

CASCADE WATER ALLIANCE

Financial Statements

For the Years Ended December 31, 2012 and 2011

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Independent Auditors' Report

***Board of Directors
Cascade Water Alliance
Bellevue, Washington***

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Cascade Water Alliance (Cascade), which comprise the statements of net position as of December 31, 2012 and 2011, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

CLARK NUBER

Opinion

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

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and modified approach for White River/Lake Tapps Reservoir Project Infrastructure Capital Assets on pages 3 through 10 and on pages 31 through 34 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Certified Public Accountants
September 19, 2013

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Management's Discussion and Analysis

Management's Discussion and Analysis presents our review of Cascade's net position as of December 31, 2012 and 2011, and Cascade's financial performance for the years then ended. These comments should be read in conjunction with Cascade's financial statements, which follow this section.

Overview of the Financial Statements

The financial statements include Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position, Statements of Cash Flows and Notes to Financial Statements.

The Statements of Net Position provide a record, or snapshot, of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources of Cascade at the close of the year. It provides information about the nature and amounts of investments in resources (assets) and obligations to creditors (liabilities). It provides a basis for evaluating the capital structure of Cascade and for assessing its liquidity and financial flexibility.

The Statements of Revenues, Expenses and Changes in Net Position present the results of the business activities over the course of the year. This information can be used to determine whether Cascade has successfully recovered all its costs through its user fees and other charges, and to evaluate its financial viability and credit worthiness.

The Statements of Cash Flows report cash receipts, cash payments and net changes in cash resulting from operating, financing and investing activities over the course of the year. The statements present information on where cash came from and what it was used for.

The Notes to Financial Statements provide useful information regarding Cascade's significant account balances and activities, certain material risks, estimates, obligations, commitments, contingencies, and subsequent events, if any.

Cascade's overall financial position is strong, with sufficient liquidity to finance operations and sufficient debt capacity to finance future capital asset acquisitions. Cascade is financed by equity and long-term debt.

Capital assets have increased due to Cascade obtaining sources of water supply and related water systems needed to deliver the supply. Cascade primarily serves a suburban area east of Lake Washington in King County.

Major debt financing to date includes:

- \$10,000,000 borrowed in 2004 from member Sammamish Plateau Water and Sewer District for acquisition of water supply sources and water systems (repaid from bond proceeds in 2006);
- \$25,904,442 owed to the City of Tacoma for acquisition of water supply sources and water systems (repaid from bond proceeds in 2006);
- Twenty-five year \$55,230,000 revenue bond proceeds (2006 revenue bonds) to pay the Sammamish Plateau Water and Sewer District and City of Tacoma and to finance system development;
- Twenty-five year \$80,095,000 revenue bond proceeds (2009 revenue bonds) to acquire the Lake Tapps system from Puget Sound Energy (PSE) and to fund property acquisitions and pipeline construction along a potential water transmission corridor; and

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- Twenty-five year \$42,695,000 revenue bond proceeds (2012 revenue bonds) to acquire independent supply production capacity, to restructure the Tacoma Water Contract, to extend the Seattle Water Contract, and to fund Lake Tapps capital improvements.

On December 11, 2012, Covington Water District withdrew as a member from Cascade upon payment of \$5,987,134.

Condensed Financial Statements Net Position as of December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Current assets	\$ 24,117,091	\$ 17,525,964
Net capital assets	267,902,371	154,590,523
Other assets	67,650,611	29,109,005
Total Assets	<u>359,670,073</u>	<u>201,225,492</u>
Current liabilities	18,325,613	18,700,218
Long-term liabilities	277,413,561	123,327,457
Total Liabilities	<u>295,739,174</u>	<u>142,027,675</u>
Invested in capital assets, net of related debt	32,537,056	44,770,283
Unrestricted	31,393,843	14,427,534
Total Net Position	<u>\$ 63,930,899</u>	<u>\$ 59,197,817</u>

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Condensed Financial Statements *Statements of Revenues, Expenses and Changes in Net Position* *For the Years Ended December 31, 2012 and 2011*

	<u>2012</u>	<u>2011</u>
Water sales	\$ 27,551,398	\$ 25,998,670
Administrative dues	2,733,191	1,444,763
Conservation program	1,386,145	1,282,647
Total Operating Revenue	31,670,734	28,726,080
Cost of water sold	22,493,836	19,830,259
Other operating costs	7,624,514	8,689,842
Total Operating Expenses	30,118,350	28,520,101
Operating Income	1,552,384	205,979
Nonoperating expenses	(9,589,084)	(3,783,717)
Capital contributions (expenses)	12,769,782	(6,973,574)
Changes in Net Position	4,733,082	(10,551,312)
Net position, beginning of year	59,197,817	69,749,129
Net Position, End of Year	<u>\$ 63,930,899</u>	<u>\$ 59,197,817</u>

Results of Operations

Operating revenues are received principally from water sales, administrative dues, and conservation charges. Cascade commenced water sales in 2004 upon acquisition of the Seattle Water Contract from Seattle Public Utilities. Cascade collects capital contributions from its members. These contributions consist of Regional Capital Facilities Charges (RCFC's) and donated systems. RCFC's are due from members for new residential equivalent customers connecting to the members' systems. Donated systems consisted of a donation of a portion of the Bellevue Issaquah pipeline in 2004 valued at \$9,208,077.

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Significant year-to-year fluctuations from 2011 to 2012 include the following:

- RCFC revenue was \$1,335,487 higher in 2012;
- Administrative dues received from members increased by \$1,288,428 in 2012 due to removal of the 5% limitation on administrative dues effective starting in 2012;
- \$10,000,000 was added to Restricted Cash in 2012 in recognition of a payable to Tacoma for water;
- A new contract for Tacoma water was signed in 2012, increasing the Tacoma water contract asset by \$119,740,687 and adding a long-term payable to Tacoma of \$109,740,687;
- Restricted cash and long-term debt both increased by approximately \$38.5 million upon receipt of net new bond debt proceeds in 2012;
- The bond premium long-term liability was increased by \$5,576,386 upon issuance of new bond debt proceeds in 2012;
- The north segment of the Tacoma Cascade Pipeline capital project was expensed in 2012 in the amount of \$5,434,360;
- A payable obligation of \$10,186,250 was recognized in 2011 for the repurchase of RCFC credits from Cascade members (capital expense). The payable was made from unrestricted cash in 2012;
- Covington Water District made a payment of \$5,987,134 to withdraw from Cascade membership in 2012; the payment was deposited to unrestricted cash.

Capital Assets and Long-Term Debt

The capital assets of Cascade increased \$113 million in 2012 due to the new Tacoma Water Contract. Capital asset expenditures have been funded from capital contributions and the 2006, 2009, and 2012 revenue bonds.

In 2006, Cascade issued revenue bonds in the amount of \$55,230,000 and obtained Public Works Trust Fund loans in the amount of \$1,100,000. The proceeds of these obligations were used to pay off the Sammamish Plateau Water and Sewer District loan and the City of Tacoma loan and to finance planning for the Tacoma Cascade Pipeline and the acquisition of water supply from Lake Tapps.

In 2009, Cascade issued revenue bonds in the amount of \$80,095,000. The proceeds of this obligation have been used in 2009, 2010, and 2011 to acquire the Lake Tapps system from PSE and to fund property acquisitions and pipeline construction along a potential water transmission corridor.

In 2012, Cascade issued revenue bonds in the amount of \$42,695,000. The proceeds of this obligation have been and are being used in 2012 and 2013 to acquire independent supply production capacity (by purchasing RCFC credits from Cascade members), to restructure the Tacoma Water Contract, to extend the Seattle Water Contract, and to fund Lake Tapps capital improvements.

Seattle Water Contract - The Seattle water contract entitles Cascade to a specified amount of water each year for a fifty-year period ending December 31, 2053. The amount of the block can be amended based on new members joining Cascade or existing members withdrawing from Cascade prior to December 31, 2011, or a reduction in water yield available to Seattle due to an order of an appropriate federal or state regulatory agency. Amortization of the Seattle water contract cost is based on the ratio of water to be supplied in that calendar year to total water to be supplied during the contract. Amortization expense for this contract was \$5,978 and \$5,979 for the years ended December 31, 2012 and 2011, respectively. At the end of the contract term, Cascade may continue to purchase up to 5.3 million gallons per day for members that cannot be economically served by any other means. In December 2008, this agreement was amended to entitle Cascade to a supplemental block of additional water through December 31, 2023.

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In 2013, the negotiations are being finalized that would extend the contract with Seattle by 10 years, to 2063. The new contract would extend current capacity of 30.3 mgd through 2039 and then ramp down through the remaining years. Under the new contract extension, Cascade would make three scheduled capacity reservation payments to Seattle; the first would be \$5 million in 2013 using bond proceeds, with subsequent payments in 2018 and 2025. Ratification of the new contract is expected in April 2013.

Tacoma Water Contract - In December 2012, a new contract was signed with Tacoma. The new contract restructures the prior Tacoma supply contract, and it clarifies Cascade's rights and responsibilities for the previously purchased capacity to enable and transfer to specific third parties through a joint offering. Under the new contract, minimum water purchase volumes have been replaced by a structured capacity reservation schedule and a new capacity commitment of 8.0 mgd provided to Cascade through 2042. The 2012 bond proceeds are funding initial payments to Tacoma of \$20 million, starting with a payment of \$10 million in January 2013.

Prior costs incurred to obtain the 2005 Tacoma contract consist of system development charges of \$16,484,000 and capacity reservation fees of \$9,420,442. The system development charges relate to the base amount of water, and capacity reservation fees relate to the additional water to be supplied. As part of the new agreement with Tacoma, Cascade and Tacoma will jointly offer the 2005 contract water supply to four cities (City of Bonney Lake, City of Auburn, City of Buckley, and City of Sumner) in 2013. Through December 31, 2012, Cascade is not able to determine the amount of future water supply the four cities will acquire from Cascade.

In 2011 the City of Bonney Lake agreed to purchase \$2,747,334 as a base amount of Tacoma Water from Cascade for the system development charge that Cascade had paid to Tacoma.

Lake Tapps Purchase Agreement - Cascade completed its purchase agreement with PSE for the purchase of Lake Tapps on December 18, 2009. The Lake Tapps system has an indefinite useful life and will be treated as infrastructure capital assets using the modified approach, except for depreciable assets, such as fleet vehicles, that will be depreciated. Cascade will conduct ongoing maintenance of the system based on current condition assessments and operating requirements.

Lake Tapps Water Rights - Costs on this project represent costs incurred by Cascade to secure water rights. These costs will be evaluated annually for impairment for acquired water rights with no expiration. The Washington State Department of Ecology issued water rights to Cascade on September 15, 2010. In August 2008, Cascade executed agreements with the Muckleshoot Indian Tribe (Muckleshoot) and the Puyallup Tribe of Indians (Puyallup) regarding Lake Tapps Reservoir water rights. The White River Management Agreement establishes an Agreed Flow Regime that limits diversions to maintain in-stream flows in the White River, and contains other provisions with respect to the operation and maintenance of the Lake Tapps Reservoir that address the concerns of Muckleshoot and Puyallup. In accordance with the Agreement, payments of \$6.2 million and \$13.0 million were paid to Muckleshoot and Puyallup, respectively, in 2011.

Interest Capitalization - Interest costs incurred for the acquisition and/or construction of assets are subject to capitalization based on the guidelines established by Financial Accounting Standards Board (FASB) Statements 34 and 62. Total interest incurred on bonds for the years ended December 31, 2012 and 2011, was \$6,317,946 and \$6,402,939, respectively. No interest was capitalized in 2012. Interest capitalized in 2011 was \$886,197.

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System Infrastructure - In February 2012, a pipe leak at a delivery point of Seattle Public Utilities (SPU) water to a Cascade member utility (City of Tukwila) has prompted a review by attorneys and engineers of SPU and Cascade to determine which agency is financially responsible for pipe leaks and other unforeseeable incidents at water points of delivery, and to determine exactly at which physical system points each agency bears responsibility. The outcome of this review may lead to an increased annual operational financial obligation for Cascade.

Projects in Process

Pipeline Routing: Tacoma Cascade Pipeline - The Tacoma Cascade Pipeline (TCP) is an eighteen-mile pipeline extending from the Tacoma Second Supply Pipeline to the Bellevue Issaquah pipeline. The TCP will deliver Tacoma water supply to Cascade members. Cascade has acquired property and easements for the entire eighteen-mile route, with the exception of portions along King County roads for which a franchise with the county will be sought.

The TCP project consists of three segments: 1) the 1.1-mile segment at the north end of the route along SR-900; 2) the northern segment between Segment 1 and Lake Youngs; and 3) the central segment between Lake Youngs and the Tacoma Second Supply Pipeline.

Construction of Segment 1 has been completed and the asset is depreciated starting in 2012. The pipeline's useful life will be dependent on soil conditions, environment, and other factors. Cascade will use a 50-year useful life for depreciation, which is consistent with other utilities' practices (like Seattle Public Utilities). Although construction is complete, the project will not be finalized until the Washington State Department of Transportation signs a final acceptance letter.

Prior to 2012, all three segments were considered as a single combined TCP project for the work and expenditures that occurred along the entire project. Starting in 2012, however, Segments 1, 2, and 3 will be accounted for separately, since separate decisions have been made for the future of each segment.

Previously capitalized expenditures related to Segment 2 were expensed in 2012 since it had become less probable that this segment would ultimately be put into service due to its complicated property and routing configuration.

Minor work and expenditures will continue on Segment 3, however, as it is far more likely than Segment 2 to ultimately be put into service. Segment 3 will not be operational until 2024 at the earliest. Starting in 2012, Segment 3 has been placed into "on hold" status until the project is more fully resumed.

Lake Tapps Milfoil Control - Cascade conducted a third year of milfoil control efforts in Lake Tapps in 2012. Hand-pulling of milfoil by divers was performed during the summer and fall and succeeded in eradicating much of the milfoil. Annual inspections and maintenance will continue as necessary to control the invasive weed. The 2013 program will consist of a combination of chemical, diver hand-pulling, and bottom barrier treatments.

White River System Operator - Veolia Water started working on January 1, 2012, under contract by Cascade, to operate and maintain the White River - Lake Tapps Reservoir Project. For 2013, agreement has been reached on a fixed fee budget of approximately \$1.5 million and a variable budget of \$350,000. A Project Operations and Maintenance Manual was also completed in 2012.

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White River System Safety Inspections - The Washington State Department of Labor and Industries conducted safety inspections of the White River - Lake Tapps Reservoir Project in October and November 2012. The inspection included the powerhouse, valve house, pipeline intake structure headworks facilities, tunnel intake building, forebay building, and 4-1 4-2 structures. Reports were received from the safety consultant and the industrial hygiene consultant identifying serious and general hazards for each facility. The inspections produced a list of serious and general hazards to correct. The issues raised will be resolved in the first half of 2013.

Lead Paint Abatement - Cascade is preparing to conduct lead paint abatement in 2013 at the Lake Tapps powerhouse. The current estimated total cost to remove the existing paint from walls, ceiling, duct work, and other areas, and to repaint these areas is approximately \$500,000. A new roofing system also will be installed to fix internal leaks inside the building. The leaks will be fixed before lead paint remediation occurs.

Bellevue Issaquah Pipeline (BIP) - A Memorandum of Understanding has been signed in 2013 between Cascade and the City of Bellevue to operate and maintain the BIP.

2012 Transmission and Supply Plan Update - The Cascade Water Alliance Board of Directors adopted the 2012 Transmission and Supply Plan (the 2012 TSP) in July 2012. This 2012 TSP fulfills Cascade's responsibility to submit a water system plan to the Washington State Department of Health. In addition, it supplements information on regional supply provided by each of its members in their respective individual water system plans. Cascade updates its TSP every six years. The TSP update includes analyses of regional growth and water demand. These analyses have demonstrated that Cascade members will need less water than was anticipated in the 2004 TSP. The outcome of the TSP update determines Cascade's capital investment program for the next several years, including the extent of contracting with Seattle and Tacoma for water and the development schedule for Lake Tapps and water transmission systems. In 2010, Cascade determined that TSP update expenditures do not meet the criteria for being a capitalizable intangible asset, so TSP update expenditures have been expensed accordingly.

Eastside Reservoir - If the new Seattle agreement is executed as expected in 2013, Cascade may not need the Eastside Reservoir and related prior capitalized expenditures will likely be expensed in 2013.

Invested Funds

In accordance with state investment laws, Cascade's governing body has entered into a formal interlocal agreement with Cascade's *ex officio* treasurer, King County, to have all its funds not required for immediate expenditure to be invested in the King County Investment Pool (Pool).

As of December 31, 2012, Cascade had the following investments:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Effective Duration</u>
King County Investment Pool	\$ 90,860,631	1.36 years

Impaired Investments

As of December 31, 2012, all impaired commercial paper investments have completed enforcement events. The King County impaired investment pool (Impaired Pool) held one commercial paper asset where the Impaired Pool accepted an exchange offer and is receiving the cash flows from the investment's underlying securities. Additionally, the Impaired Pool accepted the cash out option for the residual investments in four commercial paper assets that were part of completed enforcement events. Cascade's share of the impaired investment pool principal is \$221,585, and Cascade's fair value of these investments is \$108,926.

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Interest Rate Risk

As of December 31, 2012, the Pool's average duration was 1.36 years. As a means of limiting its exposure to rising interest rates, securities purchased in the Pool must have a final maturity or weighted average life of no longer than five years. While the Pool's market value is calculated on a monthly basis, unrealized gains and losses are not distributed to participants. The Pool distributes earnings monthly using an amortized cost methodology.

Credit Risk

As of December 31, 2012, Cascade's investment in the Pool was not rated by a nationally recognized statistical rating organization (NRSRO). In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency securities and mortgage-backed securities, municipal securities (rated at least "A" by two NRSROs), commercial paper (rated at least the equivalent of "A-1" by two NRSROs), certificates of deposit issued by qualified public depositories, repurchase agreements, and the Local Government Investment Pool managed by the Washington State Treasurer's Office.

Budget Variances

Capital expenditures in 2012 related to Lake Tapps improvements, Bellevue Issaquah Pipeline upgrades, and other minor capital expenditures, were held within budget.

RCFC were budgeted to be \$4.96 million in 2012, but actual RCFC revenue was \$6.78 million due to slightly improved construction growth in Cascade's service area. RCFC revenue is expected to increase gradually starting in 2013.

Interest and miscellaneous revenue in 2012 was \$19 million lower than budgeted due to persisting low interest rates nationally.

New Water Surcharge revenue was \$0.56 million more than expected due to reconciliation of prior year actual use of Seattle water by members. These adjustments were accommodated by reserve balances in the Operating Fund and had no impact on 2012 member rates or the Operating budget.

Other operating fund revenues were within one percent of budgeted values.

Total fund expenditures were held within budgeted amounts in 2012. In the Operating Fund, residential and commercial conservation program rebate expenditures were 39.3% lower than budgeted due to a policy change limiting households to only one toilet reimbursement starting in 2011. After December 31, 2012, the toilet rebate program has been discontinued. Unexpended funds are carried forward in fund balances and are incorporated into Cascade's Rate Model for future year budgeting and planning.

Requests for Information

This financial report has been prepared to provide readers with a general overview of the Cascade Water Alliance's finances. Questions concerning any of the information provided in this report, or requests for additional information, should be addressed to the Director of Finance and Administration's Office, 520 112th Ave. NE, Suite 400, Bellevue, WA 98004.

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**Statements of Net Position
December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
Assets		
Cash and cash equivalents	\$ 10,808,126	\$ 15,766,164
Regional capital facility charges receivable	2,389,245	1,053,758
Restricted cash and cash equivalents, current portion	10,000,000	
Interest rebate receivable	422,540	428,212
Water rights receivable, current portion	391,222	200,000
Prepaid expenses	105,958	77,830
	<u>24,117,091</u>	<u>17,525,964</u>
Total Current Assets		
Capital Assets Net of Accumulated Depreciation:		
Equipment and furniture	1,044,834	1,006,701
Seattle water contract	204,216	204,216
Tacoma water contract	129,161,129	9,420,442
SR900 pipeline	10,021,201	
Bellevue Issaquah pipeline	22,049,184	22,038,921
	<u>162,480,564</u>	<u>32,670,280</u>
Less accumulated depreciation and amortization	<u>(4,473,759)</u>	<u>(3,381,361)</u>
	158,006,805	29,288,919
Capital Assets Not Being Depreciated:		
Lake Tapps - infrastructure	78,869,110	78,806,742
Projects in process and assets not yet in service-		
Tacoma water contract	13,736,666	13,736,666
Tacoma Cascade pipeline	17,027,223	32,495,629
Eastside reservoir	262,567	262,567
	<u>267,902,371</u>	<u>154,590,523</u>
Total Capital Assets		
Restricted cash and cash equivalents, net of current portion	63,768,005	25,406,445
Water rights receivable, net of current portion	1,956,112	2,347,334
Bond issuance costs, net of accumulated amortization of \$292,790 (\$229,070 - 2011)	1,926,494	1,355,226
	<u>67,650,611</u>	<u>29,109,005</u>
Total Assets	<u><u>\$ 359,670,073</u></u>	<u><u>\$ 201,225,492</u></u>

See accompanying notes.

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Statements of Net Position (Continued)
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Liabilities and Net Position		
Payables and accrued liabilities	\$ 1,439,740	\$ 1,168,703
Retroactive water credit	865,981	1,424,215
Payables related to regional capital facilities charges credit repurchase		10,186,250
Payables related to Tacoma water contract	10,000,000	
Long-term debt, current portion	<u>48,907</u>	<u>40,069</u>
	12,354,628	12,819,237
Payables from Restricted Assets:		
Accrued interest	2,095,985	2,110,981
Long-term debt, current portion	<u>3,875,000</u>	<u>3,770,000</u>
	<u>5,970,985</u>	<u>5,880,981</u>
Total Current Liabilities	18,325,613	18,700,218
Long-Term Debt, Net of Current Portion:		
Long-term debt payable from unrestricted assets	472,890	523,859
Long-term debt payable from restricted assets	<u>159,655,000</u>	<u>120,835,000</u>
	160,127,890	121,358,859
Other Long-Term Liabilities:		
Payable related to Tacoma water contract, net of current portion	109,740,687	
Bond premium, net of amortization of \$838,114 (\$650,463 - 2011)	<u>7,544,984</u>	<u>1,968,598</u>
Total Liabilities	<u>295,739,174</u>	<u>142,027,675</u>
Net Position:		
Invested in capital assets, net of related debt	32,537,056	44,770,283
Unrestricted	<u>31,393,843</u>	<u>14,427,534</u>
Total Net Position	<u>\$ 63,930,899</u>	<u>\$ 59,197,817</u>

See accompanying notes.

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**Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
Operating Revenue:		
Water sales	\$ 27,551,398	\$ 25,998,670
Administrative dues	2,733,191	1,444,763
Conservation program	1,386,145	1,282,647
Total Operating Revenue	31,670,734	28,726,080
Operating Expenses:		
Cost of water sold	22,493,836	19,830,259
Salaries and benefits	1,927,235	1,776,544
Professional services	1,703,112	2,261,980
Conservation rebate program	376,444	607,625
Depreciation and amortization	968,466	655,224
Communication and public information	163,849	177,991
Office expenses	143,852	141,276
Bank charges	376	513
Rent	153,613	114,981
Maintenance	237,947	645,161
Operations	1,581,880	2,054,209
Insurance	87,722	101,040
Dues and subscriptions	46,296	37,451
Miscellaneous	233,722	115,847
Total Operating Expenses	30,118,350	28,520,101
Operating Income	1,552,384	205,979
Nonoperating Revenue (Expenses):		
Interest income	891,555	447,327
Interest expense, net of amount capitalized	(5,046,279)	(4,231,044)
Loss on disposition of assets	(5,434,360)	
Total Nonoperating Expenses	(9,589,084)	(3,783,717)
Capital Contributions (Expenses):		
Regional capital facilities charges	6,782,648	3,212,676
Repurchase of regional capital facilities charges credits		(10,186,250)
Member withdrawal fees	5,987,134	
Total Capital Contributions (Expenses)	12,769,782	(6,973,574)
Total Change in Net Position	4,733,082	(10,551,312)
Net position, beginning of year	59,197,817	69,749,129
Net Position, End of Year	\$ 63,930,899	\$ 59,197,817

See accompanying notes.

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Statements of Cash Flows
For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash Flows from Operating Activities:		
Cash received from members	\$ 31,670,734	\$ 28,726,080
Cash paid to suppliers	(37,735,922)	(25,754,905)
Cash paid to and for employees	(1,930,533)	(2,067,430)
Loss on disposition of assets	5,434,360	
	<u>(2,561,361)</u>	<u>903,745</u>
Net Cash (Used in) Provided by Operating Activities		
Cash Flows from Capital and Related Financing Activities:		
Regional capital facilities charges	5,447,161	3,805,283
Member withdrawal fees	5,987,134	
Water rights receivable	200,000	
Proceeds from long-term debt	47,824,049	
Payments on long-term debt	(3,812,131)	(3,723,178)
Proceeds from sale of capital assets		200,000
Acquisition of capital assets	(5,505,938)	(19,614,939)
Interest paid on bonds and other long-term debt	(5,066,947)	(5,419,696)
	<u>45,073,328</u>	<u>(24,752,530)</u>
Net Cash Provided by (Used in) Capital and Related Financing Activities		
Cash Flows from Investing Activities:		
Interest received	891,555	464,354
	<u>891,555</u>	<u>464,354</u>
Net Cash Provided by Investing Activities		
Net Change in Cash and Cash Equivalents	43,403,522	(23,384,431)
Cash and cash equivalents, beginning of year	41,172,609	64,557,040
Cash and Cash Equivalents, End of Year	<u>\$ 84,576,131</u>	<u>\$ 41,172,609</u>
Cash and Cash Equivalents Balance is Composed of the Following at December 31:		
Cash and cash equivalents	\$ 10,808,126	\$ 15,766,164
Restricted cash and cash equivalents	73,768,005	25,406,445
	<u>\$ 84,576,131</u>	<u>\$ 41,172,609</u>
Supplemental Disclosure:		
Fixed assets acquired through accounts payable	\$ -	\$ 63,641

See accompanying notes.

CASCADE WATER ALLIANCE

Statements of Cash Flows (Continued)

For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of Operating Income to Net Cash From Operating Activities:		
Net operating income	\$ 1,552,384	\$ 205,979
Adjustments to reconcile change in operating income to net cash (used in) provided by operating activities-		
Depreciation and amortization	968,466	655,224
Loss on disposition of assets	5,434,360	
Changes in operating assets and liabilities-		
Prepaid expenses	(28,128)	(36,648)
Payables related to water rights acquisition	256,041	(328,724)
Payables related to IRS Social Security refund		(294,017)
Payables related to regional capital facilities charges credit repurchase	(10,186,250)	
Retroactive water credit	(558,234)	701,931
Net Cash (Used in) Provided by Operating Activities	<u>\$ (2,561,361)</u>	<u>\$ 903,745</u>

See accompanying notes.

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 1 - Organization and Summary of Significant Accounting Policies

Cascade Water Alliance (Cascade), established on April 1, 1999, converted from a Washington State nonprofit corporation to a Washington State joint municipal utility service corporation on July 12, 2012, in accordance with the Interlocal Cooperation Act (Chapter 39.34) and the Non-Profit Miscellaneous and Mutual Corporations Act (Chapter 24.06) as a public governmental body and an instrumentality of its members. Cascade exercises essential governmental functions by providing wholesale water to meet the current and future water supply needs of its members in a cost-effective and environmentally responsible manner.

Cascade members include the cities of Bellevue, Issaquah, Kirkland, Redmond and Tukwila, along with the Covington Water District, the Sammamish Plateau Water and Sewer District and the Skyway Water and Sewer District.

On December 11, 2012, Covington Water District withdrew as a member from Cascade.

Basis of Accounting - Cascade uses the accrual basis of accounting. Expenses are recorded at the time liabilities are incurred, and revenues are recorded when earned.

Cash and Cash Equivalents - For purposes of the statements of cash flows, Cascade considers all highly liquid instruments purchased with an original maturity of three months or less and investments in the King County Treasurer's Investment Pool to be cash equivalents. Investments in the King County Treasurer's Investment Pool are stated at fair value.

Concentration of Credit Risk - Cascade maintains cash balances at financial institutions that at times exceed federally insured limits. Cascade has not experienced any losses and believes there is minimal risk associated with these excess balances.

As of December 31, 2012, the King County Investment Pool (the Pool) which holds Cascade investments was not rated by a nationally recognized statistical rating organization (NRSRO). In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency securities and mortgage-backed securities, municipal securities (rated at least "A" by two NRSROs), commercial paper (rated at least the equivalent of "A-1" by two NRSROs), certificates of deposit issued by qualified public depositories, repurchase agreements, and the Local Government Investment Pool managed by the Washington State Treasurer's office.

Regional Capital Facility Charges (RCFC) Receivable - Accounts receivable are stated at the amount management expects to collect from outstanding balances. Balances still outstanding after management has used reasonable collection efforts are written off through a charge to change in net position and a credit to accounts receivable.

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 1 - Continued

Capital Assets - Capital assets are recorded at cost. Water systems conveyed to Cascade by bill of sale are recorded at the contributing party's cost, contract price or appraised value. Major expenses for capital assets, including capital leases and major repairs that increase useful lives, are capitalized. Maintenance, repairs, and minor renewals are expensed when incurred. Estimated useful lives for capital assets are as follows:

Computer equipment	5 years
Furniture and equipment	3 - 7 years
Pipelines	50 years

Cascade has elected to use the modified approach of accounting for the Lake Tapps asset. The modified approach allows Cascade to report as expenses in lieu of depreciation, infrastructure expenditures which maintain the asset but do not add to or improve the asset. Additions and improvements to the Lake Tapps asset are capitalized.

For the year ended December 31, 2012, Cascade recorded a disposition of assets of \$5,434,360 relating to the Tacoma Cascade pipeline, as it was determined a segment was less probable to ultimately be put into service due to its complicated property and routing configuration. The disposition is included in nonoperating activities in the statements of revenues, expenses and changes in net position.

Long-Term Debt - Long-term debt is reported net of discounts, premiums and issuance costs. Discounts, premiums and issuance costs incurred on issuance of long-term debt are amortized by the interest method over the period the related debt is outstanding. A portion of the long-term debt is funded by Build America Bonds and is eligible for an annual interest rebate of up to 35%. Effective March 1, 2013, the amount of the subsidy payment issued on or after March 1, 2013 for Build America Bonds will be reduced by 8.7% due to a set of across-the-board cuts to defense and domestic discretionary spending agreed to as a part of Congressional fiscal cliff negotiations in 2012 known as sequestration.

Net Position - Net position is classified in the following three components: 1) Invested in capital assets, net of related debt - This component of net position consists of capital assets, net of accumulated depreciation and amortization and reduced by the outstanding balances of any bonds, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net position component as the unspent proceeds. 2) Restricted - This component of net position consists of restrictions placed on net asset use by external creditors (such as through debt covenants), grantors or contributors. 3) Unrestricted net position - This component of net position consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt." Cascade applies unrestricted and restricted resources to purposes for which both unrestricted and restricted net position is available based on management's discretion.

Revenues and Expenses - Revenues and expenses are distinguished between operating and nonoperating items. Operating revenues result from providing products in connection with the water system and services to members. Operating expenses include the costs associated with providing the products and services, general and administrative expenses and depreciation and amortization on capital assets. All revenues and expenses not meeting these definitions are classified as nonoperating revenues and expenses.

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 1 - Continued

Regional Capital Facilities Charges (RCFC) - RCFCs are paid to Cascade by each member for each new equivalent residential unit connected to its water distribution system, and are intended to allocate growth costs to those members that require capacity increases due to growth in customer demand. The RCFC for both 2012 and 2011 is \$6,005 per new Cascade Equivalent Residential Unit (CERU). During 2011, four Cascade members participated in the RCFC Credit Purchase Program allowing Cascade to purchase RCFC credits at \$2,500 per CERU with the payments made to all four Cascade members in 2012.

Federal Tax Status - Cascade Water Alliance is an authority and instrumentality of its governmental members, organized as a joint municipal utility service corporation pursuant to Washington State's Interlocal Cooperation Act (Chapter 39.34 RCW). As a governmental entity formed by political subdivisions of the State of Washington, it is exempt from federal income taxation under Section 115 of the Internal Revenue Code. As an instrumentality of its members, Cascade may issue obligations, the interest of which is exempt from federal income taxation under Section 103 of the Code.

Use of Estimates - The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures or expenses, as appropriate, during the reporting period. Actual results could differ from those estimates.

Compensated Absences - At termination of employment, employees may receive cash payments for accumulated vacation leave, based on current wages at termination for which an accrual has been provided.

Reclassifications - Certain reclassifications were made to the 2011 financial statements to conform to the current year presentation. The reclassifications have no effect on previously reported operating income or net position.

Note 2 - Capitalizable Contracts

Seattle Water Contract - The Seattle Water Contract entitles Cascade to a specified amount (block) of water each year for a fifty year period ending December 31, 2053. The amount of the block can be amended based on new members joining Cascade or a reduction in water yield available to Seattle due to an order of an appropriate federal or state regulatory agency. The amount of water generally to be supplied to Cascade in each year of the contract is as follows:

<u>Year Beginning</u> <u>January 1,</u>	<u>Year Ending</u> <u>December 31,</u>	<u>Average Daily Demand</u> <u>(million gallons per day-mgd)</u>
2004	2023	30.3
2024	2029	25.3
2030	2034	20.3
2035	2039	15.3
2040	2044	10.3
2045	2053	5.3

CASCADE WATER ALLIANCE

**Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011**

Note 2 - Continued

Amortization of the Seattle Water Contract cost is based on the ratio of water to be supplied in that calendar year to total water to be supplied during the contract. Amortization expense for this contract was \$5,978 and \$5,979 for the years ended December 31, 2012 and 2011, respectively.

At the end of the contract term, Cascade may continue to purchase up to 5.3 million gallons per day (mgd) for members that cannot be economically served by any other means.

In December 2008, this agreement was amended to entitle Cascade to a supplemental block of water as follows:

<u>Year Beginning</u> <u>January 1,</u>	<u>Year Ending</u> <u>December 31,</u>	<u>Average Daily Demand</u> <u>(million gallons per day-mgd)</u>
2009	2017	3.0
2018	2023	5.0

In 2013, the negotiations are being finalized that would extend the contract with Seattle by 10 years, to 2063. The new contract would extend current capacity of 30.3 mgd through 2039 and then ramp down through the remaining years. Under the new contract extension, Cascade would make three scheduled capacity reservation payments to Seattle; the first would be \$5 million in 2013 using bond proceeds, with subsequent payments in 2018 and 2025. Ratification of the new contract is expected in 2013.

The Tacoma Water Contract - In December 2012, a new water contract was signed between City of Tacoma and Cascade which superseded the Tacoma Water Contract signed in 2005. The new contract restructures the prior Tacoma supply contract, and it clarifies Cascade's rights and responsibilities to enable and transfer to specific third parties through a joint offering for the previously purchased capacity. Under the new contract, minimum water purchase volumes have been replaced by a structured capacity reservation schedule, and a new capacity commitment of 8.0 mgd is provided to Cascade through 2042. Cascade is required to make an annual installment payment in a range of \$1 million and \$6.8 million through 2042. Cascade expects to recoup some of the costs that were previously incurred on the 2005 Tacoma Water Contract, and the remaining balance will be written off in 2013.

Costs incurred to obtain the 2005 Tacoma contract consist of system development charges of \$13,736,666 and capacity reservation fees of \$9,420,442 for both years ended December 31, 2012 and 2011.

The system development charges relate to the base amount of water and the capacity reservation fees relate to the additional water to be supplied. The additional water supply will be amortized based on the ratio of the additional water to be supplied in that calendar year to total additional water to be supplied during the contract. Amortization expense for this additional water supply contract was \$357,738 and \$238,492 for the years ended December 31, 2012 and 2011, respectively.

During 2011, City of Bonney Lake has entered into an agreement with Cascade for water rights purchase under the Tacoma Water Contract for a total of \$2,747,334 that expires 2018, with a monthly payment of \$200,000 in 2011 and 2012, and \$391,222 thereafter. At December 31, 2012 and 2011, the water rights receivable of \$2,347,334 and \$2,547,334, respectively, is included in the statements of net position.

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 2 - Continued

Interest Capitalization - Interest costs incurred for the acquisition and/or construction of assets are subject to capitalization based on the guidelines established by generally accepted accounting principles.

Total interest incurred on bonds for the years ended December 31, 2012 and 2011, was \$6,317,946 and \$6,402,939, respectively. No interest was capitalized in 2012. Interest capitalized in 2011 was \$886,197. The interest rebate related to the Build America Bonds was \$1,278,965 and \$1,292,686 for the years ended December 31, 2012 and 2011, respectively, and is included as an offset to interest expense in the statements of revenues, expenses and changes in net position.

Project in Process -

Tacoma Cascade Pipeline - A pipeline extending from the Tacoma Water supply pipelines is under development to connect to the Bellevue Issaquah pipeline and deliver the Tacoma water supply to Cascade members. During the year ended December 31, 2009, management opted to defer completion of this project. The Transmission and Supply Plan was adopted by Cascade in July 2012 (and approved by King County in February 2013 and by the State Department of Health in March 2013) and projects 2024 as the estimated in-service date for this pipeline.

Note 3 - Cash and Cash Equivalents

In accordance with state investment laws, Cascade's governing body has entered into a formal interlocal agreement with Cascade's *ex officio* treasurer, King County, to have all its funds not required for immediate expenditure to be invested in the King County Investment Pool (Pool). Investments in the Pool are stated at the fair value of the Pool's underlying assets. The stated value per share is \$1. The King County Executive Finance Committee provides oversight of the Pool.

As of December 31, Cascade had the following on deposit in the pool:

	<u>2012</u>	<u>2011</u>
Unrestricted cash and equivalents	\$ 17,142,705	\$ 15,786,953
Restricted cash and equivalents	<u>73,552,816</u>	<u>25,343,067</u>
	90,695,521	41,130,020
Add fair value adjustment	269,856	102,299
Less checks in excess of cash	<u>(6,389,246)</u>	<u>(59,710)</u>
Total Cash and Cash Equivalents	<u>\$ 84,576,131</u>	<u>\$ 41,172,609</u>

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 4 - Restricted Cash and Cash Equivalents

In accordance with the bond agreements, separate restricted accounts are required to be established. The assets held in these accounts are restricted for specific uses, including construction, debt service and other special reserve requirements. Current year disbursements from the restricted asset accounts are included in total expenditures in the financial statements.

Restricted cash and cash equivalents are presented in the statements of net position as of December 31 as follows:

	<u>2012</u>	<u>2011</u>
Restricted cash and cash equivalents, current portion	\$ 10,000,000	\$ -
Restricted cash and cash equivalents, long-term	<u>63,768,005</u>	<u>25,406,445</u>
	<u>\$ 73,768,005</u>	<u>\$ 25,406,445</u>

Changes in restricted assets for the year ended December 31, 2012, are as follows:

	<i>Balance</i> <u>12/31/2011</u>	<i>Additions</i>	<i>Disbursements</i>	<i>Interest/ Unrealized Gain</i>	<i>Balance</i> <u>12/31/2012</u>
Revenue bond funds	\$ 18,582,414	\$ 16,150,371	\$(10,150,226)	\$ 230,668	\$ 24,813,227
Construction funds	<u>6,824,031</u>	<u>46,254,169</u>	<u>(4,426,983)</u>	<u>303,561</u>	<u>48,954,778</u>
	<u>\$ 25,406,445</u>	<u>\$ 62,404,540</u>	<u>\$(14,577,209)</u>	<u>\$ 534,229</u>	<u>\$ 73,768,005</u>

Included in this schedule are interest earnings of \$151,502 and unrealized gains of \$79,166 for the revenue bonds funds, and interest earnings of \$167,539 and unrealized gains of \$136,022 for the construction funds.

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 5 - Capital Assets

The following summarizes the changes in capital assets of Cascade:

	<i>Balance</i> <i>12/31/2011</i>	<i>Additions</i>	<i>Transfers</i>	<i>Deletions</i>	<i>Balance</i> <i>12/31/2012</i>
Capital Assets					
Being Depreciated:					
Equipment and furniture	\$ 1,006,701	\$ 38,133	\$ -	\$ -	\$ 1,044,834
Seattle water contract	204,216				204,216
Tacoma water 2005 contract	9,420,442				9,420,442
Tacoma water 2012 contract		119,740,687			119,740,687
SR900 pipeline			10,021,201		10,021,201
Bellevue Issaquah pipeline	22,038,921	10,263			22,049,184
Less accumulated depreciation and amortization	(3,381,361)	(1,092,398)			(4,473,759)
Total Capital Assets Being Depreciated	29,288,919	118,696,685	10,021,201		158,006,805
Capital Assets Not Being Depreciated:					
Lake Tapps - infrastructure	78,806,742	62,368			78,869,110
Tacoma water contract	13,736,666				13,736,666
Tacoma Cascade pipeline	32,495,629	3,143	(10,021,201)	(5,450,348)	17,027,223
Eastside reservoir	262,567				262,567
Total Capital Assets Not Being Depreciated	125,301,604	65,511	(10,021,201)	(5,450,348)	109,895,566
Total Capital Assets	\$ 154,590,523	\$ 118,762,196	\$ -	\$ (5,450,348)	\$ 267,902,371

CASCADE WATER ALLIANCE

**Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011**

Note 5 - Continued

	<i>Restated Balance 12/31/2010</i>	<i>Additions</i>	<i>Transfers</i>	<i>Deletions</i>	<i>Balance 12/31/2011</i>
Capital Assets					
Being Depreciated:					
Equipment and furniture	\$ 825,894	\$ 99,807	\$ 81,000	\$ -	\$ 1,006,701
Seattle water contract	204,216				204,216
Tacoma water contract	9,420,442				9,420,442
Bellevue Issaquah pipeline	22,033,919	5,002			22,038,921
Less accumulated depreciation and amortization	(2,609,348)	(772,013)			(3,381,361)
Total Capital Assets Being Depreciated	29,875,123	(667,204)	81,000		29,288,919
Capital Assets					
Not Being Depreciated:					
Lake Tapps - infrastructure	78,213,463	593,279			78,806,742
Tacoma water contract	16,484,000			(2,747,334)	13,736,666
Tacoma Cascade pipeline	31,595,453	900,176			32,495,629
Other equipment	81,000		(81,000)		
Eastside reservoir	253,215	9,352			262,567
Total Capital Assets Not Being Depreciated	126,627,131	1,502,807	(81,000)	(2,747,334)	125,301,604
Total Capital Assets	\$ 156,502,254	\$ 835,603	\$ -	\$ (2,747,334)	\$ 154,590,523

CASCADE WATER ALLIANCE

**Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011**

Note 6 - Long-Term Debt - Unrestricted

Long-term debt payable from unrestricted assets consisted of the following at December 31:

	<u>2012</u>	<u>2011</u>
<u>Public Works Trust Fund Loans (PWTF):</u>		
\$1,000,000 loan authorized, payable in equal annual principal payments based on the amount of the loan drawn to the payment due date with the first payment due July 2006 and the last payment due July 2025, plus interest at .50%, secured by the net revenue.	\$ 521,797	\$ 563,928
Total long-term debt	521,797	563,928
Less current portion	<u>(48,907)</u>	<u>(40,069)</u>
Long-Term Portion	<u>\$ 472,890</u>	<u>\$ 523,859</u>

The estimated annual debt service requirements on long-term debt, payable from unrestricted assets are as follows:

<i>For the Year Ending December 31,</i>	<u>Principal</u>	<u>Interest</u>
2013	\$ 48,907	\$ 2,560
2014	40,471	2,359
2015	40,673	2,156
2016	40,876	1,953
2017	41,081	1,748
2018 - 2022	208,505	5,640
2023 - 2025	<u>101,284</u>	<u>866</u>
	<u>\$ 521,797</u>	<u>\$ 17,282</u>

CASCADE WATER ALLIANCE

**Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011**

Note 6 - Continued

Long-term debt, payable from unrestricted assets, activity was as follows:

	<i>Balance 12/31/2011</i>	<i>Proceeds</i>	<i>Repayments</i>	<i>Balance 12/31/2012</i>
2012-				
Loan #PW-05-691-PRE-142	\$ 563,928	\$ -	\$ (42,131)	\$ 521,797
	<u>\$ 563,928</u>	<u>\$ -</u>	<u>\$ (42,131)</u>	<u>\$ 521,797</u>
	<i>Balance 12/31/2010</i>	<i>Proceeds</i>	<i>Repayments</i>	<i>Balance 12/31/2011</i>
2011-				
Loan #PW-05-691-PWP-205	\$ 20,000	\$ -	\$ (20,000)	\$ -
Loan #PW-05-691-PRE-142	592,106		(28,178)	563,928
	<u>\$ 612,106</u>	<u>\$ -</u>	<u>\$ (48,178)</u>	<u>\$ 563,928</u>

Note 7 - Long-Term Debt - Restricted

Long-term debt outstanding payable from restricted assets consisted of the following at December 31:

	<u>2012</u>	<u>2011</u>
<u>Revenue Bonds:</u>		
\$42,695,000 issued on December 27, 2012 for restructuring the Tacoma water contract in 2012, extending the Seattle water contract, acquiring independent supply production capacity, funding Lake Tapps capital improvements and cost of issuing the bond. The bond is payable from and secured by a pledge of net revenues and investments held in the bond fund and construction fund; principal due serially through the year 2038, interest payable semi-annually at 3.31 annual percentage rate.	\$ 42,695,000	\$ -
\$80,095,000 issued October 15, 2009 for supporting capital program, providing for a debt service reserve and cost of issuing the bonds. The bonds are payable from and secured by a pledge of net revenues and investments held in the bond fund and construction fund.		
- \$4,940,000 term bonds due September 1, 2016, interest payable semi-annually 3.61 annual percentage rate.	4,940,000	4,940,000
- \$75,155,000 due serially through September 1, 2034, with interest payable semi-annually 3.61 annual percentage rate.	68,620,000	70,910,000

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 7 - Continued

	<u>2012</u>	<u>2011</u>
\$55,230,000 issued May 10, 2006 for supporting capital program, payment for Sammamish Plateau Water and Sewer District Loan and cost of issuing the bonds. The bonds are payable from and secured by a pledge of net revenues and investments held in the bond fund and construction fund.		
- \$29,490,000 due serially through the year 2023, interest payable semi-annually 4.50 to 5.00 annual percentage rate.	21,535,000	23,015,000
- \$8,880,000 term bonds due September 1, 2026, with interest payable semi-annually at 4.75 annual percentage rate.	8,880,000	8,880,000
- \$16,860,000 term bonds due September 1, 2031, with interest payable semi-annually at 5.00 annual percentage rate.	<u>16,860,000</u>	<u>16,860,000</u>
Total long-term debt	163,530,000	124,605,000
Less current portion	<u>(3,875,000)</u>	<u>(3,770,000)</u>
Long-Term Portion	<u>\$ 159,655,000</u>	<u>\$ 120,835,000</u>

The 2012 bonds were issued at a premium of \$5,764,037 which is being amortized over the life of the bonds. Amortization expense for the year ended December 31, 2012 was \$4,756.

The 2009 bonds were issued at a premium of \$761,955 which is being amortized over the life of the bonds. Amortization expense for the years ended December 31, 2012 and 2011, was \$108,612 and \$105,877, respectively.

The 2006 bonds were issued at a premium of \$1,857,106 which is being amortized over the life of the bonds. Amortization expense was \$74,284 for both years ended December 31, 2012 and 2011.

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 7 - Continued

The estimated annual debt service requirements on long-term debt payable from restricted assets are as follows:

<i>For the Year Ending December 31,</i>	<u>Principal</u>	<u>Interest</u>
2013	\$ 3,875,000	\$ 7,172,926
2014	4,990,000	7,940,605
2015	5,125,000	7,751,412
2016	5,375,000	7,499,187
2017	5,640,000	7,229,187
2018 - 2022	31,795,000	31,873,889
2023 - 2027	38,960,000	23,308,106
2028 - 2032	43,910,000	12,612,777
2033 - 2037	21,140,000	2,996,513
2038	2,720,000	68,000
	<u>\$ 163,530,000</u>	<u>\$ 108,452,602</u>

Long-term debt, payable from restricted assets, activity was as follows:

	<u>Balance</u> <u>12/31/2011</u>	<u>Proceeds</u>	<u>Repayments</u>	<u>Balance</u> <u>12/31/2012</u>
2012 Revenue Bonds	<u>\$ 124,605,000</u>	<u>\$ 42,695,000</u>	<u>\$ (3,770,000)</u>	<u>\$ 163,530,000</u>
	<u>Balance</u> <u>12/31/2010</u>	<u>Proceeds</u>	<u>Repayments</u>	<u>Balance</u> <u>12/31/2011</u>
2011 Revenue Bonds	<u>\$ 128,280,000</u>	<u>\$ -</u>	<u>\$ (3,675,000)</u>	<u>\$ 124,605,000</u>

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 8 - Commitments

Lease Commitments - Cascade leases office space under a noncancelable lease agreement expiring in July 2017. The lease calls for payments of \$6,999 per month through August 2012, increasing to \$13,999, for the first year, with additional annual stepped increases after the first year.

Cascade has entered into a five year operating lease agreement for its copier that expires August 2013 with a monthly payment of \$400.

Future minimum rentals as of December 31 under noncancelable operating leases are as follows:

For the Year Ending December 31,

2013	\$ 175,220
2014	176,870
2015	181,716
2016	186,561
2017	<u>111,318</u>
Total Minimum Rental Payments	<u>\$ 831,685</u>

Rent expense for operating leases totaled \$153,613 and \$114,981 for the years ended December 31, 2012 and 2011, respectively.

Contracts - Cascade has entered into contracts with various vendors in relation to ongoing consulting services, construction services and financial services that extend beyond December 31, 2012.

Contracted services agreed to and expected to be received in 2013 include the following:

Construction and design services	\$ 2,365,733
Consulting contracted services	<u>1,790,247</u>
	<u>\$ 4,155,980</u>

Note 9 - Retirement Benefits

Cascade provides a Section 401(a) defined contribution retirement plan to all full-time and certain part-time employees. Employees contribute 4% of their annual salary. Cascade contributes 7% of an employee's salary. In addition, as a replacement of the contribution to Social Security beginning in January 2011, employees contribute an additional 6.2% of their annual salary. Cascade contributes an additional 6.2% up to the IRS limit (\$6,826 in 2012). Employee and employer contributions were \$151,267 and \$165,749, respectively, for the year ended December 31, 2012 and \$123,816 and \$155,675, respectively, for the year ended December 31, 2011.

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 9 - Continued

Cascade also provides a Section 457 retirement plan available to certain employees who make salary deferral contributions up to the maximum allowed by law. Employee contributions were not matched by Cascade for both the years ended December 31, 2012 and 2011 as this plan was completely phased out in 2012. Employee salary deferrals and Cascade matching contributions were \$142,354 and \$0, respectively, for the year ended December 31, 2012 and \$120,133 and \$14,667, respectively, for the year ended December 31, 2011.

Note 10 - Concentrations

All water purchases by Cascade were from the City of Seattle. Water sales, conservation revenues, administration dues, regional capital facilities charges and contributions for member cities in 2012 and 2011 are as follows:

2012 Member Charges-

<u>Members</u>	<u>Water Sales</u>	<u>Water Usage Adjustment</u>	<u>Conservation Revenues</u>	<u>Administration Dues</u>	<u>Regional Capital Facilities Charges</u>	<u>Total</u>
Bellevue	\$ 15,359,764	\$ (444,836)	\$ 516,491	\$ 1,018,414	\$ 1,038,865	\$ 17,488,698
Covington			137,136	270,403		407,539
Issaquah	730,481	(64,334)	88,445	174,395	1,432,193	2,361,180
Kirkland	4,034,694	(184,994)	140,879	277,784	549,458	4,817,821
Redmond	5,057,142	11,311	240,743	474,696	2,071,724	7,855,616
Sammamish	776,136	(42,669)	168,809	332,855	1,474,228	2,709,359
Skyway	311,256		29,458	58,086	156,130	554,930
Tukwila	2,007,447		64,184	126,558	60,050	2,258,239
Total	\$ 28,276,920	\$ (725,522)	\$ 1,386,145	\$ 2,733,191	\$ 6,782,648	\$ 38,453,382

2011 Member Charges-

<u>Members</u>	<u>Water Sales</u>	<u>Water Usage Adjustment</u>	<u>Conservation Revenues</u>	<u>Administration Dues</u>	<u>Regional Capital Facilities Charges</u>	<u>Total</u>
Bellevue	\$ 14,464,877	\$ (789,528)	\$ 482,150	\$ 539,117	\$ 966,805	\$ 15,663,421
Covington			116,578	140,921		257,499
Issaquah	882,306	(65,345)	81,011	90,583	411,344	1,399,899
Kirkland	4,034,665	(170,582)	131,304	146,818	318,265	4,460,470
Redmond	5,438,284	(305,705)	224,870	251,439	842,200	6,451,088
Sammamish	291,019	47,403	156,545	175,041	623,019	1,293,027
Skyway	293,634		27,679	30,949	33,028	385,290
Tukwila	1,877,642		62,510	69,895	18,015	2,028,062
Total	\$ 27,282,427	\$ (1,283,757)	\$ 1,282,647	\$ 1,444,763	\$ 3,212,676	\$ 31,938,756

CASCADE WATER ALLIANCE

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 11 - Stewardship, Compliance, and Accountability

There have been no material violations of finance-related legal or contractual provisions, and there have been no expenditures exceeding legal appropriations.

Note 12 - Subsequent Event

Subsequent to year-end, Cascade entered into an agreement with the City of Auburn to sell a 2.5 MGD System Development Charge credit relating to the 4 MGD of wholesale Water Supply in the 2005 Tacoma contract for \$7,893,300.

Additionally, Cascade entered into a separate agreement with the City of Auburn allowing Auburn the option of purchasing 2.763 MGD worth of system development charge credits of the 6 MGD capacity reservation fee in Cascades 2005 contract with Tacoma. If Auburn elects to purchase all of the 2.763 MGD then the total price would be \$1,427,864 but the actual amount due from Auburn will depend on if they exercise the option before June 30, 2017, and in what quantity they do so.

REQUIRED SUPPLEMENTARY INFORMATION

CASCADE WATER ALLIANCE

Required Supplementary Information For the Years Ended December 31, 2012 and 2011

Modified Approach for White River/Lake Tapps Reservoir Project Infrastructure Capital Assets

In accordance with GASB Statement No. 34, Cascade is required to account for and report infrastructure capital assets. Cascade defines infrastructure as the basic physical assets used by Cascade in the conduct of its business. Each major infrastructure system can be divided into subsystems. For example, the White River/Lake Tapps Reservoir Project (the Lake Tapps Project) can be divided into several distinct facilities: White River divergence; conveyance and sediment control systems; Lake Tapps Reservoir and embankments; outlet structure to forebay; penstocks; hydroelectric station; and tailrace and return to White River. For ease of defining the Lake Tapps Project, these facilities have been consolidated into three main subsystems: Upper Conveyance System (the White River divergence and conveyance and sediment control facilities); Reservoir and Embankments (or the Storage System consisting of the Lake Tapps Reservoir and dike facilities); and Lower Conveyance System (all facilities from the Lake Tapps outlet structure to the tailrace return to the White River). Subsystem detail is not presented in the basic financial statements; however, Cascade maintains detailed information on these subsystems.

Cascade has elected to use the "Modified Approach" as defined by GASB Statement No. 34 for infrastructure reporting for its Lake Tapps Project. Under GASB Statement No. 34, eligible infrastructure capital assets are not required to be depreciated under the following requirements:

- Cascade manages the eligible infrastructure capital assets using an asset management system with characteristics including: (1) an up-to-date inventory; (2) performance of condition assessments and summarization of the results using a measurement scale; and (3) an estimate of the annual amount required to maintain and preserve at the established condition assessment level.
- Cascade documents that the eligible infrastructure capital assets are being preserved approximately at or above the established and disclosed condition assessment level.

Capital Assets Assessment Prior to Cascade Ownership

In September 2006, prior to entering into the Asset Purchase Agreement with PSE, Cascade received an Engineering Report (prepared by CH2MHill for Buck and Gordon, LLP and Cascade) which, among other things, included a Facility Condition Assessment and Capital Improvement Plan for the Lake Tapps Project. The condition assessment was based on a review of available documents (such as design documents, condition inspections conducted by or for PSE and operation and maintenance evaluations), cursory field inspections and observation and interviewing site (PSE) personnel. The report described the condition of major facilities constituting the Upper and Lower Conveyance Systems and recommended improvements. The following categories of improvements were used:

- Initial Capital Upgrade (ICU): Projects need to be completed immediately to allow proper operation, to reduce the rate of deterioration or to protect health and safety (by 2010).
- Short Term Improvement (STI): Projects recommended, but not necessary to maintain the current conditions of facilities (between 2011 and 2018).
- Long Term Improvement (LTI): Projects that should be replaced at the end of their projected useful life (between 2019 and 2050).
- Maintenance (M): Projects typically included in annual maintenance programs.

See independent auditors' report.

CASCADE WATER ALLIANCE

Required Supplementary Information For the Years Ended December 31, 2012 and 2011

The following is a listing of the major Lake Tapps Project facilities in the Upper Conveyance and Lower Conveyance Systems, with the category of facility improvement recommended by CH2MHill in 2006:

Upper Conveyance System

Headworks Area Buildings	M; ICU; STI
Headgates	ICU; LTI
Rock Chutes	STI
Concrete Lined Canal	M
Timber Flume	LTI
6-Foot Outlet (Wolslegal Basin)	None
Fish Screen	STI
Twin Pipelines	M; STI; LTI

Lower Conveyance System

Tunnel Inlet/Lake Outlet	ICU
12-Foot Concrete Tunnel	LTI
"Bear Pit" Overflow Shaft	LTI
Forebay Caisson and Building	M; LTI
Penstocks/Standpipes/Surge Chambers	ICU; STI; LTI
Powerhouse	ICU

In 2008, the Washington Department of Ecology's Dam Safety Office (DSO) published the First Periodic Dam Safety Inspection Report for the Lake Tapps Project (Dikes 1 through 15). DSO inspected the Lake Tapps dikes in August 2007 and the report included an evaluation and analysis of the condition of the dikes and Printz Basin Backflow Prevention Structure.

The DSO report concluded that the dikes and the Backflow Prevention Structure "...appeared to be in good condition, and the project meets current engineering standards for dam design and construction with regard to floods and earthquakes". A few deficiencies were found and are summarized below:

- Refinements are necessary to the monitoring routines for Dikes 9,10 and 12;
- Dike 3 requires improvement to address potential for internal soil erosion, in conjunction with a proposed roadway improvement by Pierce County;
- Discharge capacity of the project may need to be increased to accommodate both the Local and General Storm Probable Maximum Flood;
- Relocating or adding weirs and adding seepage monitoring to Dike 8; and
- Completion of maintenance items, such as vegetation removal.

CASCADE WATER ALLIANCE

Required Supplementary Information For the Years Ended December 31, 2012 and 2011

Capital Assets Assessment Since Cascade Ownership

The Lake Tapps Project has been operated by PSE, under contract to Cascade, since Cascade acquired the Project from PSE in 2009. During this time, Cascade has conducted additional facility condition assessment and repair/maintenance/upgrade activities, including:

- Contracting with AECOM to perform a condition assessment of certain Project facilities;
- Contracting with NAES to repair and upgrade the Fish Screen Facility;
- Contracting with GeoEngineers to assess the condition of the dikes;
- Performing inspections and effecting repairs to the Timber Flume and Twin Pipelines and removal of sediment from the settling basins during the 2010-2011 outage;
- Implementing DSO recommended monitoring routines on Dikes 9,10 and 12;
- Implementing DSO recommendations on Dike 8;
- Demonstrating available discharge capacity;
- Completing PMP/PMF study;
- Performing repairs and inspection of the Barrier Dam in 2010, 2011, and 2012;
- Repairing the ecology block wall on Dike 13 in 2011;
- Repairing Tailrace "wingwall" adjacent to rail road crossing in 2011;
- Performing repairs on Dikes 2B, 3 and 11 in 2012;
- Improving and upgrading Project security (fences, gates, locks, etc.)
- Improving and upgrading gaging stations;
- Repairing pipeline and valve leaks;
- Developing plan for Powerhouse roof replacement;
- Upgrading SCADA system;
- Developing and implementing plan to comply with L&I / DOSH recommendations;
- Removal of hazardous wastes from Powerhouse;
- Performing routine maintenance and repairs on roads; and
- Performing routine vegetation removal.

These activities expanded upon the CH2MHill assessment and implemented some of the recommendations from CH2MHill, AECOM, GeoEngineers and DSO.

CASCADE WATER ALLIANCE

Required Supplementary Information For the Years Ended December 31, 2012 and 2011

Cascade also selected Veolia Water North America (Veolia) as its long-term contract operator for the Project. Veolia entered into the transition phase of the contract in January 2012 (observing PSE operation and training staff) and assumed all operation and maintenance responsibilities on April 16, 2012. During the transition phase (April through December 2012), Veolia, in addition to performing all necessary operation and maintenance activities:

- Developed Operation and Maintenance Manuals for all Project facilities;
- Selected and implement a Maintenance Management System (MMS) for the Project; and
- Developed the 2013 Operations and Maintenance Budget for Cascade's approval.

The manuals and 2013 budget were approved by Cascade and are the basis for Veolia's performance during 2013. The initial contract term is through 2016. Annual revisions to the manuals and budget will be negotiated and agreed upon. Cascade may extend the contract term for up to two additional periods of up to five years each.

Capital Assets Funding

Based on the condition assessment work completed to date, Cascade has included funding for ongoing maintenance and repair of Lake Tapps Project Capital Assets in its annual operating budget as well as funding for upgrading and replacement of Lake Tapps Project Capital Assets in its Capital Improvement Plan (CIP). The Operation and Maintenance Budget and CIP for Cascade's 2013-2014 Biennium are summarized below:

Lake Tapps Project Operation and Maintenance Budget:

2013	\$ 2,553,450
2014	\$ 2,421,450

Lake Tapps Project CIP Budget:

2013	\$ 1,375,000
2014	\$ 3,610,000
2015-2016	\$ 10,435,000
2017-2019	\$ 5,265,000

The Operation and Maintenance Budget and CIP for Cascade's 2013-2014 Biennium were adopted by the Board in September 2012.