assumptions were changed.

Target Allocations - The long-term expected rate of return is determined by adding expected inflation to expected long-term real returns and reflecting volatility and correlation. The capital market assumptions are per Milliman's (the System's actuary) investment consulting practice as of December 31, 2015. The target asset allocation is based on TERS Investment Policy Statement dated February 2014.

Asset Class	Target Allocation	Long-term Expected Arithmetic Real Rate of Return
Investment Grade Fixed Income	15.0%	2.00%
Us Inflation-Indexed Bonds	5.0%	1.41%
High Yield Bonds	9.0%	4.22%
Emerging Market Debt	5.0%	5.06%
Global Equity	41.5%	5.72%
Public Real Estate	2.0%	6.07%
Private Real Estate	2.5%	3.60%
Private Equity	10.0%	9.29%
Master Limited Partnerships	4.0%	3.98%
Timber	2.0%	3.73%
Infrastructure	2.0%	5.14%
Agriculture	2.0%	4.30%
Assumed Inflation - Mean		3.00%
Assumed Inflation - Standard Deviation		1.89%
Portfolio Arithmetic Real Mean Return		4.94%
Portfolio Median Nominal Geometric Return		7.06%
Portfolio Standard Deviation		11.84%
Long-Term Expected Rate Of Return, net of Investment Expenses		7.25%

Sensitivity Analysis - The following presents the net pension liability (asset) of the System, calculated using the discount rate of 7.25%, as well as what the System's net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.25%) or 1 percentage point higher (8.25%) than the current rate

	1% Decrease 6.25%	Current Discount Rate 7.25%	1% Increase 8.25%
Net pension liability (asset)	\$ 105,989,573	\$ 34,177,293	\$ (26,296,701)

As of December 31, 2015, the deferred inflows and outflows of resources are as follows:

	Deferred Inflows of Resources	Deferred Outflows of Resources
Difference Between Expected and Actual Experience	\$ (2,287,552)	\$ —
Net Difference Between Projected and Actual Earnings	—	30,122,690
Changes in Employer Proportion	(431)	24,760
Contributions Made Subsequent To The Measurement Date	—	9,322,004
Total	\$ (2,287,983)	\$ 39,469,454

The net amount of deferred inflows and outflows, other than contributions made subsequent to the measurement date, will be recognized as pension expense in each of the next four years.

Amounts will be recognized in pension expense as follows:

2016	\$ 6,736,673
2017	6,736,673
2018	6,736,672
2019	7,739,529
2020	(90,080)
	<u>\$ 27,859,467</u>

The proportionate share of the Power Division is 39.47% of total System's pension liability. The proportionate share was based on the actual contributions for the year.

NOTE 10 OTHER POST EMPLOYMENT BENEFITS (OPEB)

Plan Description - The City charges some early retirees not yet eligible for Medicare a health premium based on the claims experience of active employees and retirees rather than based on the claims experience of retirees only. This difference is a benefit to the retirees, since health claims costs generally increase with age. 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 UAAL on a closed basis of 30 years, beginning January 1, 2007. The amortization period for 2016 is 21 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, 2016 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 are \$10,200 for single coverage and \$27,500 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, 2015 valuation the total AAL was \$208,814,312, for the City, 20% lower than expected primarily due to clarification in spouse benefits, medical costs, demographic experience and a change to the assumption for future medical trends.

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

	January 1, 2013	January 1, 2015
Active employees	3,335	3,404
Terminated vested employees	394	442
Retired employees & dependents	846	744
Total	4,575	4,590
Annual Benefit Payments	\$ 9,887,335	\$ 8,963,089
Discount rate	3.75%	3.75%
Present Value of Benefits (PVB)	\$ 326,742,538	\$ 262,184,195
Actuarial Accrued Liability (AAL)	\$ 251,839,846	\$ 208,814,312
Assets	\$ –	\$ –
Unfunded Actuarial Accrued Liability (UAAL)	\$ 251,839,846	\$ 208,814,312
Normal Cost	\$ 5,484,587	\$ 3,832,131
Annual Required Contribution (ARC)	\$ 20,058,760	\$ 16,966,964

The following table shows the total value of the benefits provided, the member paid premiums and the City paid benefits as of January 1, 2015.

Value of Subsidy at 3.75% Interest Rate	Total Value of Benefits	Member Paid Premiums	City Paid Benefits
Present Value of Benefits (PVB)	\$ 420,832,932	\$ 158,648,737	\$ 262,184,195
Actuarial Accrued Liability (AAL)	\$ 291,228,295	\$ 82,413,983	\$ 208,814,312
Normal Cost	\$ 9,501,758	\$ 5,669,627	\$ 3,832,131
Annual Benefit Payments	\$ 12,325,369	\$ 3,362,280	\$ 8,963,089

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, 2016.

	City		Division	
Determination of Annual Required Contribution:				
Normal Cost at Year-end	\$	3,803,090	\$	858,656
Amortization of UALL		15,665,117		398,368
Annual Required Contribution (ARC)	\$	19,468,207	\$	1,257,024
Determination of Net OPEB Obligation:				
Annual Required Contribution (ARC)	\$	19,468,207	\$	1,257,024
Interest on prior year Net OPEB Obligation		2,666,468		377,568
Adjustments to ARC		(3,983,647)		(468,000)
Annual OPEB Cost		18,151,028		1,166,592
Actual benefits paid		(8,539,402)		(344,092)
Increase in Net OPEB Obligation		9,611,626		822,500
Net OPEB Obligation – beginning of year		73,129,502		10,068,490
Net OPEB Obligation – end of year	\$	82,741,128	\$	10,890,990

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 3.75% interest rate.

Year Ended	Annual OPEB Cost		Benefits Paid		Net OPEB Obligation	
	City	Tacoma Power	City	Tacoma Power	City	Tacoma Power
12/31/2014	\$ 19,319,944	\$ 2,084,511	\$ 9,292,539	\$ 692,894	\$ 66,138,206	\$ 9,198,300
12/31/2015	\$ 15,954,387	\$ 1,194,337	\$ 8,963,089	\$ 324,146	\$ 73,129,502	\$ 10,068,491
12/31/2016	\$ 18,151,028	\$ 1,166,592	\$ 8,539,402	\$ 344,092	\$ 82,741,128	\$ 10,890,990

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 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 21 years.

Actuarial Methods and Significant Actuarial Assumptions

Valuation Date	January 1, 2015
Census Date	January 1, 2015
Actuarial Cost Method	Entry Age
Amortization Method	Combination of level percentage and level dollar amount, see note above.
Remaining Amortization Period	21 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	2015	6.9%
	2016	6.6%
	2017	5.9%
	2020	5.5%
	2030	5.9%
	2040	5.7%

The medical cost rate is assumed to continue grading downward until achieving the ultimate rate of 4.8% in 2071 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) 3.75%

Demographic Assumptions

Eligibility:

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

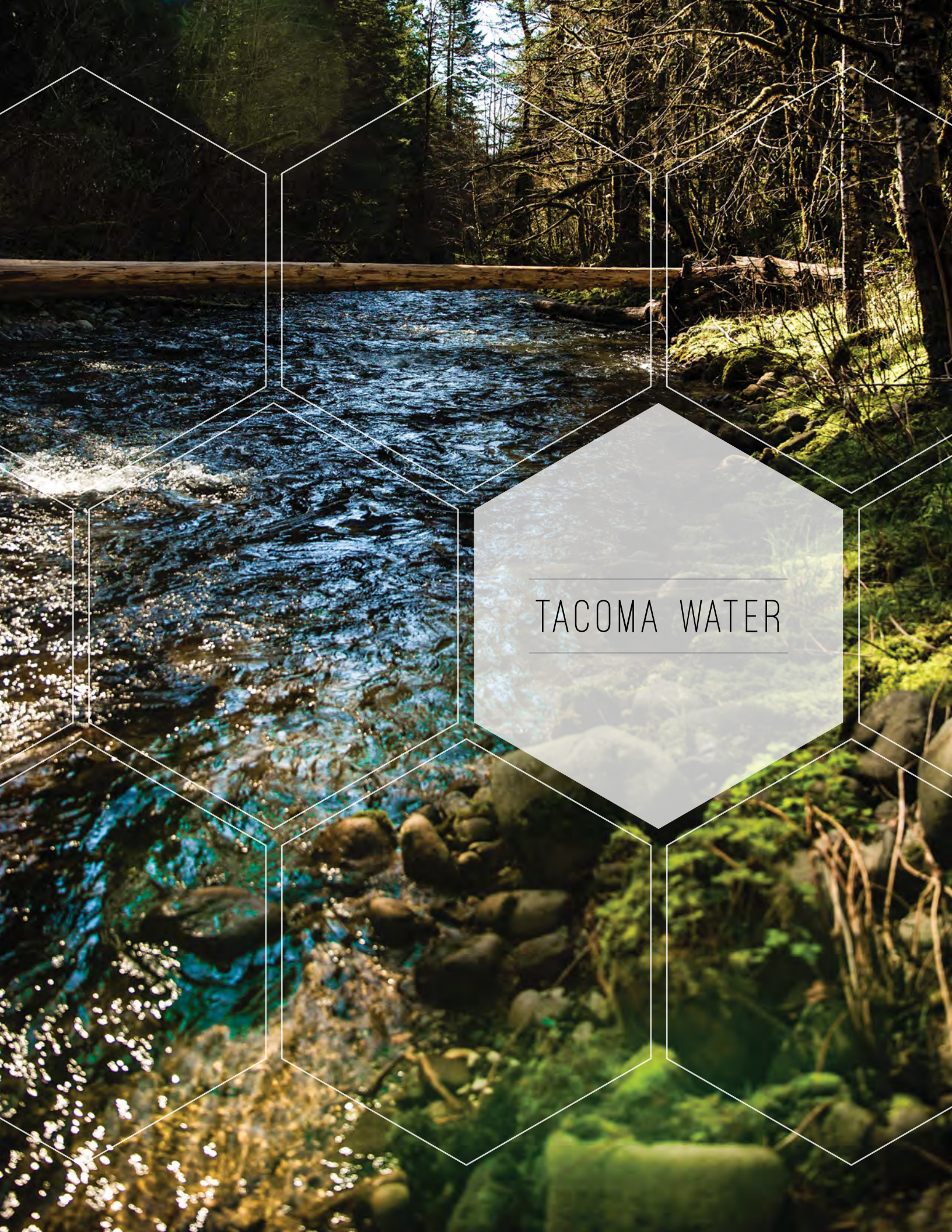
Retirement - TERS members are eligible for retiree medical benefits after becoming eligible for service retirement pension benefits (either reduced or full pension benefits):

- Age 55 with 10 years of service
- Age 40 with 20 years of service

NOTE 11 COMMITMENTS AND CONTINGENCIES

Capital Improvements - The financial requirement for Tacoma Power's 2015/2016 biennial Capital Improvement Program is approximately \$182.7 million. At December 31, 2016, the remaining financial requirement was approximately \$12 million. The remaining financial requirement for Capital Improvement Programs relating to prior biennium is approximately \$932,445.

General Legal Matters - Tacoma Power Division 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.



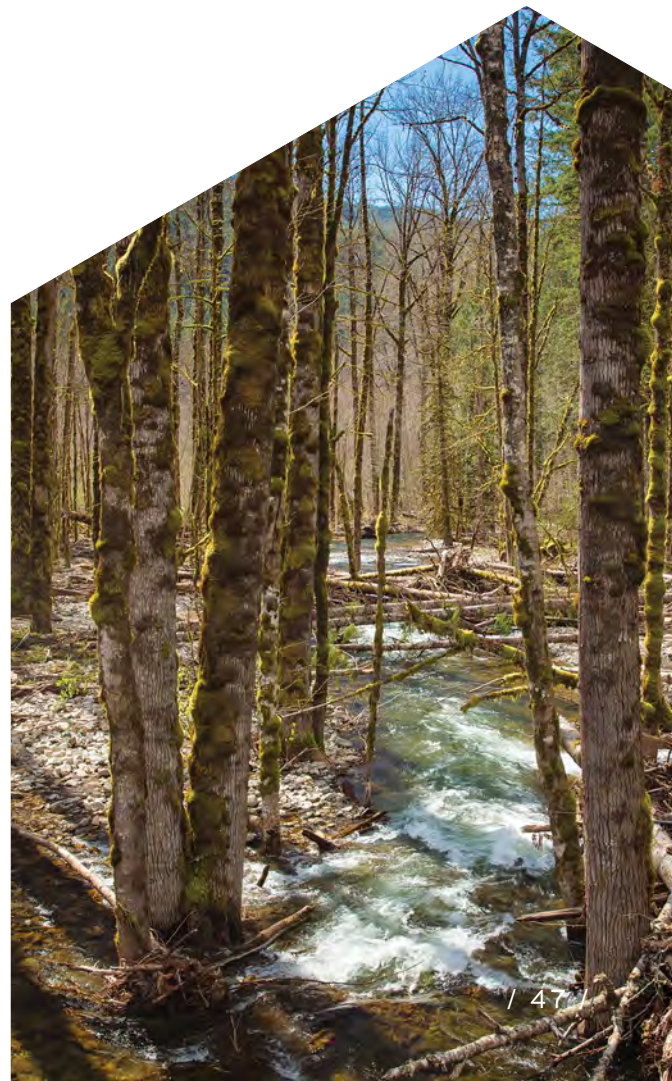
TACOMA WATER

Community engagement, improved planning and emergency preparedness were the 2016 themes for Tacoma Water.

Following the prior year's drought, snowpack and rainfall adequately supported water demands and environmental needs. Still, concerns regarding water supply were heightened in the community, as illustrated by community opposition to a proposed large industrial plant in the utility's service area that would have required a significant amount of water. Ultimately, the plant owners did not pursue the Tacoma location. Still, the utility viewed the experience as a lesson learned and developed a scope of work for an Integrated Resource Plan, which will be a priority project in 2017. The project will include a stakeholder advisory team and will study and plan for how the utility manages its future supply.

As the country learned the extent of the lead issues in Flint, Michigan, water systems – including Tacoma Water – took a deeper look at their own exposure and compliance. With just a small amount of lead pipe in its system, Tacoma Water effectively uses corrosion control methods on its water sources to limit the risks of lead in the drinking water. Even so, a series of high lead samples taken outside four customers' homes at disconnected pipes became a public issue garnering considerable attention. Tacoma Water took a proactive approach to engaging the media and customers throughout the process of further analyzing and understanding the cause of the sample results. Tacoma received positive feedback from both customers and policymakers for being open and transparent throughout the event.

TACOMA WATER
MADE SUBSTANTIAL
STRATEGIC
PROGRESS WHILE
PROVIDING CLEAN,
RELIABLE WATER AT
AFFORDABLE RATES.



FOCUS ON PLANNING, FINANCES

Tacoma Water focused on improved planning and decision making, especially as it relates to the work it does on the utility's infrastructure. With access to more data and improved analysis, the utility used strategic asset plans and maintenance strategies to drive decisions about the work performed on the system. Planning and scheduling of operations and maintenance work was a significant 2016 effort, along with further development of economic models to project optimal replacement schedules for system components.

As a tribute to the progress Tacoma Water is making in the area of planning and decision making, the utility was named one of 10 utilities nationally to receive the Association of Metropolitan Water Agencies Platinum Award for Utility Excellence.

Tacoma Water continued to make progress on its strategic plan over the year, ensuring that work is prioritized and adequately resourced, that actions are planned, progress is measured, and issues are resolved.

An independent economic competitiveness assessment was performed in 2016 on Tacoma Water's rates, fees, charges and new service requirements. The results will provide policymakers information about customer

trends, demographic and economic forecasts, cost of service, comparative water rates and charges, and a broad understanding of the utility's service territory and its competitiveness from an economic development perspective.

In further support of improved system and financial planning, Tacoma Water developed two demand forecasts with differing objectives in mind, each of which was addressed by a separate model, developed with a slightly different methodology. The short-term forecast focuses on projecting revenue for the next 10 years. This forecast will help establish revenue requirements and aid the cost-of-service analysis and rate design efforts. The long-term forecast examines potential source-of-supply constraints and wholesale/large volume customer contracting demand risks when used in conjunction with the Tacoma Water's source-of-supply model. In 2016, the utility streamlined, semi-automated and updated data for both models to provide Tacoma Water more timely and actionable forecasting results.

Toward the end of the year, Tacoma Water began negotiations to acquire a water system adjacent to Tacoma's system. The new system has been a long-standing wholesale customer and has more than 620 service connections. As part of the acquisition, Tacoma Water proposed making \$12 million in system improvements over about 10 years. The utility will recoup the cost of the system improvements through a customer surcharge. By transitioning the wholesale account to 620 retail accounts, Tacoma Water will increase annual revenue by \$100,000 a year.

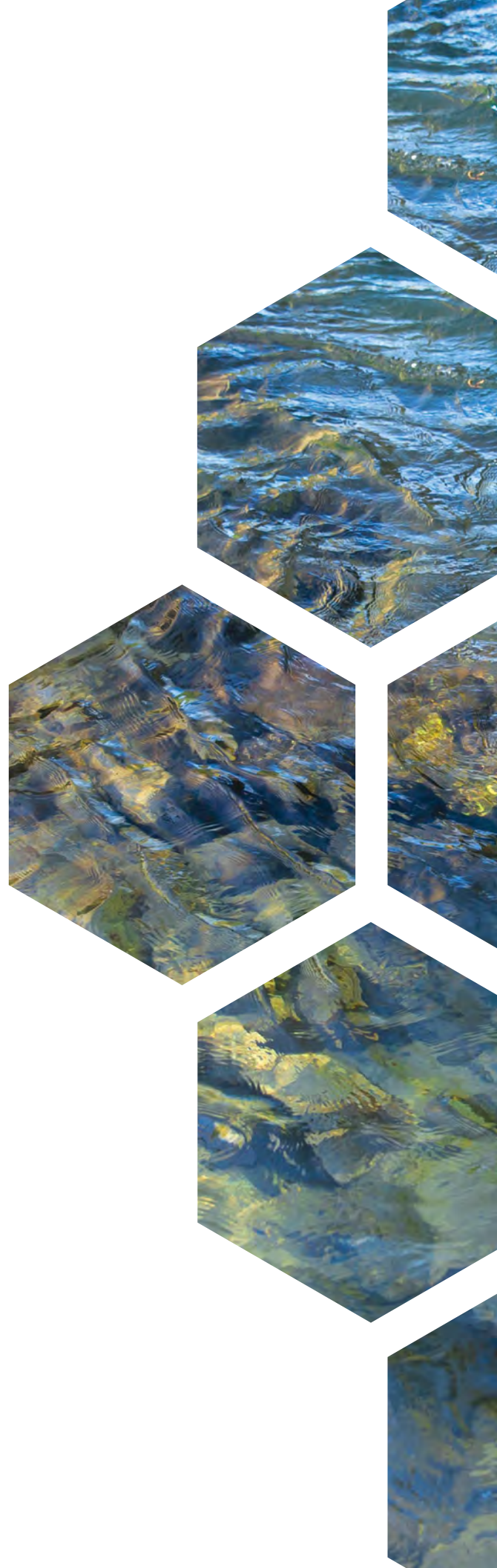
EMERGENCY PREPAREDNESS WORK

In an unprecedented planning effort spanning three counties, the area's primary water suppliers came together to help the central Puget Sound region better prepare for the impacts of risks to water supply due to seismic, water quality, drought and climate change events that have the potential to disrupt the delivery of safe and reliable water. As a result of this significant effort, not motivated by mandate or crisis, the group was named one of the 2017 Bright Ideas in Government initiative in government policies, initiatives and best practices by The Ash Center for Democratic Governance and Innovation at the John F. Kennedy School of Government, Harvard University. The group will further its work in 2017.

The Northwest is vulnerable to seismic activity, so preparing for earthquakes in particular is critical to the utility's service commitment to customers. In June, Tacoma Water and all of Tacoma Public Utilities participated in a multistate exercise based on a 9.0 earthquake occurring just off the west coast. In the scenario, infrastructure for the region was significantly damaged. Tacoma Water fully participated in the comprehensive drill and took away some key lessons that will help it be even better prepared in an emergency.

The Green River Filtration Facility completed its first full year of operation in 2016. The plant has continued to perform well and reliably produce high-quality water.

Throughout the year, Tacoma Water made substantial strategic progress while continuing to provide a high level of reliable, clean water at affordable rates to its customers.



FINANCIAL HIGHLIGHTS

In millions, for the years ended
December 31,

	2016	2015	2014	2013	2012
Tacoma Water					
Total Income	\$ 94.7	\$ 92.2	\$ 86.1	\$ 77.7	\$ 77.5
Operating Expenses	52.8	48.4	43.7	41.7	37.8
Income Available for Debt Service	\$ 41.9	\$ 43.8	\$ 42.4	\$ 36.0	\$ 39.7
Debt Service	\$ 18.3	\$ 18.8	\$ 19.9	\$ 21.0	\$ 25.1
Debt Service Coverage	2.29x	2.33x	2.14x	1.72x	1.58x
Plant Additions	\$ 36.3	\$ 223.4	\$ 95.2	\$ 138.0	\$ 106.7
Number of Customers	100,731	99,943	98,608	97,856	96,333
Average Rates (per 100 cubic feet)					
Residential	\$ 4.534	\$ 4.254	\$ 4.185	\$ 3.937	\$ 3.717
Commercial/Industrial	\$ 3.924	\$ 3.818	\$ 3.634	\$ 3.373	\$ 3.179

Water Sales (dollars in millions)	2016	2015
Residential	50.74	48.20
Commercial	17.56	14.76
Special	5.85	5.95
Other	3.97	7.73
Unbilled Revenue	(0.14)	0.32

Water Consumption (gallons in billions)	2016	2015
Residential	11.19	8.49
Commercial	4.47	3.21
Special	7.24	5.79
Other	1.71	1.95

Operating Expenses	2016	
Depreciation	\$ 23,822,527	32%
Distribution	14,334,563	19%
Production	13,881,773	18%
Administration	10,518,458	14%
Other Operating Expenses	4,829,673	7%
Taxes	4,639,031	6%
Power & Transmission	3,329,896	4%

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, 2016 and 2015, 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, 2016 and 2015, 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 14, schedule of proportionate share of net pension liability, and schedule of the City of Tacoma's contributions employer contributions on page 50 be presented to supplement the basic 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 51 through 71 and the superintendent's report presented on pages 72 through 84 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 express no opinion on it.



Tacoma, Washington
April 19, 2017

MANAGEMENT DISCUSSION & 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, 2016 and 2015. 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, 2016 and 2015, 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.

The Division adopted GASB Statement No. 72, *Fair Value Measurement and Application*, during fiscal year 2016. The statement provides guidance for determining fair value to certain investments and disclosures related to all fair value measurements, and requires accounting for investments at fair value (See note 3).

Financial Highlights

- The net position of Tacoma Water was \$549.7 million in 2016, \$542.5 million in 2015 and \$516.7 million in 2014. Of these amounts, \$57.1 million in 2016, \$53.8 million in 2015, and \$46.7 million in 2014 is reported as Unrestricted net position and is available to finance day-to-day operations without constraints established by debt covenants or other legal requirements.
- Tacoma Water's total net positions increased by \$7.2 (1.3%) million in 2016, \$24.7 (4.8%) million in 2015 and \$36.4 (7.6%) million in 2014.
- Operating revenues were \$92.8 million in 2016, a decrease of \$5.3 million (5.4%) compared to 2015. While sales and other revenue increased by \$1.5 million, contract resource obligation revenue decreased by \$6.9 million. The decrease in contract resource revenue is primarily due to a shift in focus from building the Green River Filtration Facility to operating the facility and the partners were billed accordingly. Operating revenues were \$98.1 million in 2015, a decrease of \$0.2 million (0.2%) compared to \$98.3 million in 2014. While sales revenue increased by \$7.3 million, contract resource obligation revenue decreased by \$7.5 million because the Green River Filtration Facility is complete and the partners were billed less.

- In 2016, Tacoma Water's net utility plant of \$879.5 million represented a decrease of \$5.2 million (0.6%) compared to the 2015 \$884.7 million balance. This is primarily due to a net increase of \$15.5 million in plant in service offset by an increase in accumulated depreciation of \$20.6 million. In 2015, net utility plant was \$884.7 million, \$12.6 million (1.4%) more than 2014's \$872.1 million balance. Major projects contributing to the increase include the Green River Water Filtration Facility and Main Replacements.

Overview of Financial Statements

Tacoma Water reported net operating income of \$17.4, \$34.6 and \$39.8 million in 2016, 2015 and 2014 respectively. In 2016, operating revenues decreased by \$5.3 million and operating expenses increased \$11.8 million. For 2015, operating revenues decreased by \$0.2 million and operating expenses increased \$5.0 million. The following tables highlight Tacoma Water's past three years' operating results and gallons billed.

Operating Results (in thousands)

Category	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Operating Revenues	\$ 92,802	\$ 98,139	\$ 98,320	\$ (5,337)	\$ (181)
Operating Expenses	75,356	63,588	58,557	11,768	5,031
Net Operating Income	17,446	34,551	39,763	(17,105)	(5,212)
Net Non-Operating Income (Expense)	(17,395)	(15,595)	(9,657)	(1,800)	(5,938)
Capital Contributions	10,274	9,053	8,671	1,221	382
Federal BAB Subsidies and Grants	3,579	3,610	3,959	(31)	(349)
Transfers Out	(6,754)	(6,874)	(6,352)	120	(522)
Change in Net Position	\$ 7,150	\$ 24,745	\$ 36,384	\$ (17,595)	\$ (11,639)

Gallons Billed (in millions)

Type of Customer	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Residential	8,351.1	8,483.5	7,970.7	(132.4)	512.8
Commercial & Industrial	8,763.4	9,140.7	9,187.2	(377.3)	(46.5)
Municipal & Wholesale	1,275.6	1,881.1	1,185.6	(605.5)	695.5
Total	18,390.1	19,505.3	18,343.5	(1,115.2)	1,161.8

Net Position

Net position may serve over time as a useful indicator of an entity's financial position.

The analysis highlights net position for the last three years.

Statements of Net Position (in thousands)

Description	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Net Utility & Non-Utility Plant	\$ 880,041	\$ 885,214	\$ 872,576	\$ (5,173)	\$ 12,638
Current & Other Assets	228,621	212,475	208,947	16,146	3,528
Total Assets	\$ 1,108,662	\$ 1,097,689	\$ 1,081,523	\$ 10,973	\$ 16,166
Deferred Outflows	10,623	4,003	1,588	6,620	2,415
Total Assets & Deferred Outflows	\$ 1,119,285	\$ 1,101,692	\$ 1,083,111	\$ 17,593	\$ 18,581
Net Position:					
Net Investment in Capital Assets	\$ 490,052	\$ 485,977	\$ 468,209	\$ 4,075	\$ 17,768
Restricted	2,496	2,733	1,797	(237)	936
Unrestricted	57,104	53,792	46,667	3,312	7,125
Total Net Position	549,652	542,502	516,673	7,150	25,829
Long-Term Debt	478,617	478,401	483,542	216	(5,141)
Current and Other LT Liabilities	54,919	44,283	47,321	10,636	(3,038)
Total Liabilities	533,536	522,684	530,863	10,852	(8,179)
Deferred Inflows	36,097	36,506	35,575	(409)	931
Total Net Position, Liabilities & Deferred Inflows	\$ 1,119,285	\$ 1,101,692	\$ 1,083,111	\$ 17,593	\$ 18,581

Revenues

Tacoma Water's operating revenues were \$92.8 million in 2016, a decrease of \$5.3 million (5.4%) compared to 2015. Sales of water increased in 2016 by a net of \$1.0 million of which \$4.2 million is due to an average rate increase of 4.0% effective January 1, 2016 and a decrease in usage of \$3.2 million. This is offset by a decrease in contract resource obligations of \$6.9 million. Regional Water Second Supply (RWSS) Partners reimbursed Tacoma Water for the final expenses related to building the Green River Filtration Facility in the first quarter of 2016. Contract resource revenue for the remainder of the year includes recovery of primarily O&M related expenses, resulting in a net reduction.

Operating revenues were \$98.1 million in 2015, a decrease of \$0.2 million (0.2%) compared to 2014. Sales of water increased in 2015 by \$7.3 million of which \$1.2 million is due to an average rate increase of 4.0% effective April 1, 2015 and \$6.0 million is due to an increase in usage. This is offset by a decrease in contract resource obligations of \$7.5 million. The construction of the Green River Filtration Facility is complete and the partners were billed less.

The following table highlights water sales by type of customer for 2016, 2015 and 2014.

Water Sales (in thousands)

Type of Customer	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Residential & Domestic	\$ 50,742	\$ 48,263	\$ 44,656	\$ 2,479	\$ 3,607
Commercial & Industrial	17,559	17,234	15,406	325	1,828
Special Rate	5,846	5,951	5,802	(105)	149
Wholesale	3,972	5,192	3,718	(1,220)	1,474
Unbilled Revenue	(138)	319	121	(457)	198
Total	\$ 77,981	\$ 76,959	\$ 69,703	\$ 1,022	\$ 7,256

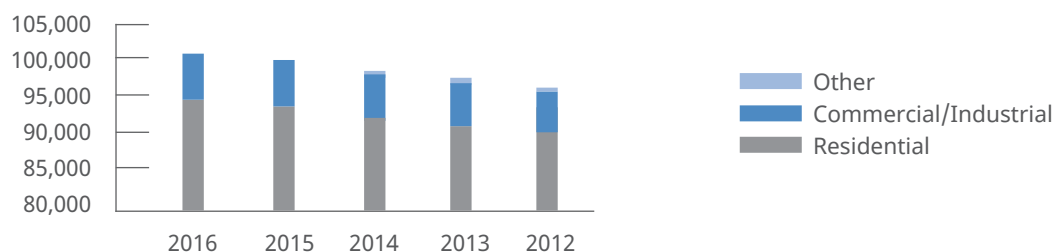
Approximately 65.1%, 62.7% and 64.1% of water sales were to residential and domestic customers in 2016, 2015 and 2014 respectively. Commercial and industrial sales were 22.5%, 22.4% and 22.1% of total sales for each year. Special rate sales were 7.5%, 7.7% and 8.3% of sales respectively.

Customers

Over the last five years, the overall number of customers has remained relatively stable. In 2016, 93.8% of all customers were residential compared to 93.6% in 2015 and 93.5% in 2014. Commercial and industrial customers were 6.2% of all customers in 2016, 6.4% in 2015 and 6.5% in 2014.

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

Number of Customers

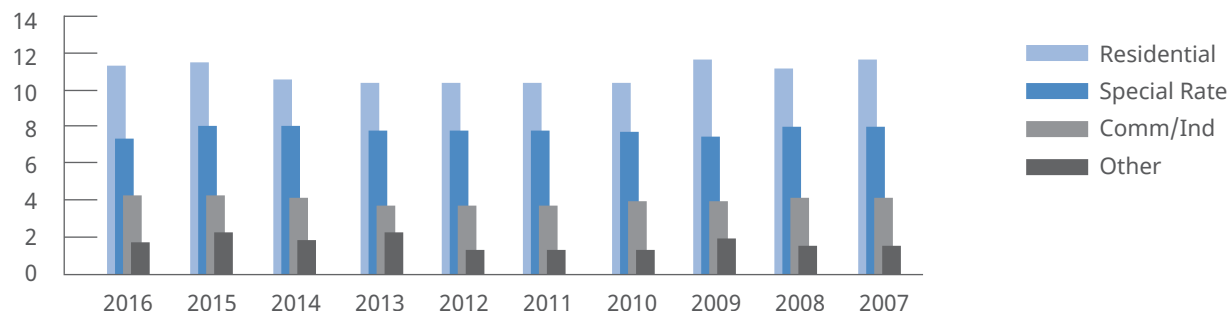


Water Users

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 2016, 2015 and 2014 residential customers used 11.2 million CCF (45.5%), 11.3 million CCF (43.5%) and 10.7 million CCF (43.4%) of total sales respectively. Special Rate customers used approximately 7.2 million CCF (29.4%), 7.7 million CCF (29.7%) and 8.1 million CCF (33.0%) respectively. Commercial and industrial customers used 4.5 million CCF (18.2%), 4.4 million CCF (16.8%) and 4.2 million CCF (16.8%) respectively. The remaining 1.7 million CCF (6.9%), 2.6 million CCF (10.0%) and 1.6 million CCF (6.8%) 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 2016, operating expenses increased \$11.8 million (18.5%), compared to an increase of \$5.0 million (8.6%) in 2015. Source of Supply saw expenses returning to normal in 2016. Increased use of in-town wells due to the 2015 drought caused a labor shift from other sections of Tacoma Water to focus on operating the wells. In 2016, the wells were used significantly less which resulted in a decrease in expenses of \$0.5 million (6.4%) when compared to 2015. Similarly, the cost to pump the well water decreased by \$0.3 million (34.0%), as well as the costs related to Transmission and Storage which decreased by \$0.1 million (1.9%).

Treatment experienced an increase of \$1.8 million (37.1%) compared to 2015 as expenses shifted back from in-town supply sources to the planned operation of the Green River Filtration Facility (GRFF). Although the GRFF came online in 2015, due to the statewide drought and the requirements to ensure adequate fish passage in the Green River, it was used less than expected. When compared to 2015, chemical expenses increased by \$0.6 million, solid handling costs increased by \$0.1 million and electricity increased by \$0.3 million. Also contributing nearly \$0.1 million to the increased treatment costs was the response to lead detected in our water system in April of 2016.

Expenses related to the Distribution system increased by approximately \$2.0 million (16.6%) in 2016. This is primarily due to a shift from capital work to a focus on operations and maintenance, which accounted for an additional \$0.4 million in labor and equipment charged to operating expenses rather than capital projects. Also contributing to the variance in Distribution was \$0.3 million that was spent in 2016 on condition assessment for distribution lines.

Due primarily to an increase in assessments, Administrative and General and Customer Accounting expenses experienced increases of \$1.6 million (18.3%) and \$0.5 million (11.6%) respectively.

Depreciation expense increased by \$6.7 million (39.3%) in 2016 due to a net increase in depreciable assets of \$192.3 million during 2015.

GASB 68, *Accounting and Financial Reporting for Pensions*, resulted in an increase in expense of \$1.4 million in 2016. This expense was allocated across the Water sections as follows: Source \$0.3 million, Treatment \$0.2 million, Transmission \$0.1 million, Distribution \$0.6 million, and Admin & General \$0.2 million.

In 2015, operating expenses increased \$5.0 million (8.6%), compared to an increase of \$2.7 million (4.8%) in 2014. Not only did the Green River Filtration Facility come online in 2015 but a statewide drought was declared as well. Source of Supply experienced the largest increase, \$1.7 million (26.6%). Two major projects during the drought were the purchase of water from Lakehaven, \$0.6 million, and the pumping of Eagle Lake, \$0.3 million. Source of Supply also experienced an increase in labor, approximately \$0.7 million, as labor was shifted from Transmission to Source.

Treatment saw an increase this year of \$1.1 million (28.3%) compared to 2014. Most of this increased cost of treatment can be attributed to the Green River Filtration Facility coming online. This shift in focus from capital to maintenance caused labor to increase by \$0.9 million. The drought also played a part by causing the need to purchase additional chemicals, \$0.2 million, to treat well water.

Power Pumping experienced an increase of \$0.3 million largely due to increased electricity expense due to the drought.

Administrative and General expense increased \$0.8 million (9.8%). In 2015, the department filled previously vacant positions causing a \$0.5 million increase in labor expense. Insurance expense also increased by \$0.2 million because Tacoma Water is now insuring the Plant and other facilities in the Headworks.

Due to the shift in focus from capital to maintenance, Distribution saw an increase of \$0.2 million (3.1%). However, Transmission experienced a decrease of \$0.1 million (5.2%) because labor was shifted from Transmission to Source of Supply.

Depreciation expense increased by \$0.3 million (1.9%) in 2015 due to an increase in depreciable assets of \$17.8 million during 2014.

The following table highlights Tacoma Water's operating expenses for 2016 – 2014.

Operating Expenses (in thousands)

Category	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Production Expense					
Source of Supply	\$ 7,541	\$ 8,056	\$ 6,333	\$ (515)	\$ 1,723
Water Treatment	6,794	4,957	3,894	1,837	1,063
Total Production Expense	14,335	13,013	10,227	1,322	2,786
Power Pumping Expense	559	847	568	(288)	279
Transmission & Storage Expense	2,770	2,823	2,966	(53)	(143)
Distribution Expense	13,882	11,902	11,695	1,980	207
Customer Accounting & Service	4,830	4,327	4,435	503	(108)
Taxes	4,639	4,681	3,779	(42)	902
Depreciation	23,823	17,103	16,784	6,720	319
Administrative & General	10,518	8,892	8,102	1,626	790
Total Operating Expenses	\$ 75,356	\$ 63,588	\$ 58,556	\$ 11,768	\$ 5,032

Capital Assets

Tacoma Water invests in a broad range of utility assets and at the end of 2016 had \$879.5 million in net utility plant, a decrease of \$5.2 million from 2015.

Plant in Service increased \$15.5 million compared to 2015. In 2016, 11.6 miles of water main were added or replaced. Construction was completed on 27 private contracts in 2016, resulting in 8.33 miles. The \$20.6 million increase in accumulated depreciation is due to the net increase in Plant in Service in 2015 of \$192.3 million.

At the end of 2015 Tacoma Water had \$884.7 million in net utility plant, an increase of \$12.6 million from 2014. Plant in Service increased \$192.3 million primarily due to the completion and capitalization of the Green River Filtration Facility. The capitalization of the new facility also attributed to the decrease of \$165.7 million in construction work in progress. In 2015, 11.7 miles of water main were added; and 11.5 miles in 2014. Construction was completed on 17 private contracts in 2015, adding 5.87 miles; and 18 private contracts in 2014 added 7.55 miles.

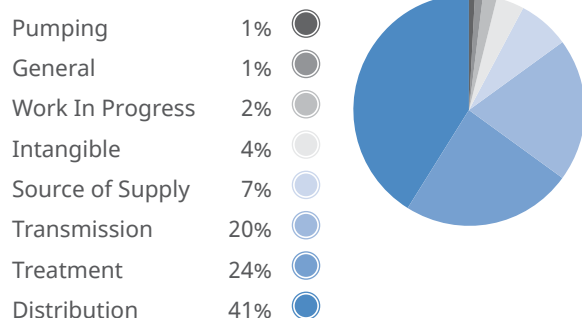
The following table summarizes Tacoma Water's capital assets, net of accumulated depreciation, for 2016 – 2014.

Capital Assets, Net of Accumulated Depreciation (in thousands)

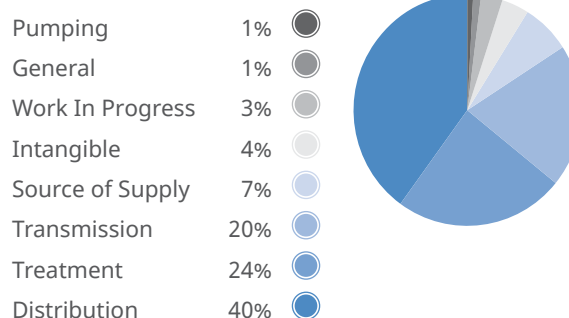
Net Utility Plant	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Intangible Plant	\$ 36,581	\$ 36,368	\$ 36,006	\$ 213	\$ 362
Source of Supply Plant	60,348	60,534	62,218	(186)	(1,684)
Pumping Plant	5,448	5,542	5,748	(94)	(206)
Water Treatment Plant	206,273	213,512	36,260	(7,239)	177,252
Transmission Plant	176,439	180,209	183,974	(3,770)	(3,765)
Distribution Plant	361,693	355,557	348,655	6,136	6,902
General Plant	12,194	12,368	12,868	(174)	(500)
Construction Work In Progress	20,572	20,631	186,354	(59)	(165,723)
Total	\$ 879,548	\$ 884,721	\$ 872,083	\$ (5,173)	\$ 12,638

The following graphs provide a visual presentation of the allocation of Tacoma Water's capital investments in 2016 and 2015.

2016 Net Utility Plant



2015 Net Utility Plant



Additional information on capital assets can be found in Note 4 of the financial statements.

Debt Administration

At December 31, 2016 Tacoma Water had outstanding revenue bond obligations of \$392.3 million (net of unamortized bond premiums), a decrease of \$7.6 million compared to 2015. As of year-end 2015, the Utility had outstanding revenue bond obligations of \$399.9 million (net of unamortized bond premiums); a decrease of \$7.4 million compared to 2014. Tacoma Water issued \$23.0 million of Water System Refunding Bonds in May 2015.

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 a debt service coverage ratio of 1.25 for principle and interest. Debt service coverage ratios (excluding RWSS) were 2.29, 2.33, and 2.14 in 2016, 2015 and 2014 respectively.

At the end of 2016, Tacoma Water had an outstanding State loan balance of \$99.5 million compared to \$89.0 million in 2015 and \$86.7 million in 2014. During 2016, Tacoma Water received \$16.8 million in Drinking Water State Revolving Fund (DWSRF) Loans. Tacoma Water received \$0.6 million against the 2010 DWSRF Loan, \$0.6 million against the 2011 DWSRF Loan, \$1.2 million against the 2012 DWSRF Loan, \$1.2 million against the 2013 DWSRF Loan, \$1.2 million against the 2013 Fall DWSRF Loan and \$12.0 million against the 2015 DWSRF Loan. These loans were specifically for the Green River Filtration Facility.

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 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

2016 FINANCIAL REPORTS

STATEMENTS OF NET POSITION

Statements of Net Position

	December 31,	
Assets and Deferred Outflows	2016	2015
Utility Plant		
In Service, at Original Cost	\$ 1,073,997,566	\$ 1,058,533,815
Less - Accumulated Depreciation	(215,021,698)	(194,443,324)
Total	858,975,868	864,090,491
Construction Work in Progress	20,571,782	20,630,616
Net Utility Plant	879,547,650	884,721,107
Non-Utility Property	492,963	492,963
Special Funds		
Construction Funds	41,717,595	33,587,187
Debt Service Funds	4,394,278	3,633,933
Bond Reserve Funds	22,030,885	22,037,730
System Development Charge Fund	58,617,922	55,889,603
Other Cash & Equity in Pooled Investments	30,066,803	28,161,316
Total Special Funds	156,827,483	143,309,769
Current Assets		
Operating Funds Cash and Equity in Pooled Investments	54,768,598	49,778,192
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$439,846 in 2016 and \$287,805 in 2015)	5,496,341	5,321,184
BABs Interest Subsidies Receivable	297,980	298,300
Accrued Unbilled Revenues	4,797,144	4,935,000
Materials and Supplies	2,341,548	2,487,075
Interfund Receivable	107,970	686,030
Prepayments	1,118,062	970,331
Total Current Assets	68,927,643	64,476,112
Other Assets		
Regulatory Asset-Public Fire Protection Fees	1,297,001	2,124,573
Regulatory Asset-Surcharges	1,569,477	1,683,348
Net Pension Asset	—	881,279
Total Other Assets	2,866,478	4,689,200
Total Assets	\$ 1,108,662,217	\$ 1,097,689,151
Deferred Outflows of Resources		
Unamortized Losses on Refunding Bonds	1,629,071	1,910,392
Deferred Outflows for Pensions	8,994,103	2,092,307
Total Deferred Outflows of Resources	10,623,174	4,002,699
Total Assets and Deferred Outflows	\$ 1,119,285,391	\$ 1,101,691,850

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

	December 31,	
Net Position, Liabilities and Deferred Inflows	2016	2015
Net Position		
Net Investment in Capital Assets	\$ 446,518,253	\$ 446,537,863
Restricted for:		
Water Capital and System Development Charge	43,533,806	39,439,003
Debt Service Funds	2,495,984	1,852,099
Net Pension Asset	—	881,279
Unrestricted	57,104,183	53,791,579
Total Net Position	549,652,226	542,501,823
Long-Term Debt		
Revenue Bonds	386,065,146	393,841,093
Public Works Trust Fund Loans	22,708,007	25,404,777
Drinking Water State Revolving Fund Loan	69,844,046	59,154,872
Total Long-Term Debt	478,617,199	478,400,742
Current Liabilities		
Current Maturities of Long-Term Debt	13,153,017	10,490,543
Current Maturities of Long-Term Liabilities	185,889	190,536
Accrued Taxes	1,492,476	1,863,652
Accrued Expenses and Contracts Payable	1,547,790	1,418,870
Salaries, Wages and Fringe Benefits Payable	680,647	584,328
Interest Payable	1,898,294	1,781,834
Customers' Deposits	349,725	348,793
Interfund Payables	1,678,889	1,582,992
Total Current Liabilities	20,986,727	18,261,548
Long-Term Liabilities		
Muckleshoot Agreements	6,943,806	7,129,695
Customer Advances for Construction	4,748,046	4,502,578
Unearned Revenue	7,568,812	7,905,152
Long-Term Accrued Compensated Absences	2,428,375	2,340,426
Net Pension Liability	7,788,151	—
Other Long-Term Liabilities	4,455,228	4,144,086
Total Long-Term Liabilities	33,932,418	26,021,937
Total Liabilities	533,536,344	522,684,227
Deferred Inflows of Resources		
Rate Stabilization	35,575,447	35,575,447
Deferred Inflows for Pensions	521,374	930,353
Total Deferred Inflows of Resources	36,096,821	36,505,800
Total Net Position, Liabilities, and Deferred Inflows	\$ 1,119,285,391	\$ 1,101,691,850

**Statements of Revenues, Expenses and
Changes in Net Position**

Year Ended December 31,

	2016	2015
Operating Revenues		
Sale of Water	\$ 77,980,741	\$ 76,959,187
Other Operating Revenues	9,997,213	9,487,934
Contract Resource Obligation Revenues	4,823,656	11,691,703
Total Operating Revenues	92,801,610	98,138,824
Operating Expenses		
Operations	17,211,669	15,571,889
Production	14,334,563	13,013,178
Administrative and General	15,348,131	13,219,166
Depreciation	23,822,527	17,102,664
Taxes	4,639,031	4,681,114
Total Operating Expenses	75,355,921	63,588,011
Net Operating Income	17,445,689	34,550,813
Non-Operating Revenues (Expenses)		
Interest Income	1,826,299	1,112,850
Other	(221,125)	(30,042)
Interest on Long-Term Debt (Net of AFUDC)	(20,754,254)	(20,022,582)
Amortization of Premium and Loss on Refunding	1,269,625	1,678,959
Interest Charged to Construction	484,093	1,665,978
Total Non-Operating Expenses	(17,395,362)	(15,594,837)
Net Income Before Capital Contributions and Transfers	50,327	18,955,976
Capital Contributions		
Cash	5,707,338	6,442,694
Donated Fixed Assets	4,566,692	2,609,980
Federal BAB Subsidies	3,577,355	3,548,228
Grants	1,752	61,478
Transfers		
City of Tacoma Gross Earnings Tax	(6,753,061)	(6,778,140)
Transfers to/from Other Funds	—	(95,327)
Change In Net Position	7,150,403	24,744,889
Net Position - Beginning Of Year	542,501,823	516,673,245
Accumulated Adjustment for Change in Accounting Principle	—	1,083,689
Total Net Position - Beginning of Year, As Adjusted	—	517,756,934
Total Net Position - End of Year	\$ 549,652,226	\$ 542,501,823

The accompanying notes are an integral part of these financial statements

Statements of Cash Flows
Year Ended December 31,

	2016	2015
Cash Flows From Operating Activities		
Cash from Customers	\$ 93,706,684	\$ 97,165,918
Cash Paid to Suppliers	(18,676,633)	(20,972,089)
Cash Paid to Employees	(25,874,134)	(25,556,817)
Taxes Paid	(5,010,207)	(4,222,796)
Net Cash From Operating Activities	44,145,710	46,414,216
Cash Flows From Non-Capital Financing Activities		
Transfer to Other Funds	—	(95,327)
Transfer Out for Gross Earnings Tax	(6,753,061)	(6,778,140)
Net Cash From Non-Capital Financing Activities	(6,753,061)	(6,873,467)
Cash Flows From Capital and Related Financing Activities		
Capital Expenditures, net	(13,598,285)	(25,464,456)
Proceeds from State Drinking Water Loan	16,800,000	6,420,000
Proceeds from Sale of Bonds	—	23,010,000
Debt Issuance Costs	13,680	(986,513)
Premium on Sale of Bonds	—	2,921,513
Principal Payments on Long-Term Debt	(12,370,124)	(10,442,545)
Principal Payments on Muckleshoot LT Liability	(190,536)	(195,300)
Payments on Refunding of Bonds	—	(25,065,000)
Interest Paid	(20,637,794)	(20,041,363)
BABs Federal Interest Subsidies	3,577,675	3,569,992
Grants Received	1,752	61,478
Contributions in Aid of Construction	5,707,338	6,442,694
System Development Charges, and Other LT Liabilities	220,270	(380,032)
Net Cash From Capital and Related Financing Activities	(20,476,024)	(40,149,532)
Cash Flows From Investing Activities		
Interest Received on Investments	1,826,299	1,112,850
Other Net Non-Op Revenues and Expenses	(234,804)	375,652
Net Cash From Investing Activities	1,591,495	1,488,502
Net Change in Cash and Equity in Pooled Investments	18,508,120	879,719
Cash & Equity in Pooled Investments at January 1	193,087,961	192,208,242
Cash & Equity in Pooled Investments at December 31	\$ 211,596,081	\$ 193,087,961

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

**Reconciliation of Net Operating Income to Net Cash
From Operating Activities**

	Year Ended December 31,	
	2016	2015
Net Operating Income	\$ 17,445,689	\$ 34,550,813
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation	23,822,527	17,102,664
Pension (Credits) Expense	1,358,655	(959,544)
Cash from changes in operating assets and liabilities:		
Accounts Receivable and Unbilled Revenue	(37,301)	(1,007,395)
Interfund Receivables	578,060	(393,736)
Regulatory Asset-Public Fire Protection Fees	827,572	816,101
Regulatory Asset Surcharges	113,871	(854,814)
Materials and Supplies	145,527	(85,552)
Prepayments	(147,731)	(263,767)
Accrued Taxes	(371,176)	458,318
Salaries, Wages and Fringe Benefits Payable	96,319	(708,707)
Long-Term Accrued Compensated Absences	87,949	39,929
Customers' Deposits	932	73,202
Accrued Expenses and Contracts Payable	128,920	(2,597,089)
Interfund Payables	95,897	243,793
Total Adjustments	\$ 26,700,021	\$ 11,863,403
Net Cash From Operating Activities	\$ 44,145,710	\$ 46,414,216

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

Cash and Equity in Pooled Investments in Special Funds	\$ 156,827,483	\$ 143,309,769
Cash and Equity in Pooled Investments in Operating Funds	54,768,598	49,778,192
Cash and Equity in Pooled Investments at December 31	\$ 211,596,081	\$ 193,087,961

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

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) and is included as an enterprise fund 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 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 100,731 customers and had 242 employees as of December 31, 2016. 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 plan, forecast and model distribution system expansion and renewal and replacements; engineer, design, and oversee construction of mains, hydrants, services, meters, pressure reducing valves and pressure zones; provide excellent customer service and key account management; support growth and development through coordination, permitting and contracting; promote water conservation through outreach and customer programs.

WATER DISTRIBUTION OPERATIONS - To effectively operate and maintain the various components of the distribution system including mains, hydrants, valves, services and meters; to respond to and repair main breaks and leaks; to install new services and hydrants as need for development; to manage the warehouse and materials purchasing; to provide customer service for outages and all other water service issues; to oversee and manage the apprenticeship program; and to provide effective leadership for Tacoma Water's safety program.

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 - Designs, constructs, operates and maintains the following of the City's water supply structures: transmission mains and appurtenances, rights-of-ways, wells, pump stations and other mechanical/electrical equipment, storage tanks and reservoirs, pressure reducing stations, many Tacoma Water buildings and properties, communication and telemetry systems (including the Water Control Center), corrosion control facilities, and administers water rights and tracks water system security issues, while overseeing and managing Tacoma Water's emergency preparedness and coordinating with outside agencies.

WATER ASSET AND INFORMATION MANAGEMENT – Prepares system and strategic plans, supports Tacoma Water’s Geographic Information System and Hydraulic Model operating technologies, promotes use and maturity of TPU information technologies, and oversees asset management implementation which incorporates risk, levels of service, and lifecycle costs into the Tacoma Water decision making process.

WATER RATES AND FINANCIAL PLANNING – Is responsible for the utility’s long range financial plan, rates and charges, budget development and monitoring, and rate and financial policies. This group provides financial, supply and demand, and customer analytics and reports to support decision-making by executive management, policymakers and the RWSS Partners. This group develops and administers special retail and wholesale water supply agreements in pursuit of the utility’s strategic objectives, and is responsible for leading new performance management, risk management, and advanced metering objectives through cross-functional engagement with the utility and TPU.

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 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 in certificates of deposit with East West Bank and Opus Bank.

The Division's equity in that portion of the City of Tacoma Investment Pool held in qualified public depositories at December 31, 2016 and 2015 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 is 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 as of December 31st.

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 (NARUC) 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, Hyada Surcharges and Andrain 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.

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. Sick leave pay is recorded as a liability and an expense in the year earned.

The accrued liability is computed at 100% vacation and PTO while sick leave is accrued at 10%, which is considered the amount vested or 25% if the employee meets retirement criteria. Based on historical information, 10% of compensated absences are considered short term.

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), pension, 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.

NOTE 3 INVESTMENTS MEASURED AT FAIR VALUE

The City measures and records its investments within the fair value hierarchy established by generally accepted accounting principles.

The hierarchy is based on the valuation inputs used to measure the fair value of the asset, where fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. These guidelines recognize a three-tiered fair value hierarchy, as follows:

- **Level 1** – Level 1 inputs are quoted (unadjusted) prices in active markets for identical assets or liabilities that the government can access at the measurement date. Observable markets include exchange markets, dealer markets, brokered markets and principal-to-principal markets.
- **Level 2** – Level 2 inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These inputs are sourced from pricing vendors using models that are market-based and corroborated by observable market data including: quoted prices; nominal yield spreads; benchmark yield curves; and other corroborated inputs.
- **Level 3**– Level 3 inputs are unobservable inputs for the asset or liability and should only be used when relevant Level 1 or Level 2 inputs are unavailable.

The fair value evaluations are provided by Interactive Data. Interactive Data utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information and for structured securities, cash flow and, when available, loan performance data. Because many fixed income securities do not trade on a daily basis, Interactive Data's evaluated pricing applications apply available information as applicable through processes such as benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing, to prepare evaluations. In addition, Interactive Data uses model processes, such as the Option Adjusted Spread model to assess interest rate impact and development payment scenarios. Their models and processes take into account market convention. For each asset class, a team of evaluators gathers information from market sources and integrates relevant credit information, perceived market movements and sector news into the evaluated pricing applications and models.

Source: Interactive Data "Summary of Inputs by Asset Class Fixed Income Evaluations, Fair Value Information Service and Valuations of Certain Other Instruments" dated January 2016.

Cash and cash equivalents include highly liquid investments including short-term investment funds. Cash and cash equivalents are valued at cost and, therefore, excluded from the fair value schedule.

Data regarding the City's investments, valued and categorized according to the above outlined levels, is below:

Debt Securities	As of 12/31/2016	Level 1	Level 2	Level 3
U.S. Treasury Securities	\$ 146,824,628	\$ —	\$ 146,824,628	\$ —
U.S. Agency Securities	544,579,831	—	544,579,831	—
Municipal Bonds	61,450,051	—	61,450,051	—
Total	\$ 752,854,510	\$ —	\$ 752,854,510	\$ —

Debt Securities	As of 12/31/2015	Level 1	Level 2	Level 3
U.S. Treasury Securities	\$ 108,647,159	\$ —	\$ 108,647,159	\$ —
U.S. Agency Securities	541,730,184	—	541,730,184	—
Municipal Bonds	119,200,942	—	119,200,942	—
Total	\$ 769,578,285	\$ —	\$ 769,578,285	\$ —

Tacoma Water's share of the City Investments shown in the table above is 24.45% and 23.98% for 2016 and 2015.

NOTE 4 UTILITY PLANT

A summary of the balances and changes in utility plant for 2016 and 2015 follows:

	Balance December 31, 2015	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2016
Intangible Plant	\$ 36,367,666	\$ 783,399	\$ (569,580)	\$ —	\$ 36,581,485
Source of Supply Plant	83,671,496	1,813,377	—	—	85,484,873
Pumping Plant	9,400,042	143,831	—	—	9,543,873
Water Treatment Plant	229,764,871	1,056,127	—	—	230,820,998
Transmission Facilities	230,986,906	2,766	—	—	230,989,672
Distribution Facilities	433,734,385	13,210,948	(2,150,707)	—	444,794,626
General Plant	34,608,449	1,189,967	(16,377)	—	35,782,039
Total Water Plant In Service	1,058,533,815	18,200,415	(2,736,664)	—	1,073,997,566
Less Accumulated Depreciation	194,443,324	23,822,527	(2,167,084)	(1,077,069)	215,021,698
	864,090,491	(5,622,112)	(569,580)	1,077,069	858,975,868
Construction Work In Progress	20,630,616	18,141,410	—	(18,200,244)	20,571,782
Net Utility Plant	\$ 884,721,107	\$ 12,519,298	\$ (569,580)	\$ (17,123,175)	\$ 879,547,650

	Balance December 31, 2014	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2015
Intangible Plant	\$ 36,006,378	\$ 556,588	\$ (195,300)	\$ —	\$ 36,367,666
Source of Supply Plant	83,383,567	287,929	—	—	83,671,496
Pumping Plant	9,388,535	32,123	(20,616)	—	9,400,042
Water Treatment Plant	50,736,258	179,028,769	(156)	—	229,764,871
Transmission Facilities	230,964,809	22,097	—	—	230,986,906
Distribution Facilities	422,055,694	13,647,713	(1,969,022)	—	433,734,385
General Plant	33,744,366	1,106,582	(29,300)	(213,199)	34,608,449
Total Water Plant In Service	866,279,607	194,681,801	(2,214,394)	(213,199)	1,058,533,815
Less Accumulated Depreciation	180,549,889	17,102,664	(2,019,094)	(1,190,135)	194,443,324
	685,729,718	177,579,137	(195,300)	976,936	864,090,491
Construction Work In Progress	186,353,639	28,745,579	—	(194,468,602)	20,630,616
Net Utility Plant	\$ 872,083,357	\$ 206,324,716	\$ (195,300)	\$ (193,491,666)	\$ 884,721,107

Total Water Plant in Service includes non-depreciable assets of \$59,139,334 for 2016 and \$58,314,508 for 2015. The total amount of interest incurred and capitalized is \$484,093 for 2016 and \$1,665,979 for 2015.

NOTE 5 LONG-TERM DEBT

The Division's Long-term Liabilities are primarily for the purpose of capital improvements. Long-term debt activities for 2016 and 2015 were as follows:

	Balance December 31, 2015	Additions	Reductions	Balance December 31, 2016	Due Within One Year
Revenue Bonds	\$ 384,705,000	\$ —	\$ (6,080,000)	\$ 378,625,000	\$ 6,225,000
Plus: Unamortized Premium	15,216,093	—	(1,550,947)	13,665,146	
Net Revenue Bonds	399,921,093	—	(7,630,947)	392,290,146	6,225,000
Public Works Trust Fund Loans	28,101,548	—	(2,696,771)	25,404,777	2,696,771
Drinking Water State Revolving Fund Loans	60,868,644	16,800,000	(3,593,351)	74,075,293	4,231,246
Total Long-Term Debt	\$ 488,891,285	\$ 16,800,000	\$ (13,921,069)	\$ 491,770,216	\$ 13,153,017

	Balance December 31, 2014	Additions	Reductions	Balance December 31, 2015	Due Within One Year
Revenue Bonds	\$ 393,065,000	\$ 23,010,000	\$ (31,370,000)	\$ 384,705,000	\$ 6,080,000
Plus: Unamortized Premium	14,231,813	2,921,513	(1,937,233)	15,216,093	
Net Revenue Bonds	407,296,813	25,931,513	(33,307,233)	399,921,093	6,080,000
Public Works Trust Fund Loans	30,798,319	—	(2,696,771)	28,101,548	2,696,771
Drinking Water State Revolving Fund Loans	55,889,417	6,420,000	(1,440,773)	60,868,644	1,713,772
Total Long-Term Debt	\$ 493,984,549	\$ 32,351,513	\$ (37,444,777)	\$ 488,891,285	\$ 10,490,543

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

SENIOR LIEN BONDS	2016	2015
2005 Water System Revenue and Refunding Bonds, with interest rate of 5.0%, due in 2025. Original Issue: \$46,550,000 Current Portion: \$0	\$ 5,000	\$ 5,000
2009 Water System Revenue Bonds, with interest rate at 5.751%, with Build America Bond (BAB) rebate ranging from 32.45% to 32.62%, 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 3.0% to 5.0%, due in yearly installments ranging from \$570,000 to \$4,655,000 through 2023. Original Issue: \$29,100,000 Current Portion: \$570,000	26,395,000	26,950,000

SENIOR LIEN BONDS (CONT.)**2016****2015**

2010B Water System Revenue Bonds, with interest rates ranging from 4.581% to 5.621%, with Build America Bond (BAB) Rebate ranging from 32.45% to 32.62% of interest, due in yearly installments 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 3.0% to 4.0%, due in yearly installments starting ranging from \$280,000 to \$355,000 through 2024. (See Note 6)

Original Issue: \$3,595,000

Current Portion: \$280,000

2,525,000

2,800,000

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 32.45% to 32.62% 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 \$745,000 to \$6,425,000 through 2032.

Original Issue: \$64,795,000

Current Portion: \$745,000

60,910,000

61,580,000

2015A Water System Refunding Bonds with interest rates ranging from 4.0% to 5.0%, due in yearly installments starting in 2017 ranging from \$1,460,000 to \$2,845,000 through 2025.

Original Issue: \$16,645,000

Current Portion: \$2,845,000

\$ 16,645,000 \$ 16,645,000

2015B Water System Refunding Bonds with interest rate of 1.15%, final installment due in the amount of \$1,785,000 in 2017.

Original Issue: \$6,365,000

Current Portion: \$1,785,000

1,785,000

6,365,000

Subtotal Sr. Lien Debt

\$ 378,625,000 \$ 384,705,000

Unamortized Premium

13,665,146

15,216,093

Less Current Portion of Revenue Bond Debt

(6,225,000)

(6,080,000)

Long-term Portion of Revenue Bond Debt

\$ 386,065,146 \$ 393,841,093

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

Year	Principal	Interest
2017	\$ 6,225,000	\$ 18,887,997
2018	6,450,000	18,690,919
2019	7,610,000	18,428,169
2020	7,950,000	18,094,669
2021	8,355,000	17,703,369
2022-2026	46,655,000	82,269,708
2027-2031	58,715,000	69,381,686
2032-2036	82,085,000	52,278,699
2037-2041	104,045,000	26,442,615
2042-2043	50,535,000	3,052,000
	\$ 378,625,000	\$ 325,229,831

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. The Division was in compliance with all debt covenants at December 31, 2016.

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

JUNIOR LIEN DEBT

Public Works Trust Fund Loans	2016	2015
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 \$52,631 through 2021.	\$ 263,158	\$ 315,789
2001 Public Works Trust Fund construction loan for the SSP, with interest of .5% per annum, due in yearly installments of \$533,333 through 2021.	2,666,667	3,200,000
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 \$54,179 through 2021.	270,898	325,077
2002 Public Works Trust Fund construction loan for the Middle and Headworks section of the SSP, with interest of .5% per annum, due in yearly installments of \$531,250 through 2022.	3,187,500	3,718,750
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.	426,901	480,263
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 \$370,589 through 2026.	3,705,882	4,076,471

JUNIOR LIEN DEBT (CONT.)**2016****2015**

2008 Public Works Trust Fund construction loan for the McMillin Reservoir Reconstruction, with interest of .5% per annum, due in yearly installments of \$545,869 through 2028.

\$ 6,550,439 \$ 7,096,308

2012 Public Works Trust Fund construction loan for the Green River Filtration Facility, with interest of .5% per annum, due in yearly installments of \$555,556 through 2031.

8,333,333 8,888,889

Drinking Water State Revolving Fund Loans

2002 construction loan for the Portland Avenue Reservoir, with interest of 2.5% per annum, due in yearly installments of \$161,053 through 2021.

805,263 966,316

2008 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.5% per annum, due in yearly installments of \$215,109 through 2028.

2,581,300 2,796,409

2009 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.0% per annum, due in yearly installments of \$367,088 through 2032.

5,873,406 6,240,494

2010 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.5% per annum, due in yearly installments of \$303,000 through 2032.

4,848,000 5,151,000

2010 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$304,579 through 2034.

5,482,421 5,187,000

2011 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.5% per annum, due in yearly installments of \$121,524 through 2033.

2,065,902 2,187,426

2011 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$303,000 through 2035.

5,757,000 5,460,000

2012 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$606,000 through 2035.

11,514,000 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 \$606,000 through 2035.

11,514,000 10,920,000

2013F construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$606,000 through 2035.

11,514,000 10,920,000

2015 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$637,895 through 2035.

12,120,000 120,000

Subtotal Junior Lien Debt

99,480,070 88,970,192

Less Current Portion of Debt

(6,928,017) (4,410,543)

Long-term Portion of Junior Lien Debt

\$ 92,552,053 \$ 84,559,649

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

Year	Principal	Interest
2017	\$ 6,928,017	\$ 1,156,239
2018	6,928,017	1,082,701
2019	6,928,017	1,009,162
2020	6,928,017	935,624
2021	6,928,017	862,087
2022-2026	28,402,373	3,295,833
2027-2031	23,575,161	1,743,272
2032-2035	12,862,451	423,036
	<u>\$ 99,480,070</u>	<u>\$ 10,507,954</u>

NOTE 6 SECOND SUPPLY PROJECT AGREEMENT

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

NOTE 7 SIGNIFICANT CUSTOMER

Contracted sales to WestRock CP LLC accounted for 7.5% and 7.7% of Tacoma Water's total water sales in 2016 and 2015, respectively. There were no outstanding accounts receivables from WestRock at year-end 2016 or 2015. Tacoma Water has contracted with WestRock to supply certain quantities of water at a specified rate through July 31, 2020.

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 2016 and 2015 were \$2,148,122 and \$2,305,433, 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 2016 and 2015, Fleet Services returned 75% of the interest earned on the capital replacement reserve to Tacoma Water's replacement fund. The amounts refunded in 2016 and 2015 were \$35,278 and \$36,966, 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 \$240,000 in 2016 and 2015. Assets in the Self-Insurance Fund total \$7.6 million which exceeds accrued and incurred but not reported liabilities. Equity in the Self-Insurance Fund is transferred to the appropriate operating divisions in accordance with GASB 10. Management believes Tacoma Water's investment in the Self-Insurance Fund is more than adequate to settle all its known or estimated claims.

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 Crime policy with a \$1 million limit and \$75,000 deductible 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 property within buildings and \$10,000 per vehicle. There is a self-insured retention of \$1.5 million for general liability. The public official liability 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 general liability and public official liability policies provide \$20 million of excess coverage with \$3 million retention. The City has a policy to cover extraordinary worker's compensation claims with a statutory limit and a self-insured retention of \$1 million per occurrence and an additional \$250,000 for each 12 month policy period.

NOTE 10 TACOMA EMPLOYEES' RETIREMENT SYSTEM FUND (TERS)

The Tacoma Employees' Retirement System (TERS or System), a pension trust fund of the City of Tacoma, issues a publicly available CAFR that includes financial statements and required supplementary information may be obtained by writing to:

Tacoma Employee's Retirement System
3628 South 35th Street
Tacoma, WA 98409

Or the TERS CAFR may be downloaded from the TERS website at www.cityoftacoma.org/retirement.

Administration of The System – The "Tacoma Employees' Retirement 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 and federal retirement plans. Employees of the Tacoma-Pierce County Health Department, as well as, certain employees of the Pierce Transit and Law Enforcement Support Agency who established membership in the System when these agencies were still City of Tacoma departments, are also members. The Board of Administration of the Tacoma Employees' Retirement System administers the plan and derives its authority in accordance with Chapter 41.28 RCW and Chapter 1.30 of the Tacoma City Code.

At the direction of the City Council, the System is administered by the Board of Administration (the Board) consisting of nine regular members and one alternate member. The members of the Board are: the Mayor, who serves as Chair; the Director of Finance; the City Manager (or designee); the Public Utilities Director (or designee); three elected employee representatives; one elected retired representative; and one City resident (not employed by the City) elected by the other eight members. The nine Board members appoint a TERS member, either active or retired, as an alternate Board member. The Board is required by the Tacoma Municipal Code to make annual reports to the City Council on the financial condition of the System. The Board, subject to City Council approval, appoints the Director who is responsible for managing the daily operations of the System.

The breakdown of membership as of December 31, 2015 is as follows:

Retirees and beneficiaries currently receiving benefits	2,234
Terminated vested and other terminated participants	644
Active members:	
City of Tacoma	2,654
South Sound 911	4
Pierce Transit	7
Tacoma-Pierce County Health Department	262
Total active members	2,927
Total membership	5,805

Membership – Substantially all employees of the City of Tacoma are members of the System, with the exception of police officers, firefighter, and Tacoma Rail employees, who are covered by state or federal retirement plans. Other members include employees of the Tacoma-Pierce County Health Department, and certain employees of the Pierce Transit and the South Sound 911 (formerly known as Law Enforcement Support Agency) who established membership in the System when these agencies were still City of Tacoma departments.

Benefits – There are two formulas to calculate the retirement benefits. The benefit paid will be issued 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 based on the member’s age and years of service. The other formula is an annuity based on member contributions. There are several options available for the retiree to provide for their beneficiaries. The System also provides death, disability and deferred retirement. Additionally, the System provides cost of living adjustment (COLA) increases up to 2.125% as of July 1st of each year; the actual COLA granted is dependent on the Consumer Price Index (Seattle Area – all items) over the preceding calendar year.

Any active member who has not retired, and has five or more years of service as a member may purchase up to five additional years of service at the time of retirement. Total service including service purchased cannot exceed 30 years.

The System participates in the portability of public retirement benefits in Washington State public retirement. As provided under Chapter 4154 of the RCW, this allows a member to use all years of service with qualified Washington systems to determine retirement eligibility and percentage factor for benefits under the System.

Contributions – The participating employers are responsible for funding the System at a level sufficient to pay obligations and ensure the actuarial and financial soundness of the System. Contribution rates for the employer and the employee are recommended by the Board of Administration and final approval rests with the Tacoma City Council. Currently, the required contribution rate for employees is 9.20% of their regular gross pay; the employer contributes 10.80%, for a combined total of 20.00% which is sufficient to amortize the UAAL of the System if future experience follows all actuarial assumptions. Changes to the contribution rate are subject to Sections 1.30.340 and 1.30.360 of the Tacoma Municipal Code.

Significant Assumptions – The following actuarial methods were used in the funding valuation.

Measurement Date	December 31, 2015
Valuation Date	January 1, 2016
Actuarial Cost Method	Entry Age Normal Funding is based on statutory contributions rate.
Amortization Method	This amount is compared to a 30-year amortization for the purposes of calculating the Actuarially Determined Contribution. The amortization method for the ADC is as follows: <ul style="list-style-type: none"> • Level percent • Open periods • 30 year amortization period at 01/01/2016 • 4% amortization growth rate
Asset Valuation Method	4 year smoothing period; Corridor - None
Inflation	3%
Salary Increases	4% general wage increase assumption
Investment Rate of Return	7.25%
Cost of Living Adjustment	2.13%
Retirement Age	Varies by age, gender, eligibility
Turnover	Varies by age, gender, eligibility
Mortality	RP-2000 mortality for healthy and disabled annuitants, with age adjustments

Benefit and Assumption Changes – The comparability of the data from year to year can be affected by changes in actuarial assumptions, benefit provisions, accounting policies, and other factors. Between January 1, 2015 and January 1, 2016 no assumptions were changed.

Target Allocations – The long-term expected rate of return is determined by adding expected inflation to expected long-term real returns and reflecting volatility and correlation. The capital market assumptions are per Milliman’s investment consulting practice as of December 31, 2015. The target asset allocation is based on TERS Investment Policy Statement dated February 2014.

Asset Class	Target Allocation	Long-term Expected Arithmetic Real Rate of Return
Investment grade fixed income	15.0%	2.00%
US inflation-indexed bonds	5.0%	1.41%
High yield bonds	9.0%	4.22%
Emerging market debt	5.0%	5.06%
Global equity	41.5%	5.72%
Public real estate	2.0%	6.07%
Private real estate	2.5%	3.60%
Private equity	10.0%	9.29%
Master limited partnerships	4.0%	3.98%
Timber	2.0%	3.73%
Infrastructure	2.0%	5.14%
Agriculture	2.0%	4.30%
Assumed inflation - mean		3.00%
Assumed inflation - standard deviation		1.89%
Portfolio arithmetic real mean return		4.94%
Portfolio median nominal geometric return		7.06%
Portfolio standard deviation		11.84%
Long-term expected rate of return, net of investment expenses		7.25%

Sensitivity Analysis – The following presents the net pension liability (asset) of the System, calculated using the discount rate of 7.25%, as well as what the System's net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.25%) or 1 percentage point higher (8.25%) than the current rate.

	1% Decrease 6.25%	Current Discount Rate 7.25%	1% Increase 8.25%
Net Pension Liability (asset)	\$ 24,152,376	\$ 7,788,151	\$ (5,992,361)

As of December 31, 2015, the deferred inflows and outflows of resources are as follows:

	Deferred Inflows of Resources	Deferred Outflows of Resources
Difference Between Expected and Actual Experience	\$ (521,276)	\$ —
Net Difference Between Projected And Actual Earnings	—	6,864,209
Changes in Employer Proportion	(98)	5,642
Contributions Made Subsequent To The Measurement Date	—	2,124,252
Total	\$ (521,374)	\$ 8,994,103

The net amount of deferred inflows and outflows, other than contributions made subsequent to the measurement date, will be recognized as pension expense in each of the next four years.

Amounts will be recognized in pension expense as follows:

Year-ended December 31,

2016	\$ 1,535,119
2017	1,535,119
2018	1,535,119
2019	1,763,645
2020	(20,525)
	<u>\$ 6,348,477</u>

The proportionate share of the Water Division is 8.99% of total System's pension liability. The proportionate share was based on the actual contributions for the year.

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 UAAL on a closed basis of 30 years, beginning January 1, 2007. The remaining amortization period for 2016 is 21 years.

The ARC represents an accounting expense, but the City is not required to contribute the ARC to a separate trust. If the City does not set aside funds equal to the ARC (less current year benefit payments) each year, then the ARC (less benefit payments) will accumulate as a liability or Net OPEB Obligation on the balance sheet. The City has a Net OPEB Obligation as of December 31, 2016 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 are \$10,200 for single coverage and \$27,500 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 released two new statements for Post Employment Benefits Other than Pension Plans, or OPEB. The new GASB Statements 74 and 75 were released in June 2015 and will replace GASB 43 and 45. The statements are available via the GASB website. GASB 74 is effective for fiscal years beginning after June 15, 2016, and GASB 75 is effective for fiscal years beginning June 15, 2017. These statements will mean fundamental changes in financial reporting for OPEB.

Summary of Changes – As of the January 1, 2015 valuation the total AAL was \$208,814,312, for the City, 20% lower than expected primarily due to clarification in spouse benefits, medical costs, demographic experience and a change to the assumption for future medical trends.

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

	January 1, 2013	January 1, 2015
Total membership:		
Active employees	3,335	3,404
Terminated vested employees	394	442
Retired employees & dependents	846	744
Total	4,575	4,590
Annual Benefit Payments	\$ 9,887,335	\$ 8,963,089
Discount Rate	3.75%	3.75%
Present Value of Benefits (PVB)	\$ 326,742,538	\$ 262,184,195
Actuarial Accrued Liability (AAL)	\$ 251,839,846	\$ 208,814,312
Assets	\$ —	\$ —
Unfunded Actuarial Accrued Liability (UAAL)	\$ 251,839,846	\$ 208,814,312
Normal Cost	\$ 5,484,587	\$ 3,832,131
Annual Required Contribution (ARC)	\$ 20,058,760	\$ 16,966,964

The following table shows the total value of the benefits provided, the member paid premiums and the City paid benefits as of January 1, 2015.

Value of Subsidy at 3.75% Interest Rate	Total Value of Benefits	Member Paid Premiums	City Paid Benefits
Present Value of Benefits (PVB)	\$ 420,832,932	\$ 158,648,737	\$ 262,184,195
Actuarial Accrued Liability (AAL)	\$ 291,228,295	\$ 82,413,983	\$ 208,814,312
Normal Cost	\$ 9,501,758	\$ 5,669,627	\$ 3,832,131
Annual Benefit Payments	\$ 12,325,369	\$ 3,362,280	\$ 8,963,089

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, 2016.

	City		Water	
Determination of Annual Required Contribution:				
Normal Cost at Year-end	\$	3,803,090	\$	263,819
Amortization of UAAL		15,665,117		113,394
Annual Required Contribution (ARC)	\$	19,468,207	\$	377,213
Determination of Net OPEB Obligation:				
Annual Required Contribution (ARC)	\$	19,468,207	\$	377,213
Interest on prior year Net OPEB Obligation		2,666,468		118,141
Adjustments to ARC		(3,983,647)		(146,437)
Annual OPEB Cost		18,151,028		348,917
Actual benefits paid		(8,539,402)		(114,698)
Increase in Net OPEB Obligation		9,611,626		234,219
Net OPEB Obligation - beginning of year		73,129,502		3,150,430
Net OPEB Obligation - end of year	\$	82,741,128	\$	3,384,649

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 3.75% interest rate.

Year Ended	Annual OPEB Cost		Benefits Paid		Net OPEB Obligation	
	City	Division	City	Division	City	Division
12/31/2014	\$ 19,319,944	\$ 575,750	\$ 9,292,539	\$ 165,318	\$ 66,138,206	\$ 2,908,139
12/31/2015	\$ 15,954,387	\$ 357,394	\$ 8,963,089	\$ 115,102	\$ 73,129,502	\$ 3,150,430
12/31/2016	\$ 18,151,028	\$ 348,917	\$ 8,539,402	\$ 114,698	\$ 82,741,128	\$ 3,384,649

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 21 years.

Valuation Date	January 1, 2015												
Census Date	January 1, 2015												
Actuarial Cost Method:	Entry Age												
Amortization Date:	Combination of level percentage and level dollar amount, see note above.												
Remaining Amortization Period:	21 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												
Medical Cost Trend	<table> <tr> <td>2015</td><td>6.90%</td></tr> <tr> <td>2016</td><td>6.60%</td></tr> <tr> <td>2017</td><td>5.90%</td></tr> <tr> <td>2020</td><td>5.50%</td></tr> <tr> <td>2030</td><td>5.90%</td></tr> <tr> <td>2040</td><td>5.70%</td></tr> </table> <p>The medical cost rate is assumed to continue grading downward until achieving the ultimate rate of 4.8% in 2071 and beyond. 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>	2015	6.90%	2016	6.60%	2017	5.90%	2020	5.50%	2030	5.90%	2040	5.70%
2015	6.90%												
2016	6.60%												
2017	5.90%												
2020	5.50%												
2030	5.90%												
2040	5.70%												
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 • Age 40 with 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, 2016 the remaining financial requirement for Capital Improvement Programs relating to all prior biennia is approximately \$4.0 million.

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

General Legal Matters – The Water Division 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.

A black and white photograph of a train wheel and axle, showing the mechanical details of the wheel and the track below. The image is overlaid with a white hexagonal pattern. The text "TACOMA RAIL" is centered within one of the hexagons.

TACOMA RAIL

This year, Tacoma Rail continued to meet its primary goal of providing efficient, cost-effective rail service.

The Tidelands Division, which provides service to the Port of Tacoma and Tacoma's industrial areas, increased its line haul count by almost 13%—about 30,000 more units in 2016 than 2015. The traffic mix of more intermodal platforms and fewer commercial railcars led to a corresponding increase in line haul revenue of approximately \$1.3 million.

The Northwest Seaport Alliance of the ports of Tacoma and Seattle celebrated its first anniversary in August. The Alliance saw modest increases in its international intermodal container business as ocean shipping lines continued to consolidate their routes and realign their vessel-sharing agreements. That was done in anticipation of new shipping alliances that will be consummated early in the second quarter of 2017.

A 10-year agreement between Union Pacific Railroad and BNSF Railway to share the latter's bridge over the Puyallup River expired in June. Following two months of deteriorating service, Tacoma Rail entered into an agreement to handle Union Pacific's international intermodal business at their Fife, Washington, yard. Service improved immediately and Union Pacific was actually able to grow its business in the final four months of the year.



CARLOAD
NUMBERS IN
THE MOUNTAIN
DIVISION
INCREASED
BY 17%



Reflecting the overall decline in North American rail freight traffic of 7% in 2016, commercial business was sluggish throughout the year. Crude oil and ethanol unit train business was steady. New Washington state environmental rules mandating the development of oil spill contingency plans will increase the expenses involved in handling unit trains in the foreseeable future.

Total traffic on the Capital Division declined 56% to 773 carloads. Most of this decline can be attributed to the expiration of Tacoma Rail's operating lease with BNSF Railway for two branch lines in Olympia and Quadlok. Tacoma Rail chose to not renew the leases when BNSF lowered the handling charge for the final switching move from their mainline to the customers' facilities. The utility continues to provide service to customers in South Tacoma and Lakewood through its freight franchise on the rail line owned by Sound Transit.

Meanwhile, business improved in the Mountain Division, administered by Tacoma Rail on behalf of the City of Tacoma. Carload numbers increased 17% from 2015. The growth was aided by the relocation of Wilcox Farms' feed grain operation to Tacoma Rail's line in McKenna. In September, Tacoma Rail sold 35 miles of railroad from Yelm to Chehalis and the locomotive servicing facilities at Western Junction to a subsidiary of Frontier Rail for \$2.8 million. The sale enabled Tacoma Rail to retire the remaining balance on a City of Tacoma general fund loan made in 2007, setting the stage for transfer of ownership of the Mountain Division from the City of Tacoma's Public Works Department to Tacoma Rail.

FINANCIAL HIGHLIGHTS

In Millions, For the Years Ended December 31,	2016	2015	2014	2013	2012
Total Income	\$ 32.2	\$ 30.3	\$ 30.5	\$ 27.9	\$ 24.1
Operating Expenses	27.1	24.6	25.5	22.8	19.4
Income Available for Debt Service	\$ 5.1	\$ 5.7	\$ 5.0	\$ 5.1	\$ 4.7
Debt Service	\$ 0.3	\$ 0.3	\$ 0.3	\$ 0.3	\$ 0.3
Debt Service Coverage	19.68x	21.75x	19.16x	19.73x	18.14x
Plant Additions	\$ 8.4	\$ 5.9	\$ 7.9	\$ 4.8	\$ 7.4
Number of Cars Switched	110,922	102,173	108,137	99,366	92,117
Average Rates (per car)					
Line Haul Car	\$ 239.90	\$ 245.12	\$ 237.29	\$ 239.48	\$ 222.36
Local & Miscellaneous Car	\$ 448.88	\$ 468.28	\$ 510.59	\$ 662.72	\$ 343.33

Switching Revenues (in millions)	2016	2015
Line Hauls - Intermodal	12.72	11.44
Line Hauls - Commercial	12.64	12.15
Line Hauls - Capital Division	0.32	0.75
Miscellaneous	1.73	1.36

Switching Activities	2016	2015
Line Hauls - Intermodal	76,714	68,453
Line Hauls - Commercial	29,583	29,091
Line Hauls - Capital Division	762	1,733
Miscellaneous	3,863	2,896

Operating Expenses	2016	
Operations	11,304,238	40%
Administration	7,715,637	27%
Mechanical	4,712,661	16%
Construction	2,963,532	10%
Depreciation	1,472,956	5%
Taxes	439,317	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, 2016 and 2015, 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, 2016 and 2015, 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 10 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 33 through 44 and the superintendent's report presented on pages 45 through 46 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 express no opinion on it.

Miss Adams LLP

Tacoma, Washington
April 19, 2017

MANAGEMENT DISCUSSION & 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, 2016 and 2015. 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, 2016 and 2015, 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.

The Division adopted GASB Statement No. 72, *Fair Value Measurement and Application*, during fiscal year 2016. The statement provides guidance for determining fair value to certain investments and disclosures related to all fair value measurements, and requires accounting for investments at fair value (See note 3).

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 a continued investment in 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 2016 indicate an increase in both intermodal platform traffic and non-intermodal traffic. The intermodal increase is due to the International Longshore and Warehouse Union (ILWU) and Pacific Maritime Association (PMA) negotiations in 2015. The increase also coincides with the continued consolidation of ocean shipping lines and realignment of vessel-sharing agreements due to the formation of the Northwest Seaport Alliance (NWSA). Non-intermodal traffic increased as three of the top four largest non-intermodal customers experienced more than 9 percent growth. Capital Division volumes decreased due to the loss of the Belmore, Olympia, and Quadlok lines. Locomotive servicing improved due to both the Union Pacific (UP) and Burlington Northern and Santa Fe Railway's (BNSF) increased demand for the service.

Overview of the Financial Statements

Tacoma Rail is reporting a change in net position of \$2.0 in 2016, compared to \$2.8 million in 2015, a decrease of \$0.8 million. The decrease in net position is predominately due to an increase of \$1.7 million in operating revenues, an increase of \$2.8 million in operating expenses, and an increase in non-operating revenues of \$0.4 million.

In 2015, Tacoma Rail realized a change in net position of \$2.8 million, compared to \$2.0 million in 2014, an increase of \$0.8 million. The increase in net position was due to a decrease of \$0.3 million in operating revenues, a decrease of \$0.8 million in operating expenses, and a decrease of \$0.3 million in transfers out.

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

Operating Results (in thousands)

Description	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Operating Revenues	\$ 30,827	\$ 29,165	\$ 29,457	\$ 1,662	\$ (292)
Operating Expenses	28,608	25,806	26,563	2,802	(757)
Operating Income	2,219	3,359	2,894	(1,140)	465
Net Non-Operating Revenues	1,425	1,061	991	364	70
Contributions	939	846	878	93	(32)
Transfers Out	(2,591)	(2,455)	(2,751)	(136)	296
Change in Net Position	\$ 1,992	\$ 2,811	\$ 2,012	\$ (819)	\$ 799

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

Statements of Net Position (in thousands)

Description	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Capital Assets (Net)	\$ 28,217	\$ 24,748	\$ 21,059	\$ 3,469	\$ 3,689
Current and Other Assets	\$ 14,026	\$ 14,909	\$ 16,029	\$ (883)	\$ (1,120)
Total Assets	\$ 42,243	\$ 39,657	\$ 37,088	\$ 2,586	\$ 2,569
Net Investments in Capital Assets	\$ 22,003	\$ 18,246	\$ 16,023	\$ 3,757	\$ 2,223
Restricted Net Position	65	65	65	—	—
Unrestricted Net Position	6,966	8,731	8,142	(1,765)	589
Total Net Position	29,034	27,042	24,230	1,992	2,812
Long-Term Debt, net of current maturities	5,397	5,556	4,483	(159)	1,073
Current and Long Term Liabilities	7,812	7,059	8,375	753	(1,316)
Total Liabilities	13,209	12,615	12,858	594	(243)
Total Net Position & Liabilities	\$ 42,243	\$ 39,657	\$ 37,088	\$ 2,586	\$ 2,569

Revenues

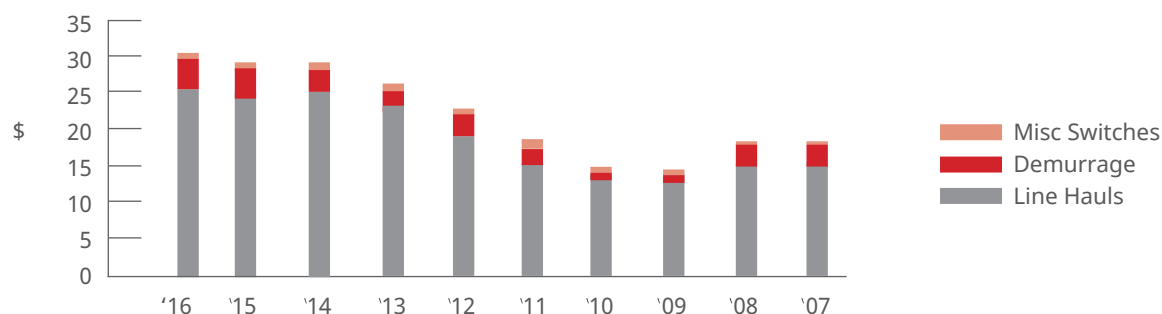
2016 Compared to 2015

In 2016, Tacoma Rail operating revenues of \$30.8 million were \$1.7 million higher than the \$29.2 million in 2015. Overall switching revenues increased \$1.7 million (6.7%), from 2015. The following table summarizes the switching revenues by activity type for the last two years.

Activity Types	Rail Cars				Switching Revenues (in thousands)			
	2016	2015	Var	% Chg	2016	2015	Var	% Chg
Intermodal Line Hauls	76,714	68,453	8,261	12.1%	\$ 12,718	\$ 11,440	\$ 1,278	11.2%
Commercial Line Hauls	29,583	29,091	492	1.7%	12,643	12,147	496	4.1%
Capital Div. Line Hauls	762	1,733	(971)	(56.0%)	323	748	(425)	(56.8%)
Miscellaneous Switches	3,863	2,896	967	33.4%	1,734	1,356	378	27.9%
Total Line Hauls	110,922	102,173	8,749	8.6%	\$ 27,418	\$ 25,691	\$ 1,727	6.7%

Demurrage and other operating revenues decreased \$65,000. Demurrage revenue decreased by \$329,000 and locomotive servicing revenue and other revenue increased \$264,000. This was due to both the Union Pacific and BNSF's increased demand for locomotive servicing.

Operating Revenues (in millions)



2015 Compared to 2014

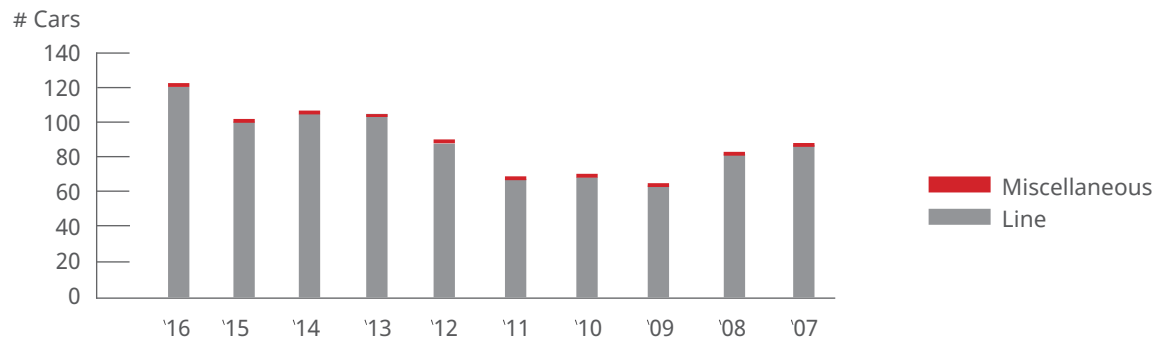
In 2015, Tacoma Rail operating revenues of \$29.2 million were \$292,000 lower than the \$29.5 million in 2014. Overall switching revenues decreased \$804,000 (3.0%), from 2014.

Switching Activities

Switching activities increased in 2016 by 8,749 cars (8.6%) to 110,922, from 102,173 in 2015. The most significant increase in switching activity can be seen in intermodal line-hauls which were up by 8,261 cars (12.1%) due to an increase in intermodal line haul rail traffic. The average number of cars switched over the last ten years is 87,638.

During 2015, total switching activities decreased by 5,964 cars (5.5%) from 2014. The decrease in commercial line-haul rail traffic was the dominant factor. Commercial line-hauls were down by 3,005 cars (9.4%) in 2015.

Switching Activities (in thousands)



The table below shows the changes in switching volumes for the last three years.

Switching Activities

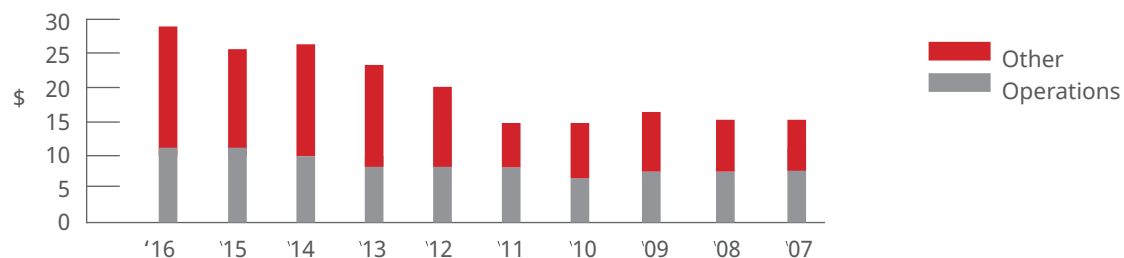
Description	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Line Hauls	107,059	99,277	105,079	7,782	(5,802)
Miscellaneous Switches	3,863	2,896	3,058	967	(162)
Total Cars Switched	110,922	102,173	108,137	8,749	(5,964)

Expenses

2016 Compared to 2015

In 2016, Tacoma Rail operating expenses of \$28.6 million were \$2.8 million higher than the \$25.8 million in 2015. Salaries and wages decreased \$0.2 million due to a decrease in personnel. Supplies and expenses increased \$2.7 million, of which Incurred But Not Reported (IBNR) claims increased \$1.2 million predominately due to a credit adjustment in 2015; volume incentives increased \$0.7 million; repair and maintenance increased \$0.4 million; and fleet replacement fees increased \$0.4 million.

Operating Expenses (in millions)



2015 Compared to 2014

In 2015, Tacoma Rail operating expenses of \$25.8 million were \$0.8 million lower than the \$26.6 million in 2014. This was primarily due to an increase of \$2.0 million in salaries and wages and decrease of \$2.9 million in supplies and expenses. Salaries and wages were higher due to an increase in personnel, an increase in cost of benefits and a new labor agreement with the largest union at Tacoma Rail. The decrease in supplies and expenses was mainly attributable IBNR claims decrease of \$2.4 million and a decrease of \$0.4 million of capitalized administrative and general (A&G) expenses.

Capital Assets

At the end of 2016, Tacoma Rail had \$28.2 million in net utility plant, an increase of \$3.5 million from 2015. This increase was reflected primarily in machinery equipment which increased by \$2.1 million due to the 2014 Locomotive Repower/Replacement project completed in 2016. Road property plant increased \$0.9 million for track upgrades and rehabilitation projects such as East Lead Low Side, Edwards Crossover, Alexander Wye Crossing, Taylor Way Wye, and the SR-509 Track Rebuild.

At the end of 2015, Tacoma Rail had \$24.7 million in net utility plant, an increase of \$3.7 million from 2014. This increase was reflected primarily in road property plant which increased by \$4.7 million due to track upgrades and rehabilitation projects such as the SR-509 track rebuild, Port of Tacoma RR crossing, Taylor Way Wye and West Loop. Machinery and equipment increased \$0.4 million due to the purchase of a Ballast Regulator.

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	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Land	\$ 167	\$ 160	\$ 160	\$ 7	\$ —
Road Property Plant	14,928	14,951	10,926	(23)	4,025
Building	2,040	1,614	1,711	426	(97)
Machinery Equipment	8,702	7,051	7,102	1,651	(51)
Office and Fixture	126	156	160	(30)	(4)
Construction Work in Progress	2,254	816	1,000	1,438	(184)
Total Net Capital Assets	\$ 28,217	\$ 24,748	\$ 21,059	\$ 3,469	\$ 3,689

Additional information on Tacoma Rail's capital assets can be found in Note 4 to the Financial Statements.

Debt Administration

In 2016, no new Washington State loans from the Department of Transportation were obtained. Draws were taken in 2016 on Edwards Crossover Rehabilitation, East Lead Low Side Rebuild, and Transfer Yard Connection (Phase 3) in the amounts of \$119,550, \$404,465 and \$115,029 respectively.

In 2015, Tacoma Rail obtained five new Washington State loans from the Department of Transportation for the following capital track projects: Taylor Way Wye rehabilitation \$311,457, Edwards Crossover rehabilitation \$156,997, East Lead Low Side rebuild \$469,270, West Lead High Side rebuild \$369,518 and Transfer Yard connection \$150,000. No funds have been drawn on these projects. Draws were taken in 2015 on Taylor Way Wye Track Rehabilitation & Extension, West Loop and SR509 track improvement in the amounts of \$594,793, \$515,770 and \$908,632 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 5 to the Financial Statements.

Long-Term Debt (in thousands)

	2016	2015	2014	16/15 Increase (Decrease)	15/14 Increase (Decrease)
Long-Term Debt Balance, December 31	\$ 6,213	\$ 6,502	\$ 5,036	(\$289)	\$ 1,466

Debt Service Coverage

Tacoma Rail is required by its bond covenants to maintain a 1.25 times debt service coverage. In 2016, principal and interest were covered 19.68 times compared to 21.75 times in 2015 and 19.16 times in 2014.

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

2016 FINANCIAL REPORTS

STATEMENTS OF NET POSITION

Statements of Net Position

December 31,

Assets	2016	2015
Capital Assets		
Road and Equipment Property	\$ 44,809,760	\$ 41,306,956
Less Accumulated Depreciation	(18,847,293)	(17,374,337)
Total	25,962,467	23,932,619
Construction Work in Progress	2,254,277	815,769
Net Capital Assets	28,216,744	24,748,388
Special Funds		
Debt Service Funds	64,974	64,861
Total Special Funds	64,974	64,861
Current Assets		
Cash and Equity in Pooled Investments	7,986,328	9,095,985
Customer Accounts Receivable (Net of Allowance for Doubtful Accounts of \$93,597 in 2016 and \$182,772 in 2015)	3,133,279	2,839,515
Interfund Receivable	9,827	53,051
Prepayments	1,807,210	1,917,733
Materials and Supplies Inventory	1,024,333	937,461
Total Current Assets	13,960,977	14,843,745
Total Assets	\$ 42,242,695	\$ 39,656,994

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

Net Position and Liabilities

	December 31,	
	2016	2015
Net Position		
Net Investment in Capital Assets	\$ 22,003,325	\$ 18,246,395
Restricted for:		
Debt Service	64,974	64,861
Unrestricted	6,965,599	8,730,405
Total Net Position	29,033,898	27,041,661
Long-Term Debt, Net of Current Maturities		
2006 Senior Lien Revenue Bond	—	64,238
State Loans	5,397,028	5,492,064
Total Long-Term Debt	5,397,028	5,556,302
Current Liabilities		
Accounts Payable	885,690	536,827
Customer Deposits	10,500	45,900
Wages Payable and Compensated Absences	279,822	243,713
Unemployment and Other Tax Payables	290,010	273,464
Volume Incentive Payable	1,249,999	1,208,334
Current Portion of Long-Term Debt	816,390	945,691
Interest Payable	866	4,214
Interfund Payable	260,518	185,446
Total Current Liabilities	3,793,795	3,443,589
Long-Term Liabilities		
On the Job Injury Reserve	773,407	721,029
Long-Term Portion of Compensated Absences	1,003,644	1,018,056
Other Post Employment Benefits	1,001,889	695,629
Incurred but not Reported Claims	1,239,034	1,180,728
Total Long-Term Liabilities	4,017,974	3,615,442
Total Liabilities	13,208,797	12,615,333
Total Net Position and Liabilities	\$ 42,242,695	\$ 39,656,994

**Statements of Revenues, Expenses and Changes
in Net Position**

	Year Ended December 31,	
	2016	2015
Operating Revenues		
Switching Revenues	\$ 27,417,653	\$ 25,690,797
Demurrage and Other Operating Revenues	3,409,347	3,474,443
Total Operating Revenues	30,827,000	29,165,240
Operating Expenses		
Maintenance of Way and Structures	2,963,532	2,507,631
Mechanical	4,712,661	4,640,554
Operations	11,304,238	11,425,661
Administration	7,715,637	5,594,322
Taxes - State	439,317	417,135
Depreciation	1,472,956	1,220,882
Total Operating Expenses	28,608,341	25,806,185
Net Operating Income	2,218,660	3,359,055
Non-Operating Revenues (Expenses)		
Interest Income	86,126	51,379
Miscellaneous	1,347,695	1,032,046
Interest Expense	(8,542)	(21,678)
Total Non-Operating Revenues	1,425,279	1,061,747
Contributions - Grants	801,949	587,480
Contributions - Others	137,686	258,583
Total Contributions	939,635	846,063
Transfers		
City of Tacoma Gross Earnings Tax	(2,591,337)	(2,410,016)
Transfers to Other Funds	—	(45,378)
Total Transfers	(2,591,337)	(2,455,394)
Change in Net Position	1,992,237	2,811,471
Total Net Position - Beginning Of Year	27,041,661	24,230,190
Total Net Position - End Of Year	\$ 29,033,898	\$ 27,041,661

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

Statements Of Cash Flows**Year To Date December 31,**
2016 **2015****Cash Flows From Operating Activities**

Cash from Customers	\$ 30,541,060	\$ 29,319,675
Cash Paid to Suppliers	(10,258,991)	(9,938,384)
Cash Paid to Employees	(15,509,184)	(15,908,933)
Taxes Paid	(422,771)	(425,106)
Net Cash Provided by Operating Activities	4,350,114	3,047,252

Cash Flows From Non-Capital Financing Activities

Transfers to Other Funds	(2,591,337)	(2,455,394)
Net Cash Used in Non-Capital Financing Activities	(2,591,337)	(2,455,394)

Cash Flows From Capital And Related Financing Activities

Capital Expenditures, Net	(4,941,312)	(4,910,461)
Principal Payments on Long-Term Debt	(932,991)	(553,009)
Interest Paid	(11,890)	(24,853)
Proceeds from Capital Contributions	939,635	846,063
Proceeds from Long-Term Debt	644,415	2,019,195
Proceeds from Other Non-Operating Revenues	1,347,695	1,032,046
Net Cash Used in Capital and Related Financing Activities	(2,954,448)	(1,591,019)

CASH FLOWS FROM INVESTING ACTIVITIES

Interest on Investments	86,126	51,379
Net Cash Provided by Investing Activities	86,126	51,379

Net Decrease in Cash and Equity in Pooled Investments	(1,109,544)	(947,782)
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Cash and Equity in Pooled Investments at January 1	9,160,846	10,108,628
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Cash and Equity in Pooled Investments at December 31	\$ 8,051,302	\$ 9,160,846
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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 To Date December 31,

	2016	2015
Operating Income	\$ 2,218,660	\$ 3,359,055
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation	1,472,956	1,220,882
Cash provided from changes in operating assets and liabilities:		
Accounts Receivable	(293,764)	104,243
Interfund Receivable	43,224	50,192
Materials and Supplies Inventory	(86,872)	(52,061)
Prepayments	110,523	70,578
Accounts Payable	348,863	(707,622)
Customer Deposits	(35,400)	—
Unemployment and Other Tax Payables	16,546	(7,971)
Wages Payable and Compensated Absences	36,109	(315,145)
Volume Incentive Payable	41,665	291,668
Interfund Payable	75,072	(314,841)
Long-Term Portion of Compensated Absences	(14,412)	117,448
On the Job Injury Reserve	52,378	24,246
Other Post Employment Benefits	306,260	332,565
Incurred but not Reported Claims	58,306	(1,125,985)
Total Adjustments	2,131,454	(311,803)
Net Cash Provided by Operating Activities	\$ 4,350,114	\$ 3,047,252

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

Cash and Equity in Pooled Investments in Special Funds	\$ 64,974	\$ 64,861
Cash and Equity in Pooled Investments in Operating Funds	7,986,328	9,095,985
Cash and Equity in Pooled Investments at December 31	\$ 8,051,302	\$ 9,160,846

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

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 2017.

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 in certificates of deposit with East West Bank and Opus Bank.

The Division's equity in that portion of City Tacoma Investment Pool held in qualified public depositories at December 31, 2016 and 2015 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 WA State Treasures LGIP is authorized by RCW 43.250. The LGIP is 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 Nonexchange 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.

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. Sick leave pay is recorded as a liability and an expense in the year earned.

The accrued liability is computed at 100% vacation and PTO while sick leave is accrued at 10%, which is considered the amount vested or 25% if the employee meets retirement criteria. Based on historical information, 10% of compensated absences are considered short term.

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 INVESTMENTS MEASURED AT FAIR VALUE

The City measures and records its investments within the fair value hierarchy established by generally accepted accounting principles.

The hierarchy is based on the valuation inputs used to measure the fair value of the asset, where fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. These guidelines recognize a three-tiered fair value hierarchy, as follows:

- **Level 1** – Level 1 inputs are quoted (unadjusted) prices in active markets for identical assets or liabilities that the government can access at the measurement date. Observable markets include exchange markets, dealer markets, brokered markets and principal-to-principal markets.
- **Level 2** – Level 2 inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These inputs are sourced from pricing vendors using models that are market-based and corroborated by observable market data including: quoted prices; nominal yield spreads; benchmark yield curves; and other corroborated inputs.
- **Level 3**– Level 3 inputs are unobservable inputs for the asset or liability and should only be used when relevant Level 1 or Level 2 inputs are unavailable.

The fair value evaluations are provided by Interactive Data. Interactive Data utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information and for structured securities, cash flow and, when available, loan performance data. Because many fixed income securities do not trade on a daily basis, Interactive Data's evaluated pricing applications apply available information as applicable through processes such as benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing, to prepare evaluations. In addition, Interactive Data uses model processes, such as the Option Adjusted Spread model to assess interest rate impact and development payment scenarios. Their models and processes take into account market convention. For each asset class, a team of evaluators gathers information from market sources and integrates relevant credit information, perceived market movements and sector news into the evaluated pricing applications and models.

Source: Interactive Data "Summary of Inputs by Asset Class Fixed Income Evaluations, Fair Value Information Service and Valuations of Certain Other Instruments" dated January 2016.

Cash and cash equivalents include highly liquid investments including short-term investment funds. Cash and cash equivalents are valued at cost and, therefore, excluded from the fair value schedule.

Data regarding the City's investments, valued and categorized according to the above outlined levels, is below:

Debt Securities	As of 12/31/2016	Level 1	Level 2	Level 3
U.S. Treasury Securities	\$ 146,824,628	\$ —	\$ 146,824,628	\$ —
U.S. Agency Securities	544,579,831	—	544,579,831	—
Municipal Bonds	61,450,051	—	61,450,051	—
Total	\$ 752,854,510	\$ —	\$ 752,854,510	\$ —

Debt Securities	As of 12/31/2015	Level 1	Level 2	Level 3
U.S. Treasury Securities	\$ 108,647,159	\$ —	\$ 108,647,159	\$ —
U.S. Agency Securities	541,730,184	—	541,730,184	—
Municipal Bonds	119,200,942	—	119,200,942	—
Total	\$ 769,578,285	\$ —	\$ 769,578,285	\$ —

Tacoma Rail's share of the City Investments shown in the table above is 1.16% and 1.14% for 2016 and 2015.

NOTE 4 CAPITAL ASSETS

A summary of the balances and changes in capital assets for 2016 and 2015 follows:

	Balance December 31, 2015	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2016
Land	\$ 160,456	\$ 6,800	\$ —	\$ —	\$ 167,256
Road Property Plant	25,818,064	867,553	—	—	26,685,617
Building	3,916,280	540,764	—	—	4,457,044
Machinery Equipment	10,726,901	2,087,300	—	—	12,814,201
Office and Fixture	685,255	387	—	—	685,642
Total Capital Assets In Service	41,306,956	3,502,804	—	—	44,809,760
Less Accumulated Depreciation	(17,374,337)	(1,472,956)	—	—	(18,847,293)
	23,932,619	2,029,848	—	—	25,962,467
Construction Work In Progress	815,769	4,941,312	—	(3,502,804)	2,254,277
Net Capital Assets	\$ 24,748,388	\$ 6,971,160	\$ —	\$ (3,502,804)	\$ 28,216,744

	Balance December 31, 2014	Additions	Retirements	Transfers & Adjustments	Balance December 31, 2015
Land	\$ 160,456	\$ —	\$ —	\$ —	\$ 160,456
Road Property Plant	21,139,870	4,678,194	—	—	25,818,064
Building	3,896,587	19,693	—	—	3,916,280
Machinery Equipment	10,353,086	373,815	—	—	10,726,901
Office and Fixture	862,954	23,430	(201,129)	—	685,255
Total Capital Assets In Service	36,412,953	5,095,132	(201,129)	—	41,306,956
Less Accumulated Depreciation	(16,354,584)	(1,220,882)	201,129	—	(17,374,337)
	20,058,369	3,874,250	—	—	23,932,619
Construction Work In Progress	1,000,440	4,910,461	—	(5,095,132)	815,769
Net Capital Assets	\$ 21,058,809	\$ 8,784,711	\$ —	\$ (5,095,132)	\$ 24,748,388

NOTE 5 LONG-TERM DEBT

Long-term debt activities for 2016 and 2015 were as follows:

	Balance December 31, 2015	Additions	Reductions	Balance December 31, 2016	Due Within One Year
Revenue Bonds	\$ 312,763	\$ —	\$ 248,525	\$ 64,238	\$ 64,238
Department of Transportation State Loans	6,189,230	644,416	684,466	6,149,180	752,152
Total Long-Term Debt	\$ 6,501,993	\$ 644,416	\$ 932,991	\$ 6,213,418	\$ 816,390

	Balance December 31, 2014	Additions	Reductions	Balance December 31, 2015	Due Within One Year
Revenue Bonds	\$ 548,332	\$ —	\$ 235,569	\$ 312,763	\$ 248,525
Department of Transportation State Loans	4,487,475	2,019,195	317,440	6,189,230	697,166
Total Long-Term Debt	\$ 5,035,807	\$ 2,019,195	\$ 553,009	\$ 6,501,993	\$ 945,691

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
2017	\$ 64,238	\$ 866

JUNIOR LIEN DEBT

Washington State Department of Transportation Loans (WADOT)	2016	2015
2009 WADOT loan for locomotive idling improvement, with 0% interest, due in yearly installments of \$1,759 from 2010 through 2024.	\$ 14,072	\$ 15,831
2009 WADOT loan for locomotive servicing facility upgrades, with 0% interest, due in yearly installments of \$16,630 from 2011 through 2025.	149,672	166,301
2011 WADOT loan for locomotive repower, with 0% interest, due in yearly installments of \$45,000 from 2013 through 2022.	270,000	315,000
2012 WADOT loan for Tacoma Rail Annie Tracks 1&2 Rail Relay, with 0% interest, due in yearly installments of \$61,200 from 2013 through 2022.	367,200	428,400
2012 WADOT loan for Yard Tracks 2,3 & 4, with 0% interest, due in yearly installments of \$34,859 from 2013 through 2022.	209,155	244,014
2013 WADOT loan for East 11th Street Crossing, with 0% interest, due in yearly installments of \$34,732 from 2014 through 2023.	243,124	277,856
2013 WASHt loan for Yard Tracks 5 & 6, with 0% interest, due in yearly installments of \$36,394 from 2014 through 2023.	254,756	291,151
2013 WADOT loan for Yard Tracks 8 & 9, with 0% interest, due in yearly installments of \$61,863 from 2015 through 2024.	494,900	556,763
2013 WADOT loan for Port Pass West, with 0% interest, due in yearly installments of \$25,000 from 2015 through 2024.	199,997	224,997
2013 WADOT loan for N. Intermodal Yard lead track, with 0% interest, due in yearly installments of \$36,639 from 2016 through 2025.	329,748	366,387
2013 WADOT loan for East Loop 17th St, with 0% interest, due in yearly installments of \$77,307 from 2016 through 2025.	695,763	773,070
2013 WADOT loan for Taylor Way Track Rehabilitation, with 0% interest, due in yearly installments of \$110,506 from 2016 through 2025.	994,552	1,105,058
2013 WADOT loan for West Loop, with 0% interest, due in yearly installments of \$51,577 from 2016 through 2025.	464,193	515,770
2014 WADOT loan for SR509 Track Improvements, with 0% interest, due in yearly installments of \$103,701 from 2016 through 2025.	819,005	908,632
2015 WADOT loan for Edwards Crossover Rehabilitation, with 0% interest, dues in yearly installments of \$40,575 from 2017 through 2026.	121,119	—
2015 WADOT loan for East Lead Low Side Rebuild, with 0% interest, due in yearly installments of \$12,112 from 2017 through 2026	405,745	—
2015 WADOT loan for Transfer Yard Connection (Phase 3), with 0% interest, due in yearly installments of \$15,000 from 2017 through 2026	116,179	—
Subtotal Junior Lien Debt	6,149,180	6,189,230
Less Current Portion of Debt	(752,152)	(697,166)
Long-term Portion of Junior Lien Debt	\$ 5,397,028	\$ 5,492,064

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

	Principal	Interest
2017	\$ 752,152	\$ —
2018	748,770	—
2019	748,770	—
2020	748,770	—
2021	748,769	—
2022-2026	2,401,949	—
	<u>\$ 6,149,180</u>	<u>\$ —</u>

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 6 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 25% and 49% of total revenues, respectively, in 2016. Revenue in 2015 was 26% and 47%, respectively. Accounts receivable from UP and BNSF in 2016 represented 29% and 49% of total customer accounts receivable, respectively. Accounts receivable in 2015 was 23% and 48%, respectively.

NOTE 7 FLEET SERVICES FUND

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

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 2016 and 2015 were \$511,522 and \$543,305, respectively.

NOTE 8 SELF-INSURANCE FUND

The Department of Public Utilities maintains a self insurance program and insurance policies. The Department has established a self-insurance fund to insure Tacoma 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 \$100,000 in 2016 and \$100,000 in 2015. Assets in the Self-Insurance Fund total \$7.6 million which exceeds accrued and incurred but not reported (IBNR) liabilities. 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 Crime policy with a \$1 million limit and \$75,000 deductible 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 property within buildings and \$10,000 per vehicle. There is a self-insured retention of \$1.5 million for general liability. The public official liability 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 general liability and public official liability policies provide \$20 million of excess coverage with \$3 million retention. The City has a policy to cover extraordinary worker's compensation claims with a statutory limit and a self-insured retention of \$1 million per occurrence and an additional \$250,000 for each 12 month policy period.

NOTE 9 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 2016 and 2015, Tacoma Rail contributed \$2,092,517 and \$2,145,824 respectively, per structures set forth by the United States Railroad Retirement Board shown as follows:

	<u>Earnings Base</u>	
	2015	2015
Employer Tier I	\$ 118,500	\$ 118,500
Employer Tier II	88,200	88,200
Employer Medicare	No Limit	No Limit
	<u>Tax Rate</u>	
	2015	2015
Employer Tier I	6.20%	6.20%
Employer Tier II	13.10%	13.10%
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 \$51.7 billion as of December 31, 2013. 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 10 OTHER POST EMPLOYMENT BENEFITS (OPEB)

PLAN DESCRIPTION - The City charges some early retirees not yet eligible for Medicare a health premium based on the claims experience of active employees and retirees rather than based on the claims experience of retirees only. This difference is a benefit to the retirees, since health claims costs generally increase with age. 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 2016 is 21 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 statements of net position. The City has a Net OPEB Obligation as of December 31, 2016 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. 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, 2015 valuation the total AAL was \$208,814,312, 20% lower than expected primarily due to clarification in spouse benefits, medical costs, demographic experience and a change to the assumption for future medical trends.

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

	<u>January 1, 2013</u>	<u>January 1, 2015</u>
Total membership:		
Active employees	3,335	3,404
Terminated vested employees	394	442
Retired employees & dependents	846	744
Total	4,575	4,590
Annual Benefit Payments	\$ 9,887,335	\$ 8,963,089
Discount rate	3.75%	3.75%
Present Value of Benefits (PVB)	\$ 326,742,538	\$ 262,184,195
Actuarial Accrued Liability (AAL)	\$ 251,839,846	\$ 208,814,312
Assets	\$ -	\$ -
Unfunded Actuarial Accrued Liability (UAAL)	\$ 251,839,846	\$ 208,814,312
Normal Cost	\$ 5,484,587	\$ 3,832,131
Annual Required Contribution (ARC)	\$ 20,058,760	\$ 16,966,964

The following table shows the total value of the benefits provided, the member paid premiums and the City paid benefits as of January 1, 2015.

Value of Subsidy at 3.75% Interest Rate	Total Value of Benefits	Member Paid Premiums	City Paid Benefits
Present Value of Benefits (PVB)	\$ 420,832,932	\$ 158,648,737	\$ 262,184,195
Actuarial Accrued Liability (AAL)	\$ 291,228,295	\$ 82,413,983	\$ 208,814,312
Normal Cost	\$ 9,501,758	\$ 5,669,627	\$ 3,832,131
Annual Benefit Payments	\$ 12,325,369	\$ 3,362,280	\$ 8,963,089

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, 2016.

	City	Division
Determination of Annual Required Contribution		
Normal Cost at Year-end	\$ 3,803,090	\$ 285,047
Amortization of UAAL	15,665,117	128,541
Annual Required Contribution (ARC)	\$ 19,468,207	\$ 413,588
Determination of Net OPEB Obligation		
Annual Required Contribution (ARC)	\$ 19,468,207	\$ 413,588
Interest on prior year Net OPEB Obligation	2,666,468	26,086
Adjustments to ARC	(3,983,647)	(32,334)
Annual OPEB Cost	18,151,028	407,340
Actual benefits paid	(8,539,402)	(101,080)
Increase in Net OPEB Obligation	9,611,626	306,260
Net OPEB Obligation – beginning of year	73,129,502	695,629
Net OPEB Obligation – end of year	\$ 82,741,128	\$ 1,001,889

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 3.75% interest rate.

Year Ended	<u>Annual OPEB Cost</u>		<u>Benefits Paid</u>		<u>Net OPEB</u>	
	City	Division	City	Division	City	Division
12/31/2014	\$19,319,944	\$ 153,125	\$ 9,292,539	\$ 51,612	\$ 66,138,206	\$ 363,064
12/31/2015	\$15,954,387	\$ 411,114	\$ 8,963,089	\$ 78,549	\$ 73,129,502	\$ 695,629
12/31/2016	\$18,151,028	\$ 407,340	\$ 8,539,402	\$ 101,080	\$ 82,741,128	\$ 1,001,889

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 21 years.

Actuarial Methods and Significant Actuarial Assumptions

Valuation Date	January 1, 2015	
Census Date	January 1, 2015	
Actuarial Cost Method:	Entry Age	
Amortization Method:	Combination of level percentage and level dollar amount, see note above.	
Remaining Amortization Period:	21 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	2015	6.9%
	2016	6.6%
	2017	5.9%
	2020	5.5%
	2030	5.9%
	2040	5.7%

The medical cost rate is assumed to continue grading downward until achieving the ultimate rate of 4.8% in 2071 and beyond. 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
- Age 40 with 20 years of service

NOTE 11 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, 2016, the deposit has been paid in full.

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, 2016.

TACOMA RAIL OPERATION OF CITY OF TACOMA, DEPARTMENT OF PUBLIC WORKS ("PUBLIC WORKS"), MOUNTAIN DIVISION - Public Works owns approximately 142 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 2017. The agreement states that Public Works would fund Tacoma Rail for any operations on the Mountain Division.



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