

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2015A Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the “Code”). In the further opinion of Bond Counsel, interest on the 2015A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the 2015A Bonds. In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, interest on the 2015B Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Code. See “TAX MATTERS.”



CITY OF TACOMA, WASHINGTON

\$16,645,000

**Water System Revenue Refunding Bonds,
Series 2015A**

\$6,365,000

**Water System Revenue Refunding Bonds,
Series 2015B (Taxable)**

Dated: Date of Delivery**Due: December 1, as shown on the inside cover**

The City of Tacoma, Washington (the “City” or “Tacoma”), acting by and through its Department of Public Utilities (the “Department”), is issuing its City of Tacoma, Washington, Water System Revenue Refunding Bonds, Series 2015A (the “2015A Bonds”) and Series 2015B (Taxable) (the “2015B Bonds” and together with the 2015A Bonds, the “Bonds”) as fixed rate bonds maturing on the dates and in the amounts and bearing interest at the rates shown on the inside front cover page of this Official Statement. Interest on the Bonds will be payable on June 1 and December 1 of each year, commencing December 1, 2015.

The Bonds will be issued as fully registered bonds and, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company (“DTC”), New York, New York, which will act as securities depository for the Bonds. Individual purchases of the Bonds will be made in book-entry form only. Purchasers of the Bonds will not receive physical certificates representing their interest in the Bonds. The Bonds will be issued in denominations of \$5,000 and any integral multiple thereof within a single series and maturity. So long as the Bonds are held by DTC or its nominee, payments of the principal of and interest on the Bonds will be payable to DTC, which in turn is obligated to remit such principal and interest to the DTC participants for subsequent disbursement to the beneficial owners of the Bonds. The fiscal agent for the State of Washington, currently U.S. Bank, National Association, has been appointed as Bond Registrar for the Bonds.

The 2015A Bonds are subject to redemption by the City prior to their stated maturities as described herein.

The City is issuing the Bonds (i) to refund certain of the City’s outstanding Parity Bonds (as further described herein, the “Refunded Bonds”) and (ii) to pay costs of issuing the Bonds.

The Bonds are special limited obligations of the City, payable solely from and secured solely by a pledge of and lien on Net Revenue of the Water System and all money and investments held in the Bond Fund, the Rate Stabilization Account, and the Construction Fund on a parity with the City’s outstanding Water System revenue bond and bonds hereafter issued on a parity therewith (collectively, the “Parity Bonds”). The Bonds are not general obligations of the City, and neither the full faith and credit nor the taxing power of the City or of the State of Washington, nor any revenues of the City derived from sources other than the Water System, are pledged to the payment thereof.

The City has established an additional “system” within the Water Division, known as the Regional Water Supply System (the “Regional System”), which is financed separately from the Water System. The Regional System has been designated by the City as a Contract Resource Obligation of the Water System. The Parity Bonds are payable from Net Revenue of the Water System after the prior payment of all costs of the Regional System, which are payable as an Operation and Maintenance Expense of the Water System. Costs of the Regional System include debt service on Regional System Revenue Bonds, operating expenses, and capital and other costs. The City has issued and there is currently outstanding \$110,080,000 aggregate principal amount of Regional Water Supply System Revenue Bonds (collectively, the “Regional System Revenue Bonds”). The obligation of Tacoma Water to pay the costs of the Regional System is offset in part to the extent of contractual payments made by the other Participants in the Regional System. See “THE WATER SYSTEM AND THE REGIONAL SYSTEM – The Regional System” and “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS” herein.

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

The Bonds are offered when, as, and if issued and delivered, subject to the approval of legality by Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the City. Certain legal matters will be passed upon for the Underwriter by its counsel, Pacifica Law Group, LLP. Certain legal matters will be passed upon by Orrick, Herrington & Sutcliffe LLP, as Disclosure Counsel to the City. It is expected that the Bonds will be available for delivery at the facilities of The Depository Trust Company in New York, New York, by Fast Automated Securities Transfer (FAST) on or about May 12, 2015.

Wells Fargo Securities

MATURITY SCHEDULE

\$16,645,000

Water System Revenue Refunding Bonds, Series 2015A

Due (December 1)	Amount	Interest Rate	Yield	CUSIP Number*
2017	\$ 2,845,000	4.000%	0.880%	873547HV8
2018	1,460,000	4.000	1.180	873547HW6
2019	1,520,000	5.000	1.420	873547HX4
2020	1,590,000	5.000	1.610	873547HY2
2021	1,670,000	5.000	1.810	873547HZ9
2022	1,755,000	5.000	2.000	873547JA2
2023	1,845,000	5.000	2.140	873547JB0
2024	1,935,000	5.000	2.280	873547JC8
2025	2,025,000	5.000	2.360 [±]	873547JD6

\$6,365,000

Water System Revenue Refunding Bonds, Series 2015B (Taxable)

Due (December 1)	Amount	Interest Rate	Yield	CUSIP Number*
2016	\$ 4,580,000	0.800%	0.800%	873547JE4
2017	1,785,000	1.150	1.150	873547JF1

[±] Priced to a redemption date of June 1, 2025.

* Copyright 2015, American Bankers Association. CUSIP® is a registered trademark of the American Bankers Association. The CUSIP data herein are provided by CUSIP Global Services, managed on behalf of the American Bankers Association by S&P Capital IQ. The CUSIP numbers are not intended to create a database and do not serve in any way as a substitute for CUSIP service. CUSIP numbers have been assigned by an independent company not affiliated with the City and are provided solely for convenience and reference. The CUSIP numbers for a specific maturity or maturities are subject to change after the issuance of the Bonds. Neither the City nor the Underwriter takes responsibility for the accuracy of the CUSIP numbers, and no representation is made as to their correctness on the applicable Bond certificates or in this Official Statement.

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

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

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

Certain statements contained in this Official Statement, including the appendices, are not historical facts but are forecasts and "forward-looking statements." No assurance can be given that the future results discussed herein will be achieved, and actual results may differ materially from the forecasts described herein. In this respect, the words "estimate," "forecast," "project," "anticipate," "expect," "intend," "believe" and similar expressions are intended to identify forward-looking statements. The forward-looking statements in this Official Statement are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in or implied by such statements. All estimates, projections, forecasts, assumptions and other forward-looking statements are expressly qualified in their entirety by the cautionary statements set forth in this Official Statement. The City specifically disclaims any obligation to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of this Official Statement.

THE BONDS WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXCEPTION CONTAINED IN SUCH ACT. THE BONDS HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE.

In connection with the offering of the Bonds, the Underwriter may over-allot or effect transactions that stabilize or maintain the market price of the Bonds at levels above those which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued or recommenced at any time. The Underwriter may offer and sell the Bonds to certain dealers (including depositing Bonds into investment trusts) and others at prices lower than the initial offering prices corresponding to the yields set forth on the inside cover, and such initial offering prices may be changed, from time to time, by the Underwriter.

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Heather Pennington, Deputy Water Superintendent, Asset and Information Manager
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Glen George, Water Supply Manager
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CITY OF TACOMA, WASHINGTON

\$16,645,000
Water System Revenue Refunding Bonds,
Series 2015A

\$6,365,000
Water System Revenue Refunding Bonds,
Series 2015B (Taxable)

INTRODUCTION

The City of Tacoma, Washington (the “City” or “Tacoma”), acting by or through its Department of Public Utilities (the “Department”), is providing this Official Statement, which includes the cover page, inside cover page and appendices hereto (collectively, the Official Statement”), in connection with the offering of \$16,645,000 aggregate principal amount of the City of Tacoma, Washington, Water System Revenue Refunding Bonds, Series 2015A (the “2015A Bonds”) and \$6,365,000 aggregate principal amount of the City of Tacoma, Washington, Water System Revenue Refunding Bonds, Series 2015B (Taxable) (the “2015B Bonds” and together with the 2015A Bonds, the “Bonds”). This Official Statement provides information concerning the City, the Bonds, the Department, the Department’s Water Division, the City’s Water System (the “Water System”), the Regional Water Supply System (the “Regional System”), the Second Supply Project (as defined herein), and Tacoma Water’s obligations with respect to the Regional System.

The City is a municipal corporation organized and existing under the constitution and laws of the State of Washington (the “State”). The Water Division, doing business as Tacoma Water (“Tacoma Water”), of the Department operates the Water System. Tacoma Water is one of the largest publicly-owned water utilities in the Pacific Northwest and had 98,607 customers in 2014. See “THE WATER SYSTEM AND THE REGIONAL SYSTEM.”

The City has established an additional “system” within the Water Division, known as the Regional Water Supply System (the “Regional System”), which is financed separately from the Water System. The Regional System has been designated by the City as a Contract Resource Obligation of the Water System. The Parity Bonds are payable from Net Revenue of the Water System after the prior payment of all costs of the Regional System, which are payable as an Operation and Maintenance Expense of the Water System. Costs of the Regional System include debt service on Regional System Revenue Bonds, operating expenses, and capital and other costs. The City has issued and there is currently outstanding \$110,080,000 aggregate principal amount of Regional Water Supply System Revenue Bonds (collectively, the “Regional System Revenue Bonds”). The obligation of Tacoma Water to pay the costs of the Regional System is offset in part to the extent of contractual payments made by the other Participants in the Regional System. See “THE WATER SYSTEM AND THE REGIONAL SYSTEM – The Regional System” and “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS.”

The Bonds are being issued pursuant to Substitute Ordinance No. 28138, passed by the City Council on March 19, 2013, as supplemented by Ordinance No. 28290, passed by the City Council on March 31, 2015 (collectively, the “Bond Ordinance”), and under the authority of chapters 35.41, 39.46 and 39.53 of the Revised Code of Washington (“RCW”). Certain provisions of the Bond Ordinance are summarized in APPENDIX A—“SUMMARY OF THE PRINCIPAL PROVISIONS OF THE BOND ORDINANCE.”

The City is issuing the Bonds (i) to refund certain outstanding Parity Bonds (as further defined herein, the “Refunded Bonds”) and (ii) to pay costs of issuing the Bonds, as more fully described herein. See “PURPOSE AND APPLICATION OF BOND PROCEEDS.”

The Bonds are special limited obligations of the City, payable from and secured solely by Net Revenue of the Water System and all money and investments held in the Bond Fund, the Rate Stabilization Account, and the Construction Fund (except for money or investments held for the purpose of compliance with rebate requirements under the Code), on a parity with the Tacoma Water’s Outstanding Parity Bonds (as defined below) and with any additional bonds issued hereafter on a parity with the Bonds and the Outstanding Parity Bonds (“Future Parity Bonds” and together with the Bonds and the Outstanding Parity Bonds, the “Parity Bonds”). As of April 1, 2015, the Water System had outstanding \$282,985,000 aggregate principal amount of Parity Bonds (the “Outstanding Parity Bonds”).

The City has covenanted in the Bond Ordinance and in the ordinances authorizing the issuance of the Outstanding Parity Bonds (collectively, the “Parity Bond Authorizing Ordinances”) that it will not issue any additional indebtedness which is secured by a pledge of and lien on the Net Revenue of the Water System that is superior to the pledge and lien of the Parity Bonds. The City reserved the right, however, under certain conditions to enter into Contract Resource Obligations for which amounts due are payable as Operation and Maintenance Expenses of the Water System prior to the payment of debt service on the Parity Bonds. See “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS—Additional Obligations—*Contract Resource Obligations*” and “THE WATER SYSTEM AND THE REGIONAL SYSTEM.”

Certain capitalized words and phrases used in this Official Statement not defined herein have the meanings given in the Bond Ordinance, unless the context shall clearly indicate that another meaning is intended. See APPENDIX A—“SUMMARY OF THE PRINCIPAL PROVISIONS OF THE BOND ORDINANCE” for certain definitions.

DESCRIPTION OF THE BONDS

General

The 2015A Bonds will be issued in the aggregate principal amount of \$16,645,000, and the 2015B Bonds will be issued in the aggregate principal amount of \$6,365,000. The Bonds will be dated the date of their initial delivery, will bear interest at the rates and mature on the dates and in the principal amounts set forth on the inside cover page of this Official Statement. Interest on the Bonds shall be calculated on the basis of a 360-day year consisting of twelve 30-day months, and shall be payable each June 1 and December 1, commencing December 1, 2015. The Bonds of each series will be issued in denominations of \$5,000 and any integral multiples thereof.

The fiscal agent for the State of Washington, currently U.S. Bank National Association, has been appointed as Bond Registrar for the Bonds.

Redemption of the Bonds

Redemption of the 2015A Bonds. The 2015A Bonds maturing in the years 2017 through 2024, inclusive, are not subject to optional redemption prior to maturity. The 2015A Bonds maturing on December 1, 2025 are subject to redemption at the option of the City, in whole or in part (and if in part, with maturities to be selected by the City) on any date on or after June 1, 2025, at a price equal to 100 percent of the principal amount to be redeemed, without premium, plus accrued interest, if any, to the date fixed for redemption.

The 2015A Bonds are not subject to mandatory sinking fund redemption.

No Redemption of the 2015B Bonds. The 2015B Bonds are not subject to optional or mandatory sinking fund redemption prior to maturity.

Partial Redemption. If less than all of the 2015A Bonds are to be redeemed, the City may select the maturity or maturities of such 2015A Bonds to be redeemed. If less than all of the 2015A Bonds of any maturity are to be redeemed, the Bonds or portions thereof to be redeemed are to be selected in a random manner by the Bond Registrar or DTC, as applicable, or in accordance with their respective standard procedures. Any Bond in a principal amount greater than \$5,000 may be partially redeemed in any integral multiple of \$5,000.

Notice of Redemption. The Bond Ordinance provides that the City is to cause notice of any intended redemption of Bonds to be given not less than 20 nor more than 60 days prior to the date fixed for redemption by first class mail, postage prepaid, to the Registered Owner of any 2015A Bond to be redeemed at the address appearing on the Bond Register at the time the Bond Registrar prepares the notice, and this requirement shall be deemed to have been fulfilled when notice has been mailed, whether or not it is actually received by the owner of any 2015A Bond. Interest on 2015A Bonds called for redemption shall cease to accrue on the date fixed for redemption, unless the notice of redemption is rescinded or money sufficient to effect the redemption is not on deposit in the Bond Fund or in any escrow account established to carry out a refunding or defeasance of the

redeemed Bonds. Notwithstanding the foregoing, for so long as the 2015A Bonds are registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”), notice of redemption is to be given in accordance with the Letter of Representations (as it may be changed).

In the case of an optional redemption, the notice may state that the City retains the right to rescind the redemption notice and the related optional redemption of Bonds by giving a notice of rescission to the affected registered owners at any time prior to the scheduled optional redemption date. Any notice of optional redemption that is so rescinded shall be of no effect, and the 2015A Bonds for which the notice of optional redemption has been rescinded shall remain outstanding.

Open Market Purchase

In the Bond Ordinance, the City reserves the right to purchase any or all of the Bonds in the open market at any time at any price acceptable to the City, plus accrued interest to the date of purchase.

Book-Entry System

The Bonds when issued will be registered in the name of Cede & Co., as registered owner and nominee of DTC. DTC will act as securities depository for the Bonds. Individual purchases may be made only in book-entry form, and purchasers will not receive certificates representing their interest in the Bonds purchased. Except as described below under “TAX MATTERS,” so long as Cede & Co. is the registered owner of the Bonds, as nominee of DTC, references herein to “Bondholders” or to “registered owners” of the Bonds mean Cede & Co. and not the Beneficial Owners of the Bonds. In this Official Statement, the term “Beneficial Owner” means the person for whom a DTC participant acquires an interest in the Bonds.

So long as DTC, or its nominee Cede & Co. (or such other nominee as an authorized officer of DTC may request), is the registered owner of all Bonds, all payments of principal of and interest on the Bonds are to be made directly to DTC, which, in turn, is to remit such amounts to the Direct and Indirect Participants for subsequent distribution to the Beneficial Owners of the Bonds. See APPENDIX B—“BOOK-ENTRY SYSTEM.”

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

Defeasance

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

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

See “TAX MATTERS—2015B Bonds” for a discussion of certain potential tax consequences upon the defeasance of the 2015B Bonds.

PURPOSE AND APPLICATION OF BOND PROCEEDS

The City is issuing the Bonds (i) to refund a portion of the outstanding 2005 Bonds for debt service savings, as shown in the table below (the “Refunded Bonds”) and (ii) to pay the costs of issuance of the Bonds.

Refunding Plan

A portion of the proceeds of the Bonds are to be applied to refund all of the Refunded Bonds shown in the table below.

Refunded Bonds					
Maturity Date	Principal Amount	Interest Rate	Redemption Date	Redemption Price	CUSIP Numbers
12/1/2016	\$ 4,525,000	5.000%	12/1/2015	100%	873547GL1
12/1/2017	4,760,000	5.000	12/1/2015	100	873547GM9
12/1/2018	1,695,000	4.125	12/1/2015	100	873547GN7
12/1/2019	1,765,000	4.125	12/1/2015	100	873547GP2
12/1/2020	1,835,000	4.125	12/1/2015	100	873547GQ0
12/1/2021	1,910,000	4.125	12/1/2015	100	873547GR8
12/1/2022	1,990,000	5.000	12/1/2015	100	873547GS6
12/1/2023	2,090,000	5.000	12/1/2015	100	873547GT4
12/1/2024	2,195,000	5.000	12/1/2015	100	873547GU1
12/1/2025	2,300,000	5.000	12/1/2015	100	873547GV9

A portion of the net proceeds from the sale of the Bonds, together with other available funds of the City, are to be irrevocably deposited into an escrow trust account (the “Escrow Account”) held by U.S. Bank National Association (the “Escrow Agent”) under an escrow agreement (the “Escrow Agreement”), to be dated the date of delivery of the Bonds, between the City and the Escrow Agent. Amounts irrevocably deposited in the Escrow Account are to be used to purchase Government Obligations, which will mature at such times and pay interest in such amounts so that, with other available funds held by the Escrow Agent under the Escrow Agreement, sufficient money will be available to pay the interest on the Refunded Bonds coming due on and prior to the date fixed for redemption and to redeem and retire the Refunded Bonds on the redemption date set forth above. Because all payments of principal of and interest on the Refunded Bonds will thereafter be provided for from money and securities on deposit with the Escrow Agent under the Escrow Agreement, the liens, pledges and covenants securing the Refunded Bonds will terminate and be discharged and released. See “VERIFICATION OF MATHEMATICAL COMPUTATIONS.”

Estimated Sources and Uses of Funds

The proceeds of the Bonds, together with other available funds of the City, are expected to be applied as follows:

Sources of Funds:	2015A Bonds	2015B Bonds	Total
Principal Amount of the Bonds	\$ 16,645,000	\$ 6,365,000	\$ 23,010,000
Original Issue Premium	2,921,513	-	2,921,513
Amount Released from Bond Fund	441,728	153,375	595,103
Total Sources	\$ 20,008,241	\$ 6,518,375	\$ 26,526,616
Uses of Funds:			
Refunding Escrow Deposits	\$ 19,802,664	\$ 6,438,254	\$ 26,240,918
Costs of Issuance ⁽¹⁾	205,577	80,121	285,698
Total Uses	\$ 20,008,241	\$ 6,518,375	\$ 26,526,616

⁽¹⁾ Includes underwriter's discount, legal fees, financial advisor's fees, Escrow Agent fees, rating agency fees, and other costs incurred in connection with the issuance of the Bonds.

SECURITY AND SOURCES OF PAYMENT FOR THE BONDS

Pledge of Net Revenues

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

In the Bond Ordinance and in the Parity Bond Authorizing Ordinances, the City is obligated to set aside and pay into the Bond Fund certain amounts out of the Net Revenue of the Water System sufficient to pay the principal of and interest on the Bonds, the Outstanding Parity Bonds, and any Future Parity Bonds.

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

The Bond Ordinance defines "Net Revenue" as Gross Revenue minus (1) Operation and Maintenance Expenses, (2) deposits into the Rate Stabilization Account and (3) proceeds from the sale of property of the Water System, and plus withdrawals from the Rate Stabilization Account.

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

Currently, there are no utility local improvement district assessments pledged to the Parity Bonds.

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

Regional System Revenue Bonds

The City has the authority under State law and the Bond Ordinance to establish additional “systems” within the Water Division, each of which is financed separately from the Water System. See “—Separate Utility Systems” below. The Water Division currently includes one such additional system – the Regional System. The Regional System currently consists of the Second Supply Project, which is owned, operated and maintained by the Water Division. The Regional System provides water to the Water System and to three other municipal water utilities. See “THE WATER SYSTEM AND THE REGIONAL SYSTEM—The Regional System.” Payment for the Water System’s share of the cost of that water supply is a “Contract Resource Obligation” and thus an Operation and Maintenance Expense of the Water System. See “—Additional Obligations—*Contract Resource Obligations*.” As such it is payable prior to debt service on the Parity Bonds.

The City, acting by and through the Department, has previously issued and there is currently outstanding \$110,080,000 aggregate principal amount of Regional System Revenue Bonds. The Water System currently is responsible for payment of approximately 70% of the costs of the Regional System, which includes debt service on the Regional System Revenue Bonds, as well as operating expenses and capital and other costs. Upon a default by any of the participating municipalities which also purchase water from the Regional System, the Water System would be responsible, at least for some period, for that municipality’s share of the costs of the Regional System, including debt service on the Regional System Revenue Bonds. The Parity Bonds are payable from Net Revenue of the Water System after the prior payment of all costs of the Regional System, which are payable as an Operation and Maintenance Expense of the Water System. Costs of the Regional System include debt service on Regional System Revenue Bonds, operating expenses, and capital and other costs. The obligation of Tacoma Water to pay the costs of the Regional System is offset in part to the extent of contractual payments made by the other Participants in the Regional System. See “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS—Pledge of Revenues” and “—Additional Obligations—*Contract Resource Obligations*” and “THE WATER SYSTEM AND THE REGIONAL SYSTEM—The Regional System.”

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

Limited Obligations

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

Flow of Funds

The City has established a special fund known as the “Water Division Fund” into which all Gross Revenue of the Water System is paid. The Bond Ordinance provides that the Gross Revenue of the Water System shall be used for the following purposes only and shall be applied in the following order of priority:

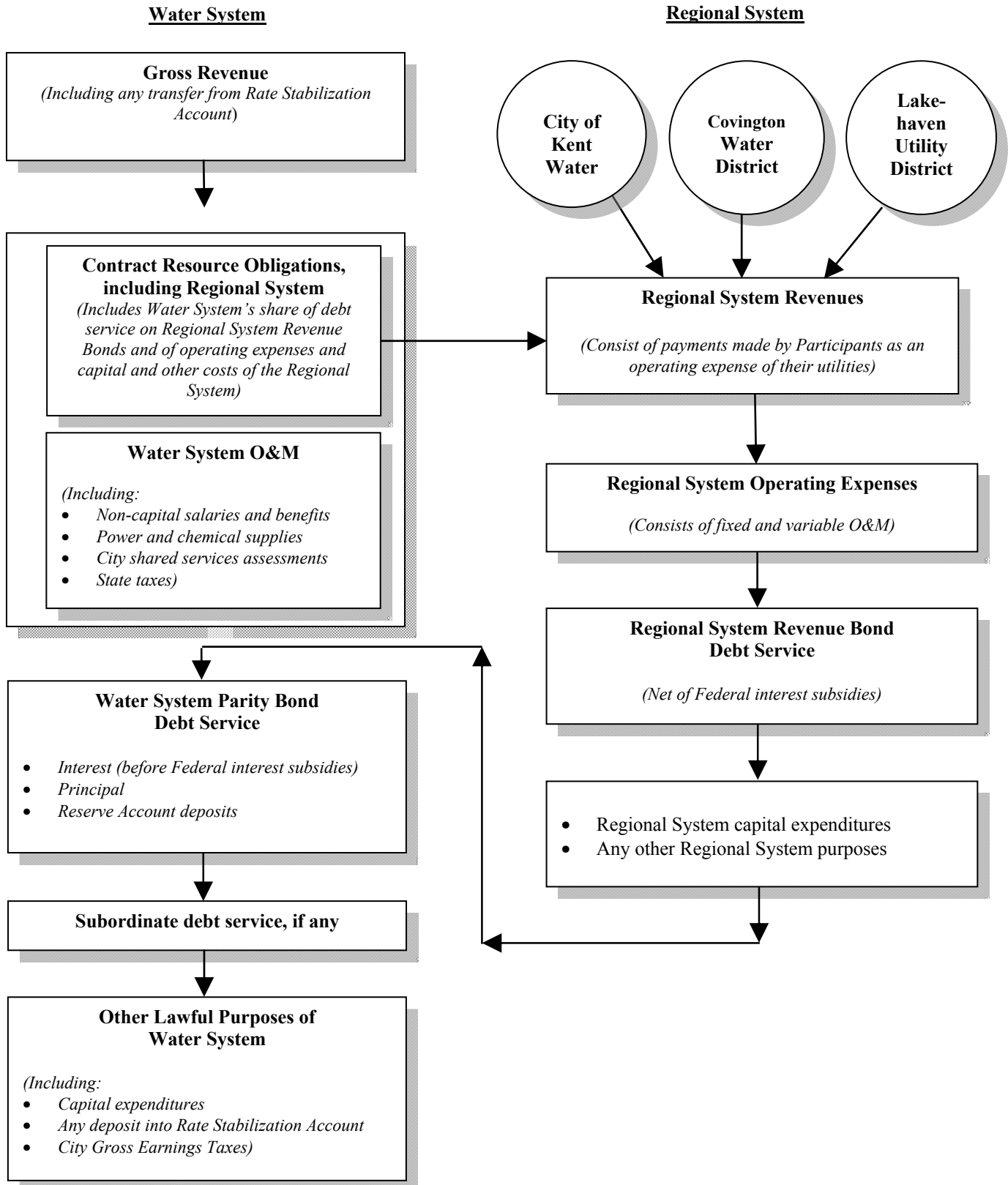
- (1) To pay Operation and Maintenance Expenses, including payments for Contract Resource Obligations;
- (2) To pay interest on Parity Bonds and net payments on Parity Payment Agreements when due;
- (3) To pay the principal of Parity Bonds as it comes due at maturity or as the principal is required to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

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

See APPENDIX A—"SUMMARY OF THE PRINCIPAL PROVISIONS OF THE BOND ORDINANCE" for definitions of certain of the capitalized terms used above and for descriptions of certain of the funds and accounts mentioned above.

The flow chart on the following page shows the flow of funds for the Water System and the Regional System.

WATER SYSTEM AND REGIONAL SYSTEM SUMMARY OF FLOW OF FUNDS



Rate Covenant

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

- (1) The Gross Revenue will be sufficient to (i) pay all Operation and Maintenance Expenses, (ii) pay when due all amounts that the City is obligated to pay into the Bond Fund and the accounts therein, and (iii) pay all taxes, assessments, or other governmental charges lawfully imposed on the Water System or the revenue therefrom or payments in lieu thereof and any and all other amounts that the City may now or hereafter become obligated to pay from the Gross Revenue by law or contract; and
- (2) The Net Revenue of the Water System in each fiscal year will be at least equal to 1.25 times the Annual Debt Service that year on all Parity Bonds (the "Coverage Requirement").

The Bond Ordinance provides that the City's failure to comply with the rate covenant as described in (1) and (2) above will not be an Event of Default as defined in the Bond Ordinance if the City promptly retains an Independent Consulting Engineer or, once the 2005 Bonds and the 2009 Bonds are no longer outstanding, an independent certified public accountant, to recommend to the City Council adjustments in the rates of the Water System necessary to meet such requirements and if the City Council adopts the recommended modifications within 180 days of the date the failure became known to the City Council.

Reserve Account; Reserve Account Surety Policy

Pursuant to the Bond Ordinance, the City established the Reserve Account within the Bond Fund to secure the payment of the principal of and interest on Parity Bonds. Under the Bond Ordinance, the City is obligated to maintain the Reserve Account at the Reserve Requirement, as adjusted from time to time. The Reserve Requirement, as of any date, is an amount equal to the lesser of Maximum Annual Debt Service or 125% of Average Annual Debt Service on the outstanding Parity Bonds secured by the Reserve Account. The additional Reserve Requirement in connection with a series of Parity Bonds secured by the Reserve Account, however, may not exceed 10% of the original net proceeds of such series of Parity Bonds. The Bond Ordinance provides that the additional Reserve Requirement in connection with the issuance of a series of Parity Bonds may be funded from proceeds, from other available moneys, or from an accumulation of such amount from equal annual deposits from the Net Revenue over a period of not more than five years.

An amendment to the Bond Ordinance in 2013 provides that, once the 2005 Bonds are no longer outstanding, a series of Parity Bonds issued thereafter (thus including the Bonds) need not be secured by the Reserve Account.

So long as any 2005 Bonds remain outstanding, the Bonds will be secured by the Reserve Account. When no 2005 Bonds remain outstanding, however, the Bonds will no longer be secured by the Reserve Account or by any other debt service reserve account. The Department is not refunding \$5,000 aggregate principal amount of the 2005 Bonds maturing in 2025. Thus, the Bonds initially will be secured by the Reserve Account. *But the City retains the right at any time to redeem or defease the remaining 2005 Bonds.*

Any deficiency created in the Reserve Account by reason of any withdrawal therefrom for payment into the Principal and Interest Account must be made up within 12 months from Net Revenue available after making the necessary deposits from Net Revenue into such Account. See "—Flow of Funds."

The Reserve Account is held by the City Treasurer for the benefit of the owners of the Parity Bonds secured thereby, rather than by a third-party fiduciary. *In the event of the bankruptcy or insolvency of the City, a bankruptcy court may be able to direct the application of money in the Reserve Account to other purposes.* See "CERTAIN INVESTMENT CONSIDERATIONS—Municipal Bankruptcies."

The City has retained the right under the Bond Ordinance to provide, at any time, all or part of the Reserve Requirement by obtaining Reserve Insurance. Reserve Insurance is defined as any bond insurance, letter of credit, guaranty, surety bond, or similar credit enhancement device obtained by the City equal to part or all of the Reserve Requirement for any Parity Bonds which is issued by an institution which has been assigned a credit rating at the time of issuance of the device in one of the two highest rating categories of each of the Rating Agencies. The Bond Ordinance provides that such Reserve Insurance may not be subject to cancellation on less than three years' notice. Upon receipt of a notice of cancellation or upon notice that the financial institution providing the Reserve Insurance no longer meets the requirements specified in the Bond Ordinance, the City is obligated to substitute Reserve Insurance in an amount necessary to make up any deficiency or to deposit in equal monthly installments over a 36-month period an amount from Net Revenue sufficient, together with other money and investments on deposit in the Reserve Account, to equal the Reserve Requirement.

Upon the issuance of the Bonds and after giving effect to the defeasance of the Refunded Bonds, the Reserve Requirement will be \$21,292,595. The amount currently on deposit or otherwise credited to the Reserve Account currently is \$21,364,705. Of this amount, \$13,658,288 is funded with cash and \$7,706,417 is funded with a reserve account surety policy (the "Reserve Policy") provided by Financial Guaranty Insurance Company ("Financial Guaranty"). There will not be any required deposit to the Reserve Account in connection with the issuance of the Bonds.

Reserve Account Surety Policy. The Reserve Policy was subsequently reinsured by National Public Finance Guarantee Corporation, a wholly-owned subsidiary of MBIA Inc. ("National"). The Reserve Policy may be drawn upon in the aggregate amount of \$7,706,417. The Reserve Policy is scheduled to terminate on the earlier to occur of December 1, 2025 (the scheduled final maturity date of the 2005 Bonds) or the date on which no 2005 Bonds are outstanding. The City is not refunding \$5,000 aggregate principal amount of the 2005 Bonds maturing in 2025. But the City retains the right at any time to redeem or defease the remaining 2005 Bonds, at which time the Reserve Policy will terminate. As the Bonds will no longer be secured by the Reserve Account when all 2005 Bonds have been redeemed or paid, the City does not expect any shortfall in the Reserve Account to occur as a result of the payment, redemption or defeasance of the last of the 2005 Bonds which remain outstanding.

Moody's Investors Service ("Moody's"), Standard & Poor's Ratings Services ("S&P") and Fitch Ratings ("Fitch") have all withdrawn their ratings for Financial Guaranty; however, as of March 31, 2015, National is rated "A3" and "AA-" by Moody's and S&P, respectively. The Bond Ordinance does not require the City to replace Reserve Insurance or to make additional deposits to the Reserve Account when the providers of Reserve Insurance are downgraded.

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

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

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

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

Rate Stabilization Account

The City has established a Rate Stabilization Account in the Water Division Fund. As of December 31, 2014, the balance of the account was \$35,575,446. For purposes of calculating the Coverage Requirement described under “—Rate Covenant,” Net Revenue in any Fiscal Year excludes deposits into the Rate Stabilization Account and includes withdrawals from the Rate Stabilization Account. The City is not obligated to deposit or maintain any stated amount in the Rate Stabilization Account. Amounts in the Rate Stabilization Account can be used for any lawful purpose of the Water System. See APPENDIX A—“SUMMARY OF THE PRINCIPAL PROVISIONS OF THE BOND ORDINANCE—PAYMENT OF AND SECURITY FOR THE BONDS—Rate Stabilization Account.”

Additional Obligations

Future Parity Bonds. Pursuant to the Bond Ordinance, the City has reserved the right to issue Future Parity Bonds for purposes of the Water System or to refund a portion of the Parity Bonds upon satisfaction of certain conditions set forth in the Bond Ordinance, including, among other things, filing with the City either:

- (1) A certificate of the Finance Director demonstrating that during any 12 consecutive calendar months out of the immediately preceding 24 calendar months, Net Revenue was at least equal to 1.25 times the projected Maximum Annual Debt Service for all Parity Bonds, including the Future Parity Bonds proposed to be issued; or
- (2) A certificate of an Independent Consulting Engineer or, once the 2005 Bonds and 2009 Bonds are no longer outstanding, an independent certified public accountant that, in his or her opinion, the Net Revenue will be at least equal to 1.25 times the projected Average Annual Debt Service for all Parity Bonds, including the Future Parity Bonds proposed to be issued. In providing that certificate, the Independent Consulting Engineer or independent certified public accountant may take into account certain adjustments to Net Revenue as permitted by the Bond Ordinance.

Pursuant to the Bond Ordinance, if the Future Parity Bonds proposed to be issued are for the sole purpose of refunding outstanding bonds payable from the Bond Fund, no such coverage certification shall be required if the Annual Debt Service on the Parity Bonds after the issuance of the Future Parity Bonds is not, for any year in which Parity Bonds are outstanding, more than \$5,000 over the Annual Debt Service on the Parity Bonds prior to the issuance of those Future Parity Bonds. The City is issuing the Bonds to refund a portion of the outstanding 2005 Bonds and is not expecting to deliver either of the coverage certificates described above.

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

Parity Payment Agreements. The Bond Ordinance permits the City to enter into a Payment Agreement for the purpose of managing or reducing the City’s exposure to fluctuations or levels of interest rates, currencies or commodities or other interest rate, investment, asset or liability management purposes. The Bond Ordinance provides that, upon satisfaction of the requirements for the issuance of Future Parity Bonds, a Payment Agreement may constitute Parity Payment Agreement pursuant to which the City’s payment obligations are expressly stated to constitute a charge and lien on the Net Revenue of the Water System equal in rank with the charge and the lien of the Parity Bonds. The City has not entered into any such Parity Payment Agreements and currently has no plans to do so. See APPENDIX A—“SUMMARY OF THE PRINCIPAL PROVISIONS OF THE BOND ORDINANCE—PAYMENT AGREEMENT AND PARITY PAYMENT AGREEMENTS.”

Reimbursement Obligations. The Bond Ordinance provides that if the City elects to meet the Reserve Requirement or any portion thereof through the use of Reserve Insurance or elects to secure any issue of Parity Bonds with bond insurance, the City may contract with the entity providing such insurance to provide that payments

to reimburse the provider shall be on a parity of lien with the Parity Bonds. The reimbursement obligations for the debt service reserve fund policy in the Reserve Account are on a parity with the City's obligation to make payments into the Reserve Account. See "—Reserve Insurance and Reserve Account Balance."

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

Before the City may enter into a Contract Resource Obligation, among other things, there must be on file a certificate of an Independent Consulting Engineer or, once the 2005 Bonds, 2009 Bonds and 2010 Bonds are no longer outstanding, an independent certified public accountant, stating that (i) the payments to be made by the City in connection with the Contract Resource Obligation are reasonable for the supply, transmission, treatment, or other service rendered; (ii) the source of any new supply, and any facilities to be constructed to provide the supply, transmission, treatment, or other service, are sound from a water or other commodity supply or transmission planning standpoint, are technically and economically feasible in accordance with prudent utility practice, and are likely to provide supply or transmission no later than a date set forth in the Independent Consulting Engineer's, or independent certified public accountant's certification; and (iii) the Net Revenue (further adjusted by the Independent Consulting Engineer's, or independent certified public accountant's estimate of the payments to be made in accordance with the Contract Resource Obligation) for the five fiscal years following the year in which the Contract Resource Obligation is incurred, as such Net Revenue is estimated by the Independent Consulting Engineer, or independent certified public accountant (with such estimate based on such factors as he or she considers reasonable), will be at least equal to the Coverage Requirement.

The Bond Ordinance provides that payments required to be made under Contract Resource Obligations shall not be subject to acceleration.

See APPENDIX A—"SUMMARY OF THE PRINCIPAL PROVISIONS OF THE BOND ORDINANCE—SEPARATE UTILITY SYSTEMS; CONTRACT RESOURCE OBLIGATIONS."

Junior Lien Obligations. Nothing in the Bond Ordinance prohibits the City from issuing or incurring obligations of the Water System with a lien on Net Revenues junior to the lien of the Parity Bonds. As of December 31, 2014, the City has outstanding eight low-interest loans from the State Public Works Trust Fund totaling \$30,798,319 and ten low-interest loans from the State Revolving Fund totaling \$55,889,417, which are junior to the Parity Bonds in their lien on the revenues and funds of the Water System. The final maturity for the currently outstanding junior lien obligations is July 1, 2037. See Note 5 in APPENDIX C—"2013 AND 2014 AUDITED FINANCIAL STATEMENTS" to see the annual debt service on the junior lien obligations. The City has no other junior lien obligations payable from or secured by the Net Revenues of the Water System.

For four of the loans from the State Public Works Trust Fund, which are currently outstanding in the aggregate principal amount of \$8,731,011, one of the remedies available to the State Public Works Trust Fund in the event of a default under each of the loan agreements is the ability to declare the outstanding balance, together with accrued interest, to be immediately due and payable.

Additional Covenants

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

Permitted Investments

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

No Acceleration Upon an Event of Default

Upon the occurrence of an Event of Default under the Bond Ordinance, neither any Owner of a Bond nor any Bondowners’ Trustee will have the right under the Bond Ordinance to accelerate the payment of debt service on the Bonds. The City thus is liable for principal and interest payments only as they become due. The inability to accelerate the Parity Bonds limits the remedies available to the Bondowners’ Trustee and the Owners upon an Event of Default, and could give rise to conflicting interests among Owners of earlier-maturing and later-maturing Bonds. The nature and extent of any such conflicts would depend in part upon the nature and duration of any default. In the event of successive defaults in payment of the principal of or interest on the Bonds, the Bondowners’ Trustee or the Owners may be required to file a separate action for each such payment not made. Any such action to compel payment or for money damages would be subject to the limitations on legal claims and remedies against public bodies under Washington State law. For a description of the Events of Default and remedies set forth in the Bond Ordinance, see APPENDIX A—“SUMMARY OF THE PRINCIPAL PROVISIONS OF THE BOND ORDINANCE—DEFAULTS AND REMEDIES.”

The Bond Ordinance does *not* prohibit the issuance of Future Parity Bonds subject to mandatory redemption or mandatory purchase or tender for purchase upon the occurrence and continuance of an Event of Default. A mandatory redemption or purchase or tender for purchase would be substantively similar to the remedy of acceleration. See also “—Additional Obligations—Junior Lien Obligations” for a description of certain loans from the State Public Works Trust Fund that are subject to acceleration.

Separate Utility Systems

The Bond Ordinance permits the City to create, acquire, construct, finance, own and operate one or more additional systems within the Water Division for water supply, transmission, treatment or other commodity or service. The Regional System is such a system. The revenue of any such separate utility system is not be included in the Gross Revenue of the Water System and may be pledged to the payment of revenue obligations issued to purchase, construct, condemn or otherwise acquire or expand the separate utility system. Neither the Gross Revenue nor the Net Revenue of the Water System would be permitted to be pledged by the City to the payment of any obligations of a separate utility system except (1) as a Contract Resource Obligation upon satisfaction of the requirements set forth in the Bond Ordinance and/or (2) with respect to the Net Revenue, on a basis subordinate to the lien of the Parity Bonds on that Net Revenue. See APPENDIX A—“SUMMARY OF THE PRINCIPAL PROVISIONS OF THE BOND ORDINANCE—SEPARATE UTILITY SYSTEMS; CONTRACT RESOURCE OBLIGATIONS.”

DEBT SERVICE REQUIREMENTS AND ADDITIONAL BORROWING

The following table shows Tacoma Water’s payments for its share of debt service on the Regional System Revenue Bonds, debt service on the Outstanding Parity Bonds and debt service on the Bonds. The table does not include debt service on junior lien obligations, including the \$86,687,736 in junior lien obligations that are currently outstanding. See “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS—Additional Obligations—*Junior Lien Obligations*.”

Debt Service Requirements

Year	Regional System Revenue Bonds ⁽¹⁾	Outstanding Parity Bonds ⁽²⁾⁽³⁾	The Bonds				Total Parity Bond Debt Service ⁽⁴⁾	Total Regional System Revenue Bond and Parity Bond Debt Service ⁽⁴⁾
			2015A Bonds		2015B Bonds			
			Principal	Interest	Principal	Interest		
2015	\$ 4,213,814	\$ 18,343,486	-	\$ 436,252	-	\$ 31,601	\$ 18,811,339	\$ 23,025,153
2016	3,897,064	13,221,983	-	789,200	\$ 4,580,000	57,168	18,648,350	22,545,414
2017	3,899,314	13,220,333	\$ 2,845,000	789,200	1,785,000	20,528	18,660,060	22,559,374
2018	3,915,314	16,568,233	1,460,000	675,400	-	-	18,703,633	22,618,947
2019	4,384,314	16,575,833	1,520,000	617,000	-	-	18,712,833	23,097,147
2020	4,393,564	16,571,833	1,590,000	541,000	-	-	18,702,833	23,096,397
2021	4,409,814	16,578,833	1,670,000	461,500	-	-	18,710,333	23,120,147
2022	4,412,564	16,574,633	1,755,000	378,000	-	-	18,707,633	23,120,197
2023	4,437,314	16,081,883	1,845,000	290,250	-	-	18,217,133	22,654,447
2024	5,522,814	13,832,133	1,935,000	198,000	-	-	15,965,133	21,487,947
2025	5,530,814	13,798,792	2,025,000	101,250	-	-	15,925,042	21,455,856
2026	5,517,314	16,174,560	-	-	-	-	16,174,560	21,691,874
2027	5,528,064	16,088,926	-	-	-	-	16,088,926	21,616,990
2028	5,526,564	15,995,811	-	-	-	-	15,995,811	21,522,375
2029	5,543,064	15,893,028	-	-	-	-	15,893,028	21,436,092
2030	5,536,314	15,795,577	-	-	-	-	15,795,577	21,331,891
2031	5,549,914	15,687,652	-	-	-	-	15,687,652	21,237,566
2032	5,282,714	15,574,667	-	-	-	-	15,574,667	20,857,381
2033	5,470,714	21,099,597	-	-	-	-	21,099,597	26,570,311
2034	5,397,234	20,862,114	-	-	-	-	20,862,114	26,259,348
2035	5,326,447	20,614,144	-	-	-	-	20,614,144	25,940,591
2036	5,247,790	20,354,824	-	-	-	-	20,354,824	25,602,614
2037	5,166,263	20,088,290	-	-	-	-	20,088,290	25,254,553
2038	5,081,587	19,813,405	-	-	-	-	19,813,405	24,894,992
2039	4,998,478	19,524,020	-	-	-	-	19,524,020	24,522,498
2040	4,911,377	19,229,272	-	-	-	-	19,229,272	24,140,649
2041	-	26,794,200	-	-	-	-	26,794,200	26,794,200
2042	-	26,791,400	-	-	-	-	26,791,400	26,791,400
2043	-	26,795,600	-	-	-	-	26,795,600	26,795,600
Total ⁽⁴⁾	\$ 129,100,542	\$ 524,545,058	\$ 16,645,000	\$ 5,277,052	\$ 6,365,000	\$ 109,296	\$ 552,941,406	\$ 682,041,948

⁽¹⁾ Includes Tacoma Water's allocable share of debt service on the \$110,080,000 aggregate principal amount of outstanding Regional System Revenue Bonds. Tacoma Water's allocable share of the debt service on the Regional System Revenue Bonds and of the operating expenses and capital and other costs of the Regional System are payable primarily from Gross Revenues of the Water System as Operating and Maintenance Expenses prior to the Parity Bonds. Upon a default by any of the other Participants, the Water System also would be responsible, at least for some period, for that Participant's share of the costs of the Regional System, including debt service on the Regional System Revenue Bonds. The debt service on the Regional System Revenue Bonds is shown before application of any federal tax credit payments. The City understands that a portion of the 35% federal subsidy it should receive for the 2010B Regional System Revenue Bonds will be reduced as a result of the Federal sequestration. The IRS has announced that the reduction will be 7.2% for payments made through September 2023 (at which time it is subject to change). See "THE WATER SYSTEM AND THE REGIONAL SYSTEM—The Regional System."

⁽²⁾ Before 35% federal credit payments. The City understands that a portion of the 35% federal subsidy it should receive for the 2009 Bonds and the 2010B Bonds will be reduced as a result of the federal sequestration. The IRS has announced that the reduction will be 7.2% for payments made through September 2023 (at which time it is subject to change).

⁽³⁾ Excludes all of the Refunded Bonds, except for 2015, which includes six months of interest on the Refunded Bonds.

⁽⁴⁾ Totals may not add due to rounding.

Additional Borrowing

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

THE CITY

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

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

The City Manager appoints a Finance Director who supervises the financial and purchasing functions of the City, including the City’s accounting system. The Finance Director is responsible for preparing the Comprehensive Annual Financial Report (“CAFR”) in accordance with generally accepted accounting principles and the instructions of the State Auditor’s Office. The Finance Director is responsible for the payment of principal and interest on all bonds issued by the City, including the Bonds.

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

THE DEPARTMENT OF PUBLIC UTILITIES—TACOMA WATER

Overview

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

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

The Director of Utilities, who is chief executive officer of the Department, is appointed by the Board and confirmed by the City Council. The Director serves at the pleasure of the Board and is confirmed by the City Council every two years following performance reviews by the Board. The Director, with the concurrence of the Board, has the power to appoint division superintendents.

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

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

Tacoma Water—General

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

As the City grew, a system of wells was developed in south Tacoma and on the North Fork of the Green River to meet summer peak use periods as well as the City's needs during periods of turbidity in the Green River. Today, the system of wells has a capacity of approximately 55 MGD and on an annual basis supplies approximately 4% of the City's water needs.

Tacoma Water is one of the largest publicly owned water utilities in the State. The following table displays selected operating data regarding Tacoma Water as of December 31, 2014 and 2013.

Selected Operating and Financial Data Calendar Years 2014 and 2013

	2014	2013
Average Number of Metered Customers	98,607	97,856
Operating Revenue	\$98,319,954	\$96,119,420
Total Water Billed (MG)	18,366	17,867
Average Daily Use (MG)	50.32	47.29
Maximum Daily Use (MG)	80.82	77.6

Source: Water Division, 2013 and 2014 Audited Financial Reports.

Service Area

Tacoma Water's current service area consists of the City and the urbanized areas of Pierce and south King Counties. The area extends from the northerly boundary of Lakewood Water District and Parkland Light and Water Company in the south, northward to the City of Federal Way in King County. The eastern boundary is the foothills of the Cascade Mountains. The western boundary is Puget Sound. Approximately 36% of Tacoma Water's residential service is outside of the City limits.

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

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

Historically, the Water System has expanded in order to meet City growth and to supply surrounding communities and water utilities. Over the years, the City has acquired water districts, water companies, and

cooperatives as well as individual services outside the City limits. The City will continue such an acquisition program when requested, provided it is economically sound and consistent with growth management policy.

Recent population trends for the retail service area indicate slow account growth inside the City, while growth outside the City, particularly in unincorporated Pierce County, continues at a moderate pace due to greater available buildable land.

Currently, wholesale service is a small part of Tacoma Water's operations, constituting approximately 5.3% of water service revenues. Wholesale purchases under standard cost of service pricing are expected to remain stable. Tacoma Water has begun to offer market-priced wholesale offerings that could result in near-term demand and service revenue growth that is not currently reflected in plans and projections contained herein.

The map on the following page shows Tacoma Water's service area.

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Management

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

William A. Gaines, Director of Utilities, assumed his position in October 2007, after serving as Superintendent/Chief Operating Officer of Tacoma Power for a year. Mr. Gaines, an experienced executive with approximately 32 years in the utility industry, came to Tacoma from Seattle City Light, where he served as Power Supply and Environmental Affairs Officer and as Power Management Executive. He spent much of his career as an executive officer at Puget Sound Energy, where he served as Vice President for Engineering and Contracting and as Vice President for Energy Supply. Mr. Gaines is active in regional industry groups including the Public Power Council, Pacific Northwest Utilities Conference Committee and Western Systems Power Pool, and sits on the Board of the Tacoma/Pierce County Chamber of Commerce and the Pierce County Economic Development Board. Mr. Gaines received a B.S. degree in electrical engineering from Washington State University and an M.B.A. from the University of Puget Sound. He also attended the executive development program at Stanford University.

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

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

Chris McMeen, P.E., Deputy Water Superintendent, Water Quality Manager, joined the City in 2002. He has over 27 years of experience in the drinking water industry, including work as an engineering consultant, drinking water regulator, utility engineer and manager. He has a B.S. and M.S. in civil engineering from the University of Washington.

Sean Senescall, Rates and Financial Planning Manager, joined the City in 2010 as the Rates and Financial Planning Assistant Division Manager, and became the Rates and Financial Planning Manager in 2013. He has nine years of experience in government finance and rate development. He studied economics at the U.S. Air Force Academy and has a B.S. in economics from the University of Washington.

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

Raymond West, Water Distribution Operations Manager, joined Tacoma Water in 1975 and became Assistant Distribution Manager in 1998 and the Distribution Operations Manager in 2006. He has several certifications including electronics and a State Water Works Operator license.

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

Budgetary Policies

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

Auditing

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

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

The City has contracted with Moss Adams LLP to perform the annual audit of the financial statements of Tacoma Water for the 2014 fiscal year. The audited financial statements of Tacoma Water for fiscal years 2013 and 2014, prepared by Tacoma Water and audited by Moss Adams LLP, are contained in APPENDIX C. Moss Adams LLP, the City's independent auditor, has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. Moss Adams LLP also has not performed any procedures related to this Official Statement.

Retirement System

Substantially all employees of Tacoma Water are covered by a contributory retirement plan administered by the City's Employee Retirement System ("TERS"). TERS is a cost-sharing multiple-employer, defined benefit retirement plan covering substantially all employees of the City, with the exception of police officers, firefighters, and Tacoma Rail employees who are covered by state or federal plans. Employees of the Tacoma-Pierce County Health Department, as well as certain employees of the Pierce Transit and the South Sound 911 who established membership in TERS when these agencies were still City departments, are also members. The Board of Administration of TERS administers the plan, and benefit provisions are established in accordance with chapter 41.28 RCW and Chapter 1.30 of the Tacoma City Code. The Board of Administration of TERS consists of nine members, including the Mayor, City Manager or the designee, Finance Director, Director of Utilities or the designee, three employees and one retiree. As of December 31, 2014, there were 2,166 retirees and beneficiaries receiving benefits, 459 vested terminated employees entitled to future benefits, and 2,884 active members in TERS. Tacoma Water is current in all payments to TERS. Further details about TERS are provided in Note 10 in Appendix C—"2013 AND 2014 AUDITED FINANCIAL STATEMENTS."

Contributions City-wide totaled \$44.6 million in 2014 (\$23.9 million employer contributions and \$20.7 million employee contributions) and totaled \$43.2 million in 2013 (\$23.1 million employer contributions and \$20.1 million employee contributions). The contribution rate for Tacoma Water's covered payroll is currently set at 20% of gross wages for 2014 (10.8% paid by Tacoma Water and 9.2% paid by employees). Tacoma Water contributed \$2,020,282 in 2014 and \$1,974,933 in 2013 into TERS. Tacoma Water is current in all payments to TERS.

The most recent actuarial valuation of TERS was completed as of January 1, 2014 by Milliman (the "Valuation Report"). Assumptions include investment earnings of 7.25%, wage growth of 4.00% and price inflation of 3.00%. According to Milliman, over the last two years investment returns of 15.8% in 2013 and 14.1% in 2012 have increased TERS's Funding Ratios. The funding ratio based on market assets has increased from 91% at the January 1, 2012 to 99% at January 1, 2014. The increases due to investment gains were somewhat offset by lowering the investment return assumption by 0.25% at both January 1, 2013 and January 1, 2014.

**TERS Valuations
(Millions of \$)**

Actuarial Valuation Date	Actuarial Value of Assets	Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	Percentage of Covered Payroll
01/01/2012	\$1,068.3	\$1,185.5	\$117.2	90.1%	\$219.4	53.4%
01/01/2013	1,187.1	1,306.6	119.5	90.9	210.6	56.7
01/01/2014	1,297.0	1,400.0	103.0	92.6	213.8	48.2

The Valuation Report provides the following information regarding long-term funding projections: The baseline projection demonstrates that if experience in all future years matches the actuarial assumptions, including 7.25% investment returns, the Funding Ratio is projected to reach 100% by 2019. However, a downside scenario projection showing that adverse investment experience similar to what TERS experienced in 2006 – 2008 could require contribution rates to increase as high as 30.53% of pay to amortize the UAAL over 30 years. Future experience is expected to be both better and worse than the actuarial assumptions at different times and is likely to result in changes to TERS's funding status.

Although TERS is funded over a long period of time, the measurement of TERS's funding status can vary widely from year-to-year due to asset returns. The following table summarizes TERS's asset returns in recent years and compares the market value gains and losses to the AAL at the following valuation date. Returns greater than the 7.25% actuarial assumption are gains; returns less than the 7.25% actuarial assumption are losses. The AVA recognizes these market value gains and losses in four equal increments starting at the end of the year in which they occur. Gains in good years are needed to offset losses in bad years.

TERS Asset Returns

Year	Market Value % Return*	Market Value Gain/ (Loss) compared to expected	End of Year Actuarial Accrued Liability (AAL)	Gain / (Loss) as a % of next AAL
2004	15.5%	\$ 60,100,000	\$ 754,300,000	8.0%
2005	8.7	8,500,000	**	0.9
2006	18.6	102,800,000	895,800,000	11.5
2007	3.9	(42,200,000)	**	(4.2)
2008	(32.0)	(451,000,000)	1,002,300,000	(45.0)
2009	27.3	147,700,000	**	13.0
2010	14.1	60,200,000	1,132,900,000	5.3
2011	1.3	(69,900,000)	1,185,500,000	(5.9)
2012	14.1	68,700,000	1,306,600,000	5.3
2013	15.8	100,000,000	1,400,000,000	7.1

* The market value returns shown above are net of investment expenses, but not administrative expenses. They are based on the TERS's annual financial statements, but may have some variance from calculations performed by other parties due to different methodology. The preliminary estimate of the market value return in 2015 was 8.13%.

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

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

Other Post-Employment Benefits

The City allows retirees to participate in medical, dental and vision programs from the time retirement begins until they qualify for federally funded programs. The City uses pay as you go funding, and upon retirement the retiree is responsible for paying a blended premium, which prior to retirement was paid by the City. The benefit is an implicit subsidy to the retiree. As of December 31, 2014, the City's net other post-employment benefit

(“OPEB”) obligation was \$66,138,206, of which \$2,908,139 was related to the Water System. Further details about OPEB are provided in Note 11 in APPENDIX C—“2013 AND 2014 AUDITED FINANCIAL STATEMENTS.”

Taxation

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

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

Program of Insurance

Tacoma Water currently maintains insurance policies and a self-insurance program. The insurance policies presently in effect include coverage on the Department’s buildings and fleet vehicles as well as general liability and public officials’ liability. The current insurance policies have deductibles or self-insured retention of \$250,000 for buildings and vehicles, and \$1,500,000 for general comprehensive liability. The public officials policy has a deductible of \$200,000 for employee practices liability. The general comprehensive liability policies provide \$60 million of coverage. The City has a policy to cover extraordinary worker’s compensation claims with a statutory limit and \$1 million retention. Earthquake coverage has a 5% or \$250,000, whichever is greater, per building self-insured retention.

Tacoma Water participates in the Department’s self-insurance claim fund (the “Self Insurance Fund”) for payment of third party claims. As of December 31, 2014, assets in the Self Insurance Fund totaled \$232,947, which exceeds accrued and incurred but not reported liabilities. Tacoma Water’s premium payments totaled \$180,000 per year in both 2014 and 2013. Tacoma Water’s premium payment in 2014 was \$180,000. Contributions are routinely reviewed to determine their adequacy. The Self Insurance Fund is dedicated and requires a two thirds vote of the City Council before it can be used for anything except insurance or casualty losses. The City and the other Second Supply Project Participants separately insure or self-insure the Second Supply Project and potential liabilities arising from or related to the Second Supply Project.

Performance and fidelity bonds covering all employees are provided in amounts up to \$1 million (subject to a \$25,000 deductible per occurrence).

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

Strategic Planning and Financial Planning and Reporting

Tacoma Water has formally adopted certain policies that serve as a guide to financial management and rate setting. These are included in the “Water Rate and Financial Policy” document, which has been reviewed and adopted as a City Resolution by the Board and City Council. These policies require that the utility set rates based on the cost of service to each customer class, adhere to restrictions on the term of debt, and maintain a minimum of 60 days of operating cash in the Current Fund, 1% of original cost plant-in-service in the Capital Reserve Fund, and \$2,000,000 in the System Development Charge Fund. These policies also specify debt service coverage minimums that are higher than those that are required by Bond Ordinance, including an “All In Debt Service Coverage” minimum of 1.25 times, and a “Senior Debt Service Coverage” minimum of 1.50 times. The policies also require that water rates be designed to adequately fund acquisitions of new resources and conservation and allow the utility to recover up to 65% of rate revenues from fixed components of the rate. The Board and City Council most recently approved the amended Water Rate Policy in 2014.

State law and City policies permit City utilities to borrow on a short-term basis from the General Fund. Tacoma Water has never borrowed from the General Fund and does not currently expect to do so.

Tacoma Water operates under the guidance of its strategic plan and reporting and tracking procedures that monitor compliance with its strategic plan, which together provide a framework for the development and implementation of strategic objectives. Tacoma Water currently is currently tracking nine strategic objectives: working with customers' best interests in mind; ensuring financial stability and effective management of costs; understanding and supporting retail customer needs; understanding and supporting wholesale customer needs; managing the execution of operational and strategic plans and decisions; managing assets at lowest life cycle cost with an acceptable level of risk; leverage technology; improving relationships between employees and their direct supervisors; and ensuring that all employees understand what is expected of them at work. Performance against these objectives is reported to executive leadership quarterly.

Financial reports are provided to the Board, and budget performance reports are published for staff and policymaker review, on a quarterly basis.

Labor Relations

As of December 31, 2014, Tacoma Water had approximately 239 employees, many of whom are represented by Local 483-International Brotherhood of Electrical Workers ("IBEW"), one of the 12 labor organizations that represent City employees. Other units representing Tacoma Water employees include Local 117-Teamsters, Local 17-Professional and Technical Engineers, and Local 120-AFSCME. Negotiations with unions are conducted by a team chaired by a Human Resources Labor Relations staff member selected by the Human Resources Director, who reports directly to the City Manager. Management of Tacoma Water strives to promote sound labor relations policies that are beneficial both to its operations and to its employees. This cooperative effort has precluded a significant work stoppage among utility employees for the last several decades, although there was an 11 day work stoppage by clerical members of IBEW, Local 483, in 1992.

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

Investment Practices

The City's Investment Committee is composed of the Mayor, the Finance Director and the City Treasurer. The City Treasurer invests City funds. The Water System'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 securities 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 similar to a demand deposit account in that all City departments, including the Water System, 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.

The Water System’s investments in that portion of the TIP held in qualified public depositories at December 31, 2014 and 2013 is entirely covered by the Federal Deposit Insurance Corporation (“FDIC”) and/or the Washington State Public Deposit Protection Commission (“PDPC”).

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’s 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.

As of December 31, 2014, the par value of the City’s investments totaled \$861.133 million. The portfolio was distributed in various types of investment instruments in the following percentages:

Government Agencies	62.23%
U.S. Treasuries	10.0
State Local Government Pool	7.57
Bank Interest-Bearing Accounts	0.83
Bankers Acceptance	0.00
Flexible Repurchase Agreements	1.02
Municipal Securities	18.35

State Local Government Investment Pool. The State Treasurer’s Office administers the Washington State Local Government Investment Pool (the “LGIP”), which invests over \$9 billion on behalf of more than 450 cities, counties and special taxing districts. In its management of LGIP, the State Treasurer is required to adhere, at all times, to the principles appropriate for the prudent investment of public funds. These principles are, in order of priority, (i) the safety of principal; (ii) the assurance of sufficient liquidity to meet cash flow demands; and (iii) the attainment of the highest possible yield within the constraints of the first two goals. Historically, the LGIP has had sufficient liquidity to meet all cash flow demands.

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

THE WATER SYSTEM AND THE REGIONAL SYSTEM

Sources of Supply

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

water in October 2005. The City recently completed construction of a filtration project on the Green River. See “—The Regional System.”

The watershed, located above the diversion, consists of approximately 230 square miles of timbered and mountainous terrain. The U.S. Army Corps of Engineers (the “Army Corps”) constructed Howard Hanson Dam and Reservoir in 1961, forming the Eagle Gorge Reservoir, about three miles upstream from Tacoma Water’s Headworks Diversion Dam. The primary authorized purpose of the dam is to provide flood control for the Green River valley during the winter. Secondary authorized purposes include augmentation of low summer flows downstream of the dam, irrigation and storing water for municipal water supply purposes by Tacoma Water and its Second Supply Project partners. In 2012, the Army Corps completed the last dam safety rehabilitation project on the Howard Hanson Dam to mitigate damages from a January 2009 storm event and insure reliability of the dam in the future. The Army Corps was responsible for all dam safety costs. Projects implemented by the Army Corps include vertical and horizontal short path seepage dewatering wells, rock armoring and additional log booms.

In the 1970s, Tacoma Water drilled seven wells on the North Fork of the Green River (the “North Fork Wells”) approximately six miles upstream from the Headworks. The North Fork Wells have been effective in maintaining the quality of Tacoma Water’s main water supply during high turbidity in the Green River source. The well water either blends with the river water or replaces the river water depending on the level of turbidity. This blending system was used principally between 1978 and 2014 to enable Tacoma Water to avoid filtration. It is expected that Tacoma Water will continue using this blending system to reduce turbidity seasonally to optimize filtration.

In addition to the North Fork Wells, Tacoma Water has a number of wells within its service area that can be used to augment supply during peak summer demands, or in the event of emergency interruption of the Green River supply. During a typical year, approximately 96% of the Water System’s water supply is from the Green River and 4% is from these wells. The following table summarizes the water supplied by source during 2014 to meet the peak and average water requirements for Tacoma Water only, it does not include capacity or production values for the Second Supply Participants (see the “—The Regional System” below).

**Tacoma Water
2014 Sources of Supply of the Water System
(MGD)**

Source	Peak Capacity	Peak Day Production⁽²⁾	Average Production⁽²⁾
Surface Water Sources:			
Green River	111.58 ⁽¹⁾	84.37	46.56
Groundwater Sources:			
Wells	53.30	0.00	5.27
Total Sources	164.88	84.37	51.83

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

⁽²⁾ Produced for Tacoma Water retail and wholesale deliveries (excludes Regional System water use by Kent, Covington and Lakehaven).

Tacoma Water’s 2015 demand forecast indicates that the Water System has sufficient water supply to meet projected demands for at least the next 50 years.

Water Rights

Tacoma Water has water rights on the Green River in excess of its current needs, which include a water right claim for 73 MGD (the “First Diversion Water Right”) plus a water permit for up to 15/36 of 65 MGD (the “Second Diversion Water Right”) and is the source of supply for Regional System, as further described below under “—The Regional System.” Second Diversion Water is conditional based on Green River flow and is, therefore, only available approximately 60% of the time on an annual basis. However, Second Diversion Water may be stored

behind Howard Hanson Dam in the spring, and as the water is being stored at a rate not to exceed the Second Diversion water right rate, it may be withdrawn at a later date, at any rate. Therefore, when needed in the peak season, water from the Green River source may be used at a rate that is limited only by pipe/plant capacity.

Water rights for the Water System's 25 wells, most of which are located within its water service area, total 115 MGD, with an installed pumping capacity of 67.2 MGD.

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

The Regional System

The City has the authority under State law and the Bond Ordinance to establish additional "systems" within the Water Division, which are financed separately from the Water System. See "SECURITY AND SOURCES OF PAYMENT FOR THE BONDS—Separate Utility Systems." The Water Division currently includes one such additional system – the Regional System. Although separately financed, the Regional System is owned, operated and maintained by the City as an integral part of the Water Division. Therefore, the Regional System is accounted for from a financial reporting standpoint as part of the Water Division.

The Regional System provides water supply and transmission services to Tacoma Water and to the City of Kent ("Kent"), the Covington Water District ("Covington") and the Lakehaven Utility District ("Lakehaven," and collectively with Tacoma, Kent and Covington, the "Participants"). The Regional System was formed by the Participants to obtain permits for and to design, finance, construct, operate, maintain and receive delivery of water from the Second Supply Project. The Participants entered into the Second Supply Project Agreement in 2002 (as subsequently amended, the "Second Supply Project Agreement"). A summary of the certain provisions of the Second Supply Project Agreement is included in this Official Statement as APPENDIX E.

In addition to increasing water supply, the Second Supply Project increases flexibility and reliability of water delivery in both Tacoma Water's and the other Participants' service areas.

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

Second Supply Project Agreement. The Second Supply Project Agreement defines the rights and obligations of the Participants with regard to the Second Supply Project. Tacoma has a 15/36 Participant Share and each of Kent, Covington and Lakehaven has a 7/36 Participant Share in the Second Supply Project. Generally, a

Participant Share represents a Participant's proportional right to receive and obligation to pay for water delivered by the Second Supply Project.

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

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

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

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

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

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

sufficient to provide for the payment of the principal of and interest on the 2010 Regional System Revenue Bonds and 2013 Regional System Revenue Bonds.

Under the Second Supply Project Agreement and the associated Repayment Agreement, Tacoma Water is responsible for paying debt service on \$32,925,000 of the principal amount of the 2010 Regional System Revenue Bonds and \$35,840,000 of the principal amount on the 2013 Regional System Revenue Bonds. Kent is responsible for paying debt service on \$11,400,000 of the principal amount of the 2010 Regional System Revenue Bonds and \$14,790,000 of the principal amount on the 2013 Regional System Revenue Bonds. Covington is responsible for paying debt service on \$3,515,000 of the principal amount of the 2010 Regional System Revenue Bonds and \$14,165,000 of the principal amount on the 2013 Regional System Revenue Bonds. Covington has received State Revolving Fund loans for the Filtration Project and is expected to contribute \$8,080,000 of loan proceeds to finance a portion of its share of the project. Kent and Covington will pay their share to Tacoma, which will pay the bond registrar for the Regional System Revenue Bonds. Those percentage shares are subject to change with the addition of a new participant, the payment default of a Participant, the issuance of additional Regional System Revenue Bonds or the optional prepayment by an obligated Participant. The payments by Tacoma Water, Kent and Covington constitute "Contract Resource Obligations" payable as operation and maintenance expenses from the gross revenues of their respective water utilities. The Repayment Agreement governs debt service payments on the Regional System Revenue Bonds and does not otherwise affect each Participant's rights and obligations under the Second Supply Project Agreement. The Repayment Agreement takes precedence over the debt repayment provisions of the Second Supply Project Agreement.

The following table sets forth the Participants' allocable shares of the annual debt service on the outstanding Regional System Revenue Bonds for years 2015 through 2024. Upon a default by any of the other Participants, the Water System also would be responsible, at least for some period, for that Participant's share of the costs of the Regional System, including debt service on the Regional System Revenue Bonds. Because Lakehaven chose to pay its allocable share of the capital costs of the initial project and the filtration project with cash, it has no allocable share of the debt service on the Regional System Revenue Bonds.

**Regional System Revenue Bonds
Participants' Allocable Shares of Annual Debt Service
(2015-2024)⁽¹⁾**

Year	Kent	Covington	Tacoma	Total
2015	\$ 1,716,294	\$ 1,059,228	\$ 4,213,814	\$ 6,989,336
2016	1,579,144	938,478	3,897,064	6,414,686
2017	1,595,394	958,228	3,899,314	6,452,936
2018	1,580,244	941,728	3,915,314	6,437,286
2019	1,795,294	1,145,728	4,384,314	7,325,336
2020	1,799,044	1,149,228	4,393,564	7,341,836
2021	1,791,494	1,146,728	4,409,814	7,348,036
2022	1,794,894	1,143,478	4,412,564	7,350,936
2023	1,796,694	1,144,478	4,437,314	7,378,486
2024	2,441,894	1,769,478	5,522,814	9,734,186
Total	\$ 17,890,390	\$ 11,396,780	\$ 43,485,890	\$ 72,773,060

⁽¹⁾ Debt service is shown net of the 35% federal interest subsidy to be received in connection with Regional System Revenue Bonds issued as *Build America Bonds*. The City understands that a portion of the 35% federal interest subsidy that should be received will be reduced as a result of the Federal sequestration. The IRS has announced that the reduction will be 7.2% for payments made through September 2023 (at which time it is subject to change).

Regional System Operations. As owner and operator of the Second Supply Project, Tacoma Water is responsible for the day-to-day operation of the Second Supply Project and is obligated, consistent with the approved annual budget then in effect, to operate and maintain the Second Supply Project in a manner that is consistent with prudent utility practice. Tacoma Water also is responsible as Project Operator for, among other things,

(i) monitoring the delivery of Second Supply Project water to each Participant and (ii) calibrating and testing for accuracy the master meter and all project and delivery meters.

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

The average daily water of the Regional System used by the Participants for the years 2010 through 2014 appear below. The Participants have other sources of water in addition to the Regional System.

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

	2010	2011	2012	2013	2014
Tacoma Water	15.57	15.53	19.57	21.64	19.80
City of Kent	0.54	0.47	0.64	0.74	0.60
Lakehaven Utility District	2.89	5.25	6.09	6.31	6.92
Covington Water District	1.90	1.96	2.60	2.88	3.01
Total Use	20.90	23.21	28.89	31.57	30.33

Filtration Project. Until December 2014, the Green River was one of the few remaining major unfiltered surface water supplies in the country. In 2006, the U.S. Environmental Protection Agency promulgated the Long Term 2 Enhanced Surface Water Treatment Rule (“LT2”), establishing new requirements for all water utilities providing water from lakes or rivers to provide treatment for inactivation or removal of *Cryptosporidium*. *Cryptosporidium* is a naturally-occurring micro-organism that can be found in open surface water sources such as the Green River, and has been responsible for waterborne disease outbreaks in some public water systems. While years of monthly testing from the Green River indicates that the presence of this organism is extremely rare, the LT2 regulation required Tacoma Water to install additional treatment for *Cryptosporidium* by 2014. The Participants worked with a consulting team to analyze potential strategies for LT2 compliance. Following substantial analysis, significant public outreach and communication, the filtration option was selected as the best solution for the long-term benefit of the utility customers. In 2010, the Board, the Covington and Lakehaven Boards and the Kent City Council each adopted a resolution approving the installation of the Filtration Project. The Second Supply Project Agreement defines the costs associated with additional or different treatment facilities to be Project Costs, apportioned to each of the Participants on the basis of their Participant Share.

Following Board and City Council approval, design was authorized in 2010, and continued through 2011 and early 2012. The Filtration Project was constructed using an alternative delivery methodology allowed under State law (Chapter 39.10 RCW) called General Contractor/Construction Manager (GC/CM). This project delivery approach enables substantial risk control through the selection of a highly qualified general contractor, and close collaboration between Tacoma Water, the design engineer, and the contractor. When authorized to proceed by the Public Utility Board and City Council in 2010, the upper bound cost projection was \$211 million (2010 dollars), with an estimated escalated cost of \$242 million at the end of construction. With the project substantially complete and in operation, anticipated total project cost at close out (summer of 2015) is anticipated to be approximately \$187.5 million.

The 2010 Regional System Revenue Bonds were issued to finance the costs of Phase I of the Filtration Project except for Lakehaven’s share (for which Lakehaven paid cash). Phase I work covered those portions of the Filtration Project completed between July 2010 and August 2013. This work included completed design, permitting, and early stages of construction, including major earthwork and the early stages of major concrete placement. Phase

II work completed the concrete, major piping, and treatment process construction steps, leading toward an operational filtration plant that began serving filtered water on December 16, 2014.

As noted above, the total cost for the Filtration Project at closeout is anticipated to be \$187.5 million. Tacoma Water is responsible for \$81.5 million of this total for its first diversion operations (the Tacoma Water System). The Regional System is responsible for \$106.0 million of Filtration Project costs; Tacoma Water is responsible for \$44.2 million of this portion. All costs of the Filtration Project have been paid for or financed.

Endangered Species Act Compliance

In 1999, the National Marine Fisheries Service (“NMFS”) listed Puget Sound Chinook salmon as a threatened species. Subsequently, the U.S. Fish & Wildlife Service (“USFWS”) listed Puget Sound bull trout and Puget Sound steelhead as threatened species in 1999 and 2007, respectively. Pursuant to regulations, NMFS and USFWS have extended to these threatened species certain protections under the Endangered Species Act (“ESA”). These protections include a prohibition on “take,” which includes not only harm to members of the species, but also adverse effects or destruction of habitat. This caused water utilities throughout the region to assess their potential liability under the ESA. Tacoma Water has approached these issues within a multi-faceted response strategy. First, it developed a Habitat Conservation Plan under Section 10 of the ESA, which was approved by the NMFS and USFWS in 2001, to protect its source of supply operations on the Green River. Acceptance of the Habitat Conservation Plan led to the issuance of 50-year Incidental Take Permits from NMFS and the USFWS for Tacoma Water’s water supply operations on the Green River. Although the protection of the threatened Chinook salmon was the incentive for plan development, the Habitat Conservation Plan eventually was approved to provide coverage for 32 aquatic and terrestrial species. This significantly reduces the risk to Tacoma Water that future water supply operations may be disrupted due to ESA issues. Second, Tacoma Water has adopted a “take” avoidance strategy for its field operations on the water distribution system. Section 4(d) of the ESA allows certain categories of activities defined by federal rule to be conducted without “take” liability. In 2001, Tacoma Public Utilities obtained coverage under this provision for a wide variety of its utility maintenance activities by adopting and implementing the federally approved “Regional Road Maintenance Endangered Species Act Program Guidelines.” Tacoma Water has modified its operation to obtain coverage under this program for many of its day to day operations.

State Department of Health/U.S. Environmental Protection Agency Requirements

Tacoma Water must comply with the requirements of the rules and regulations promulgated by the United States Environmental Protection Agency (“U.S. EPA”) pursuant to the Safe Drinking Water Act. The Washington State Department of Health (“WSDOH”) is delegated by U.S. EPA to administer these regulations in the State. In addition, WSDOH has rules and regulations for the design and operation of water systems. WSDOH provides oversight of water systems including reviews, approvals, and monitoring of performance.

Extension of Tacoma Water’s 2006 Comprehensive Water Plan (the “Water System Plan”) was approved by the Department of Health on December 30, 2013. This extension allows Tacoma Water to continue to utilize the 2006 water system plan, which still meets Tacoma Water’s needs, until January 23, 2018. The ability to update the Water System Plan at that time, following completion of the Green River Filtration Facility, will ensure that any required system changes can be thoroughly addressed. An extension in 2013, in lieu of an expensive and resource intensive update, is a new, responsible approach following the Department of Health’s appropriate level of planning guidance. The Water System Plan includes projections of future water demand requirements, water quality and treatment requirements, supply development and system capital improvements. It also describes the financial plan for funding these improvements and includes other required sections such as policies and design criteria, system inventory and operations and maintenance. Because the Water System Plan as a whole is only periodically updated, Tacoma Water updates key components of the Water System Plan more frequently. These updates include Tacoma Water’s water demand forecast, capital facilities plan, strategic plan and reports of Tacoma Water’s compliance with its strategic objectives.

Agreement with Muckleshoot Tribe

An agreement was signed in August 1995 with the Muckleshoot Indian Tribe (the “Muckleshoots”) that settles perceived impacts from utility operations on the Muckleshoots’ treaty granted rights. The settlement package

had a cost of approximately \$49 million in payments through 2044, of which \$28,250,000 has been paid to date, and includes five basic elements: (1) building a fish restoration facility and paying for annual operation and maintenance of that facility or, at the Muckleshoots' election, making an equivalent cash payment; (2) providing for enhanced flows in the Green River; (3) transferring certain lands; (4) establishing a trust fund payable over 40 years which is intended to provide for the general welfare, educational and other needs of the Muckleshoots; and (5) providing for limited access into the Green River watershed. With respect to item (1) above, the Muckleshoots have elected to accept an equivalent cash payment, relieving Tacoma Water of the annual operation and maintenance obligation. The Muckleshoots have until September 2015 to determine if they would like to utilize the cash payment they have received for a fish restoration facility. The settlement resolves past damage claims by the Muckleshoots for Tacoma Water's historical operations on the river, gains the Muckleshoots' acceptance of the Second Supply Project and provides a basis for a long-term cooperative working relationship on the Green River.

Water Quality and Treatment

Watershed monitoring and protection programs are critical to ensuring high water quality. Well managed, unpopulated watersheds minimize potential adverse effects on the water supply. Tacoma Water has a watershed control program with inspectors who patrol the watershed to protect against any unauthorized entry. Tacoma Water owns approximately 11% of the watershed area including much of the land adjacent to the Green River and the Eagle Gorge Reservoir, located approximately three miles upstream from the Green River Headworks behind Howard Hanson Dam. Most of the land that is not owned by Tacoma Water is either U.S. Forest Service property or is owned by timber companies or the State Department of Natural Resources. There are no permanent residents living within the watershed boundaries. Tacoma Water, the timber companies, and the State Department of Natural Resources work cooperatively to ensure that timber harvesting and other activities comply with watershed control best management practices, thereby minimizing any potential adverse impacts on water quality. Tacoma Water has in place agreements with all of the timber companies to document their commitment to use these best management practices.

Tacoma Water's Watershed Control Program has been approved by WSDOH and has allowed the Water System's Green River supply to remain unfiltered, provided that Tacoma Water implements this program, submits regular monitoring reports, and meets the established water quality standards at all times. The addition of filtration to the water supply will not diminish the importance of maintaining effective watershed control.

The water from Tacoma Water's wells is chlorinated before being introduced into the distribution system. The water quality is monitored on a regular basis in accordance with the requirements of the WSDOH and the U.S. EPA. One of Tacoma Water's 30 wells is equipped with an air stripping tower to remove organic compound contamination, which was discovered during the early 1980s. This treatment maintains water quality by keeping water-borne contaminants to levels that are below the detectable limits. Contaminant levels in this groundwater source have also decreased as a result of the cleanup of the pollution source and significantly more rigorous land use controls within the City to protect groundwater. In 2013, Tacoma Water completed construction of a 40 million gallon per day groundwater treatment system at its Hood Street Reservoir to bolster compliance with regulations related to corrosivity of water to household plumbing and to provide fluoridation of the groundwater.

Drought and Climate Change Resiliency

Tacoma Water has developed a water shortage response plan that specifies progressive and phased curtailment measures that can be taken in the event of a drought, which includes taking the following measures in the following order:

1. Implementing voluntary curtailment messaging.
2. Coordinating with state and federal resource agencies, as well as tribes, identifying and repairing significant leaks, reducing system flushing, and requesting more aggressive and targeted voluntary curtailment.

3. Implementing mandatory curtailment measures to eliminate discretionary use first, and essential use as necessary, implementing emergency surcharge pricing, and enforcing violations.

4. Declaring an emergency and instituting formal procedures to declare a city emergency.

Due to the diversification of Tacoma Water's supply portfolio, which includes significant groundwater resources in the City that are used to supplement the surface water supply from the Green River, as well as a number of emergency intertie arrangements with adjacent utilities with groundwater supplies, Tacoma Water believes that it is well positioned to address drought conditions that might occur from year to year. While the future impacts of climate change are not fully known, Tacoma Water is working proactively with other major utilities in the region to assess and address potential impacts of climate change. Several independent studies of the impacts of climate change on the Tacoma Water system have been conducted, and the results of the studies are being vetted and evaluated on an ongoing basis.

Water System Security

Tacoma Water, along with many other major water utilities, is taking additional steps to protect its water supply facilities and to prevent contamination of the water supply. Tacoma Water covered the last of its open basins in 2012. The basins were replaced with smaller covered reservoirs that will provide improved water quality as well as improved system security. The water quality leaving these new reservoirs has improved so much that a gas-rechlorination system has been eliminated, thus providing a decreased level of risk. Tacoma Water also has taken actions to secure the source of supply on the Green River through increased surveillance of watershed activities and closing additional areas to access. Security has been tightened regarding chemical deliveries to Tacoma Water facilities, additional monitoring of water quality has been initiated, and security provisions are reviewed on an ongoing basis to assure adaptive reaction to any changes in threat status. A system wide analysis was completed in early 2003 with the support of a U.S. EPA grant. In 2014, Tacoma Water initiated a comprehensive all hazards vulnerability assessment. The intent is to identify Tacoma Water's vulnerabilities and develop remediation and resilience strategies to assure the continued safety and security of the Water System's assets. The assessment includes all of Tacoma Water's infrastructure assets and will be completed in 2015. A separate cyber vulnerability assessment was completed in 2014, and Tacoma Water is implementing the appropriate recommendations.

Water System Operations

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

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

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

Water Supply Section. The Water Supply Section has responsibility for water supply resources, water transmission lines larger than 24 inches in diameter, reservoirs within the distribution system, pumping stations, wells, and pressure reducing valves. The Water Supply Section also has responsibility for overall Water System operations and it controls all elements of the Water System that are integral to Water System operations, including a network of communication and telemetry systems. Water System operations are managed from the Water Control Center, located in the Tacoma Water Distribution Center, which is staffed 24 hours a day.

Tacoma Water's water transmission and distribution system consists of 141 miles of transmission pipelines ranging in size from 28 to 96 inches in diameter, 29 booster pump stations, 141 million gallons of reservoir storage, and 1,209 miles of distribution pipeline ranging in size from two to 24 inches in diameter. The distribution system includes a number of pressure zones; most are supplied by reducing the pressure gradient from the McMillin Reservoir and the remainder requires additional pumping of water to serve higher areas.

The storage available in the Water System is capable of supplying approximately three days at the average daily usage rate. To maintain better water quality within the Water System and as a result of other system changes, such as the construction of the Second Supply Project, storage was reduced by approximately 143 MG from the historic storage amount to the amount of storage available in 2012.

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

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

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

Water Distribution Engineering Section. The Water Distribution Engineering Section supports the operation and maintenance crews, performs engineering for distribution main projects, and approves permits for Water System extensions including developer installed systems. The section prepares the design of developer systems rather than simply approving a system designed by the developer's engineer, which is the more common approach taken by water utilities. Benchmarking and cost analyses have demonstrated that this approach not only ensures a timely response and quality design for the developer but is less expensive than hiring a private engineering firm. This section's water main replacement program is informed by strategic asset management plans and an economic model that utilizes multiple criteria to target and schedule infrastructure replacement according to system risk analytics.

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

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

solutions. That process is used to make a variety of capital, operational and maintenance decisions, from vehicle replacements to work group relocations.

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

Customers, Water Sales, and Rates

Tacoma Water serves residential, commercial, industrial and wholesale customers, and charges cost of service rates by customer class. In 2014, revenues were attributed 64.6% to residential service and 30.2% to commercial and industrial service, including the paper mill RockTenn. The remaining approximately 5.2% was accounted for by service to municipal and other governmental customers and to wholesale customers.

RockTenn is the largest customer of Tacoma Water and accounted for approximately 8.1% of total water sales revenue in 2014. In 2014, the ten largest customers combined accounted for 16.1% of total water sales revenue.

Special Contracts and Wholesale Agreements

The City and RockTenn executed a 10-year retail contract for industrial water supply in 2006, which includes options to extend or renegotiate upon its expiration in 2015. The parties have begun negotiations to develop a new agreement. The contract currently provides that the City will furnish 15.9 MGD to RockTenn on a uniform basis, 24 hours a day. Pursuant to the contract, RockTenn would not be required to take water if its paper mill operations shut down, but would be required to pay liquidated damages.

Tacoma Water has agreements with a number of regional water purveyors to provide wholesale service, and most recently executed an agreement with the City of Auburn to provide 3.5 MGD of wholesale supply. A number of regional utilities, including the City of Auburn, have expressed an interest in increasing wholesale purchases, and Tacoma Water is actively engaged with these utilities in exploring options for expanded wholesale service.

Agreement with Cascade Water Alliance

In 2005, Tacoma Water entered into an agreement with the Cascade Water Alliance ("Cascade"), a regional wholesale water supplier, that entitled Cascade to a permanent supply of four MGD of water (average daily demand) each year, and an additional guaranteed reserved supply of six MGD (average daily demand) through 2026, declining to one MGD (average daily demand) in 2030 (the "Additional Supply"), and discontinuing thereafter. Tacoma Water entered into an Amended and Restated Agreement for the Sale of Wholesale Water with Cascade effective December 31, 2012, that specifies a fixed payment stream from Cascade to Tacoma Water from 2012 through 2042. It also enables Cascade to transfer capacity that was previously purchased from Tacoma Water to the Cities of Auburn, Bonney Lake, Buckley, and Sumner (the "Four Cities") over a period of five years, after which Tacoma Water will make such capacity available for direct purchase to the Four Cities until December 31, 2026. When such capacity transfer occurs, a wholesale water agreement will be negotiated between Tacoma Water and one or more of the Four Cities, and all water sales revenues will be received by Tacoma Water. The first such transfer occurred in 2014 with the execution of the previously mentioned agreement with the City of Auburn, which augmented the wholesale supply capacity of a prior agreement from 1.0 MGD to 3.5 MGD.

Tacoma Water will receive a fixed payment stream, totaling \$119.7 million, from Cascade in amounts ranging from \$5,000,000 to \$6,863,929 between 2012 and 2029, inclusive, and ranging from \$1,000,000 to

\$1,268,242 between 2030 and 2042, inclusive. Revenues from additional wholesale sales that result from the transfer of capacity to one of the Four Cities will be in addition to these payments from Cascade.

Water Rates

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

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

The 2015 and 2016 water rates were adopted by the City Council on March 11, 2015. The 2015 rates were implemented on April 1, 2015, and the 2016 rates are scheduled to be implemented January 1, 2016. The changes resulted in an average annual increase in water charges of approximately 4% per year. Rate increases since 2007 are summarized in the following table.

Tacoma Water Rate Increases

Year	Average Annual Increase
2007	7.5%
2008	7.5
2009	3.9
2010	2.9
2011	5.2
2012	5.2
2013	6.0
2014	6.0
2015	4.0
2016	4.0

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

**Tacoma Water
Current Water Rates and Charges
(as of April 1, 2015)**

Size of Meter (inches)	Customer Charge Per Month	
	Inside City Limits	Outside City Limits
5/8	\$ 19.60	\$ 23.52
3/4	29.40	35.28
1	49.00	58.80
1-1/2	98.00	117.60
2	156.80	188.16
3	294.00	352.80
4	490.00	588.00
6	980.00	1,176.00
8	1,568.00	1,881.60
10	2,254.00	2,704.80
12	3,307.50	3,969.00

Consumption Up to and Including:	Charge for Water Used (per ccf ⁽¹⁾)	
	Inside City Limits	Outside City Limits
Residential		
Each 100 cubic feet of consumption		
October through May.....	\$ 1.645	\$ 1.974
First 500 cubic feet of consumption June through		
September	1.645	1.974
Each 100 cubic feet of consumption over 500 cubic		
feet June through September.....	2.056	2.468
Commercial and Industrial		
General	1.817	2.180
Large Volume (over 65,000 cubic feet annually)	1.510	1.812
Parks and Irrigation		
For each 100 cubic feet.....	2.586	3.103

⁽¹⁾ ccf = 100 cubic feet

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

2015 Comparison of Average Monthly Water Bills

UTILITY	5/8" RESIDENTIAL (Average Bill)	2" COMMERCIAL (Average Bill)
Tacoma Water ⁽¹⁾	\$ 32.77	\$ 248.76
Major Regional Water Systems:		
City of Everett, WA	25.27	164.62
Portland, OR Water Bureau ⁽²⁾	36.32	194.65
Seattle Public Utilities	50.71	296.20
San Francisco, CA	53.60	370.19
Neighboring Water Systems:		
City of Bellevue, WA	46.95	358.26
City of Kent, WA	38.66	265.27
City of Puyallup, WA	17.85	149.33
Covington Water District, WA	44.55	361.76
Lakehaven Utility District, WA	22.78	192.25

⁽¹⁾ Tacoma rates effective as of April 1, 2015.

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

Source: Individual Utilities.

In 1991, Tacoma Water implemented a system development charge ("SDC"), which is a one-time charge on new services and primarily is collected on new construction. The charge is calculated for meters three inches or larger, based upon water use projections. The result of this new fee structure was an increase in SDC revenues. The SDC fees were designed to pay for approximately 50% of growth related capital costs. In addition, Tacoma Water periodically collects contributions from property owners that are restricted to specific capital projects. The table below does not include these contributions.

The following table shows annual funds recognized as revenues from SDCs from 2007 through 2014. In 2009, Tacoma Water deposited approximately \$35 million of SDC revenue into the Rate Stabilization Account, and consequently, this SDC revenue is not reflected in the table.

Tacoma Water Annual SDC Revenue

Year	SDC Recognized Revenue
2007	\$ 2,953,984
2008	1,754,475
2009	404,451
2010	5,772,945
2011	4,834,803
2012	1,810,178
2013	1,703,052
2014	2,060,893

Public Fire Protection Costs

In response to an October 2008 Washington State Supreme Court ruling that public fire protection costs are the responsibility of general government, Tacoma Water removed these costs from the water rates effective

January 19, 2009. Public fire protection costs were invoiced to the cities and counties served by the City. Representatives from the larger entities (Pierce County and the cities of University Place and Federal Way) declined to pay these costs. Tacoma Water filed suit in Pierce County Superior Court to have its legal rights determined. The defendants moved the case to King County Superior Court, where a judge entered an order on summary judgment ruling that the hydrant costs in areas with franchise agreements must be incorporated back into the utility rates. The City appealed the decision to the Washington State Supreme Court, which affirmed the outcome on January 23, 2012. Tacoma Water began collecting these costs through a fixed monthly charge to the ratepayers outside the City in 2013, and began imposing a similar fixed monthly charge inside the City on April 1, 2015.

CAPITAL IMPROVEMENT PROGRAM

Tacoma Water actively maintains a 10-year capital improvement program projection, which includes capital improvements, additions and renovations to the Water System necessary to address engineering recommendations, regulatory requirements and water quality standards and to provide for present and projected future customer needs. From this projection of need, Tacoma Water derives its Capital Improvement Program for the Water System. This program is an element of the City's Growth Management Act ("GMA") Comprehensive Plan, which contains a six-year projection of projects and is updated annually. The following table summarizes Tacoma Water's 2015-2020 Capital Improvement Program. Tacoma Water currently plans to fund these improvements with a combination of revenues from operations, Water System development funds, other miscellaneous revenue and cash on hand. Tacoma Water does not currently expect to finance its Capital Improvement Program with the proceeds of Future Parity Bonds or additional junior lien obligations. See "THE WATER SYSTEM AND THE REGIONAL SYSTEM—Water Quality and Treatment."

Tacoma Water 2015-2020 Capital Improvement Program (\$000)

Uses of Funds	2015	2016	2017	2018	2019	2020
General Plant	\$ 1,829	\$ 1,729	\$ 3,537	\$ 474	\$ 474	\$ 474
Water Supply	2,147	3,806	9,472	3,472	7,440	6,389
Water Quality ⁽¹⁾	3,048	449	840	340	840	340
Water Distribution	10,567	10,421	6,567	6,567	6,455	6,455
Environmental						
Stewardship/Conservation	250	250	250	250	250	250
Total Uses	\$ 17,841	\$ 16,655	\$ 20,666	\$ 11,103	\$ 15,459	\$ 13,908

⁽¹⁾ Includes Tacoma Water's total obligation for Regional System cost share eligible projects.

HISTORICAL OPERATING RESULTS - TACOMA WATER AND REGIONAL SYSTEM

The following table shows Tacoma Water's customer accounts and water sales for the years 2010 through 2014.

Tacoma Water Historical Number of Customers and Water Sales

	2010	2011	2012	2013	2014
Customer Accounts (Average)					
Residential & Domestic Services	90,854	90,486	90,124	91,562	92,226
Commercial & Industrial Service	6,052	6,028	5,984	6,063	6,143
RockTenn ⁽¹⁾	1	-	1	1	1
City of Tacoma	213	203	206	212	220
Wholesale	17	17	18	18	18
Total Customer Accounts⁽³⁾	97,137	96,734	96,333	97,856	98,608
Water Sales (ccf)⁽²⁾					
Residential & Domestic Services	10,386,923	10,333,508	10,415,330	10,382,316	10,652,760
Commercial & Industrial Service	4,157,544	3,976,052	3,945,975	3,945,975	4,134,342
RockTenn ⁽¹⁾	7,724,770	7,823,129	7,835,544	7,821,504	8,087,783
City of Tacoma	88,948	105,286	94,432	111,963	93,262
Wholesale	871,563	836,657	910,332	1,597,759	1,585,380
Total Water Sales⁽³⁾	23,229,748	23,074,632	23,201,613	23,859,517	24,553,527

⁽¹⁾ RockTenn is a pulp and paper mill with contracted annual usage of 15.9 MGD. See "THE WATER SYSTEM AND THE REGIONAL SYSTEM—Special Contracts and Wholesale Agreement Contract."

⁽²⁾ ccf = 100 cubic feet.

⁽³⁾ Totals may not add due to rounding.

Source: Annual Tacoma Water financial reports.

Historical Revenue and Expenses

The following table shows selected historical revenues and expenses for Tacoma Water for the years 2010 through 2014. The following table is based on consolidated audited financial statements that include Tacoma Water and the Regional System for the period between 2010 and 2014.

Tacoma Water Historical Operating Results

	2010	2011	2012	2013	2014
Operating Revenues ⁽¹⁾					
Residential and Domestic	\$ 35,503,069	\$ 36,730,275	\$ 38,737,505	\$ 40,928,354	\$ 44,584,042
Commercial & Industrial	11,703,099	11,868,976	12,478,932	13,507,900	15,022,142
RockTenn	3,798,922	4,774,237	5,031,760	5,242,359	5,801,842
City of Tacoma ⁽²⁾	364,357	400,322	383,385	445,844	454,970
Unbilled ⁽³⁾	(648,438)	478,594	416,986	468,030	121,346
Wholesale	1,530,116	1,625,163	2,090,430	3,519,409	3,718,315
Total Water Sales	\$ 52,251,125	\$ 55,877,567	\$ 59,138,998	\$ 64,111,896	\$ 69,702,657
Other Operating Revenues ⁽⁴⁾	10,735,630	9,526,467	21,541,733	32,007,524	28,617,297
Total Operating Revenue	\$ 62,986,755	\$ 65,404,034	\$ 80,680,731	\$ 96,119,420	\$98,319,954
Operating Expenses ⁽¹⁾					
Operating & Maintenance	\$ 34,453,742	\$ 32,821,611	\$ 32,602,452	\$ 35,906,356	\$ 37,993,563
Depreciation	14,474,964	14,389,681	15,262,686	16,072,243	16,783,698
Taxes ⁽⁵⁾	3,142,772	3,106,516	3,485,243	3,918,944	3,779,373
Total	\$ 52,071,478	\$ 50,317,808	\$ 51,350,381	\$ 55,897,543	\$ 58,556,634
Net Operating Income (Loss)	\$ 10,915,277	\$ 15,086,226	\$ 29,330,350	\$ 40,221,877	\$ 39,763,320
Non-Operating Revenue (Expenses) ⁽¹⁾					
Other Income	\$ 33,795	\$ (12,371)	\$ 288,182	\$ (1,246,053)	\$ 537,052
Interest Income	2,370,993	3,141,374	2,320,753	807,466	1,718,226
Interest Charges (Net)	(15,175,660)	(15,018,374)	(14,696,096)	(14,141,036)	(11,922,850)
Total Non-Operating Revenue (Expense)	\$ (12,770,872)	\$ (11,889,371)	\$ (12,087,161)	\$ (14,579,623)	\$ (9,667,572)
Net Income (Loss) Before Capital Contributions ⁽¹⁾	\$ (1,855,595)	\$ 3,196,855	\$ 17,243,189	\$ 25,642,254	\$ 30,106,748
Less: Regional System Net Income (Loss) Before Capital Contributions ⁽⁶⁾	(1,702,668)	(4,721,020)	2,849,378	17,096,763	15,783,661
Tacoma Water Net Income (Loss) Before Capital Contributions	\$ (152,927)	\$ 7,917,875	\$ 14,393,811	\$ 8,545,491	\$ 14,323,087
Debt Service Calculation Adjustments ⁽⁷⁾					
Less: Restricted Income	\$ (152,921)	\$ (341,378)	\$ (224,988)	\$ (79,510)	\$ (1,106,424)
Add: Interest Subsidies on Build America Bonds	2,048,805	2,972,443	2,972,439	2,736,130	2,756,937
Add: Depreciation	10,048,851	9,906,861	10,766,715	11,567,085	12,240,786
Add: Interest Charges (Net)	10,342,360	8,577,696	9,727,637	11,475,726	11,030,884
Add: SDC Revenues ⁽⁸⁾	5,772,945	4,834,803	1,810,178	1,703,052	2,060,893
Net Tacoma Water Revenue Available for Debt Service	\$ 27,907,113	\$ 33,868,300	\$ 39,445,792	\$ 35,947,974	\$ 41,306,163
Debt Service on Outstanding Bonds ⁽⁹⁾	\$ 16,198,876	\$ 18,689,644	\$ 18,751,491	\$ 19,306,208	\$ 18,276,907
Debt Service Coverage	1.72x	1.81x	2.10x	1.86x	2.26x

⁽¹⁾ Includes Regional System operating results. See the table below entitled "Regional System Historical Operating Results."

⁽²⁾ Retail sales to City facilities.

⁽³⁾ Accrued revenue for water service provided and not billed in the current year.

⁽⁴⁾ Includes Kent, Covington and Lakehaven payments for Regional System, as well as Public Fire Protection fees and Cascade Water Alliance fees.

⁽⁵⁾ Excludes City gross earnings tax, which is payable after debt service.

⁽⁶⁾ Includes all Regional System revenues and expenses, including depreciation before Capital Contributions. See "Net Income (Loss) Before Capital Contributions" column in the "Regional System Historical Operating Results" table.

⁽⁷⁾ All adjustments exclude Second Supply System.

⁽⁸⁾ Includes System Development Charge ("SDC") revenue as recognized and excludes deferred SDC revenue. See "SECURITY AND SOURCES OF PAYMENT FOR THE BONDS."

⁽⁹⁾ Includes debt service on Tacoma Water Parity Bonds only.

Tacoma Water and the other Participants pay all costs of the Regional System on the same lien as operating costs of their respective utilities, prior to the payment of debt service and capital expenses. The other Participants are billed and pay monthly their share of operating and maintenance expenses and quarterly their share of capital expenses. Payments for debt service on the Outstanding Parity Bonds are paid by the other Participants monthly for the 2013 Bonds and semi-annually for the 2010 Bonds in advance when the debt service payments are due. Tacoma Water receives the payments from the other Participants and pays all operating costs and debt service of the Regional System.

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

The following table shows selected historical revenues and expenses for the Regional System for the years 2010 through 2014.

Regional System Historical Operating Results (Year ending December 31)					
	2010	2011	2012	2013	2014
Operating Revenues⁽¹⁾					
Tacoma Water	\$ 4,500,707	\$ 4,026,921	\$ 4,709,244	\$ 4,719,922	\$ 4,684,331
Kent	1,890,066	1,677,415	1,869,737	4,025,953	7,597,321
Covington	1,879,914	1,671,137	1,859,353	11,731,804	4,989,511
Lakehaven	882,662	916,591	5,977,937	7,007,093	6,575,967
Total Operating Revenue	\$ 9,153,349	\$ 8,292,064	\$14,416,271	\$27,484,772	\$23,847,130
Operating Expenses					
Operating & Maintenance	\$ 2,458,379	\$ 2,485,977	\$ 2,510,085	\$ 2,895,385	\$ 2,735,246
Depreciation	4,426,113	4,482,820	4,495,971	4,505,158	4,542,912
Total Operating Expenses	\$ 6,884,492	\$ 6,968,797	\$ 7,006,056	\$ 7,400,543	\$ 7,278,158
Net Operating Income (Loss)	\$ 2,268,857	\$ 1,323,267	\$ 7,410,215	\$20,084,229	\$16,568,972
Non-Operating Revenue (Expenses)					
Other Income	\$ 0	\$ 0	\$ 0	\$ (373,899)	\$ (18,732)
Interest Income	861,775	396,391	407,622	51,743	114,387
Interest Charges (Net)	(4,833,300)	(6,440,678)	(4,968,459)	(2,507,630)	(880,966)
Total Non-Operating Revenue (Expense)	\$ (3,971,525)	\$ (6,044,287)	\$ (4,560,837)	\$ (2,829,786)	\$ (785,311)
Net Income (Loss) Before Capital Contributions	\$ (1,702,668)	\$ (4,721,020)	\$ 2,849,378	\$17,254,443	\$15,783,661
Debt Service Calculation Adjustments					
Add: Interest Subsidies on Build America Bonds	\$ 306,327	\$ 868,328	\$ 868,328	\$ 799,296	\$ 805,374
Add: Depreciation	4,426,113	4,482,820	4,495,971	4,505,158	4,542,912
Add: Interest Charges (Net)	4,833,300	6,440,678	4,968,459	2,507,630	880,966
Net Regional System Revenue Available for Debt Service	\$ 7,863,072	\$ 7,070,806	\$13,182,136	\$25,066,527	\$22,012,913
Debt Service on Outstanding Regional System Revenue Bonds	\$ 5,593,852	\$ 7,243,016	\$ 7,259,682	\$ 7,058,428	\$ 6,869,972

⁽¹⁾ Operating Revenues of the Regional System include Contract Resource Obligation payments from each of the Participants to pay for operations and maintenance expenses, debt service on Regional System Revenue Bonds, and cash-funded capital expenses for Regional System facilities that were not financed with Regional System Revenue Bonds.

The audited financial statements of Tacoma Water as of and for the years ended December 31, 2014 and December 31, 2013 are included as Appendix C to this Official Statement.

GENERAL AND ECONOMIC INFORMATION

Tacoma, the county seat of Pierce County (the “County”), is located in the west central part of State near the southern tip of Puget Sound. It is the third largest city in the State with a 2014 estimated population of 200,900. The City is located 32 miles south of Seattle and 28 miles northeast of Olympia, the State capital. The historical population of the City and Pierce County for years 2005 through 2014 is shown in the following table.

POPULATION CITY OF TACOMA AND PIERCE COUNTY

<u>Year</u>	<u>Tacoma</u>	<u>Pierce County</u>
2014	200,900	821,300
2013	200,400	814,500
2012	199,600	808,200
2011	198,900	802,150
2010	198,397	795,225
2009	198,155	796,900
2008	198,021	794,330
2007	197,405	786,911
2006	195,740	774,050
2005	194,910	756,919

Source: Washington State Office of Financial Management estimates; U.S. Census for 2010 figure.

Following are economic indicators for the City and Pierce County.

PIERCE COUNTY MAJOR EMPLOYERS

<u>Employer</u>	<u>Type of Business</u>	<u>Number of Employees</u>
Joint Base Lewis McChord	Military	66,054
Local Public School Districts (K-12)	Education	13,408
Multicare Health System	Health Services	6,904
Washington State	Public Sector	6,455
Franciscan Health System	Health Services	5,338
Pierce County Government	Government	2,979
Washington State Higher Education	Education	2,566
Fred Meyer	Retail & Distribution	2,560
State Farm Insurance	Insurance	2,206
City of Tacoma (excluding Tacoma Public Utilities)	Government	2,078
Emerald Queen Casino	Gaming	2,061
Boeing Company	Aerospace Manufacturing	1,670
U.S. Postal Service	Government	1,464
Tacoma Public Utilities	Utility Services	1,334
Wal-Mart	Retail	1,304
Safeway Stores	Retail	1,297
Costco	Retail	1,205

Source: Economic Development Board of Tacoma-Pierce County, 2014.

PIERCE COUNTY NEW RESIDENTIAL BUILDING PERMIT VALUES

Year	Single-Family		Multi-Family	
	Total Permits	Total Value	Total Units	Total Value
2013	2,369	\$636,063,255	493	\$51,383,258
2012	2,006	513,795,902	470	47,924,264
2011	1,487	358,523,919	1,072	119,788,982
2010	1,703	396,954,508	192	22,130,123
2009	1,240	242,118,582	804	79,995,681
2008	1,795	339,876,617	543	64,271,436
2007	3,537	718,169,188	1,490	176,217,591
2006	4,839	864,902,045	1,062	131,476,813
2005	5,402	928,759,256	1,204	141,101,681
2004	4,348	676,867,250	1,438	140,259,564

Source: U.S. Census Bureau.

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

Year	Pierce County	City of Tacoma
2014 ⁽¹⁾	\$9,406,090	\$3,170,608
2013	12,189,183	4,280,300
2012	11,080,671	4,046,580
2011	10,520,821	3,826,547
2010	10,624,268	3,849,214
2009	10,434,800	3,803,604
2008	11,711,653	4,288,739
2007	12,535,646	4,665,527
2006	12,154,469	4,536,401
2005	11,266,231	4,218,012
2004	10,123,074	3,832,668

⁽¹⁾ Through the first three quarters of 2014. The taxable retail sales for Pierce County and for the City for the first three quarters of 2013 were \$8,982,390,476 and \$3,148,970,270, respectively.

Source: Washington State Department of Revenue.

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

Year	Pierce County	Washington State
2014 ⁽¹⁾	\$58,526	\$58,686
2013 ⁽²⁾	57,840	57,554
2012	57,162	56,444
2011	56,114	55,500
2010	55,531	54,888
2009	56,555	55,458
2008	57,674	57,858
2007	56,426	56,141
2006	55,506	53,522
2005	50,678	50,004
2004	49,151	49,585

⁽¹⁾ Projection.

⁽²⁾ Preliminary estimate.

Source: Washington State Office of Financial Management.

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

Year	Pierce County		State of Washington	
	Total Personal Income (\$000)	Per Capita Income	Total Personal Income (\$000)	Per Capita Income
2013 ⁽¹⁾	\$36,054,002	\$43,982	\$332,654,857	\$47,717
2012	35,464,135	43,672	324,458,394	47,055
2011	34,038,137	42,368	303,999,485	44,565
2010	32,654,784	41,050	286,862,463	42,547
2009	32,168,659	40,388	280,943,954	42,137
2008	32,646,328	41,566	289,678,642	44,143
2007	30,947,081	40,062	276,741,494	42,829
2006	28,673,176	37,559	255,639,739	40,127
2005	26,451,353	35,356	235,510,032	37,638
2004	24,728,559	33,411	226,688,412	36,689

⁽¹⁾ Last available data.

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

Employment within the County is described in the following table.

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

NAICS Industry Title	Annual Average				
	2009	2010	2011	2012	2013
Resident Labor Force					
Employment	355,940	350,570	346,830	351,480	348,940
Unemployment	38,080	39,890	37,690	34,250	30,590
Total	394,020	390,460	384,520	385,730	379,530
Percent Of Labor Force	9.7%	10.2%	9.8%	8.9%	8.1%
 Total Nonfarm	 273,600	 270,700	 271,900	 274,700	 279,500
Total Private	215,800	212,300	214,100	217,800	223,400
Goods Producing	36,200	33,800	32,900	33,600	34,800
Mining and Logging	300	300	300	300	300
Construction	19,000	17,200	16,200	16,500	17,300
Specialty Trade Contractors	12,000	10,800	10,400	10,400	10,900
Manufacturing	16,900	16,300	16,400	16,700	17,200
Services Providing	237,400	237,000	239,000	241,100	244,700
Trade, Transportation And Utilities	53,400	53,400	54,800	56,500	57,600
Wholesale Trade	11,000	10,900	10,900	11,300	12,000
Retail Trade	31,200	31,200	31,700	32,000	32,400
Food And Beverage Stores	5,400	5,500	5,600	5,800	6,000
General Merchandise Stores	7,800	7,800	8,000	8,100	8,200
Transportation and Utilities	11,200	11,300	12,200	13,200	13,200
Information	3,100	3,000	2,800	2,800	2,900
Financial Activities	12,600	12,000	12,400	13,200	13,600
Professional And Business Services	23,900	23,500	23,600	23,300	23,800
Admin, Support, Waste Mgmt & Remed.	13,500	13,600	14,100	14,100	14,800
Administrative And Support Services	12,100	12,200	12,800	12,800	13,400
Education And Health Services	47,800	48,900	49,100	49,500	50,300
Ambulatory Health Care Services	14,000	14,000	14,200	14,400	14,500
Hospitals	10,200	10,600	10,900	11,100	11,600
Leisure And Hospitality	26,200	25,300	25,500	26,000	27,400
Food Services And Drinking Places	20,600	19,800	19,900	20,400	21,700
Other Services	12,700	12,600	12,900	13,000	13,000
Government	57,800	58,400	57,800	56,900	56,100
Federal Government	11,700	13,200	13,200	12,800	12,300
State Government	11,700	11,300	10,600	10,500	10,700
State Government Educational Services	3,600	3,700	3,700	3,700	3,900
Local Government	34,400	34,000	34,100	33,600	33,100
Local Government Educational Services	18,400	18,400	18,500	18,100	18,100

Source: Washington State Employment Security Department.

LITIGATION CONCERNING THE BONDS AND TACOMA WATER

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

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

TAX MATTERS

2015A Bonds

In the opinion of Orrick, Herrington & Sutcliffe LLP (“Bond Counsel”), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2015A Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the “Code”). Bond Counsel is of the further opinion that interest on the 2015A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix F hereto.

To the extent the issue price of any maturity of the 2015A Bonds is less than the amount to be paid at maturity of such Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Bonds), the difference constitutes “original issue discount,” the accrual of which, to the extent properly allocable to each Beneficial Owner thereof, is treated as interest on the Bonds which is excluded from gross income for federal income tax purposes. For this purpose, the issue price of a particular maturity of the 2015A Bonds is the first price at which a substantial amount of such maturity of the 2015A Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the 2015A Bonds accrues daily over the term to maturity of such Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such 2015A Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such 2015A Bonds. Beneficial Owners of the 2015A Bonds should consult their own tax advisors with respect to the tax consequences of ownership of 2015A Bonds with original issue discount, including the treatment of Beneficial Owners who do not purchase such Bonds in the original offering to the public at the first price at which a substantial amount of such 2015A Bonds is sold to the public.

2015A Bonds purchased, whether at original issuance or otherwise, for an amount higher than their principal amount payable at maturity (or, in some cases, at their earlier call date) (“Premium Bonds”) will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of bonds, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner’s basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the 2015A Bonds. The City has made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the 2015A Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the 2015A Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken), or events occurring (or not occurring), or any other matters coming to Bond Counsel’s attention after the date of issuance of the Bonds may adversely affect the value of, or the tax status of interest on, the 2015A Bonds. Accordingly, the opinion of Bond Counsel is not intended to, and may not, be relied upon in connection with any such actions, events or matters.

Although Bond Counsel is of the opinion that interest on the 2015A Bonds is excluded from gross income for federal income tax purposes, the ownership or disposition of, or the accrual or receipt of amounts treated as interest on, the Bonds may otherwise affect a Beneficial Owner's federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the Beneficial Owner or the Beneficial Owner's other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

Current and future legislative proposals, if enacted into law, clarification of the Code or court decisions may cause interest on the Bonds to be subject, directly or indirectly, in whole or in part, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent Beneficial Owners from realizing the full current benefit of the tax status of such interest. For example, proposals made in 2014 included one by the then Chair of the House Ways and Means Committee that would subject interest on the Bonds to a federal income tax at an effective rate of 10% or more for individuals, trusts, and estates in the highest tax bracket, and another by the Obama Administration that would limit the exclusion from gross income of interest on the 2015A Bonds to some extent for high-income individuals. The introduction or enactment of any such legislative proposals or clarification of the Code or court decisions may also affect, perhaps significantly, the market price for, or marketability of, the 2015A Bonds. Prospective purchasers of the Bonds should consult their own tax advisors regarding the potential impact of any pending or proposed federal or state tax legislation, regulations or litigation, as to which Bond Counsel is expected to express no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel's judgment as to the proper treatment of the 2015A Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the City, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The City has covenanted, however, to comply with the requirements of the Code.

Bond Counsel's engagement with respect to the 2015A Bonds ends with the issuance of the 2015A Bonds, and, unless separately engaged, Bond Counsel is not obligated to defend the City or the Beneficial Owners regarding the tax-exempt status of the 2015A Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the City and its appointed counsel, including the Beneficial Owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions with which the City legitimately disagrees, may not be practicable. Any action of the IRS, including but not limited to selection of the 2015A Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the 2015A Bonds, and may cause the City or the Beneficial Owners to incur significant expense.

2015B Bonds

In the opinion of Bond Counsel, interest on the 2015B Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Code. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the 2015B Bonds. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix F hereto.

Certain U.S. Federal Income Tax Considerations

The following discussion summarizes certain U.S. federal income tax considerations generally applicable to certain Beneficial Owners of the 2015B Bonds that (i) are U.S. persons for U.S. federal income tax purposes, and (ii) acquire their 2015B Bonds in the initial offering. The discussion below is based upon laws, regulations, rulings, and decisions in effect and available on the date hereof, all of which are subject to change, possibly with retroactive effect.

At the closing, Bond Counsel is expected to deliver its opinion, based upon an analysis of existing laws, regulations, rulings and court decisions, that, interest on the 2015B Bonds is not excluded from gross income for federal income tax purposes pursuant to Section 103 of the 1986 Code. Bond Counsel is expected to express no

opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the 2015B Bonds.

If a Beneficial Owner of a 2015B Bond, sells, or otherwise disposes of such 2015B Bond in a taxable transaction, such Beneficial Owner will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized from such sale or other disposition (less any accrued qualified stated interest which will be taxable as such) of such 2015B Bond and the beneficial owner's U.S. federal income tax basis in such 2015B Bond. If the City defeases any 2015B Bond, such 2015B Bond may be deemed to be retired and "reissued" for U.S. federal income tax purposes as a result of the defeasance. In that event, the beneficial owner of the 2015B Bond will recognize taxable gain or loss equal to the difference between the amount realized from the deemed sale, exchange or retirement (less any accrued qualified stated interest which will be taxable as such) and the beneficial owner's adjusted U.S. federal income tax basis in the 2015B Bond. See "DESCRIPTION OF THE BONDS – Defeasance."

Circular 230. Under 31 C.F.R. part 10, the regulations governing practice before the IRS (Circular 230), the City and its tax advisors are (or may be) required to inform prospective investors that: (i) any advice contained herein is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer; (ii) any such advice is written to support the promotion or marketing of the 2015B Bonds and the transactions described herein; and (iii) each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

RATINGS

Moody's Investors Service Inc. and Standard & Poor's Ratings Services, a business unit within Standard & Poor's Financial Services LLC, have assigned ratings of "Aa2" and "AA," respectively, to the Bonds. Ratings were applied for by the City and certain information was supplied by the City to the rating agencies to be considered in evaluating the Bonds. The ratings reflect only the views of the rating agencies and an explanation of the significance of the ratings may be obtained from the rating agencies. There is no assurance that the ratings will be retained for any given period of time or that the ratings will not be revised downward, suspended, or withdrawn entirely by the rating agencies if, in their judgment, circumstances so warrant. Any such downward revision, suspension, or withdrawal of the ratings would be likely to have an adverse effect on the market price of the Bonds. The City does not have any obligation to take any action, other than filing notice of a listed event, if the ratings on the Bonds are changed, suspended or withdrawn.

UNDERWRITING

Wells Fargo Bank, National Association (the "Underwriter") is purchasing the 2015A Bonds at a price of \$19,525,237.35 (representing the aggregate principal amount of the 2015A Bonds (\$16,645,000.00), plus original issue premium of \$2,921,512.65 and less an underwriter's discount of \$41,275.30), and is purchasing the 2015B Bonds at a price of \$6,349,216.44 (representing the aggregate principal amount of the 2015B Bonds (\$6,365,000.00) and less an underwriter's discount of \$15,783.56). The Bond Purchase Contract between the City and the Underwriter provides that the Underwriter will purchase all of the Bonds if any are purchased and that the purchase of the Bonds is subject to the conditions set forth in the Bond Purchase Contract.

The Underwriter has provided the following information for inclusion in this Official Statement. The City does not make any representation as to the accuracy or completeness of such information.

Wells Fargo Securities is the trade name for certain securities-related capital markets and investment banking services of Wells Fargo & Company and its subsidiaries, including Wells Fargo Bank, National Association. Wells Fargo Bank, National Association ("WFBNA"), sole underwriter of the Bonds, has entered into an agreement (the "Distribution Agreement") with its affiliate, Wells Fargo Advisors, LLC ("WFA"), for the distribution of certain municipal securities offerings, including the Bonds. Pursuant to the Distribution Agreement, WFBNA will share a portion of its underwriting or remarketing agent compensation, as applicable, with respect to the Bonds with WFA. WFBNA also utilizes the distribution capabilities of its affiliate Wells Fargo

Securities, LLC (“WFSLLC”), for the distribution of municipal securities offerings, including the Bonds. In connection with utilizing the distribution capabilities of WFSLLC, WFBNA pays a portion of WFSLLC’s expenses based on its municipal securities transactions. WFBNA, WFSLLC, and WFA are each wholly-owned subsidiaries of Wells Fargo & Company.

The Underwriter may offer and sell the Bonds to certain dealers or unit investment trusts and money market or other funds and others at lower prices than the initial offering prices corresponding to the yields set forth on the inside cover, and such initial offering prices may be changed from time to time by the Underwriter without notice.

The Underwriter and its affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, principal investment, hedging, financing and brokerage activities. The Underwriters and its affiliates may have, from time to time, performed and may in the future perform, various investment banking services for the City, for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, the Underwriter and its affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (which may include bank loans and/or credit default swaps) for their own account and for the accounts of their customers and may at any time hold long and short positions in such securities and instruments. Such investment and securities activities may involve securities and instruments of the City.

FINANCIAL ADVISOR

The City has retained Montague DeRose and Associates, LLC, Walnut Creek, California, as financial advisors (the “Financial Advisor”) in connection with the issuance and delivery of the Bonds. The Financial Advisor is not obligated to undertake, and has not undertaken to make, an independent verification of, or to assume responsibility for, the accuracy, completeness, or fairness of the information contained in this Official Statement.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Grant Thornton LLP, a firm of independent public accountants, will deliver to the City, on or before the delivery date of the Bonds, its verification report indicating that it has verified, in accordance with attestation standards established by the American Institute of Certified Public Accountants, the mathematical accuracy of (a) the mathematical computations of the adequacy of the cash and the maturing principal of and interest on the restricted required obligations, to pay, when due, the maturing principal of, interest on and related call premium requirements of the Refunded Bonds and (b) the mathematical computations of yield.

The verification performed by Grant Thornton LLP will be solely based upon data, information and documents provided to Grant Thornton LLP by the City and the Underwriter. Grant Thornton LLP has restricted its procedures to recalculating the computations provided by the Underwriter and has not evaluated or examined the assumptions or information used in the computations.

APPROVAL OF CERTAIN LEGAL MATTERS

Issuance of the Bonds is subject to receipt of the approving opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the City. The proposed form of the opinion of Bond Counsel with respect to the Bonds is included in this Official Statement as Appendix F. Bond Counsel takes no responsibility for the accuracy, completeness or fairness of this Official Statement. From time to time Orrick, Herrington & Sutcliffe LLP serves as counsel to the Underwriter and its affiliates on matters that do not relate to the City or to the Bonds.

Certain legal matters will be passed upon by Orrick, Herrington & Sutcliffe LLP as Disclosure Counsel to the City. Certain legal matters will be passed upon for the Underwriter by its counsel, Pacifica Law Group LLP.

Any opinion of Underwriter's Counsel will be rendered solely to the Underwriter, and any opinion of Underwriter's Counsel or Disclosure Counsel will be limited in scope and cannot be relied upon by investors. From time to time Pacifica Law Group LLP serves as counsel to the City on matters unrelated to the Bonds.

CERTAIN INVESTMENT CONSIDERATIONS

This section contains certain additional considerations relating to an investment in the Bonds. It is not meant to be a comprehensive or discussion of risks associated with a purchase of the Bonds and does not necessarily reflect the relative importance of such risks. Potential investors should consider the following factors along with all other information elsewhere in this Official Statement in evaluating an investment in the Bonds. There can be no assurance that other risk factors, currently known or unknown to the City, will not become material in the future.

Initiative and Referendum

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

Local Measures. Under the City Charter, voters may initiate City Charter amendments and local legislation, including modifications to existing legislation, and through referendum may prevent legislation passed by the City Council from becoming law; provided that ordinances authorizing bonds, adopting annual budgets, or making appropriations are not subject to referendum as well as ordinances not subject to referendum under state law (including rate ordinances).

Limitations on Remedies

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

In addition to the limitations on remedies contained in the Bond Ordinance, the rights and obligations under the Bonds and the Bond Ordinance may be limited by and are subject to bankruptcy, insolvency, reorganization, fraudulent conveyance, moratorium, and other laws relating to or affecting creditors' rights, to the application of equitable principles, and to the exercise of judicial discretion in appropriate cases. The opinions to be delivered by Orrick, Herrington & Sutcliffe LLP, as Bond Counsel, concurrently with the issuance of the Bonds, will be subject to limitations regarding bankruptcy, insolvency, and other laws relating to or affecting creditors' rights. The various other legal opinions to be delivered concurrently with the issuance of the Bonds will be similarly qualified. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix F.

Municipal Bankruptcies

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

Third parties, however, cannot bring involuntary bankruptcy proceedings against the City. The Department, being a department of the City, and the Water System, as a division of the Department, cannot itself file for bankruptcy protection. Should the City become a debtor in a bankruptcy proceeding, the owners of the Bonds would continue to have a lien on Net Revenues after the commencement of the bankruptcy case so long as the Net Revenues constitute “special revenues” within the meaning of the Bankruptcy Code. “Special revenues” are defined under the Bankruptcy Code to include, among other things, receipts by local governments from the ownership, operation or disposition of projects or systems that are primarily used to provide utility. While the City believes that Net Revenues constitute “special revenues,” no assurance can be given that a court would not determine otherwise. If Net Revenues do not constitute “special revenues,” there could be delays or reductions in payments by the City with respect to the Bonds.

Regardless of any specific determinations by the U.S. Bankruptcy Court in a City bankruptcy proceeding that may be adverse to the Water System or the Owners, the mere filing by the City for bankruptcy protection likely would have a material adverse effect on the marketability and market price of the Bonds. As of the date hereof, there have been no public discussions by any City officials, including the Mayor, any member of the Board of Supervisors or the City Attorney, with respect to any potential Chapter 9 filing by the City.

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

Seismic and Other Risks

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

Future Legislation

The Water System and the City are subject to various laws, rules and regulations adopted by the local, State and federal governments and their agencies. The City is unable to predict the adoption or amendment of any such laws, rules or regulations, or their effect on the operations or financial condition of the Water System.

CONTINUING DISCLOSURE UNDERTAKING

Continuing Disclosure Undertaking for the Bonds

Basic Undertaking to Provide Annual Financial Information and Notice of Listed Events. To meet the requirements of paragraph (b)(5) of United States Securities and Exchange Commission (“SEC”) Rule 15c2-12 (“Rule 15c2-12”), as applicable to a participating underwriter for the Bonds, in the Bond Ordinance the City has undertaken (the “Undertaking”) for the benefit of holders of the Bonds to provide or cause to be provided, either directly or through a designated agent, to the Municipal Securities Rulemaking Board (“MSRB”) in an electronic format as prescribed by the MSRB, accompanied by identifying information as prescribed by the MSRB: (a) annual

financial information and operating data of the type included in this Official Statement as generally described below (“annual financial information”); and (b) timely notice (not in excess of ten business days after the occurrence of the event) of the occurrence of any of the following events with respect to the Bonds: (i) principal and interest payment delinquencies; (ii) non-payment related defaults, if material; (iii) unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancements reflecting financial difficulties; (v) substitution of credit or liquidity providers, or their failure to perform; (vi) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notice of Proposed Issue (IRS Form 5701 – TEB) or other material notices or determinations with respect to the tax status of the Bonds; (vii) modifications to rights of holders of the Bonds, if material; (viii) Bond calls (other than scheduled mandatory redemptions of Term Bonds), if material, and tender offers; (ix) defeasances; (x) release, substitution, or sale of property securing repayment of the Bonds, if material; (xi) rating changes; (xii) bankruptcy, insolvency, receivership or similar event of the City, as such “Bankruptcy Events” are defined in Rule 15c2-12; (xiii) the consummation of a merger, consolidation, or acquisition involving the City or the sale of all or substantially all of the assets of the City, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (xiv) appointment of a successor or additional trustee or the change of name of a trustee, if material.

The City also covenanted to provide to the MSRB timely notice of a failure by the City to provide required annual financial information on or before the date specified below.

Type of Annual Financial Information Undertaken to be Provided. The annual financial information that the City undertakes to provide consists of (i) annual financial statements of Tacoma Public Utilities Water Division, which statements will include the Water Division Fund, prepared (except as otherwise noted therein) in accordance with the Budget Accounting and Reporting System presented by the State Auditor pursuant to RCW 43.09.200 (or any successor statute), which statements may be unaudited, provided that if and when audited financial statements are otherwise prepared and available to the City, they will be provided; (ii) principal amount of outstanding Parity Bonds and debt service coverage; (iii) water rates; and (iv) numbers of customers and water sales. Such annual financial information is required to be provided to the MSRB not later than the last day of the ninth month after the end of each fiscal year of the City (currently, a fiscal year ending December 31), as such fiscal year may be changed as required or permitted by State law, commencing with the City’s fiscal year ending December 31, 2015.

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

Amendment of Undertaking. The Undertaking is subject to amendment after the primary offering of the Bonds without the consent of any holder of any Bond, or of any broker, dealer, municipal securities dealer, participating underwriter, rating agency, or the MSRB, under the circumstances and in the manner permitted by Rule 15c2-12.

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

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

Remedy for Failure to Comply with Undertaking. If the City or any other obligated person fails to comply with the Undertaking, the City is required to proceed with due diligence to cause such noncompliance to be corrected as soon as practicable after the City learns of that failure. No failure by the City or other obligated person

to comply with the Undertaking will constitute a default in respect of the Bonds. The sole remedy of any beneficial owner of a Bond will be to take such actions as that holder deems necessary, including seeking an order of specific performance from an appropriate court, to compel the City or other obligated person to comply with the Undertaking.

Prior Compliance with Continuing Disclosure Undertakings

The City has entered into previous continuing disclosure undertakings under Rule 15c2-12. On February 17, 2013, the City filed missing information regarding assessments levied, collected and uncollected for the years 2007 through 2011 in connection with its Consolidated Local Improvement District No. 60 Bonds. The City failed to file certain lodging tax information for years 2009 and 2010, and filed the missing information in September 2012. Instead of submitting a filing for each downgrade of FSA by Fitch in 2009, the City made a single filing November 2009 reflecting the second downgrade in October 2009. The City has provided notice of certain underlying rating changes either in separate notice filings or in its financial statements, some of which may have been provided after the times specified in the City's prior undertakings. The City believes that it has been in compliance with its prior undertakings in all material respects for the previous five years.

MISCELLANEOUS

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

THE CITY OF TACOMA, WASHINGTON

By: /s/ William A. Gaines
Name: William A. Gaines
Title: Director and Chief Executive Officer
Department of Public Utilities
City of Tacoma, Washington

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APPENDIX A

SUMMARY OF PRINCIPAL PROVISIONS OF THE BOND ORDINANCE

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

DEFINITIONS

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

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

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

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

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

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

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

(c) **Interest on Parity Bonds With Respect to Which a Payment Agreement or Parity Payment Agreement is in Force.** Debt service on Parity Bonds with respect to which a Payment Agreement or Parity Payment Agreement is in force shall be based on the net economic effect on the City expected to be produced by the terms of the Parity Bonds and the terms of the Payment Agreement, including, but not limited to the effects described below under the caption “PAYMENTS AGREEMENTS AND PARITY PAYMENT AGREEMENTS.”

(d) Interest on Parity Bonds designated as “Build America Bonds.” Ordinances Nos. 27109 and 27405 have been amended to provide that the interest on Parity Bonds designated as Build America Bonds only for purposes of calculating the Reserve Requirement, shall be based on the net interest after the 35% federal direct payment or such other federal direct payment to be received for Future Parity Bonds. This provision of the Bond Ordinance described in this subsection shall be in effect when 60% of the then current owners of Parity Bonds, including the 2009 Bonds, the 2010 Bonds and the 2013 Bonds, have consented to this amendment to the definition of Annual Debt Service, which occurred upon the issuance of the 2013 Bonds.

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

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

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

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

“Bond Ordinance” means Substitute Ordinance No. 28138 passed by the City Council on March 19, 2013, as supplemented by Ordinance No. 28290 passed by the City Council on March 31, 2015.

“Bond Register” means the books or records maintained by the Bond Registrar for the purpose of identifying ownership of the Bonds.

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

“Bonds” means, collectively, the 2015A Bonds and the 2015B Bonds.

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

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

“City Council” means the City Council of the City as the same shall be duly and regularly constituted from time to time.

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

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

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

“DTC” means The Depository Trust Company.

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

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

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

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

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

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

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

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

“Outstanding Parity Bonds” means the 2005 Bonds, the 2009 Bonds, the 2010 Bonds and the 2013 Bonds.

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

“Parity Bond Authorizing Ordinance” means the ordinance and/or resolution of the City that authorizes the issuance and sale and establishes the terms of a particular issue of Parity Bonds.

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

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

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

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

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

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

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

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

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

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

“Regional System” means the Regional Water Supply System, comprised of certain property and facilities to obtain and receive deliveries of water for the participants from the exercise by the City of the Second Diversion

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

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

“Reserve Insurance” means any bond insurance, letter of credit, guaranty, surety bond or similar credit enhancement device obtained by the City equal to part or all of the Reserve Requirement for any Parity Bonds which is issued by an institution which has been assigned a credit rating at the time of issuance of the device in one of the two highest rating categories of each of the Rating Agencies.

“Reserve Requirement” means as of any date the lesser of Maximum Annual Debt Service or 125% of average Annual Debt Service on all the outstanding Parity Bonds. The Reserve Requirement for a series of Parity Bonds shall not exceed 10% of the net proceeds of such Bonds.

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

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

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

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

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

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

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

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

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

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

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

“2015A Bonds” means the City’s Water System Revenue Refunding Bonds, 2015A, issued in the original principal amount of \$16,645,000 pursuant to the Bond Ordinance.

“2015B Bonds” means the City’s Water System Revenue Refunding Bonds, 2015B (Taxable), issued in the original principal amount of \$6,365,000 pursuant to the Bond Ordinance.

PAYMENT OF AND SECURITY FOR THE BONDS

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

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

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

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

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

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

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

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

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

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

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

The Bond Ordinance provides that the Bonds may be secured by the Reserve Account for a period less than the initial final maturity date thereof, and thereafter (1) by a separate reserve account with a different reserve requirement, or (2) not be secured by a reserve account at all.

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

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

COVENANTS WITH BONDOWNERS

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

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

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

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

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

Failure of the City to comply with the rate covenants described above shall not be an Event of Default as defined in the Bond Ordinance if the City promptly retains an Independent Consulting Engineer, or once the 2005 Bonds and 2009 Bonds are no longer Outstanding, an independent certified public accountant, to recommend to the City Council adjustments in the rates of the Water System necessary to meet those covenants and if the City Council adopts the recommended modifications within 180 days of the date the failure becomes known to the City Council.

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

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

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

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

The City may sell, lease, mortgage or otherwise dispose of the Water System, including all additions to and betterments and extensions thereof at any time made, that are used, useful or material in the operation of the Water

System, if provision is made for the replacement thereof or if the City receives from the purchaser or transferee an amount equal to or greater than the greatest of the following:

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

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

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

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

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

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

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

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

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

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

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

PROVISIONS FOR FUTURE PARITY BONDS

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

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

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

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

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

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

(f) There shall be on file with the City either: a certificate of the Finance Director demonstrating that during any 12 consecutive calendar months out of the immediately preceding 24 calendar months Net Revenue was at least equal to 1.25 times the projected Maximum Annual Debt Service for all Parity Bonds including the Future Parity Bonds proposed to be issued; or a certificate of an Independent Consulting Engineer or, once the 2005 Bonds and 2009 Bonds are no longer Outstanding, an independent certified public accountant, that in his or her opinion the Net Revenue will be at least equal to 1.25 times the projected Average Annual Debt Service

for all Parity Bonds including the Future Parity Bonds proposed to be issued. In providing that certificate, the Independent Consulting Engineer, or independent certified public accountant, may take into account the following adjustments:

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

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

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

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

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

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

SEPARATE UTILITY SYSTEMS; CONTRACT RESOURCE OBLIGATIONS

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

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

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

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

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

Nothing contained in the foregoing provisions relating to the Contract Resource Obligations shall be deemed to prevent the City from entering into other agreements for the acquisition of water supply, transmission, treatment or other commodity or service from existing facilities and from treating those payments as Operation and Maintenance Expenses of the Water System, or to prevent the City from entering into other agreements for the acquisition of water supply, transmission, treatment or other commodity or service from facilities to be constructed and from agreeing to make payments with respect thereto, such payments constituting a lien and charge on Net Revenue subordinate to that of Parity Bonds.

REFUNDING OR DEFEASANCE OF BONDS

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

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

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

AMENDATORY AND SUPPLEMENTAL ORDINANCES

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

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

(1) To cure any formal defect, omission, inconsistency or ambiguity in the Bond Ordinance in a manner not adverse to the owner of any Parity Bond;

(2) To impose upon the Bond Registrar (with its consent) for the benefit of the registered owners of the Parity Bonds any additional rights, remedies, powers, authority, security, liabilities or duties which may lawfully be granted, conferred or imposed and which are not contrary to or inconsistent with the Bond Ordinance as theretofore in effect;

(3) To add to the covenants and agreements of, and limitations and restrictions upon, the City in the Bond Ordinance, other covenants, agreements, limitations and restrictions to be observed by the City that are not contrary or inconsistent with the Bond Ordinance as theretofore in effect;

(4) To confirm, as further assurance, any pledge under, and the subjection to any claim, lien or pledge created or to be created by the Bond Ordinance of any other money, securities or funds;

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

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

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

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

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

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

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

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

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

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

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

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

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

DEFAULTS AND REMEDIES

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

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

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

active steps within the 6 months after written notice has been given to remedy the default and is diligently pursuing such remedy.

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

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

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

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

Suits at Law or in Equity. Upon the happening of an Event of Default and during the continuance thereof, the Bondowners' Trustee may, and upon the written request of the registered owners of not less than 25% in principal amount of the Parity Bonds outstanding shall, take such steps and institute such suits, actions or other proceedings, all as it may deem appropriate for the protection and enforcement of the rights of the registered owners of the Parity Bonds, to collect any amounts due and owing to or from the City, or to obtain other appropriate relief, and may enforce the specific performance of any covenant, agreement or condition contained in the Bond Ordinance or in any of the Parity Bonds.

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

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

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

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

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

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

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

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

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

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

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

- an Event of Default has happened and is continuing; and
- a Bondowners' Trustee has been appointed; and
- such owner previously shall have given to the Bondowners' Trustee written notice of the Event of Default on account of which such suit, action or proceeding is to be instituted; and
- the registered owners of 25% in principal amount of the Parity Bonds, after the occurrence of such Event of Default, has made written request of the Bondowners' Trustee and have afforded the Bondowners' Trustee a reasonable opportunity to institute such suit, action or proceeding; and

- there have been offered to the Bondowners' Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby; and
- the Bondowners' Trustee has refused or neglected to comply with such request within a reasonable time.

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

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

PAYMENT AGREEMENTS AND PARITY PAYMENT AGREEMENTS

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

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

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

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

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APPENDIX B

BOOK-ENTRY SYSTEM

The following information has been provided by the Depository Trust Company, New York, New York ("DTC"). The City makes no representation regarding the accuracy or completeness thereof, or for the absence of material changes in such information subsequent to the date hereof. Beneficial Owners (as hereinafter defined) should therefore confirm the following with DTC or the Participants (as hereinafter defined).

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

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has a Standard & Poor's rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com (which website is not incorporated by reference).

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

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

When notices are given, they shall be sent by the Bond Registrar to DTC only. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct

Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

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

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

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

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

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

APPENDIX C

2013 AND 2014 AUDITED FINANCIAL STATEMENTS

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ANNUAL

TACOMA WATER

2014

**FINANCIAL
REPORT**



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Public Utility Board

WOODROW JONES

Chair

BRYAN FLINT

Vice-Chair

MARK PATTERSON

Secretary

DAVID NELSON

Member

MONIQUE TRUDNOWSKI

Member

WILLIAM A. GAINES
Director of Utilities/CEO

LINDA MCCREA
Superintendent

ANDREW CHERULLO
Finance Director

DEPARTMENT OF PUBLIC UTILITIES
CITY OF TACOMA

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CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES

TACOMA WATER

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FINANCIAL DATA

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REPORT OF INDEPENDENT AUDITORS

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

Report on the Financial Statements

We have audited the accompanying financial statements of City of Tacoma, Washington Department of Public Utilities, Water Division (the Division), which comprise the statements of net position as of December 31, 2014 and 2013, and the related statements of revenue, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

REPORT OF INDEPENDENT AUDITORS (continued)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Division as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the accompanying management's discussion and analysis on pages 5 through 12 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

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



Tacoma, Washington
April 10, 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of Tacoma Water's financial performance provides an overview of the financial activities for the years ended December 31, 2014 and 2013. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues, provide an overview of the financial activities, and identify changes in the financial position. We encourage readers to consider the information presented here in conjunction with the financial statements and notes taken as a whole.

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

The basic financial statements, presented on a comparative basis for the years ended December 31, 2014 and 2013, include Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position, and Statements of Cash Flows. The Statements of Net Position present information on all of Tacoma Water's assets, deferred outflows of resources, liabilities, and deferred inflows of resources with the difference being reported as net position. The Statements of Revenues, Expenses and Changes in Net Position report all of the revenues and expenses during the time periods indicated. The Statements of Cash Flows provide information on cash receipts and disbursements during the year and report changes in cash resulting from operating, non-capital financing, capital and related financing, and investing activities.

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

Financial Highlights

- The net position of Tacoma Water was \$516.7 million in 2014, \$480.3 million in 2013 and by \$449.9 million in 2012. Of these amounts, \$46.7 million in 2014, \$37.9 million in 2013, and \$42.5 million in 2012 were available to meet Tacoma Water's ongoing obligations to citizens and creditors.
- Tacoma Water's total net positions increased by \$36.4 (7.6%) million in 2014, \$30.4 (6.8%) million in 2013 and \$23.9 (5.5%) million in 2012.
- Operating revenues were \$98.3 million in 2014, an increase of \$2.2 million (2.3%) compared to 2013. Operating revenues were \$96.1 million in 2013, an increase of \$15.4 million (19.1%) compared to \$80.7 million in 2012. These increases are due to two average rate increases of 6.0% that went into effect January 1, 2014 and April 1, 2013. In 2013, the increase is also attributable to increases in other operating revenues and contract resource obligations.

- In 2014, Tacoma Water's net utility plant of \$872.1 million represented an increase of \$59.0 million (7.3%) over the 2013 \$813.1 million balance. In 2013, net utility plant was \$90.2 million (12.5%) more than 2012's \$722.9 million balance. Major projects contributing to the increases include the Green River Water Filtration Facility and Main Replacements Projects.

Overview of the Financial Statements

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

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

Operating Results (In thousands)

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

Gallons Billed (In millions)

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

Net Position

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

Statements of Net Position (In thousands)

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

Revenues

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

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

Water Sales
(In thousands)

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

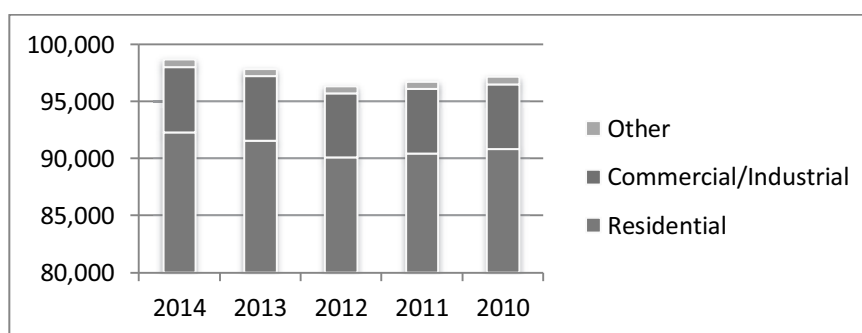
Approximately 64.0%, 63.8% and 65.5% of water sales were to residential and domestic customers in 2014, 2013 and 2012 respectively. Commercial and industrial sales were 21.6%, 21.1% and 21.1% of total sales for each year. Special rate sales were 8.3%, 8.2%, 8.5% of sales respectively.

Customers

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

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

Number of Customers



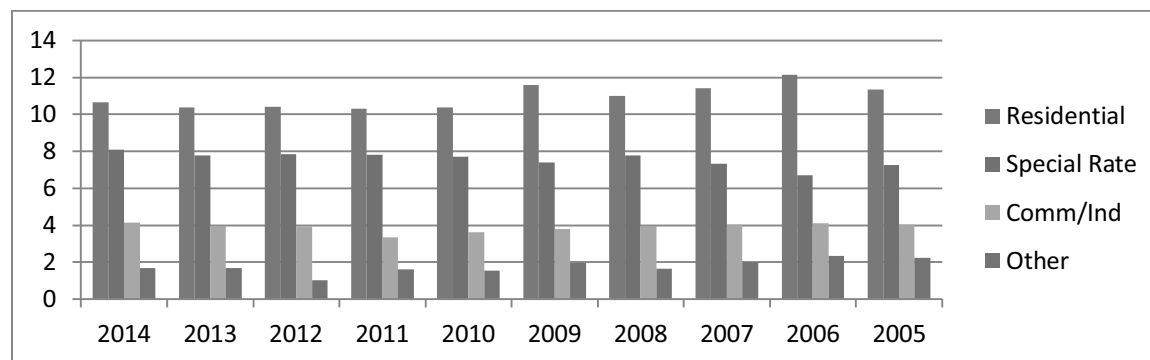
Water Users

Tacoma Water generates the majority of its revenues from its residential and domestic customer base. Consumption is measured in 100 cubic feet (CCF). In the years 2014, 2013 and 2012 residential customers used 10.7 million CCF (43.4%), 10.4 million CCF (43.5%) and 10.4 million CCF (44.9%) of total sales respectively. Special Rate customers used approximately 8.1 million CCF (33.0%), 7.8 million CCF (32.7%) and 7.8 million CCF (33.8%) respectively. Commercial and industrial customers used 4.1

million CCF (16.8%), 3.4 million CCF (14.2%) and 3.3 million CCF (14.4%) respectively. The remaining 1.7 million CCF (6.8%), 2.3 million CCF (9.6%) and 1.6 million CCF (6.9%) respectively was consumed by other customers.

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

Annual Water Usage
(In millions of CCF)



Expenses

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

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

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

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

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

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

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

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

Capital Assets

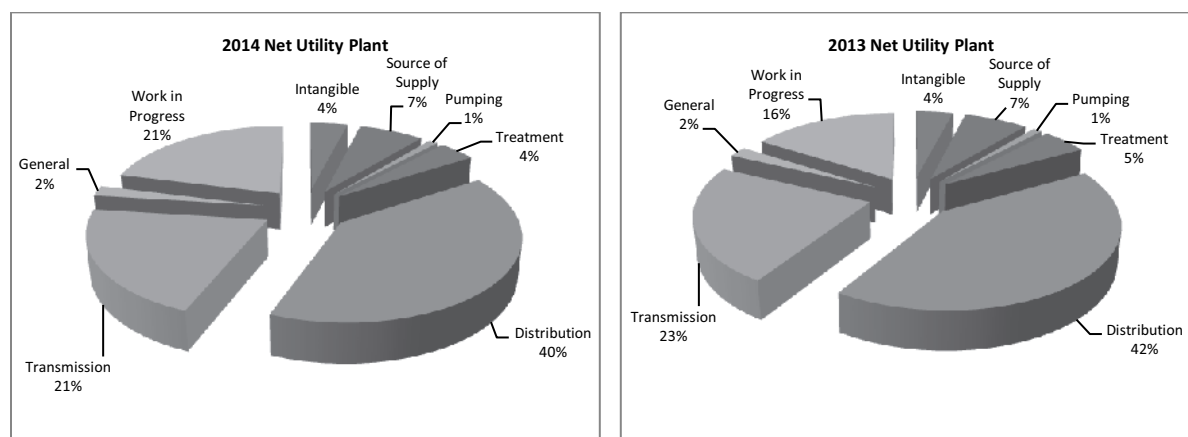
Tacoma Water invests in a broad range of utility assets and at the end of 2014 had \$872.1 million in net utility plant, an increase of \$59.0 million from 2013. The largest increase was in construction work in progress of \$53.7 million. In 2013, Tacoma Water had \$813.1 million in net utility plant,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

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

Capital Assets, Net of Accumulated Depreciation
(In thousands)

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

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



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

Debt Administration

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

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

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

At the end of 2014, Tacoma Water had an outstanding State loan balance of \$86.7 million compared to \$51.0 million in 2013 and \$42.0 million in 2012. During 2014, Tacoma Water received \$39.6 million in Drinking Water State Revolving Fund (DWSRF) Loans. Tacoma Water received \$2.4 million against the 2011 DWSRF Loan specifically for McMillin Reservoir. For the Green River Filtration Facility \$5.5 million was received against the 2010 DWSRF Loan, \$5.4 million was received against the 2011 DWSRF Loan, \$10.8 million was received against the 2012 DWSRF Loan, \$10.9 Million was received against the 2013 DWSRF Loan, and \$4.6 million was received against the 2013 Fall DWSRF Loan.

Additional information on Tacoma Water's long-term debt can be found in Note 5 of the financial statements and in the supplementary statistical data.

Summary

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

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

Management considers and takes appropriate action on 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

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CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATEMENTS OF NET POSITION

	DECEMBER 31,	
	2014	2013
ASSETS		
UTILITY PLANT		
In Service, at Original Cost	\$866,279,607	\$848,502,779
Less - Accumulated Depreciation	(180,549,889)	(168,125,255)
Total	685,729,718	680,377,524
Construction Work In Progress	186,353,639	132,672,994
Net Utility Plant	872,083,357	813,050,518
NON-UTILITY PROPERTY	492,963	492,963
SPECIAL FUNDS		
Construction Funds	39,509,127	46,470,902
Debt Service Funds	3,597,672	3,509,020
Bond Reserve Funds	22,110,124	22,095,502
System Development Charge Fund	53,255,060	53,719,777
Other Cash & Equity in Pooled Investments	27,968,224	31,023,815
Total Special Funds	146,440,207	156,819,016
CURRENT ASSETS		
Operating Funds Cash and Equity in		
Pooled Investments	45,768,035	39,622,355
Accounts Receivable	4,632,733	7,423,746
(Net of Allowance for Doubtful Accounts		
of \$258,344 in 2014 and \$581,207 in 2013)		
BABs Interest Subsidies Receivable	320,064	320,064
Accrued Unbilled Revenues	4,616,056	4,494,710
Materials and Supplies	2,401,523	2,336,648
Interfund Receivable	292,294	8,815,962
Prepayments.....	706,564	555,190
Total Current Assets	58,737,269	63,568,675
OTHER ASSETS		
Regulatory Asset-Public Fire Protection Fees ...	2,940,674	3,756,025
Regulatory Asset-Hyada Surcharges	828,534	923,574
Total Other Assets	3,769,208	4,679,599
TOTAL ASSETS	1,081,523,004	1,038,610,771
DEFERRED OUTFLOWS OF RESOURCES		
Unamortized Losses on Refunding Bonds	1,587,851	1,813,858
TOTAL ASSETS AND DEFERRED OUTFLOWS	\$1,083,110,855	\$1,040,424,629

The accompanying notes are an integral part of these financial statements

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

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CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	YEAR ENDED DECEMBER 31,	
	2014	2013
OPERATING REVENUES		
Sale of Water	\$69,702,657	\$64,111,896
Other Operating Revenues	9,454,498	9,242,674
Contract Resource Obligation Revenues	19,162,799	22,764,850
Total Operating Revenues	98,319,954	96,119,420
OPERATING EXPENSES		
Operations	15,087,555	14,694,345
Production	10,212,403	9,156,746
Administrative and General	12,693,605	12,055,265
Depreciation	16,783,698	16,072,243
Taxes	3,779,373	3,918,944
Total Operating Expenses	58,556,634	55,897,543
Net Operating Income	39,763,320	40,221,877
NON-OPERATING REVENUES (EXPENSES)		
Interest Income	1,718,226	807,466
Other	537,052	(1,246,053)
Interest on Long-Term Debt	(20,363,130)	(20,195,198)
Amortization of Premium and Loss on Refunding ..	1,115,369	1,668,313
Interest Charged to Construction	7,335,911	4,385,849
Total Non-Operating Expenses	(9,656,572)	(14,579,623)
Net Income Before Capital Contributions and Transfers	30,106,748	25,642,254
Capital Contributions		
Cash	5,002,301	4,877,687
Donated Fixed Assets	3,668,338	2,261,651
Federal BAB Subsidies	3,562,311	3,535,426
Grants	397,135	36,237
Transfers		
City of Tacoma Gross Earnings Tax	(6,274,494)	(5,838,335)
Transfer to/from Other Funds	(78,067)	(84,083)
CHANGE IN NET POSITION	36,384,272	30,430,837
TOTAL NET POSITION - BEGINNING OF YEAR	480,288,973	449,858,136
TOTAL NET POSITION - END OF YEAR	\$516,673,245	\$480,288,973

The accompanying notes are an integral part of these financial statements

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATEMENTS OF CASH FLOWS

	YEAR ENDED DECEMBER 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash from Customers	\$101,860,957	\$99,105,625
Cash Paid to Suppliers	(28,273,532)	(14,790,800)
Cash Paid to Employees	(22,558,299)	(21,118,769)
Taxes Paid	(4,003,958)	(3,884,815)
Net Cash From		
Operating Activities	47,025,168	59,311,241
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Transfer to Other Funds	(78,067)	(84,083)
Transfer Out for Gross Earnings Tax	(6,274,494)	(5,838,335)
Net Cash From Non-Capital		
Financing Activities	(6,352,561)	(5,922,418)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital Expenditures, net.....	(64,812,288)	(99,568,474)
Proceeds from PWTF Loan	-	10,000,000
Proceeds from State Drinking Water Loan	39,570,473	2,197,735
Proceeds from Sale of Bonds	-	143,100,000
Debt Issuance Costs	(299,999)	(1,574,009)
Premium on Sale of Bonds	-	12,889,179
Principal Payments on Long-Term Debt	(10,814,544)	(9,942,463)
Principal Payments on Muckleshoort LT Liability ..	(200,182)	(820,747)
Payments on Refunding of Bonds	-	(101,210,000)
Interest Paid	(20,355,144)	(20,351,944)
BABs Federal Interest Subsidies	3,562,311	3,535,426
Grants Received	397,135	36,237
System Development Charges, CIAC and Other	5,491,223	5,441,649
Net Cash From Capital and		
Related Financing Activities	(47,461,015)	(56,267,411)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received on Investments	1,718,226	807,466
Other Net Non-Op Revenues and Expenses	837,053	(4,627)
Net Cash From Investing Activities	2,555,279	802,839
Net Change in Cash and Equity in		
Pooled Investments	(4,233,129)	(2,075,749)
Cash & Equity in Pooled Investments at January 1 ...	196,441,371	198,517,120
Cash & Equity in Pooled Investments at December 31 .	\$192,208,242	\$196,441,371

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

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

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

**NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2014 AND 2013**

NOTE 1 OPERATIONS

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

Tacoma Water owns and operates the City's Water System which includes a surface water supply source (the Watershed); several extensive well fields; a water transmission system consisting of several pipelines, water treatment and quality facilities; various reservoirs, standpipes and pump stations; and an extensive distribution system. Tacoma Water supplies water to approximately 98,600 customers and had 240 employees as of December 31, 2014. Tacoma Water's service area includes the City of Tacoma and urbanized areas of Pierce and South King Counties. Water service outside the City limits is provided under franchises granted by both Pierce and King Counties and multiple other cities. Tacoma Water is organized functionally as Water Distribution Engineering, Water Distribution Operations, Water Quality, Water Supply, Asset and Information Management, and Water Rates and Financial Planning.

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

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

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

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

WATER ASSET AND INFORMATION MANAGEMENT – To prepare system and strategic plans for Tacoma Water, to support strategy and performance management; to provide GIS, SAP, Hydraulic Modeling and other technology support for Tacoma Water, and to manage strategic maintenance management, and incorporate risk and lifecycle costs into how Tacoma Water makes decisions.

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

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

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

The Division generally follows the uniform system of accounts prescribed by the National Association of Regulatory Utility Commissioners and the Division of Audits of the State Auditor's Office.

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

pooled investments is allocated daily to the participating funds based on each fund's daily equity in the TIP.

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

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

The Division's equity in that portion of the City of Tacoma Investment Pool held in qualified public depositories at December 31, 2014 and 2013 is entirely covered by the Federal Deposit Insurance Corporation (FDIC) and the Washington State Public Deposit Protection Commission (WSPDPC).

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

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

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

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

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

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

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

BOND PREMIUM AND LOSS ON REFUNDING - Bond premiums are amortized over the life of the bonds using the weighted average of the bonds outstanding. Losses on refunding are amortized on a straight-line basis over the applicable bond period.

RATE STABILIZATION - The Division has established a rate stabilization account to reduce significant year-to-year variations in rates. Amounts deposited into the account are excluded from the statement of revenues, expenses and changes in net position in accordance with regulated operations. Revenue will be recognized in subsequent periods when it is withdrawn in accordance with rate decisions and debt service covenants.

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

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

The economic lives for plant in service are as follows:

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

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

ASSET VALUATION - The Division periodically reviews the carrying amount of its long-lived assets for impairment. An asset is considered impaired when estimated future cash flows are less than the carrying amount of the asset. In the event the carrying amount of such asset is not deemed recoverable, the asset is adjusted to its estimated fair value. Fair value is generally determined based on discounted future cash flows.

ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC) - AFUDC represents the cost of borrowed funds used for the construction of utility plant, net of interest earned on unspent construction funds. Capitalized AFUDC is shown as part of the cost of utility plant and as a reduction of interest income and expense.

CONTRIBUTIONS IN AID OF CONSTRUCTION AND SYSTEM DEVELOPMENT CHARGES - GASB Statement No. 33, which addresses accounting for contributed capital, requires that contributed capital be recognized as change in net position. Capital contributions include new

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

service connections and system development charges. System development charges are collected on all new services prior to installation to ensure required new source, transmission and storage facilities needed to meet new demands are funded. The charge was developed using a cost-of-service approach and includes a share of historical plant investment and projected future outlays that will increase system capacity. Because the funds collected for this charge can only be used for system expansion projects, the balance is reflected as restricted in the Division's net position. System development charges on uncompleted projects are recorded in other long term liabilities.

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

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

COMPENSATED ABSENCES - The City has two different policies for compensated absences. The City's original policy allows employees to accrue vacation based on the number of years worked with a maximum accrual equal to the amount earned in a two-year period. These employees also accrue one day of sick leave per month without any ceiling on the maximum accrued. The City implemented a new policy in 1998 allowing employees to earn PTO (personal time off) without distinction between vacation and sick leave. Employees who worked for the City prior to the change could choose to stay with the original policy or opt to convert to the new policy. The amount of PTO earned is based on years of service. The maximum accrual for PTO is 960 hours, and upon termination, employees are entitled to compensation for unused PTO at 100%. Vacation pay and PTO are recorded as a liability and expense in the year earned. Based on historical information, 10% of compensated absences are considered short term.

Employees in the original policy accumulate sick leave at the rate of one day per month with no maximum accumulation specified. Employees receive 25% of the value at retirement or 10% upon termination for any other reason. In the event of death, beneficiaries receive 25% of the value. The accrued liability is computed at 10%, which is considered the amount vested. Sick leave pay is recorded as an expense in the year earned.

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

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

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

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

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

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

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

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

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

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

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

SIGNIFICANT RISKS AND UNCERTAINTIES - The Division is subject to certain business risks that could have a material impact on future operations and financial performance. These risks include, but are not limited to, water conditions, weather and natural disaster-related disruptions, collective bargaining labor disputes, fish and other endangered species act issues, Environmental Protection Agency regulations and federal government regulations.

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 3 UTILITY PLANT - A summary of the balances and changes in utility plant for 2014 and 2013 follows:

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

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

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

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

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

NOTE 5 LONG-TERM DEBT – The Division's Long-term Liabilities are primarily for the purpose of capital improvements. Long-term debt activities for 2014 and 2013 were as follows:

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

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

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

SENIOR LIEN BONDS

	2014	2013
2005 Water System Revenue and Refunding Bonds, with interest rates ranging from 4.125% to 5.0%, due in yearly installments ranging from \$1,695,000 to \$4,760,000 through 2025. Original Issue: \$46,550,000 Current Portion: \$4,295,000	\$ 29,365,000	\$ 33,450,000
2009 Water System Revenue Bonds, with interest rate at 5.751%, with Build America Bond (BAB) rebate ranging from 31.95% to 35.0%, due in yearly installments starting in 2033 ranging from \$9,800,000 to \$12,210,000 through 2039. Original Issue: \$76,775,000 Current Portion: \$0	76,775,000	76,775,000
2010A Water System Revenue Refunding Bonds, with interest rates ranging from 2.0% to 5.0%, due in yearly installments ranging from \$550,000 to \$4,655,000 through 2023. Original Issue: \$29,100,000 Current Portion: \$555,000	27,505,000	28,055,000
2010B Water System Revenue Bonds, with interest rates ranging from 4.581% to 5.621%, with Build America Bond (BAB) Rebate ranging from 31.95% to 35% of interest, due in yearly installments starting in 2024 ranging from \$2,115,000 to \$15,390,000 through 2040. Original Issue: \$74,985,000 Current Portion: \$0	74,985,000	74,985,000
2010A Regional Water Supply System Revenue Bonds, with interest rates ranging from 2.0% to 4.0%, due in yearly installments starting ranging from \$270,000 to \$355,000 through 2024. (See Note 6) Original Issue: \$3,595,000 Current Portion: \$270,000	3,070,000	3,335,000

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

SENIOR LIEN BONDS CONTINUED

	2014	2013
2010B Regional Water Supply System Revenue Bonds, with interest rates ranging from 5.371% to 5.621%, with Build America Bond (BAB) rebate ranging from 31.95% to 35% of interest, due in yearly installments starting in 2025 ranging from \$370,000 to \$5,775,000 through 2040. (See Note 6)		
Original Issue: \$44,245,000	44,245,000	44,245,000
Current Portion: \$0		
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	74,355,000	75,335,000
Current Portion: \$0		
2013 Regional Water Supply System Revenue and Refunding Bonds, with interest rates ranging from 4.0% to 5.0%, due in yearly installments ranging from \$670,000 to \$6,425,000 through 2032.		
Original Issue: \$64,795,000	62,765,000	63,835,000
Current Portion: \$1,185,000		
Subtotal Sr. Lien Debt	\$ 393,065,000	\$ 400,015,000
Unamortized Premium	14,231,813	15,573,188
Less Current Portion of Revenue Bond Debt	(6,305,000)	(6,950,000)
Long-term Portion of Revenue Bond Debt	<u>\$ 400,991,813</u>	<u>\$ 408,638,188</u>

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

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

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

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

JUNIOR LIEN DEBT

	2014	2013
Public Works Trust Fund Loans		
2001 Public Works Trust Fund pre-construction loan for the Second Supply Project (SSP) Howard Hanson Dam Additional Storage Project, with interest of .5% per annum, due in yearly installments of \$52,632 through 2021.	\$ 368,421	\$ 421,053
2001 Public Works Trust Fund construction loan for the SSP, with interest of .5% per annum, due in yearly installments of \$533,334 through 2021.	3,733,333	4,266,667
2002 Public Works Trust Fund pre-construction loan for Middle and Headworks section of the SSP, with interest of .5% per annum, due in yearly installments of \$54,180 through 2022.	379,257	433,437
2002 Public Works Trust Fund construction loan for the Middle and Headworks section of the SSP, with interest of .5% per annum, due in yearly installments of \$531,250 through 2021.	4,250,000	4,781,250
2004 Public Works Trust Fund pre-construction loan for the design of the Green River Ozone Facility with interest of .5% per annum, due in yearly installments of \$53,362 through 2024.	533,626	586,988
2006 Public Works Trust Fund construction loan for the Green River Ozone Treatment Plant, with interest of .5% per annum, due in yearly installments of \$370,588 through 2026.	4,447,059	4,817,647
2008 Public Works Trust Fund construction loan for the McMillin Reservoir Reconstruction, with interest of .5% per annum, due in yearly installments of \$545,870 through 2028.	7,642,178	8,188,048

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

JUNIOR LIEN DEBT CONTINUED

	2014	2013
2012 Public Works Trust Fund construction loan for the Green River Filtration Facility, with interest of .5% per annum, due in yearly installments of \$555,555 through 2031.	9,444,445	10,000,000
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 \$161,052 through 2021.	1,127,369	1,288,421
2008 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.5% per annum, due in yearly installments of \$215,109 through 2028.	3,011,517	3,226,626
2009 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.0% per annum, due in yearly installments of \$367,088 through 2032.	6,607,582	6,974,670
2010 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.5% per annum, due in yearly installments of \$303,000 through 2032.	5,454,000	5,757,000
2010 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$273,000 through 2034.	5,460,000	-
2011 construction loan for the McMillin Reservoir Reconstruction, with interest of 1.5% per annum, due in yearly installments of \$121,524 through 2033.	2,308,949	60,000
2011 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$273,000 from 2016 through 2035.	5,460,000	60,000
2012 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$546,000 from 2017 through 2036.	10,920,000	120,000
2013 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$546,000 from 2018 through 2037.	10,920,000	-

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

JUNIOR LIEN DEBT CONTINUED

	2014	2013
2013 construction loan for the Green River Water Treatment Plant Filtration Facility, with interest of 1.5% per annum, due in yearly installments of \$231,000 from 2018 through 2037.	4,620,000	-
Subtotal Junior Lien Debt	86,687,736	50,981,807
Less Current Portion of Debt	(4,137,544)	(3,743,020)
Long-term Portion of Junior Lien Debt	<u>\$ 82,550,192</u>	<u>\$ 47,238,787</u>

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

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 7 SIGNIFICANT CUSTOMER – In May of 2014, Simpson Tacoma Kraft Company (Simpson) was sold to RockTenn CP LLC. Combined, these two customers accounted for 8.3% of Tacoma Water's total water sales in 2014. In 2013 Simpson accounted for 8.2% of Tacoma Water's total water sales. There were no outstanding accounts receivables from these customers at year-end 2014 or 2013.

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

NOTE 8 FLEET SERVICES FUND - Tacoma Water pays the Fleet Services Fund for the use of the vehicles and equipment to cover fleet operating expenses. Payments made by Tacoma Water in 2014 and 2013 were \$2,453,302 and \$2,367,199, respectively.

Fleet Services' management makes an annual assessment of the capital replacement reserve balance for appropriate funding levels. It is the Fund's policy to maintain the Fund's maximum balance at a level that will provide adequate purchasing power for a three-year cycle. The solvency of the Replacement Fund allowed Fleet Services to return a portion of interest earned on Fund investments for the year to their customers. In 2014 and 2013, Fleet Services returned 75% of the interest earned on the capital replacement reserve to Tacoma Water's replacement fund. The amounts refunded in 2014 and 2013 were \$32,345 and \$38,356, respectively, which was used to offset the corresponding year's fleet expenses.

NOTE 9 SELF-INSURANCE FUND - The Department of Public Utilities maintains a self-insurance program and insurance policies. The Department has established a self-insurance fund to insure Tacoma Water and other divisions within the Department for certain losses arising from personal and property damage claims by third parties. The major risks to Tacoma Water are flooding, wind damage, chemical spills and earthquakes. Mitigating controls and emergency and business resumption plans are in place. To the extent damage or claims exceed insured values, rates may be impacted.

Tacoma Water is required to make payments to the Self-Insurance Fund to cover claims incurred by Tacoma Water and administrative expenses of the Fund. Tacoma Water's premium payments were \$180,000 in 2014 and \$180,000 in 2013. Assets in the Self-Insurance Fund total \$6.2 million which exceeds accrued and incurred but not reported liabilities. Equity in the Self-Insurance Fund is transferred to the appropriate operating divisions in accordance with GASB 10. Management believes Tacoma Water's investment in the Self-Insurance Fund is more than adequate to settle all its known or estimated claims.

The City purchases a \$15 million Fiduciary Liability Policy with a \$100,000 deductible that provides for wrongful acts arising out of the administration of the City's employee benefit programs and a \$1.0 million Crime policy for employee dishonesty and for fraudulent or dishonest acts by employees against the City for loss of money, securities and property. The insurance policies presently in effect include coverage on the Department's buildings and fleet vehicles as well as general liability and public official's liability. The current insurance policies have deductibles or self-insured retentions of \$250,000 for buildings and vehicles and \$1.5 million for general comprehensive liability. The public official's policy has a \$200,000 deductible. The Department's total liability limit is \$60 million any one occurrence and \$60 million annual aggregate. The general government comprehensive liability policies provide \$15 million of excess coverage with \$3 million retention. The City has a policy to cover extraordinary worker's compensation claims with a statutory limit (\$1 million self-insured retention).

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

This note emphasizes the employer disclosures and detailed information presented in an independent CAFR issued by the Retirement System. Further detailed information regarding these disclosures can be found in that report which may be obtained by writing to Tacoma Employees' Retirement System, 3628 South 35th Street, Tacoma, Washington 98409.

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

Basis of Accounting - The financial statements are prepared using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period in which employee services are performed and expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made. Benefit payments and refunds of contributions are recognized when due and payable in accordance with the terms of the plan.

Method Used to Value Investments - Equity securities, fixed income securities, real estate and short-term investments are all reported at fair market value. Fair market value was determined by our custodian bank utilizing standard industry practices. Private equity investments are reported by the managers subject to their fair market value policies. No investment in any one corporation or organization exceeded five percent of net position available for benefits.

Investments and Contracts - The System has no securities of the employer and related parties included in the plan assets. The System has not made any loans to the employer in the form of notes, bonds, or other instruments.

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

Contributions - Covered employees are required by Chapter 1.30 of the Tacoma Municipal Code to contribute a percentage of their gross wages to the System, and the employer contributes an additional percentage.

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

The contribution rates are provided in the following table:

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

Funding Status and Progress - Historical trend information about TERS is presented herewith as supplementary information. This information is based on the most recent actuarial valuation performed, dated January 1, 2014, and is intended to help assess TERS funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employee retirement systems.

Schedule of Funding Progress (\$ in millions):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (c)=(b)-(a)	Funded Ratio (d)=(a)/(b)	Covered Payroll (e)	UAAL as of Percentage of Covered Payroll (f)=(c)/(e)
1/1/2012	\$ 1,068.3	\$ 1,185.5	\$ 117.2	90.1%	\$ 219.4	53.4%
1/1/2013	\$ 1,187.1	\$ 1,306.6	\$ 119.5	90.9%	\$ 210.6	56.7%
1/1/2014	\$ 1,297.0	\$ 1,400.0	\$ 103.0	92.6%	\$ 213.8	48.2%

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

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

Actuarial Methods and Significant Actuarial Assumptions

Valuation Date	January 1, 2014
Actuarial Cost Method	Entry Age
Amortization Method	Level Percentage of the System's Projected Payroll
Amortization Period	30 years, Open, unless fixed rate amortizes less than 30 years
Asset Valuation Method	Asset are valued at market value, with a four year smoothing of all market value gains and losses.

Actuarial Summptions:

Investment Rate of Return	7.25%
Projected Salary Increases	4.00%
Includes Inflation at	3.00%
Postretirement Benefit Increases	2.125%

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

Schedule of Employer Contributions (\$ in millions):

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

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

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

NOTE 11 OTHER POST EMPLOYMENT BENEFITS (OPEB)

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

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

Annual OPEB Cost and Net OPEB Obligation - The Present Value of Benefits (PVB) is the present value of projected benefits discounted at the valuation interest rate (3.75%).

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

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

The Annual Required Contribution (ARC) is the amount the City is required to report as an expense for the year. The ARC is equal to the Normal Cost plus an amount to amortize the Unfunded Actuarial Accrued Liability (UAAL) on a closed basis of 30 years, beginning January 1, 2007. The remaining amortization period for 2014 is 23 years.

The ARC represents an accounting expense, but the City is not required to contribute the ARC to a separate trust. If the City does not set aside funds equal to the ARC (less current year benefit payments) each year, then the ARC (less benefit payments) will accumulate as a non-current liability (Net OPEB Obligation) on the balance sheet. The City has a Net OPEB Obligation as of December 31, 2014 as the City has not set aside funds for OPEB.

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

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

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

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

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

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

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

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

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

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

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

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

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

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

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

The portion of the actuarial present value allocated to a valuation year is called the normal cost. The portion of this actuarial present value not provided for at a valuation date by the sum of (a) the actuarial value of the assets, and (b) the actuarial present value of future normal costs is called the UAAL. In determining the Annual Required Contribution, the UAAL is amortized as a level percentage of expected payrolls for non-LEOFF 1 groups. For LEOFF 1, the UAAL is amortized as a level dollar amount. The amortization period was 30 years in 2007 and the remaining is now 23 years.

Actuarial Methods and Significant Actuarial Assumptions:

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

Actuarial Assumptions:

Discount Rate	3.75% for pay-as-you-go funding
Medical Cost Trend	
	2013 8.90%
	2014 6.50%
	2015 5.80%
	2020 6.00%
	2030 5.90%
	2040 5.60%

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

TACOMA WATER NOTES TO FINANCIAL STATEMENTS (continued)

Economic Assumptions - Discount
Rate (Liabilities)

3.75%

Demographic Assumptions:

Eligibility:

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

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

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

NOTE 12 COMMITMENTS AND CONTINGENCIES

Capital Improvements – The financial requirement for Tacoma Water's 2015-2016 biennial Capital Improvement program is approximately \$32.9 million and Tacoma Water has substantial contractual commitments relating to the program. At December 31, 2014 the remaining financial requirement for Capital Improvement Programs relating to all prior biennia is approximately \$4.5 million.

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

General Legal Matters - The Utility has received several other miscellaneous claims or litigation that either do not allege material amounts or that the Legal Department has determined do not pose a risk of liability to the Utility.

STATISTICAL DATA (Unaudited)

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

TEN-YEAR FINANCIAL REVIEW

STATEMENTS OF NET POSITION	2014	2013	2012	2011
ASSETS				
Utility Plant - Net	\$872,083,357	\$813,050,518	\$722,852,270	\$661,153,297
Special Funds & Non-Util Prop	146,933,170	157,311,979	161,863,075	214,619,106
Current Assets	58,737,269	63,568,675	56,407,560	31,403,521
Other Assets	3,769,208	4,679,599	5,300,185	4,664,090
Total Assets	1,081,523,004	1,038,610,771	946,423,090	911,840,014
Deferred Outflows	1,587,851	1,813,858	1,764,332	2,056,555
TOTAL ASSETS AND DEFERRED OUTFLOWS .	1,083,110,855	1,040,424,629	948,187,422	913,896,569
NET POSITION	516,673,245	480,288,973	449,858,136	425,932,810
LIABILITIES AND EQUITY				
Long-Term Debt	483,542,005	455,876,975	401,465,338	419,800,757
Current Liabilities	20,767,576	42,478,805	35,106,590	18,201,697
Long-Term Liabilities	26,552,582	26,204,429	26,181,911	19,385,858
Total Liabilities	530,862,163	524,560,209	462,753,839	457,388,312
Deferred Inflows	35,575,447	35,575,447	35,575,447	30,575,447
TOTAL NET POSITION, LIABILITIES, AND DEFERRED INFLOWS	\$1,083,110,855	\$1,040,424,629	\$948,187,422	\$913,896,569
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION				
OPERATING REVENUES				
Residential and Domestic	\$44,584,042	\$40,928,355	\$38,737,505	\$36,730,275
Commercial and Industrial	15,022,142	13,507,899	12,478,932	11,868,976
Special Rate-Simpson/Other	5,801,842	5,242,359	5,031,760	4,774,237
Municipal	454,970	445,844	383,385	400,322
Wholesale	3,718,315	3,519,409	2,090,430	1,625,163
Unbilled	121,346	468,030	416,986	478,594
Total Water Sales	69,702,657	64,111,896	59,138,998	55,877,567
Other Operating Revenues	28,617,297	32,007,524	21,541,733	9,526,467
Total Operating Revenues	98,319,954	96,119,420	80,680,731	65,404,034
OPERATING EXPENSES				
Operation and Maintenance	37,993,563	35,906,356	32,602,452	32,821,611
Taxes	3,779,373	3,918,944	3,485,243	3,106,516
Depreciation	16,783,698	16,072,243	15,262,686	14,389,681
Total Operating Expenses	58,556,634	55,897,543	51,350,381	50,317,808
NET OPERATING INCOME (LOSS)	39,763,320	40,221,877	29,330,350	15,086,226
NON-OPERATING REVENUES (EXPENSES)				
Other Income	537,052	(1,246,053)	288,182	(12,371)
Interest Income	1,718,226	807,466	2,320,753	3,141,374
Gain from Disposition of Property	-	-	-	-
Interest Charges (Net)	(11,911,850)	(14,141,036)	(14,462,441)	(14,867,263)
Net Income (Loss) Before Contributions & Transfers	30,106,748	25,642,254	17,476,844	3,347,966
Total Capital Contributions	8,670,639	7,175,575	7,834,345	9,250,677
Grants & Federal BAB Subsidies	3,959,446	3,535,426	3,840,767	4,006,209
Transfers Out	(6,352,561)	(5,922,418)	(5,226,630)	(4,960,736)
CHANGE IN NET POSITION	\$36,384,272	\$30,430,837	\$23,925,326	\$11,644,116

In accordance with Governmental Accounting Standards Board Statement No. 65 both 2012 and 2011 were restated for comparative purposes. Years prior to 2011 are shown as originally reported.

2010	2009	2008	2007	2006	2005
\$636,592,771	\$604,657,775	\$590,593,258	\$568,493,015	\$542,837,619	\$515,240,672
240,132,895	133,949,294	80,858,401	99,062,414	111,884,788	124,884,569
30,200,303	35,753,843	22,151,467	23,150,235	20,256,759	15,880,090
4,654,608	3,654,494	3,319,156	2,123,339	2,622,731	2,938,485
911,580,577	778,015,406	696,922,282	692,829,003	677,601,897	658,943,816
-	-	-	-	-	-
911,580,577	778,015,406	696,922,282	692,829,003	677,601,897	658,943,816
417,695,083	412,592,671	404,010,304	391,763,317	374,885,816	345,583,601
421,228,553	292,165,406	218,869,015	227,315,790	231,066,402	224,760,581
20,548,451	15,167,938	16,288,305	15,169,687	21,418,548	12,820,700
52,108,490	58,089,391	57,754,658	58,580,209	50,231,131	75,778,934
493,885,494	365,422,735	292,911,978	301,065,686	302,716,081	313,360,215
-	-	-	-	-	-
\$911,580,577	\$778,015,406	\$696,922,282	\$692,829,003	\$677,601,897	\$658,943,816
\$35,503,069	\$36,695,919	\$34,651,756	\$32,719,149	\$31,332,264	\$27,748,546
11,703,099	11,467,636	10,600,262	9,868,874	9,231,740	8,446,232
3,798,922	4,153,327	4,371,527	3,917,760	3,222,324	3,511,199
364,357	380,267	349,722	396,131	363,455	316,562
1,530,116	1,776,686	1,251,815	1,433,705	1,640,803	1,599,919
(648,438)	187,966	417,145	37,113	1,067,323	-
52,251,125	54,661,801	51,642,227	48,372,732	46,857,909	41,622,458
10,735,630	9,331,955	5,382,313	4,353,478	1,919,802	1,428,135
62,986,755	63,993,756	57,024,540	52,726,210	48,777,711	43,050,593
34,453,742	34,055,463	33,387,663	31,076,515	29,165,168	26,448,761
3,142,772	3,093,311	2,881,877	2,924,930	3,407,187	2,995,424
14,474,964	13,845,799	13,016,544	11,363,970	11,556,821	9,386,363
52,071,478	50,994,573	49,286,084	45,365,415	44,129,176	38,830,548
10,915,277	12,999,183	7,738,456	7,360,795	4,648,535	4,220,045
33,795	497,331	61,265	306,680	2,293,477	2,841,371
2,370,993	1,955,385	3,730,407	5,255,881	4,603,137	1,695,578
-	26,100	-	4,199,382	-	4,622,927
(15,175,660)	(9,076,156)	(8,406,264)	(8,484,405)	(8,403,448)	(7,185,197)
(1,855,595)	6,401,843	3,123,864	8,638,333	3,141,701	6,194,724
9,713,596	7,120,993	14,137,605	12,801,825	30,462,788	24,453,875
2,355,132	244,683	-	-	-	-
(5,110,721)	(5,185,152)	(5,014,482)	(4,562,657)	(4,302,274)	(3,951,776)
\$5,102,412	\$8,582,367	\$12,246,987	\$16,877,501	\$29,302,215	\$26,696,823

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

TEN-YEAR FINANCIAL REVIEW

STATEMENTS OF NET POSITION	2014	2013	2012	2011
ASSETS				
Utility Plant - Net	\$293,110,553	\$264,883,717	\$223,896,711	\$203,938,358
Current Assets	11,321,557	20,473,681	41,256,611	55,640,447
Total Assets	304,432,110	285,357,398	265,153,322	259,578,805
Deferred Outflows	288,520	304,624	-	-
TOTAL ASSETS AND DEFERRED OUTFLOWS .	304,720,630	285,662,022	265,153,322	259,578,805
NET POSITION	183,898,541	154,285,209	136,200,206	132,830,089
LIABILITIES AND EQUITY				
Long-Term Debt	117,798,157	120,006,348	122,882,652	124,045,739
Current Liabilities	1,993,880	10,436,851	5,253,742	1,931,325
Total Liabilities	119,792,037	130,443,199	128,136,394	125,977,064
Deferred Inflows	1,030,052	933,614	816,722	771,652
TOTAL NET POSITION, LIABILITIES, AND DEFERRED INFLOWS	304,720,630	285,662,022	265,153,322	259,578,805
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION				
OPERATING REVENUES				
CRO - Debt Service	\$6,008,599	\$6,208,432	\$6,272,476	\$6,239,797
CRO - O&M	2,706,023	2,740,645	2,478,238	1,778,186
CRO - Capital	15,132,508	18,535,695	5,665,557	274,081
Total Operating Revenues	23,847,130	27,484,772	14,416,271	8,292,064
OPERATING EXPENSES				
Operation and Maintenance	2,735,246	2,895,385	2,510,085	2,485,977
Depreciation	4,542,912	4,505,158	4,495,971	4,482,820
Total Operating Expenses	7,278,158	7,400,543	7,006,056	6,968,797
NET OPERATING INCOME (LOSS)	16,568,972	20,084,229	7,410,215	1,323,267
NON-OPERATING REVENUES (EXPENSES)				
Other Income	(18,732)	(373,899)	-	-
Interest Income	114,387	51,743	407,622	396,391
Interest Charges (Net)	(880,966)	(2,665,310)	(4,901,784)	(7,574,948)
Net Income (Loss) Before Contributions & Transfers	15,783,661	17,096,763	2,916,053	(5,855,290)
Total Capital Contributions	13,024,297	148,865	(414,376)	(508,791)
Grants & Federal BAB Subsidies	805,374	799,296	868,328	868,328
Transfers Out	-	40,079	112	79,043
CHANGE IN NET POSITION	\$29,613,332	\$18,085,003	\$3,370,117	(\$5,416,710)

In accordance with Governmental Accounting Standards Board Statement No. 65 both 2012 and 2011 were restated for comparative purposes. Years prior to 2011 are shown as originally reported.

2010	2009	2008	2007	2006	2005
\$207,242,527	\$206,708,069	\$231,099,649	\$234,373,114	\$213,434,158	\$203,311,344
59,811,400	15,845,604	9,519,659	8,924,226	6,721,684	11,318,970
267,053,927	222,553,673	240,619,308	243,297,340	220,155,842	214,630,314
1,194,533	807,387	856,484	906,294	956,724	1,161,513
268,248,460	223,361,060	241,475,792	244,203,634	221,112,566	215,791,827
138,246,799	142,801,029	151,581,061	149,348,807	136,863,991	133,125,039
124,890,764	77,694,584	88,122,323	92,649,652	80,471,326	81,480,440
5,110,897	2,865,447	1,772,408	2,205,175	3,588,936	1,032,453
130,001,661	80,560,031	89,894,731	94,854,827	84,060,262	82,512,893
-	-	-	-	188,313	153,895
268,248,460	223,361,060	241,475,792	244,203,634	221,112,566	215,791,827
\$5,119,047	\$4,293,912	\$2,016,804	\$1,999,664	\$2,095,323	\$1,774,443
2,732,956	2,517,129	6,074,980	4,646,715	4,162,516	2,415,213
1,301,346	(339,930)	-	-	-	-
9,153,349	6,471,111	8,091,784	6,646,379	6,257,839	4,189,656
2,458,379	2,629,850	2,300,026	2,377,499	2,130,748	314,507
4,426,113	4,792,037	4,803,549	3,513,441	3,413,341	768,841
6,884,492	7,421,887	7,103,575	5,890,940	5,544,089	1,083,348
2,268,857	(950,776)	988,209	755,439	713,750	3,106,308
-	-	14,360	43,532	56,160	-
861,775	184,332	293,709	355,782	282,278	185,041
(4,833,300)	(3,918,240)	(3,411,937)	(4,083,294)	(4,354,244)	(3,775,570)
(1,702,668)	(4,684,684)	(2,115,659)	(2,928,541)	(3,302,056)	(484,221)
(4,593,787)	8,085,876	1,287,306	10,186,209	7,041,008	35,703,146
306,327	-	-	-	-	-
1,435,898	(12,181,224)	3,060,607	5,227,148	-	(25)
(\$4,554,230)	(\$8,780,032)	\$2,232,254	\$12,484,816	\$3,738,952	\$35,218,900

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATEMENTS OF NET POSITION

	WATER			TACOMA WATER STATEMENTS
ASSETS	W/O RWSS	RWSS	ADJUSTMENTS	
UTILITY PLANT				
In Service, at Original Cost	\$ 630,856,710	\$ 235,422,897		\$ 866,279,607
Less - Accumulated Depreciation	(135,923,955)	(44,625,934)		(180,549,889)
Total	494,932,755	190,796,963	-	685,729,718
Construction Work In Progress	84,040,049	102,313,590		186,353,639
Net Utility Plant	578,972,804	293,110,553	-	872,083,357
NET UTILITY PROPERTY	492,963	-		492,963
SPECIAL FUNDS				
Construction Funds	39,458,385	50,742		39,509,127
Debt Service Funds	3,252,826	344,846		3,597,672
Bond Reserve Funds	13,667,516	8,442,608		22,110,124
System Development Charge Fund	53,255,060	-		53,255,060
Other Cash & Equity in Pooled Investments	26,002,368	-	1,965,856	27,968,224
Total Special Funds	135,636,155	8,838,196	1,965,856	146,440,207
CURRENT ASSETS				
Operating Funds Cash & Equity in Pooled Investments	45,768,035	1,965,856	(1,965,856)	45,768,035
Accounts Receivable	4,272,225	360,508		4,632,733
(Net of Allowance for Doubtful Accounts of \$258,344 in 2014)				
BABs Interest Subsidies Receivable	247,703	72,361		320,064
Accrued Unbilled Revenues	4,616,056	-		4,616,056
Materials and Supplies	2,401,523	-		2,401,523
Interfund Receivable	268,252	24,042		292,294
Prepayments	645,970	60,594		706,564
	58,219,764	2,483,361	(1,965,856)	58,737,269
OTHER ASSETS				
Regulatory Asset - Public Fire Protection Fees	2,940,674	-		2,940,674
Regulatory Asset - Hyada Surcharges	828,534	-		828,534
Total Other Assets	3,769,208	-	-	3,769,208
DEFERRED OUTFLOWS OF RESOURCES				
Unamortized Losses on Refunding Bonds	1,299,331	288,520	-	1,587,851
TOTAL ASSETS AND DEFERRED OUTFLOWS	\$ 778,390,225	\$ 304,720,630	\$ -	\$ 1,083,110,855

	WATER W/O RWSS	RWSS	ADJUSTMENTS	TACOMA WATER STATEMENTS
NET ASSETS AND LIABILITIES				
NET ASSETS				
Invested in Capital Assets, Net of Related Debt	\$ 251,644,076	\$ 182,639,266		\$ 434,283,342
Restricted for:				
Water Capital and System Development Charge	33,925,829	-		33,925,829
Debt Service Funds	1,931,996	-		1,931,996
Unrestricted	45,272,803	1,259,275		46,532,078
Total Net Position	332,774,704	183,898,541	-	516,673,245
LONG-TERM DEBT				
Revenue Bonds	283,193,656	117,798,157		400,991,813
Public Works Trust Fund Loans	28,101,548	-		28,101,548
Drinking Water State Revolving Fund Loan	54,448,644	-		54,448,644
Total Long-Term Debt	365,743,848	117,798,157	-	483,542,005
CURRENT LIABILITIES				
Current Maturities of Long-Term Debt	8,987,544	1,455,000		10,442,544
Current Maturities of Long-Term Liabilities	195,299	-		195,299
Accrued Taxes	1,405,334	-		1,405,334
Accrued Expenses and Contracts Payable	3,954,503	61,456		4,015,959
Salaries, Wages and Fringe Benefits Payable	1,293,035	-		1,293,035
Interest Payable	1,339,420	461,195		1,800,615
Customers' Deposits	275,591	-		275,591
Interfund Payables	1,322,970	16,229		1,339,199
Total Current Liabilities.....	18,773,696	1,993,880	-	20,767,576
LONG-TERM LIABILITIES				
Muckleshoot Agreements	7,320,231	-		7,320,231
Customer Advances for Construction	4,338,242	-		4,338,242
Unearned Revenue	7,543,633	1,030,052		8,573,685
Long-Term Accrued Compensated Absences	2,300,497	-		2,300,497
Other Long-Term Liabilities	4,019,927	-		4,019,927
Total Long-Term Liabilities	25,522,530	1,030,052	-	26,552,582
DEFERRED INFLOWS OF RESOURCES				
Rate Stabilization	35,575,447	-		35,575,447
TOTAL NET POSITION, LIABILITIES, AND DEFERRED INFLOWS	<u>\$ 778,390,225</u>	<u>\$ 304,720,630</u>	<u>\$ -</u>	<u>\$ 1,083,110,855</u>

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	WATER W/O RWSS	RWSS	ADJUSTMENTS	TACOMA WATER STATEMENTS
OPERATING REVENUES				
Sale of Water	\$ 69,702,657	\$ -		\$ 69,702,657
Other Operating Revenues	9,454,498	-		9,454,498
Contract Resource Obligation Revenues	-	23,847,130	(4,684,331)	19,162,799
Total Operating Revenues	79,157,155	23,847,130	(4,684,331)	98,319,954
OPERATING EXPENSES				
Operations	14,780,809	306,746		15,087,555
Production	7,882,700	2,329,703		10,212,403
Administrative and General	17,279,139	98,797	(4,684,331)	12,693,605
Depreciation	12,240,786	4,542,912		16,783,698
Taxes	3,779,373	-		3,779,373
Total Operating Expenses	55,962,807	7,278,158	(4,684,331)	58,556,634
Net Operating Income	23,194,348	16,568,972	-	39,763,320
NON-OPERATING REVENUES (EXPENSES)				
Interest Income	1,603,839	114,387		1,718,226
Other	555,784	(18,732)		537,052
Interest on Long-Term Debt	(14,763,957)	(5,599,173)		(20,363,130)
Amortization of Premium and Loss on Refunding	378,282	737,087		1,115,369
Interest Charged to Construction	3,354,791	3,981,120		7,335,911
Total Non-Operating Expenses	(8,871,261)	(785,311)	-	(9,656,572)
Net Income Before Capital Contributions and Transfers	14,323,087	15,783,661	-	30,106,748
Capital Contributions				
Cash	(8,021,996)	13,024,297		5,002,301
Donated Fixed Assets	3,668,338	-		3,668,338
Federal BABs Subsidies	2,756,937	805,374		3,562,311
Grants	397,135	-		397,135
Transfers				
City of Tacoma Gross Earnings Tax	(6,274,494)	-		(6,274,494)
Transfer to/from Other Funds	(78,067)	-		(78,067)
CHANGE IN NET POSITION	6,770,940	29,613,332	-	36,384,272
TOTAL NET POSITION - BEGINNING OF YEAR	326,003,764	154,285,209		480,288,973
TOTAL NET POSITION - END OF YEAR	\$ 332,774,704	\$ 183,898,541	\$ -	\$ 516,673,245

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

BOND DEBT SERVICE REQUIREMENTS
DECEMBER 31, 2014

YEAR	WATER W/O RWSS		RWSS		TOTAL
	PRINCIPAL	INTEREST	PRINCIPAL	INTEREST	
2015	4,850,000	14,088,589	1,455,000	5,534,336	25,927,925
2016	5,080,000	13,857,189	945,000	5,469,686	25,351,875
2017	5,330,000	13,614,289	1,025,000	5,427,936	25,397,225
2018	5,630,000	13,359,189	1,055,000	5,382,286	25,426,475
2019	5,865,000	13,131,870	1,990,000	5,335,337	26,322,207
2020	6,095,000	12,895,064	2,100,000	5,241,836	26,331,900
2021	6,390,000	12,606,370	2,205,000	5,143,037	26,344,407
2022	6,645,000	12,348,383	2,315,000	5,035,936	26,344,319
2023	6,485,000	12,016,133	2,455,000	4,923,486	25,879,619
2024	4,560,000	11,691,883	4,930,000	4,804,186	25,986,069
2025	4,740,000	11,473,792	5,190,000	4,561,236	25,965,028
2026	4,930,000	11,244,560	5,420,000	4,300,363	25,894,923
2027	5,085,000	11,003,926	5,700,000	4,027,936	25,816,862
2028	5,265,000	10,730,811	5,970,000	3,741,451	25,707,262
2029	5,445,000	10,448,028	6,300,000	3,441,430	25,634,458
2030	5,640,000	10,155,577	6,595,000	3,124,853	25,515,430
2031	5,835,000	9,852,652	6,880,000	2,855,022	25,422,674
2032	6,050,000	9,524,667	6,660,000	2,572,446	24,807,113
2033	11,915,000	9,184,597	4,495,000	2,298,427	27,893,024
2034	12,360,000	8,502,114	4,655,000	2,045,763	27,562,877
2035	12,820,000	7,794,144	4,830,000	1,784,106	27,228,250
2036	13,295,000	7,059,824	5,005,000	1,512,611	26,872,435
2037	13,790,000	6,298,290	5,185,000	1,231,280	26,504,570
2038	14,305,000	5,508,405	5,375,000	939,832	26,128,237
2039	14,835,000	4,689,020	5,570,000	637,703	25,731,723
2040	15,390,000	3,839,272	5,775,000	324,613	25,328,885
2041	23,820,000	2,974,200			26,794,200
2042	24,770,000	2,021,400			26,791,400
2043	25,765,000	1,030,600			26,795,600
	<u>\$282,985,000</u>	<u>\$272,944,838</u>	<u>\$110,080,000</u>	<u>\$91,697,134</u>	<u>\$757,706,972</u>

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

FUNDS AVAILABLE FOR DEBT SERVICE

	2014	2013	2012	2011	2010
Total Income	\$105,092,009	\$100,839,801	\$88,715,624	\$76,867,233	\$73,366,699
Less: Operating Exp	<u>41,772,936</u>	<u>39,825,300</u>	<u>36,087,695</u>	<u>35,928,127</u>	<u>37,596,514</u>
Income Available for Debt Service ..	<u>\$63,319,073</u>	<u>\$61,014,501</u>	<u>\$52,627,929</u>	<u>\$40,939,106</u>	<u>\$35,770,185</u>
Bond Redemption	6,896,250	8,485,830	6,668,750	6,308,333	6,092,083
Bond Interest	<u>19,828,835</u>	<u>19,562,422</u>	<u>19,342,423</u>	<u>19,624,326</u>	<u>15,700,645</u>
Debt Service Payable	<u>\$26,725,085</u>	<u>\$28,048,252</u>	<u>\$26,011,173</u>	<u>\$25,932,659</u>	<u>\$21,792,728</u>
Times Debt Service Covered	2.37	2.18	2.02	1.58	1.64

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

SUMMARY OF WATER SALES - 2014

	AVERAGE MONTHS BILLED	CONSUMPTION (CCF)	REVENUE	% of TOTAL REVENUE	MGD	% of TOTAL MGD
RESIDENTIAL AND DOMESTIC SERVICE						
Inside City						
1 <i>Single and Multiple House</i>	54,437	4,549,698	\$ 17,341,377	24.9%	9.32	18.4%
2 <i>Multiple Unit Dwellings</i>	3,205	1,638,860	\$ 4,815,060	6.9%	3.36	6.7%
3 <i>Parks & Irrigation Services</i>	183	93,466	\$ 341,859	0.5%	0.19	0.4%
4 <i>Private Fire Services</i>	98	52	\$ 62,181	0.1%	0.00	0.0%
	57,923	6,282,076	\$ 22,560,477	32.4%	12.87	25.5%
Outside City						
5 <i>Single and Multiple Houses</i>	32,167	3,276,220	\$ 17,604,781	25.3%	6.71	13.3%
6 <i>Multiple Unit Dwellings</i>	1,843	983,707	\$ 3,932,576	5.6%	2.02	4.0%
7 <i>Parks & Irrigation Services</i>	216	110,755	\$ 452,691	0.6%	0.23	0.5%
8 <i>Private Fire Services</i>	77	4	\$ 33,517	0.0%	0.00	0.0%
	34,303	4,370,686	\$ 22,023,565	31.5%	8.96	17.8%
COMMERCIAL AND INDUSTRIAL SERVICE						
Inside City						
9 <i>Large Volume Service</i>	3	573,301	\$ 878,101	1.3%	1.18	2.3%
10 <i>General Service</i>	3,691	2,274,772	\$ 6,643,995	9.5%	4.66	9.3%
11 <i>Parks & Irrigation Services</i>	291	340,972	\$ 1,181,991	1.7%	0.70	1.4%
12 <i>Private Fire Services</i>	1,026	19,028	\$ 2,577,029	3.7%	0.04	0.1%
	5,011	3,208,073	\$ 11,281,116	16.2%	6.58	13.1%
Outside City						
13 <i>Large Volume Service</i>	4	412,388	\$ 788,247	1.1%	0.85	1.7%
14 <i>General Service</i>	853	417,621	\$ 1,721,246	2.5%	0.86	1.7%
15 <i>Parks & Irrigation Services</i>	74	95,247	\$ 386,686	0.6%	0.20	0.4%
16 <i>Private Fire Services</i>	201	1,012	\$ 844,847	1.2%	0.00	0.0%
	1,132	926,268	\$ 3,741,026	5.4%	1.91	3.8%
17 ROCKTENN	1	8,087,783	\$ 5,801,842	8.3%	16.58	32.9%
CITY OF TACOMA						
18 <i>General Service</i>	104	66,452	\$ 267,760	0.4%	0.14	0.3%
19 <i>Parks & Irrigation Services</i>	83	26,715	\$ 119,852	0.2%	0.06	0.1%
20 <i>Private Fire Services</i>	33	95	\$ 67,358	0.1%	0.00	0.0%
	220	93,262	\$ 454,970	0.7%	0.20	0.4%
21 WHOLESALE	18	1,585,380	\$ 3,718,315	5.3%	3.25	6.5%
<i>Unbilled Revenue</i>			\$ 121,346	0.2%		
TOTAL WATER SALES	98,608	24,553,528	\$ 69,702,657	100.0%	50.35	100.0%

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

STATISTICS
AS OF DECEMBER 31, 2014

Tacoma Water System:		
Average daily delivery exclusive of pulp mill		36.71 MG
Average daily delivery of pulp mill		16.57 MG
Total average daily delivery		<u>53.28 MG</u>
Maximum daily production	7/12/2014	80.82 MG
Minimum daily production	10/22/2014	28.45 MG
Total water produced in 2014*		19,444 MG
Regional Water Supply System (RWSS):		
Total average daily delivery		10.53 MG
Average daily consumption per single family residential service		171.3 GPD
Miles of transmission and wells supply mains - 28" to 96" diameter (includes North Fork wells system)		150 mi
Miles of distribution mains - 2" to 24" in diameter		1,224 mi
Fire Hydrants (Inside)		6,044
Fire Hydrants (Outside)		4,457

The primary source of Tacoma's water supply is the Green River. Additionally the North Fork well field provides blending options during periods of excessive river turbidity. The Green River source consists of a 73 million gallons per day (MGD) water right. Tacoma is also partner in the Regional Water Supply System (RWSS) and holds a 27 MGD average share of that 64.6 MGD interruptible, junior water right on the Green River. Tacoma also has ground water rights totaling 87 MGD with an installed pumping capacity of 55 MGD.

Tacoma's water supply is robust and of very high quality, benefiting from decades of source protection and substantial investment in treatment. City of Tacoma business and residents continued to receive extraordinary service reliability while meeting or exceeding all regulatory requirements of the United States Environmental Protection Agency and the Washington Department of Health.

Storage facilities are provided at 15 locations. These facilities consist of 10 concrete tanks and 12 steel standpipes. The combined storage capacity is equal to approximately 140.7 million gallons. Of this storage capacity 67.6 million gallons are located at the McMillin Reservoir approximately 14 miles southeast of Tacoma.

**Includes losses and water for self-consumption excludes RWSS*

MG equals million gallons

GPD equals gallons per day

mi equals miles

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

TAXES AND EMPLOYEE WELFARE CONTRIBUTIONS
FOR THE YEAR 2014

FEDERAL

Social Security (FICA)		\$1,488,814
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STATE OF WASHINGTON

Retail Sales Tax	\$5,237,454	
Utilities and Business Activities Tax	3,188,144	
Total		8,425,598

COUNTY

Real Property	33,826	
Total		33,826

MUNICIPALITIES

City of Tacoma Gross Earnings Tax	6,274,494	
City of Fircrest Administrative Fee	7,624	
City of Lakewood Administrative Fee	6,113	
City of Puyallup Administrative Fee	35,369	
City of University Place Administrative Fee	530,036	
		6,853,636

TOTAL TAXES		<u>\$16,801,874</u>
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Taxes as a % of Non-CRO Revenues of \$79,157,155		21.23%
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EMPLOYEE WELFARE CONTRIBUTIONS

Industrial Insurance and Medical Aid	\$467,343	
Pensions	2,020,282	
Medical Insurance	3,580,924	
Dental Insurance	352,727	

TOTAL EMPLOYEE WELFARE CONTRIBUTIONS		<u>\$6,421,276</u>
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CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

2014 WATER RATES

METER SIZE		READY TO SERVE CHARGE PER MONTH	
		INSIDE	OUTSIDE
		TACOMA	TACOMA
5/8	inch	\$18.85	\$22.62
3/4	inch	\$28.28	\$33.93
1	inch	\$47.13	\$56.55
1-1/2	inch	\$94.25	\$113.10
2	inch	\$150.80	\$180.96
3	inch	\$282.75	\$339.30
4	inch	\$471.25	\$565.50
6	inch	\$942.50	\$1,131.00
8	inch	\$1,508.00	\$1,809.60
10	inch	\$2,167.75	\$2,601.30
12	inch	\$3,180.94	\$3,817.13

		CHARGE FOR WATER USED PER MONTH PER 100 CUBIC FEET	
		INSIDE	OUTSIDE
		TACOMA	TACOMA
<u>Residential Service</u>			
Each 100 cubic ft. of water consumption during the winter months of October through May		\$1.538	\$1.846
First 500 cubic ft. of water consumption per month during the summer months of June through September		\$1.538	\$1.846
Each 100 cubic ft. of water consumption over 500 cubic ft. during the summer months of June through September		\$1.923	\$2.308
<u>Commercial and Industrial</u>			
General Service		\$1.712	\$2.054
Large Volume Service (over 65,000 cubic feet annually)		\$1.469	\$1.763

<u>Parks and Irrigation Service</u>			
Each 100 cubic feet of water consumption		\$2.431	\$2.917

City of Tacoma water services are 100% metered.

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

Water rates were established by Ordinance No. 28133 and were effective January 1, 2014.

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

CITY OF TACOMA, WASHINGTON
DEPARTMENT OF PUBLIC UTILITIES
TACOMA WATER

2014 FIRE PROTECTION RATES

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

METER SIZE		MONTHLY CHARGE	WATER INCLUDED FOR MONTHLY LEAKAGE AND TESTING PURPOSES (100 Cubic Feet)
2	inch	\$24.74	2.99
3	inch	\$36.02	2.99
4	inch	\$60.18	2.99
6	inch	\$135.00	2.99
8	inch	\$240.32	2.99
10	inch	\$375.90	2.99
12	inch	\$601.24	2.99

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

MONTHLY CHARGE

12 times the monthly service charge (minimum).

CONSUMPTION

Rates per 100 cubic feet per month \$3.960

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

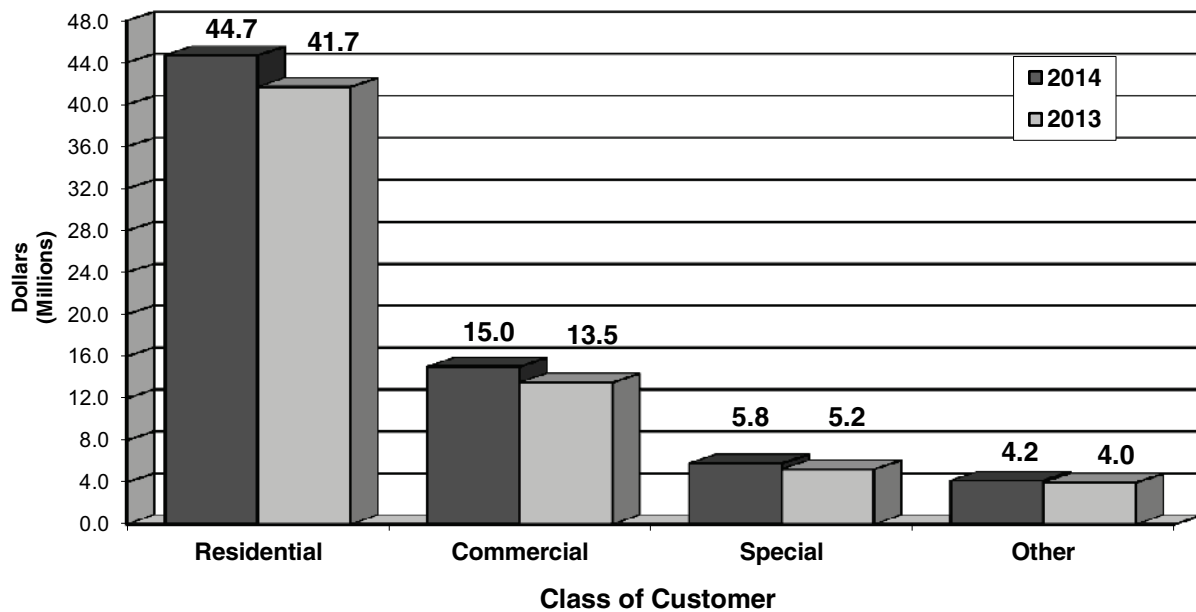
Costs associated with fire hydrant services are currently recovered from customers in two different ways, depending on their location in the service area. Customers outside the City of Tacoma with residential and commercial accounts pay a flat monthly franchise "Franchise Hydrant Service Fee" as shown below:

Outside City, other contract.....	\$4.72
Fircrest Franchise.....	\$5.07
Lakewood, Puyallup, and University Place Franchises...	\$5.20

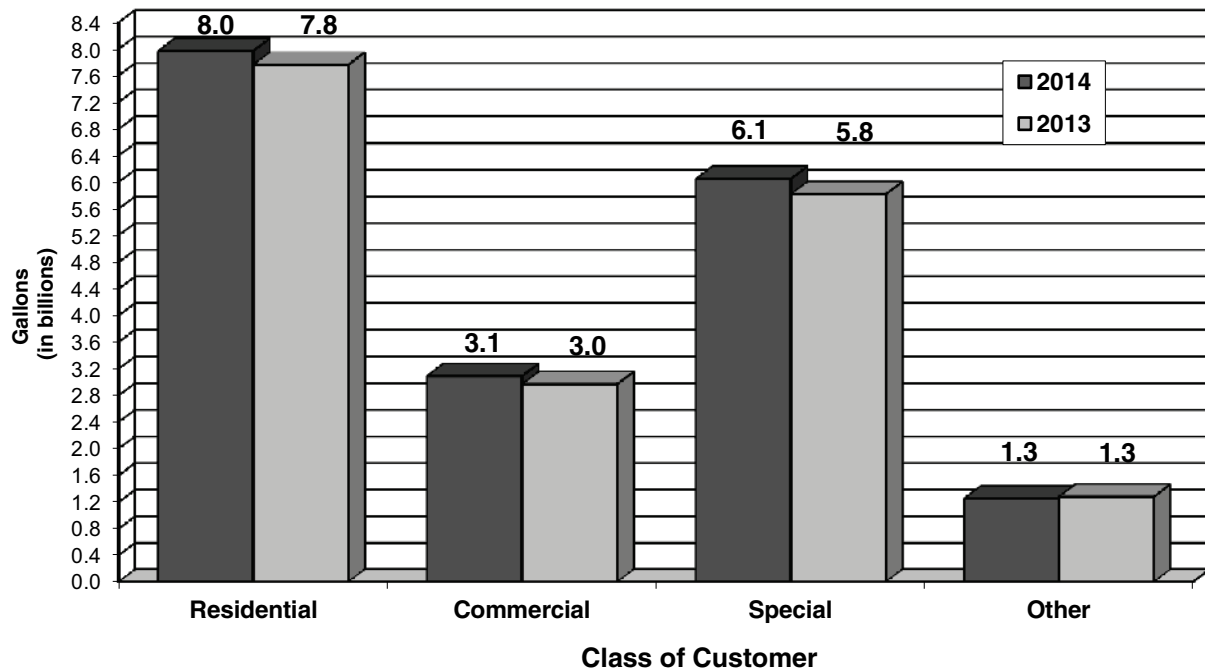
Inside the City of Tacoma, the general government is directly billed an annual "Fire Hydrant Services Fee" of \$266.95 per hydrant.

The Fire Protection Rates were established by Ordinance No. 28133 and were effective January 1, 2014.

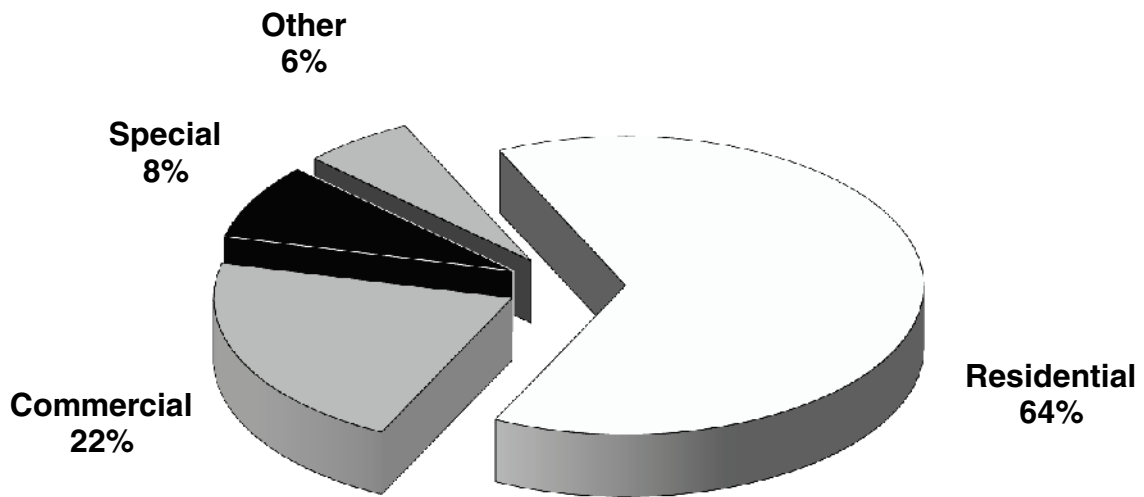
WATER SALES
Year to Date - December 2014 & 2013



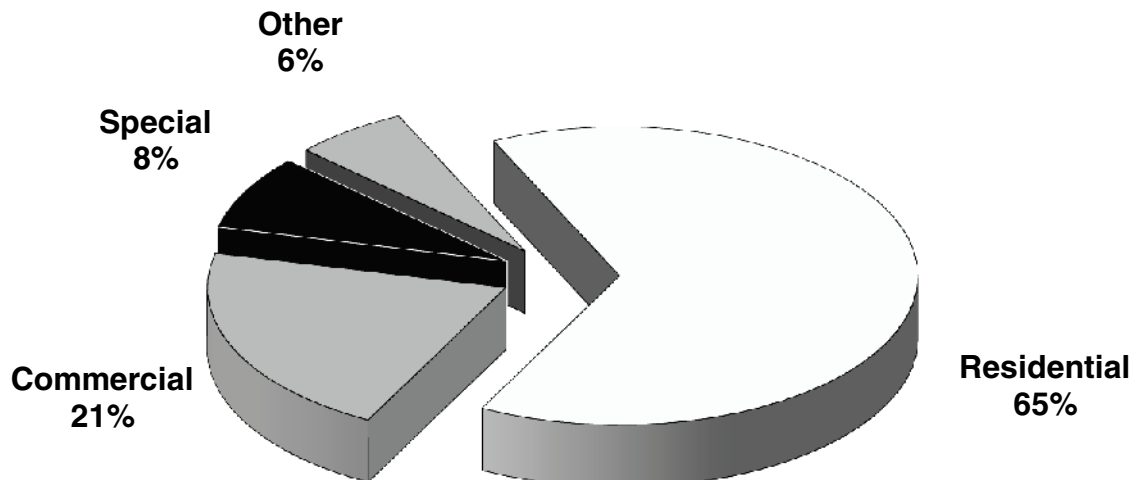
WATER CONSUMPTION
Year to Date - December 2014 & 2013



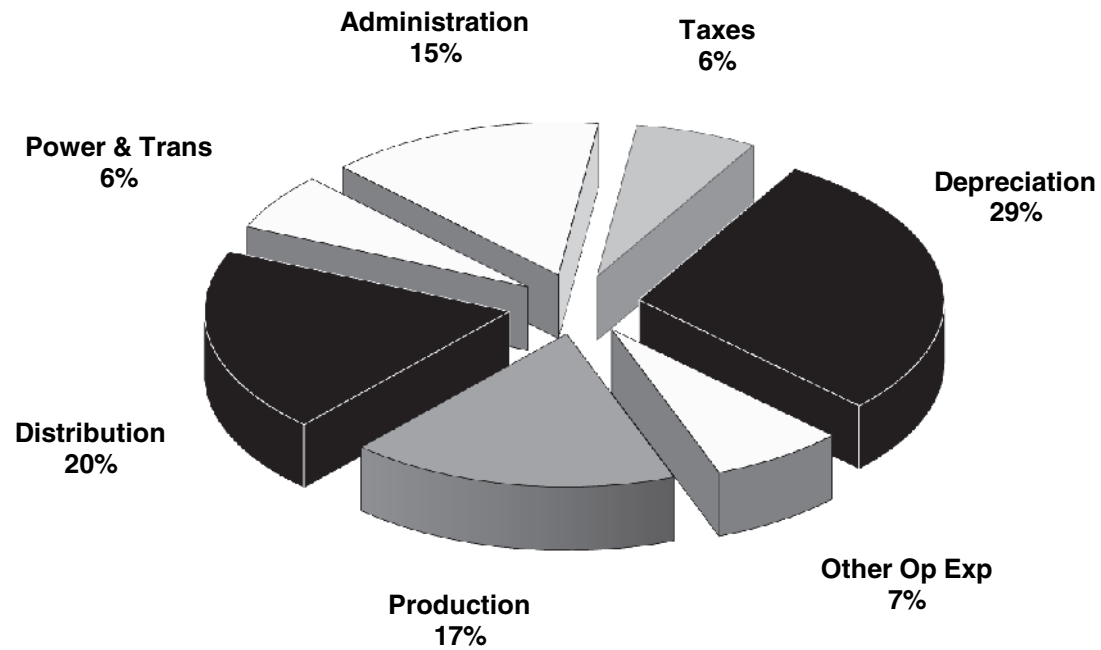
WATER SALES
Year to Date - December 2014
(\$69,702,657)



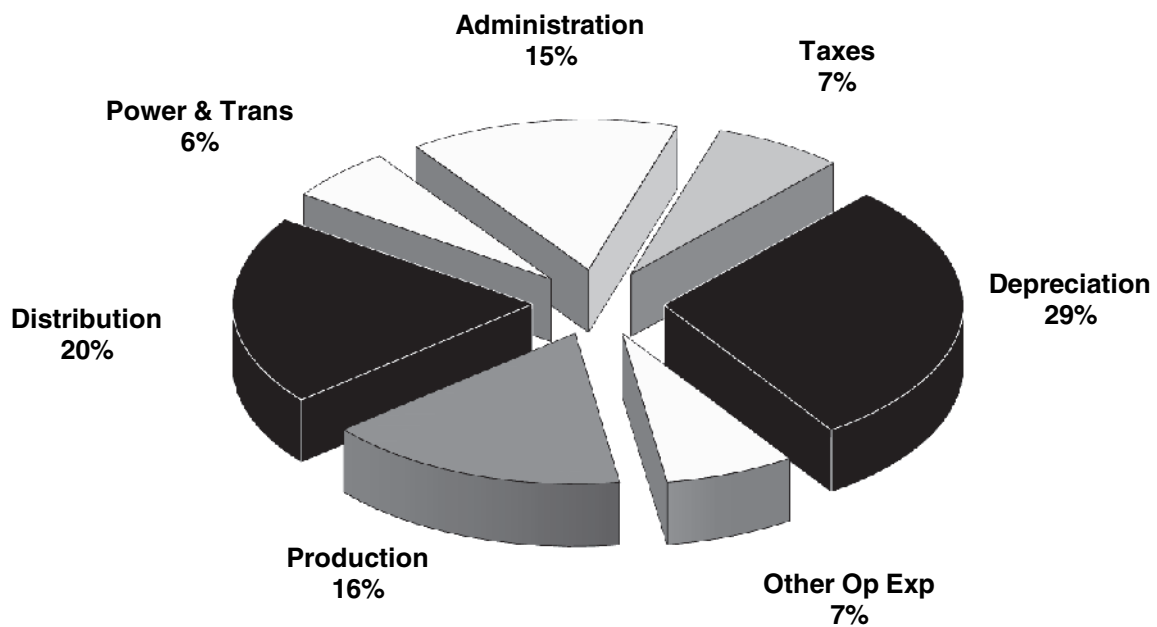
WATER SALES
Year to Date - December 2013
(\$64,111,896)



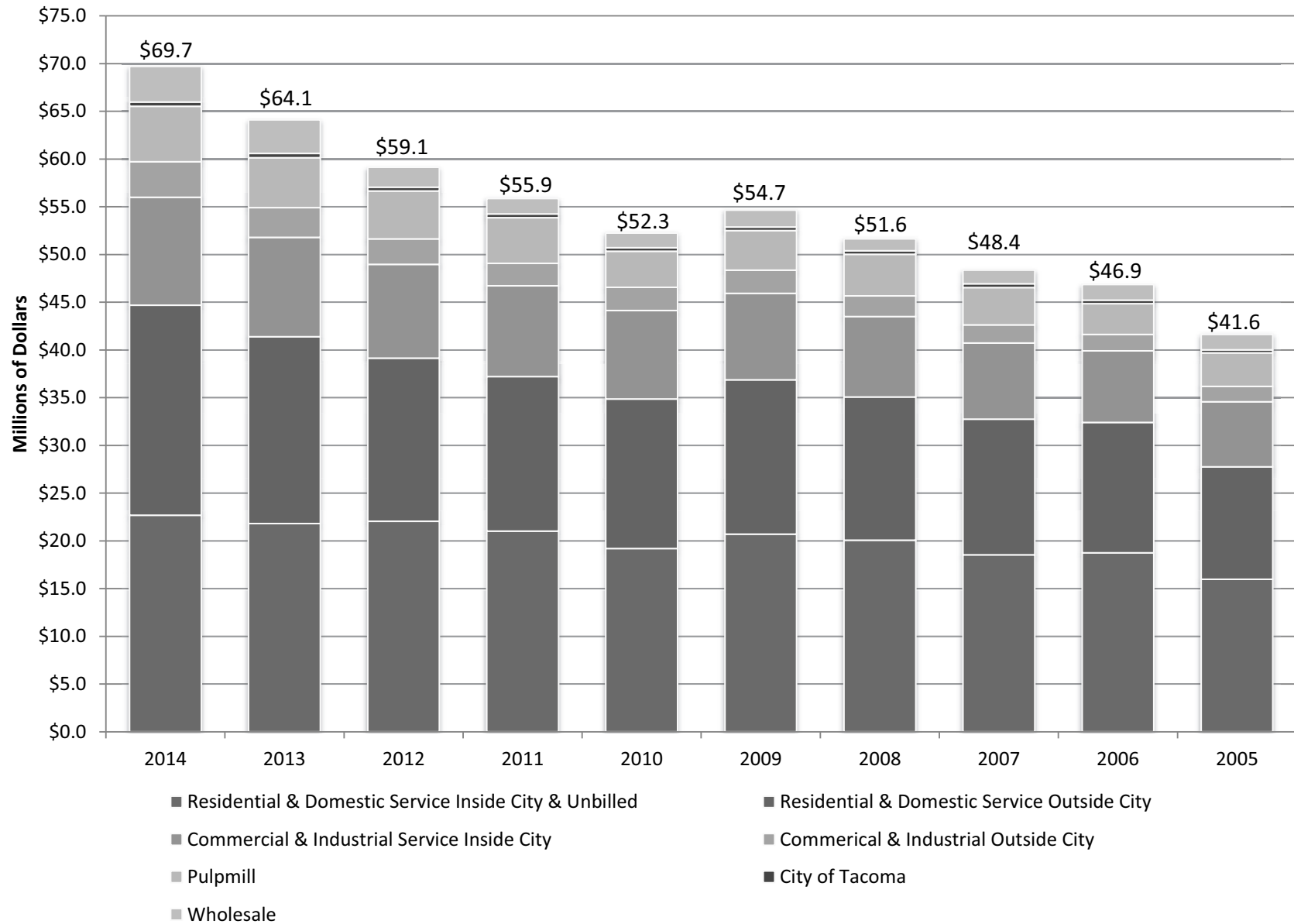
TOTAL OPERATING EXPENSES
Year to Date - December 2014
(\$58,556,634)



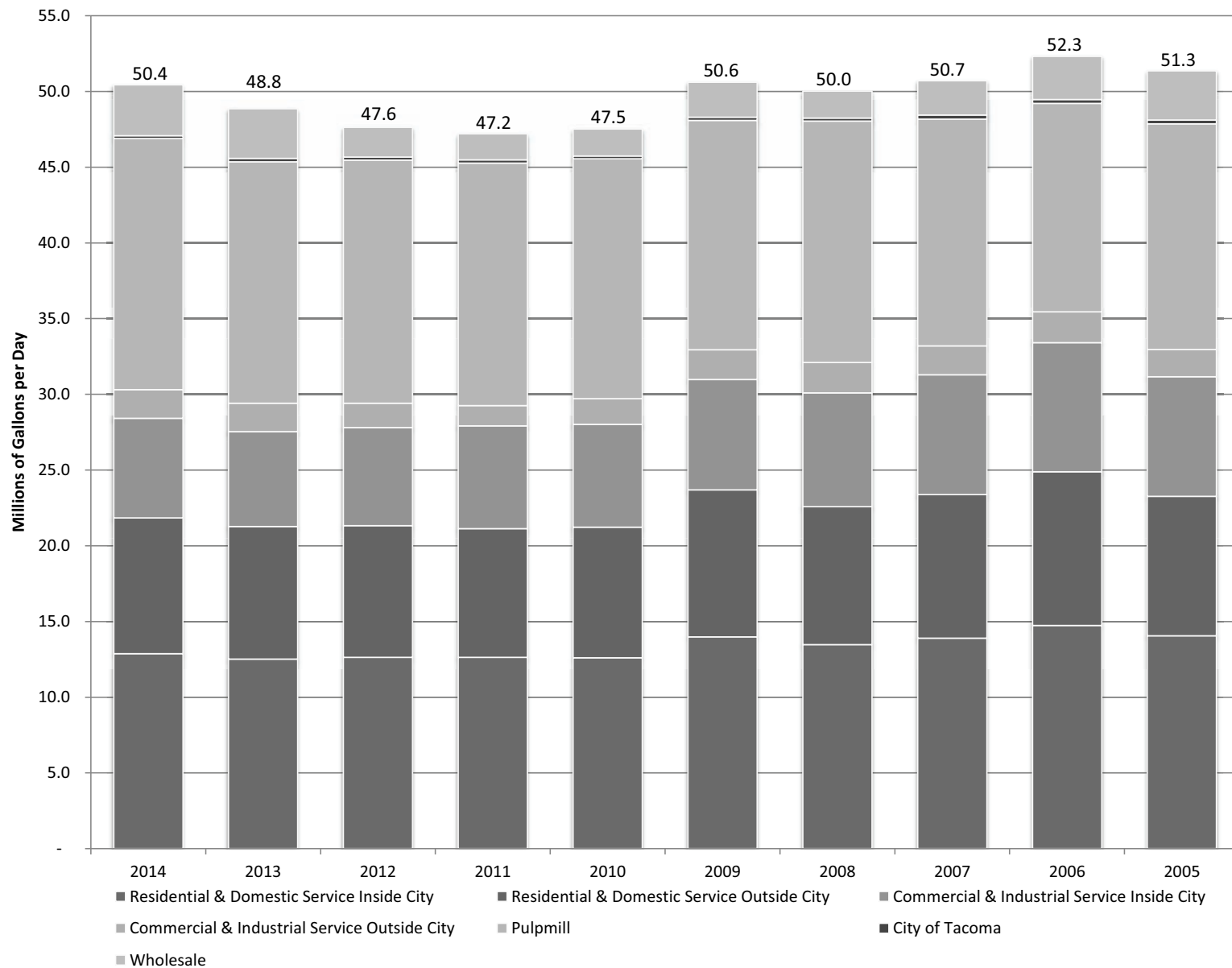
TOTAL OPERATING EXPENSES
Year to Date - December 2013
(\$55,897,543)



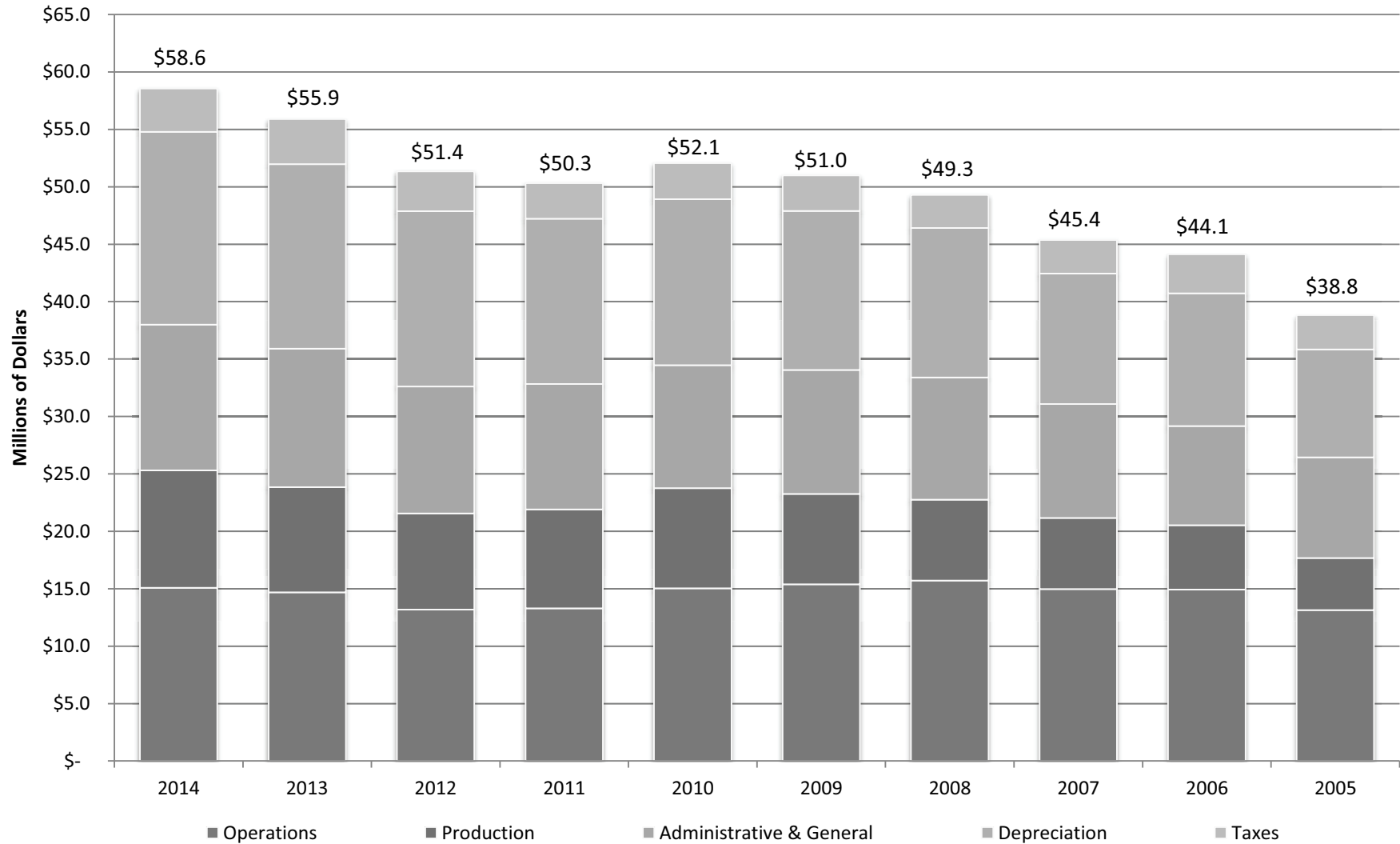
TEN-YEAR SUMMARY OF WATER SALES (MILLIONS OF \$)



TEN-YEAR SUMMARY OF WATER DEMAND (MGD)



TEN-YEAR SUMMARY OF O&M EXPENSE (MILLIONS OF \$)



2014 SUPERINTENDENT'S REPORT TACOMA WATER

One year after celebrating the centennial of Tacoma's Green River water supply, 2014 marked a new milestone: the beginning of filtration for this critical source of water supply. On December 16, 2014, the first filtered water was introduced into Tacoma's historic Pipeline 1, and began its voyage to customers. Starting in early 2015, all drinking water from the Green River, our primary water source, will be filtered. The Green River has been a high quality, low cost supply source for now over 100 years, and with new treatment, it will continue that tradition for generations to come. The Green River supply system is one of the most valued assets of our community and we are blessed by the foresight of Tacoma's early leaders who made the decision to select the Green River for their drinking water, even though it was the most expensive option at the time. Today we serve 50 percent more customers from the system than it was anticipated to be capable of serving and we project the existing supply should be able to meet the growth and development needs of our service area for at least the next 50 to 60 years.

While certainly a large project, constructing and starting filtration was by no means the only place Tacoma Water made progress in 2014. We continue to move forward initiatives identified as significant in our strategic plan. Advanced asset management planning and financial analysis was applied to capital project development work, and used in making capital budgeting decisions. Financial results for Tacoma Water are healthy and strong as a result of updated policy direction, improved forecasting and comprehensive financial management. Our 2015-2016 budget effort reflected this fiscal discipline, and resulted in proposed rate increases that are approximately one half of what they were a few years ago, despite large, required investments.

The premier accomplishment of 2013 was the attraction of Niagara Bottling Company, the largest family-owned bottled water manufacturer in the United States, to Pierce County. They began production in 2014 with one bottling line, and as they bring on the planned addition of another bottling line, will become one of Tacoma Water's largest customers. The success of attracting this new company to the area was a win for both Tacoma Water's rate payers and the region in general with the creation of good jobs and considerable capital investment.

Tacoma Water accomplishments of 2014 as detailed below are considerable thanks to the dedication and efforts of the very capable Tacoma Water staff. From innovation adopted and applied to marketing of surplus water, rehabilitation of infrastructure and technology implementation, to our Top Ops and Tapping teams competing successfully at the Pacific Northwest Section/American Water Works Association conference and at the national competition in Boston, to the numerous customer compliments received throughout the year for the responsive, caring, quality service delivered and appreciated by our customers, Tacoma Water staff have performed their work with pride and a commitment to our mission of providing clean, reliable water now and in the future.

ASSET & INFORMATION MANAGEMENT

Strategy Management (Balanced Scorecard)

2014 marked the second year of using a Balanced Scorecard approach to managing our strategic work. In 2014 we adopted a vision to help drive our strategic efforts: Engaged and Informed. We planned our initiatives and measured our progress toward defined objectives. Our objectives related to three perspectives: employee (employee engagement), internal process (customer focus and effective decision making), and outcome (financial and

customers). Through our strategy management efforts we worked to ensure that we prioritized our strategic work, adequately resourced the highest priorities, planned our actions, measured progress, and resolved issues. We continued to work on exercising the discipline to say no to some work to ensure higher priority efforts were resourced well. The result was 14 strategic initiatives completed in 2014. A 2014 highlight was the creation of a Supervisor Advisory Team, consisting of everyone in Tacoma Water with at least one direct report. This group assembled quarterly to receive training on improving employee-supervisor relationships and to come together to discuss and decide on topics such as response to the 2nd year of a TPU-wide all employee survey.

Planning, Scheduling and Communicating

The Asset and Information Management section focused on planning, scheduling and communicating how our Asset Management approach and Information Management tools work together to support all Tacoma Water sections. A work plan with a visual representation of that plan was developed and presented throughout Tacoma Water to help with understanding and promote discussions and engagement. This was an excellent opportunity to continue relationship building and face to face communication vital to the successful adoption of Asset Management, supporting technology tools, and new business and decision making processes across all levels of Tacoma Water.

Asset Management

In 2014, Tacoma Water entered the “Operationalization” phase of the Asset Management (AM) program. This self-coined term was meant to reflect the stage of the program where the Operating Sections begin to take on a leadership role in the planning for their assets from the Asset and Information Management Section. This involves continued development of Strategic Asset Management Plans and the implementation of the Strategic Maintenance Management Program. Central to this effort was continued long term planning and the update of the Asset Management Plan.

Asset Management Plan

The original 2009 AM framework was reviewed and all 14 initiatives were measured for progress against the respective tasks assigned to them. Each of the initiatives was then reviewed and recommendations regarding work efforts were created. This culminated with the development of a Gantt chart of AM efforts needed through 2020.

Operationalization of Strategic Asset Management Plans (SAMPs)

Each component of the water system is captured in a Strategic Asset Management Plan (SAMP). A large part of the year was focused on engaging with SAMP leads to measure the progress of each SAMP and based on a prescriptive list of criteria define a Phase 1 of the SAMP process. Working directly with the SAMP leads, punch lists were developed and the SAMP reports were worked on for the 11 active SAMPs. By the end of the year, all SAMPs had been measured, 4 SAMPs attained the Phase 1 milestone and 4 more are in the final stages of editing to pass this milestone.

After much discussion with SAMP leads and section managers it was decided that a new asset class should be created to deal specifically with valves rather than including them in the main SAMP, giving Tacoma Water a total of 18 SAMPs. There are now SAMPs developed for 12 of the 18 asset classes with two more started in Q4, the Valve and Electrical SAMPs. With this many SAMPs underway, the importance of each Section

and the SAMP lead taking ownership over the direction and progress of each SAMP cannot be understated. This transfer of ownership and responsibility will be a primary focus over the coming year.

The storage SAMP developed in 2014 is a great example of the benefit of developing and utilizing SAMPs. The team that developed this SAMP represented staff from multiple sections, many disciplines and both the engineering and field perspective. They produced a report that serves as a common resource regarding our water storage facilities, including facility details, calculated risk (likelihood and consequence of failure), and a consensus based set of next steps for the asset class. The next steps include future work activities around system design as well as data, process and procedure improvements that span organizational structure section boundaries.

Strategic Maintenance Management Program (SMMP)

The SMMP made great strides in 2014 with the adoption of discrete work orders within SAP for the completion and tracking of maintenance work. Maintenance plans were created for Pressure Reducing Valves (PRVs), GenSets and the existing equipment at the Green River Treatment Facility (for Ozone processes, the Intake and the Chemical building). The plans enable comparisons of estimates versus actuals, for both time and costs related to maintenance activities. In addition to understanding of O&M costs, this effort also enables the opportunity to collect feedback from staff and to improve the process over time. Specifically for PRVs, field staff identified cost cutting measures for performing maintenance along with additional condition assessment information needing to be captured and the maintenance plans were adjusted accordingly.

The above success was the result of a large amount of hands on training and support provided by the AM team to the Water Supply and Water Quality sections on the topics of maintenance plans, work order management and failure notifications.

Information Management

Significant progress was made in the area of technology and information management in 2014. The preeminent accomplishment was launching BlueWave, our new GIS.

Tacoma Water's New GIS

Successful implementation of the new ESRI-based Geographic Information System (GIS) (BlueWave) for Tacoma Water was completed in June. Training was provided for all Tacoma Water staff and overview presentations made to other city departments. Following system stabilization, the focus has been on data quality, in particular, data currency, accuracy, and adding of data to support various work groups and new map applications. The first annual GIS Day was held in November showcasing the work of our team and other GIS groups in the region. Focused work with the citywide GIS Advisory Team (GAT) has resulted in broader development and utilization of the ESRI platform and greater data sharing and collaboration.

Utility Technology Governance

Tacoma Water worked closely with Tacoma Power Utility Technology Services (UTS) regarding technology project support services, project delivery and governance including business case reviews. The Utility Technology Architecture Board's role was expanded in 2014 to develop standards and best practices for development and implementation of technology solutions at TPU. A Utility Technology Strategic Plan was produced for TPU

in 2014 with input from Tacoma Water regarding our future needs and direction. A final highlight was the IT Department's upgrade of SAP to enhancement pack 7 in the fourth quarter of 2014. This upgrade included needed capability for managing our linear assets that we plan to enable in 2015.

WATER QUALITY

Green River Treatment

The Green River Filtration Facility construction continued through the year, and reached the point of substantial completion when filtered water entered the system on December 16, 2014. With a competitive bidding climate and high quality project management from the Contractor, Design team, and the Tacoma Water team, overall project costs continued to be tightly controlled. At year close, the total project cost estimated to range from \$182M - \$233M at project approval, is now at \$187M, including an additional \$3M of work needed at the Green River Intake, and within untreated pipelines and a tunnel. In addition to construction, staffing changes have been implemented to assure reliable engineering, operation and maintenance support for this critical facility.

Regulatory Compliance & Customer Service

Water Quality personnel respond to customers who call about the quality of the water they are receiving, and we know that these calls often come with heightened concern. Timely response is extremely important. We have an established goal that at least 98.5 percent of all customers receive a call back the same business day. Staff met that goal, returning 549 of the 557 calls received in the time required (98.6 percent).

Members of our Water Quality group have been part of a multi-sectional effort to improve our operating relationships with new and long-standing Wholesale customers, and to develop new processes and approaches to ensure that these accounts are well served. In 2014, this team developed & delivered three accredited training opportunities for Wholesale and Partner Utility staff.

Watershed & Natural Resource Management

Vigorous management of the Green River Watershed continues to be a high priority for Tacoma Water. This important resource is our first treatment barrier, while contributing a wide range of ecosystem services. 2014 saw our Environmental Programs group heavily involved in tracking and reviewing the developments and documents associated with the US Army Corps of Engineers Biological Assessment for Howard Hanson Dam, along with other key elements of implementing our Habitat Conservation Plan. Ongoing management of noxious weeds, trespass, and oversight of commercial activities to protect water quality remain high priorities.

WATER SUPPLY

Transmission Mains

A leak survey of Pipeline 1 was performed in the summer of 2014. Flow in the pipeline was increased to an abnormally high level and held for several weeks. The increased flow caused an increase in the pressure in the pipeline and allowed any leakage to become visible at ground surface. Crews had cleared portions of the pipeline right-of-way in advance and monitored the area, looking for where water may be surfacing. Several potential water sources found were tested for chlorine and fluoride to determine if they were sources leaking from Pipeline 1. One leak was found during the survey.

As a follow-on to the leak survey described above, Tacoma Water then conducted a pilot project to evaluate two forms of non-destructive pipeline testing on a portion of Pipeline 1 with a history of leaks. Pipe condition assessment data was gathered from the two types of technologies which will be compared and contrasted in the final phase of the project. The two technologies used were Ultrasonic Thickness detectors and the Enhanced Electro-Magnetic detector system. Overall the pipeline in the vicinity of Boise Creek appeared to be in fairly good condition. Detailed reports of the condition assessment findings will be analyzed in the 1st Quarter of 2015.

This Condition Assessment effort required an unprecedented lengthy, yet successful shutdown of Pipeline 1 lasting 4 days (a typical shutdown for this pipeline has historically lasted no more than 1-2 days). This success was due to excellent planning and coordination within various sections of Tacoma Water and the use of Incident Command System (ICS). Following the Pipeline 1 shutdown and inspection, a disinfection and flushing plan was executed by staff, ensuring no unacceptable water was delivered to customers.

An electric valve actuator was also mounted on a vital valve during the shutdown. This will allow the valve to be operated remotely after it is fully programmed. Five (5) blow-off valves were also inspected and replaced.

Another successful pipeline shutdown was conducted on Pipeline 2 from just south of HWY-512 to S 35th St and S J St. This was a very complicated portion of the system to isolate. The shutdown was necessary to replace a critical valve at the intersection of S 64th St and S Park Ave. The valve which had failed in the open position was made to be operable again.

A large milestone in the Asset Management Program was accomplished by completing Phase 1 of the Transmission main Strategic Asset Management Plan (SAMP). There were 12 recommendations included in the report and subsequently adopted. The SAMP team has continued to make excellent progress on several of the 12 recommendations.

Storage

Several storage reservoirs were removed from service for scheduled inspection and their tri-annual cleaning. The cleanings and inspections were successfully completed and each reservoir was returned to service.

Another significant accomplishment was the completion of Phase 1 of the Storage SAMP. There were 6 recommendations included in the report. Each of the recommendations is currently being addressed.

Work Process Improvement

Preliminary work process mapping for Water Supply functions was completed as a portion of the Business Improvement Process Initiative, and as a result, several “next steps” were identified. Going forward these will be vetted and Water Supply will coordinate with the Asset Management group on training and process improvements for 2015.

Water Supplier’s Forum

The Water Supply Forum (which includes utilities such as Tacoma Water, Seattle Public Utilities, City of Everett, Cascade Water Alliance, etc.) has embarked on a major regional project to help the utilities’ ability to respond and thus improve the resiliency at a regional level. Tacoma

is providing leadership in the Water Quality area, and technical expertise in the Earthquake field. In Q4 of 2014 a Consultant was selected and brought on board to assist with this project. The work which is anticipated to be completed in 2015 will evaluate the risk to water service in the Puget Sound tri-county area of Snohomish, King and Pierce, from earthquakes, climate change, and drought and water quality events.

Vulnerability Assessment

Significant progress was made in Tacoma's All Hazard Vulnerability Assessment (VA) Project. Major activities successfully accomplished included site visits of Tacoma Water's critical facilities, a customer expectation survey, Malevolent Threats Workshop, Risk Tolerance/Critical Asset workshop, and Earthquake Scenario/Recovery Time Workshop. The project continues to be on schedule and will be completed in mid-2015.

Emergency Management

Tacoma Water successfully responded to two real-life emergencies that required multi-sectional and interagency cooperation and coordination. The large main leak at E 11th St & Portland Ave was the largest leak in memory and was a good test of our use of the ICS system. A turbidity event that originated at the Headworks was also encountered and handled without impacts to our customers. Tacoma Water continues to learn from and improve our use of the ICS system.

The successful manner in which these issues were handled continues to reinforce the necessity of our continued work in emergency preparation. Tacoma Water conducts emergency drills each year to ensure the best possible response when a real-life crisis occurs.

Instrumentation/Control/Electrical

The Instrumentation/Control/Electrical group in Water Supply has had a remarkably successful and busy year that includes the following highlights:

1. As suggested in the 2013 Cyber Vulnerability report, the SCADA servers were relocated from the Water Control Center to TPU-ABS basement data center.
2. The facility intrusion systems at several key facilities were improved. The motor starting contactor McMillin Pump Station #1 - pump #3 was replaced with a Variable Frequency Drive.
3. McMillin Pump Station #1 was modified and tested in pressure control mode for the anticipated Sunrise Standpipe shutdown.
4. Sparling flow meters at Northend PS and Headworks 10MG Reservoir outlet, Well 1B and Well 7B were replaced.
5. Hardware and software designs at Fennel Creek Pump Station were upgraded to accommodate a new valve actuator for valve #592. Installed power and control wiring for PL1 Valve 592. Calibrated valve position.
6. Fennel Creek PS genset power and control lines were converted to a permanent set-up to deter vandalism. Portable connections remain available as a backup for the local genset.
7. Operational flowcharts for 214th PS and McMillin PS #1 were developed. These will be used as a model for process documentation going forward.

8. Provided engineering support to Hoffman, S&B, and Headworks for the Green River Filtration Facility project (GRFF), and attended trainings to familiarize staff with the electrical equipment, processes, SCADA, and controls of the new facility.
9. Designed, drilled, and installed 2 Cathodic Protection deep wells (these wells will provide protection to approximately 11,000 feet of main).
10. Designed, purchased, and installed galvanic anode system to replace the existing system at North End Standpipe and Fletcher Standpipe.
11. Developed annual flow meter calibration form, scheduled and calibrated SSP flow meters.
12. Developed Headworks fiber optic cable network. Maximized fiber optic cable utilization.
13. Installed/Modified single-phase electrical services to each NF Wells.
14. Supported the upgrade of the lighting system for Water Distribution Offices.

WATER RATES & FINANCIAL PLANNING

2015-2016 Biennial Budget

On December 9, 2014, the City Council unanimously approved the utility's 2015-2016 biennial budget. This budget has been under development by utility staff since late 2013, and includes provisions for 4 percent overall increases in both 2015 and 2016, as well as the introduction of a "hydrant service fee" for ratepayers inside the City of Tacoma. The capital portion of the budget was informed by data from our Strategic Asset Management Plans and Business Case Evaluations, tools that have been developed and utilized by staff across the organization for the first time. As the utility transitions out of a very capital intensive decade of system improvements into a more operational mode, it will be focused more on repairing and maintaining its capital infrastructure. It is for this reason that making decisions based on analytics in targeted areas is a major emphasis going forward, and the approval of the 2015-2016 budget represents a major step towards working across the organization to employ analytics in decision-making.

The approval of the 2015-2016 budget was developed in the context of a multi-year financial plan that includes a capital funding strategy that utilizes much of our capital fund balances to pay directly for capital projects in the coming decade. This will enable the utility to avoid issuing additional debt in order to reduce leverage over time.

Demand Forecasting

Development of updated short- and long-term demand forecasts was initiated in 2014, and has already provided valuable outputs that have informed our multi-year financial planning efforts. Ultimately, this will provide the utility with a documented, repeatable, and transparent process for conducting forecasting on 10- and 60-year horizons, and will enhance our ability to account for uncertainty in our system planning and water supply agreement development.

Wholesale Market Pricing and Service Offerings

For the past few years, Tacoma Water has been working to make use of near-term surplus water supply capacity to increase net revenues. In 2014, the utility conducted various stages of policymaker and customer review that enables the utility to move forward with the development of agreements that incorporate customer-specific terms for pricing, duration and seasonal characteristics, among other factors. While these agreements will need to be brought back for review and approval by both the Public Utility Board and City Council, the conceptual approach

has been endorsed by both policymaking bodies, and policy changes have been adopted to enable negotiations to proceed in good faith.

Tacoma Water also executed an agreement with the City of Auburn in 2014 to increase available wholesale capacity from 1.0 million gallons per day to 3.5 million gallons per day. While water purchased under this agreement is conventionally priced, the execution of this agreement is aligned with our objective to increase net revenue from wholesale sales.

DISTRIBUTION ENGINEERING

Economic Development and New Services

After a number of years of slow economic development activity in both the commercial and residential sectors, 2014 was a positive year for growth and development. As new homes were built on the inventory of already developed lots, work on new plats started back up. Although we had good activity in this area, it is still not where it was before the economic downturn in 2008. Economic development downtown Tacoma included additions of the UW Tacoma YMCA and the St. Joseph Medical Center expansion. Planning for the 2015 US Open at Chambers Bay Golf Course in University Place continued. Distribution Engineering staff, Tacoma's Community and Economic Development Department, Tacoma Pierce County Economic Development Board and the Port of Tacoma have been actively engaged in support of the region's economic development agenda.

In 2014, Tacoma Water developed an acquisition agreement with the Andrain Road Water Association (Andrain), presently a wholesale customer of Tacoma Water. Andrain operates a water system serving 59 residential customers in the vicinity of 128th Street East and 78th Avenue East in Pierce County. Due to the limited capacity of their water system, Andrain has not allowed new service connections within their service area. In response, the Washington State Department of Health required Andrain to develop a water system plan that would provide service for up to 150 service connections. In lieu of developing a new water system plan, Andrain requested Tacoma Water acquire their service area and provide direct retail service to their members. Following approval of the acquisition agreement by the Public Utility Board and City Council, Tacoma Water will begin the process of replacing the existing Andrain water system and provide direct retail service to customers within the Andrain service area. Replacement of the water system will be paid for through a customer surcharge upon those customers located within the Andrain service area.

Main Replacement Program

Progress continued in the area of distribution main replacements targeting mains with a history of breaks and substandard performance. A little less than 4 miles of distribution main were replaced in 2014. A considerable effort was invested in building an economic model for the distribution main strategic asset management plan. As refinements are made to that model over the next few years, mains targeted for rehabilitation or replacement will be an output of the model. The 2014 main projects were distributed throughout our service area, both within and outside the City of Tacoma.

Customer Service

In an effort to continuously improve service to our customers; many Water Distribution Engineering staff attended comprehensive customer service training offered through the American Water Works Association. Additionally, analysis of the consolidation of customer service functions for all Tacoma Public Utilities divisions led to a recommendation that development and permitting services all be located in a central location on the main floor of the

Utilities' Building. Design of the main floor lobby to support all TPU customer service functions was completed in 2014. Additionally, looking for opportunities to expedite permitting, online options have been developed by Distribution Engineering staff and have been rolled out in coordination with new software installed by the City for their development services. Finally, improvements to Tacoma Public Utilities' website include customer request forms for Tacoma Water services. Customer Relationship Management software was installed and is currently used to track all contacts with our key accounts.

Distribution Engineering staff worked with Metro Parks staff to design and construct a new main in Point Defiance Park to provide improved fire flow to Fort Nisqually. With the passage of a Capital Improvement Bond in 2014, Metro Parks is in the process of developing a master plan for Point Defiance Park. Tacoma Water is actively engaged in the determination of the best means of providing utility service to the Park.

DISTRIBUTION OPERATIONS

Construction

New service installations, increased to 943 in 2014 and the average number of new meter installs increased by 50% over 2013.

Water Service Supervisors continued to identify improvements to the planning and scheduling of construction work. By use of an electronic shared calendar, unscheduled and scheduled absences along with training are more able to be considered when scheduling jobs. A two-week job/project forecast is tracked in the same calendar which helps facilitate matching staffing levels to scheduled work. Real time afternoon updates provide the ability to modify planned work with additional personnel or equipment needs to be prepared for the next day. At 7:30 the next morning, last minute, emergency crew staffing/equipment adjustments can also be made to the planned work. The Mobile Dispatch screen is monitored for workload to determine if one or two man crew vacancies need to be backfilled. Once the planned work is reviewed and finalized, the magnetic staffing board is updated and displayed in the hallway.

Operations

In 2014, we had 54 main breaks, with an average response time of 29 minutes. Over half of the breaks occurred during cold, dry weather in November and December. Even with the increased main failures and significant number of frozen meters/pipes, our response to each event was quick and we received good feedback from customers.

In October of 2014, our crews did an outstanding job responding to a significant main break which required turning off service to our largest customer (Rock Tenn). The break occurred in the evening and caused flooding putting the intersection under several feet of water. Our first responders did an exceptional job of controlling the leak and securing the intersection.

Maintenance

Systematic flushing

In 2014, our unidirectional flush crews cleaned 201 miles of distribution mains, about a fifth of the system and in addition 2,282 dead end mains were flushed. We have a number of plots with a limited number of homes built in the projects and as a result we spent 80 days flushing in these areas to maintain good water quality.

Fire Hydrant Maintenance

All fire hydrants receive comprehensive maintenance every other year. Efficient routing, improved record keeping, replacement of old scissor style hydrants and a mature hydrant maintenance program has resulted in a high degree of hydrant reliability and low incidence of issues. In 2014, 3,079 hydrants were inspected and maintained.

Meters

In 2014, we started a pilot project to select a replacement for our antiquated analog phone read AMR system. We installed new cell phone based registers on eight meters in our water distribution system with good results. As a result, we are preparing to install forty six more on key meters using the Sensus PhoneRead system. The new system uses cellular technology to collect meter reading data in five minute increments and the data is stored on a cloud server for our use. Our Rates and Finance group is working to identify additional locations where we would benefit from the data these units will provide.

Fleet Improvements

To ensure the best possible service from Fleet Operations a service level agreement document was completed through collaboration (with the departure of the fleet manager this document was not signed). The document will be used as a tool to improve communications and expectations.

Linda McCrea
Water Superintendent



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

APPENDIX D

SUMMARY OF REGIONAL WATER SUPPLY SYSTEM BOND ORDINANCES

Following is a summary of certain of the provisions of Ordinance No. 28137 providing for the issuance of the 2013 Regional Water Supply System Bonds (the “2013 Regional System Bond Ordinance”), which summary is qualified in its entirety by reference to the complete text of the 2013 Regional System Bond Ordinance on file with the City Clerk of the City. The terms and provisions of Ordinance No. 27903 providing for the issuance of 2010 Regional Water Supply System Bonds (the “2010 Regional System Bond Ordinance” and the together with the 2013 Regional System Bond Ordinance, the “Regional Water Supply System Bond Ordinances”), a copy of which is also on file with the City Clerk of the City, are materially the same as those of the 2013 Regional System Bond Ordinance.

DEFINITIONS

“Accreted Value” means, with respect to any Capital Appreciation Bond, as of the time of calculation, the sum of the amount representing the initial principal amount of such bond plus interest accrued, compounded thereon as of the most recent compounding date. With respect to any particular Payment Date, the Accreted Value is the amount set forth on the Accreted Value Table included as part of the form of Capital Appreciation Bond. In the event the Accreted Value of any Capital Appreciation Bond is required to be determined as of a date other than the Payment Date, the Accreted Value shall be determined by adding to the Accreted Value for the next preceding Payment Date the product obtained by multiplying (a) the difference between the Accreted Value for the next Payment Date and the Accreted Value for the next preceding Payment Date, by (b) the ratio obtained by dividing by 180 the number of days elapsed since the next preceding Payment Date (calculated on the basis of a 360-day year of 12, 30-day months).

“Accreted Value Table” means the Accreted Value Table printed on the Capital Appreciation Bonds reflecting the Accreted Value of such Bonds as of any Payment Date.

“Annual Debt Service” means the amount required to be paid in a calendar year for (1) interest due in such calendar year on all outstanding Parity Bonds (excluding the accrued interest paid to the City upon issuance of Parity Bonds), (2) principal of all outstanding Serial Bonds due in such calendar year, and (3) any Mandatory Amortization Installment for such calendar year. If on such date of calculation the interest rate on any Variable Interest Rate Bonds shall then be fixed for a specified period, including pursuant to a Payment Agreement, the interest rate used for such specified period for the purpose of the foregoing calculation shall be such actual interest rate. For purposes of computing Annual Debt Service on any Parity Bonds which constitute Balloon Indebtedness, it shall be assumed that the principal of such Balloon Indebtedness, together with interest thereon at the rate applicable to such Balloon Indebtedness, shall be amortized in equal annual installments over a term equal to the lesser of (1) 25 years or (2) the average weighted useful life (expressed in years and rounded to the next highest integer) of the properties and assets constituting the project (if any) financed out of the proceeds of such Balloon Indebtedness. The interest on Parity Bonds designated as Build America Bonds or similar bonds, including the 2010B RWSS Bonds, for purposes of calculating the Annual Debt Service for purposes of the Reserve Requirement, shall be based on the net interest after the 35% federal direct payment or such other federal direct payment to be received for the 2010B RWSS Bonds and Future Parity Bonds.

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

“Balloon Indebtedness” means any series of Parity Bonds more than 25% of the principal of which, in accordance with the terms of such Parity Bonds, is due and payable in any one Fiscal Year either by reason of the stated maturity date of such Parity Bonds or pursuant to a sinking fund installment; provided that with respect to any Parity Bonds issued as Term Bonds, such Bonds shall only be treated as Balloon Indebtedness if more than 25% of the principal thereof is due in any one Fiscal Year pursuant to the applicable sinking fund requirement or upon the stated maturity date thereof (assuming that the only principal due on the stated maturity date thereof will be the principal remaining outstanding after all redemptions have been made pursuant to the applicable sinking fund requirement).

“Bond Counsel” means a firm of lawyers nationally recognized and accepted as bond counsel and so employed by the City for any purpose under the 2013 Regional System Bond Ordinance applicable to the use of that term.

“Bond Fund” means the City of Tacoma Regional Water Supply System Bond Fund, including any subfunds within such fund.

“Bond Obligation” means, as of any given date of calculation, the sum of (1) the aggregate principal amount of all outstanding Current Interest Bonds and (2) the aggregate Accreted Value of all outstanding Capital Appreciation Bonds calculated as of the date of calculation if that date is a Payment Date or as of the next preceding Payment Date if the date of calculation is not a Payment Date.

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

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

“Capital Appreciation Bonds” means Parity Bonds, the interest on which accrues and compounds, payable at maturity or earlier redemption.

“Certified Public Accountant” means an independent licensed certified public accountant (or firm of certified public accountants) selected by the City.

“City” means the City of Tacoma, Washington.

“City Clerk” means the City Clerk of the City, or any other officer who succeeds to substantially all of the responsibilities of that office specified in the 2013 Regional System Bond Ordinance.

“Code” means the Internal Revenue Code of 1986, as amended, together with corresponding and applicable final, temporary, or proposed regulations and revenue rulings issued or amended with respect thereto by the United States Treasury Department or the Internal Revenue Service, to the extent applicable to the 2015 RWSS Bonds.

“Construction Account” means the Tacoma Second Supply Project Construction Account established by the Finance Director of the City in accordance with Substitute Ordinance No. 27001.

“Council” means the City Council of the City, as the same shall be duly and regularly constituted from time to time.

“Current Interest Bonds” means Parity Bonds, the interest on which is paid periodically.

“CWD” means Covington Water District.

“Debt Service Account” means the Debt Service Account in the Bond Fund. “Department” means the Department of Public Utilities.

“Engineer” means an independent licensed professional engineer (or firm of licensed professional engineers) selected by the City and experienced and skilled in the operation of water systems of comparable size and character to the Regional System.

“Filtration Treatment Project” means the design and construction of the portion of the filtration treatment system financed by the Regional System.

“Finance Director” means the Director of the Department of Finance of the City, or any other officer who succeeds to substantially all of the responsibilities of that office specified in the 2013 Regional System Bond Ordinance.

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

“Fiscal Year” means the fiscal year used by the City at any time. At the time of the adoption of the 2013 Regional System Bond Ordinance, the Fiscal Year is the 12-month period beginning January 1 of each year.

“Future Parity Bonds” means any revenue bonds or any other revenue obligations of the City issued in accordance with the 2013 Regional System Bond Ordinance after the date of issuance of the 2013 RWSS Bonds, that are secured by a lien and charge as described in the 2013 Regional System Bond Ordinance equal to the lien and charge securing the payment of the principal of and interest on the 2013 RWSS Bonds and the Outstanding Parity Bonds.

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

“Issue Date” means, with respect to any Series of Bonds, the date of initial issuance and delivery of such Series to the purchaser in exchange for the purchase price of such Series.

“Kent” means the City of Kent.

“Lakehaven” means Lakehaven Utility District.

“Mandatory Amortization Installment” means, for any Fiscal Year, the principal amount of Term Bonds required to be purchased, redeemed, or paid in such year as established by the ordinance or resolution of the City authorizing the issuance of such Term Bonds.

“Maximum Interest Rate” means, with respect to any particular Variable Interest Rate Bond, a numerical rate of interest, which shall be set forth in any ordinance authorizing such Bond that shall be the maximum rate of interest such Bond may at any time bear.

“Moody’s” means Moody’s Investors Service, Inc., or its comparable recognized business successor.

“Net Revenues” means, for any period, the excess of Revenues over Operating Expenses for such period, excluding from the computation of Revenues any profit or loss derived from the sale or other disposition, not in the ordinary course of business, of properties, rights, or facilities of the Regional System or gains or losses resulting from the early extinguishment of debt or the requirements to mark assets or liabilities to market.

“Operating Expenses” means all expenses incurred by the City in causing the Regional System to be operated and maintained in good repair, working order and condition, including, without limitation: deposits, premiums, assessments or other payments for insurance, if any, on the Regional System; payments into pension funds; State-imposed taxes; payments made to any other person or entity for the receipt of water supply or transmission or other right, commodity or service; payments made to any other person or entity that are required in connection with the operation of the Regional System or the acquisition or transmission of water and that are not subordinate to the lien of the Parity Bonds; and payments with respect to any other expenses of the Regional System that are properly treated as operation and maintenance expenses under generally accepted accounting principles

applicable to municipal corporations. Operating Expenses do not include any depreciation or taxes levied or imposed by the City, Payment Agreement payments, or payments to the City in lieu of taxes, any Rebate Amount, or capital additions or capital replacements to the Regional System.

“Outstanding Parity Bonds” means the 2002 RWSS Bonds and the 2010 RWSS Bonds.

“Parity Bonds” means the Outstanding Parity Bonds and the 2013 RWSS Bonds and any Future Parity Bonds.

“Participants” mean the City, Kent, CWD and Lakehaven.

“Participants’ Payments” means all payments received from the Participants under the Project Agreement.

“Participants’ Systems” or “Participant’s System” means the City’s Water System, Kent’s water system, CWD’s water system, and Lakehaven’s water and sewer system.

“Payment Date” means the dates on which principal and/or interest on the Parity Bonds is due and payable.

“Permitted Investments” means investments that are now or may hereafter be permitted to the City by the laws of the State.

“Project Agreement” means the Agreement for the Regional System among the Participants and the Repayment Agreement among the Participants, as it may be amended.

“Qualified Insurance” means any municipal bond insurance policy or surety bond issued by any insurance company licensed to conduct an insurance business in any state of the United States (or by a service corporation acting on behalf of one or more such insurance companies), which insurance company or companies, as of the time of issuance of such policy or surety bond, are currently rated in one of the two highest rating categories by two Rating Agencies.

“Qualified Letter of Credit” means any letter of credit issued by a financial institution for the account of the City on behalf of the owners of the Parity Bonds, which institution maintains an office, agency, or branch in the United States and as of the time of issuance of such letter of credit is currently rated in one of the two highest rating categories by two Rating Agencies.

“Rating Agencies” means Moody’s, S&P, or another nationally recognized rating agency rating municipal bonds.

“Rebate Amount” means the amount, if any, determined to be payable with respect to the 2013 RWSS Bonds by the City to the United States of America in accordance with Section 148(f) of the Code.

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

“Regional System” means the Regional Water Supply System, comprised of certain property and facilities to obtain and receive deliveries of water for the Participants from the exercise by Tacoma of the Second Diversion Water Right from the Green River and granted by the State of Washington Department of Ecology, which property and facilities include (i) a Main Branch pipeline to Tacoma with a 72 MGD nominal capacity; (ii) Headworks

improvements associated with the Second Diversion Water Right; (iii) related fisheries and environmental enhancements; (iv) improvements and additions to the Howard Hanson Dam to raise the summer storage pool to elevation 1,167 in phase I to provide an additional 20,000 acre feet of water storage, together with improvements and additions related to accommodating fish passage; (v) the Filtration Treatment Project; and (vi) additional related water treatment facilities; and as the same will be added to, improved, and extended for as long as any of the Parity Bonds are outstanding. The Regional System shall not include the Water System or any other separate system.

“Reserve Account” means the Reserve Account in the Bond Fund, or such separate reserve account that may be created for any Future Parity Bonds.

“Reserve Account Requirement” means an amount equal to Average Annual Debt Service on the outstanding 2013 RWSS Bonds, but in no case shall the amount in the Reserve Account allocable to the 2013 RWSS Bonds exceed 10% of the proceeds of such 2013 RWSS Bonds. The Reserve Account Requirement with respect to Future Parity Bonds will be either (1) an amount equal to Average Annual Debt Service on such issuance of Future Parity Bonds, but in no case shall the amount in the Reserve Account allocable to such issuance of Future Parity Bonds exceed 10% of the proceeds of such bonds, or (2) the ordinance authorizing such issuance of Future Parity Bonds may provide for the creation of a separate reserve account, in which case the Reserve Account Requirement, if any, for such issuance of Future Parity Bonds may be set in such ordinance and the Reserve Account created by Ordinance No. 27001 shall not secure such series of Future Parity Bonds. In the case of Variable Interest Rate Bonds, for the purpose of calculating Annual Debt Service, the interest rate thereon shall be calculated on the assumption that such bonds will bear interest during such period at a rate equal to the rate most recently reported by *The Bond Buyer* as the Bond Buyer Index for long-term revenue bonds as of the date the Parity Bonds are sold; provided, that if on such date of calculation the interest rate on such bonds shall then be fixed for a specified period, the interest rate used for such specified period for the purpose of the foregoing calculation shall be such actual interest rate.

“Revenue Fund” means the Regional Water Supply System Fund.

“Revenues” means the income, revenues, receipts and loan proceeds derived by the City through the ownership and operation of the Regional System, including Participants’ Payments, but, except as provided in the 2013 Regional System Bond Ordinance, shall not include any income derived by the City through the ownership and operation of the Water System or any other separate utility system of the City.

“Rule 15c2-12” means the Securities and Exchange Commission’s Rule 15c2-12 under the Securities Exchange Act of 1934, as amended, and as the same may be amended from time to time.

“S&P” means Standard & Poor’s Ratings Services, or its comparable recognized business successor.

“Serial Bonds” means Parity Bonds other than Term bonds.

“Series of Bonds” or “Series” means a series of Bonds issued pursuant to the 2013 Regional System Bond Ordinance.

“State” means the State of Washington.

“Tax Certificate” means the certificate executed by the Finance Director of the City pertaining to the calculation and payment of any Rebate Amount with respect to the 2013 RWSS Bonds.

“Term Bonds” means Bonds designated as such and those Parity Bonds designated as such in the applicable ordinance authorizing such Parity Bonds.

“2002 RWSS Bonds” means the City’s Regional Water Supply System Revenue Bonds, 2002, issued in the original principal amount of \$82,700,000 pursuant to Substitute Ordinance No. 27001, passed on November 5, 2002.

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

“2010A RWSS Bonds” means the City’s Regional Water Supply System Revenue Bonds, 2010A, issued in the original principal amount of \$3,595,000 pursuant to Ordinance No. 27903, passed on July 20, 2010.

“2010B RWSS Bonds” means the City’s Regional Water Supply System Revenue Bonds, 2010B (Taxable Build America Bonds – Direct Payment), issued in the original principal amount of \$44,245,000 pursuant to Ordinance No. 27903, passed on July 20, 2010.

“2013 RWSS Bonds” means the “City of Tacoma, Washington, Regional Water Supply System Revenue Refunding Bonds, 2013” issued in the original principal amount of \$64,795,000 pursuant to Ordinance No. 28137, passed on March 19, 2013.

“Variable Interest Rate” means a variable interest rate or rates to be borne by a Series of Parity Bonds or any one or more maturities within a series of Parity Bonds. The method of computing such variable interest rate shall be specified in the bond ordinance authorizing such series of Parity Bonds. Such variable interest rate shall be subject to a Maximum Interest Rate and there may be an initial rate specified, in each case as provided in such bond ordinance, or a stated interest rate that may be changed from time to time as provided in the bond ordinance authorizing such Bonds. Such bond ordinance shall also specify either (i) the particular period or periods of time or manner of determining such period or periods of time for which each value of such variable interest rate shall remain in effect or (ii) the time or times upon which any change in such variable interest rate shall become effective.

“Variable Interest Rate Bonds” for any period of time means Parity Bonds that during such period bear a Variable Interest Rate, provided that Parity Bonds the interest rate on which shall have been fixed for the remainder of the term thereof shall no longer be Variable Interest Rate Bonds.

“Water Bond Authorizing Ordinances” means Ordinances Nos. 27109, 27405, 27837, 27902, and the ordinance authorizing the Water System Revenue and Refunding Bonds, 2013, of the City.

“Water System” means the water system of the City as it now exists, and all additions thereto and betterments and extensions thereof at any time made, but shall not include the Regional System or any future separate water system created by the City.

“Water System Bonds” means the City’s (i) \$51,380,000 original principal amount of Water System Revenue and Refunding Bonds, 2003; (ii) \$46,550,000 original principal amount of Water System Revenue and Refunding Bonds, 2005; (iii) \$76,755,000 original principal amount of Water System Revenue Bonds, 2009; (iv) \$29,100,000 original principal amount of Water System Revenue Refunding Bonds, 2010A; (v) \$74,985,000 original principal amount of Water System Revenue Bonds, 2010B (Taxable Build America Bonds – Direct Payment); (vi) the Water System Revenue and Refunding Bonds, 2013, issued on or around the date of the 2013 RWSS Bonds; and (vii) any obligations thereafter issued on a parity with such Water System Bonds.

FUNDS AND ACCOUNTS

Revenue Fund. The City has covenanted in the 2013 Regional System Bond Ordinance that it will pay, or cause to be paid, into the Revenue Fund all of the Revenues and all other money required to be paid into the Revenue Fund pursuant to the 2013 Regional System Bond Ordinance.

The City has covenanted that it shall pay into the Revenue Fund in each month, as an operating expense of the Water System, from Gross Revenues of the Water System, an amount which, together with other Participants’ Payments and other Revenues available for such purpose, is equal to the Regional Supply System Costs which are then unpaid, together with the estimated Regional Supply System Costs for the next succeeding month.

In each month, the City shall apply amounts in the Revenue Fund first, to the payment of Operating Expenses for such month, and second, to the deposit in the Bond Fund of the amounts required pursuant to the 2013 Regional System Bond Ordinance and, in the event the City has entered into any Parity Payment Agreement on a parity of lien with the Parity Bonds, to make any regularly scheduled City Payments adjusted by any regularly scheduled Receipt (provided, however, that termination payments with respect to any Parity Payment Agreement

shall not rank on a parity of lien with the Parity Bonds); and, in the event the City has entered into a reimbursement agreement authorized by the 2013 Regional System Bond Ordinance, to make all payments required to be made on a parity of lien with the Parity Bonds pursuant to such reimbursement agreement in connection with a Qualified Letter of Credit, Qualified Insurance, or other credit facility, provided that if there is not sufficient money to make all payments under more than one such reimbursement agreement, the payments shall be made on a pro rata basis. After such required payments are made, amounts in the Revenue Fund may be used to pay junior lien obligations of the Regional System, to finance capital improvements or for any other lawful purpose of the Regional System.

Bond Fund.

The Bond Fund has been created under the 2013 Regional System Bond Ordinance and divided into two accounts: the Debt Service Account and the Reserve Account. At the option of the City, separate accounts may be created in the Bond Fund for the purpose of paying or securing the payment of principal, premium, if any, and interest on any series of Parity Bonds. So long as any Parity Bonds are outstanding, the Bond Fund shall be used solely and Revenues are appropriated for the purposes of paying the principal of premium, if any, and interest on Parity Bonds and retiring Parity Bonds prior to maturity in the manner provided in the 2013 Regional System Bond Ordinance or in any ordinance authorizing Parity Bonds.

The City will be required to set aside and pay into the Bond Fund out of the Revenue Fund certain fixed amounts sufficient (together with other available funds on hand and paid into the Bond Fund) to pay the principal of, premium, if any, and interest on the 2002 RWSS Bonds, the 2010 RWSS Bonds, the 2013 RWSS Bonds, and all other Parity Bonds from time to time outstanding pursuant to the 2013 Regional System Bond Ordinance and all other ordinances authorizing Parity Bonds as the same respectively become due and payable, either at the maturity thereof or in accordance with the terms of any Mandatory Amortization Installment schedule established for the retirement of Term Bonds. The fixed amounts to be paid into the Bond Fund, to the extent that such payments are not made from bond proceeds or from other money that may legally be available therefor, shall be made out of the Revenue Fund into the Bond Fund in the following order of priority: first, to pay interest; second, to pay principal and Mandatory Amortization Installments; and third, into the Reserve Account.

(a) **Interest.** In the case of all Parity Bonds, no later than the day prior to the date on which an installment of interest falls due on any Parity Bonds, there shall be on deposit in the Debt Service Account in the Bond Fund an amount equal to the installment of interest then falling due on all outstanding Parity Bonds.

(b) **Principal.** No later than the day prior to the date upon which an installment of principal on Parity Bonds that are Serial Bonds falls due, there shall be on deposit in the Debt Service Account in the Bond Fund an amount equal to the installment of principal then falling due on all outstanding Parity Bonds that are Serial Bonds.

(c) **Term Bonds.** No later than the day prior to the date upon which a Mandatory Amortization Installment falls due, there shall be on deposit in the Debt Service Account an amount equal to the Mandatory Amortization Installment for such date. The City shall apply all such money to the redemption or purchase of Term Bonds on the next ensuing Mandatory Amortization Installment due date (or may so apply such money prior to such Mandatory Amortization Installment due date), pursuant to the terms of the 2013 Regional System Bond Ordinance or of the ordinance authorizing the issuance thereof. If the principal amount of Term Bonds retired by purchase or redemption exceeds the cumulative amount required to be redeemed by Mandatory Amortization Installment, then such excess may be credited against Mandatory Amortization Installments in the manner determined by the City at the time of such purchase or redemption. Any such purchase of Term Bonds by the City may be made with or without tenders of such bonds in such manner as the City shall, in its discretion, deem to be in its best interest.

(d) **Reserve Account.**

(i) The City has covenanted in the 2013 Regional System Bond Ordinance that, if necessary, on the Issue Date it will pay into the Reserve Account out of proceeds of the 2013 RWSS Bonds and other funds lawfully available therefor and/or acquire Qualified Insurance or a Qualified Letter of Credit so that the amount in the Reserve Account at least equals the Reserve Account Requirement for the 2013 RWSS Bonds and the

Outstanding Parity Bonds. The City may, at any time, substitute Qualified Insurance or a Qualified Letter of Credit for the money and investments in the Reserve Account or may substitute money and investments for Qualified Insurance or a Qualified Letter of Credit in accordance with the 2013 Regional System Bond Ordinance. The face amount of such Qualified Insurance or Qualified Letter of Credit shall be at least equal to the amount of the money or investments for which the Qualified Insurance or Qualified Letter of Credit is substituted.

(ii) Valuation of the amount in the Reserve Account and all subaccounts therein shall be made by the City on each December 31 and may be made on any other date. Such valuation shall be at the market value of the obligations in such account and such subaccounts (including accrued interest); provided, that investments which mature within one year shall be valued at their maturity value.

(iii) In the event of the issuance of any Future Parity Bonds, the ordinance authorizing the issuance of such Future Parity Bonds shall provide for further and additional approximately equal monthly payments into the Reserve Account from the money in the Revenue Fund, in such amounts and at such times so that by no later than five years from the date of issuance of such Future Parity Bonds or by the final maturity established for such series of Future Parity Bonds, whichever occurs first, there will be credited to the Reserve Account an amount equal to the Reserve Account Requirement, if any. Notwithstanding the foregoing provisions described in this clause, the proceedings authorizing the issuance of Future Parity Bonds, to the extent permitted under the Code, may provide for payments into the Reserve Account from the proceeds of such Future Parity Bonds or from any other money lawfully available therefor, or may provide for the City to obtain Qualified Insurance or a Qualified Letter of Credit for amounts required by clause (v) below or similar provisions in other ordinances authorizing Parity Bonds to be paid out of the Reserve Account. The face amount of any such Qualified Insurance or Qualified Letter of Credit shall be credited against the amounts required to be maintained in the Reserve Account as described under the subheading or similar provisions in other ordinances authorizing Parity Bonds to the extent that such payments and credits to be made are insured by an insurance company, or guaranteed by a letter of credit from a financial institution. Such Qualified Letter of Credit or Qualified Insurance shall not be cancelable on less than five years' notice.

On receipt of a notice of cancellation of any Qualified Letter of Credit or Qualified Insurance or upon notice that the entity providing the Qualified Letter of Credit or Qualified Insurance no longer meets the requirements described in 2013 Regional System Bond Ordinance, the City shall substitute a Qualified Letter of Credit or Qualified Insurance in the amount required to make up the deficiency created in the Reserve Account or in the alternative shall create a special account in the Revenue Fund and deposit therein, on or before the 25th day of each of the 36 succeeding calendar months (commencing with the 25th day of the calendar month next following the date of the notice) one thirty-sixth of the amount sufficient, together with other money and investments on deposit in the Reserve Account, to equal the Reserve Account Requirement in effect as of the date the cancellation or disqualification of the entity becomes effective. Those amounts shall be deposited in the special account from money in the Revenue Fund after making provision for payment of Operating Expenses and for required payments into the Bond Fund. Amounts on deposit in that special account shall not be available to pay debt service on Parity Bonds or for any other purpose of the City, and shall be transferred to the Reserve Account on the effective date of any cancellation of a Qualified Letter of Credit or Qualified Insurance to make up all or part of the deficiency caused thereby. Amounts in that special account or in the Reserve Account may be transferred to the Revenue Fund and used for any purpose if and when a qualifying Qualified Letter of Credit or Qualified Insurance is obtained.

(iv) If at any time the money and value of Permitted Investments in the Reserve Account exceeds the amount of money and value of Permitted Investments then required to be maintained therein, such excess may be transferred to the Revenue Fund.

(v) In the event that there shall be a deficiency in the Debt Service Account, the City shall promptly make up such deficiency from available funds in the Reserve Account by the withdrawal of cash therefrom for that purpose and by the sale or redemption of obligations held in the Reserve Account, if necessary, in such amounts as will provide cash in the Reserve Account sufficient to make up any such deficiency, and if a deficiency still exists immediately prior to an interest payment date and after the withdrawal of cash, the City shall then draw from any Qualified Letter of Credit, Qualified Insurance, or other equivalent credit facility in sufficient amount to make up the deficiency. Such draw shall be made at such times and under such circumstances as the

agreement for such Qualified Letter of Credit or Qualified Insurance shall provide. The City has covenanted in the 2013 Regional System Bond Ordinance that any deficiency created in the Reserve Account by reason of any withdrawal therefrom for payment into the Debt Service Account shall be made up from money in the Revenue Fund first available after providing for the required payments into such Debt Service Account and after providing for payments under a reimbursement agreement entered into by the City under the 2013 Regional System Bond Ordinance.

(vi) When a series of Parity Bonds is refunded in whole or in part, money may be withdrawn from the Reserve Account to pay or provide for the payment of refunded Parity Bonds; provided that immediately after such withdrawal there remains in or be credited to the Reserve Account money, Qualified Insurance, Qualified Letter of Credit and Permitted Investments in an amount equal to the Reserve Account Requirement or so much thereof as is then required to be maintained.

Money in the Bond Fund is required to be transmitted to the Bond Registrar in amounts sufficient to meet the maturing installments of principal of, premium, if any, and interest on all Parity Bonds when due. All money remaining in the Bond Fund after provision for the payment in full of the principal of, premium, if any, and interest on all Parity Bonds is to be returned to the Revenue Fund. The Bond Fund is to be drawn upon solely for the purpose of paying the principal of, premium, if any, and interest on Parity Bonds. Money set aside from time to time with the Bond Registrar for such payment is required to be held in trust for the owners of Parity Bonds in respect of which the same is to have been so set aside. Until so set aside, all money in the Bond Fund are to be held in trust for the benefit of the owners of all Parity Bonds at the time outstanding equally and ratably.

Money in the Bond Fund may, at the option of the City, be invested and reinvested as permitted by law in Permitted Investments maturing, or which are redeemable at the option of the owner, prior to the date needed or prior to the maturity date of the final installment of principal of the Parity Bonds payable out of the Bond Fund. At the City's option, earnings on investments in the Bond Fund may be retained in the Bond Fund or transferred to the Revenue Fund, except that earnings on investments in the Reserve Account are required to be first applied to remedy any deficiency in such Account.

Money in each of the subaccounts described under this subheading may be used, if necessary, to pay Rebate Amounts to the extent that such Rebate Amounts are directly attributable to earnings on such subaccount.

SECURITY FOR PARITY BONDS

The Parity Bonds are special limited obligations of the City payable from and secured solely by Revenues, including the amount of Gross Revenues of the Water System and Participants' Payments required to be deposited in the Revenue Fund pursuant to the 2013 Regional System Bond Ordinance, subject to the prior payment of Operating Expenses, and other funds specifically pledged under the 2013 Regional System Bond Ordinance. The following are pledged as security for the payment of the principal, premium, if any, and interest on the Parity Bonds in accordance with their terms and the provisions of the 2013 Regional System Bond Ordinance, and any City Payments or reimbursement obligations as set forth in the 2013 Regional System Bond Ordinance: (1) the proceeds of the sale of the Parity Bonds to the extent held in the Bond Fund and any construction fund established for the Parity Bonds; (2) the Revenues, including such Gross Revenues of the Water System and Participants' Payments as provided in the 2013 Regional System Bond Ordinance; and (3) the money and investments, if any, credited to the Bond Fund and construction fund established for the Parity Bonds, and the income therefrom. The Revenues and other money and securities pledged by the 2013 Regional System Bond Ordinance shall immediately be subject to the lien of such pledge without any physical delivery or further act, and the lien of such pledge shall be valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the City.

All Parity Bonds hereafter outstanding shall be equally and ratably payable and secured without priority by reason of date of adoption of the ordinance providing for their issuance or by reason of their number or date of sale, issuance, execution or delivery, or by the liens, pledges, charges, trusts, assignments and covenants made herein or in any ordinance authorizing Future Parity Bonds, except as otherwise expressly provided or permitted in the 2013 Regional System Bond Ordinance and except as to insurance which may be obtained by the City to insure the repayment of one or more series or maturities within a series.

Parity Bonds shall not in any manner or to any extent constitute general obligations of the City or of the State, or any political subdivision of the State, or a charge upon any general fund or upon any money or other property of the City or of the State, or of any political subdivision of the State, not specifically pledged thereto by the 2013 Regional System Bond Ordinance.

DEFEASANCE

The City may issue refunding bonds pursuant to the laws of the State of Washington or use money available from any other lawful source to pay the principal of and interest on the 2013 RWSS Bonds, or such portion thereof included in a refunding or defeasance plan, as the same become due and payable and to redeem and retire, release, refund or defease all such then-outstanding 2013 RWSS Bonds (the “defeased 2013 RWSS Bonds”) and to pay the costs of such refunding or defeasance. In the event that money and/or “Government Obligations,” as such obligations are now or may hereafter be defined under RCW 39.53 or other applicable State law, maturing at such time or times and bearing interest to be earned thereon in amounts sufficient to redeem and retire the defeased 2013 RWSS Bonds or any of them in accordance with their terms are set aside in a special account to effect such redemption or retirement and such money and the principal of and interest on such obligations are irrevocably set aside and pledged for such purpose, then no further payments need be made into the Bond Fund for the payment of the principal of and interest on the defeased 2013 RWSS Bonds so provided for and such defeased 2013 RWSS Bonds shall cease to be entitled to any lien, benefit or security of the 2013 Regional System Bond Ordinance except the right to receive the funds so set aside and pledged, and such defeased 2013 RWSS Bonds shall be deemed not to be outstanding under the 2013 Regional System Bond Ordinance.

In the event that the refunding plan provides that the defeased 2013 RWSS Bonds or the refunding bonds to be issued be secured by money and/or Government Obligations pending the prior redemption of the defeased 2013 RWSS Bonds and if such refunding plan also provides that certain money and/or Government Obligations are pledged irrevocably for the prior redemption of the defeased 2013 RWSS Bonds included in that refunding plan, then only the debt service on the 2013 RWSS Bonds which are not defeased 2013 RWSS Bonds shall be included in the computation of the requirement for the issuance of Future Parity Bonds and for determining compliance with the rate covenants.

COVENANTS

The City has covenanted with the owner of each 2013 RWSS Bond at any time outstanding, as follows:

Operation and Maintenance. The City agreed to at all times maintain, preserve and keep the Regional System in good repair, working order and condition; will make all necessary and proper improvements, replacements and extensions thereof; and will at all times operate or cause to be operated the properties of the Regional System and the business in connection therewith in an efficient manner and at a reasonable cost.

Rate Covenants.

(a) The City agreed to establish, maintain and collect contract charges or other amounts for water and other goods and services sold or supplied through the facilities of the Regional System that will provide the City with Revenues sufficient for the payment of Regional Supply System Costs.

(b) The City agreed to establish, maintain, and collect rates and charges for water and other goods and services sold or supplied through the facilities of the Water System sufficient to pay the cost of operation and maintenance of the Water System and to provide Gross Revenues of the Water System sufficient, together with amounts on deposit in the Revenue Fund and available for such purpose (including Participants’ Payments), to pay all Regional Supply System Costs and all obligations against Gross Revenues of the Water System now or hereafter imposed by law or contract.

Project Agreement. The City agreed not amend certain sections of the Project Agreement in any manner that would materially impact the security for the Parity Bonds or increase or reduce a Participant’s obligations to pay its share of debt service on the Parity Bonds or any Future Parity Bonds, other than to allow for a new Participant or

an existing Participant (other than the City) to assign its interests in the Project Agreement if (i) the new Participant signs a Project Agreement substantially in the form of the Project Agreement, (ii) the new Participant's water system is rated at least in one of the three highest categories by one Rating Agency, (iii) the Participant's resolutions or ordinances authorizing outstanding water revenue bonds permit the Participant to pay all costs it owes under the Project Agreement as an operating and maintenance expense of its water system and any other utility that is combined with its water system, (iv) the tax-exempt status of any outstanding Parity Bonds issued as tax-exempt obligations or the entitlement of the City to receive federal direct payments from the United States Treasury with respect to any outstanding Parity Bonds issued as Build America Bonds will not be affected, and (v) to the extent that the new Participant's share of debt service on any Parity Bonds exceeds 10%, the new Participant shall execute a continuing disclosure undertaking that satisfies the requirements of Rule 15c2-12.

Sale, Transfer, or Disposition of the Regional System. The City may sell, transfer, or otherwise dispose of any of the works, plant, properties, facilities or other part of the Regional System or any real or personal property comprising a part of the Regional System only consistent with State law and the City Charter and one or more of the following:

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

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

(c) The City in its discretion may carry out such a transfer if the aggregate depreciated cost value of the facilities or property of the Regional System being transferred as described in this clause (c) in any Fiscal Year comprises no more than 5% of the total assets of the Regional System; or

(d) The City may sell, lease, mortgage or otherwise dispose of the Regional System, including all additions to and betterments and extensions thereof at any time made, that are used, useful or material in the operation of the Regional System, if provision is made for the replacement thereof or provision is made for the payment, redemption or other retirement of a principal amount of Parity Bonds equal to the greater of the following amounts:

(i) An amount that will be in the same proportion to the net Bond Obligation of Parity Bonds then outstanding (defined as the total Bond Obligation of such Parity Bonds outstanding less the amount of cash and investments in the Debt Service Account) that the revenues attributable to the part of the Regional System sold or disposed of for any 12 consecutive of the most recent 24 months bears to the total revenues for such period; or

(ii) An amount that will be in the same proportion to the net Bond Obligation of Parity Bonds then outstanding that the book value of the part of the Regional System sold or disposed of bears to the book value of the entire Regional System immediately prior to such sale or disposition.

Books and Accounts. The City has agreed to keep proper books, records and accounts with respect to the operations, income, and expenditures of the Regional System in accordance with generally accepted accounting practices relating to municipal utilities, and will cause those books, records, and accounts to be audited on an annual basis by the State Auditor or by a Certified Public Accountant selected by the City. It will prepare annual financial and operating statements after the close of each Fiscal Year of the Regional System showing in reasonable detail the financial condition of the Regional System.

Maintenance of Insurance. The City has agreed to keep the Regional System insured, and will carry such other insurance, with responsible insurers, with policies payable to the City, against risks, accidents or casualties, at least to the extent that insurance is deemed prudent and/or necessary by the other Participants; provided, however, that the City may, with the other Participants' approval, institute or continue a self-insurance program with respect

to any or all of the aforementioned risks. In the event of any loss or damage, the City will promptly deposit the insurance proceeds into the Construction Account or other capital account, or any construction fund hereafter created for the Regional System, and use such funds to repair or replace the damaged portion of the insured property and apply the proceeds of any insurance policy or self-insurance funding for that purpose; or in the event the City should determine not to repair or reconstruct such damaged portion of the properties of the Regional System, the proceeds of such insurance or self-insurance funding shall be transferred to the Reserve Account to the extent that such transfer shall be necessary to make up any deficiency in the Reserve Account and the balance, if any, shall, at the option of the City, be used for repairs, renewals, replacements, or additions to or extension of the Regional System or be used in the retirement of Parity Bonds prior to maturity, either by purchase at prices not to exceed the next applicable redemption price or by call for redemption.

PARITY DERIVATIVE PRODUCTS

For purposes of the provisions of the 2013 Regional System Bond Ordinance summarized in this section, the following words shall have the following definitions:

“Payment” means any payment (designated as such by an ordinance) required to be made by or on behalf of the City under a Payment Agreement and which is determined according to a formula set forth in the Payment Agreement.

“Parity Payment Agreement” means a Payment Agreement under which the City’s payment obligations are expressly stated to be secured by a pledge of and lien on Net Revenues on an equal and ratable basis with the Net Revenue required to be paid into the Bond Fund to pay and secure the payment of the principal of and interest on Parity Bonds.

“Payment Agreement” means a written agreement, for the purpose of managing or reducing the City’s exposure to fluctuations or levels of interest rates, currencies or commodities or for other interest rate, investment, asset or liability management purposes, entered into on either a current or forward basis by the City and a Qualified Counterparty, all as authorized by any applicable laws of the State. Such agreement may or may not be characterized by a structure of reciprocity of payment.

“Payment Date” means any date specified in the Payment Agreement on which a City Payment or Receipt is due and payable under the Payment Agreement.

“Receipt” means any payment (designated as such by an ordinance) to be made to, or for the benefit of, the City under a Payment Agreement by the Payor.

“Payor” means a Qualified Counterparty to a Payment Agreement that is obligated to make one or more payments thereunder.

“Qualified Counterparty” means a party (other than the City or a party related to the City) who is the other party to a Payment Agreement that has or whose obligations are unconditionally guaranteed by a party that has at least an investment grade rating from a Rating Agency or who is otherwise qualified to act as the other party to a Payment Agreement under any applicable laws of the State.

A Payment made under a Payment Agreement may be on a parity with the 2013 RWSS Bonds if the Payment Agreement satisfies the requirements for Future Parity Bonds described in the 2013 Regional System Bond Ordinance, taking into consideration regularly scheduled Payments and Receipts (if any) under the Payment Agreement. The following shall be conditions precedent to the use of any Payment Agreement on parity with the 2013 RWSS Bonds:

(a) The City obtains an opinion of Bond Counsel on the due authorization and execution of such Payment Agreement, the validity and enforceability thereof and opining that the action proposed to be taken is authorized or permitted by the 2013 Regional System Bond Ordinance or the applicable provisions of any supplemental ordinance and will not adversely affect the excludability for federal income tax purposes of the interest

on any outstanding Parity Bonds issued as tax-exempt obligations or the entitlement of the City to receive federal direct payments from the United States Treasury with respect to any outstanding Parity Bonds issued as Build America Bonds.

(b) Prior to entering into a Payment Agreement, the City adopts an ordinance, which:

(i) sets forth the manner in which the Payments and Receipts are to be calculated and a schedule of Payment Dates;

(ii) establishes general provisions for the rights of parties to Payment Agreements; and

(iii) sets forth such other matters as the City deems necessary or desirable in connection with the management of Payment Agreements as are not clearly inconsistent with the provisions of the 2013 Regional System Bond Ordinance. The Payment Agreement may oblige the City to pay, on one or more scheduled and specified Payment Dates, the Payments in exchange for the Payor's obligation to pay or to cause to be paid to the City, on scheduled and specified Payment Dates, the Receipts. The City may also enter into Payment Agreements that are not reciprocated by the other party to the agreement.

If the City enters into a Parity Payment Agreement, Payments shall be made from the Debt Service Account in the Bond Fund and Annual Debt Service are to include any regularly scheduled City Payments adjusted by any regularly scheduled Receipts during a Fiscal Year. Receipts are to be made directly into the Bond Fund. Obligations to make unscheduled payments, such as termination payments, may not be entered into on parity with the 2015 RWSS Bonds.

Nothing described under this heading will preclude the City from entering into Payment Agreements with a claim on Net Revenues junior to that of the 2013 RWSS Bonds. Furthermore, nothing described under this heading will preclude the City from entering into obligations on parity with the 2013 RWSS Bonds in connection with the use of Payment Agreements or similar instruments if the City obtains an opinion of Bond Counsel that the obligations of the City thereunder are consistent with the 2013 Regional System Bond Ordinance.

FUTURE PARITY BONDS

The City reserves the right in the 2013 Regional System Bond Ordinance to issue Future Parity Bonds from time to time as may be required for any lawful purpose of the City relating to the Regional System, including, but not limited to, acquiring, constructing and installing additions, betterments and improvements to and extensions of, acquiring necessary equipment for, or making necessary renewals, replacements or repairs and capital improvements to the Regional System and refunding any outstanding indebtedness.

The City has covenanted in the 2013 Regional System Bond Ordinance that Future Parity Bonds will be issued only upon compliance with the following conditions:

(a) The Project Agreement shall be in effect.

(b) At the times of the issuance of such Future Parity Bonds there is no deficiency in the Bond Fund or in any of the accounts therein. The ordinances authorizing the issuance of the Future Parity Bonds shall require that there shall be paid into the Reserve Account in the Bond Fund (i) from the proceeds of such Future Parity Bonds an amount such that the amount on deposit in the Reserve Account, allowing for any amount covenanted in an ordinance authorizing the issuance of outstanding Parity Bonds to be paid into such Account over five years, in equal monthly installments, as provided in the 2013 Regional System Bond Ordinance, is equal to the Reserve Account Requirement, if any, or (ii) from the Revenue Fund in not more than five years, in equal monthly installments, as provided in the 2013 Regional System Bond Ordinance such that the amount on deposit in the Reserve Account is equal to the Reserve Account Requirement. Upon the issuance of any series of Future Parity Bonds, the City is to recalculate the Reserve Account Requirement, which recalculated Reserve Account Requirement will become effective as of such date of recalculation.

(c) Without obtaining a certificate described in clauses (i) or (ii) below, Future Parity Bonds may be issued for refunding purposes as described in the 2013 Regional System Bond Ordinance. For all other Future Parity Bonds there is required to be on file with the City Clerk either:

(i) A certificate of the Finance Director (or equivalent official) of each Participant (including the City in the case of the Water System) that will be responsible for paying debt service on the Future Parity Bonds stating that “Revenues” or “Gross Revenues” (as defined in the Participant’s System bond ordinances or resolutions) in any 12 consecutive months out of the most recent 24 months preceding the delivery of the Future Parity Bonds then proposed to be issued, as determined from the financial statements of the Participant’s System, were sufficient to pay the operation and maintenance expenses of the Participant’s System and the Participant’s portion of the debt service on the Future Parity Bonds then proposed to be issued based on the highest debt service in the next three calendar years following the year interest is capitalized or the Project being financed is placed in service, whichever is later, and “Net Revenues” (as defined in the Participant’s System bond ordinance or resolution) for such 12-month period were sufficient to pay debt service on the Participant’s senior lien water revenue bonds and meet the Participant’s rate coverage required by such ordinance or resolution; or

(ii) For each Participant (including the City) that will be responsible for paying debt service on the Future Parity Bonds, a certificate of an Engineer or a Certified Public Accountant showing that the “Adjusted Revenues” (determined as described herein) for each calendar year during the life of the Future Parity Bonds proposed to be issued will be sufficient to pay the operation and maintenance expenses of the Participant’s System and the Participant’s portion of the debt service on outstanding Parity Bonds and on the Future Parity Bonds then proposed to be issued, based on the highest debt service in the three calendar years following the year interest is capitalized, or the Project being financed is placed in service, whichever is later, and “Adjusted Net Revenues” (determined as described herein) will be sufficient to pay debt service on the Participant’s senior lien water revenue bonds and meet the Participant’s rate coverage required by the ordinances or resolutions authorizing such senior lien bonds.

The “Adjusted Revenues” or “Adjusted Net Revenues,” as applicable, is to be the Participant’s System water revenue for a period of any 12 consecutive months out of the 24 months immediately preceding the date of delivery of such proposed Future Parity Bonds (the “Base Period”) as adjusted by such Engineer or Accountant to take into consideration changes in revenues estimated to occur under the following conditions for each year after such delivery for so long as any Parity Bonds, including the Future Parity Bonds proposed to be issued, shall be outstanding:

A. the additional revenues that would have been received if any change in rates and charges adopted prior to the date of such certificate and subsequent to the beginning of the Base Period and effective within 12 months of the certificate had been in force during the full Base Period;

B. the additional net revenues that would have been received if any facility of the Participant’s System that became fully operational after the beginning of the Base Period had been so operating for the entire Base Period;

C. the additional revenues to the Participant’s System estimated by such Engineer or Accountant to be received (1) as a result of any additions, betterments and improvements to and extensions of any facilities of the Participant’s System which are under construction at the time of such certificate or (2) as a result of improvements to the Regional System to be constructed or acquired from the proceeds of the Future Parity Bonds to be issued; and

D. the additional revenues that would have been received if any customers added to the Participant’s System during the Base Period or subsequent thereto had been customers for the entire Base Period. Such Accountant or Engineer may rely upon, and the Accountant’s or Engineer’s certificate shall have attached thereto, financial statements of the Participant’s System, certified by the Finance Director, or equivalent official of such Participant, showing income and expenses for the period upon which the same is based.

In the event that any Future Parity Bonds as described under this heading are issued for refunding purposes and the issuance of such refunding Future Parity Bonds results in a present value monetary saving to the City and

such refunding Future Parity Bonds will not require an increase of greater than \$5,000 in debt service payments to be paid in any Fiscal Year or calendar year thereafter than would have been required to be paid in the same Fiscal Year or calendar year for Annual Debt Service on the Parity Bonds being refunded, then the provisions described under subsection (c) above need not be complied with to permit such refunding Future Parity Bonds to be issued, although the provisions described under subsections (a) and (b) above must still be complied with.

In making any calculations required to be made by a Finance Director or the Engineer or Accountant under subsection (c) above, in the case of Variable Interest Rate Bonds, for purposes of calculating Annual Debt Service the interest rate thereon shall be calculated on the assumption that such bonds will bear interest at a rate equal to the rate most recently reported by *The Bond Buyer* as the Bond Buyer's Index for long-term revenue bonds; provided, that if on such date of calculation the interest rate on such bonds shall then be fixed to maturity, the interest rate used for such specified period for the purpose of the foregoing calculation shall be such actual interest rate.

REIMBURSEMENT OBLIGATIONS

In the event that the City elects to meet the requirements described under subsection (d) under the heading "FUNDS AND ACCOUNTS—Bond Fund" with respect to the Reserve Account as to any issue of Parity Bonds through the use of a Qualified Letter of Credit, Qualified Insurance or other equivalent credit enhancement device, the City may contract with the entity providing such Qualified Letter of Credit, Qualified Insurance or other equivalent credit enhancement device that the City's reimbursement obligation, if any, to such entity ranks on a parity of lien with the Parity Bonds.

In the event that the City elects additionally to secure any issue of Variable Interest Rate Bonds through the use of a letter of credit, insurance or other equivalent credit enhancement device, the City may contract with the entity providing such letter of credit, insurance or other equivalent credit enhancement device that the City's reimbursement obligation, if any, to such entity ranks on a parity of lien with the Parity Bonds; provided, that the payments due under such reimbursement agreement are such that if such reimbursement obligation were a series of Future Parity Bonds, such Future Parity Bonds could be issued in compliance with the provisions described above under the heading "FUTURE PARITY BONDS."

JUNIOR LIEN OBLIGATIONS

Nothing in the 2013 Regional System Bond Ordinance will prevent the City from issuing bonds, notes, warrants, or other obligations payable from and secured by a lien and charge junior to the lien and charge described under the heading "SECURITY FOR PARITY BONDS."

ADDITIONAL OR SUPPLEMENTAL ORDINANCES

The Council from time to time and at any time may pass an ordinance or ordinances supplemental to the 2013 Regional System Bond Ordinance, which ordinance or ordinances thereafter shall become a part of the 2013 Regional System Bond Ordinance, for any one or more or all of the following purposes:

(a) To add to the covenants and agreements of the City contained in the 2013 Regional System Bond Ordinance other covenants and agreements thereafter to be observed which will not adversely affect the interests of the owners of any Parity Bonds or to surrender any right or power reserved to or conferred upon the City; or

(b) To make such provisions for the purpose of curing any ambiguities or of curing, correcting or supplementing any defective provision contained in the 2013 Regional System Bond Ordinance or any ordinance authorizing Parity Bonds in regard to matters or questions arising under such ordinances as the Council may deem necessary or desirable and not inconsistent with such ordinances and which shall not adversely affect the interest of the owners of the Parity Bonds. Any such supplemental ordinance of the City may be passed without the consent of the owners of any Parity Bonds at any time outstanding, notwithstanding any of the provisions of described in the paragraph below, if the City obtains an opinion of Bond Counsel to the effect that such

supplemental ordinance is solely for one or more of the purposes stated above and will not adversely affect the interests of the owners of Parity Bonds.

With the consent of the owners of not less than 51% in aggregate Bond Obligations of the Parity Bonds at the time outstanding, the City may pass an ordinance or ordinances supplemental to the 2013 Regional System Bond Ordinance for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the 2013 Regional System Bond Ordinance or of any supplemental ordinance; provided, however, that no such supplemental ordinance shall: (i) extend the fixed maturity of any Parity Bonds, or reduce the rate of interest thereon, or extend the times of payment of interest thereon from their due dates, or reduce the amount of the principal thereof, or reduce any premium payable on the redemption thereof, without the consent of the owner of each Parity Bond so affected; or (ii) reduce the aforesaid percentage of bondowners required to approve any such supplemental ordinance, without the consent of the owners of all of the Parity Bonds then outstanding. It will not be necessary for the consent of bondowners described in this paragraph to approve the particular form of any proposed supplemental ordinance, but it will be sufficient if such consent approves the substance thereof.

Upon the passage of any supplemental ordinance pursuant to the provisions described under this heading, the 2013 Regional System Bond Ordinance are deemed to be modified and amended in accordance therewith, and the respective rights, duties and obligations of the City under the 2013 Regional System Bond Ordinance and of all owners of Parity Bonds outstanding under the 2013 Regional System Bond Ordinance shall thereafter be determined, exercised, and enforced thereunder, subject in all respects to such modification and amendments, and all the terms and conditions of any such supplemental ordinance shall be deemed to be part of the terms and conditions of the 2013 Regional System Bond Ordinance for any and all purposes. To the extent the Bonds are insured, the insurer may consent on behalf of owners of the Bonds to any amendment to the 2013 Regional System Bond Ordinance so long as the Insurer is not in default on its obligations to pay.

DEFAULTS AND REMEDIES

Events of Default. The following shall constitute “Events of Default” under the 2013 Regional System Bond Ordinance with respect to the Parity Bonds:

(a) If a default is made in the payment of the principal of or interest on any of the Parity Bonds when the same becomes due and payable; or

(b) If the City defaults in the observance and performance of any of the covenants, conditions and agreements on the part of the City set forth in the 2013 Regional System Bond Ordinance or any covenants, conditions, or agreements on the part of the City contained in any ordinance authorizing Parity Bonds and such default or defaults have continued for a period of six months after it has received from the Bondowners’ Trustee (as defined below) or from the registered owners of not less than 25% in principal amount of the Parity Bonds, a written notice specifying and demanding the cure of such default. However, if the default in the observance and performance of any other of the covenants, conditions, and agreements is one which cannot be completely remedied within the six months after written notice has been given, it shall not be an Event of Default with respect to the Parity Bonds as long as the City has taken active steps within the six months after written notice has been given to remedy the default and is diligently pursuing such remedy; or

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

Bondowners’ Trustee. So long as such Event of Default has not been remedied, a bondowners’ trustee (the “Bondowners’ Trustee”) may be appointed by the registered owners of 25% in principal amount of the Parity Bonds, by an instrument or concurrent instruments in writing signed and acknowledged by such registered owners of the Parity Bonds or by their attorneys-in-fact duly authorized and delivered to such Bondowners’ Trustee, notification thereof being given to the City. That appointment shall become effective immediately upon acceptance thereof by the Bondowners’ Trustee. Any Bondowners’ Trustee appointed under the provisions described under this subsection shall be a bank or trust company organized under the laws of the State of Washington or the State of New York or a national banking association. The bank or trust company acting as Bondowners’ Trustee may be removed at any time, and a successor Bondowners’ Trustee may be appointed, by the registered owners of a majority in

principal amount of the Parity Bonds, by an instrument or concurrent instruments in writing signed and acknowledged by such registered owners of the Parity Bonds or by their attorneys-in-fact duly authorized. The Bondowners' Trustee may require such security and indemnity as may be reasonable against the costs, expenses, and liabilities that may be incurred in the performance of its duties.

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

The Bondowners' Trustee appointed in the manner described in the 2013 Regional System Bond Ordinance, and each successor thereto, is declared to be a trustee for the registered owners of all the Parity Bonds and is empowered to exercise all the rights and powers conferred on the Bondowners' Trustee in the 2013 Regional System Bond Ordinance.

Suits at Law or in Equity. Upon the happening of an Event of Default and during the continuance thereof, the Bondowners' Trustee may, and upon the written request of the registered owners of not less than 25% in principal amount of the Parity Bonds outstanding shall, take such steps and institute such suits, actions, or other proceedings, all as it may deem appropriate for the protection and enforcement of the rights of the registered owners of the Parity Bonds, to collect any amounts due and owing to or from the City, or to obtain other appropriate relief, and may enforce the specific performance of any covenant, agreement, or condition contained in the 2013 Regional System Bond Ordinance or in any ordinance authorizing Parity Bonds.

Nothing contained in the 2013 Regional System Bond Ordinance, as described under this heading, shall, in any event or under any circumstance, be deemed to authorize the acceleration of maturity of principal on the Parity Bonds, and the remedy of acceleration is expressly denied to the registered owners of the Parity Bonds under any circumstances including, without limitation, upon the occurrence and continuance of an Event of Default.

Any action, suit, or other proceedings instituted by the Bondowners' Trustee under the 2013 Regional System Bond Ordinance shall be brought in its name as trustee for the owners of Parity Bonds and all such rights of action upon or under any of the Parity Bonds or the provisions of the 2013 Regional System Bond Ordinance may be enforced by the Bondowners' Trustee without the possession of any of those Parity Bonds and without the production of the same at any trial or proceedings relative thereto except where otherwise required by law. Any such suit, action, or proceeding instituted by the Bondowners' Trustee shall be brought for the ratable benefit of all of the registered owners of those Parity Bonds, subject to the provisions of the 2013 Regional System Bond Ordinance. The respective registered owners of the Parity Bonds, by taking and holding the same, shall be conclusively deemed irrevocably to appoint the Bondowners' Trustee the true and lawful trustee of the respective registered owners of those Parity Bonds, with authority to institute any such action, suit, or proceeding; to receive as trustee and deposit in trust any sums becoming distributable on account of those Parity Bonds; to execute any paper or documents for the receipt of money; and to do all acts with respect thereto that the registered owner himself or herself might have done in person. Nothing in the 2013 Regional System Bond Ordinance will be deemed to authorize or empower the Bondowners' Trustee to consent to accept or adopt, on behalf of any registered owner of the Parity Bonds, any plan of reorganization or adjustment affecting the Parity Bonds or any right of any registered owner thereof, or to authorize or empower the Bondowners' Trustee to vote the claims of the registered owners thereof in any receivership, insolvency, liquidation, bankruptcy, reorganization or other proceeding to which the City is a party.

Application of Money Collected by Bondowners' Trustee. Any money collected by the Bondowners' Trustee at any time pursuant to the provisions of the 2013 Regional System Bond Ordinance described under this heading shall be applied in the following order of priority:

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

Second, to the payment to the persons entitled thereto of all installments of interest then due on the Parity Bonds in the order of maturity of such installments and, if the amount available shall not be sufficient to pay

in full any installment or installments maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon to the persons entitled thereto, without any discrimination or preference; and

Third, to the payment to the persons entitled thereto of the unpaid principal amounts of any Parity Bonds which shall have become due (other than Parity Bonds previously called for redemption for the payment of which money is held pursuant to the provisions of the 2013 Regional System Bond Ordinance), whether at maturity or by proceedings for redemption or otherwise, in the order of their due dates and, if the amount available shall not be sufficient to pay in full the principal amounts due on the same date, then to the payment thereof ratably, according to the principal amounts due thereon to the persons entitled thereto, without any discrimination or preference.

Duties and Obligations of Bondowners' Trustee. The Bondowners' Trustee shall not be liable except for the performance of such duties as are specifically set forth in the 2013 Regional System Bond Ordinance. During an Event of Default, the Bondowners' Trustee shall exercise such of the rights and powers vested in it by the 2013 Regional System Bond Ordinance, and shall use the same degree of care and skill in its exercise, as a prudent person would exercise or use under the circumstances in the conduct of his or her own affairs. The Bondowners' Trustee shall have no liability for any act or omission to act under the 2013 Regional System Bond Ordinance except for the Bondowners' Trustee's own negligent action, its own negligent failure to act or its own willful misconduct. The duties and obligations of the Bondowners' Trustee shall be determined solely by the express provisions of the 2013 Regional System Bond Ordinance, and no implied powers, duties or obligations of the Bondowners' Trustee shall be read into the 2013 Regional System Bond Ordinance.

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

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

The Bondowners' Trustee may consult with counsel and the opinion of such counsel shall be full and complete authorization and protection in respect of any action taken or suffered by it under the 2013 Regional System Bond Ordinance in good faith and in accordance with the opinion of such counsel. The Bondowners' Trustee will not be answerable for any neglect or default of any person, firm or corporation employed and selected by it with reasonable care.

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

- (a) an Event of Default has happened and is continuing; and
- (b) a Bondowners' Trustee has been appointed; and
- (c) such owner previously shall have given to the Bondowners' Trustee written notice of the Event of Default on account of which such suit, action, or proceeding is to be instituted; and
- (d) the registered owners of 25% in principal amount of the Parity Bonds, after the occurrence of such Event of Default, have made written request of the Bondowners' Trustee and have afforded the Bondowners' Trustee a reasonable opportunity to institute such suit, action, or proceeding; and
- (e) there have been offered to the Bondowners' Trustee security and indemnity satisfactory to it against the costs, expenses, and liabilities to be incurred therein or thereby; and

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

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

Payment Solely From Net Revenue and Certain Funds. Nothing described under this heading will be deemed to require payment to owners of Parity Bonds from any source other than the Net Revenue and money and investments in the funds pledged under the 2013 Regional System Bond Ordinance.

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APPENDIX E

SUMMARY OF THE SECOND SUPPLY PROJECT AGREEMENT

Following is a summary of certain of the provisions of the Second Supply Project Agreement (as amended), which summary is qualified in its entirety by reference to the complete text of Second Supply Project Agreement (as amended) on file with the City Clerk of the City.

DEFINITIONS

“Additional Water” means water from any source, other than the First Diversion and Second Diversion Water, that is proposed by any Participant for introduction into the Project, and such introduction is approved by the Project Committee, pursuant to the provisions of the Second Supply Project Agreement described in “SECOND SUPPLY PROJECT AGREEMENT—*Project Committee*” and “—*Delivery of Additional Water*.”

“Annual Operating Plan” means the plan for the operation of the Project during any Operating Year that is prepared in accordance with the provisions of the Second Supply Project Agreement described in “SECOND SUPPLY PROJECT AGREEMENT—*Management of Project Water and Storage Use*.”

“Capital Expenditures” means expenditures of funds subsequent to Initial Project Construction, which are in excess of five hundred dollars (\$500.00), or such other amount as may be established by the Project Committee in accordance with the Second Supply Project Agreement, are made to enhance the value or extend the life of the Project, and are contained in the Capital Expenditures element of any Project Annual Budget. This definition is to be used after Initial Project Construction for the purpose of categorizing costs for preparing the Project Annual Budget. This definition has no application to the treatment of costs incurred during Initial Project Construction, or to costs incurred pursuant to agreements entered into prior to the Project being placed in operation, and does not in any way limit or require the Participants to utilize a similar definition in accounting for the costs of the Project on such Participant’s books of account.

“CWD” means the Covington Water District.

“Delivery Meter” means each of the meters which is located at or in the vicinity of the Points of Delivery of each of the Participants, and which measures the amount of Project Water delivered to each Participant from the Project.

“Due Date” means the date by which payment of any invoice issued pursuant to the provisions described in “SECOND SUPPLY PROJECT AGREEMENT—*Payment*” is due to Tacoma or to an established escrow agent, which date shall be the close of business on the thirtieth (30th) day after an invoice is issued pursuant to the Second Supply Project Agreement, provided, however, that if such thirtieth day falls on a Saturday, Sunday or legal holiday observed by Tacoma, the Due Date shall be extended until the close of business of the next regular business day of Tacoma.

“Effective Date” means December 19, 2002.

“Excess Project Capacity” means any capacity of the Project that is available during any Operating Year, or any portion thereof, as a result of one or more Participants not making full use of their Project Capacity Share.

“Financing Plan” means a plan for the funding of Project Costs which includes the issuance (or multiple issuances) of Project Bonds as approved by the Project Committee pursuant to the Second Supply Project Agreement, and shall generally be in the form attached to the Second Supply Project Agreement.

“First Diversion Water” means water obtained under Tacoma’s First Diversion Water Right Claim.

“Fixed O&M Costs” means the costs incurred by Tacoma to operate and maintain the Project in accordance with the Second Supply Project Agreement, which are neither Capital Expenditures nor Variable O&M Costs, and that do not vary based on the quantity of Project Water delivered to the Participants.

“Flow Control Valve” means the valve located in the vicinity of the Point(s) of Delivery for each Participant that controls the volume of Project Water that is delivered to each Participant. Flow Control Valves are not part of the Project

“Headworks” means those Tacoma water system facilities located along a certain one-half mile section of the Green River near Palmer, Washington, that generally include the river diversion structures and the water control building/employee residence area.

“Howard Hanson Dam Additional Storage Project” means, under Phase I, the construction of certain environmental enhancement features and raising the summer storage pool to elevation 1,167 which will make available additional storage for water for municipal water supply purposes, and under Phase II, the construction of additional environmental enhancement features and raising the summer storage pool to elevation 1,177, which will make available additional water for fishery and municipal water supply purposes.

“Initial Project Construction” means the design, construction and placing in commercial operation those Project elements set forth in the Initial Project Construction Budget and the Initial Project Construction Schedule.

“Initial Project Construction Budget” means the budget for Initial Project Construction.

“Initial Project Construction Schedule” means the schedule for Initial Project Construction.

“Interest Rate” means for each day that it is applied a rate equal to one-three hundred and sixty-fifth (1/365) of the prime interest rate for preferred customers established from time to time by the Bank of America, or such other bank as may be designated by the Project Committee pursuant to the Second Supply Project Agreement. When used to calculate the late payment charge pursuant to section 25, three (3) percentage points shall be added to such prime interest rate for each thirty (30) days that the payment of any invoice remains past due.

“Joint Delivery Meter” means a type of Delivery Meter that measures the amount of Project Water that will be shared between more than one Project Participant.

“Kent” means the City of Kent.

“Lakehaven” means the Lakehaven Utility District.

“Master Meter” means the meter located at or near the Headworks that measures the flow of Project Water into the Second Supply Pipeline through the Headworks.

“Operating Life” means the period of time during which the Project is operational and capable of fulfilling its delivery function in a reasonably efficient and economical manner. The provisions of the Second Supply Project Agreement described below in “SECOND SUPPLY PROJECT AGREEMENT—*Term of the Second Supply Project Agreement*” summarizes the expectations of the Participants regarding the Operating Life.

“Operating Year” means any consecutive twelve (12) month period commencing on each July 1st, and ending on the following June 30th.

“Participants” means (1) the City of Tacoma, Department of Public Utilities, Water Division, (2) the City of Kent, (3) the Covington Water District, and (4) the Lakehaven Utility District, the parties to the Second Supply Project Agreement.

“Participant Share” means that fraction of the Project and Project Costs that, as provided in the Second Supply Project Agreement, each Participant is entitled to use and each Participant is obligated to pay. Each Participant’s Share is as follows: Tacoma- 15/36; Kent- 7/36; CWD- 7/36; and Lakehaven- 7/36.

“Point of Delivery” means the point where facilities have been constructed that permit a Participant or Participants to divert and take delivery of Project Water from the Project, and which serve to interconnect the Project and the water supply system of such Participant or Participants.

“Project” shall have the meaning ascribed to such term in the provisions of the Second Supply Project Agreement summarized below under “THE SECOND SUPPLY PROJECT AGREEMENT—*The Project*.”

“Project Annual Budget” means the budget for all of the costs of the Project for each Operating Year, including without limitation the costs of operation, maintenance, insurance, renewal, replacement, additions and improvements to the Project, that are approved by the Project Committee pursuant to the provisions of the Second Supply Project Agreement summarized in “SECOND SUPPLY PROJECT AGREEMENT—*Project Committee*.”

“Project Bonds” means those bonds issued by Tacoma’s separate system in accordance with the Second Supply Project Agreement for the purpose of providing funds for the payment of certain Project Costs.

“Project Capacity Share” means the right of each Participant to use its Participant Share of the Project available under varying operating conditions to move Second Diversion Water from the Headworks to their respective Point(s) of Delivery, and for such other uses as set forth in the Second Supply Project Agreement.

“Project Committee” means the committee constituted pursuant to the provisions of the Second Supply Project Agreement.

“Project Costs” means costs, including but not limited to Fixed O&M Costs, Variable O&M Costs, Initial Project Construction Costs and Capital Expenditures, which Tacoma incurs to permit, design, construct, operate, maintain, insure, decommission, improve, renew, add to or replace Project pursuant to the terms of the Second Supply Project Agreement, and the costs incurred by Tacoma or any other Participant which qualify as Reimbursable Costs pursuant to the Second Supply Project Agreement.

“Project Cost Estimate” means the estimate of the costs of Initial Project Construction.

“Project Map” means the map of the Project set forth in the Second Supply Project Agreement.

“Project Meter” means a meter that measures the flow of Project Water and is needed for the operation of the Project, but is not a Master Meter or a Deliver Meter.

“Project Operator” means the Participant that is designated pursuant to the Second Supply Project Agreement to operate and maintain the Project, which Participant shall be Tacoma.

“Project Quality Assurance Procedures” means the quality assurance procedures followed during Initial Project Construction.

“Project Specifications” means the specifications governing Initial Project Construction.

“Project Water” means any and all water, including without limitation First Diversion Water, Second Diversion Water and Additional Water, that is introduced into and that uses some portion of the Project, regardless of its source.

“Prudent Utility Practice” means at a particular time any of the practices, methods or acts which, in the exercise of reasonable judgment in light of the facts known at the time a decision is made (including but not limited to the practices, methods and acts engaged in or approved by a significant portion of the water utility industry in the Puget Sound region), would be expected to accomplish the desired result at the lowest reasonable cost consistent with Project longevity, reliability, safety and expedition.

“Reasonable Costs” means the costs that are consistent with, and not in excess of, the level of costs that a water utility operating water facilities in the Puget Sound region and acting consistent with Prudent Utility Practice

and in a manner expected to produce the lowest total project cost would incur to design, construct and operate such facilities, taking into account any circumstances particular to the facility or facilities.

“Reimbursable Costs” mean costs incurred by a Participant, other than costs incurred pursuant to the Second Supply Project Agreement, to plan, design and construct facilities that are subsequently incorporated into the Project, and which are reviewed and approved pursuant to the Second Supply Project Agreement, and may include to the extent incurred the costs of project specific environmental documents, rights of way, real property acquisition, engineering and design, permitting and regulatory approvals, surveying, field investigations, inspections, material, labor expenses, financing costs, state and local taxes, project administration up to and including the project manager, special legal counsel, consulting services related to the project, and indirect costs of up to ten percent (10%) of the direct labor costs of the project, but shall not include the costs of programmatic environmental documents, project administration costs for personnel above project manager, costs of in-house legal counsel, accounting or purchasing personnel, or gross earnings taxes.

“Second Diversion Water” means water that is obtained under the provisions of the Second Diversion Water Right.

“Storage” means the retention of water at the Howard Hanson Dam until withdrawn therefrom, all pursuant to the Second Supply Project Agreement.

“Surcharge Rate” means a rate equal to four times the highest wholesale water rate for sales to retail water utilities that Tacoma then has in effect.

“Tacoma” means the City of Tacoma, Department of Public Utilities, Water Division.

“Treatment Facilities” means facilities that are necessary, as in effect as of the effective date of the Second Supply Project Agreement and in the future, to ensure that the quality of Project Water is in compliance with all applicable federal and state drinking water regulations, laws and standards, including without limitation chlorination, fluoridation, corrosion control and filtration facilities.

“Uncontrollable Force” means any event or occurrence that is beyond the reasonable control of a Participant and which by the exercise of due diligence and reasonable foresight such Participant could not have reasonably been expected to avoid or remove, and includes but is not limited to flood, earthquake, storm, accident, fire, lightning and other natural catastrophes, epidemic, war, labor or material shortage, strike or labor dispute, or sabotage, and also includes restraint by an order of a court of competent jurisdiction or by regulatory authorities against any action taken or not taken by a Participant, after a good faith effort by such Participant to obtain: (a) relief from such order; or (b) any necessary authorizations or approvals from any governmental agency or regulatory authority. In no event shall the duty of a Participant to make any payment under the Second Supply Project Agreement be excused by reason of an Uncontrollable Force.

“Variable O&M Costs” means the costs incurred by Tacoma to operate and maintain the Project in accordance with the Project Agreement, and which are neither Capital Expenditures nor Fixed O&M Costs, and which costs vary based on the quantity of Project Water delivered to a Participant during an Operating Year.

THE SECOND SUPPLY PROJECT AGREEMENT

The Project

The Participants have entered into the Second Supply Project Agreement to permit, design, finance, construct, operate, and maintain the Project and to receive deliveries of Project Water. For purposes of the Second Supply Project Agreement, the Project consists of the following: (1) the water from the exercise of the Second Diversion Water Right (up to 100 cfs); (2) the Second Supply Pipeline commencing at the Headworks and continuing to Tacoma’s Pipeline No. 4 near the Portland Avenue Reservoir (approximately thirty-four miles with a nominal capacity of seventy-two mgd); (3) a portion of the improvements at the Headworks diversion dam and intake (associated with the Second Diversion Water Right), as specified in the Second Supply Project Agreement; (4) a portion of the Project fisheries and environmental enhancements, as specified in the Second Supply Project

Agreement; (5) the right to store water as a result of the Howard-Hanson Dam Additional Storage Project (up to 20,000 acre-feet per year of municipal water supply storage available for withdrawal during each Operating Year in Phase I and options to participate in Phase II); and (6) the expansion of existing or the construction of additional Treatment Facilities.

Pursuant to the Second Supply Project Agreement, the Project has been designed to permit all Participants to receive at their point(s) of Delivery their respective Participant Share of Second Diversion Water simultaneously. The Participants understand and acknowledge in the Second Supply Project Agreement that the capability of Project facilities at any point in time is dependent upon the use being made of the Project by the Participants, and external factors as well.

The Second Supply Project Agreement provides that Tacoma shall own the Project, and all facilities related thereto.

Rights and Obligations of the Participants

Pursuant to the terms of the Second Supply Project Agreement, each Participant shall have the following contractual rights and obligations:

- The contractual right to use an undivided share of the Project equal to its Project Capacity Share, and the contractual right to use available Excess Project Capacity.
- The contractual right to schedule for delivery and receive at its Point(s) of Delivery its Participant Share of Second Diversion Water, and the contractual obligation to take delivery of the Second Diversion Water so delivered.
- The contractual right to schedule for delivery and receive at its Point(s) of Delivery Additional Water, and the contractual obligation to take delivery of the Additional Water so delivered.
- The contractual right to its Participant Share of Storage.
- The contractual obligation to pay its Participant Share of Project Costs, initially as a capital contribution in exchange for, and to qualify each Participant to enjoy, the rights and interests described in this section, and upon operation as a share of operating and maintenance costs of a Project providing water that is furnished by each of the Participants to its customers.

Rights and Obligations of Tacoma as Project Operator

Pursuant to the Second Supply Project Agreement, Tacoma is the Project Operator and is responsible for the day to day operation of the Project, including without limitation, coordination of Storage with the Army Corps of Engineers, delivery of Project Water to the Participants at their Points of Delivery, performance of maintenance, renewals, replacements, improvements and additions to the Project, reading and testing of the Master Meter and all Delivery Meters, obtaining and maintaining required permits, approvals and regulatory authorizations needed to operate the Project, all as set forth in the Second Supply Project Agreement. As Project Operator, Tacoma is required, consistent with the terms of the Second Supply Project Agreement and the approved Project Budget then in effect, to operate and maintain the Project in a manner that is consistent with Prudent Utility Practice.

As Project Operator, consistent with Prudent Utility Practice and the Second Supply Project Agreement, Tacoma is required:

- to deliver to each Participant at its Point(s) of Delivery Project Water as scheduled by each Participant pursuant to the Second Supply Project Agreement;

- to ensure that all Project Water delivered to Participants at their Point(s) of Delivery is in compliance with all applicable state and federal drinking water laws, regulations and standards; and
- to ensure that Project Water is delivered to Participants at their Point(s) of Delivery, and that such deliveries are made at the pressures specified, and measured at the locations set forth, in the Second Supply Project Agreement.

Tacoma is required to report to the other Participants its activities as Project Operator, as such reports are required pursuant to the Second Supply Project Agreement. Notwithstanding Tacoma's duty to report to the other Participants, Tacoma may without consulting the other Participants take such actions as it determines to be appropriate under the circumstances as Tacoma understands them to fulfill its duties under the Second Supply Project Agreement as Project Operator, consistent with Prudent Utility Practice.

In the event that circumstances require Tacoma to take actions not contemplated by the Project Annual Budget then in effect, Tacoma is required to make a reasonable effort to consult with the other Participants if circumstances permit. The Second Supply Project Agreement provides, however, that Tacoma may take such actions as it judges to be appropriate under the circumstances as Tacoma understands them without prior consultation with the other Participants. If Tacoma takes such actions without prior consultation with the other Participants, it is required to promptly notify the other Participants of the action taken and consult with them as soon as practicable.

Term of the Project Agreement

The Second Supply Project Agreement took effect when executed by all of the Participants, and is to remain in full force and effect during the Operating Life of the Project, including any and all renewals, replacements and additions thereto. Except for those sections and subsections that expressly survive the termination, the Second Supply Project Agreement is to terminate for all Participants on the date that the Participants determine, pursuant to the provisions of the Second Supply Project Agreement summarized below, that the Operating Life of the Project has ended.

The Second Supply Project Agreement provides that it is the expectation of the Participants that the Project will have an Operating Life of not less than one hundred (100) years. The Second Supply Project Agreement provides further that this is only the expectation of the Participants, and does not impose any duty, obligation, liability or responsibility on Tacoma regarding the Project other than as set forth in other sections of the Second Supply Project Agreement.

Tacoma is the holder of the Second Diversion Water Right Permit. The rights of the other Participants to a share of the water available under the Second Diversion Water Right arise under the terms of the Second Supply Project Agreement. Upon the termination of the Second Supply Project Agreement pursuant, each Participant is to have the right to participate in any subsequent project that is constructed, in whole or in part, to make available to one or more of the Participants Second Diversion Water, and shall include the right to obtain and use a share of Second Diversion Water and Storage then available on a basis and in amounts comparable to such Participant's right under the Second Supply Project Agreement. Pursuant to the Second Supply Project Agreement, the rights and obligations of the Participants described in this paragraph shall survive the termination of the Second Supply Project Agreement, and shall be fully enforceable subsequent thereto.

Pursuant to the Second Supply Project Agreement, all obligations incurred during the term of the Second Supply Project Agreement shall survive the termination or expiration of the Second Supply Project Agreement, and shall survive until satisfied.

Project Committee

The Second Supply Project Committee provides that there shall be a Project Committee composed of one (1) representative of each Participant. Each Participant may change its representative and/or its alternate

representative at any time by providing written notification to all other Participants. The representatives of the Participants shall have the following votes at the Project Committee meetings: (i) Tacoma- Fifteen (15) votes; (ii) CWD- Seven (7) votes; (iii) Kent- Seven (7) votes; and (iv) Lakehaven- Seven (7) votes.

The Second Supply Project Agreement requires that for the Project Committee to take action, there must be present a quorum of not less than three (3) Participants, one of which must be the Project Operator. Tacoma is obligated to attend any Project Committee meeting convened pursuant to the Second Supply Project Agreement. All decisions and actions of the Project Committee are required to be taken by a vote of the Participants present. All matters decided by the Project Committee, other than those items described in the following two paragraphs, require a simple majority of the votes cast by the Participants present.

Pursuant to the Second Supply Project Agreement, the following matters require for approval the affirmative vote of twenty-nine thirty-sixths (29/36) of the Project Committee votes and three of the Participants: (i) any amendment or modification to the Project Specifications; (ii) approval of Treatment Facilities inconsistent with the description set forth in the Second Supply Project Agreement; (iii) any amendment or modification to the Initial Project Construction Budget; (iv) any amendment or modification to the Initial Project Construction Schedule; (v) approval of any change order that exceeds one-half of the original contingency for the contract for which the change order is requested, or which exceeds the sum of \$500,000.00; (vi) approval of the Capital Expenditures contained in any Project Annual Budget; and (vii) approval or revision of any Financing Plan. In addition to the foregoing, in order for a representative to vote on any Financing Plan or revision thereto, the representative must present to the Project Committee a resolution (or ordinance, as appropriate) passed in the sixty (60) days prior to the Project Committee vote by the governing body of the Participant on whose behalf the representative will vote, and indicating the nature of the vote to be cast by such representative.

The Second Supply Project Agreement provides that any determination of the Operating Life requires the affirmative vote of all Participants. In order for a representative to vote on the determination of the Operating Life, the representative must present to the Project Committee a resolution (or ordinance, as appropriate) passed in the sixty (60) days prior to the Project Committee vote by the governing body of the Participant on whose behalf the representative will vote, and indicating the nature of the vote to be cast by such representative.

The Project Committee is required to adopt such rules as it determines to be convenient and appropriate for the conduct of its business, including without limitation rules of procedure for meetings. Persons who are not designated representatives of any Participant but who are elected officials, directors, officers, employees, consultants or agents of a Participant may attend meetings of the Project Committee.

After the completion of Initial Project Construction, the Project Committee is required to meet no less frequently than once each quarter. The Project Committee may meet more frequently should circumstances warrant. The dates for all regularly scheduled Project Committee meetings are to be established at the last Project Committee meeting prior to the year in which such meetings shall take place.

Any Participant may convene a Project Committee meeting after the completion of Initial Project Construction by giving written notice to all other Participants no less than fourteen (14) days prior to the proposed date of the Project Committee meeting. The written notice shall indicate the time, location and agenda items to be discussed.

Subsequent to the completion of Initial Project Construction, the Project Committee is responsible for the following activities, and for such other activities as the Project Committee agrees to undertake: approving new Points of Delivery; approving and revising the Project Annual Budget; approving Additional Water deliveries; approving and revising Financing Plans; approving imposition of the Surcharge Rate; determining actions needed to maintain water quality; determining amounts and types of insurance and self-insurance arrangements; determining Project Operating Life; disposition of unexpended funds from Initial Project Construction Budget; establishing operating ranges for the Master and Delivery Meters; establishing ramp rates for changes to scheduled flows; establishing scheduling procedures; establishing metering testing standards; establishing procedures for scheduling run of river Second Diversion Water; establishing procedures for excess deliveries of run of river Second Diversion Water; receiving the annual operator's report; resolving hydraulic issues; revising the commencement date of any Operating Year; revising deadlines set forth in the Second Supply Project Agreement relating to management of

project water and storage use, delivery of Additional Water and water metering; revising dates for storage periods; revising the dollar limit for Capital Expenditures; revising reporting requirements by Project Operator; review and approval of the Capital Element of the Annual Budget; review and approval of the Annual Operating Plan; selecting a substitute bank for computing Interest Rate; and selecting a third party auditor.

Decisions of the Project Committee taken pursuant to the provisions of the Second Supply Project Agreement, and any impasse or inability of the Project Committee to reach a decision on any topic, are not subject to the dispute resolution process described below under “SECOND SUPPLY PROJECT AGREEMENT—***Dispute Resolution.***” By unanimous agreement, the Participants may voluntarily elect to submit to mediation or arbitration any topic that is subject to disposition by the Project Committee.

Project Financing

After the completion of Initial Project Construction, from time to time the Participants will be required to fund the replacement, renewal, repair, improvement or make capital additions to the Project pursuant to the Second Supply Project Agreement. If all or any portion of the funding for the costs of such replacements, renewals, repairs, improvements and capital additions is to be provided by the issuance of Project Bonds, Tacoma is required to submit to the Project Committee a Financing Plan setting forth the purpose, amount, repayment schedule and timing of the proposed issuance (or issuances). Upon approval by the Project Committee, Tacoma may cause to be issued by such separate system in accordance with the approved Financing Plan Project Bonds for such purposes, the repayment of which shall be secured by the payments to be made by the Participants to the Second Supply Project Agreement.

The costs of operating and maintaining the Project shall be established in accordance with the applicable provisions of the Second Supply Project Agreement.

Provisions Applicable to All Project Financing

Pursuant to the Second Supply Project Agreement, Tacoma may establish a separate system for accounting and bond issuance purposes for the Project. All Project Bonds are to be issued in accordance with a Financing Plan approved by the Project Committee, are to be for the purpose of financing Project Costs, and may be issued by Tacoma’s separate system. If and to the extent permitted by the then current law, such Project Bonds are to be issued as non-recourse, tax-exempt municipal bonds, the repayment of which shall be secured by the payments to be made by the Participants pursuant to the Second Supply Project Agreement.

The Participants shall be given the opportunity to review and comment upon any preliminary and final official statements prepared in conjunction with the issuance of all project bonds.

If Tacoma issues Project Bonds on behalf of any other participants, Tacoma is required to take all commercially reasonable actions necessary to ensure that the proceeds from such issuances are available in a timely manner to fund the construction, replacement, renewal, repair, improvement of or capital additions to the Project, while seeking to minimize the interest rates of such Project Bonds. Tacoma is authorized in the Second Supply Project Agreement to purchase bond insurance and other credit enhancement devices, issue bonds in series, and take all such other actions as may be commercially reasonable to reduce the costs to the Participants of Project Bonds issued in accordance with the Second Supply Project Agreement.

The costs incurred by Tacoma from time to time to cause the issuance of Project Bonds, including without limitation the costs of Tacoma staff and associated overheads, are to be treated as Project Costs.

Except to the extent Participants elect to make payments as described in the following paragraph, each of the Participants agrees in the Second Supply Project to pay its Participant Share of any and all amounts necessary to repay Project Bonds, including without limitation the costs of issuing such Project Bonds as described in this section, and such payments are to be made in such amounts and at such times as required by the covenants of such Project Bonds. Except as otherwise described in this section, and as described below under “SECOND SUPPLY PROJECT AGREEMENT—Reimbursable Costs,” the obligation of the Participants to make all such payments are to be apportioned among the Participants based upon their Participant Shares.

In lieu of paying its Participant Share of amounts necessary to repay Project Bonds, any Participant may elect to fund all or any part of its Participant Share of a Project Cost, which is to be funded by the issuance of Project Bonds, by the payment of cash obtained by issuing its own bonds, by obtaining loans from private or public sources, or any other lawful means. Any Participant electing to pay cash for its Participant Share of any such Project Cost is required to inform all other Participants of such election in writing not less than ninety (90) days prior to the proposed date of issuance of the Project Bonds, as set forth in the approved Financing Plan for such Project Bonds. Upon receipt of such written notice from any Participant, the timing and amounts of the payments any Participant electing to pay cash will be obligated to make shall be established by the Project Committee, and is to be included in the Project Annual Budget and in the Financing Plan containing the Project Cost to be so paid. The Participant so electing will be required to make the payments in the amounts and at the times specified by the Project Committee in the relevant Financing Plan and Project Annual Budgets.

Nothing in the provisions of the Second Supply Project Agreement summarized in this section will prohibit two or more Participants from entering into an agreement under which one Participant funds the Participant Share of a Project Cost of the other Participant, provided, however, that such agreement will not serve to relieve any Participant of its obligation to pay its Participant Share of a Project Cost under the Second Supply Project Agreement.

If and to the extent there is funding available from sources other than Project Bonds and cash payments made as described above, including without limitation grants, cost sharing, federal, state or local government funding, such funding is to be applied to the costs of constructing, operating or enhancing the Project, as determined by the Project Committee, such that all Participants share the financial benefits of such funding in proportion to their Participant's Share of federal, state or local loans to an individual Participant to assist the Participant in providing for its Participant Share of Project Cost (e.g. public works trust fund loans) shall not be required to be so shared.

If and to the extent there are funds remaining in any bond fund established in conjunction with Project Bonds after the repayment in full of all outstanding Project Bonds, such funds are to be used in accordance with the applicable covenants and bond resolutions, or if no such direction is provided by the applicable covenants or bond resolutions, at the discretion of the Project Committee for the benefit of the Project.

Notwithstanding any other provision of the Second Supply Project Agreement, the obligation of the Participants to make payments to pay any and all amounts necessary to repay Project Bonds issued by Tacoma's separate system, including without limitation the costs of issuing Project Bonds, shall survive the expiration or termination of the Second Supply Project Agreement, and shall be fully enforceable subsequent thereto.

To the extent necessary for Tacoma to comply with applicable securities laws and regulations, including continuing disclosure requirements under SEC Regulation 15c2-12, Participants for whom Tacoma issues bonds shall provide information to Tacoma for inclusion in official statements, continuing disclosure filings and similar documents to filings.

Treatment of Certain Cost Overruns

The Second Supply Project Agreement states that modifications to the Headworks as set forth in the Project Specifications will benefit both the Project and Pipeline No. 1. In the event that the modifications to the Headworks either exceed or fall short of the amounts budgeted for such work in the Initial Project Construction Budget, then any such overrun or surplus are to be apportioned between the Project and Pipeline No. 1 using the allocator that was applied to the costs of the constructing the Headworks modifications, as set forth in the Second Supply Project Agreement. The portion of any such overrun or surplus allocated to Pipeline No. 1 shall not be treated as a Project Cost.

In the event that the cost of constructing a Point of Delivery either exceeds or falls short of the amounts budgeted for such work, the Participant that will receive Project Water through such Point of Delivery will be required to pay for any cost overrun, or receive a credit in the amount of any surplus attributable to the construction of the Point of Delivery. The cost of constructing Points of Delivery is not to be treated as a Project Cost.

Except as described in the preceding two paragraphs, in the event that the cost of constructing any portion of the Project exceeds or falls short of the amounts budgeted therefore in the Initial Project Construction Budget, then any such amount is to be treated as a Project Cost or as surplus funds of the Project.

Use of Project for First Diversion Water

Pursuant to the Second Supply Project Agreement, Tacoma shall have the right to use its Project Capacity Share to move First Diversion Water when Tacoma deems it appropriate to do so. Tacoma shall also have the right to use any Excess Project Capacity available to it under the Second Supply Project Agreement to move First Diversion Water. In such event, the First Diversion Water shall have the same priority to Excess Project Capacity as Second Diversion Water. First Diversion Water that is moved through the Project pursuant to the provisions of the Second Supply Project Agreement described in this section are not subject to the requirements of the Second Supply Project Agreement relating to the delivery of Additional Water, but are subject to all other provisions of the Second Supply Project Agreement.

Use of Project Capacity During Certain Events

Certain Participants have entered into an agreement pursuant to which they will provide aid and assistance upon the occurrence of specified events on their respective systems (the “agreement”). Nothing in the agreement between such Participants entitles them to take any action or refrain from any action that would be inconsistent with the rights under the Second Supply Project Agreement, or that would result in any other Participant being unable to fully exercise its rights under the Second Supply Project Agreement.

Notwithstanding any other provision of the Second Supply Project Agreement, the signatories to the agreement retain the right to revise or modify the terms of their agreement without the approval or consent of any Participant that is not a signatory thereto.

The Second Supply Project Agreement provides that should Tacoma receive from any Participant a request for deliveries of Project Water that exceeds the rights of such Participant under the Second Supply Project Agreement, and such request is due to the occurrence of an Uncontrollable Force event on the requesting Participant’s system that renders such Participant incapable of meeting the water supply needs of its retail customers, Tacoma is required to promptly notify all other Participants of such request. Tacoma may, but shall not be obligated to, query the other Participants or convene a Project Committee meeting to determine if there are voluntary actions that could be taken by some or all of the Participants to alleviate the situation on the system of the Participant making such request. Tacoma shall not take any action to comply with the request of any Participant subject to an Uncontrollable Force event without the consent of each and every Participant that will be affected by such action.

Notwithstanding anything to the contrary in the Second Supply Project Agreement, should Tacoma lose the use, in part or in whole, of Tacoma’s Pipelines Nos. 1, 2 or 4 due to an Uncontrollable Force event, and as a consequence thereof experience a water supply shortage on the Tacoma water system, then in that event Tacoma may use the Project to move First Diversion Water if so doing will alleviate such water supply shortage. In order to make such use of the Project, Tacoma may curtail or interrupt deliveries of Project Water to other Participants, so long as the reductions to the deliveries of Project Water to other Participants are: (i) made to all other Participants as nearly as practicable in proportion to the Participant Share of each Participant; (ii) do not exceed the reductions in deliveries of Project Water being experienced by Tacoma; and (iii) do not cause a water shortage on the water system of the other Participants that exceeds the water supply shortage being experienced by Tacoma.

Discharge of Project Water

From time to time as Project Operator, Tacoma may judge it necessary to discharge Project Water into the system of one or more Participants for purposes of maintaining water quality, performance of maintenance or for other purposes.

The Second Supply Project Agreement provides that when Tacoma determines that it is necessary to discharge Project Water as described in the preceding paragraph, and the Project Water so discharged will enter the system of any other Participant, Tacoma is required to promptly notify the Participant or Participants into whose distribution systems the discharge will occur of the timing of such discharge, the volume of water involved, and the reason for such discharge. The Second Supply Project Agreement provides Tacoma shall not implement a proposed discharge unless and until it has received the permission therefore from the Participant or Participants into whose distribution systems the discharge will occur. Such Participant or Participants is not to unreasonably withhold permission for a discharge as proposed by Tacoma.

Project Water received by a Participant due to a discharge implemented by Tacoma pursuant to the Second Supply Project Agreement in amounts equal to or less than the Project Water the Participant scheduled for delivery during the time period when the discharged Project water is received shall be considered as the delivery of Project Water for all purposes under the Second Supply Project Agreement. If and to the extent the Project Water received by a Participant due to such a discharge exceeds the Project Water the Participant scheduled for delivery during the time period when the Discharged Project Water is received, such amount of Project Water in excess of the scheduled amounts are not to be considered as the delivery of Project Water for any purpose under the Second Supply Project Agreement, and are to be deducted from the amounts of Project Water metered pursuant to the Second Supply Project Agreement.

Project Water discharged by Tacoma pursuant to the Second Supply Project Agreement which is not considered as the delivery of Project Water, is to be deducted from the amount of Project Water available to all Participants in proportion to their respective Participant Share.

Water Quality

Project Water available to the Participants pursuant to the Second Supply Project Agreement is to be in compliance with all applicable state and federal drinking water laws, regulations and standards.

The Participants agree in the Second Supply Project Agreement that if applicable state or federal drinking water laws, regulations or standards require additional or different Treatment Facilities in order for Project Water to remain in compliance therewith, the Participants will take the steps necessary to add such Treatment Facilities to the Project. The costs of so doing shall be treated as Project Costs, and shall be apportioned to each of the Participants on the basis of their Participant Share.

The Project Committee is required to make all necessary determinations regarding what Treatment Facilities should be added to the Project in order to comply with the provisions of the Second Supply Project Agreement summarized in this section. For purposes of making all such determinations, any Treatment Facility shall be located at or near the Headworks, is to be capable of treating water in amounts equal to the maximum capacity of the Project as set forth in the Second Supply Project Agreement, and is to use the technology which is expected to have the lowest life cycle costs. Any decision by the Project Committee to take inconsistent actions must be approved in accordance with the provisions of the Second Supply Project Agreement summarized under “SECOND SUPPLY PROJECT AGREEMENT—***Project Committee***.”

The Second Supply Project Agreement provides that Tacoma may elect to increase the capacity of the Treatment Facilities used for the chlorination of Project Water to enable such facilities to chlorinate First Diversion Water. To exercise such option, Tacoma must give written notice of its election to all Participants prior to the initiation of final Project design for Initial Project Construction. If Tacoma exercises such option to increase the capacity of such Treatment Facilities to chlorinate First Diversion Water, Tacoma will be responsible for paying the incremental costs for such increased treatment capacity.

Should Tacoma elect to increase the chlorination capacity of the Treatment Facilities to accommodate First Diversion Water, and it is subsequently required that First Diversion Water and Second Diversion Water must be given filtration treatment, then Tacoma will be required to pay to the Project, upon the commencement of construction of such filtration facility, a credit calculated pursuant to the formula set out in the Second Supply Project Agreement.

Availability of Storage

Pursuant to the Second Supply Project Agreement, storage of Second Diversion Water is to be provided by Phase I of the Howard Hanson Additional Storage Project.

When Phase I is completed, each Participant will have the right to store Second Diversion Water in proportion to their Participant Share of Second Diversion Water between February 15 and June 30. In most years, the total amount of stored water is to equal 20,000 acre-feet if all Participants commit the full amount of their allocation of Second Diversion Water to Storage. Second Diversion Water used by any Participant during the February 15 through June 30 period for purposes other than Storage is to be accounted for as a use of that Participant's share of Storage, unless full Storage has been achieved prior to June 30 and Second Diversion Water is available as run of the river water.

If the Howard Hanson Additional Storage Project proceeds to Phase II, then in that event the Participants are to be afforded the opportunity to participate in such Phase II in proportion to their respective Participant Share. Should any Participant decline to participate, in whole or in part, in Phase II, each Participant participating in Phase II is to have a right of first refusal to any portion of Phase II in which any other Participant declines participation. The share of Phase II which is declined by a Participant is to be made available to the Participants participating in Phase II based on their Participant Share, assuming that the sum of the Participant Shares of those Participants that will participate in Phase II equals one hundred percent of the Project.

The timing and amount of Storage available to the Participants under the Second Supply Project Agreement will be governed by the Howard Hanson Project Cooperation Agreement, executed by Tacoma and the Army Corps of Engineers.

Management of Project Water and Storage Use

The Second Supply Project Agreement provides that each Participant is entitled to schedule the use of its Project Capacity Share to deliver Project Water to its Point(s) of Delivery, notwithstanding the use of such Project capacity as Excess Project Capacity by any other Participant. Excess Project Capacity is to be first made available to Participants for the delivery of Second Diversion Water to Participants Point(s) of Delivery, and in the case of Tacoma for the delivery of First and Second Diversion Water, and then any Excess Project Capacity remaining thereafter is to be made available to Participants for the delivery of Additional Water. Such rights and priorities are to apply to all aspects of the provisions of the Second Supply Project Agreement summarized in this section, including the review and revision of Participants' operating plans, review and approval of Annual Operating Plans, and the scheduling of Project Water within an Operating Year.

Participants' Operating Plans and Annual Operating Plan

On or before April 1st of each year during the term hereof, Tacoma is required to provide to each Participant a written estimate of the expected availability of the Project for the next Operating Year, and the expected availability of Second Diversion Water. This is to include, but not be limited to, information regarding expected operating constraints and any additional information available to Tacoma that may be useful to Participants in planning their use of the Project in the next Operating Year.

Not later than thirty (30) days after receipt of the information from Tacoma, each Participant is required to submit to Tacoma and to all other Participants a written draft operating plan for the next Operating Year. Each Participant's draft operating plan is to include, but not be limited to, the amount of Additional Water and Second Diversion Water that each such Participant expects to receive from the Project in each week during the next Operating Year, the amount of Second Diversion Water each Participant expects to place in Storage, and the timing and amount of expected withdrawals from Storage. If any Participant expects to make use of Excess Project Capacity during the next Operating Year, such Participant's draft operating plan is to identify the quantity, duration, timing and the specific facilities that are intended to be so used.

In making Excess Project Capacity available to the Participants as may be requested in their draft operating plans, all requests for the use of Excess Project Capacity to move Second Diversion Water (and, in the case of Tacoma, to move First and Second Diversion Water) are required to be satisfied first, and then any Excess Project Capacity remaining thereafter are required to be made available to fulfill requests to move Additional Water.

Not later than thirty (30) days after receipt of the Participants operating plans, Tacoma is required to prepare and submit to the Project Committee a draft Annual Operating Plan that incorporates the draft operating plans submitted to Tacoma. The Project Committee is to convene one or more meetings to consider the draft Annual Operating Plan prepared by Tacoma, and to approve the Annual Operating Plan as submitted or as may be revised by the Project Committee, for the next Operating Year. The Annual Operating Plan so approved is required to include, at a minimum, the Participants' operating plans and any revisions thereto, allocation of Excess Project Capacity among the Participants, scheduled maintenance outages, their timing and duration, and any constraints on the availability of Second Diversion Water or Storage. If and to the extent that the Annual Operating Plan reflects a constraint or diminution in the capability of the Project to deliver Project Water to the Participants, or in the amount or availability of Second Diversion Water or Storage, the Annual Operating Plan for the Operating Year in which such constraint or diminution occurs is to apportion to all Participants in proportion to their Participant Share the consequences of such constraint or diminution; *provided however*, that a constraint or diminution that affects facilities that serve some but not all of the Participants is to be borne only by those Participants served thereby.

If any operating plan submitted by a Participant includes the introduction by that Participant of Additional Water into the Project during the Operating Year, then as part of the consideration and approval process, all of the conditions of the Second Supply Project Agreement relating to the delivery of Additional Water shall also apply thereto.

The Project Committee may elect to advance or delay the commencement of any Operating Year if it determines that it is necessary and appropriate to do so.

Scheduling Delivery of Project Water During an Operating Year

Prior to 10:00 A.M. on any Thursday during each Operating Year, any Participant may submit to Tacoma, in the manner and in the form established by the Project Committee, a schedule for Project Water deliveries for the following seven (7) days. Such schedule is required to contain at a minimum a uniform rate of water deliveries for each day of the schedule, and shall take effect on the day following the Thursday the schedule is submitted. Schedules so submitted are to remain in effect until replaced by a subsequent schedule submitted in accordance with the provisions of the Second Supply Project Agreement. As Project Operator, Tacoma, consistent with the priorities for the use of Project capacity as set forth in the Second Supply Project Agreement, will be required to take all reasonable actions required to ensure that the amount of Project Water scheduled by each Participant is available to the scheduling Participant at its Point(s) of Delivery. Tacoma will not be responsible for the operation of Flow Control Valves by which Participants withdraw water from the Project.

Tacoma may revise schedules submitted, if and to the extent any such schedule calls for deliveries that are in excess of the submitting Participant's rights under the Second Supply Project Agreement, cannot be accommodated within Excess Project Capacity available, or is inconsistent with Project operating constraints. Tacoma will be required to notify any Participant whose schedule is revised. In the event that a change in circumstances necessitates a change to a schedule then in effect, the submitting Participant may request a change to such schedule, and Tacoma will be required to take all reasonable actions that are consistent with the Second Supply Project Agreement to accommodate such schedule change.

If Tacoma receives a schedule that exceeds the rights of the submitting Participant under the Second Supply Project Agreement, Tacoma will be required to make reasonable efforts to accommodate such schedule by using any available Excess Project Capacity. To the extent that Tacoma receives more than one schedule that calls for deliveries in excess of the rights of the submitting Participants under the Second Supply Project Agreement, Tacoma will be required to make reasonable efforts to accommodate such schedules by using Excess Project Capacity. If such schedules so submitted exceed the amount of Excess Project Capacity available, Tacoma shall, consistent with the priorities for the use of Project capacity summarized above, prorate the available Excess Project Capacity to the schedules which require such Excess Project Capacity on the basis of the Participant Shares of the

submitting Participants, and will be required to promptly notify each such Participant of the amount of the schedule that cannot be accommodated. Each Participant so notified will have until 3:00 P.M. to notify Tacoma if, and the extent to which, it has been able to accommodate its schedule

Pursuant to the Second Supply Project Agreement, the scheduling provisions summarized in this section are designed primarily to apply to the withdrawal and use of Second Diversion Water from Storage, and are not meant to apply to the scheduling of Second Diversion Water available as run of river water. The Project Committee will be required to formulate, and revise from time to time as appropriate, procedures under which Tacoma shall provide Participants with information regarding the availability of, and Participants shall schedule delivery of Second Diversion Water available as run of river water.

Each week during every Operating Year, Tacoma will be required to transmit to each of the Participants a report regarding the status of operations related to the Project. The report is to be transmitted to the Participants by means determined by the Project Committee. The Project Committee may from time to time revise the information to be included in the weekly report by Tacoma.

The Project Committee may modify the deadlines for the submission of information required by the Second Supply Project Agreement.

Delivery of Additional Water

Subject to the requirements of the Second Supply Project Agreement summarized in the preceding section and in this section, each Participant will have the right to use its Project Capacity Share to move Project Water in accordance with the Second Supply Project Agreement.

Any Participant wishing to use Project facilities to move Additional Water that was not included in the Annual Operating Plan then in effect is required to make all reasonable efforts to notify all other Participants at the earliest practicable date of its intention to move such Additional Water. Such notification is to include, but not be limited to information regarding the quantity, source, duration, destination and water quality of any Additional Water proposed to be so moved. A Participant wishing to move Additional Water will be required to submit to the Project Committee in writing the required information not later than sixty (60) days prior to the date the Additional Water is proposed to be first introduced into the Project.

The Project Committee is then to determine whether the proposed introduction of Additional Water is: (a) consistent with the proposing Participant's rights under the Second Supply Project Agreement; (b) conforms with all applicable state and federal drinking water laws, regulations and standards; and (c) is compatible with the water quality of Project Water at the point of introduction into the Project. If the Project Committee makes a determination that such Additional Water does not meet all of the foregoing conditions, it will disapprove the proposed introduction of the Additional Water. Such determination is to be made within sixty (60) days of the date of receipt of the written notice.

The Second Supply Project Agreement provides that the testing and monitoring of the quality and quantity of any Additional Water introduced into the Project is to be the responsibility of Tacoma.

The Participant that proposes to introduce Additional Water into the Project re to pay the costs of acquiring and installing a separate meter that complies with Project meter standards, to measure the flow of Additional Water. Tacoma is to acquire, install and maintain such meter, and the meter shall be part of the Project.

The Participant which introduces Additional Water into the Project is to be responsible for paying any and all costs associated with the introduction of Additional Water as determined by the Project Committee, including without limitation, the costs of any testing and monitoring water quality, increased Variable O&M Costs attributable to such Additional Water, and the costs of additional metering.

Metering of Water Deliveries

The Master Meter will be located at the Headworks to measure the flow of Project Water. Each Participant's Delivery Meter shall be located at the Point of Delivery for each such Participant. All Point of Delivery facilities will be designed and constructed as part of the Project, but the costs of designing and constructing such facilities will be billed separately to the Participant that will receive deliveries of Project Water at such Point (or Points) of Delivery, and will not be treated as Project Costs. Each Participant shall be responsible, at its own expense, for operating and maintaining those Point of Delivery facilities for which it is separately billed.

Unless alternative provision is made in the Project Annual Budget, the cost of installing the initial and any replacement Delivery Meter(s) for each Participant are to be borne of each such Participant. The cost of installing the Master Meter is to be a Project Cost. All such meters are to be considered a part of the Project.

The Second Supply Project Agreement provides that, as Project Operator, Tacoma will be responsible for the calibration and testing of the Master Meter, Project Meters, Joint Delivery Meters, and Delivery Meters (collectively referred to as "All Meters"). All Meters are to be tested for accuracy at least once a year, and the results of such testing are to be made available to all Participants at no charge. The costs of the annual test of the Master Meter and the Project Meters are to be a Project Cost. The costs of the annual tests of the Delivery Meter(s) are to be borne by the Participant whose Project Water deliveries are measured by such Delivery Meter(s). The costs of the annual test of the Joint Delivery Meters are to be apportioned to the Project Participants sharing the meter(s) by separate agreement. In addition to the annual meter test, any Participant may test any meter that measures Project Water at any reasonable time and at such Participant's expense. The results of any additional meter test are to be made available to all other Participants at no charge.

Any and all maintenance, repairs, and replacements to the Master Meter, Project Meters, Joint Delivery Meters, and Delivery Meters are to be the sole responsibility of Tacoma as Project Operator. The costs of any and all maintenance, repairs and replacements of the Master Meter and Project Meters are to be Project Costs. The costs of any and all maintenance, repair and replacement of Delivery Meters are to be borne by the Participant whose Project Water deliveries are measured by such Delivery Meter. The costs of any and all maintenance, repairs, and replacement of Joint Delivery Meters are to be apportioned to the Project Participants sharing the meter(s) by separate agreement.

In the event there is a difference between the quantity of Project Water as measured at the Master Meter and the quantity of Project Water as measured by summing the readings on each of the Delivery Meters, such difference are to be apportioned among the Participants based on the volumes as recorded on each of the Participants meters, unless the Project Committee determines that a different adjustment is appropriate under the circumstances.

For Joint Delivery Meters, an annual comparison is to be done between the summation of daily Joint Delivery Meter readings and the summation of readings from daily Participants' Delivery Meter(s) downstream. If the difference between the two annual readings is greater than 2 percent, then an appropriate adjustment to the amount of Project Water delivered to each affected Participant is to be made. The adjustment is to be apportioned among the Participants based on the volumes recorded on each of the Participants' meters, unless the involved Participants determine that a different adjustment is appropriate under the circumstances.

Pursuant to the procedures summarized above under "SECOND SUPPLY PROJECT AGREEMENT—***Project Committee***," the Project Committee is required to establish the size and the flow range within which each Delivery Meter must operate. Should Tacoma determine that any Delivery Meter is operating outside the flow range so established, it will be required to notify in writing the Participant whose Project Water deliveries are measured by such Delivery Meter, and the size of the replacement meter needed to operate within the flow range. Tacoma will be required to provide the Participant an opportunity to discuss the problem with the existing Delivery Meter, and the need for the proposed replacement Delivery Meter. After providing such written notice, Tacoma may replace the faulty Delivery Meter and bill the Participant for the costs of procuring and installing such meter, and such Participant will be obligated to pay such bill.

The Flow Control Valve for each Participant is to be owned by and under the control of each Participant, and Flow Control Valves will not be a part of the Project. Each Participant is responsible for the operation and

control of its own Flow Control Valve. Upon reasonable notice and subject to scheduling with the other Participant, each Participant is to have the right to enter the meter and/or valve vault or vaults of any other Participant for any reason related to the Project.

As Project Operator, Tacoma is to have access to the control signals from each meter station, and access to each vault in which a Delivery Meter is located. Each Participant is to have the right to receive the control signal for its Delivery Meter(s), and the control signal from any other meters operated in conjunction with the Project. The costs of equipment necessary to receive any such control signals are to be borne by the Participant receiving such signals.

Deliveries of Project Water in Excess of Schedules

The Second Supply Project Agreement provides that, as Project Operator, Tacoma is to monitor the delivery of Project Water to each Participant to ensure that the withdrawals and deliveries of Project Water comport with the schedules submitted by each Participant.

Should Tacoma determine that a Participant is receiving deliveries of Project Water at their Point(s) of Delivery in excess of their scheduled amounts, Tacoma will be required to notify such Participant of the excess deliveries, and the Participant will be required to promptly take the steps necessary to reduce its deliveries to amounts equal to its scheduled amounts, or to revise its schedules to reflect the level of deliveries it is receiving.

If the Participant receiving deliveries in excess of its scheduled amounts has not taken action to revise its schedules or to reduce its deliveries to a level equal to its scheduled amounts within twenty-four hours of receiving notice from Tacoma, Tacoma may take any action it deems necessary to reduce the deliveries to a level equal to the Participant's scheduled amounts.

For any Participant that has received deliveries of Project Water in excess of its scheduled amount, Tacoma is to deduct from such Participant's balance of water remaining in Storage an amount equal to such excess delivery. If such excess deliveries exceed the water remaining in Storage for such Participant, Tacoma is to charge such Participant the Surcharge Rate for such excess deliveries that cannot be deducted from the Participant's Storage balance.

For any Participant that takes delivery of Project Water in excess of scheduled amounts, and does so in a manner that deprives any other Participant of their right to receive delivery of their Participant Share of Project Water without the agreement of such Participant, then if any Participant protests, or if Tacoma deems appropriate, Tacoma is to submit said matter to the Project Committee for its consideration on whether such excess deliveries be subject to the Surcharge Rate. If approved by the Project Committee, Tacoma is to charge such Participant the Surcharge Rate for such deliveries in excess of scheduled amounts.

Project Annual Budgets

At each quarterly meeting of the Project Committee, Tacoma will be required to present to the Participants a comparison of actual expenditures to expenditures projected in the Project Annual Budget for the then current calendar year, with an explanation of any material variations between budget and actual amounts.

Not later than each July 1st, Tacoma will be required to prepare and submit to the Project Committee a proposed Project Annual Budget for the next calendar year, the work papers supporting each of the elements set forth in such proposed Project Annual Budget and a comparison of actual expenditures to the expenditures projected Project Annual Budget for the then current calendar year. Each such proposed Project Annual Budget shall contain, at a minimum, the following elements:

- amounts necessary to operate and maintain the Project;
- for Variable O&M Costs, the cost per million gallons (MG);

- proposed Capital Expenditures including proposed Capital Expenditures for any renewals, replacements, additions or improvements to the Project;
- amounts necessary to replenish any Project contingency fund;
- amounts and timing of any payments due on outstanding Project Bonds;
- amounts and timing of any proposed Project Bond issuances; and
- payment schedules for all elements in the Project Annual Budget.

Each proposed Project Annual Budget is to be prepared generally in the form set forth in the Second Supply Project Agreement. In preparing each proposed Project Annual Budget, Tacoma is to take into account any funds expected to remain, or liabilities left unfunded, which are expected to remain at the end of the then current calendar year.

The Project Committee will have until October 15th to approve the Project Annual Budget as submitted by Tacoma, or to approve a Project Annual Budget as revised by the Project Committee. If the Project Committee has not approved a Project Annual Budget by the first day of any calendar year, then Tacoma may operate the Project and expend funds in accordance with the Project Annual Budget from the immediately prior calendar year, and the Participants shall be obligated to pay invoices issued by Tacoma in accordance with such Project Annual Budget unless and until the Project Committee approves a Project Annual Budget for the then current calendar year.

At any time during any calendar year, Tacoma may submit to the Project Committee a proposed revision to any Project Annual Budget then in effect if, in Tacoma's judgment, the Project Annual Budget then in effect will not be adequate to fund the operation of the Project. The proposed revision, as proposed by Tacoma or as revised by the Project Committee, are to take effect upon approval by the Project Committee.

The Project Committee may modify the deadlines for the submission of the proposed Project Annual Budget, and any action relating thereto.

Payments

Pursuant to the Second Supply Project Agreement, Tacoma is required to prepare and forward to each Participant invoices for the payment of costs as set forth in the Project Annual Budget then in effect. Each such invoice is to also set forth the operations and maintenance costs that vary with use based on the use of the Project by the Participant in the preceding month or months calculated using the rate for such use contained in the Project Annual Budget then in effect. Such invoices are to be prepared and forwarded to the Participants no more frequently than once each calendar month.

Any Participant may request from Tacoma, and Tacoma is to promptly provide to the requesting Participant, any documentation or other information that the requesting Participant may reasonably require to understand the nature of the costs contained in any invoice.

Payment of any and all invoices forwarded to each Participant by Tacoma shall be due and payable by the Participant receiving such invoice on or before the Due Date, with payment to be made by wire transfer or such other means as agreed to by Tacoma and the Participant, subject to the following:

- For any and all amounts set forth in any such invoice that are required to be paid to satisfy principal and interest obligations set forth in Project Bonds and related covenants, payment shall be made to the Project Bond escrow agent or fiscal agent specified in the Project Annual Budget for such Operating Year.
- For any and all amounts set forth in such invoice, other than those amounts described in the preceding clause, payment is to be made to the bank and account designated by Tacoma; provided

however, in the event that a Participant desires to make a cash payment towards its Participant Share of Project Costs (e.g. a capital contribution in aid to construction for Project Costs), said payment are to be made to the Project escrow agent, which is then, as a common paymaster and subject to the approval of Tacoma or Project Committee, as appropriate, to direct said payment for Project Costs.

If full payment of any invoice is not received by Tacoma on or before the Due Date, such payment will be considered past due, and the unpaid amount of such invoice will accrue a late payment charge for each day that the invoice remains unpaid in an amount equal to the product of the unpaid amount of the invoice and the Interest Rate. Such charge will continue to accumulate until the unpaid amount of the invoice and all late payment charges are paid in full to Tacoma. Further, if an invoice or any portion thereof remains unpaid for a period of thirty (30) days after the Due Date, Tacoma may elect to suspend deliveries of Project Water scheduled by any Participant who has failed to make full payment until such Participant has paid all amounts due and owing, and any late payment charges due thereon.

If any Participant disputes all or any portion of an invoice issued by Tacoma, the Participant will be required to pay such invoice in full, and shall indicate in writing to Tacoma the portions of the invoice that the Participant disputes and the reasons therefore. The Participants is to make a good faith effort to resolve such dispute. If such efforts are unsuccessful, either Participant to the dispute may seek resolution of the dispute pursuant to the provisions of the Second Supply Project Agreement summarized below under “SECOND SUPPLY PROJECT AGREEMENT—*Dispute Resolution*.”

If the resolution of any dispute over an invoice, whether by agreement of the Participants or by dispute resolution, results in the payment of money from Tacoma to the Participant disputing a bill, such payment is to include an interest payment for the period commencing with the date the disputed invoice was paid, and ending on the date the payment resolving the dispute is made to the Participant, calculated using the Interest Rate.

Each Participant covenants and agrees in the Second Supply Project Agreement that it shall establish, maintain and collect rates or charges for water and other services, facilities and commodities sold, furnished or supplied by it which shall be adequate to provide revenues sufficient to enable the Participant to make the payments required to be made pursuant to the terms of the Second Supply Project Agreement, and to pay all other charges and obligations payable from or constituting a charge or lien upon such revenues.

Each Participant is required to make the payments required under the Second Supply Project Agreement whether or not the Project is completed, operable or operating and notwithstanding the suspension, interruption, interference, reduction or curtailment in the operation of the Project for any reason whatsoever, in whole or in part. Such payments will not be subject to any reduction, whether by offset or otherwise, and will not be conditioned upon the performance or nonperformance of any Participant to the Second Supply Project Agreement, including without limitation the Project Operator, or of any entity under the Second Supply Project Agreement or any other agreement or instrument.

True-Up of Variable O&M Costs

The Second Supply Project Agreement provides that if the cost or costs per MG as calculated as described in the preceding paragraph vary from the cost per MG set forth in the Project Annual Budget for the immediately prior calendar year for such Project uses, Tacoma is to calculate for each Participant either the additional payment required or the credit due based on the actual usage of Project Water by each Participant during the prior calendar year. If any additional payment is due from a Participant, Tacoma is to issue an invoice for such payment. If a credit is due to a Participant, Tacoma is to first apply the credit to the reimbursement of the Regional Water Supply System Operating Reserve Account, in the event such payment is needed pursuant to the provisions of the Second Supply Project Agreement described below under “SECOND SUPPLY PROJECT AGREEMENT—*Regional Water Supply System Operating Reserve Account*.” No interest is to be paid on any such adjustment.

Not later than sixty (60) days after the first day of each calendar year, Tacoma is to calculate the difference between the actual Fixed O&M Costs incurred during the previous calendar year and the Fixed O&M Costs billed to each Participant.

If the Fixed O&M Costs actually incurred as calculated as described in the preceding paragraph varies from that billed, Tacoma is to calculate for each Participant either the additional payment required or the credit due. If any additional payment is due from a Participant, Tacoma is to issue an invoice for such payment. If a credit is due to a Participant, Tacoma is to first apply the credit to the reimbursement of the Regional Water Supply System Operating Reserve Account in the event such payment is needed pursuant to the provisions of the Second Supply Project Agreement described below under “SECOND SUPPLY PROJECT AGREEMENT—*Regional Water Supply System Operating Reserve Account*.” No interest is to be paid on any such adjustment.

Dispute Resolution

Except as otherwise provided in the Second Supply Project Agreement, any and all disputes arising under the Second Supply Project Agreement are to be resolved by binding arbitration.

Pursuant to the Second Supply Project Agreement, the Participants are to make good faith efforts to resolve by informal discussion any dispute arising under or in connection with the Second Supply Project Agreement. If at any time a Participant to a dispute determines that such informal discussions will not result in a resolution, such Participant may initiate binding arbitration of any dispute arising under or in connection with the Second Supply Project Agreement. Any such arbitration shall be conducted pursuant to the rules for commercial arbitration of the American Arbitration Association or the rules of such other non-judicial dispute resolution service as agreed to by the Participants to the dispute. In any such arbitration proceeding, the Participants to such dispute are to have the rights of discovery available to parties in civil litigation under the Federal Rules of Civil Procedure.

The Second Supply Project Agreement provides that the award of the arbitrators will be final, and may be enforced in any court having jurisdiction. In making any such award, the arbitrators shall have the authority to grant such relief as they deem appropriate, including without limitation the award of damages and the granting of specific performance.

Pending the decision in any binding arbitration process pursuant to the Second Supply Project Agreement, the Participants to such process are to continue to fulfill their respective duties under the Second Supply Project Agreement.

Uncontrollable Forces

A Participant will not be in breach of the Second Supply Project Agreement as a result of such Participant's failure to perform its obligations under the Second Supply Project Agreement when such failure is due to an Uncontrollable Force, to the extent that such Participant, despite the exercise of due diligence, is unable to remove such Uncontrollable Force. Nothing in the Second Supply Project Agreement will be construed to require any Participant to prevent or settle any strike or labor dispute in order to obtain relief under the provisions of the Second Supply Project Agreement summarized in this section.

Any Participant subject to an Uncontrollable Force that may impair its performance under the Second Supply Project Agreement is required to notify all other Participants as soon as practicable. Any Participant subject to an Uncontrollable Force is to be excused from performance under the Second Supply Project Agreement only for the duration of and to the extent of the Uncontrollable Force. Any Participant subject to an Uncontrollable Force will be required to take all reasonable actions to remove the Uncontrollable Force. Neither the occurrence of an Uncontrollable Force nor the provisions of the Second Supply Project Agreement summarized in this section will relieve any Participant of its obligation to pay money when due under the terms of the Second Supply Project Agreement.

Default of Obligation

If any Participant fails to make any payment in full when due under the Second Supply Project Agreement for a period of forty-five (45) days or more, Tacoma will be required to make written demand upon such Participant to make payment in full within ten (10) days of the date of such written demand. If the failure to pay is not cured within the ten (10) day time period, the Participant shall be deemed to be in default.

The Second Supply Project Agreement provides that in addition to the remedies summarized above under “SECOND SUPPLY PROJECT AGREEMENT—*Payments*,” if the Participant has been in default of payment for a period of sixty (60) days or more, and the payment in default includes any amounts necessary to make payment on any Project Bonds, then the Project Committee is to offer for assignment to the non-defaulting Participants a pro rata share of the Participant Share of the defaulting Participant. The assignment of the defaulting Participant’s Participant Share is to vest in the assignee all of the rights and obligations under the Second Supply Project Agreement that the defaulting Participant could have exercised by virtue of such Participant Share, including without limitation, the right to use a pro rata share of the Second Diversion Water. If any non-defaulting Participant declines to accept all or any portion of the defaulting Participant’s Participant Share under the Second Supply Project Agreement, such Participant Share (or the remaining portion thereof) is to be reoffered to the remaining non-defaulting Participants until there is no unassigned Participant Shares of the defaulting Participant remaining, or no Participant wishes to accept any additional assignment. Any Participant accepting the assignment of all or any portion of the defaulting Participant’s Participant Shares is upon acceptance of such assignment to cure a proportionate share of any existing default in payment, and is to be responsible for the payment of any and all obligations associated with the Participant Share so assigned under the Project Agreement. For purposes of the provisions of the Second Supply Project Agreement summarized in this paragraph, pro rata share shall mean for each non-defaulting Participant the ratio obtained by dividing its Participant share by the sum of the Participant Shares of the non-defaulting Participants.

If after following the process described in the preceding paragraph there remains unassigned all or a portion of the Participant Share of the defaulting Participant, then Tacoma will be required to have its Participant Share increased in an amount equal to the defaulting Participant’s Participant Share remaining after any reassignment.

The Second Supply Project Agreement provides that the fact that other Participants have assumed the obligation to make payments which were due and owing from the defaulting Participant will not relieve the defaulting Participant of its liability for such payments, and the Participants assuming such obligations, whether individually or as a member of a group, will have a right of recovery from the defaulting Participant. Any Participant, as its interests may appear, whether jointly or severally, may commence such suits, actions or proceedings, at law or in equity, including suits for specific performance, as may be necessary or appropriate to enforce the obligations of the Second Supply Project Agreement against any defaulting Participant. To the extent that a Participant in said litigation is successful, then said Participant is entitled to recover its reasonable attorney fees and costs against the defaulting Participant.

In the event that the Participant Share of a defaulting Participant is assigned to another Participant(s) as described above, the non-defaulting Participants will be required to enter into good faith negotiations to revise by mutual agreement the apportionment of votes and the approval requirements described above under “SECOND SUPPLY PROJECT AGREEMENT—*Project Committee*.” Any such revision are to be done in a manner that recognizes the change in Participant Share as a result of such assignment, while maintaining the initial intentions of the Participants as expressed therein. Absent a mutual agreement to such revision, notwithstanding any assignment pursuant to the Second Supply Project Agreement, no Participant will be entitled to cast the votes allocated to the defaulting Participant.

Pursuant to the Second Supply Project Agreement, taking the actions described in this section, including without limitation a determination of default, will not be subject to dispute resolution provisions described above under “SECOND SUPPLY PROJECT AGREEMENT—*Dispute Resolution*.”

Assignment and Other Arrangements

Except as otherwise provided in the Second Supply Project Agreement, the rights and obligations of the Second Supply Project Agreement may not be sold, assigned or, otherwise transferred in whole or in part by a Participant to a party that is not a Participant without the prior written consent of all other Participants, which consent shall not be unreasonably withheld.

The Second Supply Project Agreement provides that nothing in the Project Agreement will prohibit a Participant from transferring to any other Participant for a period longer than an Operating Year any right or privilege of such Participant under the Second Supply Project Agreement. Prior to consummating any such transfer,

the Participant transferring the right or privilege will be required to provide to all other Participants the contract under which the transfer will occur, and permit the other Participants a reasonable period of time to comment on the proposed transfer. Any such agreement between two or more Participants is not to change the rights and duties of such Participants under the Second Supply Project Agreement.

Waivers

Except as otherwise provided in the Second Supply Project Agreement or as agreed to by the Participants, no provision of the Second Supply Project Agreement may be waived except as documented or confirmed in writing. Any waiver at any time by a Participant of its rights with respect to a default under the Second Supply Project Agreement or with any other matter arising in connection therewith, will not be deemed a waiver with respect to any subsequent default or matter. Any Participant may waive any notice or agree to accept a shorter notice than specified in the Second Supply Project Agreement. Such waiver of notice or acceptance of shorter notice by a Participant at any time regarding a notice will not be considered a waiver with respect to any subsequent notice required by the Second Supply Project Agreement.

Disposition of Funds Upon Termination of the Project

When the Project is terminated in accordance with the Second Supply Project Agreement, the Participants will be required to use any proceeds that are obtained by selling all or any portion of the Project for salvage to satisfy any obligation then outstanding on any Project Bonds. If after satisfying all such obligations, the remaining proceeds are required to be used to satisfy any other cost of the Project that remains unpaid. Any proceeds from the salvage of the Project that remain after satisfying such obligations are to be divided among the Participants in accordance with their Participant Shares.

Amendments

No change, amendment or modification of any provision of the Second Supply Project Agreement will be valid unless set forth in a written amendment to the Second Supply Project Agreement signed by all Participants. Those changes, amendments or modifications considered by unanimous vote of the Project Committee to be non-substantive in nature may be preliminarily adopted and temporarily implemented by said vote but do not become official until executed as a written amendment signed by all Participants.

Liability

The Second Supply Project Agreement provides that with respect to actions approved by the Project Committee, any liability, loss, cost, damages or expense suffered by the Project are to be deemed a Project Cost and are to be shared by all Participants in accordance with their respective Participant Share. With respect to actions or omissions by Tacoma, if related to Tacoma's duties in operating and managing the Project pursuant to the Second Supply Project Agreement, then any liability, loss, cost, damages or expense suffered by the Project as a result of such actions or omissions are to be deemed a Project Cost, and are to be shared by each Participant in accordance with their respective Participant Share, excepting only those resulting from actions or omissions by Tacoma that are determined to be inconsistent with Prudent Utility Practice.

Regional Water Supply System Operating Reserve Account

Pursuant to the Second Supply Project Agreement, to provide for operating cash to cover Regional Water Supply System Fixed O&M Costs and Variable O&M Costs during the period of time from when expenses are incurred by Tacoma until the costs are reimbursed, Tacoma is required to maintain an operating reserve account equal to two-months Fixed O&M Costs and Variable O&M Costs as projected in the current Project Annual Budget. Each Participant is required to pay into the operating reserve account an amount equal to its two-month Participant Share of Fixed O&M Costs and, for Variable O&M Costs, an amount equal to two-months of its Variable O&M Costs as projected in the current Project Annual Budget.

Not later than sixty (60) days after the first day of each calendar year, Tacoma is to calculate the funds necessary to maintain the Regional Water Supply System Operating Reserve Account equal to two months' Fixed O&M Costs and Variable O&M Costs as projected in the current year Project Annual Budget for each Participant, consistent with the payment requirements of the Second Supply Project Agreement described in the preceding paragraph.

If the funds necessary to maintain the Regional Water Supply System Operating Reserve Account equal to two months' Fixed O&M Costs and Variable O&M Costs as projected in the Project Annual Budget vary from the actual amount in the Regional Water Supply System Operating Reserve Account after the above calculation is made, Tacoma will be required to calculate for each Participant either the additional payment required or the credit due to maintain the Regional Water Supply System Operating Reserve Account equal to two months' Fixed O&M Costs and Variable O&M Costs of the current Project Annual Budget. If a payment is required, Tacoma is to issue an invoice for such payment pursuant. No interest is to be paid on any such adjustment.

Any interest earned on the Regional Water Supply System Operating Reserve Account is to be used as a credit, based on each Participant's cash balance in the Regional Water Supply System Operating Reserve Account, in the annual calculation performed as described above.

Pursuant to the Second Supply Project Agreement, should the Regional Water System Reserve Account be dissolved for any reason, the funds are to be returned to the Project Participants consistent with each Participant's cash balance in the Regional Water Supply System Operating Reserve Account.

APPENDIX F

PROPOSED FORM OF OPINION OF BOND COUNSEL

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May __, 2015

City of Tacoma, Washington
Department of Public Utilities
Tacoma, Washington

Re: City of Tacoma, Washington
Water System Revenue Refunding Bonds, Series 2015A and Series 2015B (Taxable)
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel to the City of Tacoma, Washington, acting by and through the Department of Public Utilities (the “City”), in connection with issuance of \$16,645,000 aggregate principal amount of City of Tacoma, Washington, Water System Revenue Refunding Bonds, Series 2015A (the “2015A Bonds”) and \$6,365,000 aggregate principal amount of City of Tacoma, Washington, Water System Revenue Refunding Bonds, Series 2015B (Taxable) (the “2015B Bonds” and together with the 2015A Bonds, the “Bonds”), issued pursuant to the provisions of Chapters 35.41, 35.92, 39.46 and 39.53 of the Revised Code of Washington, the Charter of the City of Tacoma (the “Charter”), and Substitute Ordinance No. 28138, passed by the City Council on March 19, 2013 (the “Master Bond Ordinance”), as supplemented by Ordinance No. 28290, passed by the City Council on March 31, 2015 (the “Supplemental Ordinance” and together with the Master Bond Ordinance, the “Bond Ordinance”). Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Bond Ordinance.

In such connection, we have reviewed the Bond Ordinance, the Tax Certificate, dated the date hereof (the “Tax Certificate”), executed and delivered by the City, an opinion of counsel to the City, certificates of the City, U.S. Bank National Association, as bond registrar, and others, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this letter speaks only as of its date and is not intended to, and may not, be relied upon or otherwise used in connection with any such actions, events or matters. Our engagement with respect to the Bonds has concluded with their issuance, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the City. We have assumed,

without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents and of the legal conclusions contained in the opinion, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Bond Ordinance and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the 2015A Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Bond Ordinance and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, receivership, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against municipal corporations in the State of Washington. We express no opinion with respect to any indemnification, contribution, liquidated damages, penalty (including any remedy deemed to constitute a penalty), right of set-off, arbitration, choice of law, choice of forum, choice of venue, non-exclusivity of remedies, waiver or severability provisions contained in the foregoing documents, nor do we express any opinion with respect to the state or quality of title to or interest in any of the assets described in or as subject to the lien of the Bond Ordinance or the accuracy or sufficiency of the description contained therein of, or the remedies available to enforce liens on, any such assets. Our services did not include financial or other non-legal advice. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion herein with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Bonds constitute the valid and binding limited obligations of the City.
2. The Bond Ordinance has been duly enacted by, and constitutes the valid and binding obligation of, the City. The Bond Ordinance creates a valid pledge, to secure the payment of the principal of and interest on the Bonds, of the Net Revenues of the Water System and all money and investments held in the Bond Fund, the Rate Stabilization Account and Construction Fund (except for money or investments held for the purpose of compliance with rebate requirements under the Code), subject to the provisions of the Bond Ordinance permitting the application thereof for the purposes and on the terms and conditions set forth in the Bond Ordinance.
3. Interest on the 2015A Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Code. Interest on the 2015A Bonds is not a specific

City of Tacoma, Washington

May __, 2015

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preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Interest on the 2015B Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Code. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

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