#### OFFICIAL STATEMENT DATED MAY 15, 2012

New Issue Book-Entry Only Moody's Rating: Aal
Standard & Poor's Rating: AA+
(See "Other Bond Information—Ratings on the Bonds.")

DUE: SEPTEMBER 1, AS SHOWN ON PAGE i

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

# THE CITY OF SEATTLE, WASHINGTON \$238,770,000

# WATER SYSTEM REFUNDING REVENUE BONDS, 2012

#### DATED: DATE OF INITIAL DELIVERY

The City of Seattle Water System Refunding Revenue Bonds, 2012 (the "Bonds"), will be issued as fully registered bonds under a book-entry only system, registered in the name of Cede & Co. as bond owner and nominee for the Depository Trust Company ("DTC").

DTC will act as initial securities depository for the Bonds. Individual purchases of the Bonds will be made in book-entry form, in the denomination of \$5,000 or any integral multiple thereof within a single maturity. Purchasers will not receive certificates representing their interest in the Bonds. Interest on the Bonds is payable semiannually on each March 1 and September 1, beginning September 1, 2012. The principal of and interest on the Bonds are payable by the City's Bond Registrar, currently the fiscal agent of the State of Washington (currently The Bank of New York Mellon in New York, New York), to DTC, which is obligated in turn to remit such payments to its participants for subsequent disbursement to beneficial owners of the Bonds, as described in "Description of the Bonds—Book-Entry Transfer System" and in Appendix D.

The Bonds are being issued to refund, depending on market conditions, certain outstanding obligations of the Water System and to pay the administrative costs of the refunding and the costs of issuing the Bonds.

The Bonds are subject to redemption prior to maturity as described herein. See "Description of the Bonds—Redemption of Bonds."

The Bonds are special limited obligations of the City of Seattle (the "City") payable solely out of the Bond Account. The Net Revenue of the Water System and all money and investments held in the Bond Account, the Rate Stabilization Account and the Construction Account (with certain limited exceptions) are pledged to the payment of all Parity Bonds, including the Bonds. This pledge constitutes a lien and charge upon the Net Revenue prior and superior to any other liens and charges. See "Security for the Bonds."

The Bonds do not constitute general obligations of the City, the State of Washington (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, the State, or any political subdivision of the State not specifically pledged thereto by the legislation authorizing the issuance of the Bonds. Neither the full faith and credit nor the taxing power of the City, nor any revenues of the City derived from sources other than the Water System, are pledged to the payment of the Bonds.

The Bonds are offered for delivery to the initial purchaser, when, as, and if issued, subject to the approving legal opinion of Foster Pepper PLLC, Seattle, Washington, Bond Counsel. The form of Bond Counsel's opinion is attached hereto as Appendix B. It is expected that the Bonds will be ready for delivery at DTC's facilities in New York, New York, or to the Bond Registrar on behalf of DTC by Fast Automated Securities Transfer, on or about May 30, 2012.

This cover page contains certain information for quick reference only. It is not a summary of this issue. Investors must read the entire official statement to obtain information essential in making an informed investment decision.

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

The information set forth herein has been furnished by the City, DTC, and certain other sources that the City believes to be reliable. The information and expressions of opinion contained herein are subject to change without notice. Any statements made in this Official Statement involving matters of opinion or estimates, whether or not so expressly stated, are set forth as such and not as representations of fact or representations that the estimates will be realized. Summaries of documents do not purport to be complete statements of their provisions, and all such summaries are qualified by references to the entire contents of the summarized documents.

Neither the City's independent auditors nor the State Auditor nor any other independent accountants have compiled, examined, or performed any procedures with respect to this Official Statement or any financial information contained herein, nor have they expressed any opinion or any other form of assurance on such information, and they assume no responsibility for, and disclaim any association with, this Official Statement and such information.

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 hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the City since the date hereof.

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

This Official Statement contains forecasts, projections, and estimates that are based upon expectations and assumptions that existed at the time such forecasts, projections, and estimates were prepared. In light of the important factors that may materially affect forecasted conditions, the inclusion in this Official Statement of such forecasts, projections, and estimates should not be regarded as a representation by the City that such forecasts, projections, and estimates will occur. Such forecasts, projections, and estimates are not intended as representations of fact or as guarantees of results. If and when included in this Official Statement, the words "plan," "expect," "forecast," "estimate," "budget," "project," "intends," "anticipates," and similar words are intended to identify forward-looking statements, and any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include, among others, general economic conditions, changes in political conditions, weather conditions, social and economic conditions, regulatory initiatives and compliance with governmental regulations, litigation, and various other events, conditions, and circumstances, many of which are beyond the control of the City. These forward-looking statements speak only as of the date they were prepared.

This Official Statement is not to be construed as a contract with the purchasers of the Bonds.

The Bonds have not been registered under the Securities Act of 1933, as amended, in reliance upon a specific exemption contained in such act, nor have they been registered under the securities laws of any state.

# **MATURITY SCHEDULE**

# THE CITY OF SEATTLE, WASHINGTON \$238,770,000

# WATER SYSTEM REFUNDING REVENUE BONDS, 2012

Due		Interest		
September 1	Amounts	Rates	Yields	CUSIP Numbers(1)
2012	\$ 2,445,000	2.00%	0.20%	812728RQ8
2013	1,260,000	3.00	0.30	812728RR6
2014	8,500,000	4.00	0.40	812728RS4
2015	10,825,000	5.00	0.55	812728RT2
2016	11,335,000	5.00	0.69	812728RU9
2017	11,845,000	5.00	0.87	812728RV7
2018	12,400,000	5.00	1.07	812728RW5
2019	12,990,000	5.00	1.26	812728RX3
2020	13,695,000	5.00	1.49	812728RY1
2021	15,550,000	5.00	1.72	812728RZ8
2022	16,435,000	5.00	1.88	812728SA2
2023	17,010,000	5.00	$2.06^{(2)}$	812728SB0
2024	8,580,000	5.00	$2.19^{(2)}$	812728SC8
2025	9,010,000	5.00	$2.31^{(2)}$	812728SD6
2026	9,465,000	5.00	$2.44^{(2)}$	812728SE4
2027	9,935,000	4.00	$2.72^{(2)}$	812728SF1
2028	10,340,000	4.00	$2.85^{(2)}$	812728SG9
2029	10,750,000	3.00	3.10	812728SH7
2030	11,080,000	5.00	$2.64^{(2)}$	812728SJ3
2031	11,635,000	5.00	$2.70^{(2)}$	812728SK0
2032	9,270,000	4.00	$3.16^{(2)}$	812728SL8
2033	9,645,000	4.00	$3.23^{(2)}$	812728SM6
2034	4,770,000	4.00	$3.30^{(2)}$	812728SN4

<sup>(1)</sup> The CUSIP data herein are provided by CUSIP Global Services, managed on behalf of the American Bankers Association by Standard & Poor's. 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 are subject to change after the issuance of the Bonds. Neither the City nor the purchaser of the Bonds take responsibility for the accuracy of the CUSIP numbers.

<sup>(2)</sup> Calculated to the September 1, 2022, par call date.

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# THE CITY OF SEATTLE

# **CITY OFFICIALS AND CONSULTANTS**

#### MAYOR AND COUNCIL

Mayor

Michael McGinn

Sally Clark	President, City Council
Sally Bagshaw	Council Member
Tim Burgess	Council Member
Richard Conlin	Council Member
Jean Godden	Council Member
Bruce Harrell	Council Member
Nick Licata	Council Member
Mike O'Brien	Council Member
Tom Rasmussen	Council Member

# **CITY ADMINISTRATION**

Glen M. Lee	Director of Finance
Peter Holmes	City Attorney

#### SEATTLE PUBLIC UTILITIES

Director
Deputy Director for Corporate Strategies and Communication
Deputy Director for Human Resources and Service Equity
Deputy Director for Field Operations and Maintenance
Deputy Director for Finance and Administration
Deputy Director for Customer Service
Deputy Director for Utility Systems Management
Deputy Director for Project Delivery

# **BOND COUNSEL**

Foster Pepper PLLC Seattle, Washington

# FINANCIAL ADVISOR

Seattle-Northwest Securities Corporation Seattle, Washington

# **BOND REGISTRAR**

Washington State Fiscal Agent The Bank of New York Mellon New York, New York This page left blank intentionally

#### OFFICIAL STATEMENT

# THE CITY OF SEATTLE, WASHINGTON \$238,770,000

#### WATER SYSTEM REFUNDING REVENUE BONDS, 2012

The purpose of this Official Statement, which includes the cover, inside cover, and appendices, is to set forth certain information concerning The City of Seattle, Washington (the "City"), a municipal corporation duly organized and existing under and by virtue of the laws of the State of Washington (the "State"), Seattle Public Utilities ("SPU"), and the City's water system, referred to in the legislation authorizing the issuance of the Bonds as the "Municipal Water System" (the "Water System"), in connection with the offering of \$238,770,000 aggregate principal amount of its Water System Refunding Revenue Bonds, 2012 (the "Bonds"), dated the date of their initial delivery.

The Bonds are to be issued by the City in accordance with Ordinance 121939, passed by the City Council on September 26, 2005, as amended (the "Bond Ordinance"), and Resolution 31382, adopted by the City Council on May 15, 2012 (the "Bond Resolution," and together with the Bond Ordinance, the "Bond Legislation"). The Bonds also are issued pursuant to chapters 35.92 and 39.53 of the Revised Code of Washington ("RCW") and the Seattle City Charter.

Appendix A to this Official Statement is a copy of Ordinance 121939. Appendix B is the form of the legal opinion of Foster Pepper PLLC of Seattle, Washington ("Bond Counsel"). Appendix C is the audited 2011 financial statements of the Water Fund. Appendix D provides demographic and economic information for the City. Appendix E is a description provided on its website by The Depository Trust Company, New York, New York ("DTC"), of DTC procedures with respect to book-entry bonds. Capitalized terms that are not defined herein have the meanings set forth in the Bond Legislation.

#### **DESCRIPTION OF THE BONDS**

#### **Registration and Denomination**

The Bonds are issuable only as fully registered bonds under a book-entry transfer system, registered in the name of Cede & Co. as bondowner and nominee for DTC. DTC will act as initial securities depository for the Bonds. Purchasers will not receive certificates representing their interest in the Bonds purchased. The Bonds will be issued in denominations of \$5,000 or any integral multiple thereof.

The Bonds will be dated the date of their initial delivery. The Bonds will mature on September 1 in the years and amounts set forth on page i of this Official Statement. Interest on the Bonds is payable semiannually on each March 1 and September 1, beginning September 1, 2012, at the rates set forth on page i of this Official Statement. Interest on the Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months.

The principal of and interest on the Bonds are payable by the City's Bond Registrar, currently the fiscal agent of the State of Washington (currently The Bank of New York Mellon in New York, New York) to DTC, which is obligated in turn to remit such payments to its participants for subsequent disbursement to beneficial owners of the Bonds, as described herein under "Book-Entry Transfer System" and in Appendix E.

#### Redemption of the Bonds

Optional Redemption. The Bonds maturing on and before September 1, 2022, are not subject to redemption prior to maturity. The City reserves the right and option to redeem Bonds maturing on and after September 1, 2023, prior to their stated maturity dates at any time on and after September 1, 2022, as a whole or in part at a price of par plus accrued interest to the date fixed for redemption.

Selection of Bonds for Redemption. If fewer than all of the Bonds subject to redemption are to be optionally redeemed prior to maturity, the City will select the maturity or maturities to be redeemed. If fewer than all of a single maturity of Bonds are to be redeemed prior to maturity, then:

- (i) if such Bonds are in book-entry form at the time of such redemption, DTC is required to select the specific Bonds in accordance with the Letter of Representations, and
- (ii) if such Bonds are not in book-entry form at the time of such redemption, the Bond Registrar is required to select the specific Bonds for redemption by lot or in such manner as the Bond Registrar in its discretion may deem to be fair and appropriate.

The portion of any Bond of a denomination more than \$5,000 to be redeemed will be in the principal amount of \$5,000 or any integral multiple thereof, to be selected, as the case may be, by DTC in accordance with the Letter of Representations or by the Bond Registrar in such manner as the Bond Registrar in its discretion may deem to be fair and appropriate.

Notice of Redemption. Notice of any intended redemption of Bonds will be given not less than 20 nor more than 60 days prior to the date fixed for redemption by first-class mail, postage prepaid, to the registered owner of any Bond to be redeemed at the address appearing on the Bond Register at the time the Bond Registrar prepares the notice. The notice requirements will be deemed to have been fulfilled when notice is mailed, whether or not it actually is received by the owner of any Bond. As long as the Bonds are held in book-entry form, notices will be given in accordance with procedures established by DTC. See "Description of the Bonds—Book-Entry Transfer System" and Appendix E.

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 the Bonds by giving a notice of rescission to the affected registered owners at any time on or prior to the scheduled optional redemption date. Any notice of optional redemption that is so rescinded shall be of no effect, and the Bonds for which the notice of optional redemption has been rescinded shall remain outstanding.

*Effect of Redemption.* Interest on Bonds called for redemption will cease to accrue on the date fixed for redemption unless the notice of redemption has been duly rescinded or the Bonds called are not redeemed when presented pursuant to the call.

#### **Purchase**

The City reserves the right to purchase any of the Bonds at any time at any price acceptable to the City plus accrued interest to the date of purchase.

# **Book-Entry Transfer System**

Book-Entry Bonds. DTC will act as initial securities depository for the Bonds. The ownership of one fully registered Bond for each maturity of the Bonds, as set forth on page i of this Official Statement, each in the aggregate principal amount of such maturity, will be registered in the name of Cede & Co., as nominee for DTC. See Appendix E for additional information. As indicated therein, certain information in Appendix E has been obtained from DTC's website. The City makes no representation as to the accuracy or completeness of the information in Appendix E provided by DTC. Purchasers of the Bonds should confirm this information with DTC or its participants.

Termination of Book-Entry Transfer System. If DTC resigns as the securities depository and the City is unable to retain a qualified successor to DTC or if the City determines that a continuation of the book-entry transfer system is not in the best interest of the City, the City will deliver at no cost to the beneficial owners of the Bonds or their nominees Bonds in registered certificate form, in the denomination of \$5,000 or any integral multiple thereof within a maturity of the Bonds. Thereafter, the principal of the Bonds will be payable upon the presentation and surrender thereof at the principal office of the Bond Registrar. Interest on the Bonds will be paid by checks or drafts mailed by the Bond Registrar on the interest payment date to the registered owners at the address appearing upon the Bond Register on the 15th day of the month preceding the interest payment date or, at the request of a registered owner of \$1,000,000 or more in aggregate principal amount of Bonds, by

wire transfer to an account in the United States designated in writing by such registered owner prior to the Record Date. The Bonds then will be transferable as provided in the Bond Legislation.

# Refunding or Defeasance of Bonds

The City may issue refunding bonds or use money available from any other lawful source to redeem and retire, release, refund, or defease the Bonds or any portion thereof (the "Defeased Bonds"). If sufficient money and/or Government Obligations, defined below (taking into account known earned income from the investment thereof) are set aside in a special fund pledged irrevocably to the redemption, retirement or defeasance of the Defeased Bonds (the "Trust Account"), then all right and interest of the owners of the Defeased Bonds in the pledges and covenants of the Bond Legislation and in the Net Revenues and the funds and accounts pledged to the payment of the Defeased Bonds, other than the right to receive the funds so set aside and pledged, will cease and become void. Such owners thereafter will have the right to receive payment of the principal of and interest or redemption price on the Defeased Bonds from the Trust Account.

The term "Government Obligations" has the meaning given in chapter 39.53.010 RCW, as amended, currently: (i) 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; (ii) 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; (iii) public housing bonds and project notes fully secured by contracts with the United States; and (iv) 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.

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 may determine.

#### **USE OF PROCEEDS**

# Purpose

The Bonds are being issued to refund certain outstanding obligations of the Water System, described under "Refunding Plan," and to pay the administrative costs of the refunding and the costs of issuing the Bonds.

#### Sources and Uses of Funds

The proceeds of the Bonds will be applied as follows:

SOURCES OF FUNDS	
Par Amount of Bonds	\$ 238,770,000
Net Original Issue Premium	45,515,451
Total Sources of Funds	\$ 284,285,451
USES OF FUNDS	
Refunding Escrow Deposit	\$ 282,897,364
Costs of Issuance*	1,388,087
Total Uses of Funds	\$ 284,285,451

<sup>\*</sup> Includes legal fees, financial advisory and rating agency fees, printing costs, underwriter's discount, and other costs of issuing the Bonds and refunding the Refunded Bonds.

# **Refunding Plan**

The City intends to refund the City's outstanding callable Water System Revenue Bonds, 2001, Water System and Refunding Revenue Bonds, 2003, and Water System Revenue Bonds, 2004 (the "Refunded Bonds"), set forth below. The refunding is being undertaken to achieve debt service savings.

# REFUNDED BONDS

Bond	Maturity Date	Interest Rate	Par Amount	Call Date	Call Price	CUSIP Number
Water System Re	evenue Bonds, 2001					
Serials	11/01/2012	5.000%	\$ 1,365,000	06/29/2012	100%	812728HB2
	11/01/2013	5.000	1,425,000	06/29/2012	100	812728HC0
	11/01/2014	5.000	1,490,000	06/29/2012	100	812728HD8
	11/01/2015	5.000	1,555,000	06/29/2012	100	812728HE6
	11/01/2016	5.000	1,630,000	06/29/2012	100	812728HF3
	11/01/2017	5.000	1,705,000	06/29/2012	100	812728HG1
	11/01/2018	5.000	1,790,000	06/29/2012	100	812728HH9
	11/01/2019	5.000	1,875,000	06/29/2012	100	812728HJ5
	11/01/2020	5.000	1,970,000	06/29/2012	100	812728HK2
	11/01/2021	5.000	2,070,000	06/29/2012	100	812728HL0
Term	11/01/2026	5.000	12,025,000	06/29/2012	100	812728HR7
Term	11/01/2031	5.000	 15,420,000	06/29/2012	100	812728HW6
Subtotal			\$ 44,320,000			
	Maturity	Interest	Par			CUSIP
Bond	Date	Rate	Amount	Call Date	Call Price	Number
Water System ar	nd Refunding Reven	ue Bonds, 2003				
Serials	09/01/2014*	4.000%	\$ 7,705,000	09/01/2013	100%	812728JL8
	09/01/2015*	5.000	8,005,000	09/01/2013	100	812728JM6
	09/01/2016*	5.000	8,385,000	09/01/2013	100	812728JN4
	09/01/2017*	5.000	8,750,000	09/01/2013	100	812728JP9
	09/01/2018*	5.000	9,150,000	09/01/2013	100	812728JQ7
	09/01/2019*	5.000	9,585,000	09/01/2013	100	812728JR5
	09/01/2020*	5.000	10,120,000	09/01/2013	100	812728JS3
	09/01/2021	5.000	11,790,000	09/01/2013	100	812728JT1
	09/01/2022	5.000	12,480,000	09/01/2013	100	812728JU8
	09/01/2023	5.000	12,870,000	09/01/2013	100	812728JV6
	09/01/2024	4.625	4,225,000	09/01/2013	100	812728JW4
	09/01/2025	4.625	4,420,000	09/01/2013	100	812728JX2
Term	09/01/2028	4.700	14,535,000	09/01/2013	100	812728JY0
Term	09/01/2033	5.000	 29,320,000	09/01/2013	100	812728JZ7
Subtotal			\$ 151,340,000			

<sup>\*</sup> Partial maturities.

#### **REFUNDED BONDS (CONTINUED)**

	Maturity	Interest		Par			CUSIP
Bond	Date	Rate		Amount	Call Date	Call Price	Number
Water System Re	evenue Bonds, 2004						
Serials	09/01/2015	5.000%	\$	2,060,000	09/01/2014	100%	812728KS1
	09/01/2016	5.000		2,165,000	09/01/2014	100	812728KT9
	09/01/2017	5.000		2,270,000	09/01/2014	100	812728KU6
	09/01/2018	5.000		2,385,000	09/01/2014	100	812728KV4
	09/01/2019	5.000		2,505,000	09/01/2014	100	812728KW2
	09/01/2020	5.000		2,630,000	09/01/2014	100	812728KX0
	09/01/2021	5.000		2,760,000	09/01/2014	100	812728KY8
	09/01/2022	5.000		2,900,000	09/01/2014	100	812728KZ5
	09/01/2023	5.000		3,045,000	09/01/2014	100	812728LA9
	09/01/2024	5.000		3,195,000	09/01/2014	100	812728LB7
	09/01/2025	5.000		3,355,000	09/01/2014	100	812728LC5
	09/01/2026	5.000		3,525,000	09/01/2014	100	812728LD3
	09/01/2027	5.000		3,700,000	09/01/2014	100	812728LE1
	09/01/2028	5.000		3,885,000	09/01/2014	100	812728LF8
	09/01/2029	5.000		4,080,000	09/01/2014	100	812728LG6
Term	09/01/2034	5.000		23,665,000	09/01/2014	100	812728LH4
Subtotal			\$	68,125,000			
Total			\$ 2	263,785,000			

The City will enter into a Refunding Trust Agreement with U.S. Bank, National Association, as Refunding Trustee, upon the delivery of the Bonds, to provide for the refunding of the Refunded Bonds. The Refunding Trust Agreement creates an irrevocable trust fund to be held by the Refunding Trustee and to be applied solely to the payment of the Refunded Bonds. A portion of the proceeds of the Bonds will be deposited with the Refunding Trustee and will be invested in Government Obligations that will mature and bear interest at rates sufficient to pay the principal of and accrued interest coming due on the redemption date of the Refunded Bonds.

The Government Obligations and earnings thereon will be held solely for the benefit of the registered owners of the Refunded Bonds.

The mathematical accuracy of (i) the computations of the adequacy of the maturing principal amounts of and interest on the Government Obligations to be held by the Refunding Trustee to pay principal of and interest on the Refunded Bonds as described above, and (ii) the computations supporting the conclusion of Bond Counsel that the Bonds are not "arbitrage bonds" under Section 148 of the Code, will be verified by Causey Demgen & Moore Inc., independent certified public accountants.

# SECURITY FOR THE BONDS

#### Pledge of Net Revenue

The Bonds are special limited obligations of the City payable solely from the Bond Account. The Net Revenue of the Water System and all money and investments held in the Bond Account, the Rate Stabilization Account and the Construction Account (with certain limited exceptions) are pledged to the payment of all Parity Bonds, including the Bonds. This pledge constitutes a lien and charge upon the Net Revenue prior and superior to any other charges. See Appendix A—Bond Ordinance—Section 16. The City has reserved the right to combine the Water System, including its funds and accounts, with other City utility systems, funds and accounts. See "Combined Utility Systems" below.

THE BONDS DO NOT CONSTITUTE GENERAL OBLIGATIONS OF THE CITY, THE STATE OF WASHINGTON (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, THE STATE, OR ANY POLITICAL SUBDIVISION OF THE STATE NOT SPECIFICALLY PLEDGED THERETO BY THE BOND LEGISLATION. NEITHER THE FULL FAITH AND CREDIT NOR THE TAXING POWER OF THE CITY, NOR ANY REVENUES OF THE CITY DERIVED FROM SOURCES OTHER THAN THE WATER SYSTEM, ARE PLEDGED TO THE PAYMENT OF THE BONDS.

The Water Revenue Bond Account (the "Bond Account") has been created in the Water Fund for the sole purpose of paying the principal of and interest on all Parity Bonds, including the Bonds. The City has agreed to pay into the Bond Account on or prior to the respective dates on which principal and interest are payable, all utility local improvement district ("ULID") assessments on their collection (except for ULID assessments deposited in a construction account) and certain amounts from the Net Revenue of the Water System sufficient to pay such principal and interest when due. See Appendix A—Bond Ordinance—Section 13.

#### **Reserve Subaccount**

The Reserve Subaccount has been created in the Bond Account to secure the payment of the principal of and interest on the Parity Bonds. So long as any Parity Bonds remain outstanding, the City is required to maintain the Reserve Subaccount at the lesser of (i) Maximum Annual Debt Service or (ii) 125% of Average Annual Debt Service on the Parity Bonds (the "Reserve Requirement"). Under the Bond Legislation, the City must fund any increase in the Reserve Requirement due to the issuance of the Bonds from Parity Bond proceeds, Net Revenue in no more than five annual installments, or Reserve Insurance. See Appendix A—Bond Ordinance—Section 13.

Upon the issuance of the Bonds, the Reserve Requirement is expected to be funded as shown in the following table. Under the Bond Legislation, the following surety policies qualify as Reserve Insurance in order to satisfy the Reserve Requirement, as each issuer was assigned a credit rating in the two highest rating categories at the time of issuance. See Appendix A—Bond Ordinance.

		Surety	Expiration	Current l	Ratings
<b>Bond Issue</b>	Surety Bonds	Provider	Date	Moody's	S&P
1993 <sup>(1)</sup>	\$ 19,069,616	AMBAC	12/01/2023	Withd	rawn
1997 <sup>(1)</sup>	3,783,203	FGIC	08/01/2026	Withd	rawn
1998 <sup>(1)</sup>	5,397,000	AMBAC	10/01/2027	Withd	rawn
1999 <sup>(1)</sup>	4,431,090	FGIC	03/01/2029	Withd	rawn
1999B <sup>(1)</sup>	9,440,403	FGIC	07/01/2029	Withd	rawn
2001	1,279,360	FGIC	11/01/2031	Withd	rawn
2003	4,256,356	MBIA (2)	09/01/2033	В3	В
2004	3,474,371	MBIA (2)	09/01/2034	В3	В
2006	3,110,214	FSA	02/01/2037	Aa3	AA-
Total Surety Bond Amounts	\$ 54,241,613				
Cash Deposit from 2008 Bond Proceeds	\$ 8,936,113				
Cash Deposit from 2010 Bond Proceeds	7,748,123				
Total Cash and Surety Bonds	\$ 70,925,849				
Reserve Fund Requirement	\$ 65,392,996				

<sup>(1)</sup> Surety will be outstanding until the earlier of the termination date or the day on which no Parity Bonds are outstanding.

<sup>(2)</sup> Reinsured by National Public Finance Guarantee Corp., a wholly-owned subsidiary of MBIA, Inc., currently rated Baa2 by Moody's and BBB by S&P.

# **Outstanding Bonds**

Outstanding Parity Bonds. The outstanding 2001 Bonds, 2003 Bonds, 2004 Bonds, 2005 Bonds, 2006 Bonds, 2008 Bonds, 2010A Bonds, and 2010B Bonds issued by the City and secured by revenues of the Water System on a parity with the Bonds collectively are referred to as the "Outstanding Parity Bonds." The Outstanding Parity Bonds, the Bonds and any Future Parity Bonds collectively are referred to as the "Parity Bonds." The following table provides a summary of the Outstanding Parity Bonds.

#### **OUTSTANDING PARITY BONDS**

Bond Description	Original Par Amount	Outstanding Principal on 05/01/2012
Water System Revenue Bonds, 2001*	\$ 52,525,000	\$ 44,320,000
Water System Revenue and Refunding Bonds, 2003*	271,320,000	185,725,000
Water System Revenue Bonds, 2004*	84,750,000	73,735,000
Water System Revenue and Refunding Bonds, 2005	138,040,000	123,000,000
Water System Revenue and Refunding Bonds, 2006	189,970,000	173,015,000
Water System Revenue and Refunding Bonds, 2008	205,080,000	185,205,000
Water System Revenue Bonds, 2010A	109,080,000	109,080,000
Water System Revenue and Refunding Bonds, 2010B	 81,760,000	73,500,000
Total	\$ 1,132,525,000	\$ 967,580,000

<sup>\*</sup> All of the Water System Revenue Bonds, 2001, and a portion of the Water System Revenue and Refunding Bonds, 2003, and Water System Revenue Bonds, 2004, will be refunded with a portion of the proceeds of the Bonds. See "Use of Proceeds—Refunding Plan."

#### **Other Outstanding Obligations**

Since 1993, the City has entered into six agreements with the Washington State Department of Community, Trade and Economic Development under its Public Works Assistance Account Loan Program for the construction of certain capital improvements, as described below. These loans are secured by a lien on Net Revenue of the Water System junior to that of the Parity Bonds.

# PUBLIC WORKS ASSISTANCE ACCOUNT LOANS (AS OF DECEMBER 31, 2011)

Year of Agreement	Amount Outstanding	Interest Rate
1993	\$ 236,433	1.00%
2005	3,189,474	1.50%
2007	3,142,222	1.50%
2008	2,551,579	1.50%
2010	5,920,997	1.00%
2010	2,583,474	1.50%
Total	\$ 17,624,179	

### **Future Obligations**

*Future Parity Bonds.* Future Parity Bonds may be issued upon satisfaction of certain conditions set forth in the Bond Legislation. Among other conditions, the City must have on file at the time of the issuance of the Future Parity Bonds:

- (i) a certificate of the Director of Finance showing that during any 12 consecutive months out of the preceding 24 months Adjusted Net Revenue was at least equal to 1.25 times the Adjusted Annual Debt Service (the "Coverage Requirement") for all Parity Bonds plus the Future Parity Bonds to be issued, or
- (ii) a certificate of the Director of Finance and the Director of SPU stating that, in their opinion, the Adjusted Net Revenue (taking into account certain permitted revenue adjustments) will be at least equal to the Coverage Requirement for the five years next following the earlier of (a) the end of the period during which interest on the Future Parity Bonds to be issued is capitalized or, if no interest is capitalized, the year in which the Future Parity Bonds are issued, or (b) the date on which substantially all the facilities financed with those Future Parity Bonds are expected to commence operations.

Future Subordinate Lien Bonds. In the Bond Legislation, the City has reserved the right to issue revenue bonds or other obligations having a lien on Gross Revenue subordinate to the lien thereon of the Parity Bonds.

Parity Payment Agreements. The City may enter into Parity Payment Agreements secured by a pledge of and lien on Net Revenue on a parity with the Parity Bonds, subject to the satisfaction of the requirements for the issuance of Future Parity Bonds. See Appendix A—Bond Ordinance—Section 19.

Contract Resource Obligations. The City may enter into Contract Resource Obligations to acquire water supply, transmission or other commodity or service from facilities to be constructed. The City may determine that all payments under those Contract Resource Obligations (including payments prior to the time such supply or service is being provided or during suspension or after termination of supply or service) will be an Operation and Maintenance Expense, upon compliance with certain requirements of the Bond Legislation. See Appendix A—Bond Ordinance—Section 22.

#### **Rate Covenant**

The City has covenanted to establish, maintain, and collect rates and charges for water service that will produce Adjusted Net Revenue of the Water System in each fiscal year at least equal to 1.25 times the Adjusted Annual Debt Service on all Parity Bonds for that year (the "Coverage Requirement"). See Appendix A—Bond Ordinance—Section 1 for definitions of "Adjusted Net Revenue" and "Adjusted Annual Debt Service," and Appendix A—Bond Ordinance—Section 17(b).

Rate Stabilization Account. The City may deposit Gross Revenue and any other money received by the Water System into the Rate Stabilization Account and may withdraw money from that account for inclusion in Adjusted Gross Revenue for any fiscal year of the Water System. Such deposits and withdrawals may be made up to and including the date that is 90 days after the end of the fiscal year for which the deposit or withdrawal will be included as Adjusted Gross Revenue. No deposit of Gross Revenue may 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. As of December 31, 2011, the balance in the Rate Stabilization Account was \$9.0 million. See "Water System—Financial Policies" and Appendix A—Bond Ordinance—Section 15.

#### Other Covenants

In the Bond Legislation, the City has entered into other covenants, including those with respect to maintenance of the Water System, sale of the Water System, and preservation of tax exemption for interest on the Bonds. See Appendix A—Bond Ordinance—Section 17.

#### No Acceleration of the Bonds

The Bonds are not subject to acceleration upon the occurrence of a default. The City, therefore, would be liable only for principal and interest payments as they become due. In the event of multiple defaults in payment of principal of or interest on the Parity Bonds, the registered owners would be required to bring a separate action for each such payment not made. This could give rise to a difference in interests between registered owners of earlier and later maturing Parity Bonds.

#### **Separate Utility Systems**

The City may create, acquire, construct, finance, own, and operate one or more additional systems for water supply, transmission or other commodity or service. The revenue of the separate system will not be included in Gross Revenue, and may be pledged to the payment of revenue obligations issued for the purposes of the separate system. Neither the Gross Revenue nor the Net Revenue of the Water System will be pledged to the payment of any obligations of the separate system, except as a Contract Resource Obligation or on a basis subordinate to the lien of the Parity Bonds on that Net Revenue. See Appendix A—Bond Ordinance—Section 21.

#### **Combined Utility Systems**

The City has reserved the right to combine the Water System with other City utility systems, including their funds and accounts. See the definition of "Municipal Water System" in Appendix A—Bond Ordinance—Section 1. Also see "Seattle Public Utilities—Administrative Structure" for a description of existing City utilities that have reserved the right to combine with other City utilities.

# **Debt Service Requirements**

The following table shows the debt service scheduled to be paid from the Net Revenue of the Water System.

DEBT SERVICE ON THE OUTSTANDING PARITY BONDS<sup>(1)</sup>

									The B onds			
Year	2001	2003	2004	2005	2006	2008	2010A (2)	2010B	Principal	Interest		Total
2012	\$ 1,108,000	\$ 14,125,163	3,763,625	\$ 10,894,400	\$ 13,120,625	\$ 14,481,050	\$ 6,100,956	\$ 8,051,900	\$ 2,445,000	\$ 2,805,922	\$	76,896,641
2013	-	10,427,200	2,061,500	10,883,400	13,108,000	14,477,800	6,100,956	8,052,500	1,260,000	11,051,450		77,422,806
2014	-	2,731,600	2,058,000	10,865,900	13,103,625	14,481,550	6,100,956	8,058,600	8,500,000	11,013,650		76,913,881
2015	-	2,749,000	-	10,856,650	13,096,750	14,481,550	6,100,956	8,067,000	10,825,000	10,673,650		76,850,556
2016	-	2,772,250	-	10,844,650	13,086,875	14,482,175	6,100,956	8,071,600	11,335,000	10,132,400		76,825,906
2017	-	2,794,250	-	10,839,400	13,083,250	14,477,800	6,100,956	8,077,200	11,845,000	9,565,650		76,783,506
2018	-	2,814,750	-	10,829,900	13,080,000	14,482,550	6,100,956	8,088,400	12,400,000	8,973,400		76,769,956
2019	-	2,868,500	-	10,820,650	13,076,375	14,480,550	9,460,956	4,769,600	12,990,000	8,353,400		76,820,031
2020	-	2,908,500	-	10,815,900	13,086,250	14,481,050	9,409,044	4,777,850	13,695,000	7,703,900		76,877,494
2021	-	-	-	10,819,650	13,083,750	14,483,050	9,357,229	4,789,350	15,550,000	7,019,150		75,102,179
2022	-	-	-	10,815,650	13,083,250	14,480,675	9,304,914	4,800,950	16,435,000	6,241,650		75,162,089
2023	-	-	-	10,813,400	13,078,875	14,478,050	9,243,120	4,810,450	17,010,000	5,419,900		74,853,795
2024	-	-	-	10,816,900	13,084,500	14,483,925	9,184,699	4,825,450	8,580,000	4,569,400		65,544,874
2025	-	-	-	10,804,900	13,084,000	14,477,300	9,109,559	4,840,200	9,010,000	4,140,400		65,466,359
2026	-	-	-	10,797,150	13,081,500	11,449,800	9,033,152	4,849,200	9,465,000	3,689,900		62,365,702
2027	-	-	-	7,357,400	13,080,875	11,453,925	8,966,001	4,867,200	9,935,000	3,216,650		58,877,051
2028	-	-	-	7,350,244	13,071,125	11,454,925	8,885,868	-	10,340,000	2,819,250		53,921,412
2029	-	-	-	7,344,675	13,068,588	11,452,050	8,804,708	-	10,750,000	2,405,650		53,825,671
2030	-	-	-	-	6,920,900	11,448,719	8,716,804	-	11,080,000	2,083,150		40,249,573
2031	-	-	-	-	6,918,538	11,452,613	8,626,705	-	11,635,000	1,529,150		40,162,005
2032	-	-	-	-	6,920,713	11,452,094	8,520,033	-	9,270,000	947,400		37,110,239
2033	-	-	-	-	6,916,975	7,078,844	8,412,265	-	9,645,000	576,600		32,629,684
2034	-	-	-	-	6,916,875	7,077,850	8,297,817	-	4,770,000	190,800		27,253,342
2035	-	-	-	-	6,919,738	7,076,500	8,178,560	-	-	-		22,174,797
2036	-	-	-	-	6,920,000	7,078,875	8,056,639	-	-	-		22,055,514
2037	-	-	-	-	6,917,213	7,079,056	7,926,465	-	-	-		21,922,734
2038	-	-	-	-	-	7,081,125	7,792,745	-	-	-		14,873,870
2039	-	-	-	-	-	-	7,649,888	-	-	-		7,649,888
2040	-	-	-	-	-	-	7,507,601	-	-	-		7,507,601
Total	\$ 1,108,000	\$ 44,191,213	7,883,125	\$ 184,570,819	\$290,909,163	\$325,365,450	\$233,151,461	\$ 99,797,450	\$238,770,000	\$125,122,472	\$ 1,	550,869,152

<sup>(1)</sup> Totals may not add due to rounding. Excludes the Refunded Bonds.

<sup>(2)</sup> Does not reflect the 35% interest rate subsidy associated with the 2010A Bonds

#### **SEATTLE PUBLIC UTILITIES**

#### **Administrative Structure**

Seattle Public Utilities ("SPU"), a single department of the City, administers four distinct business lines: drainage, wastewater, and solid waste for Seattle residents and businesses, and drinking water for 1.3 million regional customers. Each business line has a manager responsible for ensuring that its assets perform adequately to meet defined customer service levels.

Within SPU, there are three separate funds: the Water Fund, the Drainage and Wastewater Fund, and the Solid Waste Fund. The City has reserved the right to combine the Water System, including the Water Fund, with other City utility systems, funds, and accounts.

# Management

SPU consists of the Director's Office and six Executive Branches: Human Resources and Service Equity, Field Operations and Maintenance, Finance and Administration, Customer Service, Project Delivery, and Utility Systems Management. The Director administers SPU in accordance with policies established by the Mayor of the City (the "Mayor") and the City Council. Brief biographies of the members of SPU's executive management team follow.

Ray Hoffman, Director. Mr. Hoffman was appointed Acting Director of SPU in 2009 and was named Director in 2010. In this role, he is responsible for SPU's annual budget and oversight of its rates and utility funds, as well as conservation of the City's watersheds and compliance with federal and state water quality and environmental laws. Previously, he was Director of Corporate Policy and Performance, with responsibilities for external government relations, legislative affairs, and risk management. In addition, he formerly served as an advisor to the Mayor on utilities and environmental issues, was the lead for regional affairs and negotiations for SPU, worked in recycling planning and program development for solid waste, and served as Executive Director for Washington Citizens for Recycling. With more than 20 years of increasingly responsible roles in public policy and management, Mr. Hoffman is known for negotiating multi-party agreements on complex policy issues. Mr. Hoffman has a doctorate from the University of Washington School of Business, as well as a bachelor's degree and master's degree in accounting from the University of Illinois.

Martin Baker, Deputy Director for Corporate Strategies and Communications. Mr. Baker was appointed to the interim position in 2009 and named the permanent deputy director in 2010. He currently oversees all functions related to corporate policy and performance, asset management and economic services, and corporate communications, as well as climate change and sustainability and community relations development. Previously, he served as a Strategic Advisor in the Director's Office for 13 years. Prior to joining SPU, Mr. Baker served as Deputy Director, Habitat Program, with the Washington Department of Fish and Wildlife, Public Affairs Director of the Central Puget Sound Regional Transit Authority), and Executive Director of the Washington Environmental Council. He graduated from the University of Washington with both a master's degree and a bachelor's degree in history.

Kimberly Collier, Deputy Director for Human Resources and Service Equity. Ms. Collier was appointed to this position in 2009. The Human Resources and Service Equity branch is comprised of the Human Resources Division, HR Operations and Management, and the Environmental Justice and Service Equity Division. Prior to joining SPU, Ms. Collier was a human resources executive for Cox Communications in Arizona, where she also had responsibilities for diversity leadership including serving as the co-founder of the company's Diversity Council and held a number of roles in the community supporting diversity. A graduate of the College of New Jersey, Ms. Collier earned a bachelor's degree in management.

Rick Scott, Deputy Director for Field Operations and Maintenance. Mr. Scott joined SPU in 2010 as director of SPU's Distribution and Transmission Division and was appointed to Deputy Director of Field Operations and Maintenance in November 2011. As Deputy Director, he is responsible for developing operational strategies and directing and managing the production, delivery, and maintenance for water, wastewater, storm water, and solid waste services. Prior to joining SPU, he served as the water treatment superintendent for the City of

Glendale, Arizona, where he worked for 24 years. He started out as a plant mechanic and held roles with increasing responsibilities throughout the utility, serving as the water treatment superintendent for eight years. Mr. Scott has an associate degree in civil engineering from Glendale Community College and additional credit hours in utility operations and management or work-related courses.

Melina Thung, Deputy Director for Finance and Administration. Ms. Thung was appointed to this position in 2005 and oversees the branch's activities, including finance, information technology, fleet and facilities management, and risk management. Prior to that, she was Finance Director for SPU and also formerly served as budget analyst, budget manager, and environmental planner. She holds a bachelor's degree in international relations from Georgetown University, a master's degree in public administration from the University of Washington, and a master's degree in finance from Seattle University.

Susan Sánchez, Deputy Director for Customer Service. Ms. Sánchez was appointed to Acting Deputy Director in 2009 and in 2010 was named Deputy Director for the branch, which serves as the main liaison between SPU ratepayers and the department's operations. Prior to this, she was the Director for the Customer Programs and Contract Management Division, which manages the city's graffiti abatement and education, waste prevention, resource conservation, and community stewardship programs. Ms. Sánchez has over 20 years of experience in the environmental, transportation, and land use fields at the local, regional, and federal levels. Before joining SPU, she was Director of the Planning, Policy, and Major Projects Division for the Seattle Department of Transportation. She holds a bachelor's degree in urban planning from the University of Washington.

Nancy Ahern, Deputy Director for Utility Systems Management. Ms. Ahern, who was appointed to this position in 2005, leads staff who provide policy direction, regulatory compliance, and capital programming for SPU's drinking water, drainage, wastewater, and solid waste lines of business. She joined SPU in 2001 as Deputy Director for Resource Management and previously spent more than 15 years in state and local government services, focusing on utilities and natural resource management. During that time, she served as manager of the Water and Land Resources Division for King County, and prior to that, she worked in the City of Bellevue Utilities Department for six years and for the Puget Sound Water Quality Authority for three years. She also worked in Washington D.C. for the World Wildlife Fund/Conservation Foundation and in environmental consulting. Ms. Ahern holds a bachelor's degree in biology and environmental studies from Principia College and a Ph.D. degree in natural resource management from the University of Michigan. She also has a master's degree from Seattle University in organizational systems and renewal.

Linda De Boldt, Deputy Director for Project Delivery. Ms. De Boldt was appointed to this position in 2007. In this role, she serves as the chief engineer for the utility and leads engineering services for the capital improvement programs for all of the lines of business. The branch also provides other key technical services such as review of private development proposals and management of SPU's dam safety and landslide mitigation programs. She is a licensed professional engineer with 27 years of experience in public works engineering and management for the City. She has worked for the City as a design engineer, engineering manager, and division director in the fields of transportation, drainage, wastewater, water supply and treatment, and environmental restoration. She graduated from the University of Washington with a bachelor's degree in civil engineering.

# **Employment Retirement System and Employee Relations**

Currently SPU has approximately 1,400 regular employees, almost all of whom are members of the Seattle City Employee Retirement System ("SCERS"). SCERS requires SPU, like all City departments, to make contributions equal to an actuarially determined percentage of covered payrolls. See "The City of Seattle—Pension System." Approximately 70 percent of SPU employees are represented under one of ten labor agreements with unions. SPU is currently negotiating with two unions on labor agreements that expired December 31, 2011. Currently there is no expected date by which an agreement will be reached, and the unions continue to operate under the expired contracts. Eight additional labor agreements are effective through December 31, 2013. SPU believes that labor relations are satisfactory. See "The City of Seattle—Labor Relations."

#### WATER SYSTEM

#### General

The Water System was established in 1890. It currently includes two watershed sources of supply east of the City and two small wellfields south of the City, as well as approximately 1,800 miles of pipeline and 400 million gallons ("MG") of storage capacity in transmission and distribution reservoirs. The Water System's service area includes retail service to Seattle and portions of the Cities of Shoreline, Burien and Lake Forest Park, as well as a portion of unincorporated King County (the "direct service area"), and wholesale service to areas served by 21 suburban water districts and municipalities plus the Cascade Water Alliance ("Cascade") (together, the "Wholesale Customers") in King County and south Snohomish County. The population of the Water System's direct service area is approximately 670,000, and the population indirectly served through the Wholesale Customers is approximately 634,000. The map on the following page shows the direct service area and the locations of the Wholesale Customers. A summary of operating statistics for the Water System follows.

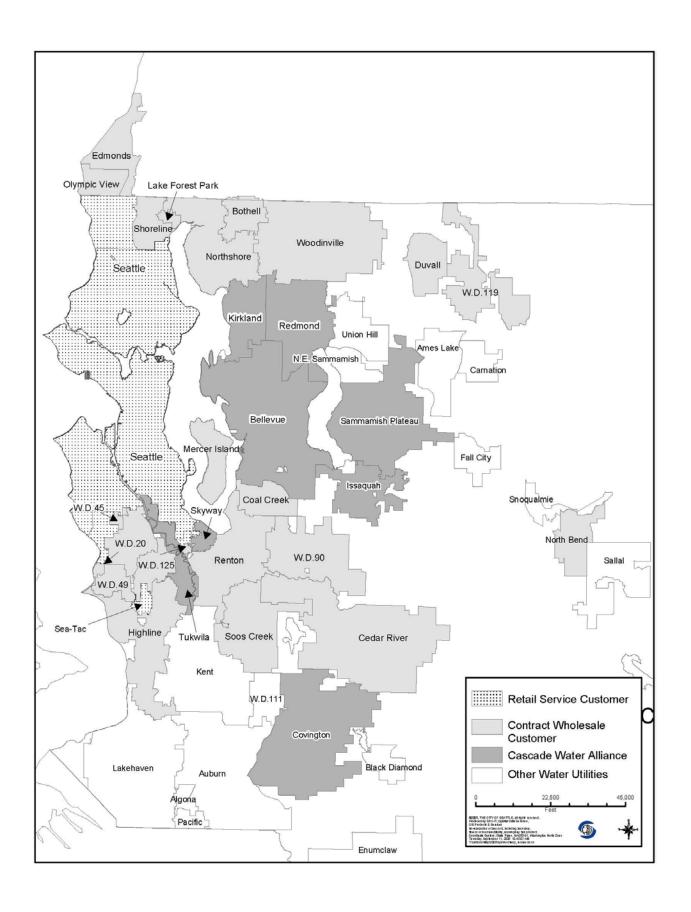


TABLE 1
WATER SYSTEM OPERATING STATISTICS

		2007		2008		2009		2010		2011	
Population Served				•		•				•	
Retail		642,385		649,286		658,951		664,458		669,654	
Wholesale (1)		609,613	616,592		621,606		628,536		634,193		
Total Population Served	1	1,251,998		1,265,878		1,280,557		1,292,994		1,303,847	
Water Sales Revenues (\$000) (2)(3)											
Retail	\$	102,334	\$	106,689	\$	130,272	\$	136,443	\$	137,382	
Wholesale		41,558		42,884		48,454		45,073		44,050	
Total Water Sales Revenues	\$	143,892	\$	149,573	\$	178,726	\$	181,515	\$	181,432	
Billed Water Consumption (MG) (3)											
Retail		21,311		20,599		20,956		19,868		19,305	
Wholesale		22,741		22,255		23,554		20,437		20,922	
Total Billed Water Use		44,052		42,853		44,510		40,305		40,227	
Operating Costs (\$ per MG) <sup>(4)</sup>	\$	3,143	\$	3,423	\$	3,679	\$	4,075	\$	3,842	
Gallons Used per Day per Capita		96		93		95		85		85	
Retail Meters in Use		185,272		187,032		188,102		188,332		188,754	
Number of New Retail Meters		1,696		1,760		1,070		230		422	
Total Water Diversions (MGD)		125.9		125.1		129.5		118.4		117.9	
Non-Revenue		5.2		8		7.5		8		7.7	
% Non-Revenue		4.1		6.4		5.8		6.7		6.5	

<sup>(1)</sup> This is the estimated total population served by SPU's water supply. As some Wholesale Customers obtain some or all of their water from sources other than SPU, this number is less than the total population of the shaded areas on the map on the previous page.

Source: Seattle Public Utilities

#### **Comprehensive Planning**

The SPU Water System Plan (the "Water System Plan") is a 20-year comprehensive plan for the Water System that is updated every six years. The most recent Water System Plan was approved by the Washington State Department of Health (the "DOH") in 2007. The 2013 Water System Plan is undergoing public review and is yet to be adopted by the City Council and approved by the DOH; the information provided herein is based on work used to develop the update. The Water System Plan provides guidance for planning and operating the Water System, and includes objectives for the next six years in the areas of water quality, maintenance and rehabilitation, water conservation, and water supply.

# Water Supply

The Water System's two surface water supply diversions are located on the Cedar River and on the South Fork of the Tolt River, each approximately 25 miles east of Seattle. The watershed areas upstream of the water supply intakes on these two rivers consist of approximately 104,000 acres of forest land in the Cascade

<sup>(2)</sup> Revenues represent payments from customers for service provided at published rates in each year. Revenues shown are not net of transfers to the Rate Stabilization Account or other credits or deferrals of income.

<sup>(3)</sup> Revenue increases have been a result of increases in rates, as retail consumption has steadily decreased due largely to conservation efforts. Variations in billed water use are primarily associated with year-to-year variations in temperature and precipitation in the summer irrigation period. There has been no significant change in the geographic area served nor any appreciable change in the number or composition of retail customers.

<sup>(4)</sup> The increases in per-unit operating costs in 2009 and 2010 are due in part to a temporary increase in the City's utility tax rate and increased amortization expense, both due to *Lane v. City of Seattle*. See "Litigation and Claims."

Mountains of western Washington. Rainfall in the watersheds averages in excess of 100 inches annually. The snow pack at higher elevations averages five feet per year. Raw water storage capacity is 40,000 acre feet in the Cedar River Watershed and 56,000 acre feet in the South Fork Tolt Watershed. Two barge-mounted pumping plants on Chester Morse Lake in the Cedar River Watershed provide access to an additional 42,000 acre feet of stored water.

The City has diverted water from the Cedar River for use by the Water System since 1902. The City acquired this right by purchase, riparian right, appropriation, and other applicable laws. This claim of water rights, its relationship to instream flow requirements and the effect of the City's diversion dam in blocking passage of anadromous fish have been addressed in the Cedar River Watershed Habitat Conservation Plan (the "HCP"), a comprehensive, 50-year set of legal agreements with State and federal governments signed in 2000. In 2006, in a comprehensive settlement with the Muckleshoot Indian Tribe regarding the Cedar River Watershed, the City agreed to further limits on its annual diversions. The City agreed to dedicate that portion of its water right above 124 million gallons per day ("MGD") to instream flows, and to certain limits on its annual diversions from the Cedar River in perpetuity. The agreement resolved long-standing issues between the City and the Muckleshoot Indian Tribe and strengthened the status of the City's water rights on the Cedar River.

The establishment of water rights under State law is a complex process subject to ongoing interpretation and litigation. The City's water rights on the South Fork of the Tolt River were established by permits for water storage and water diversion granted by the State in 1957, with a priority date of July 14, 1936. The reservoir storage certificate was issued in 2003, but the diversion water right remains in permit status. In 1989, the Federal Energy Regulatory Commission granted a license to Seattle City Light to build a hydroelectric power plant on the South Fork of the Tolt River, resulting in modifications to the terms of the original water permits. In 1997, Seattle City Light documented the full beneficial use of the water needed for the hydropower plant and received a certificate of water right.

In two wellfields located immediately north of the Seattle-Tacoma International Airport (the "Seattle Well Fields"), the City has developed three supply wells with a combined capacity of 10 MGD to augment the City's surface water supply. The feasibility of augmenting recharge of the aquifer with surplus winter-spring flows from the Cedar River has been tested successfully. The wells are operated under temporary permits from the State of Washington Department of Ecology ("Ecology"). The City has applied for permits that can be converted into water rights.

The City also has water rights applications on file with Ecology for potential future sources of supply, including the North Fork of the Tolt River and the Snoqualmie Aquifer. See "Future Water Supply and Conservation."

# **Future Water Supply and Conservation**

At present, SPU has adequate supply resources to meet Water System demands under a wide range of weather conditions. Existing sources of supply owned by the City provide an average annual firm yield of 172 MGD, an increase of one MGD from that reported in the 2007 Water System Plan. The current firm yield is based on an update completed in 2011 to represent current operating conditions, namely the use of the current spring refill target of elevation 1,563 feet for Chester Morse Lake and the use of a revised monthly demand distribution based upon the actual demand in 2005 through 2009. Demand in the service area has averaged less than 130 MGD since 2005.

While population has steadily risen in the service area, water demand has been decreasing due to conservation. Conservation has been encouraged through higher marginal rates in the summer peak season, aggressive water conservation programs, new state plumbing codes specifying efficiency standards for water fixtures, and improved Water System operations. In addition, water use reductions occur without SPU intervention when customers purchase new plumbing fixtures and water-using appliances that meet or, in many cases, exceed federal and State codes. Between 1999 and 2010, these programs and actions achieved an estimated cumulative average annual savings of more than 30 MGD.

SPU and 18 of the Wholesale Customers operate regional conservation programs collaboratively as the Saving Water Partnership. These regional conservation programs provide opportunities for customers within the direct service area and the service areas of participating Wholesale Customers.

In 2003, the State Legislature passed a Municipal Water Law that resulted in the adoption of water use efficiency rules by the DOH. The rules include planning requirements, distribution leakage standards, water use efficiency goal-setting, and performance reporting. SPU's 2007 Water System Plan includes a six-year regional conservation goal to achieve compliance with the Municipal Water Law for 2007 through 2012. SPU's draft 2013 Water System Plan includes the six-year regional goals proposed for 2013 through 2018. See "Capital Improvement Program."

Current forecasts of demand and supply included in the draft 2013 Water System Plan suggest that a new primary source of supply will not be needed before 2060, which is the end of the planning horizon currently used by SPU. This is due in part to the impact of the conservation savings noted above and in part to the declining-block contract with Cascade. See "Wholesale Customer Contracts." SPU considered the potential uncertainties associated with demand forecasts, as well as the potential impacts future climate change may have on its water supplies and demands, in determining that no significant investments in new sources are needed before 2060. Nevertheless, in addition to new conservation programs, several potential new water resources were identified in the 2007 Water System Plan and will be carried forward in the 2013 Water System Plan. These include:

- (i) development of the Snoqualmie River Valley/North Bend Aquifer,
- (ii) use of a permanent pumping plant at Chester Morse Lake for normal supply,
- (iii) drawdown of Lake Youngs (which stores water from the Cedar River) for water supply,
- (iv) additional drawdown of the reservoir on the South Fork of the Tolt River,
- (v) development of a new source of supply at the North Fork of the Tolt River, and
- (vi) development of reclaimed water projects in the direct service area.

These new resource alternatives vary in the amount of new supply provided, capital and operating costs, and level of effort needed to develop. SPU has not selected a preferred next source of supply.

### **Endangered Species Act**

In 1999, the National Marine Fisheries Service ("NMFS") listed the Puget Sound Chinook salmon, which migrate through waterways within and adjacent to the City, as a "threatened species" under the Endangered Species Act (the "ESA"). NMFS subsequently finalized a "4(d) rule" extending the ESA's prohibition against "take" to Puget Sound Chinook salmon. This rule enables jurisdictions to submit plans that, if approved, would limit the application of the general prohibition to activities covered in the plan. Eligible activities include certain municipal, residential, commercial, and industrial development activities, certain road maintenance activities, and certain forestry activities. The full implications of this listing and the 4(d) rule for the Water System are difficult to predict due to the many legal and scientific uncertainties associated with the application of the ESA to water supply operations.

In an effort to reduce uncertainty with regard to its largest water supply source, the Cedar River, the City entered into the HCP with the U.S. Fish and Wildlife Service ("USFWS") and NMFS in 2000. The HCP specifies the measures the City will undertake to minimize and mitigate potential impacts on listed species. The HCP commits the City to spend about \$103 million (in 2012 dollars) to improve conditions for fish and wildlife within the Cedar River Watershed through the year 2050. See "Watershed Management Policies" and "Capital Improvement Program." While these measures include commitments to instream flow levels, the Water System's estimated firm yield would not be impacted adversely by the HCP. The incidental take permit, which the City was issued when the HCP was approved, protects the City from ESA liability resulting from potential impacts of the Water System's Cedar River operations on Chinook salmon, bull trout, steelhead, northern spotted owls, marbled murrelets, bald eagles, and approximately 76 other species of fish,

mammals, birds, and amphibians known to be present and potentially affected by the City's water supply and hydroelectric and land management activities.

The second major Water System supply is drawn from the South Fork of the Tolt River with the aid of a dam. Streamflow levels downstream from the impoundment are affected by dam operations and water diversions, with potential impacts on Chinook salmon and steelhead, which are both listed under the ESA as threatened. The City, tribes, and several federal agencies entered into the Tolt River Settlement Agreement in 1988, which included commitments for streamflows and habitat improvements that are intended to mitigate for impacts caused by the City's water supply and power generation operations.

Bull trout also have been listed as threatened and endangered and other fish listings can be anticipated. Because it is unknown whether bull trout are present in the Tolt River, the impact of the bull trout listing on the Tolt River and other City operations is unknown.

To further manage legal risks, the City has invested in Chinook salmon research for its major waterways and participated in regional watershed planning for the Cedar River, the Snohomish/Tolt Rivers, and the Green/Duwamish Rivers. As a result, the City has assembled substantial data on Chinook salmon and new scientific methods that provide the basis for development of best management practices in several key City activity areas, including for water maintenance activities within road rights-of-way. In addition, salmon research and funding of staff at federal regulatory agencies responsible for ESA Section 7 consultations are allowing better project design, which is expected to result in fewer anticipated permit delays.

The City and SPU expect that additional funding will be needed to support habitat restoration programs that address salmon-related policy objectives. Funding for these programs is expected to come from a variety of sources, including City water rates, drainage and wastewater rates, taxes or fees imposed by other local jurisdictions, and federal and State grants.

#### **Transmission Facilities**

The transmission facilities of the Water System consist of multiple primary transmission lines from the Cedar River, one transmission line and substantial portions of a second line from the Tolt River ("Tolt 1" and "Tolt 2") and a network of supply mains throughout the service area. In all, there are approximately 160 miles of primarily concrete or steel pipelines ranging in diameter from 30 to 96 inches.

After two segments of Tolt 1 ruptured in the late 1980s, the entire pipe was replaced or sliplined with new pipe by 2005. In addition, for both reliability and new capacity, approximately 18 miles of Tolt 2 were constructed beginning at the Tolt Regulating Basin and running parallel to and interconnecting with Tolt 1 at several locations. SPU is also expanding its cathodic protection program to extend the service life of both steel and concrete cylinder pipelines.

To assist in maintaining water flow to the distribution portion of the Water System, the transmission system includes two regulating basins, seven covered storage reservoirs and six elevated tanks and standpipes. In addition, there are 15 transmission pumping stations with a total rated capacity of more than 180,000 gallons per minute ("GPM"). The following table shows the hydraulic capacities of the primary transmission lines and the transmission regulating basins and reservoirs of the Water System.

 ${\bf TABLE~2} \\ {\bf HYDRAULIC~CAPACITY~OF~INDIVIDUAL~COMPONENTS~OF~THE~TRANSMISSION~SYSTEM~^{(1)}} \\$ 

<b>Facility</b>	<b>Capacity</b>
Transmission Lines (MGD)	
Cedar River	200
Tolt River	<u>135</u>
Total	335
Raw Water Storage Facilities (MG)	
Lake Youngs (regulating basin) <sup>(2)</sup>	4,812
Tolt Regulating Basin <sup>(2)</sup>	312
Total	5,124
Treated Water Storage Facilities (MG)	
Reservoirs	215
Elevated Tank and Other Storage	8
Total	223

<sup>(1)</sup> Treatment capacity is 120 MGD on the Tolt River source and 180 MGD on the Cedar River source. Equalizing reservoirs (clearwells) at the outlet of the treatment plants (5 MG on the Tolt River supply, 20 MG on the Cedar River supply) make it possible to deliver higher flow rates as needed into the transmission system for several hours. Averaged over several days, though, effective transmission capacity cannot exceed treatment capacity, as all water must be treated.

Source: Seattle Public Utilities

During the month of record maximum consumption, July 1985, the transmission lines delivered an average of 301 MGD. Water delivery by transmission pipelines on peak days at present typically does not exceed 250 MGD.

In 2009, Tolt Pipelines 1 and 2 were found to cross a historic slide located between the regulating basin and the Tolt Water Treatment Facility. The slide had been dormant, and therefore unknown, since the pipelines were installed in the 1960s and late 1990s, but has become more active, apparently due to a combination of logging in upland area and erosion by the North Fork Tolt River. This slope movement has affected both pipelines. Since the discovery of the slide, Tolt Pipeline 1 has been kept empty most of the time to reduce the risk of new small joint leaks triggered by the ground movement and aggravating slope stability. A 48-inch double ball joint expansion sleeve was installed on the newer steel Tolt Pipeline 2 to allow the pipeline to better conform to the creeping slide. In addition, SPU initiated an on-going survey and inclinometer monitoring program to track the slide and pipeline movement.

#### Storage and Distribution

Storage of water within the distribution portion of the Water System is accomplished by eight reservoirs, five standpipes, and one elevated tank, with capacities as follows:

TABLE 3
CURRENT DISTRIBUTION CAPACITY (MG)

Reservoirs	167.8
Standpipes	6.4
Elevated Tank	<u>1.0</u>
Total	175.2

Source: Seattle Public Utilities

The adequacy of SPU's distribution and transmission storage volumes has been demonstrated by using a computerized hydraulic model of the Water System to simulate a suite of emergency and peak demand conditions and other analyses.

<sup>(2)</sup> Effective capacity under current operating guidelines is less than the capacity shown in the table.

The distribution system consists of approximately 1,690 miles of predominantly cast iron and ductile iron pipe and some concrete cylinder and steel pipe. To assist in maintaining adequate pressure within the distribution system, there are 16 electric and hydraulic pumping stations with a total rated pumping capacity of more than 100,000 GPM.

The storage and distribution facilities and conservation incentives have met the needs of the expanding population in the service area. Peak day consumption levels as high as 329 MG and 348 MG were recorded on June 29, 1987, and July 15, 1970, respectively. However, since 2003, peak daily consumption has been less than 250 MG.

In 2010, SPU's total uses of non-revenue producing water (leakage, system cleaning and flushing, fire fighting, and lake flushing) was estimated to be 8.0 MGD, or 6.8% of total water produced. System-wide leakage losses for 2010, including meter inaccuracies, were approximately 7.7 MGD.

# **System Reliability**

Since the late 1980s, several engineering evaluations have been made of the major parts of the Water System to assess its reliability in the event of a major earthquake. Analysis has included the effects of (i) a magnitude 7.5 earthquake centered under critical Water System facilities such as reservoirs and transmission lines, and (ii) a magnitude 8.25 subduction earthquake within 95 miles of critical facilities. Overall, Water System facilities generally are expected to remain operational in the event of a major earthquake. Most of the tank-type reservoirs, both elevated tanks and standpipes, are predicted to sustain some damage and leakage resulting in water outages until repairs can be made.

Since 1993, several tanks and standpipes have been replaced or retrofitted with additional supports. Other potential upgrades or replacements will be undertaken if it is determined that benefits outweigh costs. The two transmission pipeline seismic upgrades and a major valve control structure identified by the original seismic evaluations have been completed. While some smaller seismic upgrade projects may be undertaken in the future, it is expected that most of the investments in this program have already been made.

# **Emergency Preparedness**

SPU has an active program to identify and analyze security risks to the Water System's critical assets and systems, and to invest in strategies to lower risks, develop emergency plans, and train employees for improved response. The Water System's integrated security system includes access control devices, door and hatch contacts, alarms, CCTV, and around-the-clock monitoring and surveillance. Additional physical security measures are in place at the Cedar River and South Fork Tolt Watersheds. The reservoir covering program is providing communities with multiple benefits, including improved water quality and security. SPU conducts vulnerability and risk assessments; invests in security countermeasures; and partners with local, State and federal agencies to coordinate planning and response activities.

SPU has developed and equipped a wildland fire crew to attack and suppress wildland fires that may start on the Cedar River or South Fork Tolt Watersheds. To supplement classroom training and planned field exercises, the team participates in mobilization training missions on actual wildfire events at the request of the local, State, or federal governments during wildfire emergencies, when available.

#### Water Quality

SPU has a comprehensive source-to-tap water quality management program. Water quality is ensured through an integrated effort of source protection, state-of-the-art treatment and ongoing monitoring throughout the Water System for potential microbial and chemical contaminants.

SPU owns more than 99% of the Cedar River Watershed and 70% of the South Fork Tolt Watershed (the other 30% is U.S. Forest Service land) above the intake points. Protection of the two watersheds from agricultural, industrial and recreational activities helps ensure that high quality water is delivered to 1.3 million people in the Seattle area. In addition to the two primary surface sources, three wells on an aquifer south of

the City periodically provide a small portion of the City's water supply. These wells, collectively known as Seattle Well Fields, are deep and afford natural protection from contamination.

In 2001, SPU commissioned a new treatment plant for the Tolt supply with a maximum treatment capacity of 120 MGD. The Tolt filtration plant is operated under a long-term contract with American Water/CDM. The plant provides primary treatment for the Tolt supply using treatment processes including ozonation, direct filtration, pH and alkalinity adjustment, and chlorination.

On the Cedar River source, water is screened and fluoridated at the Landsburg Cedar River Diversion facilities ahead of traveling through transmission pipelines to Lake Youngs. Primary treatment for the source is provided by the Cedar Water Treatment Plant at the outlet of Lake Youngs, which was commissioned in 2004 with a maximum treatment capacity of 180 MGD. The Cedar treatment plant is operated under a long-term contract with CH2M HILL OMI. The plant treatment processes include ozonation, ultraviolet light disinfection, pH adjustment, and disinfection with chlorine.

When Seattle Well Fields are in operation, treatment includes chlorination, fluoridation and pH adjustment. The intent of treatment is to protect public health and to comply with treatment and monitoring requirements of the DOH. SPU operates a water quality laboratory accredited by Ecology for bacteriological and chemical analyses to help ensure compliance with drinking water standards.

As an operator of a public water system, SPU must comply with treatment and monitoring requirements of the Safe Drinking Water Act of 1974 as amended and any additional requirements as specified by the DOH. Water quality parameters and regulations of particular significance are discussed below.

*Surface Water Treatment*. The federal Surface Water Treatment Rule established filtration and disinfection requirements for public water systems utilizing surface sources. Since startup of the Tolt Treatment Facility in 2001, the Tolt supply has been treated to meet these requirements.

The Surface Water Treatment Rule also established criteria for unfiltered systems with a Limited Alternative to Filtration ("LAF"), including (i) watershed protection and management, (ii) raw water quality, (iii) treatment efficiency and redundancy, and (iv) some aspects of distribution system water quality. In 2004, SPU began operation of the new Cedar Treatment Facility under the requirements of the LAF.

In 2006, the United States Environmental Protection Agency (the "EPA") issued the Long-Term 2 Enhanced Surface Water Treatment Rule, which requires higher levels of treatment for water sources with higher levels of *Cryptosporidium*. SPU has completed monitoring for *Cryptosporidium* in the Tolt and Cedar supplies. The results showed extremely low levels, and no change of water treatment is required.

Lead and Copper. Lead and copper have not been detected in the source water. Lead in water normally comes from plumbing materials, primarily from corrosion of lead solder used to connect copper pipes and corrosion of brass fixtures that contain lead. SPU recognized this as a potential problem over 25 years ago and has been treating the water to reduce its corrosiveness since the early 1980s. The City was the first municipality in the nation to ban the use of lead solder in potable plumbing systems. The steps taken in the last two decades to reduce the corrosiveness of the water have been successful in reducing lead levels at customer taps. Results from residential tap sampling in 2004 showed further reduction in lead and copper levels since the Tolt Treatment Facility came on line, corrosion control was optimized, and two Tolt service area reservoirs were covered. At the request of the DOH, the sampling frame was partitioned in 2004 into four subregions. Monitoring has continued to show that all four subregions are below the lead and copper action levels required by regulations.

Disinfection Byproducts. The use of disinfectants, such as chlorine, to provide protection against microbes in water can result in the formation of disinfection byproducts ("DBPs") when the disinfectants react with organic matter in the water. SPU meets current (Stage 1 DBP Rule) regulatory standards for DBPs. In addition, SPU has completed investigatory monitoring for the Stage 2 DBP Rule (issued in 2006), and anticipates meeting the more stringent monitoring requirements of the rule, which took effect on April 1, 2012, without any changes to the Water System.

Open Reservoirs. The 1994 revisions to DOH drinking water regulations required the development of a plan to cover all open distribution reservoirs, and subsequently the Long-Term 2 Enhanced Surface Water Treatment Rule required public water systems to have a state-approved plan for covering or treating finished drinking water reservoirs in place by 2009. SPU developed and is now nearing the completion of its reservoir covering plan, which the DOH approved. Since 2001, SPU has covered six reservoirs, and expects to complete a seventh, the 60-million gallon Maple Leaf Reservoir, in 2012. Shortly after the completion of the Maple Leaf Reservoirs, SPU expects to remove its remaining two open storage facilities, the Roosevelt and Volunteer Reservoirs, from service on a test basis. This test period may last for two or more years and is intended to determine how the system operates without these two reservoirs in service. At the end of these test periods (it may be different for each of the reservoirs), SPU would make the final decision to decommission each of these reservoirs (most likely) or to proceed with reservoir covering plans (less likely). SPU maintains an open reservoir protection plan with annual updates submitted to the DOH, which will no longer be needed after the remaining two open reservoirs are either decommissioned or covered

Arsenic. EPA's maximum contaminant level for arsenic is ten parts per billion ("ppb"). Testing of the City's two primary drinking water sources from the Cedar River and South Fork Tolt Watersheds indicate that arsenic is not present above one part per billion, the analytic detection limits. Naturally occurring arsenic concentrations in the Seattle Well Fields have ranged from 1.5 to 5.7 ppb.

Radon. Radon is a radioactive gas that emits ionizing radiation and may be released from tap water. No current rule regulates radon in water. EPA proposed a radon rule in 1999; however, there has been very little activity by EPA in the regulation of radon in drinking water in the past few years, so it is unknown if and when a new regulation might be issued. Radon has not been detected in samples analyzed from the Cedar and Tolt supplies. While the seasonally operated Seattle Well Fields contain naturally occurring radon, SPU expects to be able to comply with the proposed radon rule requirements under current operational practices.

# Watershed Management Policies

SPU carries out programs of watershed resource management, fire protection and the protection of water resources within the Cedar River and South Fork Tolt Watersheds. Seattle City Light also operates small hydroelectric plants in the Cedar River and South Fork Tolt Watersheds.

Land development impacts and more stringent regulatory standards have made ownership of the property in the watersheds an increasingly important element of SPU's overall strategy to preserve and enhance water quality. The City now owns more than 99% of the 141-square-mile Cedar River Watershed above the intake point. The City owns 70% of the 21-square-mile South Fork Tolt Watershed above the intake point, and the U.S. Forest Service owns the remainder.

The City's ownership of the Cedar River Watershed has resulted in strengthening forest management, wildlife and other programs that are based upon comprehensive management policies adopted in 1989 to guide the secondary uses of the watershed. In 2000, the City committed to discontinuing timber harvesting for commercial purposes over the 50-year lifespan of the Cedar River Watershed HCP. While trees may be cut, timber harvests are allowed only when they benefit fish or wildlife populations and support the goals and objectives of the HCP.

The HCP commits the City to improving fish and wildlife habitat, including providing salmonid fish passage above the Landsburg diversion dam, ecological and restoration thinning and planting of more than 17,000 acres of second growth forest, restoration of riparian, wetland and stream habitats, and the abandonment of more than 200 miles of logging roads in the watershed.

A watershed management plan was developed for the South Fork Tolt Watershed in 2008 to provide a long-term framework for managing the land and natural resources in the South Fork Tolt Watershed.

#### Wholesale Customer Contracts

Approximately 24% of water sales revenue is derived from wholesale sales to Wholesale Customers. Wholesale Customers consist of 21 water districts and municipalities served under individual contracts and Cascade, a consortium of eight municipalities and water districts that includes five formerly served under individual contracts.

Since 2001, 18 Wholesale Customers, representing about 56% of total Wholesale Customer consumption and 29% of total Water System consumption, have signed fixed block or full and partial requirements contracts that expire January 1, 2062. The full and partial requirements contracts obligate the City to meet the Wholesale Customers' demand that is not already met by their independent sources of supply. The full and partial contracts also allow the development by Wholesale Customers of alternative sources of water and the reduction of purchases from the City. One customer, Highline Water District, has given notice under the contract that it intends to reduce purchases from the City by an amount up to two mgd (approximately 975,900 hundred cubic feet ("ccf")), effective August 1, 2016.

SPU signed a 50-year declining block sales contract with Cascade in 2003 that capped Cascade's demand from the Water System at 30.3 MGD through 2023, when the block volume begins to decline. In 2009, the contract was amended to increase Cascade's block to 33.3 MGD from 2009 through 2017 and to 35.3 MGD from 2018 through 2023, after which the block begins to decline. Cascade's 2008 demand represents about 44% of total Wholesale Customer consumption and 23% of Water System consumption. Cascade expects to develop sources of supply to satisfy the future water demands of Cascade members above the block amount and is pursuing the use of Lake Tapps in Pierce County as a potable water supply. In June 2009, Cascade requested negotiations to further amend the contract, delaying the year in which the block volume begins to decline, and to consider further increments in block size. This would allow Cascade to delay development of Lake Tapps.

In 2008, SPU signed a 60-year partial requirements contract with the City of North Bend to provide untreated water for North Bend's use in supplementing stream flows affected by their well operation. This contract has a cap of 1.1 MGD. Water deliveries began in 2009.

In 2011, two Wholesale Customers (Lake Forest Park Water District and the City of Edmonds) signed emergency intertie agreements with Seattle to replace their previous wholesale supply contracts that were scheduled to expire at the end of 2011. These customers have alternate supplies and did not purchase water from Seattle on a regular basis, and the new contracts more appropriately reflect this status.

SPU currently serves approximately 11,000 retail customers in the City of Shoreline, directly north of Seattle. This represents approximately half of the retail customers in the City of Shoreline. The remainder are served by Shoreline Water District, which is a Wholesale Customer. In November 2009, the City of Shoreline requested to begin negotiations to acquire SPU's water distribution system to provide retail service within its city limits. Under the ordinances of the City authorizing the issuance of the Outstanding Parity Bonds, the City may sell or transfer any facilities or property of the Water System if the aggregate depreciated cost value of the facilities or property being transferred in any fiscal year comprises no more than 3% of the total assets of the Water System. See Appendix A—Bond Ordinance—Section 18(c). The aggregate depreciated cost of value of SPU's water distribution system in Shoreline is less than 3% of the total assets of the Water System. If SPU determines to sell or transfer its water distribution system in Shoreline, SPU expects to continue to provide wholesale water service to the City of Shoreline, and does not expect that any such sale or transfer would have a material adverse impact on the City's ability to pay principal of and interest on the Bonds when due.

The following table lists consumption in hundred cubic feet by individual Wholesale Customers and revenues generated by water sales to individual Wholesale Customers in 2011.

TABLE 4 ANNUAL WATER SALES TO WHOLESALE CUSTOMERS IN 2011  $^{(1)}$ 

Wholesale Customer	Consumption(ccf)	Revenue
Cascade Water Alliance	12,364,705	\$ 18,052,107
Northshore Utility District (2)	2,473,758	4,743,305
Soos Creek Water and Sewer District <sup>(2)</sup>	2,008,295	3,247,261
Highline Water District <sup>(3)</sup>	2,126,929	3,136,124
Woodinville Water District (2)	1,759,518	3,051,175
Water District #20 <sup>(2)</sup>	1,234,040	1,802,531
City of Mercer Island <sup>(2)</sup>	924,044	1,402,294
Cedar River Water and Sewer District	758,691	1,269,758
City of Bothell <sup>(2)</sup>	637,415	1,206,272
Water District #49	638,260	934,501
Shoreline Water District <sup>(2)</sup>	656,942	908,684
Coal Creek Utility District <sup>(2)</sup>	507,604	830,027
Water District #90 <sup>(2)</sup>	493,819	711,960
Water District #125	499,267	708,198
Olympic View Water and Sewer District	348,497	515,049
City of Duvall	233,390	441,165
Water District #119 <sup>(2)</sup>	110,073	203,393
Water District #45 <sup>(2)</sup>	106,783	155,513
City of Renton	88,749	119,661
Other Wholesale Customers	3,187	17,397
Total	27,973,966	\$ 43,456,376

<sup>(1)</sup> Figures are 2011 metered water consumption and associated revenue from SPU records, not net of certain credits, accruals, and allowances included in the audited financial statements.

Source: Seattle Public Utilities

#### Major Retail Water Users

There are no major water-intensive retail customers in the service area. The Water System's ten largest retail water users in 2011 were the University of Washington, the City of Seattle, the Port of Seattle, Seattle Housing Authority, King County, Seattle Steam, Todd Shipyards, Nucor Steel, Seattle Public Schools, and Swedish Medical Center. In the aggregate, revenue from these customers was less than 9% of billed direct service revenues in 2011.

#### **Water Rates**

Establishment of Rates. Water rates are proposed by the Mayor, reviewed by the City Council and adopted after public hearings. The City Council has exclusive authority to set rates and charges for water services. The City is not subject to the rate-making jurisdiction of the Washington Utilities and Transportation Commission or any other State or federal agency.

<sup>(2)</sup> Indicates Wholesale Customers that buy all their water from SPU.

<sup>(3)</sup> Highline Water District has given notice under the contract that it intends to reduce purchases from the City by an amount up to 975,900 ccf, effective August 1, 2016.

The following table shows historical water rate increases for the last five years and adopted water rate increases for 2013 and 2014.

TABLE 5
HISTORICAL WATER RATE INCREASES

Year	Rate Increase
2008	5.9%
2009(1)	11.7
2009 <sup>(2)</sup>	6.9
2010	9.3
2011	0.6
2012	12.2
2013	7.2
2014	7.6

Source: Seattle Public Utilities

The following table shows the rates in effect as of January 1, 2012. Both retail and wholesale rates are seasonally differentiated; the summer residential rate has an inclining block structure. The structure and basis for rates to Wholesale Customers served through master meters are governed by the Wholesale Customer contracts.

TABLE 6
SEATTLE WATER SYSTEM
MONTHLY WATER RATES EFFECTIVE IN 2012

	Residential <sup>(1)</sup>	Commercial <sup>(1)</sup>	Wholesale
Commodity Charge (\$ per ccf)			
Winter (eight months)	\$ 4.04	\$ 4.04	\$ 1.52
Summer (four months)		5.15	2.26
Up to 5 ccf	4.34	na	na
Next 10 ccf	5.15	na	na
Over 15 ccf	11.80	na	na
Basic Service Charge (\$ per month	n) <sup>(2)</sup>		
3/4"	\$ 13.25	\$ 13.25	na
1"	13.65	13.65	na
1 1/2"	21.05	21.05	na
2"	23.35	23.35	na
4"	123.75	123.75	na

<sup>(1)</sup> Retail rates to customers outside the City limits and not within the City of Shoreline or the City of Lake Forest Park are 14% higher than in the table above. Rates for customers within the City of Shoreline and the City of Lake Forest Park are 21% higher than in the table above.

Source: Seattle Public Utilities

<sup>(1)</sup> January 1, 2009.

<sup>(2)</sup> March 31, 2009; a temporary surcharge through December 31, 2010, to cover costs related to *Lane v. City of Seattle*. See "Litigation and Claims."

<sup>(2)</sup> The Basic Service Charge is based on the size of the customer's meter. Rates for larger meters are not shown.

Rate Comparisons. SPU's water rates have risen faster than the rate of inflation over the past five years and now are above the average of other cities of its size. The following table shows January 1, 2012, representative water bills for SPU compared to other cities in the region.

TABLE 7
REGIONAL COMPARISONS
(RATES IN EFFECT AS OF JANUARY 1, 2012)

		Residential	Commercial	Industrial
City	State	(5.0 ccf/month)	(500 ccf/month)	(15,000 ccf/month)
Seattle	Washington	\$33.95	\$2,265.35	\$66,447.00
Bellevue	Washington	29.48	1,976.66	58,152.88
Tacoma	Washington	24.96	876.74	22,642.40
Portland	Oregon	24.76	1,601.63	46,369.81
Everett	Washington	16.02	737.30	18,283.30

Source: SPU Survey

Billing. SPU accounts are billed bimonthly for residential and small commercial customers and monthly for larger accounts. Inside the City, residential customers receive a combined utility bill that itemizes amounts due for water, wastewater and solid waste services, while commercial customers receive a combined utility bill that itemizes amounts due for water and wastewater. Customers outside the City receive bills for water only. Payments received from the combined utility bills are allocated to the appropriate funds. If a payment received from a customer is insufficient to cover the total amount due and payable under the combined utility bill, that payment is credited first to the Solid Waste Fund. The balance of the payment is then credited to the Drainage and Wastewater Fund and then, if funds are available, to the Water Fund. If an account is 33 days past due, customers receive a water shut-off notice. By State law, water may be shut off when an account is delinquent, and outstanding balances are considered a lien on the property. Delinquent charges bear interest at the rate of 12% per annum. Total 90-day-plus outstanding balances for SPU billed water, wastewater and solid waste services were \$2.9 million (less than 1% of annual direct service revenue billed by SPU) as of December 2011. These figures include all outstanding amounts going back to 2006.

# **Financial Policies**

The Mayor and City Council have established financial policies by resolution for SPU, including the Water System. In accordance with these policies, water rates are set to achieve generally positive net income and cash balances and a minimum debt service coverage ratio on fixed rate long-term Parity Bonds of 1.70 times annual debt service. In addition, in each rate study period, an average of at least 20% of capital expenditures is expected to be financed with current revenue, with a minimum of 15% in any one year. The current rate study period is 2012-2014, and approximately 45% of capital expenditures are expected to be financed with current revenue during this period. Rates were adopted in late 2011 with increases effective on January 1, 2012, 2013, and 2014.

In 2002, the City by ordinance strengthened the Rate Stabilization Account by announcing an intent to raise rates to establish a balance of \$9.0 million. As of December 31, 2011, the balance in the Rate Stabilization Account was \$9.0 million. The \$9.0 million minimum balance in the account is intended for use during periods of poor water sales, but amounts over and above the minimum balance may be used to meet operating expenditures, pay capital improvement program expenditures, or meet financial policy requirements. Revenues contributed to the Rate Stabilization Account are not considered available for debt service coverage in the year they are contributed, but are considered available for coverage in the year they are withdrawn. See Appendix A—Bond Ordinance—Section 14.

Under the City Charter, City taxes on the Water System may be paid only after provision has been made for debt service and obligations of the Water System as well as for necessary betterments and replacements for the current year.

#### **Financial Performance**

The table titled "Operating Results" shows actual revenues and expenses of the Water System for the years 2007 through 2011, as well as projected results for 2012 and 2013. Footnotes for the table are on the following page. The projections reflect rate increases effective January 1, 2012, and January 1, 2013, which were approved in 2011.

Overall demand is assumed to decline by approximately 1.2% per year in 2012 and 2013. Regional conservation programs are expected to continue offsetting the impact of population and employment growth on wholesale water demand, while more than offsetting the effects of growth within the City.

SPU does not as a matter of course make public projections as to future sales, earnings or other results. However, the management of SPU has prepared the prospective financial information as set forth below under "Water System Operating Results" and "Capital Improvement Program" to provide readers of this Official Statement information related to projected revenues and expenses of the Water System. The accompanying prospective financial information was not prepared with a view toward public disclosure or with a view toward complying with the guidelines established by the American Institute of Certified Public Accountants with respect to prospective financial information, but, in the view of SPU's management, was prepared on a reasonable basis, reflects the best currently available estimates and judgments, and presents, to the best of management's knowledge and belief, the expected course of action and the expected future financial performance of the Water System. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and potential purchasers of the Bonds and the readers of this Official Statement are cautioned not to place undue reliance on the prospective financial information.

NEITHER SPU'S INDEPENDENT AUDITORS NOR THE STATE AUDITOR NOR ANY OTHER INDEPENDENT ACCOUNTANTS HAVE COMPILED, EXAMINED, OR PERFORMED ANY PROCEDURES WITH RESPECT TO THIS OFFICIAL STATEMENT OR ANY FINANCIAL INFORMATION CONTAINED HEREIN, NOR HAVE THEY EXPRESSED ANY OPINION OR ANY OTHER FORM OF ASSURANCE ON SUCH INFORMATION, AND THEY ASSUME NO RESPONSIBILITY FOR, AND DISCLAIM ANY ASSOCIATION WITH, THIS OFFICIAL STATEMENT AND SUCH INFORMATION.

The financial statements of the Water Fund as of and for the fiscal year ended December 31, 2011, included herein as Appendix C, have been audited by Moss Adams LLP, independent accountants, as stated in its report appearing herein. Seattle Public Utilities has not requested that Moss Adams LLP provide consent for inclusion of its audited financial statements in this Official Statement, and Moss Adams LLP has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. Further, Moss Adams LLP has not participated in any way in the preparation or review of this Official Statement.

TABLE 8
WATER SYSTEM OPERATING RESULTS

	Actual			Projected			
	2007	2008	2009	2010	2011	2012	2013
Operating Revenue							
Water Sales	\$ 143,892,005	\$ 149,573,411	\$ 178,726,401	\$ 181,515,455		\$ 202,310,622	\$ 213,649,602
(Deposits to)/Withdrawals from Revenue Stabilization Fund (1)	-	-	-	3,000,000	1,522,974	-	-
Other	16,269,301	14,831,619	12,643,187	10,688,010	11,636,551	12,077,587	12,954,668
Total Operating Revenue	\$ 160,161,306	\$ 164,405,030	\$ 191,369,588	\$ 195,203,465	\$ 194,572,652	\$ 214,388,209	\$ 226,604,270
Other Income							
Interest Income-Other	\$ 3,909,309	\$ 1,065,889	\$ 677,639	\$ 3,206,775	\$ 2,887,919	\$ 3,054,094	\$ 2,990,155
Gain/(Loss) on Sale of Assets, and Others-net	5,331,997	(976,997)	8,805,017	1,661,609	1,591,017	753,076	767,161
Total Other Income	\$ 9,241,306	\$ 88,892	\$ 9,482,656	\$ 4,868,384	\$ 4,478,936	\$ 3,807,170	\$ 3,757,316
Operating Expenses							
Operating and Maintenance Expenses							
Expenses	\$ 76,835,299	\$ 81,265,096	\$ 84,557,526	\$ 79,662,813	\$ 77,923,361	\$ 84,174,580	\$ 92,787,903
Taxes Other Than City Taxes	5,609,435	5,761,732	6,559,190	7,035,586	7,231,727	7,886,099	8,475,169
Other Expenses							
City Taxes (2)	18,561,201	19,029,097	27,062,094	29,454,840	23,279,845	25,704,554	27,652,878
Depreciation and Amortization	37,435,778	40,615,626	46,099,498	48,085,386	46,061,914	48,693,325	50,517,862
Total Operating Expenses	\$ 138,441,713	\$ 146,671,551	\$ 164,278,307	\$ 164,238,626	\$ 154,496,847	\$ 166,458,558	\$ 179,433,812
Other Income (Expenses)							
Interest Expenses and Amortization of Debt Issue Costs							
and Net Discount	\$ (37,668,952)	\$ (34,661,405)	\$ (40,736,109)	\$ (47,307,331)	\$ (46,289,430)	\$ (45,454,427)	\$ (44,229,583)
Contributions in Aid of Construction	7,886,096	17,339,107	10,033,490	12,183,558	3,531,294	2,878,935	2,933,836
Total Other Income (Expenses)	\$ (29,782,856)	\$ (17,322,298)	\$ (30,702,618)	\$ (35,123,773)	\$ (42,758,136)	\$ (42,575,492)	\$ (41,295,747)
Net Income	\$ 1,178,043	\$ 500,073	\$ 5,871,318	\$ 709,451	\$ 1,796,605	\$ 9,161,329	\$ 9,632,027
Other Revenue Available for Debt Service							
City Taxes (3)	\$ 18,561,201	\$ 19,029,097	\$ 27,062,094	\$ 29,454,840	\$ 23,279,845	\$ 25,704,554	\$ 27,652,878
Deprecitaion and Amortization	37,435,778	40,615,626	46,099,498	48,085,386	46,061,914	48,693,325	50,517,862
Interest paid on Revenue Bonds	40,713,418	38,355,433	45,337,887	50,274,477	49,595,335	48,419,784	46,929,947
(Transfer to)/Withdrawal from Bonneville Power Admin. Account (4)	413,024	595,473	436,196	198,207	100,000	-	-
Capitalized Interest	(3,286,626)	(4,446,525)	(4,704,212)			(2,697,800)	(2,697,800)
Accrued and Other Non-Cash Expenses	(1,911,672)	(12,153,362)	(4,805,551)			(725,000)	(750,625)
Total Revenue Available for Debt Service (5)	\$ 93,103,166	\$ 82,495,815	\$ 115,297,230	\$ 115,716,683	\$ 116,803,043	\$ 128,556,192	\$ 131,284,289
Debt Service (6)							
Parity Bonds Debt Service	\$ 52,215,444	\$ 56,250,906	\$ 70,377,702	\$ 72,749,679	\$ 78,552,207	\$ 79,529,306	\$ 79,503,656
Subordinate Lien Debt Service (7)	6,173,146	3,489,526	867,289	870,641	1,041,421	1,173,770	1,375,633
Total Debt Service	\$ 58,388,590	\$ 59,740,432	\$ 71,244,991	\$ 73,620,320	\$ 79,593,628	\$ 80,703,076	\$ 80,879,289
Debt Service Coverage (6)							
Parity Lien Debt Service Coverage	1.78	1.47	1.64	1.59	1.49	1.62	1.65
Overall Debt Service Coverage	1.59	1.38	1.62	1.57	1.47	1.59	1.62

#### **NOTES TO TABLE:**

- (1) Withdrawals from the Rate Stabilization Account are added to Operating Revenues and deposits are deducted, in accordance with FAS 71. Withdrawals from the Rate Stabilization Account are available for debt service and increase debt service coverage. Deposits to the Rate Stabilization Account reduce revenue available for debt service and lower debt service coverage.
- (2) The City currently levies a tax of 15.54% upon total gross income of the Water System from its retail business within and outside the City. This rate was temporarily 19.87% from March 31, 2009, through December 31, 2010.
- (3) Under the City Charter, City taxes on the Water System may be paid only after ample provisions has been made for debt service and obligations of the Water System as well as for necessary betterments and replacements for the current year.
- (4) Windfall revenues associated with the sale of an easement to the Bonneville Power Administration are included in net income in 2003, but are not considered available for payment of debt service until withdrawn from the Rate Stabilization Account.
- (5) Revenue available for debt service = net income (including contributions in aid of construction) + City taxes + depreciation + interest expenses + debt cost amortization + accrued and other non-cash expenses.
- (6) Includes the effect of refunding certain subordinate lien bonds in 2009 through the issuance of Parity Bonds. Does not include the effect of refunding the Refunded Bonds.
- (7) Includes Public Works Assistance Account loans. See "Security for the Bonds—Other Obligations."

Source: Seattle Public Utilities

The Water System has been designed and maintained to require a minimum of pumping, and does not rely on outside sources to meet water demand. Inflationary pressures have increased operations and maintenance expenses, which have been partially offset by decreasing CIP needs.

Operating revenues are generated primarily from wholesale and retail water sales. The water sales revenue increase of 43% from 2006 to 2011 is primarily due to rate increases, as there was a decline in demand during this period. Fluctuations in other operating revenue are primarily due to demand in tap installations and the resulting installation fee revenue. These fluctuations are due to economic conditions.

Operating results during the period 2006 to 2011 were affected by a variety of factors:

- (i) a temporary increase in amortization expense and in the City tax rate for 2009 and 2010 related to the *Lane v. City of Seattle* case (see "Litigation and Claims."),
- (ii) withdrawals from the Rate Stabilization Account as planned for in the 2009-2011 rate study and authorized by Ordinance 122841,
- (iii) significant asset sales in 2007 (unused reservoir site) and 2009 (easement along pipeline corridor to local gas utility),
- (iv) the refunding of certain subordinate lien bonds in 2009 through the issuance of Parity Bonds, and
- (v) the receipt of federal Build America Bonds credit payments beginning in 2010 reported under Interest Income.

Policy targets for net income, year-end cash, and cash financing of the Capital Improvement Program (the "CIP") were, or are projected to be, met for 2006-2012; however, the debt service coverage level fell below the policy target beginning in 2008. For 2009 and beyond, this is partially due to the decision to issue additional Parity Bonds to refund certain subordinate lien bonds, which occurred after the November 2008 rate proposal was finalized. Under rates approved for 2012-2014, debt service coverage is projected to exceed the debt service target by 2014.

#### **Capital Improvement Program**

Capital investments are guided by the Water System Plan and multi-year CIP, which is developed within the framework of the Water System Plan and included in the capital improvement program of the City as a whole. The CIP is reviewed, revised and adopted annually by the Mayor and City Council as part of the City's budget process. The CIP identifies facility needs and financing for rehabilitation, enhancement and expansion of the Water System. Currently the main areas of focus are to rehabilitate the water distribution system and make water quality improvements.

SPU expects to issue approximately \$81 million in long-term debt for the CIP during the period 2012 through 2017. Annual debt service is expected to rise from \$80 million in 2011 to \$87 million in 2017.

The CIP is organized into program areas: (i) Distribution, (ii) Habitat Conservation, (iii) Shared Cost Projects, (iv) Technology, (v) Transmission, (vi) Water Quality and Treatment, (vii) Water Resources, and (viii) Watershed Stewardship, as shown in the table below. The amount shown for each program area is based on the adopted CIP.

TABLE 9
WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM
(Amounts in Thousands of Nominal Dollars)

Adopted 2012 2013 2014 2015 2016 2017 **Total** Program Area Distribution \$ 15,194 \$ 19,778 \$ 20,394 \$ 22,751 \$ 24,085 \$ 25,279 \$ 127,481 **Habitat Conservation** 4,913 3,372 3,649 2,945 2,489 1,809 19,176 Shared Cost Projects (1) 14,641 18,164 17,696 17,590 16,643 20,472 105,205 Technology 5,358 7,709 8,685 6,456 5,916 5,999 40,122 Transmission 1,343 3,027 3,076 3,137 3,195 3,393 17,172 13,978 Water Quality and Treatment 6,613 5,293 1,547 202 210 113 Water Resources 51,199 5,616 5,576 8,743 8,741 12,222 10,301 Watershed Stewardship 729 1,828 1,035 600 600 600 5,392 \$ 63,954 \$ 64,519 \$ 62,422 \$ 67,965 Total \$ 55,506 \$ 65,360 \$ 379,725 **Funding Sources** Debt Financing **Outstanding Parity Bonds** \$ 25,898 \$ \$ \$ 60,812 \$ 33,479 \$ 1,435 \$ **Future Parity Bonds** 25,409 27,472 29,032 30,223 112,136 Total Debt Financing \$ 25,898 \$ 33,479 \$ 26,844 \$ 27,472 \$ 29,032 \$ 30,223 \$ 172,948 Revenue Financing Internally Generated Funds \$ 19,428 \$ 18,999 \$ 26,081 \$ 23,623 \$ 24,511 \$ 25,485 \$ 138,127 Grants and Reimbursements 2,012 2,062 1,854 1,883 1,916 1,964 11,692 \$ 21,282 Total Revenue Financing \$ 20,882 \$ 27,997 \$ 25,587 \$ 26,523 \$ 27,547 \$ 149,819 Adjustment for Expected Accomplishment<sup>(2)</sup> \$ 8,326 \$ 9,593 \$ 9,678 \$ 9,363 \$ 9,805 \$ 10,194 \$ 56,959 Total \$ 55,506 \$ 63,954 \$ 64,519 \$ 62,422 \$ 379,725 \$ 65,360 \$ 67,965

#### **NOTES TO TABLE:**

- (1) Includes projects that affect the Water System, but involve more than a water purpose and are typically funded from multiple sources. Current projects include Sound Transit projects, the Alaskan Way Viaduct and Seawall replacement, State Route 520 replacement, and the South Lake Union Urban Center redevelopment area.
- (2) The amounts shown reflect the difference between the full amount of the budgeted CIP and the expected amount of CIP spending.

The development of the CIP balances financial capacity with the demands of rehabilitation, improvement, water quality, and expansion. SPU steadily expanded the CIP through the late 1990s and the 2000s, raised rates, and increased its long-term borrowing. In managing the CIP, SPU has emphasized efficient project design and careful staging of improvements within the 20-year time frame of the Water System Plan, and has reached a point where CIP needs are decreasing compared to the highs of the last decade. In the period 2012 through 2017, SPU expects the financial requirements for these projects to be met from Net Revenue of the Water System and from the proceeds of Future Parity Bonds. Approximately 35% of projected CIP spending is expected to be financed by the issuance of Future Parity Bonds.

#### Risk Management and Quality Assurance

A Risk and Quality Assurance Program ("RQA") was first established by SPU in 2004 and more formally as a separate division within the organization in January 2011. The RQA's goals and objectives are to provide a more structured framework to evaluate, manage and improve risk and performance levels for all business lines through three main task areas: performance management, risk management and internal auditing. A Risk and Quality Assurance Board, consisting of the SPU Director, the Executive Team, a Law Department representative and six RQA staff members provide corporate-level oversight and accountability for the program. RQA staff also coordinate with supervisors, project managers and subject matter experts throughout SPU to use the framework to guide decision-making related to policy and program development, capital projects and day to day operations.

The RQA's work plan priorities for 2012 include assessing and improving internal controls, restricting the subrogation claim process, and overseeing implementation of prior audit recommendations. Additionally, RQA staff are currently coordinating a focused internal audit and using external auditors to review the recently discovered embezzlement of approximately \$1 million in Water System funds by a former employee. This audit is expected to result in implementation of additional control measures for handling financial transactions within the utility. The City does not expect that the embezzlement incident or any resulting legal action would have a material adverse impact on the City's ability to pay principal of and interest on the Bonds when due.

#### Litigation and Claims

In *Lane v. City of Seattle,* 164 Wn.2d 875, 194 P.3d 977 (2008), the Washington Supreme Court ruled that the cost of maintaining fire hydrants is a general governmental requirement that must be paid from taxes rather than utility rate revenues. As a consequence, the City's general fund was required to reimburse the Water Fund for fire hydrant costs incurred from March 1, 2002, through December 31, 2004, and SPU was required to make refunds to Water System ratepayers for those fire hydrant costs included in water rates during that period, plus 12% interest. In response, the City adopted Ordinance 122916 temporarily increasing the utility tax imposed on SPU from 15.54% to 19.87% from March 31, 2009, through December 31, 2010. To pay the temporarily increased utility tax, the City adopted Ordinance 122913 imposing a 10.2% temporary surcharge on water rates for all SPU retail customers from March 31, 2009, through December 31, 2010. All payments related to the *Lane* case have been made.

Other claims associated with the normal operation of the Water System periodically are filed against the City. The Water System's practice is to include in its annual budget an amount for such claims that is equal to the reasonably probable payment of claims for that year. For the purposes of financial reporting, annual claims costs are accrued based on actuarial studies of claims history.

#### THE CITY OF SEATTLE

The following provides general information about the City.

#### **Municipal Government**

Incorporated in 1869, the City is the largest city in the Pacific Northwest and is the seat of King County.

The City is a general purpose government that provides a broad range of services typical of local municipalities, such as streets, parks, libraries, human services, law enforcement, fire fighting and emergency medical services, planning, zoning, animal control, municipal court, and utilities. King County also provides certain services throughout the County and within the City, including courts of general jurisdiction, felony prosecution and defense, jail, public health, and transit services.

The City is organized under the mayor-council form of government and operates under its City Charter. The mayor, the city attorney, nine City Council members, and eight Municipal Court judges are all elected to four-year terms.

Mayor. The Mayor serves as the chief executive officer of the City. The Mayor presents to the City Council annual statements of the financial and governmental affairs of the City, budgets, and capital improvement plans. The Mayor signs, or causes to be signed on behalf of the City, all deeds, contracts and other instruments.

City Council. The City Council is the policy-making legislative body of the City. The nine City Council members are elected at-large to four-year staggered terms and serve on a full-time basis. The City Council sets tax levies, sets utility rates, makes appropriations and adopts and approves the annual operating budget for the City.

Municipal Court. The State Constitution provides for the existence of county superior courts as the courts of general jurisdiction and authorizes the State Legislature to create other courts of limited jurisdiction. The Seattle Municipal Court has limited jurisdiction over a variety of cases, including misdemeanor criminal cases, traffic and parking infractions, collection of fines, violation of no-contact or domestic violence protection orders, and civil actions for enforcement of City fire and housing codes. The Municipal Court has eight judges. Municipal Court employees report to the judges.

#### **Financial Management**

City financial management functions are provided by the Department of Finance and Administrative Services.

Accounting. The accounting and reporting policies of the City conform to generally accepted accounting principles for municipal governments and are regulated by the State Auditor's Office, which maintains a resident staff at the City to perform a continual current audit as well as an annual post-fiscal year audit of City financial operations. The Accounting Services Division of the Department of Finance and Administrative Services maintains general supervision over the accounting functions of the City.

Auditing. The State Auditor is required to examine the affairs of all local governments at least once every three years; the City is audited annually. The examination must include, among other things, the financial condition and resources of the City, compliance with the laws and Constitution of the State, and the methods and accuracy of the accounts and reports of the City. Reports of the State Auditor's examinations are required to be filed in the office of the State Auditor and in the Department of Finance and Administrative Services. The City's Comprehensive Annual Financial Report for 2011 may be obtained from the Department of Finance and Administrative Services and is available at <a href="http://www.seattle.gov/cafrs/default.htm">http://www.seattle.gov/cafrs/default.htm</a>, which website address is not incorporated herein by reference. The Water System's 2011 financial statements are also audited by an independent auditor and are attached as Appendix C.

In 2005, pursuant to an initiative approved by the State's voters, the State Auditor's Office was given authority to conduct independent performance audits of State and local government entities. The Office of the City

Auditor also reviews the performance of a wide variety of City activities such as management of city trees, district councils, span of control, City-wide collections, special events permitting, and specific departmental activities.

Municipal Budget. City operations are guided by a budget prepared under the direction of the Mayor by the City Budget Office pursuant to State statute (chapter 35.32A RCW). The proposed budget is submitted to the City Council by the Mayor each year not later than 90 days prior to the beginning of the next fiscal year. Currently the fiscal year of the City is January 1 through December 31. The City Council considers the proposed budget, holds public hearings on its contents, and may alter and revise the budget at its discretion, subject to the State requirement that budgeted revenues must at least equal expenditures. The City Council is required to adopt a balanced budget at least 30 days before the beginning of the next fiscal year, which may be amended or supplemented from time to time by ordinance. The 2012 budget was adopted on November 21, 2011.

The City's adopted General Subfund budget was \$893.6 million in 2011 and \$918.0 million in 2012. Total general government tax revenue increased by about 1.2% from 2009 to 2010 (see Table 1). According to the City's November 2011 forecast, total General Fund revenues are expected to be about 2.5% and 2.9% higher in 2011 and 2012, respectively.

#### **Investments**

Authorized Investments. Chapter 35.39 RCW permits the investment by cities and towns of their inactive funds or other funds in excess of current needs in the following: United States bonds; United States certificates of indebtedness; State bonds or warrants; general obligation or utility revenue bonds of its own or of any other city or town in the State; its own bonds or warrants of a local improvement district that are within the protection of the local improvement guaranty fund law; and any other investment authorized by law for any other taxing district. Under chapter 39.59 RCW, a city or town also may invest in the following: bonds of any local government in the State that have at the time of investment one of the three highest credit ratings of a nationally recognized rating agency; general obligation bonds of any other state or local government of any other state that have at the time of the investment one of the three highest credit ratings of a nationally recognized rating agency; registered warrants of a local government in the same county as the government making the investment; and any investments authorized by law for the State Treasurer or any local government of the State other than a metropolitan municipal corporation (other than bank certificates of deposit of banks or bank branches not located in the State). Under chapter 43.84 RCW, the State Treasurer (and, under chapter 39.59 RCW, cities and towns) may invest in the following: obligations of the United States or its agencies and of any corporation wholly owned by the government of the United States; State, county, municipal or school district general obligation bonds or general obligation warrants of taxing districts of the State, if within the statutory limitation of indebtedness; motor vehicle fund warrants; Federal Home Loan Bank notes and bonds, Federal Land Bank bonds, Fannie Mae notes, debentures and guaranteed certificates of participation and obligation of any other government-sponsored corporation whose obligations are eligible for collateral for advances to Federal Reserve System member banks; bankers' acceptances purchased in the secondary market; negotiable certificates of deposit of any national or state commercial or mutual savings bank or savings and loan association doing business in the United States; and commercial paper.

Money available for investment may be invested on an individual fund basis or may, unless otherwise restricted by law, be commingled within one common investment portfolio. All income derived from such investment may be either apportioned to and used by the various participating funds or for the benefit of the general government in accordance with City ordinances or resolutions.

Authorized Investments for Bond Proceeds. Funds derived from the sale of bonds or other instruments of indebtedness will be invested or used in such manner as the initiating ordinances, resolutions, or bond covenants may lawfully prescribe. In addition to the eligible investments discussed above, bond proceeds may also be invested, subject to certain restrictions, in mutual funds with portfolios consisting of (i) only United States government bonds or United States government guaranteed bonds issued by federal agencies with average maturities of less than four years; bonds of the State or of any local government in the State that have at the time of the investment one of the four highest credit ratings of a nationally recognized rating agency;

general obligation bonds of any other state or local government of any other state that have at the time of the investment one of the four highest credit ratings of a nationally recognized rating agency; (ii) bonds of states and local governments or other issuers authorized by law for investment by local governments that have at the time of investment one of the two highest credit ratings of a nationally recognized rating agency; or (iii) securities otherwise authorized by law for investment by local governments.

City Investments. The information in this section does not pertain to pension funds that are administered by the City (see "Pension Plans"), and certain refunding bond proceeds that are administered by trustee service providers.

All cash-related transactions for the City, including its utilities, are administered by the Department of Finance and Administrative Services. City cash is deposited into a single bank account and cash expenditures are paid from a consolidated disbursement account. Investments of temporarily idle cash may be made, according to existing City Council-approved policies, by the Treasury Division of the Department of Finance and Administrative Services in securities described under "Authorized Investments."

State statutes, City ordinances and Department of Finance and Administrative Services policies require the City to minimize market risks by safekeeping all purchased securities according to governmental standards for public institutions and by maintaining safety and liquidity above consideration for returns. Current City investment policies require periodic reporting on the City's investment portfolio to the Mayor and the City Council. The City's investment operations are reviewed by the City Auditor and by the State Auditor.

As of December 31, 2011, the combined investment portfolios of the City, including SPU funds, totaled \$1,274 million at book value. The City's Investment Pool is constituted solely of City funds. The City does not invest any funds in other pools, with the exception of tax collection receipts initially held by King County. For the 12-month period ending December 31, 2011, the yield on the City's investment portfolio was 0.91%. As of December 31, 2011, the average maturity of the portfolio was 822 days. Approximately 12%, or \$154.4 million, was invested in securities with maturities of three months or less. The City held no securities with maturities longer than 15 years. Investments were allocated as follows:

Government-Sponsored Enterprises	77.4%
Taxable Municipal Bonds	8.2
Commercial Paper	6.1
Repurchase Agreements	5.2
U.S. Treasuries	3.0
Mortgage-Backed Securities	0.1

Interfund Loans. The City municipal code authorizes the Director of Finance, after consultation with the Director of Administrative Services, the Budget Director, and the City Council Finance Committee Chair, to approve interfund loans for a duration of up to 90 days and to establish a rate of interest on such loans. Extension or renewal of interfund loans requires City Council approval by ordinance. The Director of Finance also is authorized by City ordinance to make loans to individual funds participating in a common investment portfolio by carrying funds in a negative cash position for a period of up to 90 days, or for a longer period upon approval by ordinance, to the extent that such loans can be supported prudently by the common investment portfolio and the borrowing fund is reasonably expected to be able to repay the loan. Loans of this type bear interest at the common investment portfolio's rate of return.

#### Risk Management

The City purchases excess liability insurance to address general, automobile, professional, public official, and other exposures. The policies provide \$40 million limits above a \$6.5 million self-insured retention per occurrence, but coverage excludes partial or complete failure of any dam. The City also purchases all risk property insurance, including earthquake and flood perils, that provide up to \$500 million in limits subject to a schedule of deductibles. City hydroelectric generation and transmission equipment and certain other utility systems and equipment are not covered by the property insurance policy.

The City insures a primary level of fiduciary, crime liability, inland marine, and various commercial general liability, medical, accidental death and dismemberment, and miscellaneous exposures. Surety bonds are purchased for certain public officials, notary publics, and workers who are permanently and totally disabled from a workplace injury or occupational disease.

#### **Pension Plans**

City employees are covered by one of the following defined benefit pension plans: SCERS, Firefighter's Pension Fund, Police Relief and Pension Fund, and Law Enforcement Officers' and Fire Fighters' Retirement System ("LEOFF"). The first three are administered by the City; the State administers LEOFF through the Department of Retirement Systems.

Nearly all permanent non-uniformed City employees, employees of the Seattle Public Library and certain grandfathered employees of King County (and a predecessor agency of the County) participate in SCERS, a single-employer public employee retirement system. SCERS estimated its total assets to be \$1.813 billion as of January 1, 2011.

Actuarial data for SCERS are determined through actuarial valuation. Historically, these reports were prepared biennially, but in 2011 the City began preparing them annually. Unlike most public pension systems, SCERS used the market value of assets to calculate its funding ratio in the past. Consequently, the full impact of annual asset losses occurring in recent years was reflected in each actuarial valuation. From January 1, 2008, to January 1, 2010, the valuation ratio was reported as having fallen from 92.4% to 62.0%.

To improve its ability to manage short-term market volatility, the City adopted a five-year asset smoothing methodology in 2011. The most recent actuarial valuation of SCERS was conducted by Milliman, Inc. as of January 1, 2011, and reflects the following assumptions: investment return, 7.75%; price inflation, 3.50%; expected annual average membership growth, 1.00%; and wage inflation, 3.50%. Based on this valuation, the actuarial value of net assets available for benefits was \$2.014 billion and the actuarial accrued liability was \$2.709 billion. The unfunded actuarial accrued liability declined from \$1.008 billion on January 1, 2010, to \$695.4 million on January 1, 2011. The funding ratio increased from 62.0% on January 1, 2010 to 74.3%, due to a variety of factors listed below, including the adoption of the five-year asset smoothing methodology.

SOURCES OF CHANGE	FUNDING RATIO
January 1, 2010, Actuarial Valuation	62.0%
Expected Valuation to Valuation Change	(0.6%)
Asset Gain/(Loss) on Market Value	3.0%
Salary Less/(Greater) than Expected	2.2%
Assumptions Changes (Demographic)	0.6%
Asset Smoothing Adoption	7.5%
Other	(0.4%)
Total Change	12.3%
January 1, 2011, Actuarial Valuation	74.3%

According to the January 1, 2010, actuarial valuation, the actuarial required contribution ("ARC") was calculated to be 25.03% of pay based on the then-current mark to market valuation methodology. Although the total contribution rate increased from 16.06% to 18.06% from 2010 to 2011, it was still insufficient to fully amortize the system's unfunded actuarial accrued liability. With the adoption of the smoothing methodology, the January 1, 2011, actuarial valuation showed that the ARC would be 21.30% for 2012. Subsequent revisions to this valuation, including lowering the credit interest rate from 5.75% to 4.47%, further reduced the ARC to 21.04%. The credit interest rate is the rate at which member contributions earn interest if such contributions are withdrawn from the system.

On November 21, 2011, the City Council passed Resolution 31334 affirming the City's intent to fully fund the actuarial required contribution each year with its budget. The City's adopted 2012 Budget fully funds the

ARC. Under the City's existing collective bargaining contracts, most of which expire at the end of 2013, increases in the employee contribution rate are limited to a total of 2.00%. The City is exploring options for managing the system more cost-effectively in the long term.

Contribution rates for SCERS increased from 2010 to 2012 as shown below:

YEAR	EMPLOYER	EMPLOYEE	TOTAL
2009	8.03%	8.03%	16.06%
2010	8.03%	8.03%	16.06%
2011	9.03%	9.03%	18.06%
2012	11.01%	10.03%	21.04%

Employee and employer contributions are expected to be \$60.2 million in 2012, of which approximately 34% is from general government departments. City utilities pay the employer share for their employees.

The Firefighter's Pension Fund and the Police Relief and Pension Fund are single-employer pension plans that were established by the City in compliance with State law. Since the effective date of LEOFF in 1970, no payroll for employees was covered under these City plans, and the primary liability for pension benefits for these City plans shifted from the City to the State. However, the City was still liable for all benefits of employees in service at that time plus certain future benefits. The City is not required to adopt a plan to fund the actuarial accrued liability of these City plans.

In 1994, the City established an actuarial fund for the Firefighter's Pension Fund and adopted a policy of fully funding the actuarial accrued liability by the year 2018 (which was subsequently extended to 2023). For 2011, the City has elected to make the annual required contribution but not to make any additional contribution toward funding the actuarial accrued liability of the Firefighter's Pension Fund. As of January 1, 2011, the actuarial value of net assets available for benefits in the Firefighter's Pension Fund was \$11.4 million, and the actuarial accrued liability was \$126.8 million. As a result, the unfunded actuarial accrued liability was \$115.4 million and the funding ratio was 9.0%. The City's employer contribution to the fund in 2010 was \$7.3 million; there were no current member contributions.

The City funds the Police Relief and Pension Fund as benefits become due. As of January 1, 2011, the unfunded actuarial accrued liability in the Police Relief and Pension Fund was \$136.4 million. The City's employer contribution to the fund in 2011 was \$8.7 million; there were no current member contributions.

LEOFF is a cost-sharing multiple-employer retirement system comprised of two separate defined-benefit plans. LEOFF participants who joined the system by September 30, 1977, are Plan 1 members. Those who joined afterward are Plan 2 members. Membership in LEOFF includes all full-time, fully compensated local law enforcement officers and firefighters in the State.

Actuarial data for LEOFF are determined annually by the Office of the State Actuary. The most recent actuarial valuation of LEOFF was conducted as of June 30, 2010. Based on this valuation, the actuarial accrued surplus of Plan 1 was \$1.180 billion and the funded ratio was 127%; the actuarial accrued surplus of Plan 2 was \$1.179 billion and the funded ratio was 124%.

Employee and employer contribution rates (calculated as a percentage of covered payroll) are developed by the Office of the State Actuary to fully fund LEOFF. The contribution rates for Plan 1 are currently zero for employees and 0.16% for employers, all of which is allocated to administrative expenses. The contribution rates for Plan 2 are currently 6.36% for employees, 5.24% for employers (which includes 0.16% for administrative expenses), and 3.38% for the State. The City's employer contributions in 2011 were \$14,000 for Plan 1 and \$12.1 million for Plan 2.

For additional information regarding the City's retirement plans, see Note 11 to the City's Comprehensive Annual Financial Report for 2010, which may be obtained from the Department of Finance and Administrative Services and is available at <a href="http://www.seattle.gov/cafrs/default.htm">http://www.seattle.gov/cafrs/default.htm</a>, which website address is not incorporated herein by reference.

#### **Post-Employment Retirement Benefits**

The City has liability for two types of other post-employment benefits ("OPEB"): (i) an implicit rate subsidy for health insurance covering employees retiring under SCERS or LEOFF Plan 2 and dependents of employees retiring under LEOFF Plan 1 and (ii) medical benefits for eligible beneficiaries of the City's Firefighter's Pension Fund and Police Relief and Pension Fund. The implicit rate subsidy is the difference between (i) what retirees pay for their health insurance as a result of being included with active employees for rate-setting purposes and (ii) the estimated required premiums if their rates were set based on claims experience of the retirees as a group separate from active employees. The City has assessed its OPEB liability in order to satisfy the expanded reporting requirements specified by the Governmental Accounting Standards Board Statement No. 45 ("GASB 45"). While GASB 45 requires reporting and disclosure of the unfunded OPEB liability, it does not require that it be funded. The City funds its OPEB on a pay-as-you-go basis.

As of January 1, 2010, the unfunded actuarial accrued liability for the implicit rate subsidy was \$93.5 million; the City's contribution in 2010 was \$3.2 million. As of January 1, 2011, the unfunded actuarial accrued liability for OPEB in the City's Firefighter's Pension Fund was \$241.4 million; the City's contribution in 2010 was \$10.4 million. As of January 1, 2011, the unfunded actuarial accrued liability for OPEB in the Police Relief and Pension Fund was \$261.0 million; the City's contribution in 2010 was \$12.0 million.

For additional information regarding the City's OPEB, see Note 11 to the City's Comprehensive Annual Financial Report for 2011, which may be obtained from the Department of Finance and Administrative Services and is available at <a href="http://www.seattle.gov/cafrs/default.htm">http://www.seattle.gov/cafrs/default.htm</a>, which website address is not incorporated herein by reference.

#### **Labor Relations**

The City has 28 separate departments and offices with approximately 11,500 regular and temporary employees. Twenty-six different unions and 47 bargaining units represent approximately 76% of the City's regular employees. The City has agreements with the coalition of City unions (representing most of the non-uniformed employees) that expire at the end of 2013. Agreements with the Seattle Dispatchers' Guild; International Association of Machinists and Aerospace Workers, District Lodge 160, Local 289 and 79; Firefighters Local 27; Fire Chiefs Local 2898; and the Seattle Police Management Association expired at the end of 2011. Two agreements with the International Brotherhood of Electrical Workers Local 77 expire on January 22, 2013. The City's labor agreement with the Seattle Police Officers' Guild expired at the end of 2010. The City is actively negotiating renewals of these contracts. Negotiations also continue for two new bargaining units that have not been covered by contracts in the past; the Seattle Prosecuting Attorneys and WSCCCE, Local 21 (City Light).

#### INITIATIVE AND REFERENDUM

#### **State-wide Measures**

Under the State Constitution, Washington voters may initiate legislation (either directly to the voters, or to the State Legislature and then, if not enacted, to the voters) and require that legislation passed by the State Legislature be referred to the voters. Any law approved in this manner by a majority of the voters may not be amended or repealed by the State 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 State Legislature in the same manner as other laws. The Washington State Constitution may not be amended by initiative.

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.

In recent years, several State-wide initiative petitions to repeal or reduce the growth of taxes and fees, including City taxes, have garnered sufficient signatures to reach the ballot. Some of those tax and fee

initiative measures have been approved by the voters and, of those, some remain in effect while others have been invalidated by the courts. Tax and fee initiative measures continue to be filed, but it cannot be predicted whether any more such initiatives might gain sufficient signatures to qualify for submission to the State Legislature and/or the voters or, if submitted, whether they ultimately would become law.

#### **Local Measures**

Under the City Charter, City 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.

#### LEGAL AND TAX INFORMATION

#### No Litigation Affecting the Bonds

There is no litigation pending with process properly served on the City questioning the validity of the Bonds or the power and authority of the City to issue the Bonds.

#### Other Litigation

Various lawsuits and claims are pending against the City involving claims for money damages. (See the discussion of claims in Appendix B—The City's 2010 Comprehensive Annual Financial Report—Note 14, Contingencies.) Based on its past experience, the City has concluded that its ability to repay the Bonds on a timely basis will not be impaired by the aggregate amount of uninsured liabilities of the City and the timing of any anticipated payments of judgments that might result from suits and claims. For a description of litigation relating to the Water System, see "Water System—Litigation and Claims."

#### **Approval of Counsel**

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

#### **Limitations on Remedies**

Any remedies available to the registered owners of the Bonds upon the occurrence of an event of default under the Bond Legislation 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 Legislation 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 registered owners of the Bonds.

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

#### Tax Exemption

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

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

Corporate Alternative Minimum Tax. While interest on the Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, under Section 55 of the Code, tax-exempt interest, including interest on the Bonds, received by corporations is taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations (as defined for federal income tax purposes). Under the Code, alternative minimum taxable income of a corporation will be increased by 75% of the excess of the corporation's adjusted current earnings (including any tax-exempt interest) over the corporation's alternative minimum taxable income determined without regard to such increase. A corporation's alternative minimum taxable income, so computed, that is in excess of an exemption of \$40,000, which exemption will be reduced (but not below zero) by 25% of the amount by which the corporation's alternative minimum taxable income exceeds \$150,000, is then subject to a 20% minimum tax.

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

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

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

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

#### **Certain Other Federal Tax Consequences**

Bonds Not "Qualified Tax-Exempt Obligations" for Financial Institutions. Section 265 of the Code provides that 100% of any interest expense incurred by banks and other financial institutions for interest allocable to tax-exempt obligations acquired after August 7, 1986, will be disallowed as a tax deduction. However, if the tax-exempt obligations are obligations other than private activity bonds, are issued by a governmental unit that, together with all entities subordinate to it, does not reasonably anticipate issuing more than \$10,000,000 of tax-exempt obligations (other than private activity bonds and other obligations not required to be included in such calculation) in the current calendar year, and are designated by the governmental unit as "qualified tax-exempt obligations," only 20% of any interest expense deduction allocable to those obligations will be disallowed.

The City is a governmental unit that, together with all subordinate entities, reasonably anticipates issuing more than \$10,000,000 of tax-exempt obligations (other than private activity bonds and other obligations not required to be included in such calculation) during the current calendar year and has <u>not</u> designated the Bonds as "qualified tax-exempt obligations" for purposes of the 80% financial institution interest expense deduction. Therefore, no interest expense of a financial institution allocable to the Bonds is deductible for federal income tax purposes.

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

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

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

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

Original Issue Discount. The Bonds maturing on September 1, 2029, have been sold at a price reflecting original issue discount ("Discount Bonds"). Under existing law, the original issue discount in the selling price of each Discount Bond, to the extent properly allocable to each owner of such Discount Bond, is excluded from gross income for federal income tax purposes with respect to such owner. The original issue discount is the excess of the stated redemption price at maturity of such Discount Bond over the initial offering price to the public, excluding underwriters and other intermediaries, at which price a substantial amount of the Discount Bonds of such maturity were sold.

Under Section 1288 of the Code, original issue discount on tax-exempt bonds accrues on a compound basis. The amount of original issue discount that accrues to an owner of a Discount Bond during any accrual period generally equals (i) the issue price of such Discount Bond plus the amount of original issue discount accrued in all prior accrual periods, multiplied by (ii) the yield to maturity of such Discount Bond (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), less (iii) any interest payable on such Discount Bond during such accrual period. The amount of original issue discount so accrued in a particular accrual period will be considered to be received ratably on each day of the accrual period, will be excluded from gross income for federal income tax purposes, and will increase the owner's tax basis in such Discount Bond. Any gain realized by an owner from a sale, exchange, payment or redemption of a Discount Bond will be treated as gain from the sale or exchange of such Discount Bond.

The portion of original issue discount that accrues in each year to an owner of a Discount Bond may result in certain collateral federal income tax consequences. The accrual of such portion of the original issue discount will be included in the calculation of alternative minimum tax liability as described above, and may result in an alternative minimum tax liability even though the owner of such Discount Bond will not receive a corresponding cash payment until a later year.

Owners who purchase Discount Bonds in the initial public offering but at a price different from the first offering price at which a substantial amount of those Discount Bonds were sold to the public, or who do not purchase Discount Bonds in the initial public offering, should consult their own tax advisors with respect to the tax consequences of the ownership of such Discount Bonds. Owners of Discount Bonds who sell or otherwise dispose of such Discount Bonds prior to maturity should consult their own tax advisors with respect to the amount of original issue discount accrued over the period such Discount Bonds have been held and the amount of taxable gain or loss to be recognized upon that sale or other disposition of Discount Bonds. Owners of Discount Bonds also should consult their own tax advisors with respect to state and local tax consequences of owning such Discount Bonds.

Original Issue Premium. The Bonds maturing on September 1 in the years 2012 through and including 2028 and 2030 through and including 2034 have been sold at prices reflecting original issue premium ("Premium Bonds"). An amount equal to the excess of the purchase price of a Premium Bond over its stated redemption price at maturity constitutes premium on such Premium Bond. A purchaser of a Premium Bond must amortize any premium over such Premium Bond's term using constant yield principles, based on the purchaser's yield to maturity. The amount of amortizable premium allocable to an interest accrual period for a Premium Bond will offset a like amount of qualified stated interest on such Premium Bond allocable to that accrual period, and may affect the calculation of alternative minimum tax liability described above. As premium is amortized, the purchaser's basis in such Premium Bond is reduced by a corresponding amount, resulting in an increase in the gain (or decrease in the loss) to be recognized for federal income tax purposes upon a sale or disposition of such Premium Bond prior to its maturity. Even though the purchaser's basis is reduced, no federal income tax deduction is allowed. Purchasers of Premium Bonds, whether at the time of initial issuance or subsequent thereto, should consult with their own tax advisors with respect to the determination and treatment of premium for federal income tax purposes and with respect to state and local tax consequences of owning such Premium Bonds.

#### **Continuing Disclosure Undertaking**

Basic Undertaking to Provide Annual Financial Information and Notice of Listed Events. To meet the requirements of United States Securities and Exchange Commission ("SEC") Rule 15c2-12(b)(5) ("Rule 15c2-12"), as applicable to a participating underwriter for the Bonds, the City will undertake in the Resolution (the "Undertaking") for the benefit of holders of the Bonds, as follows.

Annual Financial Information. The City will provide or cause to be provided, either directly or through a designated agent, to the Municipal Securities Rulemaking Board (the "MSRB"), in an electronic format as prescribed by the MSRB:

- (i) annual financial information and operating data of the type included in this Official Statement as generally described below under "Type of Annual Financial Information Undertaken to be Provided"; and
- (ii) 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:
  - (a) principal and interest payment delinquencies;
  - (b) non-payment related defaults, if material;
  - (c) unscheduled draws on debt service reserves reflecting financial difficulties;
  - (d) unscheduled draws on credit enhancements reflecting financial difficulties;
  - (e) substitution of credit or liquidity providers, or their failure to perform;

- (f) 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;
- (g) modifications to rights of holders of the Bonds, if material;
- (h) Bond calls (other than scheduled mandatory redemptions of Term Bonds), if material, and tender offers;
- (i) defeasances;
- (j) release, substitution, or sale of property securing repayment of the Bonds, if material;
- (k) rating changes;
- (1) bankruptcy, insolvency, receivership, or similar event of the City, as such "Bankruptcy Events" are defined in Rule 15c2-12;
- (m) 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
- (n) appointment of a successor or additional trustee or the change of name of a trustee, if material.

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

Type of Annual Financial Information Undertaken to be Provided. The annual financial information that the City undertakes to provide will consist of:

- (i) annual financial statements of the Water System, prepared in accordance with generally accepted accounting principles applicable to governmental units (except as otherwise noted therein), as such principles may be changed from time to time and as permitted by State law; which statements will not be audited, except that if and when audited financial statements are otherwise prepared and available to the City they will be provided;
- (ii) a statement of authorized, issued and outstanding bonded debt secured by Net Revenue of the Water System;
- (iii) debt service coverage ratios;
- (iv) summary operating statistics for the Water System, including population served, water sales revenue and billed water use; and
- (v) current water rates.

Annual financial information, as described above, will be provided to the MSRB not later than the last day of the ninth month after the end of each fiscal year of the City (currently, a fiscal year ending December 31), as such fiscal year may be changed as permitted or required by State law, commencing with the City's fiscal year ended December 31, 2012. The annual information may be provided in a single or in 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 any broker, dealer, municipal securities dealer, participating underwriter, rating agency, or the MSRB, under the circumstances and in the manner permitted by Rule 15c2-12.

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

information will include a narrative explanation of the effect of that change on the type of information to be provided.

Termination of Undertaking. The City's obligations under the Undertaking will terminate upon the legal defeasance, prior repayment, or payment in full of all of the then outstanding Bonds. In addition, the City's obligations under the Undertaking will terminate if those provisions of Rule 15c2-12 that 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. The City has agreed to proceed with due diligence to cause any failure to comply with the Undertaking to be corrected as soon as practicable after the City learns of that failure. No failure by the City or any other obligated person to comply with the Undertaking will constitute a default in respect of the Bonds. The sole remedy of any holder 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.

Other Continuing Disclosure Undertakings of the City. The City has entered into undertakings to provide annual information and the notice of the occurrence of certain events with respect to all bonds issued by the City subject to Rule 15c2-12. The City believes that it has not failed to comply, in any material respect, with all such undertakings.

#### OTHER BOND INFORMATION

#### Ratings on the Bonds

The Bonds have been rated "Aa1" and "AA+" by Moody's Investors Service, Inc. and Standard & Poor's Ratings Services, respectively. The ratings reflect only the views of the rating agencies, and an explanation of the significance of the ratings may be obtained from each rating agency. No application was made to any other rating agency for the purpose of obtaining an additional rating on the Bonds. 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 or withdrawn entirely by the rating agencies if, in their judgment, circumstances so warrant. Any such downward revision or withdrawal of the ratings will be likely to have an adverse effect on the market price of the Bonds.

#### Purchaser of the Bonds

The Bonds are being purchased by Citigroup Global Markets Inc. at a price of \$283,163,231.60 and will be reoffered at a price of \$284,285,450.60. The purchaser of the Bonds may offer and sell the Bonds to certain dealers (including dealers depositing the Bonds into investment trusts) and others at prices lower than the initial offering prices corresponding to the yields set forth on page i of this Official Statement, and such initial offering prices may be changed from time to time by such purchaser. After the initial public offering, the public offering prices may be varied from time to time.

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

#### **Fees Contingent**

Some of the fees of the Financial Advisor and Bond Counsel are contingent upon the sale of the Bonds.

#### **Official Statement**

So far as any statements are made in this Official Statement involving matters of opinion or of estimates, whether or not so expressly stated, they are set forth as such and not as representations of fact, and no representation is made that any of the estimates will be realized. Information concerning the City, SPU, and

the Water System contained in this Official Statement has been furnished by the City. Neither this Official Statement nor any statement which may have been made orally or in writing is to be construed as a contract with the owners of any of the Bonds.

Neither the delivery of this Official Statement nor any sale of the Bonds will, under any circumstances, create any implication that there has been no change in the affairs of the City since the date hereof. The City specifically disclaims any obligations to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of this Official Statement, except as otherwise expressly provided under "Legal and Tax Information—Continuing Disclosure Undertaking."

The execution and delivery of this Official Statement have been duly authorized by the City.

The City of Seattle

By: /s/ Glen M. Lee

Glen M. Lee Director of Finance This page left blank intentionally

# APPENDIX A BOND ORDINANCE

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Karen J. Boyle 2005 Water Refunding Bond Ordinance August 24, 2005 Version 1

# ORDINANCE 121939

AN ORDINANCE relating to the municipal water system of The City of Seattle; authorizing the issuance and sale of water system revenue bonds, in one or more series, for the purpose of paying all or part of the costs of refunding certain of the City's water system revenue bonds and issuing and selling the bonds; providing for terms, covenants and manner of sale of the bonds; describing the lien of the bonds; and providing for agreements and activities in connection with the disposition of the proceeds of the bonds.

Passed \_\_\_\_\_\_\_, 2005

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# ORDINANCE 12 1939

AN ORDINANCE relating to the municipal water system of The City of Seattle; authorizing the issuance and sale of water system revenue bonds, in one or more series, for the purpose of paying all or part of the costs of refunding certain of the City's water system revenue bonds and issuing and selling the bonds; providing for terms, covenants and manner of sale of the bonds; describing the lien of the bonds; and providing for agreements and activities in connection with the disposition of the proceeds of the bonds.

WHEREAS, The City of Seattle (the "City") owns and operates a municipal water system (the "Municipal Water System"); and

WHEREAS, the City issued water system revenue bonds pursuant to the ordinances and resolutions set forth in Exhibit A to this ordinance (the "Outstanding Parity Bonds"); and

WHEREAS, the City has determined that it is in the best interest of the City to authorize the issuance and sale, subject to the provisions of this ordinance, of water system refunding revenue bonds (collectively, the "Bonds"), in one or more series, for the purpose of paying all or part of the cost of refunding all or a portion of the Outstanding Parity Bonds, the Bonds and certain water system revenue bonds hereafter issued (collectively, the "Refundable Bonds") and of paying all or part of the costs of issuance and sale of the Bonds; and

WHEREAS, the City from time to time will receive, review and adopt a plan to refund selected maturities of those Refundable Bonds, which selected maturities will be identified in the Bond Resolutions (hereinafter defined); and

WHEREAS, this ordinance will allow the refunding of any Refundable Bonds only if the refunding is (a) consistent with City financial policies in effect at the time of the proposed refunding and (b) approved by resolution of the City Council; NOW, THEREFORE,

### BE IT ORDAINED BY THE CITY OF SEATTLE AS FOLLOWS:

Section 1. <u>Definitions</u>. As used in this ordinance and for the purposes of this ordinance the following words shall have the following meanings:

## "Accreted Value" means:

(1) with respect to any Capital Appreciation Bonds, as of the time of calculation, the sum of the amount representing the initial principal amount of such Capital Appreciation Bonds as set forth in the applicable Parity Bond Authorizing Ordinance plus the



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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.

"Acquired Obligations" means those Government Obligations purchased to accomplish the refunding of the Refunded Bonds, consistent with the Refunded Bond Legislation and any applicable agreements with Bond Insurers.

"Adjusted Annual Debt Service" for any fiscal year means Annual Debt Service minus

(1) an amount equal to ULID Assessments due in that year and not delinquent, (2) an amount
equal to earnings from investments in the Reserve Subaccount and (3) Annual Debt Service
provided for by Parity Bond proceeds.

"Adjusted Gross Revenue of the Municipal Water System" or "Adjusted Gross Revenue" means Gross Revenue of the Municipal Water System plus withdrawals from the Rate Stabilization Account and minus (1) ULID Assessments, (2) earnings from investments in the Reserve Subaccount and (3) deposits into the Rate Stabilization Account.

"Adjusted Net Revenue of the Municipal Water System" or "Adjusted Net Revenue" means Adjusted Gross Revenue less Operation and Maintenance Expenses.

"Annual Debt Service" means, for any fiscal year of the City, all amounts required to be paid in respect of interest on and principal of Parity Bonds and Payment Agreement Payments in respect of Parity Payment Agreements, subject to the following:

(i) <u>Debt Service on Term Bonds</u>. 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;

- (ii) <u>Interest on Parity Bonds</u>. For purposes of determining compliance with the Coverage Requirement, the Reserve Requirement and conditions for the issuance of Future Parity Bonds,
- (A) Generally. Except as otherwise provided by subparagraph (ii)(B) with respect to Variable Interest Rate Bonds and by subparagraph (ii)(C) with respect to Parity Bonds with respect to which a Payment Agreement is in force, interest on any issue of Parity Bonds shall be calculated based on the actual amount of accrued, accreted or otherwise accumulated interest that is payable in respect of that issue taken as a whole, at the rate or rates set forth in the Parity Bond Authorizing Ordinance;
- (B) <u>Interest on Variable Interest Rate Bonds</u>. 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 RBI during the fiscal quarter preceding the quarter in which the calculation is made;
- (C) Interest 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 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 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, the following assumptions shall be made:

Variable Interest Rate Bonds. If any Payment Agreement obligates a Qualified Counterparty to make payments to the City based on the actual Variable Interest Rate on Parity Bonds that would, but for the Payment Agreement, be treated as Variable Interest Rate Bonds and obligates the City to make payments to the Qualified Counterparty based on a fixed rate, payments by the City to the Qualified Counterparty shall be assumed to be made at the fixed rate specified by the Payment Agreement and payments by the Qualified Counterparty to the City shall be assumed to be made at the actual Variable Interest Rate on such Parity Bonds, without regard to the occurrence of any event that, under the provisions of the Payment Agreement, would permit the Qualified Counterparty to make payments on any basis other than the actual Variable Interest Rate on such Parity Bonds, and the Parity Bond Authorizing Ordinance shall set forth a debt service schedule for those Parity Bonds based on that assumption;

- (2) <u>Variable Interest Rate Bonds and Payment Agreements</u>

  Having the Same Variable Rate Component. If both a Payment Agreement and related Parity

  Bonds that would, but for the Payment Agreement, be treated as Variable Interest Rate Bonds

  include a variable rate payment component that is required to be calculated on the same basis

  (including, without limitation, on the basis of the same variable rate index), it shall be assumed
  that the variable rate payment component payable pursuant to the Payment Agreement is equal in

  amount to the variable rate interest component payable on those Parity Bonds;
- (3) <u>Variable Interest Rate Bonds and Payment Agreements</u>

  <u>Having Different Variable Rate Interest Components.</u> If a Payment Agreement obligates either



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the City or the Qualified Counterparty to make payments of a variable rate interest component of
a basis that is different (including, without limitation, on a different variable rate index) from the
basis that is required to be used to calculate interest on the Parity Bonds that would, but for the
Payment Agreement, be treated as Variable Interest Rate Bonds, it shall be assumed:

(a) <u>City Obligated to Make Payments Based on Variable Rate Index.</u> If payments by the City under the Payment Agreement are to be based on a variable rate index and payments by the Qualified Counterparty are to be based on a fixed rate, that payments by the City to the Qualified Counterparty will be based upon an interest rate equal to the assumed RBI-based rate, and that payments by the Qualified Counterparty to the City will be based on the fixed rate specified by the Payment Agreement; and

(b) <u>City Obligated to Make Payments Based on Fixed Rate</u>. If payments by the City under the Payment Agreement are to be based on a fixed rate and payments by the Qualified Counterparty are to be based on a variable rate index, that payments by the City to the Qualified Counterparty will be based on an interest rate equal to the rate (the "assumed fixed payor rate") that is 105% of the fixed rate specified by the Payment Agreement, and that payments by the Qualified Counterparty to the City will be based on a rate equal to the actual Variable Interest Rate on the Variable Interest Rate Bonds;

(4) <u>Certain Payment Agreements May be Disregarded.</u>

Notwithstanding the provisions of subparagraphs (ii)(C)(1), (2) and (3) of this definition, the City shall not be required to (but may in its discretion) take into account in determining Annual Debt Service the effects of any Payment Agreement that has a term of ten years or less;

(D) <u>Debt Service on Parity Payment Agreements</u>. 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 under subparagraph (ii)(C) of this definition. However, for any period during which Payment Agreement Payments are not

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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) City Obligated to Make Payments Based on Fixed Rate. 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 payor 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) <u>City Obligated to Make Payments Based on Variable Rate</u>
<u>Index.</u> 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; and

(E) <u>Balloon Bonds</u>. For purposes of calculating debt service on any Balloon Bonds, it shall be assumed that the principal of those Balloon Bonds, together with interest thereon at a rate equal to the assumed RBI-based rate, will be amortized in equal annual installments over a term of 30 years.

"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 Bonds" means any series of Parity Bonds designated as Balloon Bonds in the applicable Parity Bond Authorizing Ordinance.

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"Bond Account" means that special account of the City known as the Water Revenue Bond Account created by Ordinance 116705 in the Water Fund of the City for the payment of the principal of, mandatory sinking fund payments, Payment Agreement Payments, premiums, (if any), and interest on the Parity Bonds.

"Bond Counsel" means a firm of lawyers nationally recognized and accepted as bond counsel and so employed by the City for any purpose under this ordinance applicable to the use of that term.

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

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

"Bond Register" means the books or records maintained by the Bond Registrar on which are recorded the names and addresses of the Registered Owners of each of the Bonds.

"Bond Registrar" or "Registrar" means the Fiscal Agency of the State of Washington, or any successor bond registrar selected by the City, whose duties include the registration and authentication of the Bonds, maintenance of the Bond Register, effecting transfer of ownership of the Bonds, and paying the principal of and premium, if any, and interest on the Bonds.

"Bond Resolution" means the resolution or resolutions of the City Council adopted pursuant to this ordinance to specify certain additional provisions of each series of the Bonds and their sale.

"Bonds" means the refunding bonds issued in one or more series from time to time pursuant to, under the authority of and for the purposes provided in this ordinance.

"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" means The City of Seattle, Washington.

"City Council" means the City Council of the City.

"Closing Date" means the date on which a series of Bonds is delivered to the initial purchaser or purchasers thereof upon payment in full therefor.

"Code" means the Internal Revenue Code of 1986, as amended, and applicable rules and regulations promulgated thereunder.

"Contract Resource Obligation" means an obligation of the City, designated as a Contract Resource Obligation and entered into pursuant to Section 22 of this 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 Section 21 of this ordinance).

"Coverage Requirement" in any fiscal year of the City means an amount of Adjusted

Net Revenue of the Municipal Water System equal to at least 1.25 times the Adjusted Annual

Debt Service that year on all Parity Bonds.

"<u>Director of Finance</u>" 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 this ordinance.

"DTC" means The Depository Trust Company, New York, New York, as initial Securities Depository for the Bonds.

"Event of Default" shall have the meaning assigned to that term in Section 27(a) of this ordinance.

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"Fiscal Agency" means either of the fiscal agencies of the State of Washington located in Seattle, Washington, and New York, New York, or any other paying agent/registrar of the City, as the same may be designated in the Bond Resolution or otherwise designated from time to time.

"Future Parity Bonds" means all revenue bonds and other obligations (other than the Bonds) of the City issued hereafter, the payment of which constitutes a charge and lien on the Net Revenue of the Municipal Water System equal in rank with the charge and lien upon such revenue required to be paid into the Bond Account to pay and secure the payment of the principal of and interest on the Parity Bonds. Future Parity Bonds may include Parity Payment Agreements and any other obligations issued in compliance with Section 19.

"Government Obligations" means those government obligations defined by RCW 39.53.010(9) as it now reads or hereafter may be amended or replaced.

"Gross Revenue of the Municipal Water System" or "Gross Revenue" means in any fiscal year of the City all of the revenues of the Municipal 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; ULID Assessments; net receipts from Payment Agreements; and earnings from the investment of money in the Water Fund. However, Gross Revenue shall not include earnings of a separate utility system that may be acquired or constructed by the City pursuant to Section 21 of this ordinance; principal proceeds of Parity Bonds or other borrowings; or earnings or proceeds from any investments in a trust, defeasance or escrow fund created to defease or refund Municipal Water System obligations (until commingled with other earnings and revenues of the Municipal 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 of municipal utilities



of comparable size and character to the Municipal 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 Municipal Water System.

"Letter of Representations" means, for each series of Bonds, the Letter of Representations relating to the Bonds to be delivered by the City to DTC.

"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.

"Municipal 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, together with any utility systems of the City hereinafter combined with the Municipal Water System. The Municipal Water System shall not include any water supply or other utility system service or other facilities that may be created, acquired or constructed by the City as a separate utility system as provided in Section 21 of this ordinance.

"Net Revenue of the Municipal Water System" or "Net Revenue" means the Gross Revenue less Operation and Maintenance Expenses.

"Operation and Maintenance Expenses" means all expenses incurred by the City in causing the Municipal 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 Municipal Water System; payments into pension funds; State-imposed taxes; amounts due under Contract Resource Obligations (but only at the times described in Section 22 of this ordinance); payments made to any other person or entity for the receipt of water supply or transmission or other commodity or service; and payments with respect to any other expenses of the Municipal 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, or payments to the City in lieu of taxes, or capital additions or capital replacements to the Municipal Water System.

"Outstanding Parity Bonds" means the then-outstanding 1997 Bonds, 1998 Bonds, 1999A, 1999B Bonds, 2001 Bonds, 2003 Bonds and 2004 Bonds, as described in Exhibit A.

"Parity Bonds" means the Outstanding Parity Bonds, the Bonds, and any Future Parity Bonds.

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

"Parity Payment Agreement" means a Payment Agreement under which the City's payment obligations are expressly stated to constitute a charge and lien on the Net Revenue of the Municipal Water System equal in rank with the charge and lien upon such revenue required to be paid into the Bond Account to pay 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 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 as authorized by any applicable laws of the State in connection with, or incidental to, the issuance, incurring or carrying of particular bonds, notes, bond anticipation notes, commercial paper, or other obligations for borrowed money, or lease, installment purchase or other similar financing agreements or certificates of participation therein, that provides for an exchange of payments based on interest rates, ceilings or floors on such payments, options on such payments, or any combination thereof or any similar device.

"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.

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

"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 account of that name created in the Water Fund pursuant to Ordinance 116705 and redesignated for accounting purposes as the Revenue Stabilization Subfund of the Water Fund pursuant to Ordinance 120875.

"Rating Agencies" means Moody's Investors Service, Inc., and Standard & Poor's Ratings Services, a Division of The McGraw-Hill Companies, Inc., and their successors, and any other nationally-recognized securities rating agency or agencies rating Parity Bonds at the request of the City.

"RBI" means The Bond Buyer Revenue Bond Index or comparable index, or, if no comparable index can be obtained, 80% of the interest rate for actively traded 30-year United States Treasury obligations.

"Refundable Bonds" means, collectively, all or a portion of any Outstanding Parity Bonds and the Bonds, and all or a portion of those Future Parity Bonds that have been designated as Refundable Bonds in the applicable Parity Bond Ordinance.

"Refunded Bonds" means those Refundable Bonds included in a Refunding Plan.

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"Refunded	Bond	Legislation"	means	the	respective	Parity	Bond	Authorizing
Ordinances pursuan	t to whi	ch the Refunde	d Bonds	were	issued.			

"Refunding Plan" means, with respect to the issuance of each series of Bonds, the refunding of all or a portion of the Refundable Bonds through the issuance of such series, as more particularly described in the Bond Resolution.

"Refunding Trust Agreement" means, with respect to each series of Bonds, a refunding trust or escrow agreement between the City and a Refunding Trustee, dated as of the Closing Date of such series, providing for the safekeeping of certain Bond proceeds and the refunding of all or a portion of the Refundable Bonds.

"Refunding Trustee" means, for each series of Bonds, the Director of Finance, or the trustee or escrow agent designated by the Director of Finance, consistent with the Refunded Bond Legislation and any applicable agreements with Bond Insurers.

"Registered Owner" means the person shown on the Bond Register as the owner of one or more 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 the Parity Bonds.

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

"Securities Depository" means any one of the following registered securities depositories which has been designated by the City: (i) DTC; (ii) Midwest Securities Trust Company, Chicago, Illinois; (iii) Philadelphia Depository Trust Company, Philadelphia,

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Pennsylvania; or (iv) such other securities depositories as the City may designate in a certificate of the City delivered to the Bond Registrar.

"State" means the State of Washington.

"State Auditor" means the office of the Auditor of the State or such other department or office of the State authorized and directed by State law to make audits.

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

"Term Bonds" means those Parity Bonds designated as such in the applicable Parity Bond Authorizing Ordinance.

"ULID" means a utility local improvement district.

"ULID Assessments" means all assessments levied and collected in a ULID of the City created for the acquisition or construction of additions to and betterments and extensions of the Municipal Water System if (and only if) those assessments are pledged to be paid into the Bond Account, not including any prepaid assessments paid into a construction fund or account. ULID Assessments shall include installments thereof and any interest or penalties thereon.

"Undertaking" means the City's undertaking in the Bond Resolution to provide certain disclosure as provided by Section 24.

"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 (including a Bond Resolution), 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 Fund" means the fund of that name into which is paid the Gross Revenue of the Municipal Water System.

Section 2. Authorization and Description of Bonds. The City is authorized to issue Bonds for the purpose of providing all or a part of the funds with which to pay the cost of refunding, defeasing, or refunding and defeasing, the Refunded Bonds and to pay all or part of the costs of issuing and selling the Bonds. The Bonds may be issued in one or more series at any time on or before December 31, 2015, and may be combined with other Parity Bonds authorized separately. The maximum principal amount of any series of the Bonds shall not exceed 125% of the then-outstanding principal amount of the Refundable Bonds refunded by that series of Bonds.

The Bonds shall be dated and have such year and series or other designation as determined by the Director of Finance or as specified by the Bond Resolution; shall be in the denomination of \$5,000 or any integral multiple thereof within a single maturity or such other denomination specified in the Bond Resolution; and shall be numbered separately, in the manner and with any additional designation as the Bond Registrar deems necessary for the purpose of identification. The Bonds shall mature on the dates and in the amounts and bear interest payable on the dates and at the rates specified in the Bond Resolution, except that the net interest cost shall not exceed a weighted average rate of ten percent per annum. All or some of the Bonds

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may be Term Bonds, as specified by the Bond Resolution. The final maturity of any series of Bonds shall not exceed 40 years from the issue date for that series.

Section 3. <u>Bond Resolution</u>. With respect to each series of Bonds, the City Council may adopt the Bond Resolution and in that resolution may provide for the matters described in this ordinance, including the manner of sale and delivery of and payment for the Bonds, the refunding of the Refunded Bonds, and such other matters that the City Council deems necessary and appropriate to carry out the purposes of this ordinance. Once adopted, the Bond Resolution shall be deemed a part of this ordinance as if set forth herein.

For each series of Bonds, the Bond Resolution may provide for Bond Insurance or Reserve Insurance, and conditions or covenants relating thereto, including additional terms, conditions and covenants relating to the Bonds that are required by the bond insurer or letter of credit provider and are consistent with the provisions of this ordinance, including but not limited to restrictions on investments and requirements of notice to and consent of the bond insurer or letter of credit provider.

For each series of Bonds, the Bond Resolution may approve and authorize the execution and delivery on behalf of the City of any contracts consistent with the provisions of this ordinance for which the City's approval is necessary or to which the City is a party and that are related or incidental to the initial issuance and sale of the Bonds, the initial establishment of the interest rate or rates on the Bonds and any redemption of the Bonds, including but not limited to Payment Agreements and similar contracts for such purposes.

The Bond Resolution for each series of Bonds shall identify the Refunded Bonds to be refunded by that series, shall establish the terms and conditions upon which the Refunded Bonds are to be refunded, and shall confirm the Director of Finance as, or the Director of Finance's appointment of, the Refunding Trustee. The City Council may specify in the Bond Resolution the amount, if any, from the proceeds of or accrued interest on the Bonds to be deposited into specified funds, subfunds, accounts and subaccounts. In the absence of such a determination and

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specification in the Bond Resolution, the Director of Finance may make such determination and specification.

Section 4. Allocation of the Bonds to the Refunded Bonds. With respect to each series of Bonds, the City Council shall, by the Bond Resolution, provide for the allocation of that series of Bonds to the various series of the Refunded Bonds in a manner consistent with the Code. Such allocation shall be reflected in schedules attached to the Bond Resolution.

Section 5. Registration and Transfer or Exchange of Bonds. The Bonds shall be issued only in registered form as to both principal and interest and recorded on the Bond Register. The Bond Register shall contain the name and mailing address of the Registered Owner of each Bond and the principal amount and number of each of the Bonds held by each Registered Owner.

Bonds surrendered to the Bond Registrar may be exchanged for Bonds in any authorized denomination of an equal aggregate principal amount and of the same series, interest rate and maturity. Bonds may be transferred only if endorsed in the manner provided thereon and surrendered to the Bond Registrar. Any exchange or transfer shall be without cost to the Registered Owner or transferee. The Bond Registrar shall not be obligated to exchange or transfer any Bond during the 15 days preceding any principal or interest payment or redemption date (or other record date established by the Bond Resolution).

The City appoints DTC as initial Securities Depository for the Bonds. For so long as DTC is the Securities Depository for the Bonds, DTC or its nominee shall be deemed to be the Registered Owner of the Bonds for all purposes hereunder, and all references in this ordinance or the Bond Resolution to the Registered Owners of the Bonds shall mean DTC or its nominee and shall not mean the owners of any beneficial interests in the Bonds. Payments of principal of, premium, if any, and interest on all outstanding Bonds registered in the name of the nominee of DTC, or its registered assign, shall be made as provided in the Letter of Representations.



Bonds executed and delivered in fully immobilized form shall be executed and delivered in the form of one fully-registered immobilized certificate for each series and maturity of the Bonds representing the aggregate principal amount of the Bonds of that series and maturity, which Bonds shall (except as provided below for the discontinuation or substitution of Securities Depository) be registered in the name of the Securities Depository or its nominee. For so long as DTC serves as Securities Depository for the Bonds, the Bonds shall be registered in the name of Cede & Co., as nominee of DTC; however, if DTC shall request that the Bonds be registered in the name of a different nominee, the Bond Registrar shall exchange all or any portion of the Bonds for an equal aggregate principal amount of Bonds registered in the name of such other nominee or nominees of DTC. No person other than DTC or its nominee shall be entitled to receive from the City or the Bond Registrar any Bond or any other evidence of ownership of the Bonds, or any right to receive any payment in respect thereof, unless DTC or its nominee shall transfer record ownership of all or any portion of the Bonds on the Bond Register, in connection with discontinuing the book entry system as provided below or otherwise.

For so long as the Bonds are registered in the name of DTC or any nominee thereof, all payments of the principal of, or premium, if any, or interest with respect to the Bonds shall be made to DTC or its nominee in immediately available funds on the dates provided for such payments under this ordinance and the Bond Resolution and at such times and in the manner provided in the Letter of Representations. Each such payment to DTC or its nominee shall be valid and effective to fully discharge all liability of the City or the Bond Registrar with respect to the principal of, premium, if any, or interest with respect to the Bonds to the extent of the sum or sums so paid. In the event of the redemption of less than all of the Bonds of any series and maturity, the Bond Registrar shall not require surrender by DTC or its nominee of the Bonds so redeemed, and DTC or its nominee may retain such Bonds and make an appropriate notation thereon as to the amount of such partial redemption. DTC shall deliver to the Bond Registrar, upon request, a written confirmation of such partial redemption. The records maintained by the

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Bond Registrar shall be conclusive as to the amount of the Bonds of such series and maturity that have been redeemed.

All transfers of beneficial ownership interests in Bonds registered in the name of DTC or its nominee shall be effected by the procedures of DTC's participants and/or indirect participants for recording and transferring the ownership of beneficial interests in bonds.

The City and the Bond Registrar may treat DTC (or its nominee) as the sole and exclusive Registered Owner of the Bonds registered in its name for the purposes of payment of the principal of, premium, if any, or interest with respect to those Bonds, selecting Bonds or portions thereof to be redeemed, giving any notice permitted or required to be given to Registered Owners under this ordinance or the Bond Resolution, registering the transfer of Bonds, obtaining any consent or other action to be taken by Registered Owners of Bonds and for all other purposes whatsoever; and the City and the Bond Registrar shall not be affected by any notice to the contrary. The City and the Bond Registrar shall not have any responsibility or obligation to any direct or indirect DTC participant, any person claiming a beneficial ownership interest in the Bonds under or through DTC or any such participant, or any other person which is not shown on the Bond Register as being a Registered Owner of Bonds, with respect to: (i) the Bonds; (ii) any records maintained by DTC or any such participant; (iii) the payment by DTC or any such direct or indirect participant of any amount in respect of the principal of, premium, if any, or interest with respect to the Bonds; (iv) any notice which is permitted or required to be given to Registered Owners of Bonds under this ordinance or the Bond Resolution; (v) the selection by DTC or any such direct or indirect participant of any person to receive payment in the event of a partial redemption of the Bonds; or (vi) any consent given or other action taken by DTC as Registered Owner of the Bonds.

For so long as the Bonds are registered in the name of DTC or any nominee thereof, all notices required or permitted to be given to the Registered Owners of such Bonds under this

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ordinance or the Bond Resolution shall be given to DTC as provided in the Letter of Representations.

In connection with any notice or other communication to be provided to Registered Owners pursuant to this ordinance or the Bond Resolution by the City or the Bond Registrar with respect to any consent or other action to be taken by Registered Owners of the Bonds, DTC shall consider the date of receipt of notice requesting such consent or other action as the record date for such consent or other action; however, the City or the Bond Registrar may establish a special record date for such consent or other action and shall give DTC notice of such special record date not less than 15 calendar days in advance of such special record date to the extent practical.

Any successor Bond Registrar, in its written acceptance of its duties under this ordinance and the Bond Resolution, shall agree to take any actions necessary from time to time to comply with the requirements of any applicable Letter of Representations.

The book-entry system for registration of the ownership of the Bonds delivered in fully immobilized form may be discontinued at any time if: (i) after notice to the City and the Bond Registrar, DTC determines to resign as Securities Depository for the Bonds; or (ii) after notice to DTC and the Bond Registrar, the City determines that a continuation of the system of book-entry transfers through DTC (or through a successor Securities Depository) is not in the best interests of the City. In each of such events (unless, in the case described in clause (i) above, the City appoints a successor Securities Depository), the Bonds shall be delivered in registered certificate form to such persons, and in such maturities and principal amounts, as may be designated by DTC, but without any liability on the part of the City or the Bond Registrar for the accuracy of such designation. Whenever DTC requests the City and the Bond Registrar to do so, or whenever the City requests DTC and the Bond Registrar to do so after the determination by the City to replace DTC with a successor Securities Depository, the City and the Bond Registrar shall cooperate with DTC in taking appropriate action after reasonable notice to arrange for another Securities Depository to maintain custody of certificates evidencing the Bonds.

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hereunder shall become mutilated or be destroyed, stolen or lost, the City may, if not then prohibited or otherwise required by law, cause to be executed and delivered a new Bond of like amount, interest rate, maturity date, series and tenor in exchange and substitution for and upon cancellation of such mutilated Bonds, or in lieu of and in substitution for such destroyed, stolen or lost Bonds, upon payment by the Registered Owner thereof of the reasonable expenses and charges of the City and the Bond Registrar in connection therewith, and in the case of a Bond destroyed, stolen or lost, the filing with the Bond Registrar of evidence satisfactory to it that such Bond was destroyed, stolen or lost, and of the ownership thereof, and furnishing the City and the Bond Registrar with indemnity satisfactory to each of them. If the mutilated, destroyed, stolen or lost Bond already has matured or been called for redemption in accordance with its terms it shall not be necessary to issue a new Bond prior to payment. If the provisions of State law at any time differ from the provisions of this Section 6 with respect to the requirements or procedures for replacing or otherwise handling mutilated, lost, stolen or destroyed Bonds, then the provisions of State law shall prevail.

Section 6. Mutilated, Lost, Stolen and Destroyed Bonds. In case any Bonds issued

Section 7. Payment of Bond Principal and Interest. Principal of, premium, if any, and interest on the Bonds shall be payable in lawful money of the United States of America. Interest on the Bonds shall be paid by checks or drafts mailed by the Bond Registrar on the interest payment date to the Registered Owners at the addresses appearing on the Bond Register on the 15th day of the month preceding the interest payment date (or other record date established by the Bond Resolution) (the "Record Date") or, at the request of a Registered Owner of \$1,000,000 or more in aggregate principal amount of Bonds, by wire transfer to an account in the United States designated in writing by such Registered Owner prior to the Record Date. Principal of and premium, if any, on the Bonds shall be payable upon presentation and surrender of the Bonds by the Registered Owners at either of the principal corporate trust office or offices of the Bond Registrar at the option of the Registered Owners. Notwithstanding the foregoing, payment

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of any Bonds registered in the name of DTC or its nominee shall be made in accordance with the Letter of Representations.

The Bonds shall be payable solely out of the Bond Account and shall not be general obligations of the City.

## Section 8. Redemption and Open Market Purchase of Bonds.

- (a) Optional Redemption. All or some of the Bonds may be subject to redemption at the option of the City at the times and on the terms set forth in the Bond Resolution.
- (b) <u>Mandatory Redemption</u>. The City shall redeem any Term Bonds, if not redeemed under the optional redemption provisions set forth in the Bond Resolution or purchased in the open market under the provisions set forth below, by lot (or in such other manner as the Bond Registrar shall determine) at par plus accrued interest on the dates and in the years and principal amounts as set forth in the Bond Resolution.

If the City redeems Term Bonds under the optional redemption provisions set forth in the Bond Resolution or purchases Term Bonds in the open market as set forth below, the Term Bonds so redeemed or purchased (irrespective of their redemption or purchase price) shall be credited at the par amount thereof against the remaining mandatory redemption requirements in a manner to be determined by the Director of Finance or, if no such determination is made, on a pro-rata basis.

(c) Partial Redemption. Whenever less than all of the Bonds of a single series and maturity are to be redeemed, the Bond Registrar shall select the Bonds or portions thereof to be redeemed from the Bonds of that series and maturity by lot, or in such other manner as the Bond Registrar shall determine, except that, for so long as the Bonds are registered in the name of DTC or its nominee, DTC shall select the Bonds or portions thereof to be redeemed in accordance with the Letter of Representations. In no event shall any Bond be outstanding in a principal amount that is not an authorized denomination.



Portions of the principal amount of any Bond, in integral amounts of \$5,000, may be redeemed, unless otherwise provided in the Bond Resolution. If less than all of the principal amount of any Bond is redeemed, upon surrender of that Bond at either of the principal offices of the Bond Registrar, there shall be issued to the Registered Owner, without charge therefor, a new Bond (or Bonds, at the option of the Registered Owner) of the same series, maturity and interest rate in any of the denominations authorized by the Bond Resolution in the aggregate total principal amount remaining unredeemed.

- (d) Open Market Purchase. The City reserves the right and option 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. The principal amount of Term Bonds purchased pursuant to this Section 8 shall be credited at the par amount thereof against the next mandatory redemption requirement, or as otherwise directed by the Director of Finance.
- (e) <u>Bonds to be Canceled</u>. All Bonds purchased or redeemed under this Section 8 shall be canceled.

Section 9. Notice of Redemption. The City shall cause notice of any intended redemption of Bonds to be given not less than 30 nor more than 60 days prior to the date fixed for redemption by first-class mail, postage prepaid, to the Registered Owner of any Bond to be redeemed at the address appearing on the Bond Register at the time the Bond Registrar prepares the notice, and the requirements of this sentence shall be deemed to have been fulfilled when notice has been mailed as so provided, whether or not it is actually received by the Registered Owner of any Bond. Interest on Bonds called for redemption shall cease to accrue on the date fixed for redemption unless the Bond or Bonds called are not redeemed when presented pursuant to the call. In addition, the redemption notice shall be mailed by the Bond Registrar within the same period, postage prepaid, to each of the Rating Agencies at their offices in New York, New York, to any Bond Insurer for the Bonds, and to such other persons and with such additional

information as the Director of Finance shall determine or as specified in the Bond Resolution, but these additional mailings shall not be a condition precedent to the redemption of Bonds.

Section 10. Failure to Redeem Bonds. If any Bond is not redeemed when properly presented at its maturity or call date, the City shall be obligated to pay interest on that Bond at the same rate provided in the Bond from and after its maturity or call date until that Bond, principal of, premium, if any and interest, is paid in full or until sufficient money for its payment in full is on deposit in the Bond Account and the Bond has been called for payment by giving notice of that call to the Registered Owner of each of those unpaid Bonds.

Section 11. Form and Execution of Bonds. The Bonds shall be typed, photocopied, printed or lithographed on good bond paper in a form consistent with the provisions of this ordinance, the Bond Resolution and State law, shall be signed by the Mayor of The City of Seattle and Director of Finance, either or both of whose signatures may be manual or in facsimile, and the seal of the City or a facsimile reproduction thereof shall be impressed or printed thereon.

Only Bonds bearing a Certificate of Authentication in substantially the following form (with the designation, year, and series of the Bonds completed consistent with this ordinance), manually signed by the Bond Registrar, shall be valid or obligatory for any purpose or entitled to the benefits of this ordinance:

## CERTIFICATE OF AUTHENTICATION

This Bond is one of the fully registered The City of Seattle, Washington, Water System Refunding Revenue Bonds, [Year] [Series], described in the Bond Ordinance.

WASHINGTON	STATE	FISCAL	AGENCY
Bond Registrar			

By:		
,	Authorized Signer	



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The authorized signing of a Certificate of Authentication shall be conclusive evidence that the Bond so authenticated has been duly executed, authenticated and delivered and is entitled to the benefits of this ordinance.

If any officer whose facsimile signature appears on the Bonds ceases to be an officer of the City authorized to sign bonds before the Bonds bearing his or her facsimile signature are authenticated or delivered by the Bond Registrar or issued by the City, those Bonds nevertheless may be authenticated, delivered and issued and, when authenticated, issued and delivered, shall be as binding on the City as though that person had continued to be an officer of the City authorized to sign bonds. Any Bond also may be signed on behalf of the City by any person who, on the actual date of signing of the Bond, is an officer of the City authorized to sign bonds, although he or she did not hold the required office on the date of issuance of the Bonds.

Section 12. Bond Registrar. The Bond Registrar shall keep, or cause to be kept, at its principal corporate trust office, sufficient books for the registration and transfer of the Bonds which shall at all times be open to inspection by the City. The Bond Registrar is authorized, on behalf of the City, to authenticate and deliver Bonds transferred or exchanged in accordance with the provisions of the Bonds and this ordinance, to serve as the City's paying agent for the Bonds and to carry out all of the Bond Registrar's powers and duties under this ordinance and SMC Chapter 5.10 establishing a system of registration for the City's bonds and obligations, as that chapter now exists or may be amended.

The City reserves the right in its discretion to appoint special paying agents, registrars or trustees in connection with the payment of some or all of the principal of or interest on the Bonds. If a new Bond Registrar is appointed by the City, notice of the name and address of the new Bond Registrar shall be mailed to the Registered Owners of the Bonds. The notice may be mailed together with the next interest payment due on the Bonds, but, to the extent practicable, shall be mailed not less than 15 days prior to a maturity date of the principal or a mandatory redemption date of any Bond.

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The Bond Registrar shall be responsible for its representations contained in the Bond Registrar's Certificate of Authentication on the Bonds. The Bond Registrar may become the Registered Owner of Bonds with the same rights it would have if it were not the Bond Registrar and, to the extent permitted by law, may act as depository for and permit any of its officers or directors to act as members of, or in any other capacity with respect to, any committee formed to protect the rights of the Registered Owners of the Bonds.

Section 13. <u>Bond Account</u>. Ordinance 116705 created the Water Revenue Bond Account (the "Bond Account") in the Water Fund and further divided the Bond Account into two subaccounts: the Principal and Interest Subaccount and the Reserve Subaccount. So long as any Parity Bonds are outstanding, the City shall set aside and pay into the Bond Account all ULID Assessments on their collection (except for ULID Assessments deposited in a construction account) and, out of the Net Revenue, certain fixed amounts without regard to any fixed proportion, namely:

- (a) Into the Principal and Interest Subaccount (i) upon receipt thereof, the accrued interest, if any, received by the City from the purchaser of the Bonds, and (ii) 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 Subaccount, in approximately equal annual payments, amounts necessary to fund the Reserve Requirement within five years from the date of issuance of such Parity Bonds after taking into account the capitalization of all or any part of the Reserve Requirement. The City may 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:

The 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 specified herein, the City shall substitute Reserve Insurance in the amount required to make up the deficiency created in the Reserve Subaccount or in the alternative shall create a special account in the Water 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 Subaccount, to equal the Reserve Requirement in effect as of the date the cancellation or disqualification of the entity becomes effective. The required amounts shall be deposited in that special account from money in the Water Fund after making provision for payment of Operation and Maintenance Expenses and for required payments into the Bond Account. 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 Subaccount 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 Subaccount may be transferred back to the Water Fund and used for any purpose if and when qualifying Reserve Insurance is obtained.

Except for withdrawals therefrom and payments over time as authorized herein, the Reserve Subaccount shall 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 Subaccount, obligations in which money in the Reserve Subaccount 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 Subaccount 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 Subaccount by the withdrawal of cash therefrom for that purpose. Any deficiency created in the Reserve Subaccount by reason of any such withdrawal shall within 12 months be made up from ULID Assessments and Net Revenue available after making necessary provisions for the required payments into the Principal and Interest Subaccount.

The money in the Reserve Subaccount may be applied to the payment of the last outstanding bonds payable out of the Bond Account, except that any money in the Reserve Subaccount (including investment earnings) in excess of the Reserve Requirement may be withdrawn and deposited in the Principal and Interest Subaccount 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 Municipal Water System purpose. When the total amount in the Bond Account (including investment earnings) shall equal 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 Account.

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

All money in the Bond Account may be kept in cash or invested in legal investments maturing, for investments in the Principal and Interest Subaccount, not later than the dates when the funds are required for the payment of principal of or interest on the Parity Bonds and, for investments in the Reserve Subaccount, 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 Subaccount shall be deposited in that account. Earnings from investments in the Reserve Subaccount shall be deposited in that account. Notwithstanding the provisions for the deposit of earnings, any earnings that are subject to federal arbitrage rebate requirements may be withdrawn from the Bond Account for deposit into a separate fund or account created for the purpose of compliance with those rebate requirements.

The City may create sinking fund accounts or other accounts in the Bond Account for the payment or securing the payment of Parity Bonds as long as the maintenance of such accounts does not conflict with the rights of the owners of such Parity Bonds.

Section 14. Rate Stabilization Account. The Rate Stabilization Account has been created in the Water Fund. The City may at any time, as determined by the City and as consistent with Section 18 of this ordinance, deposit in the Rate Stabilization Account Gross Revenue and any other money received by the Municipal Water System and available to be used therefor. The City may withdraw any or all of the money from the Rate Stabilization Account

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for inclusion in the Adjusted Gross Revenue for any fiscal year of the City. 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 Adjusted Gross Revenue.

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.

Section 15. Finding as to Sufficiency of Gross Revenue. A series of Bonds will be issued only if the City Council finds and determines by the Bond Resolution (i) that the Gross Revenue and benefits to be derived from the operation and maintenance of the Municipal Water System of the City at the rates to be charged from time to time for water and other services and commodities from the Municipal Water System consistent with Section 17(b) hereof, will be sufficient to meet all Operation and Maintenance Expenses and to permit the setting aside into the Bond Account out of the Gross Revenue of amounts sufficient to pay the principal of and interest on the Bonds and any mandatory redemption requirements when due, and (ii) that in fixing the amounts to be paid into the Bond Account the City has exercised due regard for Operation and Maintenance Expenses, and has not bound and obligated itself to set aside and pay into the Bond Account a greater amount or proportion of the Gross Revenue than in the judgment of the City will be available over and above the Operation and Maintenance Expenses.

Section 16. Pledge of Net Revenue and Lien Position. The Net Revenue of the Municipal Water System and all money and investments held in the Bond Account and the Rate Stabilization Account is pledged to the payment of the Parity Bonds and to make payments into the Reserve Subaccount required by this ordinance, the Bond Resolution and 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.

Section 17. <u>Parity Bond Covenants</u>. The City covenants and agrees with the owner of each Bond at any time outstanding, as follows:

- (a) Operation and Maintenance. It will at all times maintain, preserve and keep the properties of the Municipal 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 so that at all times the business carried on in connection therewith will be properly and advantageously conducted, and will at all times operate or cause to be operated the properties of the Municipal Water System and the business in connection therewith in an efficient manner and at a reasonable cost.
- (b) Establishment and Collection of Rates and Charges. It will establish, maintain and collect rates and charges for services and facilities provided by the Municipal 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 Account and the subaccounts therein, and (iii) pay all taxes, assessments or other governmental charges lawfully imposed on the Municipal 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
- (2) The Adjusted Net Revenue of the Municipal Water System in each fiscal year will be at least equal to the Coverage Requirement; and
- (3) Except to aid the poor or infirm and for fire-fighting 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 Municipal Water System free of charge to any person, firm or corporation, public or private.

The failure of the City to comply with subparagraphs (1) and (2) of this paragraph (b) shall not be an Event of Default if the City promptly retains an Independent Consulting Engineer to recommend to the City Council adjustments in the rates of the Municipal Water System



necessary to meet the requirements of those subparagraphs and if the City Council adopts the recommended modifications within 180 days of the date the failure became known to the City Council.

following:

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

- (1) 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 Municipal Water System, or shall have become unserviceable, inadequate, obsolete or unfit to be used in the operation of the Municipal Water System or are no longer necessary, material or useful to the operation of the Municipal Water System; or
- (2) The City in its discretion may carry out such a transfer if the aggregate depreciated cost value of the facilities or property being transferred under this subparagraph (2) in any fiscal year comprises no more than three percent of the total assets of the Municipal Water System; or
- (3) The City in its discretion may carry out such a transfer if the City receives from the transferee an amount equal to the fair market value of the portion of the Municipal Water System transferred. As used in this subparagraph, "fair market value" means the most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale, the willing buyer and willing seller each acting prudently and knowledgeably and assuming that the price is not affected by coercion or undue stimulus. The proceeds of the transfer shall be used (i) to promptly redeem, or irrevocably set aside for the redemption of, Parity Bonds, and/or (ii) to provide for part of the cost of additions to and

betterments and extensions of the Municipal Water System. Before any such transfer under this subparagraph (3), the City must obtain a certificate of an Independent Consulting Engineer to the effect that in his or her professional opinion, upon such transfer and the use of proceeds of the transfer as proposed by the City, the remaining Municipal Water System will retain its operational integrity and the Adjusted Net Revenue of the Municipal Water System will be at least equal to the Coverage Requirement during the five fiscal years following the fiscal year in which the transfer is to occur, taking into account, (w) the reduction in revenue resulting from the transfer; (x) the use of any proceeds of the transfer for the redemption of Parity Bonds, (y) the Independent Consulting Engineer's estimate of revenue from customers anticipated to be served by any additions to and betterments and extensions of the Municipal Water System financed in part by the proposed portion of the proceeds of the transfer, and (z) any other adjustment permitted in the preparation of a certificate under Section 19(f)(2) of this ordinance. Before such a transfer, the City also must obtain confirmation from each of the Rating Agencies to the effect that the rating then in effect will not be reduced or withdrawn upon such transfer.

The amount required to be paid to the City 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 transferce, are allowed as a setoff against the transfer price that would otherwise be payable to the City.

Upon the redemption or defeasance of all then outstanding 1997 Bonds, 1998 Bonds, 1999A Bonds, 1999B Bonds, 2001Bonds, 2003 Bonds, and 2004 Bonds, the City may sell, transfer or otherwise dispose of any of the works, plant, properties, facilities or other part of the Municipal Water System or any real or personal property comprising a part of the Municipal Water System only consistent with one or more of the following:

(1) The City in its discretion may carry out such a sale, transfer or disposition (each, a "transfer") if the facilities or property transferred are not material to the operation of the Municipal Water System, or shall have become unserviceable, inadequate,

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obsolete or unfit to be used in the operation of the Municipal Water System or are no longer necessary, material or useful to the operation of the Municipal Water System; or

(2) The City in its discretion may carry out such a transfer if the aggregate depreciated cost value of the facilities or property being transferred under this subparagraph (2) in any fiscal year comprises no more than five percent (5%) of the total assets of the Municipal Water System; or

(3) The City in its discretion may carry out such a transfer if the proceeds from such transfer are used to acquire new useful operating facilities or properties of the Municipal Water System, or are used to retire outstanding Parity Bonds or other revenue obligations of the Municipal Water System, if, at the time of such transfer, the City has on file a a certificate of both the Director of Finance and the Director of Seattle Public Utilities (or any officer who succeeds to substantially all of the responsibilities of either office) demonstrating that in their opinion, upon such transfer and the use of proceeds of the transfer as proposed by the City, the remaining facilities of the Municipal Water System will retain their operational integrity and, based on the financial statements for the most recent fiscal year available, the proposed transfer would not prevent the Municipal Water System from complying with the Coverage Requirement during the five fiscal years following the fiscal year in which the transfer is to occur. The certificate shall take into account, (A) the reduction in revenue and expenses, if any, resulting from the transfer; (B) the use of any proceeds of the transfer for the redemption of Parity Bonds, (C) the estimate of revenue from customers anticipated to be served by any additions to and betterments and extensions of the Municipal Water System financed in part by the proposed portion of the proceeds of the transfer, and (D) any other adjustment permitted in the preparation of a certificate under Section 19(f)(2) of this ordinance. Before such a transfer, the City also must obtain confirmation from each of the Rating Agencies to the effect that the rating then in effect will not be reduced or withdrawn upon such transfer.

(d)

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.

(e) Books and Accounts. It will keep proper books, records and accounts

in this ordinance, it will not at any time create or permit to accrue or to exist any lien or other

Liens Upon the Municipal Water System. Except as otherwise provided

with respect to the operations, income and expenditures of the Municipal Water System in accordance with generally accepted accounting practices relating to the 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 City, 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 showing in reasonable detail the financial condition of the Municipal 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 Account and into any and all special funds or accounts created pursuant to the provisions of this 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 Municipal 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.

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- Collection of Delinquent Accounts. On at least an annual basis, it will (f) 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 Municipal 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 Municipal Water System and the owners of the Parity Bonds against loss.
- (h) 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 Municipal 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 Municipal Water System.
- Section 18. Flow of Funds. All ULID Assessments shall be paid into the Bond Account as provided by this ordinance. The Gross Revenue of the Municipal Water System shall be used for the following purposes only and shall be applied in the following order of priority:
  - (a) To pay the Operation and Maintenance Expenses;
  - To pay interest on Parity Bonds and net payments on Parity Payment Agreements when due:
  - 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 which agreement requires those payments to be treated on a parity of lien with the Parity Bonds;



- (d) To make all payments required to be made into the Reserve Subaccount, 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 Subaccount;
- (e) 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 Municipal Water System junior and inferior to the lien thereon for the payment of the principal of and interest on the Parity Bonds; and
- (f) To retire by redemption or purchase in the open market any outstanding revenue bonds or other revenue obligations of the Municipal Water System, to make necessary additional betterments, improvements and repairs to or extensions and replacements of the Municipal Water System, to make deposits into the Rate Stabilization Account, or for any other lawful Municipal Water System purposes.

The City may transfer any money from any funds or accounts of the Municipal 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 Account.

Section 19. 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 Municipal 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 Account and no Event of Default with respect to any Parity Bonds 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 ULID 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 Account, 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 Account.



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- (d) The Parity Bond Authorizing Ordinance shall provide for the payment of amounts into the Bond Account 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 Subaccount.
- (e) The Parity Bond Authorizing Ordinance shall provide for the deposit into the Reserve Subaccount 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 ULID Assessments and Adjusted 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:
  - (1) a certificate of the Director of Finance demonstrating that during any twelve consecutive calendar months out of the immediately preceding 24 calendar months Adjusted Net Revenue was at least equal to the Coverage Requirement for all Parity Bonds plus the Future Parity Bonds proposed to be issued (and assuming that the debt service of the proposed Future Parity Bonds for that twelve-month period was the Average Annual Debt Service for those proposed bonds); or
  - (2) a certificate of both the Director of Finance and the Director of Seattle Public Utilities (who has succeeded to substantially all of the responsibilities of the Superintendent of the Municipal Water System), or any officer who succeeds to substantially all of the responsibilities of either office, that in their opinion the Adjusted Net Revenue for the five fiscal years next following the earlier of (A) the end of the period during which interest on those Future Parity Bonds is to be capitalized or, if no interest is capitalized, the fiscal year in which the Future Parity Bonds are issued, or (B) the date on which substantially all new facilities financed with those Future Parity Bonds are expected to commence operations, such Adjusted Net Revenue further adjusted as provided in paragraphs (i) through (iv) below, will be at least equal to the Coverage Requirement. That certificate 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 Municipal Water System who have become customers during the 12 consecutive month period or thereafter, and their estimate of net revenue from



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any customers to be connected to the Municipal Water System who have paid the required connection charges, adjusted to reflect one year's net revenue from those customers;

- (iii) Their estimate of net revenue from 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 Municipal Water System.

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

Nothing contained herein 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 ULID 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 ULID assessments are levied for improvements constructed from the proceeds of those junior lien bonds.

Section 20. Reimbursement Obligations. 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 through the use of Bond Insurance, the City may contract with the entity providing such Reserve Insurance or Bond Insurance to the effect that the City's reimbursement obligation, if any, to such entity ranks on a parity of lien with the Parity Bonds.

If provided by the Bond Resolution, if the principal of, interest or mandatory redemption requirements due on the Bonds is paid by a Bond Insurer pursuant to a Bond Insurance policy, the Bonds shall not be considered paid by the City, and the covenants, agreements and other



obligations of the City to the Registered Owners shall continue to exist and the Bond Insurer shall be subrogated to the rights of the Registered Owners.

Section 21. Separate Utility Systems. The City may create, acquire, construct, finance, own and operate one or more additional systems for water supply, transmission or other commodity or service. The revenue of that separate utility system shall not be included in the Gross Revenue of the Municipal 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 Municipal 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 Section 22 hereof and/or (2) with respect to the Net Revenue, on a basis subordinate to the lien of the Parity Bonds on that Net Revenue.

Section 22, Contract Resource Obligations. The City may at any time enter into one or more Contract Resource Obligations for the acquisition, from facilities to be constructed, of water supply, transmission or other commodity or service relating to the Municipal Water System. The City may determine that, and may agree under a Contract Resource Obligation to provide that, all payments under that Contract Resource Obligation (including payments prior to the time that water supply or transmission 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 a Contract Resource Obligation is entered into:

- (a) No Event of Default has occurred and is continuing.
- (b) There shall be on file a certificate of an Independent Consulting Engineer stating that (i) the payments to be made by the City in connection with the Contract Resource Obligation are reasonable for the supply or transmission rendered; (ii) the source of any new supply, and any facilities to be constructed to provide the supply or transmission, 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



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Engineer's certification; and (iii) the Adjusted Net Revenue (further adjusted by the Independent Consulting Engineer's estimate of the payments to be made in accordance with the Contract Resource Obligation) for the five fiscal years following the year in which the Contract Resource Obligation is incurred, as such Adjusted Net Revenue is estimated by the Independent Consulting Engineer in accordance with the provisions of and adjustments permitted in Section 19(f)(2)

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of this ordinance, 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 in this Section shall be deemed to prevent the City from entering into other agreements for the acquisition of water supply, transmission or other commodity or service from existing facilities and from treating those payments as Operation and Maintenance Expenses. Nothing in this Section shall be deemed to prevent the City from entering into other agreements for the acquisition of water supply, transmission 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.

Section 23. Preservation of Tax Exemption for Interest on Bonds. covenants that it will take all actions consistent with the terms of the Bonds, this ordinance and the Bond Resolution reasonably within its power and necessary to prevent interest on the Bonds from being included in gross income for federal income tax purposes and it will neither take any action nor make or permit any use of the proceeds of the Bonds or other funds of the City treated as proceeds of the Bonds at any time during the term of the Bonds which will cause interest on the Bonds to be included in gross income for federal income tax purposes.

The City has not been notified of any listing or proposed listing by the Internal Revenue Service to the effect that the City is a bond issuer whose arbitrage certifications may not be relied upon.

Section 24. Continuing Disclosure. The City shall undertake to provide for the benefit of holders of the Bonds disclosure of certain financial information and operating data of the type included in the final official statement for the Bonds, as well as disclosure of certain material



events respecting the Bonds, in the manner and to the extent required by United States Securities and Exchange Commission Rule 15c2-12(b)(5). The particular terms of any such Undertaking shall be set forth in the Bond Resolution.

Section 25. Advance Refunding or Defeasance of Bonds. The City may issue advance 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 this 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

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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.

Section 26. Amendatory and Supplemental Ordinances.

only the debt service on the Bonds which are not defeased Bonds and the refunding bonds, the

- (a) This ordinance shall not be modified or amended in any respect subsequent to the initial issuance of the Bonds, except as provided in and in accordance with and subject to the provisions of this Section.
- (b) The City, from time to time, and at any time, without the consent of or notice to the owners of the Bonds, may pass supplemental or amendatory ordinances as follows:
- (1) To cure any formal defect, omission, inconsistency or ambiguity in this 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 owners of the Bonds any additional rights, remedies, powers, authority, security, liabilities or duties which may lawfully be granted, conferred or imposed and which are not contrary to or inconsistent with this ordinance as therefore in effect;
- (3) To add to the covenants and agreements of, and limitations and restrictions upon, the City in this ordinance, other covenants, agreements, limitations and restrictions to be observed by the City which are not contrary or inconsistent with this ordinance as therefore 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 this ordinance of any other money, securities or funds;
- (5) To authorize different denominations of the Bonds and to make correlative amendments and modifications to this ordinance regarding exchangeability of Bonds of different



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authorized denominations, redemptions of portions of Bonds of particular authorized denominations and similar amendments and modifications of a technical nature;

- (6) To modify, alter, amend or supplement this ordinance in any other respect which is not materially adverse to the owners of the Parity Bonds and which does not involve a change described in subsection (c) of this Section;
- (7) Because of change in federal law or rulings, to maintain the exclusion from gross income of the interest on the Bonds from federal income taxation; and
- (8) To add to the covenants and agreements of, and limitations and restrictions upon, the City in this 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 owners of the Parity Bonds.

Before the City shall adopt any such supplemental ordinance pursuant to this subsection (b), 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 this 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 Bonds.

(c) (1) Except for any supplemental ordinance entered into pursuant to subsection (b) of this Section, subject to the terms and provisions contained in this subsection (c) and not otherwise, 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 this ordinance; except that, unless approved in writing by the Registered Owners of all Parity Bonds, nothing contained in this Section shall permit, or be construed as permitting:

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- 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
- A preference or priority of any Parity Bond or Bonds or any other bond or bonds, or
- A reduction in the aggregate principal amount of Parity Bonds, the consent of the Registered Owners of which is required for any such supplemental ordinance.
- (2) If at any time the City shall pass any supplemental ordinance for any of the purposes of this subsection (c), 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.
- (3) 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 this 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.
- (4) If Registered Owners of not less than the percentage of Parity Bonds required by this subsection (c) shall have consented to and approved the execution and delivery thereof as herein provided, 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



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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.

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

## Section 27. Defaults and Remedies.

- (a) Events of Default. The following shall constitute "Events of Default" with respect to the Bonds:
- (1) If a default is made in the payment of the principal of or interest on any of the Bonds when the same shall become due and payable; or
- (2) 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 this 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 Bond Owners' 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 has taken active steps within the six months after written notice has been given to remedy the default and is diligently pursuing such remedy.

(b)

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

Bond Owners' Trustee. So long as such Event of Default has not been

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remedied, a trustee (the "Bond Owners' 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 Bond Owners' Trustee, notification thereof being given to the City. That appointment shall become effective immediately upon acceptance thereof by the Bond Owners' Trustee. Any Bond Owners' Trustee appointed under the provisions of this subsection (b) 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 Bond Owners' Trustee may be removed at any time, and a successor Bond Owners' 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 Bonds or by their attorneys-in-fact duly authorized. The Bond Owners' 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 Bond Owners' Trustee is cured and the Bond Owners' Trustee furnishes to the City a certificate so stating, that Event of Default shall be conclusively deemed to be cured and the City, the Bond Owners' 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 Bond Owners' Trustee appointed in the manner herein provided, 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 herein conferred on the Bond Owners' Trustee.



(c) Suits at Law or in Equity. Upon the happening of an Event of Default and during the continuance thereof, the Bond Owners' 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 this ordinance or in any of the Parity Bonds.

Nothing contained in this Section 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 Bond Owners' Trustee hereunder shall be brought in its name as trustee for the Bond owners and all such rights of action upon or under any of the Parity Bonds or the provisions of this ordinance may be enforced by the Bond Owners' 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 Bond Owners' Trustee shall be brought for the ratable benefit of all of the Registered Owners of those Parity Bonds, subject to the provisions of this ordinance. The respective Registered Owners of the Parity Bonds, by taking and holding the same, shall be conclusively deemed irrevocably to appoint the Bond Owners' 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 herein shall be deemed to authorize or empower the Bond Owners' 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 owner thereof, or to authorize or empower the Bond Owners' 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.

- (d) Application of Money Collected by Bond Owners' Trustee. Any money collected by the Bond Owners' Trustee at any time pursuant to this Section shall be applied in the following order of priority:
  - (i) first, to the payment of the charges, expenses, advances and compensation of the Bond Owners' Trustee and the charges, expenses, counsel fees, disbursements and compensation of its agents and attorneys; and
  - (ii) 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
  - (iii) 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.
- (e) <u>Duties and Obligations of Bond Owners' Trustee</u>. The Bond Owners' Trustee shall not be liable except for the performance of such duties as are specifically set forth herein. During an Event of Default, the Bond Owners' 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 Bond Owners' Trustee shall have no liability for any act or omission to act



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hereunder except for the Bond Owners' Trustee's own negligent action, its own negligent failure to act or its own willful misconduct. The duties and obligations of the Bond Owners' Trustee shall be determined solely by the express provisions of this ordinance, and no implied powers, duties or obligations of the Bond Owners' Trustee shall be read into this ordinance.

The Bond Owners' 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 Bond Owners' Trustee, except as may result from its own negligent action, its own negligent failure to act or its own willful misconduct.

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

The Bond Owners' 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 Bond Owners' Trustee shall not be answerable for any neglect or default of any person, firm or corporation employed and selected-by it with reasonable care.

- (f) <u>Suits by Individual Bond Owners Restricted</u>. No 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:
  - (i) an Event of Default has happened and is continuing;
  - (ii) a Bond Owners' Trustee has been appointed;
  - (iii) such owner previously shall have given to the Bond Owners' Trustee written notice of the Event of Default on account of which such suit, action or proceeding is to be instituted;
  - (iv) 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 Bond Owners' Trustee and have afforded the Bond Owners' Trustee a reasonable opportunity to institute such suit, action or proceeding;

Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby; and

(vi) the Bond Owners' Trustee has refused or neglected to comply with such request within a reasonable time.

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

there have been offered to the Bond Owners'

(g) Failure to Comply With Undertaking. Notwithstanding anything in this Section to the contrary, the failure of the City or any obligated person to comply with the Undertaking adopted by the Bond Resolution pursuant to Section 24 shall not constitute an Event of Default hereunder, and the sole remedy of any holder of a Bond shall be to seek an order of specific performance from an appropriate court to compel the City to comply with the Undertaking.

#### Section 28. Execution of Refunding Plan.

- (a) Appointment of Refunding Trustee. Consistent with the applicable requirements of the Refunded Bonds Legislation and any applicable agreements with Bond Insurers, the Director of Finance may serve as, or appoint the Refunding Trustee for each series of Bonds, which service or appointment shall be confirmed by the Bond Resolution.
- Obligations. For each series of Bonds, sufficient proceeds of the sale of the Bonds shall be deposited immediately upon the receipt thereof with the Refunding Trustee and used to pay the amounts required by the Refunding Plan to discharge the obligations of the City with respect to the applicable Refunded Bonds. The Refunding Plan shall be carried out, and proceeds of the Bonds shall be applied, in accordance with this ordinance, the respective Refunded Bond Legislation, the Bond Resolution and the laws of the State. To the extent practicable, such obligations shall be discharged fully by the Refunding Trustee's simultaneous purchase of the Acquired Obligations, bearing such interest and maturing as to principal and interest in such

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amounts and at such times so as to provide, together with a beginning cash balance, if necessary, for the payment of the amount required to be paid by the Refunding Plan. The Acquired Obligations shall be listed and more particularly described in a schedule attached to the Refunding Trust Agreement, and shall be subject to substitution as set forth therein. Any surplus money resulting from the sale, transfer, other disposition or redemption of the Acquired Obligations and the substitutions therefor shall be released from the trust estate and transferred to the Water Fund to be used for any lawful purpose.

- (c) Administration of Refunding Plan. The Refunding Trustee is authorized and directed to purchase the Acquired Obligations (or substitute obligations) and to make the payments required to be made by the Refunding Plan from the Acquired Obligations (or substitute obligations) and money deposited with the Refunding Trustee pursuant to this ordinance. All Acquired Obligations (or substitute obligations) and the money deposited with the Refunding Trustee and any income therefrom shall be held irrevocably, invested and applied in accordance with the provisions of the Refunded Bond Legislation, this ordinance, the Bond Resolution, chapter 39.53 RCW and other applicable statutes of the State of Washington and the Refunding Trust Agreement. All necessary and proper fees, compensation and expenses of the Refunding Trustee and all other costs incidental to the setting up of the escrow to accomplish the refunding of the Refunded Bonds and costs related to the issuance and delivery of the Bonds, including bond printing, verification fees, Bond Counsel's fees and other related expenses, shall be paid out of the proceeds of the Bonds.
- Authorization for Refunding Trust Agreement. To carry out the (d) Refunding Plan for each series of Bonds, the Director of Finance is authorized and directed to execute and deliver to the Refunding Trustee, in connection with each series of Bonds, a Refunding Trust Agreement substantially in the form approved by the Bond Resolution setting forth the duties, obligations and responsibilities of the Refunding Trustee in connection with the

Karen J. Boyle 2005 Water Refunding Bond Ordinance August 24, 2005 Version 1

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payment, redemption and retirement of the Refunded Bonds as provided herein and in the Bond Resolution.

Section 29. Call for Redemption of the Refunded Bonds. As a part of the Refunding Plan, the City may in the Bond Resolution call the Refunded Bonds for redemption. Such call for redemption of the Refunded Bonds shall specify the Refunded Bonds, call dates and redemption prices, and shall be irrevocable after the delivery to the initial purchaser of the applicable series of Bonds. The dates on which the Refunded Bonds are called for redemption shall be, in the judgment of the Director of Finance, the earliest practical dates on which those bonds may be called for redemption.

The proper officials of the City are authorized and directed to give or cause to be given such notices as required, at the times and in the manner required pursuant to the applicable Refunded Bond Legislation in order to effect the redemption prior to maturity of the Refunded Bonds.

Section 30. City Findings with Respect to Refunding. With respect to each series of Bonds, the Refunding Plan shall be carried out only if the City finds and determines in the Bond Resolution that the money to be deposited with the Refunding Trustee will discharge and satisfy the obligations of the City with respect to the Refunded Bonds under the applicable Refunded Bond Legislation, and the pledges, charges, trusts, covenants and agreements of the City therein made or provided for as to the Refunded Bonds, and that the Refunded Bonds shall no longer be deemed to be outstanding under such legislation immediately upon the deposit of such money with the Refunding Trustee.

Section 31. Sale of Bonds. At least 10 days before the City Council adopts a Bond Resolution for a series of Bonds, the Director of Finance shall notify the President of the City Council, in writing, of the Director of Finance's determination that the issuance of the series of Bonds is consistent with the then-current financial policies of the City. The notice shall set forth the reasons for the Director of Finance's determination. Upon giving such notice, the Director of



1 Finance may provide for the sale of that series of Bonds (or any portion thereof) by public sale or 2 by a negotiated sale with an underwriter or other financial institution chosen through a selection 3 process acceptable to the Director of Finance. The City Council's adoption of the Bond 4 Resolution shall be conclusive evidence that proper notice was provided to the President of the 5 City Council. The Director of Finance is authorized to specify a date and time of sale of the 6 Bonds, to give notice of that sale, to determine any bid requirements and criteria for determining 7 the award of the bid, to provide for the use of an electronic bidding mechanism, and to specify 8 other matters in his or her determination necessary, appropriate, or desirable to carry out the sale 9 of the Bonds. The terms of that sale shall be consistent with this ordinance and the Bond 10 Resolution and shall be confirmed by the Bond Resolution. The Bonds shall be delivered to the 11 purchasers as provided in the Bond Resolution immediately upon payment to the City of the 12 purchase price plus accrued interest, if any, to the Closing Date in immediately available federal 13

funds in Seattle, Washington, at the City's expense or at another time or place upon which the Director of Finance and the purchaser may mutually agree at the purchaser's expense.

CUSIP numbers will be printed on the Bonds if requested by the purchasers, but neither failure to print CUSIP numbers on any Bond nor error with respect thereto shall constitute cause for a failure or refusal by the purchasers to accept delivery of and pay for the Bonds in accordance with the purchase offer. All expenses in relation to the printing of CUSIP numbers on the Bonds shall be paid by the City, but the fee of the CUSIP Service Bureau for the assignment of those numbers shall be the responsibility of and shall be paid by the purchasers.

The City will cause the Bonds to be typed, photocopied, printed or lithographed, sealed and executed and will furnish the approving legal opinion of Bond Counsel, the opinion also being printed on each Bond unless the Bond is typed or photocopied.

Section 32. General Authorization. The Mayor and the Director of Finance of the City and each of the other appropriate officers of the City are each authorized and directed to do everything as in their judgment may be necessary, appropriate or desirable in order to carry out

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Karen J, Boyle 2005 Water Refunding Bond Ordinance August 24, 2005 Version 1

the terms and provisions of, and complete the transactions contemplated by, this ordinance. In particular, and without limitation, the Director of Finance may, in his or her discretion and without further action by the City Council, (i) issue requests for proposals for underwriting or financing facilities and execute engagement letters with underwriters, bond insurers or other financial institutions based on responses to such requests, (ii) deem final and approve the distribution of any preliminary official statement or official statement relating to the Bonds, (iii) comply with any continuing disclosure requirements applicable to the Bonds and (iv) change the Bond Registrar or any securities depository appointed for the Bonds.

Section 33. Severability. The provisions of this ordinance are declared to be separate and severable. If a court of competent jurisdiction, all appeals having been exhausted or all appeal periods having run, finds any provision of this ordinance to be invalid or unenforceable as to any person or circumstance, such offending provision shall, if feasible, be deemed to be modified to be within the limits of enforceability or validity. However, if the offending provision cannot be so modified, it shall be null and void with respect to the particular person or circumstance, and all other provisions of this ordinance in all other respects, and the offending provision with respect to all other persons and all other circumstances, shall remain valid and enforceable.

Section 34. Ratification of Prior Acts. Any action taken consistent with the authority but prior to the effective date of this ordinance, including, if applicable, but not limited to issuing requests for proposals for financing or underwriting services, executing engagement letters for financing or underwriting services based on responses to such requests, giving notices of the sale of Bonds, adopting the Bond Resolution, executing contracts, making fund transfers and paying warrants, is ratified, approved and confirmed.

Section 35. <u>Section Headings</u>. The Section headings in this ordinance are used for convenience only and shall not constitute a substantive portion of this ordinance.

Karen J. Boyle 2005 Water Refunding Bond Ordinance August 24, 2005 Version 1

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Section 36. Effective Date. This ordinance shall take effect and be in force 30 days from and after its approval by the Mayor, but if not approved by the Mayor and returned by the Mayor within ten days after presentation, it shall take effect as provided by Municipal Code Section 1.04.020.

Passed by the City Council the 26th day of September, 2005, and signed by me in open session in authentication of its passage this 26th day of September, 2005.

the City Council

Approved by me this 3

Filed by me this 3rd day of October

Gregory J. Nickels, Mayor 

### EXHIBIT A

### Outstanding Water Parity Bonds

Issue Name	Dated Date	Original Par Amount	Parity Bond Authorizing Legislation
Water System Revenue Bonds, 1997 ("1997 Bonds")	3/15/1997	\$53,000,000	Ordinance 118512 and Resolution 29553
Water System Revenue Bonds, 1998 ("1998 Bonds")	6/1/1998	\$80,000,000	Ordinance 118973 and Resolution 29785
Water System Revenue Bonds, 1999 ("1999A Bonds")	6/1/1999	\$100,000,000	Ordinance 119457 and Resolution 29973
Water System Revenue Bonds, 1999, Series B ("1999B Bonds")	10/1/1999	\$110,000,000	Ordinance 119649 and Resolution 30057
Water System Revenue Bonds, 2001 ("2001 Bonds")	11/1/2001	\$52,525,000	Ordinance 120547 and Resolution 30419
Water System and Refunding Revenue Bonds, 2003 ("2003 Bonds")	4/29/2003	\$271,320,000	Ordinance 121094 and Resolution 30598
Water System Revenue Bonds, 2004 ("2004 Bonds")	10/25/2004	\$84,750,000	Ordinance 121587 and Resolution 30710



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### APPENDIX B FORM OF BOND COUNSEL OPINION

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#### [FORM OF APPROVING LEGAL OPINION]

The City of Seattle, Washington

Re: The City of Seattle, Washington

\$238,770,000 Water System Refunding Revenue Bonds, 2012

We have served as bond counsel to The City of Seattle, Washington (the "City"), in connection with the issuance of the above referenced bonds (the "Bonds"), and in that capacity have examined such law and such certified proceedings and other documents as we have deemed necessary to render this opinion. As to matters of fact material to this opinion and of which attorneys within the firm involved with the issuance of the Bonds have no independent knowledge, we have relied upon representations contained in the certified proceedings and other certifications of public officials furnished to us.

The Bonds are issued pursuant to the laws of the State of Washington and Ordinance 121939, as amended, and Resolution 31382 of the City (collectively, the "Bond Legislation") to carry out the refunding of all or a portion of the City's outstanding Water System Revenue Bonds, 2001, Water System and Refunding Revenue Bonds, 2003 and Water System Revenue Bonds, 2004, and to pay the issuance costs of selling the Bonds, all as set forth in the Bond Legislation.

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

The Bonds are special limited obligations of the City payable solely out of the Water Revenue Bond Account (the "Bond Account"), into which account the City irrevocably has bound itself to pay all ULID Assessments upon their collection (except for ULID Assessments deposited in a construction account) and, out of the Net Revenue, certain fixed amounts without regard to any fixed proportion, namely amounts sufficient to pay the principal of and interest on the Parity Bonds and net payments on Parity Payment Agreements as they respectively become due and to fund the Reserve Requirement, all at the times and in the manner set forth in the Bond Legislation.

The Net Revenue and all money and investments held in the Bond Account (including the Reserve Subaccount therein) and the Rate Stabilization Account have been pledged to the payment of the Parity Bonds and to make payments into the Reserve Subaccount required by the Bond Legislation and Parity Bond Authorizing Ordinances, and this pledge constitutes a lien and charge upon the Net Revenue prior and superior to any other charges whatsoever.

Under the Internal Revenue Code of 1986, as amended (the "Code"), the City is required to comply with certain requirements after the date of issuance of the Bonds in order to maintain the exclusion of the interest on the Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of Bond proceeds and the facilities financed or refinanced with Bond proceeds, limitations on investing gross proceeds of the Bonds in higher yielding investments in certain circumstances and the arbitrage rebate requirement to the extent applicable to the Bonds. The City has covenanted in the Bond Legislation to comply with those requirements, but if the City fails to comply

with those requirements, interest on the Bonds could become taxable retroactive to the date of issuance of the Bonds. We have not undertaken and do not undertake to monitor the City's compliance with such requirements.

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

- 1. The City is a duly organized and legally existing first class city under the laws of the State of Washington;
- 2. The City has duly authorized and approved the Bond Legislation, and the Bonds are issued in full compliance with the provisions of the Constitution and laws of the State of Washington, the Bond Legislation and the ordinances of the City relating thereto;
- 3. The Bonds constitute valid obligations of the City payable solely out of the Net Revenue of the Water System and money in the Bond Account (including the Reserve Subaccount therein) and the Rate Stabilization Account, except only to the extent that enforcement of payment may be limited by bankruptcy, insolvency or other laws affecting creditors' rights and by principles of equity if equitable remedies are sought;
  - 4. The Bonds are not general obligations of the City; and
- 5. Assuming compliance by the City after the date of issuance of the Bonds with applicable requirements of the Code, the interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals; however, while interest on the Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the Bonds received by corporations is to be taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations, interest on the Bonds received by certain S corporations may be subject to tax, and interest on the Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. We express no opinion regarding any other federal tax consequences of receipt of interest on the Bonds.

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

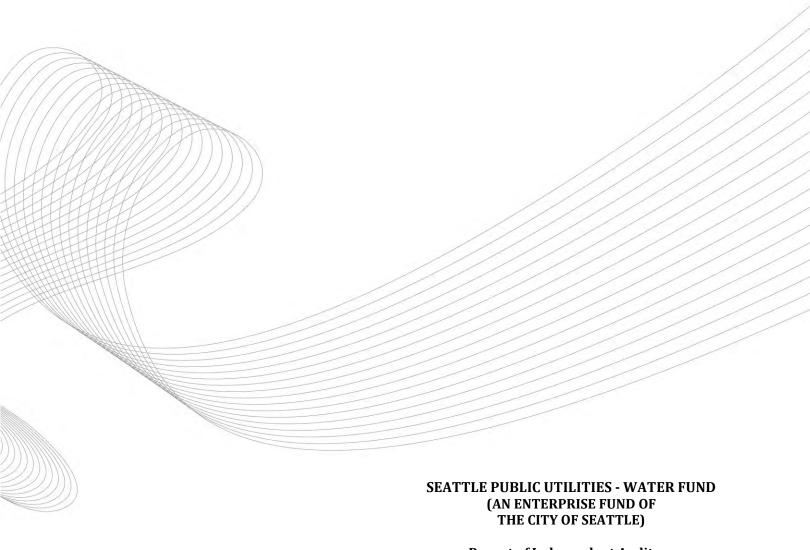
We express no opinion herein concerning the completeness or accuracy of any official statement, offering circular or other sales or disclosure material relating to the issuance of the Bonds or otherwise used in connection with the Bonds. We bring to your attention the fact the foregoing opinions are expressions of our professional judgment on the matters expressly addressed and do not constitute guarantees of result.

Respectfully submitted,

#### APPENDIX C

#### 2011 AUDITED FINANCIAL STATEMENTS OF THE WATER FUND

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Report of Independent Auditors and Financial Statements with Required Supplementary Information and Supplemental Information

**December 31, 2011 and 2010** 

### MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

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#### REPORT OF INDEPENDENT AUDITORS

To the Director of Seattle Public Utilities Water Fund Seattle, Washington

We have audited the accompanying balance sheets of Seattle Public Utilities - Water Fund (the "Fund"), as of December 31, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Seattle Public Utilities - Water Fund as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

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



Our audits were conducted for the purpose of forming an opinion on the basic financial statements. The supplemental information following the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The supplemental information following the financial statements has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Seattle, Washington April 25, 2012

Moss Adams HP

As management of Seattle Public Utilities ("SPU"), a department of the City of Seattle (the "City"), we offer readers of SPU's financial statements this narrative overview and analysis of the financial activities of the Water Fund (the "Fund") for the fiscal years ended December 31, 2011 and 2010. The revenues, expenses, assets, and liabilities of Seattle's water system are recorded in the Water Fund, the functions of which are primarily supported by user fees and charges charged to customers. The financial situation of other aspects of Seattle City government, including other utility services and general government operations, are reported elsewhere.

#### **OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the Fund's financial statements. The financial statements include Management's Discussion and Analysis and basic financial statements with accompanying notes.

**Basic Financial Statements** - The basic financial statements of the Fund report information about the Fund using accounting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information about its activities. The basic financial statements begin on page 11 of this report and are comprised of three components: (1) Balance Sheets, (2) Statements of Revenues, Expenses, and Changes in Net Assets, and (3) Statements of Cash Flows.

The Balance Sheets present information, as of December 31, 2011 and 2010, on all of the Fund's assets and liabilities, with the difference between the two reported as net assets. They also provide information about the nature and amounts of investments in resources (assets), obligations to the Fund's creditors (liabilities), and provide the basis for assessing the liquidity and financial flexibility of the Fund.

The Statements of Revenues, Expenses, and Changes in Net Assets present changes in the Fund's net assets for the years ended December 31, 2011 and 2010. All changes in net assets are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. These statements reflect the results of the Fund's operations for the years identified to provide information about the Fund's credit worthiness and its ability to successfully recover all its costs through service fees and other charges.

The Statements of Cash Flows are required to provide information about the Fund's cash receipts and cash payments during the years ended December 31, 2011 and 2010. To provide answers to questions about sources, uses, and impacts to cash, these statements report cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities for the reporting period.

**Notes to the Financial Statements** - The notes are an integral part of the financial statements. They provide additional disclosures that are essential to a full understanding of the data provided in the financial statements, such as for certain estimates and financing details. The notes to the financial statements begin on page 16 of this report.

#### FINANCIAL ANALYSIS

Increases or decreases in net assets may serve over time as a useful indicator of whether the Fund's financial position is improving or deteriorating. At December 31, 2011 and 2010, the Fund's assets exceeded liabilities, resulting in surpluses in total net assets of \$312.7 million and \$310.9 million, respectively. During these years, the Fund's overall position improved, with increases in net assets amounting to \$1.8 million (0.6%) and \$0.7 million (0.2%) during 2011 and 2010, respectively. The following summary balance sheets present the assets of the Fund and show the mix of liabilities and net assets used to acquire these assets:

#### SUMMARY BALANCE SHEETS

	2011	2010	2009
ASSETS			
Current assets	\$ 38,558,607	\$ 40,383,090	\$ 36,865,593
Capital assets, net	1,203,705,381	1,204,705,000	1,174,893,172
Restricted, deferred and other	140,023,920	170,315,553	90,748,661
Total assets	1,382,287,908	1,415,403,643	1,302,507,426
LIABILITIES			
Current liabilities	66,665,963	67,597,206	64,312,832
Revenue bonds	961,925,299	993,907,949	890,018,584
Other	41,018,801	43,017,248	38,004,221
Total liabilities	1,069,610,063	1,104,522,403	992,335,637
NET ASSETS			
Invested in capital assets, net of related debt	290,541,426	275,465,946	297,764,998
Restricted	27,646,433	25,143,871	19,608,899
Unrestricted accumulated surplus (deficit)	(5,510,014)	10,271,423	(7,202,108)
TOTAL NET ASSETS	\$ 312,677,845	\$ 310,881,240	\$ 310,171,789

#### **2011 Compared to 2010**

**Assets** - Current assets decreased \$1.8 million (4.5%) from 2010. This decrease was due to decreases in operating cash of \$1.2 million, due from other City funds of \$0.7 million, due from other governments of \$0.3 million and inventory of \$.03 million. The decrease was offset by an increase in unbilled revenues of \$0.7 million.

Restricted, deferred, and other assets decreased \$30.3 million (17.8%) over 2010. The largest portion of the change was due to reductions in the construction fund of \$38.6 million and the revenue stabilization account of \$1.4 million. These decreases were offset by increases in other deferred charges of \$9.2 million, mostly due to charges for the Morse Lake Pump Plant, and in notes and contracts receivable of \$0.5 million.

**Liabilities** - Current liabilities decreased \$0.9 million (1.4%) from 2010. Most notable decreases were due to other City funds for \$2.4 million, interest payable of \$0.4 million, and other current liabilities and deferred credits of \$0.3 million. These decreases were offset by a \$2.3 million increase in the current portion of bonds payable.

#### FINANCIAL ANALYSIS (Continued)

Other liabilities decreased \$2.0 million (4.6%). The most significant factors affecting this were decreases in deferred credits for the revenue stabilization account of \$1.4 million, noncurrent public works trust loans payable of \$0.9 million, and other noncurrent liabilities of \$0.7 million. This decrease was offset by increases in Habitat Conservation Plan ("HCP") liability of \$0.7 million and other postemployment benefits of \$0.5 million.

**Net Assets** - Net assets invested in capital assets, net of debt, was the largest portion of the Fund's net assets (\$290.5 million or 92.9%). This amount reflects the Fund's investment in capital assets such as land, buildings, and equipment, less any related outstanding debt used to acquire those assets. The Fund uses these assets to provide services to customers; consequently, these assets are not available for future spending. Although the Fund's investment in its capital assets is reported net of related debt, the resources needed to repay the debt are provided by fees paid by customers for services provided by these assets. In 2011, net assets invested in capital assets increased \$15.1 million from 2010 primarily from a decrease in debt offset by an increase in other deferred charges.

The Fund's restricted net assets (\$27.6 million or 8.8%) represent resources that are subject to restrictions on how they may be used. Restricted net assets increased \$2.5 million primarily due to the restriction of deferred charges.

The Fund's unrestricted net deficit (\$5.5 million deficit or 1.8%) represent resources that are not subject to external restrictions and may be used to meet the Fund's obligations to creditors. This portion decreased \$15.8 million in 2011.

#### **2010 Compared to 2009**

**Assets** - Current assets increased \$3.5 million (9.5%) over 2009. This increase was primarily due to increases in accounts receivable of \$2.2 million, unbilled revenues of \$1.1 million and the prepayments and other of \$1.1 million. The increase was offset by decreases in amounts due from other City funds and other governments of \$0.5 million and a reduction in the BPA account of \$0.4 million.

Restricted, deferred, and other assets increased \$79.6 million (87.7%) over 2009. The largest portion of the change was due to an increase of \$91.7 million from bonds issued January 21, 2010. In addition, the BPA account increased \$0.2 million and unamortized loan fees rose by \$0.1 million. These increases were offset by a \$9.4 million decrease in other deferred charges and a \$3.0 million withdrawal from the revenue stabilization account.

**Liabilities** - Current liabilities increased \$3.3 million (5.1%) from 2009. Most notable increases were a \$3.7 million increase in the current portion of bonds payable, a \$2.8 million increase in interest payable, a \$2.8 million increase in amounts due to other City funds and \$1.4 million increase for deferred credits related to the Consolidated Customer Services System. These increases were offset by a \$5.2 million decrease in the current portion of the Habitat Conservation Plan and a \$2.2 million decrease in accounts payable.

#### FINANCIAL ANALYSIS (Continued)

Other liabilities increased \$5.0 million (13.2%). The most significant factors affecting this increase were a \$6.0 million loan from the American Recovery and Reinvestment Act and \$2.7 million loan from the Public Works Trust Fund. This increase was offset by a \$3.6 million decrease in deferred credits, mostly from a withdrawal from the Revenue Stabilization account.

**Net Assets** - Net assets invested in capital assets, net of debt, was the largest portion of the Fund's net assets (\$275.5 million or 88.6%). This amount reflects the Fund's investment in capital assets such as land, buildings, and equipment, less any related outstanding debt used to acquire those assets. The Fund uses these assets to provide services to customers. Consequently, these assets are not available for future spending. Although the Fund's investment in its capital assets is reported net of related debt, the resources needed to repay the debt are provided by fees paid by customers for services provided by these assets. In 2010, net assets invested in capital assets decreased \$22.3 million from 2009 primarily from an increase in the debt related to capital assets placed in service.

The Fund's restricted net assets (\$25.1 million or 8.1%) represent resources that are subject to restrictions on how they may be used. Restricted net assets increased \$6.0 million primarily due to the restriction of 2010 bond proceeds set aside as a bond reserve.

The Fund's unrestricted net assets (\$10.3 million or 3.3%) represent resources that are not subject to external restrictions and may be used to meet the Fund's obligations to creditors. This portion increased \$17.5 million in 2010.

The following summary statements of revenues, expenses, and changes in net assets present the annual surplus of revenues over expenses (the change in net assets):

#### SUMMARY STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

	2011	2010	2009
Operating revenues Operating expenses	\$ 194,572,652 (154,496,847)	\$ 195,203,465 (164,238,625)	\$ 191,369,588 (164,278,308)
Net operating income	40,075,805	30,964,840	27,091,280
Other expenses, net of other revenues Fees, contributions, and grants	(41,810,494) 3,531,294	(42,438,947) 12,183,558	(31,253,453) 10,033,491
Change in net assets	\$ 1,796,605	\$ 709,451	\$ 5,871,318

#### **2011 Compared to 2010**

Operating revenue decreased approximately \$0.6 million (0.3%) over 2010. This change was driven by a \$1.0 million decrease in wholesale water revenue and \$1.5 million reduction in the revenue stabilization account. The decrease was offset by increases in direct service revenue of \$0.9 million and other ancillary revenue of \$0.9 million.

#### FINANCIAL ANALYSIS (Continued)

Operating expenses decreased by \$9.7 million (5.9%) primarily due to the decrease in City taxes of \$6.2 million due to the City tax rate decreasing from 19.87% to 15.54% as of January 1, 2011, and amortization of deferred charges decreasing \$3.7 million primarily as a result of the fully amortized Lane settlement in 2010.

#### **2010 Compared to 2009**

Operating revenue increased approximately \$3.8 million (2.0%) over 2009. This change was driven by an increase in water rates effective January 1, 2010 and a surcharge added to rates through December 31, 2010 to recover costs related to the hydrant settlement (see Note 12), resulting in a \$6.2 million rise in direct customer water service revenue. In addition, \$3.0 million was recognized as rate stabilization revenue. These increases were offset by a decrease in wholesale revenue of \$3.4 million due to a wetter than normal summer and a reduction in new water services of \$2.0 million due to a continued economic downturn.

Operating expenses decreased by 0.04 million 0.02% due to several factors. Overall branch expenses decreased 4.9 million. This decrease was offset by increases in city taxes of 2.4 million due to an increase in the City tax rate from 15.54% to 19.87% from March 2009 to December 2010, depreciation and amortization increases of 2.0 million due mainly for depreciation on donated asset additions and increases in other taxes by 0.5 million.

#### **CAPITAL ASSETS**

The following table summarizes capital assets, net of accumulated depreciation, by major asset category as of December 31, 2011, 2010, and 2009.

#### SUMMARY OF CAPITAL ASSETS, NET OF ACCUMULATED DEPRECIATION

	2011	2010		2009
Land and land rights	\$ 41,554,148	\$ 40,634,660	\$	39,127,903
Buildings	139,390,553	133,716,122		136,730,786
Structures	207,894,613	211,678,140		185,675,086
Machinery and equipment	732,620,473	731,874,638		696,527,888
Computer systems	25,297,192	28,659,382		28,883,342
Construction in progress	56,020,194	57,228,686		87,082,670
Other property	 928,208	 913,372		865,497
Capital assets, net of				
accumulated depreciation	\$ 1,203,705,381	\$ 1,204,705,000	\$	1,174,893,172

Additional information about the Fund's capital assets can be found in Note 3 of this report.

#### **CAPITAL ASSETS** (Continued)

#### **2011 Compared to 2010**

The Fund's investment in capital assets for the year ended December 31, 2011, amounted to \$1.2 billion, net of accumulated depreciation. This represents a net decrease of approximately \$1.0 million (0.1%) for the current fiscal year. The decrease in 2011 as compared with 2010 was due mainly to fewer additions to projects in construction and retirements in computer systems and structures. Highlights of the Fund's major capital assets placed in service during 2011 include the following:

- Improvements at the Cedar Watershed and emergency preparedness programs totaling \$17.1 million.
- Distribution pipelines upgrades and replacements totaling \$13.0 million.
- Water tank and pump station improvements totaling \$4.4 million.
- Water pipeline replacements for Operational Facilities and other projects totaling \$1.7 million.
- Water pipeline replacements for Alaskan Way and Spokane Street Viaduct project totaling \$1.7 million.

The Fund had \$56.0 million in construction work in progress as of December 31, 2011. Projects under construction are the following:

- Reservoir covering projects totaling \$39.6 million.
- Business and technology infrastructure upgrades totaling \$3.3 million.
- Water conservation projects totaling \$2.6 million.
- Water system improvements and rehabilitation projects totaling \$2.1 million.
- South Lake Union project totaling \$1.8 million.
- Regional facility project totaling \$1.3 million.
- Rebuilding for Alaskan Way Viaduct & Seawall project totaling \$1.2 million.
- "One Percent for Art" program totaling \$1.1 million.

#### **2010 Compared to 2009**

The Fund's investment in capital assets for the year ended December 31, 2010, amounted to \$1.2 billion, net of accumulated depreciation. This represents a net increase of approximately \$29.8 million (2.5%) for the fiscal year.

#### **CAPITAL ASSETS** (Continued)

Highlights of the Fund's major capital assets placed in service during 2010 include the following:

- West Seattle reservoir covering project was completed at a cost of \$34.8 million.
- Water tanks and pump station improvements were placed in service at a cost of \$12.5 million.
- Improvements at the Cedar River Watershed and emergency preparedness programs totaling \$5.4 million.
- Water pipeline upgrades and replacements totaling \$5.2 million.

The Fund had \$57.2 million in construction work in progress as of December 31, 2010. Projects under construction are the following:

- Water system improvements, rehabilitations, reservoir coverings, and environmental stewardship projects totaling \$27.5 million.
- Water conservation projects totaling \$11.7 million.
- Design and construction of the Sockeye hatchery at the Cedar River Watershed and improvements at the Ballard Locks totaling \$8.2 million.
- Business and technology infrastructure upgrades totaling \$3.2 million.
- Rebuilding water systems for interagency projects and operation facilities totaling \$3.9 million.

#### **DEBT ADMINISTRATION**

The Fund's debt primarily consists of bonded debt and public works trust loans. Bonded debt is secured solely by water system revenues and provides financing for capital improvements. Public works trust loans are unsecured loans issued by the Washington State Department of Commerce for certain capital improvements.

Additional detail about the Fund's revenue bonds and public works trust loans are located in Notes 4 and 9 of this report.

#### **2011 Compared to 2010**

At December 31, 2011 the Fund had \$977.1 million in bonded debt and \$17.6 million in public works trust and American Recovery and Reinvestment Act loans, as compared to \$1,006.3 million and \$18.5 million, respectively, at December 31, 2010. Bonded debt decreased \$29.1 million, attributed primarily to the payment of debt principal on existing bonds. Loans decreased \$0.9 million due to payment of principal on existing loans.

#### **DEBT ADMINISTRATION** (Continued)

#### **2010 Compared to 2009**

At December 31, 2010 the Fund had \$1,006.3 million in bonded debt and \$18.5 million in public works trust and American Recovery and Reinvestment Act loans, as compared to \$904.0 million and \$10.5 million, respectively, at December 31, 2009. Bonded debt increased \$102.3 million, attributed primarily to the issuance of \$190.8 million of new debt during the year, offset by a payment of \$61.8 million to refund the 1998 Water Parity bond and payments of \$26.7 million of debt principal on existing bonds. Loans increased \$8.6 million due to additional draw downs of \$2.7 million in public works trust loans and a \$5.9 million loan from the American Recovery and Reinvestment Act.

#### REQUESTS FOR INFORMATION

The Fund's financial statements are designed to provide a general overview of the Fund's finances, as well as to demonstrate the Fund's accountability to its customers, investors, creditors, and other interested parties. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Seattle Public Utilities, Finance and Administration Branch, Finance Division, PO Box 34018, Seattle, WA 98124-4018, telephone (206) 684-3000.

#### SEATTLE PUBLIC UTILITIES - WATER FUND (An Enterprise Fund of the City of Seattle) BALANCE SHEETS DECEMBER 31, 2011 AND 2010

#### **ASSETS**

GUDDENIT ACCEPTO		2011		2010
CURRENT ASSETS  Cash and equity in pooled investments	\$	7,297,606	\$	8,504,138
Accounts receivable, net of allowance for doubtful	Ψ	7,277,000	Ψ	0,304,130
accounts of \$529,345 and \$514,850, respectively		13,532,093		13,618,259
Unbilled revenues		10,947,286		10,198,787
Due from other City funds		910,697		1,615,647
Due from other governments		755,085		1,065,352
Current portion of notes and contracts receivable		16,118		21,228
Materials and supplies inventory		3,820,951		4,074,958
Prepayments and other		1,210,771		1,184,721
BPA account - cash and equity in pooled investments		68,000		100,000
Total current assets		38,558,607		40,383,090
RESTRICTED ASSETS				
Bond reserve account - cash and equity in pooled investments Construction fund		16,710,973		16,700,466
Cash and equity in pooled investments		60,641,445		81,101,884
Dedicated investments		-		18,097,906
Vendor deposits - cash and equity in pooled investments		-		13,250
Revenue stabilization fund - cash and equity				
in pooled investments		9,014,423		10,444,399
BPA account - cash and equity in pooled investments		395,294		463,101
Total restricted assets		86,762,135		126,821,006
DEFERRED CHARGES AND OTHER				
Unamortized bond issue costs and loan fees		4,918,240		5,180,374
Notes and contracts receivable		465,194		169
Deferred conservation costs		29,905,009		29,568,737
Other deferred charges		17,973,342		8,745,267
Total deferred charges and other		53,261,785		43,494,547
CAPITAL ASSETS, at cost				
Capital assets - excluding land		664,690,270		,627,958,898
Less accumulated depreciation		559,487,439)		(522,030,616)
Capital assets, net of accumulated depreciation	1,1	105,202,831	1	,105,928,282
Construction in progress		56,020,194		57,228,686
Land and land rights		41,554,148		40,634,660
Other property		928,208		913,372
Total capital assets	1,2	203,705,381	1	,204,705,000
TOTAL ASSETS	\$ 1,3	882,287,908	\$ 1	,415,403,643

#### **SEATTLE PUBLIC UTILITIES - WATER FUND**

(An Enterprise Fund of the City of Seattle)
BALANCE SHEETS (CONTINUED)
DECEMBER 31, 2011 AND 2010

#### LIABILITIES AND NET ASSETS

	2011	2010	
CURRENT LIABILITIES			
Accounts payable	\$ 5,126,658	\$ 5,322,275	
Accrued payroll and payroll taxes payable	1,465,971	1,358,521	
Taxes payable	523,314	541,047	
Interest payable	18,172,161	18,552,762	
Due to other City funds	4,553,017	6,959,499	
Claims payable	1,626,270	1,649,957	
Compensated absences payable	401,748	400,168	
HCP liability	533,222	527,457	
Revenue bonds due within one year	31,425,000	29,140,000	
Public works trust loans due within one year	858,293	858,293	
Other current liabilities and deferred credits	1,980,309	2,287,227	
Total current liabilities	66,665,963	67,597,206	
REVENUE BONDS			
Revenue bonds - due serially	977,160,000	1,006,300,000	
Less revenue bonds due within one year	(31,425,000)	(29,140,000)	
Bond premiums	30,949,689	32,856,664	
Loss on refunding	(14,759,390)	(16,108,715)	
Total revenue bonds	961,925,299	993,907,949	
NONCURRENT AND OTHER LIABILITIES			
Vendor deposits payable	_	13,250	
Compensated absences payable	4,346,982	4,417,733	
Other postemployment benefits	2,033,474	1,551,050	
Public works trust loans	16,765,886	17,624,179	
Claims payable	3,966,596	4,087,808	
HCP liability	4,514,553	3,784,109	
Deferred credits - Revenue Stabilization Fund	9,007,262	10,443,950	
Other noncurrent liabilities	384,048	1,095,169	
Total noncurrent and other liabilities	41,018,801	43,017,248	
Total liabilities	1,060,610,062	1 104 522 402	
Total Habilities	1,069,610,063	1,104,522,403	
NET ASSETS			
Invested in capital assets - net of related debt	290,541,426	275,465,946	
Restricted	27,646,433	25,143,871	
Unrestricted accumulated deficit	(5,510,014)	10,271,423	
Total net assets	312,677,845	310,881,240	
TOTAL LIABILITIES AND NET ASSETS	\$ 1,382,287,908	\$ 1,415,403,643	

# SEATTLE PUBLIC UTILITIES - WATER FUND (An Enterprise Fund of the City of Seattle) STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
OPERATING REVENUES		
Direct service	\$ 137,382,037	\$ 136,442,800
Rate stabilization revenue	1,522,974	3,000,000
Wholesale	44,031,090	45,072,655
Other	11,636,551	10,688,010
Total operating revenues	194,572,652	195,203,465
OPERATING EXPENSES		
Pre-capital planning and development	1,330,792	2,059,112
Utility systems management	14,717,263	14,906,335
Field operations	22,836,313	20,816,456
Project delivery	4,311,408	6,419,956
Customer services	7,453,815	7,666,552
General and administrative	27,273,770	27,794,402
City taxes	23,279,845	29,454,840
Other taxes	7,231,727	7,035,586
Depreciation and amortization	46,061,914	48,085,386
Total operating expenses	154,496,847	164,238,625
NET OPERATING INCOME	40,075,805	30,964,840
OTHER INCOME (EXPENSES)		
Investment income	2,887,919	3,206,775
Interest expense	(46,589,417)	(47,576,654)
Amortization of bond premiums and discounts	1,906,975	1,916,704
Amortization of loss on refunding	(1,349,325)	(1,389,620)
Amortization of debt expenses	(257,663)	(257,760)
Gain on sale of assets	543,577	153,772
Other, net	1,047,440	1,507,836
Total other expenses	(41,810,494)	(42,438,947)
FEES, CONTRIBUTIONS, AND GRANTS		
Capital fees, contributions, and grants	3,096,313	11,643,915
Operating fees, contributions, and grants	434,981	539,643
Total fees, contributions, and grants	3,531,294	12,183,558
CHANGE IN NET ASSETS	1,796,605	709,451
	,,	, - <u>-</u>
NET ASSETS		
Beginning of year	310,881,240	310,171,789
End of year	\$ 312,677,845	\$ 310,881,240

#### SEATTLE PUBLIC UTILITIES - WATER FUND (An Enterprise Fund of the City of Seattle) STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$ 194,414,793	\$ 193,874,859
Cash paid to suppliers	(27,067,874)	(29,811,046)
Cash paid to employees	(54,453,769)	(54,676,245)
Cash paid for taxes	(31,107,892)	(33,993,625)
Net cash provided by operating activities	81,785,258	75,393,943
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating grants received	440,981	525,064
Other cash inflows	2,384,713	2,936,200
Other cash outflows	(228,870)	(39,136)
Net cash provided by noncapital financing activities	2,596,824	3,422,128
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of bonds	-	132,995,704
Capital fees, contributions, and grants	1,738,807	1,605,384
Principal payments on revenue bonds	(29,140,000)	(26,700,000)
Proceeds from public works trust loans	-	8,647,997
Principal payments on public works trust loans	(858,293)	(714,766)
Capital expenditures and deferred charges	(50,989,161)	(61,482,337)
Interest paid on long-term debt	(49,600,802)	(47,483,998)
Proceeds from sale of capital assets	267,253	558,744
Debt issuance costs	-	(230,554)
Net cash (used in) provided by capital		
and related financing activities	(128,582,196)	7,196,174
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	-	(78,500,000)
Proceeds from sales of investments	18,100,000	60,400,000
Interest received on investments	2,905,391	2,093,019
Net cash provided by (used in) investing activities	21,005,391	(16,006,981)
NET (DECREASE) INCREASE IN CASH AND EQUITY IN POOLED INVESTMENTS	(23,194,723)	70,005,264
CASH AND EQUITY IN POOLED INVESTMENTS Beginning of year	117,322,464	47,317,200
End of year	\$ 94,127,741	\$ 117,322,464

#### **SEATTLE PUBLIC UTILITIES - WATER FUND**

(An Enterprise Fund of the City of Seattle) STATEMENTS OF CASH FLOWS (CONTINUED) YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
RECONCILIATION OF NET OPERATING INCOME TO		
NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net operating income	\$ 40,075,805	\$ 30,964,840
Adjustments to reconcile net operating income to net		
cash provided by operating activities		
Depreciation and amortization	46,061,914	48,085,386
Changes in operating assets and liabilities		
Accounts receivable	86,166	(2,156,411)
Unbilled revenues	(748,499)	(1,090,118)
Due from other City funds	704,950	(128,922)
Due from other governments	572,356	647,191
Materials and supplies inventory	254,007	96,492
Prepayments and other	(43,522)	(33,217)
Notes and contracts receivable	(459,914)	21,978
Vendor deposits payable	(208,283)	(71,847)
Accounts payable	(195,618)	(2,156,854)
Accrued payroll and payroll taxes payable	107,450	14,147
Taxes payable	(17,732)	85,177
Compensated absences payable	(69,171)	(39,962)
Other postemployment benefits	482,424	314,618
Due to other City funds	(2,406,482)	2,842,134
Due to other governments	-	(79,082)
Claims payable	(144,899)	379,815
Deferred credits - Revenue Stabilization Fund	(1,436,689)	(2,863,094)
Other deferred credits and liabilities	(829,005)	561,672
Total adjustments	41,709,453	44,429,103
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 81,785,258	\$ 75,393,943
NONCASH TRANSACTIONS		
Change in fair value of investments	\$ (8,142)	\$ 8,142
Contributed infrastructure	1,095,415	10,038,531
		, , -
Total noncash transactions	\$ 1,087,273	\$ 10,046,673

#### Note 1 - Operations and Summary of Significant Accounting Policies

**Operations** - The City of Seattle, Seattle Public Utilities - Water Fund (the "Fund") is a public utility enterprise fund of the City of Seattle (the "City"). The Fund was established to account for activities of the water system operated by Seattle Public Utilities ("SPU"). The water system, established in 1890, provides water to the greater Seattle area through direct service to customers and through purveyors, such as suburban water districts and non-profit water associations. The activities of the water system include protection of available water supply, transmission of water to customers, development of water conservation programs, evaluation of new water sources, and management of the City's water system assets, which include the Tolt and Cedar River Watersheds, water pipes, pumping stations, and aquifers.

On January 1, 1997, the City created SPU, which brought together under one administrative umbrella the water, solid waste, and drainage and wastewater functions of the City. The Fund (as well as SPU's other funds) remains separate for accounting purposes.

SPU receives certain services from other departments and agencies of the City, including some that are normally considered to be general and administrative. The Fund is charged a share of these costs and additionally pays public utility tax to the City's General Fund. During 2011 and 2010, the Fund paid \$9,547,222 and \$10,263,046, respectively, to the City for its share of general and administrative services. Additionally, the Fund paid \$23,279,845 and \$29,454,840 in 2011 and 2010, respectively, to the City for public utility taxes.

Water services provided to other City departments and agencies are billed at rates prescribed by City ordinances. The Fund collected \$2,722,327 and \$2,646,901 in 2011 and 2010, respectively, from the City for water services provided.

The utility billing function is co-managed by both SPU and Seattle City Light ("SCL"). SPU provides customer service through the call center and walk-in center. SCL operates and manages the billing system, Combined Customer Services System ("CCSS"). SPU and SCL billed and reimbursed each other for these services in 2011 and 2010. Within SPU, the costs and reimbursements were shared among its three utility funds (Water, Drainage and Wastewater, and Solid Waste). The Fund received reimbursements related to the call center and walk-in center of \$1,438,374 and \$1,637,727 in 2011 and 2010, respectively. The Fund paid \$396,012 and \$316,482 for CCSS services in 2011 and 2010, respectively, which does not include reimbursements to SCL for the Fund's share of capital costs to upgrade the CCSS system.

The Fund is subject to regulation by the City and the state of Washington. Service rates are authorized by ordinances passed by the Seattle City Council ("City Council"). Accounting policies and financial reporting are regulated by the Washington State Auditor's Office, and conform to accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Fund has chosen to apply all pronouncements and interpretations issued by GASB, as well as those issued by the Financial Accounting Standards Board ("FASB") on or before November 30, 1989, except when they conflict with GASB.

#### Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

Basis of Accounting - The Fund is accounted for on a flow of economic resources measurement focus. Its financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to governmental units using the accrual basis of accounting. With the flow of economic resources measurement focus, all assets and liabilities associated with the Fund's operations are included on the balance sheets. The operating statements present increases (revenues) and decreases (expenses) in total net assets.

Cash and Equity in Pooled Investments - Cash resources of the Fund are combined with cash resources of the City to form a pool of cash that is managed by the City's Finance and Administration Services Department. Under the City's investment policy, the Finance and Administration Services Department invests all temporary cash surpluses either directly or through a sweep account. Interest earned on the pooled investments is prorated to individual funds at the end of each month on the basis of their average daily cash balances during the month when interest was earned. The Fund's share of the pool is included in the accompanying Balance Sheets under the caption "cash and equity in pooled investments." The pool operates like a demand deposit account in that all City departments may deposit cash at any time and can also withdraw cash out of the pool without prior notice or penalty. Accordingly, the Statements of Cash Flows reconcile to cash and equity in pooled investments. Cash and equity in pooled investments are reported at fair market value.

**Investments** - The Fund's restricted cash resources are invested by the Finance and Administration Services Department separate from the cash and investments pool. Investments are managed in accordance with the City's investment policy, with limits and restrictions applied at the City-wide level rather than to specific investments of the Fund. These investments are reported at fair value.

**Receivables and Unbilled Revenues** - Customer 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 Fund also accrues an estimated amount for services that have been provided but not billed.

Notes and contracts receivable arise from written agreements or contracts with private individuals or organizations. Activity between funds that is outstanding at the end of the year not related to the provision of utility services is reported as due from other funds.

**Allowance for Doubtful Accounts** - A reserve has been established for uncollectible accounts receivable based on actual historical write-off trends and knowledge of specific circumstances that indicate collection of an account may be unlikely.

**Materials and Supplies Inventory** - The Fund values its inventory based on a moving average method. The most recent total cost of an inventory item is divided by the total units of the item that remain in inventory to determine the moving average cost of the item. The moving average cost is then applied to all the units of the inventory item.

**Restricted Assets** - The construction fund accounts are comprised of unexpended bond proceeds, a portion of which will be spent during 2012.

#### Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

**Unamortized Bond Issue Costs** - Costs associated with the issuance of bonds are amortized to expense over the term of the related debt. Amortization expense is calculated under the straight-line method or effective interest method, depending on the maturity schedule of the related bonds.

Revenue Stabilization Fund - The Revenue Stabilization Fund ("RSF") was established by the City Council to reduce year-to-year variation in rates. Amounts deposited into the RSF are excluded from the statement of revenues, expenses, and changes in net assets and treated as a deferred credit in accordance with Accounting Standards Codification ("ASC") 980. Council ordinance specifies that the balance in the RSF be maintained at a minimum of \$9.0 million. There were no deposits to the RSF other than interest earnings of \$0.1 million in both 2011 and 2010. The RSF is included in the "Revenue Stabilization Account" identified in the Fund's bond covenants. These covenants provide that withdrawals and deposits from the "Revenue Stabilization Account" shall augment or reduce adjusted net revenue available for the payment of debt service. During 2011 and 2010, \$1.5 million and \$3.0 million, respectively, were withdrawn from the Revenue Stabilization Fund as authorized by City ordinance 122841.

**Deferred Conservation Costs** - Conservation program costs that result in long-term benefits and reduce or postpone other capital expenditures or have a legal requirement are deferred and amortized over their expected useful lives, commencing when each program is in place. The conservation program costs are amortized over their expected useful lives of ten years. Certain costs related to the Habitat Conservation Plan ("HCP") are included in the deferred costs and amortized through 2050, the year in which the plan expires. An incidental take permit was issued to the City by the federal government approving the HCP for 50 years. Costs of administering the conservation and HCP programs are expensed as incurred.

**Other Deferred Charges** - Other deferred charges include costs such as the Water System Plan, leasehold improvements, the hydrant settlement, Morse Lake Pump Plant, and payments to the Muckleshoot Indian Tribe. The Fund amortizes these charges over a 2 to 33 year period. Further discussion of the hydrant settlement may be found in Note 12.

**Capital Assets** - Capital assets are stated at cost or, if contributed, at fair value at the date of contribution. Costs include direct material, labor, and indirect costs such as engineering, supervision, payroll taxes, pension benefits, and interest relating to the financing of projects under construction. The cost of current repairs and maintenance is charged to expense, while the cost of additions and improvements is capitalized. SPU's policy is to capitalize assets with a cost of \$5,000 or more. The Fund receives donated assets such as water mains from developers and other governmental agencies.

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

**Other Property** - Other property is stated at cost, or if contributed, the fair value at the date of contribution. Other property includes artwork and property held for future use. The artwork is acquired through the City's "One Percent for Art" program, which supports the City ordinance established to direct the inclusion of works of art in public spaces within the City.

#### Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

**Depreciation** - Capital assets in service are depreciated on the straight-line method over estimated useful lives as follows:

Buildings and fixtures	10 to 50 years
Earthen source of supply developments	100 years
Transmission and distribution pipelines, reservoirs, and tanks	15 to 100 years
Water mains	33 to 57 years
Pumps, wells, and treatment equipment	10 to 50 years
Machinery and equipment	3 to 20 years
Computer systems	3 to 10 years

Composite rates based on year of addition are used for depreciating the transmission and distribution pipelines, water mains asset group, reservoirs, and tanks. For most assets, it is SPU's policy to begin depreciation in the year following acquisition and to record a full year's depreciation in the year of disposition. This does not apply to heavy equipment, for which depreciation begins in the month following the equipment's in-service date to more accurately allocate equipment costs to various activities.

BPA Account - In 2003, the Bonneville Power Administration ("BPA") purchased an easement in the amount of \$6.0 million from the Fund to construct a power transmission line through the Cedar River Watershed. This amount was included in gain on sale of land rights and timber in the 2003 statement of revenues, expenses, and changes in net assets. This \$6.0 million, together with \$657,149 in timber sales related to the easement, were deposited into the BPA account and classified as restricted assets. At December 31, 2011 and 2010, the cash balance in the BPA account was \$463,294 and \$563,101, respectively. Monies in the BPA account are considered a portion of the "Revenue Stabilization Account" described in bond covenants, and therefore shall augment or reduce adjusted net revenue available for the payment of debt service. The Fund will recognize the revenues deposited in the BPA account in the calculation of adjusted net revenues available for the payment of debt service as they are withdrawn to fund certain activities in the Cedar River Watershed.

**Compensated Absences** - Employees earn vacation based upon their date of hire and years of service, and may accumulate earned vacation up to a maximum of 480 hours. Unused vacation at retirement or normal termination is considered vested and payable to the employee. Earned but unused vacation is accrued as a liability of the Fund. Employees also earn up to 12 days of sick leave per year and may accumulate sick leave balances without limit. The Fund records a liability for estimated sick leave payments.

Employees who submit the required documentation to be represented by the Coalition of City Unions are paid 35% of the value of unused sick leave upon retirement as part of the Health Reimbursement Arrangement – Voluntary Employees' Beneficiary Association ("HRA-VEBA") program. If the employee fails to submit the required documentation by their last working day of employment, their sick leave balance is forfeited.

#### Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

Retiring employees who are not eligible to participate in the HRA-VEBA program may elect to receive 25% of the value of unused sick leave upon retirement or defer receipt of 35% of the value of their sick leave balance to the City's 457 Plan and Trust, subject to the year-to-date or life-to-date limitations on deferrals and contributions. If the 35% value of the sick leave balance exceeds the maximum amount deferred to the City's 457 Plan and Trust, the employee shall receive a taxable cash payment equal to the amount by which the 25% value of the sick leave balance exceeds the 35% that was allowed to be deferred.

**Operating Revenues** - The Fund provides water service to wholesale and retail customers and recognizes revenue when such service is provided. Wholesale customers ("Purveyors") are under contract with the Fund, and rates are set based on cost allocation criteria stipulated in the contracts.

Service rates for all customers are authorized by ordinances passed by the City Council. Service revenues are recorded through cycle billings rendered to customers monthly or bimonthly. The Fund accrues and records unbilled water service revenues in the financial statements for services provided from the date of the last billing to year end.

**Operating Expenses** - Certain expenses of the Fund are reported on the statements of revenues, expenses, and changes in net assets by functional category. The types of work performed within each category are as follows:

- Pre-capital planning and development Provides planning services and other related costs prior to the start of capital projects.
- Utility systems management Accounts for the overall management of the Fund's infrastructure assets, assuring they are properly designed, constructed, operated, and protected.
- Field operations Operates and maintains the Fund's water system.
- Project delivery Provides project management and engineering services to the Fund and executes the Fund's capital projects from start to completion.
- Customer services Invoices the Fund's customers for services provided and is the primary point
  of contact for customers.

**Taxes** - The Fund is charged a public utility tax by the City at a rate of 15.54% of Fund revenues, net of certain credits and certain revenues. In addition, the Fund paid a 5.029% public utility tax to the State on a certain portion of revenues identified as utility revenues. The Fund also paid business and occupation tax to the State at the rate of 1.8% on certain other non-utility revenues.

**Other Revenues and Expenses** - This includes the non-operating revenues and expenses that arise from transactions not related directly to the major income-earning operations of the utility and are of a recurring nature. Major items are investment and interest income, interest expense, gains or losses on the sale of assets, and amortization of debt expenses.

# SEATTLE PUBLIC UTILITIES - WATER FUND (An Enterprise Fund of the City of Seattle) NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

#### Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

**Net Assets** - The Statement of Net Assets reports all financial and capital resources. The difference between assets and liabilities is net assets. There are three components of net assets: invested in capital assets - net of related debt, restricted, and unrestricted.

Net assets invested in capital assets, net of related debt, consists of capital assets, less accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Net assets are restricted when constraints placed on net asset 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. The Fund's restricted net assets as of December 31, 2011, and 2010, are related to the BPA and RSF accounts, bond debt reserve funds, and certain deferred charges.

Unrestricted net assets are those that are not "invested in capital assets, net of related debt" or "restricted."

**Arbitrage Rebate Requirement** - The Fund is subject to the Internal Revenue Code ("IRC"), Section 148(f), related to its tax-exempt revenue bonds. The IRC requires that earnings on gross proceeds of any revenue bonds that are in excess of the amount prescribed will be surrendered to the Internal Revenue Service. As such, the Fund would record such a rebate as a liability. The Fund had no liability for arbitrage as of December 31, 2011 or 2010.

**Accounting Changes** - The Fund adopted GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, as of January 1, 2010. This statement clarified the definition of intangible assets as used in the description of capital assets in GASB Statement No. 34. The adoption of GASB 51 did not have a significant impact on the Fund's financial statements for 2011 or 2010.

The Fund adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, as of January 1, 2010. This statement provides guidance for the recognition, measurement and disclosure of activity related to derivative instruments held by state and local governments. The adoption of GASB 53 did not have a significant impact on the Fund's financial statements for 2011 or 2010.

GASB issued Statement No. 59 *Financial Instruments Omnibus*, to update and improve existing financial reporting and disclosure standards of certain financial instruments and external investment pools. This statement became effective for periods beginning after June 15, 2010 and did not have a significant impact on the Fund's financial statements for 2011 or 2010.

GASB has issued Statement No. 62, *Codification of Pre-November 30, 1989 FASB Pronouncements*. This statement combines the authoritative accounting and financial reporting of the FASB and the American Institute of Certified Public Accountants ("AICPA"). The statement will eliminate the need for financial statement preparers and auditors to determine which FASB and AICPA pronouncement provisions apply to state and local governments. The statement is effective for periods beginning after December 15, 2011 and likely will not have a significant impact on the Fund's financial statements.

# SEATTLE PUBLIC UTILITIES - WATER FUND (An Enterprise Fund of the City of Seattle) NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

# **Note 1 - Operations and Summary of Significant Accounting Policies** (Continued)

GASB has issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.* The requirements of this statement will standardize the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. The statement is effective for periods beginning after December 15, 2011. The Fund is evaluating the impact of this standard on the financial statements.

**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. Estimates and assumptions are used to record unbilled revenues, allowance for doubtful accounts, accrued sick leave, capitalized interest, depreciation, risk liabilities, and other contingencies. Changes in these estimates and assumptions may have a material impact on the financial statements.

**Significant Risks and Uncertainties** - The Fund 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, federal government regulations or orders concerning the operation, maintenance, and licensing of facilities.

**Reclassifications** - Certain reclassifications have been made to prior year balances to provide a presentation consistent with the current year.

#### Note 2 - Cash and Investments

**Custodial Credit Risk - Deposits** - As of December 31, 2011 and 2010, the City's pool contained cash on deposit with the City's custodial banks in the amounts of \$19,666,051 and \$16,663,123, respectively. The deposits in excess of \$250,000 in both 2011 and 2010 were uninsured and uncollateralized. As such, these deposits were exposed to custodial credit risk, which is the risk that the deposits may not be returned to the City in the event of a bank failure. The City attempts to minimize exposure to custodial credit risk for deposits by requiring the depository bank to have sufficient capital to support the activity of the City. In addition, banks having a deposit relationship with the City are required to provide financial statements for the City's use in reviewing the bank's financial condition.

All deposits not covered by FDIC insurance are under the regulation of the Washington State Public Deposit Protection Commission (the "Commission") established in RCW 39.58 for public depository financial institutions. The Commission requires a pledge agreement and a trustee for each public depository financial institution. The trustee ensures eligible collateral defined as securities and designated for the benefit of public depositors as described in RCW 39.58.050 (5) and (6), are segregated from all other assets. Eligible collateral is utilized by the trustee when the Commission has determined a loss, net of deposit insurance, has been incurred by a public depository financial institution.

# Note 2 - Cash and Investments (Continued)

**Investments** - As of December 31, the Fund's dedicated investments, the City's pooled investments, and dedicated investments of other funds were as follows:

			2011		
	Dedicated Investments of the Fund	City Pool	Other Dedicated Investments	Total	Weighted Average Maturity (Days)
U.S. Government Agencies State and Local Governments Commercial Paper Repurchase Agreements U.S. Government Obligations Total	\$ - - - - - - - -	\$ 991,128,738 105,403,511 77,494,937 66,785,435 37,993,718 \$ 1,278,806,339	\$ - - - - - - - -	\$ 991,128,738 105,403,511 77,494,937 66,785,435 37,993,718 \$ 1,278,806,339	974 513 10 3 816
			J	ted Average Maturity	823
	Dedicated Investments of the Fund	City Pool	2010 Other Dedicated Investments	Total	Weighted Average Maturity (Days)
U.S. Government Agencies Commercial Paper Repurchase Agreements U.S. Government Obligations State and Local Governments	\$18,097,906 - - - -	\$ 628,004,011 256,364,545 56,365,904 39,624,611 1,020,110	\$ 63,436,250 - - - -	\$ 709,538,167 256,364,545 56,365,904 39,624,611 1,020,110	655 21 3 398 213
Total	\$18,097,906	\$ 981,379,181	\$ 63,436,250	\$ 1,062,913,337	
			Portfolio Weig	hted Average Maturit	y 458

The Fund's share of the City Pool was as follows as of December 31:

	2011	2010
Cash and equity in pooled investments Restricted cash and equity in pooled investments	\$ 7,297,606 86,830,135	\$ 8,504,138 108,818,326
Total	\$ 94,127,741	\$ 117,322,464
Balance as a percentage of City Pool cash and investments	7.4%	11.9%

# SEATTLE PUBLIC UTILITIES - WATER FUND (An Enterprise Fund of the City of Seattle) NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

# Note 2 - Cash and Investments (Continued)

**Interest Rate Risk** - Interest rate risk is the risk that changes in market interest rates that will adversely affect the fair value of an investment. In general, the longer the maturity of an investment, the greater the sensitivity of the investment's fair value to changes in market interest rates. The City manages this risk by limiting the average maturity of investments to five years. However, the Fund's investments are selected for greater liquidity in order to support the Fund's cash flow needs and therefore typically have much shorter average maturities.

**Credit Risk** - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In accordance with the City's investment policy, investments in commercial paper purchased on the secondary market are limited to those with maturities not longer than 180 days from purchase and with the highest rating by at least two nationally recognized statistical rating organizations ("NRSROs"). As of December 31, 2011 and 2010, the City's investments in commercial paper were rated P-1 by Moody's Investors Service and A-1 to A-1+ by Standard & Poor's Rating Service.

The City also purchases obligations of government-sponsored enterprises which are eligible as collateral for advances to member banks as determined by the Board of Governors of the Federal Reserve System. These include, but are not limited to, debt securities of Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal Farm Credit Bank, and Federal National Mortgage Association. As of December 31, 2011 these investments were rated Aaa, Aa1 and P-1 by Moody's Investors Service and AAA, AA+, and AA by Standard & Poor's Rating Service. As of December 31, 2010, these investments were rated Aaa by Moody's Investors Service, and AAA by Standard & Poor's Rating Service.

As of December 31, 2011, the City's investments in repurchase agreements require a signed and executed 2011 Version of the Global Master Repurchase Agreement, a standardized form published by the Securities Industry and Financial Markets Association ("SIFMA") and International Capital Market Association ("ICMA"), with an approved repo counterparty of the City. Additionally, the City will have to sign and execute a Tri-Party Custodial Agreement between the counterparty and one of the two third-party custodians, JPMorgan Chase and BNY Mellon, respectively. The City conducts repo transactions with investment grade rated primary dealers after thorough internal credit due diligence of the counterparty. Securities delivered as collateral must be priced at a minimum of 102% of their market value. Potentially higher margins of 103% to 105% would be used for pricing collateral in a volatile market environment. Parameters for acceptable collateral are determined by the City's investment policy, which abides by Washington State statute. As of December 31, 2011, the securities underlying the City's investments in repurchase agreements have included U.S. Treasuries, U.S. Agency debentures, and U.S. Agency mortgage-backed pass-throughs. The City has not accepted collateral containing credit risk, such as bankers' acceptances, commercial paper, or municipal bonds. Repurchase agreements do not have credit ratings.

**Concentration of Credit Risk** - The City's investment policy limits concentration of credit risk for the City's investments as a whole, inclusive of the Fund's investments. These policy limits vary for each investment category.

# Note 2 - Cash and Investments (Continued)

The City's investments in which 5% or more is invested in any single issuer as of December 31 are as follows:

	2011		2010	)
		Percent of		Percent of
		Total		Total
Issuer	Fair Value	Investments	Fair Value	Investments
Federal Home Loan Mortgage Corp	\$ 395,358,375	31%	\$ 114,398,437	11%
Federal National Mortgage Association	\$ 317,039,812	25%	\$ 276,373,623	26%
Federal Home Loan Bank	\$ 194,321,359	15%	\$ 218,644,903	21%
Federal Farm Credit Bank	\$ 83,708,078	7%	\$ 100,121,203	9%
Washington State	\$ 68,388,721	5%	\$ -	0%
Wells Fargo	\$ 66,785,435	5%	\$ 32,565,904	3%
Sheffield Receivables Corporation	\$ -	0%	\$ 54,343,164	5%

As of December 31, 2011, the Fund liquidated all dedicated investment to the construction fund account. The Fund's dedicated investments in which 5% or more is invested in any single issuer as of December 31 are as follows:

		201	1	20	)10
			Percent		Percent
			of Total		of Total
Issuer	Fair	Value	Investments	Fair Value	Investments
Federal Home Loan Bank	\$	-	0%	\$ 12,192,375	67%
Federal Farm Credit Bank	\$	-	0%	\$ 5,905,531	33%

# **Note 3 - Capital Assets**

Capital asset activity consisted of the following for the year ended December 31, 2011:

	Beginning Balance	Additions and Transfers In	Retirements and Transfers Out	Ending Balance	
Buildings	\$ 169,430,642	\$ 9,125,644	\$ -	\$ 178,556,286	
Structures	255,588,246	928,393	-	256,516,639	
Machinery and equipment	1,104,325,621	29,020,514	(407,322)	1,132,938,813	
Computer systems	98,614,389	2,510,212	(4,446,069)	96,678,532	
Total capital assets - excluding land	1,627,958,898	41,584,763	(4,853,391)	1,664,690,270	
Less accumulated depreciation	(522,030,616)	(42,267,086)	4,810,263	(559,487,439)	
	1,105,928,282	(682,323)	(43,128)	1,105,202,831	
Construction in progress	57,228,686	53,193,633	(54,402,125)	56,020,194	
Land and land rights	40,634,660	1,104,956	(185,468)	41,554,148	
Other property	913,372	14,836		928,208	
Capital assets, net	\$ 1,204,705,000	\$ 53,631,102	\$ (54,630,721)	\$ 1,203,705,381	

# Note 3 - Capital Assets (Continued)

Capital asset activity consisted of the following for the year ended December 31, 2010:

	Beginning Balance	Additions and Transfers In	Retirements and Transfers Out	Ending Balance	
Buildings	\$ 168,996,850	\$ 485,484	\$ (51,692)	\$ 169,430,642	
Structures	226,981,061	77,027,173	(48,419,988)	255,588,246	
Machinery and equipment	1,042,886,627	62,501,572	(1,062,578)	1,104,325,621	
Computer systems	92,434,967	6,222,023	(42,601)	98,614,389	
Total capital assets - excluding land	1,531,299,505	146,236,252	(49,576,859)	1,627,958,898	
Less accumulated depreciation	(483,482,403)	(40,864,673)	2,316,460	(522,030,616)	
	1,047,817,102	105,371,579	(47,260,399)	1,105,928,282	
Construction in progress	87,082,670	116,669,354	(146,523,338)	57,228,686	
Land and land rights	39,127,903	1,506,852	(95)	40,634,660	
Other property	865,497	47,875		913,372	
Capital assets, net	\$ 1,174,893,172	\$ 223,595,660	\$ (193,783,832)	\$ 1,204,705,000	

During 2011 and 2010, the Fund capitalized interest costs relating to construction of \$2,635,254 and \$2,697,823, respectively.

#### **Note 4 - Revenue Bonds**

The Fund issues bonds to provide financing for capital improvements. Payment of debt service on the bonds is derived solely from the revenues generated by the Fund. The Fund has set aside \$16,710,973 in a debt service reserve fund and has obtained reserve insurance policies to meet the remainder of its reserve requirements. The total bonds outstanding as of December 31, 2011 and 2010 were \$977,160,000 and \$1,006,300,000, respectively.

The Fund did not issue Revenue Bonds during the year ended December 31, 2011.

In January 2010, the Fund issued \$109,080,000 of Water System Revenue Bonds with varying annual principal payments due beginning in 2019 and ending in 2040, at interest rates ranging from 4.67% to 5.89%. The bonds were issued as taxable, direct pay Build America Bonds. Designation as Build America Bonds allows the Fund a credit payable by the United States Treasury in an amount equal to 35% of the interest payable on each bond interest payment date. As a result, interest on the bonds is not excludable from gross income. Proceeds of the revenue bonds are being used to finance certain capital improvements and additions to the water system.

# Note 4 - Revenue Bonds (Continued)

Also, in January 2010, the Fund issued \$81,760,000 of Water System Improvement and Refunding Revenue Bonds with varying annual principal payments due beginning in 2010 and ending in 2027, at interest rates ranging from 3.00% to 5.00%. A portion of the proceeds from the issuance was set aside in the Fund's restricted cash and used on January 21, 2010, to refund the remaining portion of the 1998 Water Revenue Bonds, totaling \$61,825,000. The remaining proceeds will be used for certain capital improvement projects for the Fund. As a result of the refunding, the Fund reduced total debt service requirements by \$9.5 million resulting in an economic gain (difference between the present value of the debt service payments on the old and new debts) of \$6.7 million. A deferred charge (the difference between the cost to refund outstanding debts and the carrying value of bonds refunded) of \$1.2 million is being amortized over the life of the refunded bonds using the straight-line method. The defeased bonds were subsequently redeemed in 2010. No outstanding bonds are considered defeased at December 2011 and 2010.

Revenue bonds outstanding as of December 31, 2011 and 2010 consisted of the following Municipal Water bonds:

Name of Issue	Issuance Date	Maturity Years	Interest Rates	Original Issue Amount	Bonds Outstanding, 2011	Bonds Outstanding, 2010
2001 parity bonds	11/20/01	2005-2031	4.5-5.0%	\$ 52,525,000	\$ 44,320,000	\$ 45,630,000
2003 parity, refunding bonds	5/12/03	2003-2033	4.0-6.0%	271,320,000	185,725,000	194,240,000
2004 parity bonds	10/25/04	2005-2034	3.0-5.0%	84,750,000	73,735,000	75,430,000
2005 parity, refunding bonds	12/28/05	2006-2029	4.0-5.0%	138,040,000	123,000,000	127,600,000
2006 parity, refunding bonds	10/23/06	2008-2037	4.0-5.0%	189,970,000	177,655,000	182,100,000
2008 parity, refunding bonds	12/15/08	2009-2038	4.0-5.25%	205,080,000	190,145,000	193,885,000
2010A parity, revenue bonds	1/21/10	2019-2040	4.67-5.89%	109,080,000	109,080,000	109,080,000
2010B parity, refunding revenue bonds	1/21/10	2010-2027	3.0-5.0%	81,760,000	73,500,000	78,335,000
				\$ 1,132,525,000	\$ 977,160,000	\$ 1,006,300,000

# Note 4 - Revenue Bonds (Continued)

Minimum debt service requirements to maturity on revenue bonds are as follows:

Years Ending December 31,	Principal		 Interest		Total
2012	\$	31,425,000	\$ 48,103,807	\$	79,528,807
2013		32,795,000	46,709,282		79,504,282
2014		34,240,000	45,251,907		79,491,907
2015		35,810,000	43,675,882		79,485,882
2016		37,545,000	41,926,482		79,471,482
2017 - 2021		215,415,000	180,141,296		395,556,296
2022 - 2026		233,360,000	123,228,962		356,588,962
2027 - 2031		191,700,000	68,544,422		260,244,422
2032 - 2036		117,810,000	27,958,776		145,768,776
2037 - 2040		47,060,000	 4,894,093		51,954,093
	\$	977,160,000	\$ 630,434,909	\$	1,607,594,909

The following table shows the revenue bond activity during the year ended December 31, 2011:

	Beginning Balance	Ado	ditions	Reductions	Ending Balance	Due Within One Year
Bonds payable Revenue bonds	\$ 1,006,300,000	\$	_	\$ (29,140,000)	\$ 977,160,000	\$ 31,425,000
Add (deduct) deferred amounts:						
Issuance premiums	32,856,664		-	(1,906,975)	30,949,689	-
Issuance discounts	-		-		-	-
Loss on refunding	(16,108,715)		-	1,349,325	(14,759,390)	
Total bonds payable	\$ 1,023,047,949	\$	-	\$ (29,697,650)	\$ 993,350,299	\$ 31,425,000

The following table shows the revenue bond activity during the year ended December 31, 2010:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable Revenue bonds	\$ 903,985,000	\$ 190,840,000	\$ (88,525,000)	\$ 1,006,300,000	\$ 29,140,000
Add (deduct) deferred amounts:					
Issuance premiums	28,111,017	6,662,351	(1,916,704)	32,856,664	-
Issuance discounts	(306,733)	-	306,733	-	-
Loss on refunding	(16,345,700)	(1,152,635)	1,389,620	(16,108,715)	
Total bonds payable	\$ 915,443,584	\$ 196,349,716	\$ (88,745,351)	\$ 1,023,047,949	\$ 29,140,000

# Note 4 - Revenue Bonds (Continued)

**Debt Service Coverage** - The revenue bonds contain certain financial covenants, the most significant of which requires the Fund to maintain adjusted net revenue available for debt service of not less than 125% of actual annual debt service. In 2011, adjusted net revenue available for debt service, as defined by the bond covenants was 148% of debt service. For 2010, adjusted net revenue available for debt service was 159%. Net revenue available for debt service for the year ended December 31 is determined as follows:

	2011	2010
Change in net assets	\$ 1,796,605	\$ 709,451
Add:		
City taxes	23,279,845	29,454,840
Depreciation and amortization	46,061,914	48,085,386
Interest paid on revenue bonds	49,224,670	50,274,477
Draws on BPA account	100,000	198,207
	120,463,034	128,722,361
Less:		
Donation of assets	1,095,415	10,038,531
Capitalized interest	2,635,254	2,697,823
Amortization of bond premiums, debt		
expenses, and loss on refunding	299,987	269,324
Adjusted net revenue available for debt service	\$ 116,432,378	\$ 115,716,683
Debt service requirement (cash basis)	\$ 78,552,207	\$ 72,749,679
Coverage percentage	148%	159%

#### Note 5 - Leases

The Fund has non-cancelable operating lease commitments for real and personal property with minimum payments of \$384,595 in 2011 and \$375,965 in 2010. Rents are paid as they become due and payable. Minimum payments under the leases as of December 31, 2011 are shown below:

	Minimum Payments	
2012	\$ 392,972	
2013	274,933	
2014	248,136	
2015	256,273	
2016	221,013	
2017 - 2021	54,045	
2022 - 2026	54,045	
2027 - 2029	 32,427	
	\$ 1,533,844	

#### Note 6 - Retirement and Other Postemployment Benefit Plans

**Pension Costs** - All permanent Fund employees are eligible to participate in the Seattle City Employees' Retirement System (the "System"), a cost-sharing public employee retirement system operated by the City. Benefits vest after five years of covered service. City employees may retire after 30 years of service regardless of age; after age 52, with 20 or more years of service; after age 57, with ten or more years of service; and after age 62, with five or more years of service. The System also provides death and disability benefits. These benefit provisions and all other requirements are established by City ordinances.

City employees are required to contribute 9.03% of their annual base salaries to System. Employer rates are established by the City Council on a biannual basis. The Fund's contributions to the System for the years ended December 31, 2011, 2010, and 2009, were \$3,892,675, \$3,601,358 and \$3,861,387, respectively. The Fund's contribution in 2011 represents its full liability to the System.

The System issues stand-alone financial statements, which may be obtained by writing to the Seattle City Employees' Retirement System, 720 Third Avenue, Suite 900, Seattle, Washington, 98104, telephone: (206) 386-1293.

Employer contributions for the City are as follows (dollars in millions):

Year Ended December 31,	Re	City equired cribution	A	City Actual tribution	Percentage Contributed	
2009	\$	46.7	\$	46.7	100%	
2010	\$	45.2	\$	45.2	100%	
2011	\$	50.2	\$	50.2	100%	
Actuarial data and assumptions:						
Valuation date			Januar	y 1, 2011		
Actuarial cost method			]	Entry age		
Amortization method			Leve	el percent		
Remaining amortization period		30 years, open				
Asset valuation method		5-Year Sn	noothin	g Method		
Investment rate of return	7.75%					
Projected general wage inflation				4.0%		
Postretirement benefit increases				1.5%		

Schedules of funding progress are as follows (dollars in millions):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liabilities (AAL) Entry Age <sup>1</sup> (b)	Unfunded AAL (UAAL) <sup>2</sup> (b-a)	Funded Ratio (a/b)	Covered Payroll <sup>3</sup> (c)	UAAL as a % of Covered Payroll ((b-a)/c)
January 1, 2008	\$ 2,119.4	\$ 2,294.6	\$ 175.2	92.4%	\$ 501.9	34.9%
January 1, 2010	\$ 1,645.3	\$ 2,653.8	\$ 1,008.5	62.0%	\$ 580.9	173.6%
January 1, 2011	\$ 2,013.7	\$ 2,709.0	\$ 695.4	74.3%	\$ 563.2	123.5%

- 1 Actuarial present value of benefits less actuarial present value of future normal costs based on entry age actuarial cost method.
- 2 Actuarial accrued liabilities less actuarial value of assets.
- 3 Covered payroll includes compensation paid to all active employees on which contributions are calculated.

# SEATTLE PUBLIC UTILITIES - WATER FUND (An Enterprise Fund of the City of Seattle) NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

#### Note 6 - Retirement and Other Postemployment Benefit Plans (Continued)

**Deferred Compensation** - The City offers all of its employees a deferred compensation plan (the "Plan") created in accordance with Internal Revenue Code ("IRC") Section 457. The Plan permits employees to defer a portion of their salaries until future years. The deferred compensation is paid to employees upon termination, retirement, death, or unforeseen emergency.

The Plan is an eligible deferred compensation plan under Section 457 of the IRC of 1986, as amended, and a trust exempt from tax under IRC Sections 457(g) and 501(a). The Plan is operated for the exclusive benefit of participants and their beneficiaries. No part of the corpus or income of the Plan shall revert to the City or be used for, or diverted to, purposes other than the exclusive benefit of participants and their beneficiaries. The Plan is not reported in the financial statements of the City or the Fund.

It is the opinion of the City's legal counsel that the City has no liability for investment losses under the Plan. Under the Plan, participants select investments from alternatives offered by the Plan Administrator, who is under contract with the City to manage the Plan. Investment selection by a participant may be changed from time to time. The City does not manage any of the investment selections. By making the selection, participants accept and assume all risks inherent in the Plan and its administration.

**Other Postemployment Benefits** - Health care plans for active and retired employees are administered by the City as single-employer defined benefit public employee health care plans.

Eligible retirees (younger than age 65) may contribute to the medical plan and any additional health care programs contemplated or amended by ordinance of the City Council and as provided in Seattle Municipal Code 4.50.020.

The Seattle City Council authorizes the obligations of the plan members and the City as employer by passing ordinances and amendments regarding contributions to the plans. Eligible retirees self-pay 100% of the premiums based on blended rates which were established by including the experience of retirees with the experience of active employees for underwriting purposes. The plan is financed on a pay-as-you-go basis, and the City was required to contribute \$3.2 million in 2010 and \$3.0 million in 2009.

The table below summarizes the City's annual cost, expected contributions to the plan, and changes in the net OPEB obligation for fiscal year ended December 31, 2010 and 2009. These calculations are based on the most recent actuarial valuation data available, dated January 1, 2010. The Fund has accrued \$2,033,474 to the plan as of December 31, 2011, as a reasonable estimate of expected contributions.

	2010	2009
Annual required contribution	\$ 10,709,000	\$ 9,269,000
Interest on net OPEB obligation	898,000	693,000
Adjustment to annual required contribution	(1,239,000)	(915,000)
Annual OPEB cost (expense)	10,368,000	9,047,000
Expected contribution (employer-paid benefits)	(3,202,000)	(2,954,000)
Increase in net OPEB obligation	7,166,000	6,093,000
Net OPEB obligation, beginning of year	20,446,000	14,353,000
Net OPEB obligation, end of year	\$ 27,612,000	\$ 20,446,000
Fund's allocated share of city liability	\$ 1,551,050	\$ 1,236,432

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially-determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Actuarial calculations are based on the types of benefits provided under the terms of the plan and on the pattern of shared costs between the employer and plan members, at the time of each valuation. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future. Actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

Significant methods and assumptions are as follows:

#### **Actuarial data and assumptions**

Valuation date January 1, 2010
Actuarial cost method Entry age normal
Amortization method Level dollar
Remaining amortization period 30 years, open

Discount rate 4.39%

Health care cost trend rates - 10.0%, decreasing by 0.5% for each year for

medical: 10 years to an ultimate rate of 5%.

Participation 40% of Active Employees who retire participate

Mortality General Service Actives and Retirees based on the

Group Annuity Mortality (GAM) 1994 Static Table

(Final) with ages set forward one year.

Marital status 60% of members electing coverage are assumed to

be married or to have a registered domestic partner. Male spouses two years older than their

female spouses.

Morbidity factors Morbidity rate ranges for ages 50 through 64:

104.25% to 203.61% for male retirees, 76.78% to 149.96% for female retirees, 123.03% to 229.84% for male spouses, and

90.62% to 169.29% for female spouses.

Retirees' spouses pay a lower premium than

retirees.

dependent coverage are assumed to elect same

plan and coverage after retirement.

Schedules of funding progress are as follows (dollars in millions):

	Actu	arial							UAAL as a %
	Valu	ie of		AAL			Funded	Covered	of Covered
Actuarial	Ass	ets	Ent	ry Age	J	JAAL	Ratio	Payroll	Payroll
Valuation Date	(a	a)		(b)	(	b-a)	(a/b)	(c)	((b-a)/c)
January 1, 2008	\$	-	\$	78.8	\$	78.8	0.0%	NA	NA
January 1, 2009	\$	-	\$	84.1	\$	84.1	0.0%	NA	NA
January 1, 2010	\$	-	\$	93.5	\$	93.5	0.0%	NA	NA

The Health Care Subfund of the General Fund is reported in the City's Comprehensive Annual Financial Report, which can be obtained by writing the Department of Finance, City of Seattle, PO Box 94747, Seattle, WA 98124-4747.

#### **Note 7 - Claims Payable**

The City and the Fund are self-insured for certain losses arising from personal and property damage claims by third parties and for casualty losses to the Fund's property. Liabilities for identified claims and claims incurred but not reported have been recorded by the Fund.

For 2011 and 2010, liabilities for workers' compensation claims, as well as other claims, are discounted over a 15-year period at the City's rate of return on investments, 0.824% and 1.027%, respectively. Claims expected to be paid within one year were \$1,626,270 and \$1,649,957 at December 31, 2011 and 2010, respectively. The table below presents the changes in the liability for workers' compensation claims and other claims (risk-financing liabilities) as of December 31:

	2011	2010
Beginning liability, undiscounted Payments Incurred claims and changes in estimate	\$ 5,929,939 (947,194) 759,346	\$ 5,627,641 (1,698,655) 2,000,953
Ending liability, undiscounted	\$ 5,742,091	\$ 5,929,939
Ending liability, discounted (recorded balance at December 31)	\$ 5,592,866	\$ 5,737,765

The Fund is involved in litigation from time to time as a result of operations. Claims are pursued if determined to be in the best interest of the Fund's customers.

### **Note 8 - Compensated Absences**

The Fund has recorded a liability for earned but unused holiday, compensatory, merit, and vacation leave, as well as estimated sick leave payments calculated based on the termination payment method. The schedule below presents the compensated absences activity during the years ended December 31:

	2011		2010
Beginning liability Additions	\$ 4,817,901 3,675,559		\$ 4,857,863 5,287,424
Reductions	 (3,744,730)	_	 (5,327,386)
Ending liability	\$ 4,748,730		\$ 4,817,901

#### Note 9 - Public Works Trust Loans

The Fund has various construction projects that are financed by low interest loans issued by the State. The loan agreements require that the Fund finance a portion of these projects from other sources. These loans have been used to enhance and protect the water system.

Loans outstanding as of December 31, 2011 and 2010 are as follows:

Description	Maturity Years	Interest Rate	Amount Borrowed	Loans Outstanding, 2011	Loans Outstanding, 2010
Magnolia Manor Reservoir	1994-2013	1.0%	\$ 2,220,000	\$ 236,433	\$ 354,650
Myrtle Reservoir	2008-2025	1.5%	4,040,000	3,142,222	3,366,667
Beacon Reservoir	2008-2026	1.5%	4,040,000	3,189,474	3,402,105
West Seattle Reservoir	2009-2027	1.5%	3,030,000	2,551,579	2,711,053
Maple Leaf ARRA	2009-2032	1.0%	5,920,997	5,920,997	5,920,997
Maple Leaf	2010-2029	1.5%	2,727,000	2,583,474	2,727,000
			\$ 21,977,997	\$ 17,624,179	\$ 18,482,472

# Note 9 - Public Works Trust Loans (Continued)

Minimum debt service requirements to maturity on the loans are as follows:

Years Ending December 31,	Principal	Interest	Total
2012	\$ 858,293	\$ 315,479	\$ 1,173,772
2013	1,154,343	221,292	1,375,635
2014	1,036,126	206,048	1,242,174
2015	1,036,126	191,987	1,228,113
2016	1,036,126	177,925	1,214,051
2017 - 2021	5,180,629	678,702	5,859,331
2022 - 2026	4,956,185	327,160	5,283,345
2027 - 2031	2,070,302	74,519	2,144,821
2032	296,049	2,961	299,010
	\$ 17,624,179	\$ 2,196,073	\$ 19,820,252

The table below summarizes the activity for the loans for the years ended December 31:

	2011	2010
Net public works trust loans, beginning of year Loan proceeds Principal payments	\$ 18,482,472 - (858,293)	\$ 10,549,241 8,647,997 (714,766)
Net public works trust loans, end of year	\$ 17,624,179	\$ 18,482,472
Public works trust loans due within one year	\$ 858,293	\$ 858,293
Public works trust loans, noncurrent	\$ 16,765,886	\$ 17,624,179

# **Note 10 - Notes and Contracts Receivable**

The Fund has an agreement with the Seattle Housing Authority for the recovery of the remaining unreimbursed cost of the Fund's contributions of public infrastructure to the New Holly redevelopment project. As of December 31, 2011 the Seattle Housing Authority receivable was \$480,855.

#### **Note 10 - Notes and Contracts Receivable** (Continued)

Notes and contracts receivable are composed of the following as of December 31:

	2011	2010	
Seattle Housing Authority receivable	\$ 480,855	\$	-
Water main assessments	457		4,038
Land sales receivable	-		17,359
Total notes and contracts receivable	481,312		21,397
Due within one year	 (16,118)		(21,228)
Total non-current notes and contracts receivable	\$ 465,194	\$	169

#### **Note 11 - Commitments**

The Fund is required by the Washington State Department of Health ("DOH") to complete a program to cover its open, above-ground distribution system reservoirs by the year 2020. The total cost of burying five reservoirs is expected to be approximately \$123.2 million through the year 2016; costs beyond 2016 are not estimable as of the date of this report. As of December 31, 2011 and 2010, total cumulative costs incurred were \$112.4 million and \$111.5 million, respectively.

In 2011, Seattle signed new water supply contracts with eight wholesale customers whose contracts were to expire January 31, 2011. Six of the customers signed full or partial requirements contracts that are very similar to the full and partial requirements contracts already in place with the majority of the Fund's wholesale customers. These new full and partial requirements contracts do not change Seattle's obligation to supply water. All eight of these new contracts expire December 31, 2062.

#### Note 12 - Hydrant Settlement

A class action lawsuit against the Fund alleged that fire hydrant costs were improperly paid by the Fund's ratepayers and sought refund of such costs. The Fund settled the lawsuit and was ordered to refund ratepayers and to collect hydrant charges from the City. At the settlement date, the Fund recorded a liability of \$16.2 million for refunds to ratepayers and a \$14.3 million receivable due from the City in reimbursements. As of December 31, 2010, the Fund processed \$13.5 million for refunds that were received per the terms of the settlement. Of the total estimated liability, \$2.7 million was not claimed by ratepayers and was recorded as other non-operating revenue of the Fund.

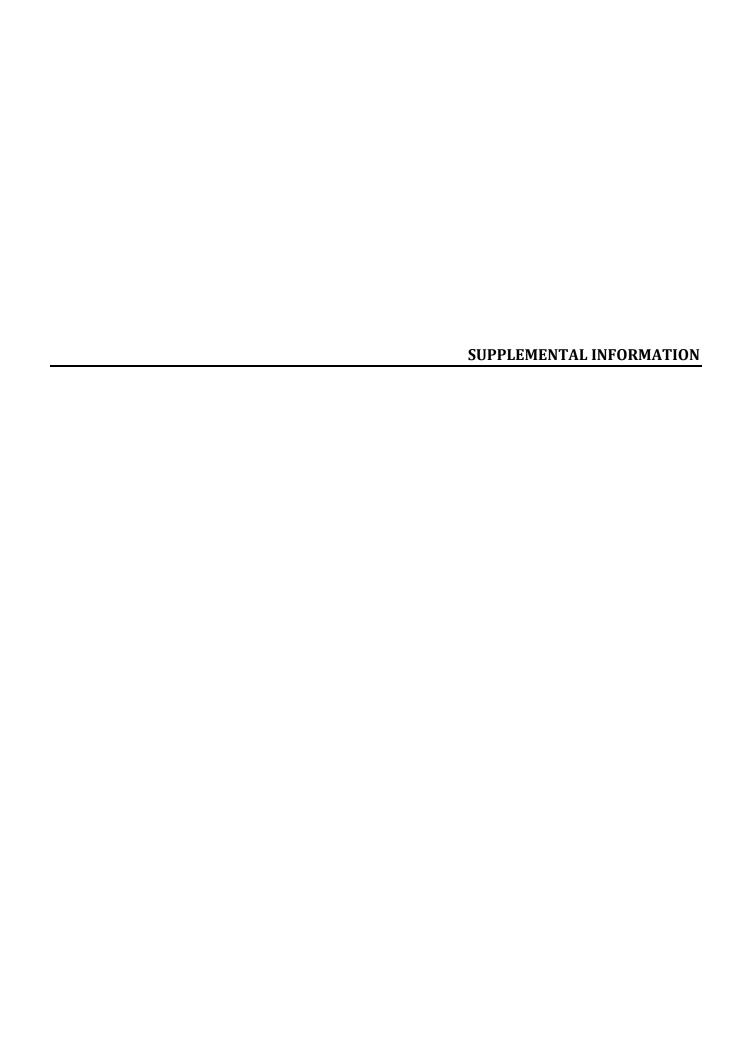
The Fund had \$6.8 million of deferred costs related to the settlement, which represented a surcharge collected from ratepayers to cover these costs. As of December 31, 2010, the deferred costs were fully amortized.

SEATTLE PUBLIC UTILITIES - WATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

#### Note 13 - Habitat Conservation Program Liability

SPU has prepared a comprehensive environmental management plan for its Cedar River Watershed. The purpose of the Habitat Conservation Plan ("HCP") is to protect all species of concern that may be affected by the operations of SPU and SCL in the Cedar River Watershed, while allowing the City to continue to provide high quality drinking water to the region. The federal government has accepted the HCP. The total cost of implementing the HCP is expected to be \$101.6 million (in 2011 dollars) over a period of 50 years (from the year 2000 through the year 2050).

Expenditures are being funded from a combination of the Fund's operating revenues and issuance of revenue bonds. The total amount expended for the HCP through 2011 is \$81.2 million. The remaining \$20.4 million to complete the HCP is comprised of a \$5.0 million liability and an estimate of \$15.4 million for construction and operating commitments. The construction activities will add to the Fund's capital assets and the operating activities are mainly research, monitoring, and maintenance of the HCP program that will be expensed as incurred.



# Water System Operating Statistics

	2007	2008	2009	2010	2011
Population Served					
Retail	642,385	649,286	658,951	664,458	669,654
Wholesale <sup>(1)</sup>	609,613	616,592	621,606	628,536	634,193
Total Population Served	1,251,998	1,265,878	1,280,557	1,292,994	1,303,847
Water Sales Revenues (\$000) <sup>(2)(3)</sup>					
Retail	\$102,334	\$106,689	\$130,272	\$136,443	\$137,382
Wholesale	\$41,558	\$42,884	\$48,454	\$45,073	\$44,050
Total Water Sales Revenues	\$143,892	\$149,573	\$178,726	\$181,516	\$181,432
Billed Water Consumption (MG) <sup>(3)</sup>					
Retail	21,311	20,599	20,956	19,868	19,305
Wholesale	22,741	22,255	23,554	20,437	20,922
Total Billed Water Use	44,052	42,854	44,510	40,305	40,227
Operating Costs (\$ per MG) <sup>(4)</sup>	\$3,143	\$3,423	\$3,679	\$4,075	\$3,842
Gallons Used per Day per Capita	96	93	95	85	85
Retail Meters in Use	185,272	187,032	188,102	188,332	188,754
Number of New Retail Meters	1696	1760	1070	230	422
Total Water Diversions (MGD)	125.9	125.1	129.5	118.4	117.9
Non-Revenue	5.2	8.0	7.5	8.0	7.7
% Non-Revenue	4.1	6.4	5.8	6.7	6.5

<sup>(1)</sup> This is the estimated total population served by SPU's water supply. As some Wholesale Customers obtain some or all of their water from sources other than SPU, this number is less than the total population shown in the shaded areas on the map on the inside front cover.

<sup>(2)</sup> Revenues represent payments from customers for service provided at published rates in each year. Revenues shown are not net of transfers to the Rate Stabilization Account or other credits or deferrals of income.

<sup>(3)</sup> Revenue increases have been a result of increases in rates, as retail consumption has steadily decreased due largely to conservation efforts. Variations in billed water use are primarily associated with year-to-year variations in temperature and precipitation in the summer irrigation period. There has been no change in the geographic area served or any appreciable change in the number or composition of retail customers.

<sup>(4)</sup> The increases in per unit operating costs in 2009 and 2010 are due in part to a temporary increase in the City's utility tax rate and increased amortization expense, both due to Lane v. City of Seattle. See "Litigation and Claims."

# SEATTLE PUBLIC UTILITIES - WATER FUND (An Enterprise Fund of the City of Seattle) SUPPLEMENTAL INFORMATION

# Major Retail Water Customers - 2010 Annual Revenues and Volumes

The Water System's ten largest retail water users in 2011 were the University of Washington, City of Seattle, Port of Seattle, Seattle Housing Authority, Seattle Steam Company, Todd Shipyards, Nucor Steel Seattle, Seattle Public Schools, and Swedish Medical Center. In the aggregate, revenue from these customers was less than nine percent of billed direct service.

# SEATTLE PUBLIC UTILITIES - WATER FUND (An Enterprise Fund of the City of Seattle) SUPPLEMENTAL INFORMATION

# Water Rates - Effective January 1, 2012

				Direct	Service								Wholesale
RATE SCHEDULES		Insid	e City			Outsio	le City		City of Sh	oreline/Cit	y of Lake Fo	rest Park	
	Residential	MMRD*	Gen Svc	Fire Service	Residential	MMRD*	Gen Svc	Fire Service	Residential	MMRD*	Gen Svc	Fire Service	<b>Full and Partial</b>
Commodity Charge (\$/100 Cubic	Feet)												
Offpeak Usage (Sept 16-May 15)	\$4.04	\$4.04	\$4.04		\$4.61	\$4.61	\$4.61		\$4.90	\$4.90	\$4.90		\$1.52
Peak Usage (May 16-Sept 15)													
Up to 5 ccf**	\$4.34	\$4.34	\$5.15		\$4.95	\$4.95	\$5.87		\$5.26	\$5.26	\$6.25		\$2.26
Next 13 ccf**	\$5.15	\$5.15	\$5.15		\$5.87	\$5.87	\$5.87		\$6.25	\$6.25	\$6.25		\$2.26
Over 18 ccf**	\$11.80	\$11.80	\$5.15		\$13.45	\$13.45	\$5.87		\$14.31	\$14.31	\$6.25		\$2.26
Usage over base allowance				\$20.00				\$22.80				\$24.30	\$22.00
Utility Credit (\$/month)	\$16.97		\$10.14		\$16.97		\$10.14		\$16.97		\$10.14		
Base Service Charge (\$/month/m	eter)												New Srvc Fee (One Time)
					*****		*****		****		***		****
3/4 inch and less	\$13.25		\$13.25		\$15.10		\$15.10		\$16.05		\$16.05		\$483
1 inch	\$13.65		\$13.65		\$15.55	+0	\$15.55		\$16.55	+	\$16.55		\$1,566
1-1/2 inch	\$21.05	\$21.05	\$21.05		\$24.00	\$24.00	\$24.00		\$25.55	\$25.55	\$25.55		\$3,915
2 inch	\$23.35	\$23.35	\$23.35	\$15.40	\$26.60	\$26.60	\$26.60	\$18.00	\$28.30	\$28.30	\$28.30	\$19.00	\$6,264
3 inch	\$86.35	\$86.35	\$86.35	\$20.00	\$98.45	\$98.45	\$98.45	\$23.00	\$104.70	\$104.70	\$104.70	\$24.00	\$17,226
4 inch	\$123.75	\$123.75	\$123.75	\$37.00	\$141.10	\$141.10	\$141.10	\$42.00	\$150.10	\$150.10	\$150.10	\$45.00	\$24,273
6 inch		\$152.30	\$152.30	\$63.00		\$173.60	\$173.60	\$72.00		\$184.70	\$184.70	\$76.00	\$51,678
8 inch		\$199.00	\$199.00	\$100.00		\$227.00	\$227.00	\$114.00		\$241.00	\$241.00	\$121.00	\$87,696
10 inch		\$297.00	\$297.00	\$144.00		\$339.00	\$339.00	\$164.00		\$360.00	\$360.00	\$175.00	\$132,327
12 inch		\$402.00	\$402.00	\$210.00		\$458.00	\$458.00	\$239.00		\$488.00	\$488.00	\$255.00	\$186,354
16 inch		\$477.00	\$477.00			\$544.00	\$544.00			\$579.00	\$579.00		\$186,354
20 inch		\$614.00	\$614.00			\$700.00	\$700.00			\$745.00	\$745.00		\$186,354
24 inch		\$771.00	\$771.00			\$879.00	\$879.00			\$935.00	\$935.00		\$186,354

<sup>\*</sup> Master Metered Residential Development \*\* per residence

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# APPENDIX D

# DEMOGRAPHIC AND ECONOMIC INFORMATION

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#### DEMOGRAPHIC AND ECONOMIC INFORMATION

Seattle is the largest city in the Pacific Northwest, serves as the County seat and is the center of the County's economic activity. King County is the largest county in the State in population, number of cities and employment, and the fourteenth most populated county in the United States. Of the State's population, nearly 30% reside in King County, and of the County's population, 32% live in the City of Seattle.

#### **Population**

Historical and current population figures for the State of Washington, the County, the two largest cities in the County, and the unincorporated areas of the County are given below.

#### **POPULATION**

		King			Unincorporated
<b>Year</b>	<b>Washington</b>	County	<b>Seattle</b>	<b>Bellevue</b>	King County
1980 <sup>(1)</sup>	4,130,163	1,269,749	493,846	73,903	503,100
1990 <sup>(1)</sup>	4,866,692	1,507,319	516,259	86,874	NA
2000 (1)	5,894,121	1,737,034	563,374	109,827	349,773
2001 (2)	5,974,900	1,758,300	568,100	111,500	353,579
2002 (2)	6,041,700	1,774,300	570,800	117,000	351,675
2003 (2)	6,098,300	1,779,300	571,900	116,400	351,843
2004 (2)	6,167,800	1,788,300	572,600	116,500	356,795
2005 (2)	6,256,400	1,808,300	573,000	115,500	364,498
2006 (2)	6,375,600	1,835,300	578,700	117,000	367,070
2007 (2)	6,488,800	1,861,300	586,200	118,100	368,255
2008 (2)	6,587,600	1,884,200	592,800	119,200	341,150
2009 (2)	6,668,200	1,909,300	602,000	120,600	343,180
2010 (2)	6,733,250	1,933,400	612,000	122,900	343,340
2011 (2)	6,767,900	1,942,600	612,100	123,400	285,265

(1) Source: U.S. Department of Commerce, Bureau of Census

(2) Source: State of Washington, Office of Financial Management

# Per Capita Income

The following table presents per capita personal income for the Seattle Primary Metropolitan Statistical Area ("PMSA"), the County, the State, and the United States.

#### PER CAPITA INCOME

	2006	2007	2008	2009	2010	2011
Seattle PMSA	\$ 50,202	\$ 53,327	\$ 54,621	\$ 51,118	\$ 51,698	N/A
King County	54,641	57,735	58,628	54,517	55,136	N/A
State of Washington	39,570	42,192	44,106	41,837	42,589	44,294
United States	37,725	39,506	40,947	38,846	39,937	41,663

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

#### Construction

The table below lists the value of housing construction for which building permits have been issued by entities within the City of Seattle. The value of public construction is not included in this table.

# CITY OF SEATTLE RESIDENTIAL BUILDING PERMIT VALUES

**New Single Family Units New Multi-Family Units** Value(\$) Number Number Value(\$) Total Value(\$) Year 2005 533 94,398,888 3,185 278,146,082 372,544,970 2006 482 90,534,640 5,538 597,085,138 687,619,778 2007 775 153,268,586 5,939 681,283,338 834,551,924 685,869,079 2008 595 122,997,326 4,256 562,871,753 2009 216 47,666,932 562 67,880,407 115,547,339 2010 241 53,269,934 2,456 192,261,935 245,531,869 448,400,601 2011 316 71,808,767 2,857 376,591,834

Source: U.S. Bureau of the Census

#### **Retail Activity**

The following table presents taxable retail sales in Seattle and King County.

# THE CITY OF SEATTLE AND KING COUNTY TAXABLE RETAIL SALES (000)

<b>Year</b>	King County	Seattle
2005	\$ 40,498,328,830	\$ 14,236,200,469
2006	43,993,478,514	15,564,363,159
2007	47,766,338,768	17,030,512,254
2008	45,711,920,389	17,096,581,492
2009	39,594,903,520	15,101,407,742
2010	39,275,353,182	14,783,168,934
2011	40.846.119.020	15.751.585.858

Source: Washington State Department of Revenue

# **Industry and Employment**

The following table presents State-wide employment data in 2010 for certain major employers in the Puget Sound area.

# PUGET SOUND AREA MAJOR EMPLOYERS

Employer	Employees*
The Boeing Company	76,400
U.S. Army Fort Lewis	51,000
Navy Region Northwest	41,300
Microsoft	40,300
University of Washington	27,900
Providence Health & Services	19,100
Wal-Mart Stores, Inc.	18,000
Fred Meyer Stores	13,500
King County Government	13,400
U.S. Postal Service	12,400
City of Seattle	10,700
MultiCare Health System	9,000
Franciscan Health System	8,200
Costco	8,200
Group Health Cooperative	8,100

<sup>\*</sup> Excludes part-time or seasonal employment figures.

Source: Puget Sound Book of Lists, 2012 (rounded)

# KING COUNTY RESIDENT CIVILIAN LABOR FORCE AND EMPLOYMENT AND NONAGRICULTURAL WAGE AND SALARY EMPLOYMENT\*

			Annual Aver	age	
	2007	2008	2009	2010	2011
Civilian Labor Force	1,071,850	1,094,310	1,115,900	1,107,060	1,105,550
Total Employment	1,030,140	1,042,790	1,021,540	1,006,000	1,015,970
Total Unemployment	41,710	51,520	94,360	101,060	89,580
Percent of Labor Force	3.9	4.7	8.5	9.1	8.1
NAICS INDUSTRY	2007	2008	2009	2010	2011
Total Nonfarm	1,156,242	1,133,200	1,151,950	1,217,567	1,200,600
Total Private	991,450	966,233	984,750	1,051,158	1,037,175
Goods Producing	149,983	148,158	160,442	186,475	188,358
Natural Resources and Mining	500	467	508	583	692
Construction	48,792	49,675	57,142	73,883	74,525
Manufacturing	100,717	98,017	102,792	112,000	113,133
Services Providing	1,006,258	985,042	991,508	1,031,092	1,012,242
Trade, Transportation, and Utilities	212,233	206,350	209,175	224,667	224,392
Information	80,050	79,408	80,192	79,767	75,642
Financial Activities	67,292	67,658	71,192	77,525	78,683
Professional and Business Services	184,592	176,675	176,792	194,242	189,925
Educational and Health Services	142,908	138,142	137,683	133,258	127,683
Leisure and Hospitality	112,133	108,700	108,117	113,358	111,750
Other Services	42,258	41,142	41,158	41,867	40,742
Government	164,792	166,967	167,200	166,408	163,425
Workers in Labor/Management Disputes	0	0	0	958	0

	Mar. 2012
Civilian Labor Force	1,108,310
Total Employment	1,029,730
Total Unemployment	78,590
Percent of Labor Force	7.1%

<sup>\*</sup> Columns may not add to totals due to rounding.

Source: Washington State Employment Security Department

# APPENDIX E

# **BOOK-ENTRY TRANSFER SYSTEM**

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#### **BOOK-ENTRY TRANSFER SYSTEM**

The following information has been provided by the Depository Trust Company ("DTC"). The City makes no representation as to the accuracy or completeness thereof. Purchasers of the Bonds (the "beneficial owners") should confirm the following with DTC or its participants (the "Participants").

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities 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, each in the aggregate principal amount of 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 posttrade 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.

Purchases of 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 Owner 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 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.

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. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and

proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within a maturity 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. will consent or vote with respect to 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 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, 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 such 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 may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to the City or the Bond Registrar. Under such circumstances, in the event that a successor depository is not obtained, Bond certificates are required to be printed and delivered.

The following information has been provided by the City.

The City may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered to DTC.

The information in this appendix concerning DTC and DTC's book-entry system has been obtained from sources the City believes to be reliable, but the City takes no responsibility for the accuracy thereof.

The Bond Registrar is not obligated to exchange or transfer any Bond during the 15 days preceding any principal or interest payment or redemption date.

The City and the Bond Registrar may treat DTC (or its nominee) as the sole and exclusive registered owner of the Bonds registered in such name for the purposes of payment of the principal of, premium, if any, or interest with respect to those Bonds, selecting Bonds or portions thereof to be redeemed, giving any notice permitted or required to be given to registered owners of Bonds under the Bond Legislation, registering the transfer of Bonds, obtaining any consent or other action to be taken by registered owners of Bonds, and for all other purposes whatsoever; and the City and the Bond Registrar shall not be affected by any notice to the contrary. The City and the Bond Registrar shall not have any responsibility or obligation to any direct or indirect DTC participant, any person claiming a beneficial ownership interest in the Bonds under or through DTC or any such participant, or any other person which is not shown on the Bond Register as being a registered owner of Bonds, with respect to: (i) the Bonds; (ii) any records maintained by DTC or any such participant; (iii) the payment by DTC or such participant of any amount in respect of the principal of, premium, if any, or interest with respect to the Bonds; (iv) any notice which is permitted or required to be given to registered owners of Bonds under the Bond Legislation; (v) the selection by DTC or any such participant of any person to receive

payment in the event of a partial redemption of the Bonds; or (vi) any consent given or other action taken by DTC as registered owner of the Bonds.