Central Puget Sound Regional Transit Authority

Financial Statements and Independent Auditors' Report for the Years Ended December 31, 2017 and 2016

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STATEMENT OF MANAGEMENT'S RESPONSIBILITY

The financial statements of the Central Puget Sound Regional Transit Authority (Sound Transit or the agency) have been prepared from its accounting system in accordance with generally accepted accounting principles. The integrity and objectivity of information in Sound Transit's financial statements, including estimates and judgments, are the responsibility of management.

Sound Transit maintains a system of internal accounting controls designed to provide reasonable assurance as to the integrity and reliability of financial reporting, the safeguarding of assets and the prevention and detection of material errors or fraudulent financial reporting. Monitoring of such systems includes management's responsibility to objectively assess the effectiveness of internal accounting controls and recommend improvements therein.

Limitations exist in any system of internal accounting controls in which the cost of the system being implemented should not exceed the benefits derived. Sound Transit believes that the organization's system does provide reasonable assurance that transactions are executed in accordance with management's general or specific authorizations and is adequate to accomplish the stated objectives.

The independent auditors, whose report is included herein, were engaged to express an opinion on our 2017 financial statements. Their opinion is based on procedures performed in accordance with generally accepted auditing standards, including 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 and evaluating the overall financial statement presentation.

In an attempt to assure objectivity, the financial information contained in this report is subject to review by the Board of Directors.

Peter M. Rogoff
Chief Executive Officer

Michael Trzupek
Interim Chief Financial Officer

Kelly A. Priestley
Deputy Executive Director - Accounting

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MANAGEMENT'S DISCUSSION AND ANALYSIS

For the years ended December 31, 2017 and 2016

Management's Discussion and Analysis (MD&A) presents a narrative overview and analysis of the financial activities of Sound Transit for the years ended December 31, 2017 and 2016. The MD&A is designed to assist readers of financial statements in focusing on significant financial activities and issues and to identify any significant changes. As this information is presented in summary form, it should be read in conjunction with the financial statements and notes to the financial statements as a whole.

Sound Transit is a regional transit authority implementing and operating a high-capacity transportation system throughout parts of King, Pierce and Snohomish counties including commuter rail (Sounder), light rail (Link) and a regional express bus system (ST Express). Established by the legislature in 1993, in 1996 voters approved the initial phase of its System Plan, *Sound Move* – a 10-year regional transit system plan, which authorized tax collections for funding of its operations and the first set of regional transit projects. Then in 2008, the region's voters approved a second phase of the System Plan, *ST2* – a 15-year program authorizing additional tax collections to fund additional bus and commuter rail service, as well as 36 miles of new Link light rail service. Most recently, in 2016, the region's voters authorized additional tax collections, including a property tax, for a third phase of system expansion. *ST3* – a 25-year program, funds 62 new miles of light rail, bus rapid transit, expanded capacity and service on Sounder south line, ST Express bus service and improved access to stations.

The final elements of Sound Move were completed last year with the opening of University and South 200th (Angle Lake) light rail extensions.

Sound Transit's financial statements reflect a growth in net position of $1,292.2 million in 2017 with the implementation of additional ST3 tax revenues authorized by voters and by $747.7 million in 2016 reflecting new planning and the continued build out the agency's capital expansion program approved in the ST2 and ST3 voter approved plan. System expansion continues in all corridors (North, Central, South and East) and across all modes, most significantly light rail. In 2016, Sound Transit opened its University and Angle Lake light rail extensions, adding three additional stations and a parking garage, significantly increasing capacity and ridership. Net loss from operations, also referred to as an operating subsidy, increased 9.7% from 2016, with ridership increasing 9.2%. The capital program and operating subsidy are funded through sales and use tax, rental car tax, motor vehicle excise tax and in 2017 a property tax as well as federal and state grants or other contributions.

Financial Highlights

- Total operating revenues were $96.5 million for 2017, while loss from operations was $353.1 million, an increase of 11.6% and 9.7% respectively, reflecting the full year impact of the opening of University Link in March 2016 and Angle Lake light rail extension in September 2016.
    - Passenger fare revenues grew by $9.7 million or 9.2% on system-wide ridership growth on Link light rail of 4.0 million rides.
    - Operating expenses increased 6.5% and depreciation expenses increased by 17.3%, with the additional light rail service in 2016, as well as increased service capacity and higher operating costs on service operated by Pierce Transit for ST Express.
- Non-operating revenues, net of expenses, were $1,273.4 million, a 46.9% increase from 2016, with the additional ST3 voter approved sales, use and motor vehicle excise tax revenues and a new property tax for an increase of $705.9 million.

- Capital contributions from federal, state and local funding arrangements were $371.9 million, an increase from 2016 or 83.5%, as landbank credits with the Washington State Department of Transportation (WSDOT) were utilized for airspace leases, as well as in payment of State costs incurred for the I-90 Bridge center roadway East Link extension.
- Total net position at December 31, 2017 was $8.6 billion, an increase of 17.7% from 2016 and reflecting the additional tax revenue and continued progress on the voter-approved capital expansion program.

Overview of the Financial Statements

Sound Transit's financial statements are prepared in conformity with U.S. generally accepted accounting principles (GAAP). The 2017 and 2016 financial statements are presented using the economic resource measurement focus and accrual basis of accounting. As Sound Transit comprises a single proprietary fund, no fund level financial statements are shown.

In accordance with GAAP, all revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred. All assets, deferred outflows of resources, liabilities and deferred inflows of resources associated with the operation of Sound Transit are included in the Statements of Net Position, and depreciation and amortization of capital assets is recognized in the Statements of Revenues, Expenses and Changes in Net Position.

The financial statements provide both long term and short term information about Sound Transit's overall financial status as well as Sound Transit's net position, segregated by net investment in capital assets, restricted and unrestricted. Net position is the difference between Sound Transit's assets, deferred outflows of resources, liabilities and deferred inflows of resources and, over time, may serve as a useful indicator of Sound Transit's financial position. The financial statements also include notes that provide additional information that is essential to a full understanding of the information provided.

Financial Analysis

Net Position

Sound Transit's total net position at December 31, 2017 was $8.6 billion, an increase of $1.3 billion or 17.7% from 2016. Total assets increased $1,277.3 million or 12.7% and total liabilities decreased by $19.1 million or 0.7%. The increase in total assets reflects capital program spending, as well as an increase in current assets with the increased tax revenues. See the following table for a summary of Sound Transit's net position.

Statements of Net Position

(in millions)	2017	December 31 2016	2015	% Change 2017-2016	% Change 2016-2015
Assets					
Current assets, excluding restricted assets	$ 1,731.9	$ 1,587.4	$ 1,085.6	9.1%	46.2%
Restricted assets	94.7	89.7	91.6	5.5	(2.1)
Capital assets	9,130.1	8,000.7	7,259.1	14.1	10.2
Other non-current assets	393.6	395.2	389.0	(0.4)	1.6
Total assets	**11,350.3**	**10,073.0**	**8,825.3**	**12.7**	**14.1**
Deferred Outflows of Resources	**37.1**	**41.2**	**45.8**	**(9.9)**	**(10.0)**
Liabilities					
Current liabilities, excluding interest payable from restricted assets	288.2	263.0	205.2	9.6	28.2
Interest payable from restricted assets	23.9	21.8	21.6	9.7	1.1
Long-term debt	2,393.1	2,441.3	2,005.7	(2.0)	21.7
Other long-term liabilities	69.2	67.4	65.4	2.7	3.0
Total liabilities	**2,774.4**	**2,793.5**	**2,297.9**	**(0.7)**	**21.6**
Net Position					
Net investment in capital assets	6,738.6	5,567.4	5,268.7	21.0	5.7
Restricted net position	69.3	66.0	68.2	5.0	(3.2)
Unrestricted net position	1,805.1	1,687.4	1,236.2	7.0	36.5
Total net position	**$ 8,613.0**	**$ 7,320.8**	**$ 6,573.1**	**17.7%**	**11.4%**

Current assets, excluding restricted assets, increased from the prior year by 9.1% in 2017 and 46.2% in 2016. The increase in 2017 relates to higher tax receivables from increased sales and MVET taxes and in 2016 due to higher cash and investments following the issuance of additional parity green bonds. Restricted and other non-current assets remain comparable between 2017, 2016 and 2015.

Capital assets increased 14.1% from 2016 and by 10.2% between 2016 and 2015 as planning and construction spending continued for the expansion projects as well as rehabilitation and replacement fleet activities. Total capital project spending for 2017 was $1,447.1 million (2016 was $892.3 million) reflecting increased construction spending on the East Link extension, the Operations Maintenance Facility East and light rail vehicles for ST2. In 2016 capital spending was 4.4% higher than 2015 as construction ramped up on the East Link extension, design on the Lynwood Link extension, construction of the Point Defiance Bypass project for WSDOT and the Tacoma Trestle Track and Signal replacement project.

In all, total capital spending for light rail was $1,214.9 million or 84.0% of total capital spending ($665.5 million or 74.3% in 2016). Capital spending on Sounder and ST Express projects, as a percentage of total capital spending, was 6.9% and 8.2% respectively (13.9% and 10.9% in 2016), with the decrease in Sounder spending reflecting the completion of the Point Defiance ByPass projects and the Tacoma Trestle Track and Signal replacement projects in 2017.

Transfers out of capital projects in progress were $655.1 million in 2017 while in 2016 they were $1.8 billion with the completion of the University Link and Angle Lake extensions and the start-up of a significant light rail expansion. In 2017, transfers from capital projects in progress included access rights acquired through the Landbank for the I-90 center roadway, land acquisitions, Sounder and ST Express revenue service vehicles as well as additional South 200th and University Link costs. Given the nature of Sound Transit's capital program, transfers out of capital projects in progress can vary significantly from year to year.

Transfers Out of Capital Projects in Progress

(in millions)	For the Year Ended December 31		
	2017	**2016**	**2015**
Transferred to property, vehicles and equipment	$ 376.4	$ 1,786.4	$ 134.3
Contributions to other governments	278.7	6.5	13.0
Total	**$ 655.1**	**$ 1,792.9**	**$ 147.3**

Deferred outflows of resources includes the excess of the price paid on debt refunding and the net carrying amount of the old debt, which is amortized over the remaining life of the old debt or the new debt, whichever is shorter. The amortization is comparable between the years presented.

Total liabilities were comparable between 2017 and 2016 however increased by 21.6% between 2016 and 2015 most significantly due to the issuance of parity green bonds in 2016 for net new proceeds of $400.0 million. Current liabilities increased by 9.6% or $25.2 million in 2017 and by 28.2% or $57.8 million in 2016 as spending on planning, construction and service has increased.

Sound Transit's net position represents the cumulative effect of the excess of revenues over expenses together with the impact of Sound Transit's financing decisions. Net investment in capital assets reflects investment in construction in progress, non-depreciable assets and depreciable assets, net of related debt used in its operations. Restricted net position comprises assets net of liabilities restricted for a specific purpose by a third party. Unrestricted net position is the remainder of assets net of liabilities not invested in capital nor restricted for a specific purpose.

Net Position

(in millions)	December 31			% Total Net Position		
	2017	**2016**	**2015**	**2017**	**2016**	**2015**
Net investment in capital assets	$ 6,738.6	$ 5,567.4	$ 5,268.7	78.2%	76.1%	80.2%
Restricted net position	69.3	66.0	68.2	0.8	0.9	1.0
Unrestricted net position	1,805.1	1,687.4	1,236.2	21.0	23.0	18.8
Total	**$ 8,613.0**	**$ 7,320.8**	**$ 6,573.1**	**100.0%**	**100.0%**	**100.0%**

Net investment in capital assets increased 21.0% from 2016 and 5.7% between 2016 and 2015 as capital program spending continues, net of debt issuances. Restricted net position is comparable between years presented. Unrestricted net position increased by 7.0% in 2017 and 36.5% in 2016 and reflects the increase in cash and investments from the higher taxes in 2017 and the bond issuance in 2016, however as a percent of total net position declined by 2.0% as investments in capital assets weren't funded with debt in the current year.

Changes in Net Position

Changes in net position reflect the excess of revenue over expenses for a year. In 2017, revenues exceeded expenses by $1,292.2 million, an increase from the prior year of 72.8% with implementation of additional and new taxes approved by the voters with the ST3 ballot initiative. In 2016 revenues exceeded expense by $747.7 million or an 8.2% increase from 2015, as a higher loss from operations was more than offset by higher tax revenues and capital contributions from federal grants. Sound Transit's Statement of Revenue, Expenses and Changes in Net Position is summarized in the table below.

Changes in Net Position

(in millions)	For the Year Ended December 31			% Change	
	2017	**2016**	**2015**	**2017-2016**	**2016-2015**
Operating revenues					
Passenger fares	$ 90.3	$ 80.6	$ 65.4	12.1%	23.1%
Other	6.2	5.9	6.6	4.2	(9.8)
Total operating revenues	**96.5**	**86.5**	**72.0**	**11.6**	**20.1**
Operating expenses					
Total operating expenses, before depreciation	289.2	271.6	228.2	6.5	19.0
Depreciation	160.4	136.7	105.1	17.3	30.1
Total operating expenses	**449.6**	**408.3**	**333.3**	**10.1**	**22.5**
Loss from operations	**(353.1)**	**(321.8)**	**(261.3)**	**9.7**	**23.2**
Non-operating revenues, net of expenses	1,273.4	866.8	816.0	46.9	6.2
Income before capital contributions	**920.3**	**545.0**	**554.7**	**68.9**	**(1.8)**
Capital contributions	371.9	202.7	136.1	83.5	48.9
Change in net position	**1,292.2**	**747.7**	**690.8**	**72.8**	**8.2**
Total net position, beginning	7,320.8	6,573.1	5,882.3	11.4	11.7
Total net position, ending	**$ 8,613.0**	**$ 7,320.8**	**$ 6,573.1**	**17.7%**	**11.4%**

Operating Revenues

Operating revenues are comprised of passenger fares and other revenue related to operations, such as advertising, rental of transit facilities to other transit agencies, and operating contributions from local, state and federal sources.

Passenger Fare Revenue

Passenger fares are derived from the sale of Sounder commuter rail and Link light rail tickets at ticket vending machines (TVMs), fare box receipts on ST Express, and use of One Regional Card for All (ORCA) products on all modes. Fares are charged on each service, except Tacoma Link. Passenger fare revenue increased in 2017 by 12.1% and 23.1% in 2016 primarily due to the opening of the University Link and Angle Lake light rail extensions in March and September 2016, respectively. Continued growth in ridership on Link and Sounder in conjunction with a higher average fare per boarding (AFB) on all modes contributed to the increase. Link in 2017 became the largest revenue-generating mode for the first time providing 42.1% of total passenger fare revenue, ST Express contributed 41.3% and Sounder commuter rail contributed 16.6% of total passenger fare revenue, respectively.

Passenger fare revenue by mode are as follows:

Passenger Fare Revenue

(in millions)	2017	2016	2015	% Change 2017-2016	% Change 2016-2015
Link	$ 38.0	$ 30.8	$ 18.2	23.5%	69.1%
ST Express	37.3	36.2	35.3	3.0	2.5
Sounder	15.0	13.6	11.9	10.8	14.1
Total	**$ 90.3**	**$ 80.6**	**$ 65.4**	**12.1%**	**23.1%**

Ridership

Sound Transit provided 46.8 million rides in 2017, an increase of 9.2% from 2016 and reflects the full year impact on Link light rail ridership with the opening of the University Link extension in March 2016 and the Angle Lake extension in September 2016. The more densely populated Capitol Hill neighborhood continues to attract ridership on Link. Continued economic growth in Sound Transit's service area and increased congestion contributed to increased ridership on the light and heavy rail fixed route modes. Changes in ridership by mode were as follows:

- Link ridership increased 20.1% from 2016 and 60.4% between 2016 and 2015. The growth reflects the opening of the University Link extension in March 2016, servicing the high-density area of Capitol Hill and the opening of the Angle Lake extension in September 2016, together with the addition of a parking garage at the Angle Lake station, adding capacity to the southernmost terminus.

- ST Express ridership was comparable to 2016 and 2015. Capacity was added in 2017 and, more significantly in 2016, to address overcrowding, alleviate East Link construction impacts and to connect to the new light rail service from the University of Washington. A mature service, some ridership has shifted to Sounder, a service not impacted by traffic congestion.

- Sounder commuter rail ridership increased 3.1% in 2017 and by 11.9% in 2016, reflecting job growth in the local economy, increased congestion, and increased capacity from the addition of an additional mid-day round trip in September 2017 and 2016 on the South Line between Lakewood and Seattle.

A summary of the ridership by year and mode of transportation are as follows:

Ridership					
(in millions)				**% Change**	
	2017	**2016**	**2015**	**2017-2016**	**2016-2015**
Link	24.0	20.0	12.5	20.1%	60.4%
ST Express	18.4	18.5	18.3	(0.5)	0.9
Sounder	4.4	4.3	3.9	3.1	11.9
Total	**46.8**	**42.8**	**34.7**	**9.2%**	**23.6%**

Average Fare per Boarding

The combined AFB increased by 2.5% in 2017 in part due to ST Express and Sounder fare changes that went into effect in March 2016 being in place for all of 2017. In March 2016, ST Express fares were increased by $0.25 for adult, youth and reduced fare riders with the implementation of a low income adult fare to ST Express. In March 2016, a low income adult fare was also introduced on Sounder along with a base fare increase of $0.50 (from $2.55 to $3.05) for adult and youth, and $0.25 for reduced fare riders. The AFB was comparable between 2016 and 2015, however, increased ridership on the lower fare service Link light rail offset a higher AFB and ridership on the higher fare Sounder service.

Average Fare per Boarding					
				% Change	
	2017	**2016**	**2015**	**2017-2016**	**2016-2015**
Link	$ 1.65	$ 1.61	$ 1.58	2.6%	2.0%
ST Express	2.03	1.96	1.93	3.5	1.5
Sounder	3.38	3.15	3.09	7.5	1.9
Combined average fare per boarding	**$ 1.97**	**$ 1.92**	**$ 1.94**	**2.5%**	**(1.0)%**

Other Operating Revenues

Other operating revenues consist of vehicle advertising, insurance recoveries, rental of facilities, operating grants and other miscellaneous revenue.

Operating Expenses

Operating expenses are comprised of operations and maintenance costs, agency administration, fare and regional planning, and depreciation and amortization. Major operations and maintenance expense categories consist of services, materials, utilities, insurance, taxes, and purchased transportation, allocated overhead from general and agency administration divisions and operating leases and rentals. Purchased transportation includes amounts paid to Community Transit, King County Department of Transportation (DOT) and Pierce Transit who operate Sound Transit's express bus service, King County DOT Rail Division, which operates Link light rail and associated paratransit services and to BNSF, which operates Sounder commuter rail. Purchased transportation services accounts for 58.3% of this category in 2017 (58.4% in 2016). Services are the next largest expenditure category and include the Sounder vehicle maintenance, contracted to Amtrak, and various contracts for facilities maintenance, King County Sherriff policing services and security at Sound Transit's owned and shared facilities. Services were 20.0% in 2017 (19.7% in 2016) of total operating and maintenance expenses.

The following two sections discuss changes in operating expenses, first by function, then by mode.

Operations and Maintenance Expenses by Function

Operations and maintenance expenses by function are classified using National Transit Database (NTD) definitions as prescribed by the Federal Transit Administration into vehicle operations, vehicle maintenance and non-vehicle maintenance and include allocated general administration costs. Vehicle operations expense consists of fuel, costs to dispatch and operate vehicles while in revenue service, including security and fare collection. Vehicle maintenance expense includes costs associated with ensuring the revenue vehicles are operational, fueled, inspected, repaired and remain in state of good repair. Non-vehicle maintenance expense includes costs necessary to ensure buildings, equipment, and transit structures and systems are operational.

Operations and maintenance expenses increased $20.0 million or 8.0% in 2017 and $38.2 million or 17.9% in 2016. Both years reflect the impact of opening University Link in March 2016 and the Angle Lake extension in September 2016, which included three stations and a parking garage. Higher insurance and overhead costs also impacted 2016 expenses compared to prior year. ST Express purchased transportation costs also increased in both years with increased service and higher operating costs in 2017 on service operated by Pierce Transit.

See the following table for the operating and maintenance expense impact by function.

Operations and Maintenance Expenses by Function

(in millions)	2017	2016	2015	% Change 2017-2016	% Change 2016-2015
Vehicle operations	$ 160.0	$ 148.4	$ 126.7	7.8%	17.1%
Vehicle maintenance	57.4	55.7	49.1	3.2	13.5
Non-vehicle maintenance	53.8	47.1	37.2	14.1	26.5
Total	**$ 271.2**	**$ 251.2**	**$ 213.0**	**8.0%**	**17.9%**

All functional categories increased in 2017 and 2016 with the full year effect of opening University Link and Angle Lake services, stations and garage, as well as higher cost for purchased transportation on ST Express. Major impacts by functional category in 2017 are as follows:

- Vehicle operations expenses increased by $11.6 million and reflect higher purchased transportation and utility costs as additional operators and traction power are required for the expansion of Link light rail, additional bus service hours and bus operating partner rate increases as well as increased security requirements for the expanded Link alignment and stations. ST Express provided 785 thousand annual service hours in 2017, 765 thousand annual service hours in 2016 and 728 thousand annual service hours in 2015. The increased hours provided additional capacity to alleviate overcrowding, mitigate impacts from East Link construction and to offset the negative impacts of traffic congestion necessary to maintain the schedule. In 2016, new bus connections to University Link were created. Sounder service expanded on the south-line adding one additional round trip in September 2016 and two additional round trips in September 2017.

- Vehicle maintenance expenses increased by $1.7 million or 3.2%. While service has expanded as the additional vehicles necessary to provide the service are newer, fleet maintenance costs increased at slower rate in 2017 and were favorably impacted by insurance recoveries related to repairs incurred in prior years. In 2016, vehicle maintenance costs reflected the expanded service on Link light rail and the 37 thousand additional service hours added on ST Express.

- Non-vehicle maintenance expenses increased $6.7 million in 2017 and by $9.9 million in 2016, as additional facilities came on line with the opening of the University Link and Angle Lake service and the agency was responsible for a higher share of costs associated with the use of the Downtown Seattle Transit Tunnel to meet increased Link headways. Overall maintenance costs for the tunnel also increased, as well as at the Tacoma Dome Station. Non-vehicle maintenance costs may fluctuate from year to year depending upon major facility repair projects. Significant repair projects in 2017 included Sounder maintenance of way, elevator maintenance and in 2016 a maintenance project at the Lakewood garage.

Operations and Maintenance Expenses by Mode

The following table presents operating and maintenance expenses by mode:

Operations and Maintenance Expenses by Mode

(in millions)				% Change	
	2017	**2016**	**2015**	**2017-2016**	**2016-2015**
Link	$ 100.4	$ 88.8	$ 64.3	13.1%	37.9%
ST Express	125.0	117.6	108.1	6.4	8.8
Sounder	45.8	44.8	40.6	2.1	10.4
Total	**$ 271.2**	**$ 251.2**	**$ 213.0**	**8.0%**	**17.9%**

Link operations and maintenance expenses include both Link and Tacoma Link light rail and increased $11.6 million or 13.1% in 2017. This increase reflects the opening of the University Link in March 2016 and the Angle Lake extensions in September 2016, which included extending service by 4.7 miles, adding three stations and a parking garage at Angle Lake. With these extensions, two of the Northwest's most densely populated areas, Capitol Hill and the University of Washington, are now connected by light rail, as well as the South King County communities of Kent, Normandy Park, Federal Way and Des Moines through the Angle Lake Station in SeaTac. Ridership far exceeded initial expectations, requiring an increase in the number of three car trains from two car trains during peak hours.

ST Express operations and maintenance expenses increased $7.4 million or 6.4% in 2017, due to additional service hours added in 2017 and 2016, as well as increased purchased transportation costs in 2017 from all three bus partners and most significantly from King County Metro and Pierce Transit who operate the largest share of Sound Transit's express bus service. Starting in March 2016, 37 thousand annual express bus hours were added (44 weekday or mid-day trips) together with the addition of double decker busses to mitigate increasingly crowded conditions on the commuter bus service and to maintain the schedule amidst worsening traffic congestion. In 2017, 20 thousand annual service hours were added primarily to alleviate impacts of East Link construction and park and ride closures. Major service changes included a new route 541 connecting Overlake Village Park-and-Ride/Overlake Transit Center with the University of Washington Link Station over State Route 520 bridge and mid-day service was added on State Route 542.

Sounder operations and maintenance expenses increased by $1.0 million or 2.1% in 2017 and by 10.4% in 2016. Service changes over the past two years include two additional round trips in 2017 on the South Line between Lakewood and Seattle an additional round trip in 2016 in September of each year, the addition of 9 new cab cars to support the increased service as well as cost increases in insurance, contracted maintenance and structural contracts in 2016.

Agency Administration

Agency administration expenses are comprised of costs not allocated to capital projects or operations and in 2017, 2016 and 2015 includes only costs attributable to the general cost of government, such as the costs of the Chief Executive Office, public relations and agency costs over or under allocated. Agency administration expenses increased by $2.6 million in 2017 and by $3.0 million in 2016. Since 2015 additional staffing and service costs have been incurred in support of the agency's growth as well as the creation of the Office of Equal Employment Opportunity, Equity and Inclusion to better support the agency's mission.

Fare and Regional Planning

Fare and regional planning expense of $7.3 million ($12.2 million in 2016), includes regional fare planning, policy research and development, and planning with regional agencies to develop new markets and policies regarding regional and system-wide projects and issues. These costs have decreased with the passage of the ST3 ballot measure in 2016 and the planning work necessary for that process, however were higher in 2016 from 2015 by $2.2 million due to election expenses for the ST3 ballot measure.

Depreciation and Amortization

Depreciation and amortization comprises non-cash expenses that reflect the reduction in the value of capital assets over time. In 2017, depreciation and amortization increased $23.7 million or 17.3% and by $31.6 million or 30.1% in 2016 reflecting the increase in capital assets put into service in 2016, which included the University Link (March 2016) and Angle Lake (September 2016) extensions, three stations and a parking garage.

Non-Operating Revenues (Expenses)

Net non-operating revenues increased by $406.6 million or 46.9% in 2017 and by $50.8 million or 6.2% between 2016 and 2015. Tax revenues are the largest component of non-operating revenues (expenses), and increased significantly in 2017 with the implementation of ST3 tax revenues and strong regional economic growth. Net non-operating revenues (expenses) are summarized as follows:

(in millions)				% Change	
	2017	**2016**	**2015**	**2017-2016**	**2016-2015**
Non-operating revenues					
Sales and use tax	$ 1,119.7	$ 749.7	$ 699.1	49.3%	7.2%
Motor vehicle excise tax	280.4	85.5	79.5	227.9	7.5
Property tax	140.9	-	-	100.0	-
Rental car tax	3.6	3.5	3.3	1.2	6.4
Investment income	16.9	12.6	5.1	33.8	146.4
Other revenues	18.5	29.8	51.4	(37.8)	(42.1)
Total	**1,580.0**	**881.1**	**838.4**	**79.3**	**5.1**
Non-operating expenses					
Contributions to other governments	279.3	4.7	18.0	5,814.6	(73.8)
Interest expense	15.6	1.7	1.8	782.8	(1.8)
Other expenses	9.4	9.9	2.6	(5.1)	272.7
Loss (gain) on disposal of assets	0.4	(2.0)	-	(118.4)	200.0
Impairment	1.9	-	-	100.0	-
Total	**306.6**	**14.3**	**22.4**	**2,036.8**	**(36.1)**
Non-operating revenues, net	**$ 1,273.4**	**$ 866.8**	**$ 816.0**	**46.9%**	**6.2%**

Sales and Use Tax revenues increased by 0.5% from 0.9% to 1.4%, effective April 1, 2017. As a result year over year sales and use tax revenues in 2017 increased by $370.0 million or 49.3%. Excluding the impact of the increase in rate, sales tax would otherwise have increased by 4.6%, in 2017 while in 2016 sales and use tax revenues increased by $50.6 million or 7.2%. Sales tax continues to be fueled by strong regional economic growth, particularly in the retail trade, construction, accommodation and food services sectors.

An additional 0.8% Motor Vehicle Excise Tax (MVET) was implemented in March of 2017 for a total MVET of 1.1% assessed annually on renewals. As a result, MVET increased by $194.9 million in 2017 or 227.9%. Excluding the impact of the additional MVET tax, MVET would otherwise have increased by 3.5% in 2017 while in 2016 it grew by $6.0 million or 7.5%. In positive economic conditions, consumers are more likely to replace existing or purchase additional vehicles. As the Motor Vehicle Excise Tax is computed on the depreciated vehicle value, this results in a higher average collected tax, as newer vehicles tend to have greater taxable values.

Also authorized by the ST3 ballot measure was a new property tax of $0.25 per $1,000 of assessed property value, resulting in $140.9 million of revenue in 2017.

Investment income increased in 2017 and 2016 as cash balances increased with the 2016 and 2015 debt issuances, as well as an increase interest rates in 2017. Investment income includes the impact of market adjustments to fair market value at year-end, reflecting market conditions. Other non-operating revenues were $18.5 million while they were $29.8 million in 2016 and $51.4 million in 2015. In both 2017 and 2016, the agency received federal operating grants for preventative maintenance on Link light rail and ST Express, which were lower in 2017 due to a change in the appropriation of preventative maintenance funding.

Non-operating expenses increased by $292.3 million in 2017 of which $273.9 million related to the substantial completion of Phase 3 I-90 bridge two-way transit and HOV lane and $13.9 million to interest expense. The agency receives credit from WSDOT under the landbank agreement for funding such highway purpose improvement projects incurred which can be used for portions of property to Sound Transit for non-highway use, see also note 12. Contributions to others are dependent upon the timing and scope of project activities. As such, there may be significant fluctuations from year to year depending upon the timing and scope of capital improvement or funding arrangements for other governments. Interest expense increased as the agency's outstanding borrowing increased at the end of 2016 and not all interest was capitalized in 2017. Interest incurred in 2017 was $97.6 million as compared to $84.2 million in 2017, while interest capitalized was comparable between years ($82.0 million in 2017; and $82.5 million in 2016).

Capital Contributions

Capital contributions include federal grant funding and state and local contributions to Sound Transit. Capital contributions increased in 2017 by $169.2 million or 83.5% and by $66.6 million or 48.9% in 2016 as a result of utilization of WSDOT Landbank credits for airspace leases. The following table summarizes capital contributions by major category.

Capital Contributions

(in millions)	2017	2016	2015	% Change 2017-2016	% Change 2016-2015
Federal	$ 77.4	$ 142.6	$ 132.2	(45.7)%	7.8%
State and local governments	294.5	60.1	3.9	390.4	1,448.3
Total	**$ 371.9**	**$ 202.7**	**$ 136.1**	**83.5%**	**48.9%**

Federal capital contributions of $77.4 million in 2017 were 45.7% lower than 2016 with the completion of the University Link project in 2016 and a decrease in eligible expenditures on the Tacoma Point Defiance Bypass as that project approaches completion in 2018. Tacoma Point Defiance Bypass project spending peaked in 2016 resulting in federal drawdowns on the grant agreement being 7.8% higher than in 2015. The agency is currently pursuing full funding grant agreements on the Lynnwood Link and Federal Way extensions and is authorized for New Starts federal funding on the Tacoma Link extension, which is in final design. Starting in 2015 the agency has also secured federal assistance through the Federal Transportation Infrastructure Finance and Innovation Act (TIFIA) program, however the benefits of this program is in access to lower interest rates, rather than federal capital contributions (see note 8).

Projects receiving funding in excess of $5.0 million in 2017 included Tacoma Point Defiance Bypass and D to M street track construction, while in 2016 they included Tacoma Point Defiance Bypass, University Link, Northgate Link, Sounder Commuter Rail Easements and Tacoma Trestle Track and Signal.

State and local government contributions increased $234.4 million in 2017 and $56.2 million in 2016. In 2017 landbank credits from WSDOT were utilized for improvements, temporary construction easements and an airspace lease on the I-90 Center Roadway while in 2016 they were utilized for temporary construction easements on the SR-520 Roadway, both related to East Link (see also note 12).

Capital Assets

As of December 31, 2017, Sound Transit had invested $9.1 billion in capital assets, net of accumulated depreciation and amortization, of which $4.8 billion are depreciable assets in service. This represents a $1.1 billion or 14.1% increase over 2016. The largest increase was in access rights, which increased $113.5 million or 30.9% and non-depreciable assets, which includes land and capital projects in progress increased $934.4 million or 27.8%.

A summary of Sound Transit's capital assets are presented in the following table.

Capital Assets, net

(in millions)	December 31			% Change	
	2017	**2016**	**2015**	**2017-2016**	**2016-2015**
Land	$ 753.2	$ 631.7	$ 543.8	19.2%	16.1%
Permanent easements	541.5	520.1	489.4	4.1	6.3
Capital projects in progress	3,001.6	2,210.1	3,110.8	35.8	(29.0)
Total non-depreciable assets	**4,296.3**	**3,361.9**	**4,144.0**	**27.8**	**(18.9)**
Buildings, transit facilities & heavy equipment	3,900.6	3,826.4	2,274.0	1.9	68.3
Access rights	481.3	367.8	380.7	30.9	(3.4)
Revenue vehicles	446.8	438.3	453.3	1.9	(3.3)
Software, furniture, equipment & vehicles	5.1	6.3	7.1	(19.2)	(10.1)
Total depreciable assets	**4,833.8**	**4,638.8**	**3,115.1**	**4.2**	**48.9**
Total capital assets, net	**$ 9,130.1**	**$ 8,000.7**	**$ 7,259.1**	**14.1%**	**10.2%**

In 2017, spending on capital projects in progress was $1,447.1 million while in 2016 it was $892.3 million. Project spending on light rail projects increased by 82.5% as construction spending increased on the Northgate Extension where all three stations are under construction; acquisition of temporary construction easements from WSDOT on East Link as construction activities commence on that extension and acquisition of land for the Lynnwood Link extension. Other project spending in 2017 included Sounder Point Defiance and Tacoma Trestle projects as well as bus acquisitions. In 2016, significant project activity occurred on the same light rail extension projects and Sounder projects, however the Northgate extension was the only expansion project in the construction phase.

Capital projects that incurred major spending activity in 2017 and 2016 are summarized in the following table.

Year	Sounder	Link	ST Express
2017	Point Defiance By-Pass Sounder Vehicle Maintenance Tacoma Trestle Track Signal	Downtown Redmond Link Extension East Link (International District to Overlake) Federal Way Link Extension Lynnwood Link Extension - Northgate Station - Lynnwood Transit Center Northgate Link Extension - UW Station to Northgate Station - Tunnel Operations Link Operations & Maintenance Facility - East Link Rail Vehicle – Fleet Expansion Tacoma Link Extension	I-90 Two-Way Transit and HOV Lanes Stage 3 ST Express Fleet Replacement
2016	Positive Train Control Tacoma Trestle Track Signal Point Defiance By-Pass Sounder South Expanded Service Sounder Vehicle Maintenance	East Link (International District to Overlake) Federal Way Link Extension Lynnwood Link Extension - Northgate Station - Lynnwood Transit Center Northgate Link Extension - UW Station to Northgate Station - Tunnel Operations South 200th Link Extension University Link - Maintenance of Way Building - Stations	I-90 Two-Way Transit and HOV Lanes Stage 3 ST Express Fleet Replacement

See note 6 to the Financial Statements for additional information about Sound Transit's capital assets.

Long-Term Debt

In June 2017, Sound Transit executed the second loan under the TIFIA Master Credit Agreement with the United States Department of Transportation for the Operations and Maintenance Facility East project for up to $87.7 million with a fixed rate of 2.73% to fund a portion of that project's costs. Sound Transit had entered into the Master Credit Agreement in December 2016 with a contingent commitment of up to $1.99 billion for a program of four loans for: the Northgate Link Extension, Lynnwood Link Extension, Federal Way Extension and the Operations and Maintenance Facility East. Concurrent with the execution of the TIFIA Master Credit Agreement, Sound Transit executed the first loan under the TIFIA Master Credit Agreement for the Northgate Link Extension for a loan of up to $615.3 million with a fixed rate of 3.13% to fund a portion of the project costs for that extension. With the closing of the Master Credit Agreement and the Northgate TIFIA Loan, S&P upgraded Sound Transit's TIFIA loans to A+ and Fitch upgraded the TIFIA loans to AA+.

Prior to entering into the TIFIA Master Credit Agreement, Sound Transit had entered into a $1.33 billion TIFIA loan with a fixed rate of 2.38% in January 2015, funding a portion of the project costs for the East Link Extension. At December 31, 2017, no TIFIA loans have been drawn on, with the first draw on the Northgate Link Extension loan occurring subsequent to year end.

In December 2016, Sound Transit issued additional Parity Bonds of $400.0 million of fixed rate Sales Tax and Motor Vehicle Excise Tax Bonds. These bonds represent the second issuance of Green Bonds financing projects that adhere to Sound Transit's Sustainability Plan. With the addition of the 2016 Parity Bonds, S&P affirmed the Prior Bonds' AAA rating, removed the negative outlook from the Parity Bonds AAA rating and Moody's upgraded Sound Transit's Prior Bonds to Aaa and the Parity Bonds to Aa1.

Under state law, issuance of bonds payable from any type of taxes is subject to statutory debt limitations. Sound Transit is currently authorized to incur debt in an amount equal to 1.5% of the value of taxable property within the service area, without securing voter approval for bonds. With the approval of 60.0% of the region's voters, Sound Transit may incur aggregate indebtedness of up to 5.0% of the value of taxable property within the service area. Based on the 2016 assessed valuations for collection of 2017 taxes, Sound Transit's current non-voter approved remaining debt capacity is $5.3 billion and its additional remaining debt capacity subject to voter approval is $27.8 billion.

Economic Conditions

Sound Transit diversified and increased its tax base in 2017 with the voter approval of the ST3 Regional Transit System Plan ballot measure. ST3 taxes authorized for the first time a property tax, as well as tax rate increase for sales and use tax and an additional motor vehicle excise tax. Property tax was levied at the maximum permissible rate of $0.25 per $1,000 of assessed property value. Statutorily property tax levies in future years cannot exceed 101 percent of the prior year's total plus the value of new additions.

Retail trade remained strong and is the largest industry sector generating 39% of sales taxes, followed by the construction sector at 21% and accommodation & food services sector at 11%. Together, these three industries generated 71% of all sales taxes within the Sound Transit district.

Regional employment for 2017 is estimated to have increased another 2.9%, after 3.2% growth in 2016, while the projected unemployment rate of 4.0%, is lower than last year's 4.6%.

The Puget Sound region has experienced relatively mild price increases for general goods and services. Inflation for the region has risen to 3%, up from 2.2% last year. However, the region has experienced one the of highest property appreciation of any major U.S. city in 2017 and construction prices also appear to be higher than prior periods. Construction costs are projected to rise 5.3% during 2018, while up 2.4% in 2017. Sound Transit's land acquisition costs grew 6.5% from 2016 to 2017, and is expected to rise 10.6% from 2017 to 2018. These inflation increases are assumed in Sound Transit's long-range finance plan.

These inflation rates are a risk for Sound Transit. It is possible that Seattle's construction and real estate markets will continue to boom. Higher inflation than planned will further increase construction costs and acquisition costs, as well as operating labor costs. Historically, retail sales and use tax, the agency's primary revenue source, has risen with general price levels partially mitigating this risk.

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KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

Independent Auditors' Report

Audit and Reporting Committee
Central Puget Sound Regional Transit Authority

We have audited the accompanying financial statements of the Central Puget Sound Regional Transit Authority (a public corporation acting under the service name of Sound Transit) as of and for the years ended December 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise Sound Transit's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; 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 audit. We conducted our audit 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sound Transit as of December 31, 2017 and 2016, and the changes in financial position, and where applicable, cash flows thereof for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG

Other Matter

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 1 through 15 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.

KPMG LLP

Seattle, Washington
May 23, 2018

STATEMENTS OF NET POSITION

(in thousands)	December 31 2017	December 31 2016
ASSETS		
Current assets		
Cash and cash equivalents (note 3)	$ 266,405	$ 313,993
Restricted assets (note 3)	63,782	58,461
Investments (note 3)	1,134,799	1,051,907
Taxes and other receivables (note 4)	289,908	190,116
Inventory, land for disposition and prepaids	40,822	31,392
Total current assets	**1,795,716**	**1,645,869**
Non-current assets		
Restricted assets (note 3)	30,860	31,237
Investments (note 3)	323,311	320,494
Prepaid expenses and deposits	7,420	12,835
Investment held to pay capital lease obligation (note 5)	62,832	61,916
Capital assets, net (note 6)	9,130,085	8,000,743
Total non-current assets	**9,554,508**	**8,427,225**
Total assets	**11,350,224**	**10,073,094**
Deferred outflows of resources		
Unamortized costs on bond refunding	**37,130**	**41,190**
LIABILITIES		
Current liabilities		
Cash overdraft	6,603	-
Accounts payable and accrued liabilities (note 7)	229,535	213,926
Unearned revenue	10,713	9,652
Interest payable from restricted assets	23,906	21,793
Current portion, long-term debt (note 8)	35,560	33,235
Other claims and short-term obligations	5,822	6,202
Total current liabilities	**312,139**	**284,808**
Non-current liabilities		
Long-term debt (note 8)	2,393,064	2,441,340
Capital lease obligations (note 5)	62,832	61,916
Other long-term obligations (note 9)	6,359	5,462
Total non-current liabilities	**2,462,255**	**2,508,718**
Total liabilities	**2,774,394**	**2,793,526**
Commitments and contingencies (notes 5, 8, 9, 11 and 12)		
NET POSITION		
Net investment in capital assets	6,738,590	5,567,358
Restricted (note 10)	69,324	66,035
Unrestricted	1,805,046	1,687,365
Total net position	**$ 8,612,960**	**$ 7,320,758**

See accompanying notes to financial statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

(in thousands)	December 31 2017	December 31 2016
Operating revenues		
Passenger fares	$ 90,339	$ 80,563
Other operating revenue	6,183	5,934
Total operating revenues	**96,522**	**86,497**
Operating expenses		
Vehicle operations	160,031	148,386
Vehicle maintenance	57,427	55,669
Non-vehicle maintenance	53,772	47,114
Agency administration	10,678	8,180
Fare and regional planning	7,269	12,210
Depreciation, amortization and accretion	160,428	136,748
Total operating expenses	**449,605**	**408,307**
Loss from operations	**(353,083)**	**(321,810)**
Non-operating revenues (expenses)		
Sales tax	1,119,720	749,735
Motor vehicle excise tax	280,382	85,515
Property tax	140,869	-
Rental car tax	3,548	3,506
Investment income	16,897	12,630
Other revenues	18,509	29,762
Contributions to other governments	(279,282)	(4,722)
Interest expense	(15,640)	(1,772)
Other expenses	(9,360)	(9,864)
(Loss) gain on disposal of assets	(371)	2,011
Impairment	(1,919)	-
Total non-operating revenues, net	**1,273,353**	**866,801**
Income before capital contributions	**920,270**	**544,991**
Federal capital contributions	77,424	142,616
State and local capital contributions	294,508	60,052
Total capital contributions	**371,932**	**202,668**
Change in net position	**1,292,202**	**747,659**
Total net position, beginning of year	**7,320,758**	**6,573,099**
Total net position, end of year	**$ 8,612,960**	**$ 7,320,758**

See accompanying notes to financial statements.

STATEMENTS OF CASH FLOWS

(in thousands)

	December 31	
	2017	2016
Cash flows from operating activities		
Cash receipts from fares	$ 90,471	$ 81,584
Cash receipts from other operating revenue	4,791	5,686
Payments to employees for wages and benefits	(25,608)	(21,725)
Payments to suppliers	(98,602)	(103,244)
Payments to transportation service providers	(171,054)	(138,809)
Net cash used by operating activities	**(200,002)**	**(176,508)**
Cash flows from non-capital financing activities		
Preventative maintenance grants received	11,891	26,962
Taxes received	1,429,003	834,485
Cash overdraft position	6,603	-
Tax collection fees paid	(5,853)	(3,036)
Net cash provided by non-capital financing activities	**1,441,644**	**858,411**
Cash flows from capital and related financing activities		
Capital contributions from grants	123,009	152,751
Proceeds from insurance recoveries and sale of assets	34	7,128
Proceeds from issuance of bonds	-	478,791
(Payments) proceeds for betterments and recoverable costs	(214)	1,242
Payments for bond principal	(33,235)	(30,430)
Payments for interest and bond related costs	(97,507)	(82,821)
Payments to employees capitalized to projects	(74,160)	(67,780)
Payments to suppliers for capital activities	(1,007,537)	(557,529)
Purchase of property	(124,479)	(87,827)
Refund (payments) for insurance premiums, net	169	(4,072)
Net cash used by capital and related financing activities	**(1,213,920)**	**(190,547)**
Cash flows from investing activities		
Investment income	19,382	14,755
Proceeds from sales or maturities of investments	662,094	433,622
Purchases of investments	(752,274)	(747,787)
Net cash used by investing activities	**(70,798)**	**(299,410)**
Net (decrease) increase in cash and cash equivalents	**(43,076)**	**191,946**
Cash and cash equivalents		
Beginning of year	381,246	189,300
End of year	**$ 338,170**	**$ 381,246**
Cash and cash equivalents (note 3)		
Unrestricted	$ 266,405	$ 313,993
Current restricted	63,199	57,878
Non-current restricted	8,566	9,375
	$ 338,170	**$ 381,246**

See accompanying notes to financial statements.

STATEMENTS OF CASH FLOWS, continued

(in thousands)	December 31	
	2017	**2016**
Loss from operations	**$ (353,083)**	**$ (321,810)**
Adjustments to reconcile loss from operations to net cash used by operating activities		
(Increase) decrease in bad debt expense	(50)	87
Depreciation, amortization and accretion	160,428	136,748
Inventory allowance	787	-
Non-operating expense	(723)	-
Changes in operating assets and liabilities		
(Increase) decrease in other receivables	(6,429)	1,064
Increase in inventory, prepaid and deposits	(2,885)	(1,270)
(Decrease) increase in accounts payable and accrued liabilities	(748)	5,275
Increase in unearned revenue	1,433	2,758
Increase in other current liabilities	1,268	640
Net cash used by operating activities	**$ (200,002)**	**$ (176,508)**

(in thousands)	December 31	
	2017	**2016**
Supplemental disclosures of non-cash operating, investing and financing activities		
Contributions (to) from other governments	(274,282)	278
Capital contribution from Land Bank	272,350	55,400
Construction in progress in current liabilities	178,407	163,523
Decrease in fair value of investments	(5,091)	(2,492)
Interest expense on capital leases	(4,634)	(4,571)
Interest income from investments held to pay capital leases, net	4,634	4,571
Spare parts previously capitalized	(2,217)	(3,109)
Start-up costs previously capitalized	(2,494)	(6,802)

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2017 AND 2016

1. ORGANIZATION AND REPORTING ENTITY

As provided under the Revised Code of Washington (RCW) Chapter 81.112 applicable to a regional transit authority, the Central Puget Sound Regional Transit Authority, a public corporation acting under the service name of Sound Transit, was established in 1993. Sound Transit was formed to implement a high capacity transportation system throughout parts of King, Pierce, and Snohomish counties in the State of Washington through the design, construction, and implementation of a commuter rail (Sounder), light rail (Link) and regional express bus system (ST Express).

Reporting Entity—Sound Transit is a special purpose government supported primarily through sales and use, motor vehicle excise, property and rental car sales taxes assessed in Sound Transit's operating jurisdiction (the District). In addition, Sound Transit receives capital and operating funding from federal, state and local agencies.

Sound Transit is governed by an eighteen-member board, seventeen of whom are appointed by the respective member county executives and confirmed by the council of each member county. Membership is based on the population from the portion of each county that lies within Sound Transit's service area. Representation on the board includes an elected official representing the largest city in each county and ensures proportional representation from other cities and from unincorporated areas of each county. The final board position is held by the Secretary of Transportation, Washington State Department of Transportation.

Generally accepted accounting principles (GAAP) require the reporting entity include the primary government, all organizations for which the primary government is financially accountable and other organizations that, by the nature and significance of their relationship with the primary government, would cause the financial statements to be incomplete or misleading if excluded. Based on these criteria, Sound Transit is considered a primary government and does not have any component unit relationships. Conversely, Sound Transit is not considered a component unit of any primary government.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following summary of significant accounting policies is presented to assist the reader in interpreting the financial statements and should be considered an integral part of the financial statements.

Basis of Accounting— The accounts are maintained and financial statements prepared using the economic resources measurement focus and accrual basis of accounting in accordance with GAAP. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles.

Tax revenues are recorded in the period when the underlying transaction occurs on which the tax is imposed and include a sales and use tax on goods and services, motor vehicle excise taxes, a property tax and a rental car tax. Sales, use and rental car taxes are collected on Sound Transit's behalf by the Department of Revenue and the motor vehicle excise tax by the Department of Licensing, both departments of the State of Washington. Property tax is levied on a calendar year basis and is administered and collected by King, Pierce and Snohomish counties.

Taxes are levied within the district at a rate of 0.9% for sales and use, 0.3% for motor vehicle excise and 0.8% on car rentals. In November, 2016 voters approved an increase in the sales tax of 0.5%, an additional motor vehicle excise tax of 0.8% and a property tax in the amount of $0.25 per $1,000 of assessed property value. Property tax is levied annually, with the first levy authorized for calendar year 2017; the additional motor vehicle tax came into effect March 1, 2017 for a total motor vehicle tax of 1.1% thereafter; and, the additional sales and use tax came into effect April 1, 2017 for a total sales and use tax of 1.4% thereafter.

Operating revenues are recognized in the period earned and consist of passenger fares, fees earned from advertising, license use fees and income from non-capital grants. Operating expenses are recognized in the period in which they are incurred. All assets and liabilities associated with the operation of Sound Transit are included in the Statements of Net Position. Depreciation and amortization of capital assets and amortization of unearned revenue, asset retirement obligations and unearned rent are recognized in the Statements of Revenues, Expenses and Changes in Net Position.

Capital Assets— Capital assets are stated at cost, except for capital assets contributed to Sound Transit, which are stated at the fair value on the date of contribution. Expenditures and contributions for additions and improvements with a value in excess of $5,000 and a useful life of more than one year are capitalized. Expenditures for maintenance, repairs and minor improvements are charged to operations as incurred. Depreciation and amortization of capital assets are recorded using the straight-line method applied to each asset over its estimated useful life and leasehold improvements over the shorter of the life of the asset or length of the related agreement in following table:

	Estimated Useful Life
Access rights	5 – 100 years
Buildings and leasehold improvements	5 – 30 years
Furniture, equipment and vehicles	3 – 8 years
Revenue vehicles	12 – 40 years
Software	3 – 5 years
Transit facilities, rail and heavy equipment	6 – 150 years

On an annual basis, Sound Transit evaluates whether events or circumstances have occurred affecting capital assets that are other than temporary in nature and which could result in an impairment of those assets. Impairment is considered to have occurred if there is a large permanent decline in the asset's service utility and the event or circumstance is outside the normal life cycle of the asset. Impairment losses on assets that will no longer be used are measured based on the lower of carrying value or fair value of the affected asset. Impairment losses on assets that will continue to be used are measured using the best method that reflects the diminished service utility of the related asset.

All costs directly and indirectly attributable to capital projects are capitalized. Construction In Progress (CIP) balances include costs incurred for transportation projects not yet in service and are segregated between assets in which Sound Transit maintains a continuing ownership interest and capital assets that will be transferred to other governments upon completion.

Access rights include costs incurred or rights acquired that allow Sound Transit to operate its services in public and private right of ways. Access rights are amortized over the life of the underlying asset constructed or the term of the contractual agreement granting the related right.

Interest costs on funds borrowed through tax-exempt and taxable debt to finance the construction or acquisition of certain capital assets are capitalized during the period of construction or acquisition and are depreciated over the life of the related assets once placed into service.

Capital Contributions to Other Governments— Pursuant to capital improvement agreements, Sound Transit has provided funding to, or constructed assets, for various governments for transit-related capital improvements. For assets constructed for other governments, these costs are capitalized and included in CIP until the asset is substantially completed and accepted, at which time it is charged to contributions to other governments.

Cash and Cash Equivalents— Cash and cash equivalents are carried at cost, which approximates fair value. Restricted cash and cash equivalents contain externally imposed legal and contractual obligations and are classified as current or non-current in accordance with their requirements.

Compensated Absences— Vacation leave that has been earned but not paid is accrued. Similarly, sick leave is accrued as the benefits are earned but only to the extent that Sound Transit will compensate the employees through cash payments conditional on the employee’s termination, retirement or death. Vacation pay, which may be accumulated up to 50 days, is payable upon termination, retirement or death or in accordance with bi-annual elections within established policy. Sick leave is earned at the rate of 0.046 for each hour worked and is accrued at the rate of 50% up to 120 days for employees hired before January 1, 2004 or 25% up to 240 days for employees hired thereafter. Regardless of hire date, sick leave is paid at 50% of the accumulated leave balance upon termination, retirement or death.

Environmental Remediation Obligations— Environmental remediation activities are reviewed annually to determine whether an obligating event, as defined by GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, has occurred, when the liability should be accrued and whether the cost should be expensed or capitalized. Generally such costs are incurred with respect to properties that Sound Transit is preparing for its own use or are required in the construction of its projects and subsequently resold. As such, these costs are recorded as incurred and capitalized to the project. Costs in excess of the property’s fair market value, or that do not meet capitalization criteria under generally accepted accounting principles, are expensed as soon as a reasonable estimate can be obtained.

Indirect Cost Allocation— Indirect costs relate to the overall costs of running the agency and include employee costs, office space, services and information technology costs. These indirect costs are allocated to capital projects, operating activities, agency administration and fare and regional planning using overhead rates that are based primarily on headcount in 2017 and budgeted expenditures in 2016. Overhead rates are designed to allocate all agency overhead costs except for certain executive divisions and marketing costs.

Inventory— Inventory includes spare parts and is recorded at the lower of average purchased cost, or net realizable value. Allowances for excess and obsolete parts are provided for spare parts currently identified as excess and obsolete. Allowances are reflected as a charge to operations and are based on management’s estimate that is subject to change. As of December 31, 2017 and 2016, inventory reflects an allowance of $902 thousand and $115 thousand, respectively.

Investment Valuation— Investments are stated at fair value.

Land Held for Disposition— Properties determined to be excess to Sound Transit's use, authorized by the Board for disposition and the intention is to dispose of the property within one year. Pursuant to RCW 81.112.350, surplus properties are evaluated for suitability as housing as 80% of such properties must be offered for either transfer at no cost, sale, or long-term lease first to qualified entities that agree to develop affordable housing on the property, consistent with local land use and zoning laws. Properties meeting such criteria and subject to an agreement or request for proposal are reclassified to land held for disposition at carrying cost until such time as the disposition closes, at which time a contribution to affordable housing is recorded. Properties not disposed as part of the 80% requirement are valued at the lower of purchase cost or net realizable value.

New Accounting Pronouncements— In June 2017, the GASB issued Statement No. 87, *Leases*, effective for reporting periods beginning after December 15, 2019. GASB 87 is a significant change in the model for accounting for leases, requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset and a lessor is required to recognize a lease receivable and a deferred inflow of resources. Sound Transit is evaluating the impact of this pronouncement and changes in systems necessary for implementation for 2020.

The following statements of the GASB have been evaluated and have no impact or have been implemented with no impact to Sound Transit's financial statements and disclosures:

- Statement No. 75 issued June 2015, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. This statements establish new accounting and financial reporting requirements around other postemployment benefits (OPEB), effective for years beginning after June 15, 2017.
- Statement No. 84 issued January 2017, *Fiduciary Activities*. This statement establishes criteria for identifying fiduciary activities and how those activities should be reported, effective for reporting periods beginning after December 15, 2018.
- Statement No. 85 issued March 2017, *Omnibus 2017*. This statement is to address issues that have been identified during implementation of certain GASB statements, effective for reporting periods beginning after June 15, 2017.
- Statement No. 86 issued May 2017, *Certain Debt Extinguishment Issues*. This statement is to improve consistency for in-substance defeasance of debt by providing guidance for transaction in which cash and other monetary assets acquired with existing resources are placed in an irrevocable trust for the sole purpose of extinguishing debt.

Subsequent to year end, the GASB issued in April 2018, Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowing and Direct Placements*. This statement is effective for reporting periods that begin after June 15, 2018 and will be evaluated for the effect of adopting for 2019.

Reclassifications – Certain reclassifications have been made to the 2016 Financial Statements to conform to the current year's presentation.

Reserves— Sound Transit's financial policies require the agency to maintain certain internal reserves as follows: an operating expense reserve in the amount of two months average annual spending expenses; a capital replacement reserve supported by a specific investment fund; and an emergency loss fund to cover retention, deductible or excess loss due to uninsured loss or portion of loss. As these cash and investment reserves are derived from internal restrictions, they are included in unrestricted net position.

Restricted Net Position— Restricted net position consists of cash, cash equivalents and investments that contain externally imposed legal and contractual obligations. Assets comprising restricted net position are used in accordance with their requirements, and where both restricted and unrestricted resources are available for use, restricted resources are used first and then unrestricted resources as they are needed.

Revenue and Expense Classification— Sound Transit distinguishes operating revenues and expenses from non-operating items in the preparation of its financial statements. Operating revenues and expenses generally result from providing passenger services in connection with Sound Transit's principal ongoing operations. The principal operating revenues are passenger fares. Sound Transit's operating expenses include labor, materials, depreciation and amortization, services, claims, purchased transportation and other expenses related to the delivery of passenger transportation within the Central Puget Sound region. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Tax Abatements – The Governmental Accounting Standards Board (GASB) Statement No. 77 requires state and local governments to disclose tax abatements where a decrease in specific taxes for a particular payer may contribute to economic development or otherwise benefits the government or its citizens.

As of December 31, 2017, Sound Transit has no direct tax abatement agreements.

In 2017, Sound Transit collected property tax revenue through Snohomish County, King County and Pierce County which have direct tax abatement agreements. The tax abatements do not result in reduction or loss of revenue to Sound Transit because, pursuant to Washington State law, these taxes were reallocated to other property tax payers.

Undivided Interests— Sound Transit participates in a joint operation (or undivided interest), jointly governed with six other agencies for the provision of regional fare collection services (RFCS). Sound Transit reports its undivided interest in assets, liabilities, expenses and revenues of RFCS within its financial statements, as they are specifically identifiable to Sound Transit. RFCS does not meet the definition of a component unit as defined in GASB No. 61 – *The Financial Reporting Entity: Omnibus.*

Use of Estimates— The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

3. CASH, CASH EQUIVALENTS, INVESTMENTS AND RESTRICTED ASSETS

Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments with maturities of three months or less when purchased. Cash in the Local Government Investment Pool (LGIP) is managed by the Washington State Treasurer's Office and investments in the King County Investment Pool (KCIP) are managed by the King County Finance Division. The LGIP is invested in a manner generally consistent with Rule 2a-7 money market funds, as currently recognized by the Securities and Exchange Commission, and managed to meet the portfolio maturity, quality, diversification and liquidity requirements set forth in GASB 79 for external investment pools who wish to measure investments at amortized costs. The LGIP and the KCIP represent an interest in a group of securities and have no specific security subject to custodial risk.

Sound Transit's bank deposits are covered by the Federal Deposit Insurance Corporation (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC). All deposits not covered by the FDIC are covered by the PDPC.

Cash, cash equivalents, investments and restricted assets consist of the following:

(in thousands)	December 31	
	2017	**2016**
Cash and cash equivalents - current		
Washington State Local Government Investment Pool *	$ 260,488	$ 297,638
FDIC or PDPC insured bank deposits	271	11,472
Cash on hand	5,646	4,883
	266,405	**313,993**
Restricted assets - current		
Cash and cash equivalent		
Health reimbursement trust	3,202	2,549
Washington State Local Government Investment Pool	59,997	55,329
	63,199	**57,878**
Investment - King County Investment Pool	583	578
Other	-	5
	63,782	**58,461**
Investments - current	**1,134,799**	**1,051,907**
Restricted assets - non-current		
Cash and cash equivalents		
Washington State Local Government Investment Pool	562	1,371
Escrow funds	8,004	8,004
	8,566	**9,375**
Investments - Debt service and OCIP reserve	22,187	21,755
Other	107	107
	30,860	**31,237**
Investments - non-current		
Capital replacement	**323,311**	**320,494**
Total cash, cash equivalents, investments and restricted assets	**$ 1,819,157**	**$ 1,776,092**

* The balance includes amounts set aside in satisfaction of Sound Transit's financial policies for an operating expense reserve and an emergency loss fund.

All surplus cash is invested in accordance with Washington State statute and an asset liability management policy approved by Sound Transit's Board. Qualifying investments under this policy include obligations of the United States government, Treasury and Agency securities, bankers' acceptances, certificates of deposit, commercial paper, general obligation municipal bonds and repurchase agreements. Sound Transit's policy and monitoring program addresses common deposit and investment risks as described below, with detailed information by investment type presented in the tables that follow. Duration is presented in years.

Sound Transit holds a significant amount of investments that are measured at fair value on a recurring basis, within the following hierarchy:

- Level 1 – inputs are quoted prices (unadjusted) for identical assets or liabilities in active markets that a government can access at the measurement date
- Level 2 – inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly
- Level 3 – inputs are unobservable inputs for an asset or liability

Unrestricted investments consist of the following:

(in thousands)	2017			2016		
	Total	**Level 1**	**Level 2**	**Total**	**Level 1**	**Level 2**
Investments – Undesignated						
Commercial Paper	$ 24,920	$ -	$ 24,920	$ 75,016	$ -	$ 75,016
King County Investment Pool *	150,878	-	-	189,195	-	-
U.S. Agency Securities	456,364	-	456,364	272,985	-	272,985
U.S. Treasury Securities	502,637	502,637	-	514,711	514,711	-
Total Investments - current	**$ 1,134,799**	**$ 502,637**	**$ 481,284**	**$ 1,051,907**	**$ 514,711**	**$ 348,001**
Investments – Capital Replacement						
Municipal Bonds	$ 25,976	$ -	$ 25,976	$ 26,437	$ -	$ 26,437
U.S. Agency Securities	253,217	-	253,217	235,020	-	235,020
U.S. Treasury Securities	44,118	44,118	-	59,037	59,037	-
Total Investments – non-current	**$ 323,311**	**$ 44,118**	**$ 279,193**	**$ 320,494**	**$ 59,037**	**$ 261,457**

* The KCIP is valued using net asset value and is not included in the fair value hierarchy.

Restricted investments consist of the following:

(in thousands)	2017			2016		
	Total	**Level 1**	**Level 2**	**Total**	**Level 1**	**Level 2**
Restricted Assets - Current						
King County Investment Pool*:						
Link Risk Fund	**$ 583**	**$ -**	**$ -**	**$ 578**	**$ -**	**$ -**
Restricted Assets - Non-current						
Municipal bonds	**$ 19,891**	**$ -**	**$ 19,891**	**$ 19,514**	**$ -**	**$ 19,514**
OCIP Reserve						
U.S. Agency securities	**2,296**	**-**	**2,296**	**2,241**	**-**	**2,241**
	$ 22,187	**$ -**	**$ 22,187**	**$ 21,755**	**$ -**	**$ 21,755**

* The KCIP is valued using net asset value and is not included in the fair value hierarchy.

U.S Treasury securities are classified as Level 1 and are valued using prices in active markets for identical assets. Commercial paper, U.S. Agency securities, and municipal bonds are classified as Level 2 and are valued using inputs that are observable but not active using the market approach.

The KCIP is valued using net asset value. The objective of the KCIP investment policy is to invest public funds in a manner which will preserve the safety and liquidity of all investments while obtaining a reasonable rate of return. The redemption period for the KCIP is one to ten days, depending on the dollar amount redeemed.

Interest Rate Risk— Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. For its undesignated and capital replacement funds, Sound Transit matches its investments to cash flow requirements and manages its exposure to fair value losses using the modified duration method, whereby the modified duration of fixed income securities held in its investment portfolios is compared to established benchmarks. Modified duration benchmarks for the undesignated fund was 0.91 and for the capital replacement fund was 2.57. Investments in the KCIP are reported using effective duration. Duration estimates the sensitivity of a bond's price to interest rate changes. For the Debt Service Reserve funds and the Link Risk funds, interest rate risk is managed by using the specific identification method.

Modified duration

(in thousands)	**2017**			**2016**		
	Total	**Duration**	**Percent of total**	**Total**	**Duration**	**Percent of total**
Investments – Undesignated						
Commercial Paper	$ 24,920	0.20	2.2%	$ 75,016	0.25	7.1%
King County Investment Pool	150,878	1.02	13.3%	189,195	1.10	18.0%
U.S. Agency Securities	456,364	0.85	40.2%	272,985	1.06	26.0%
U.S. Treasury Securities	502,637	0.82	44.3%	514,711	1.01	48.9%
Total Investments - current	**$ 1,134,799**	**0.84**	**100.0%**	**$ 1,051,907**	**0.98**	**100.0%**
Investments – Capital Replacement						
Municipal Bonds	$ 25,976	1.96	8.0%	$ 26,437	2.86	8.2%
U.S. Agency Securities	253,217	2.91	78.3%	235,020	2.90	73.4%
U.S. Treasury Securities	44,118	1.49	13.7%	59,037	1.69	18.4%
Total Investments – non-current	**$ 323,311**	**2.64**	**100.0%**	**$ 320,494**	**2.67**	**100.0%**

Specific identification

(in thousands)	December 31			
	2017	2016	Maturity	Call Date
Restricted Assets - Non-current				
Debt Service Reserve				
Municipal bonds:				
Florida State Public Education BAB	$ 5,228	$ 5,371	6/1/2030	6/1/2019*
Georgia State GO Unlimited	10,000	9,534	4/1/2026	4/1/2017*
Georgia State GO Unlimited BAB	4,663	4,609	11/1/2027	11/24/2009*
	$ 19,891	**$ 19,514**		
OCIP Reserve				
U.S. Agency securities:				
Federal Home Loan Mortgage Corporation	$ 902	$ 885	3/15/2023	
Federal National Mortgage Association	1,394	1,356	7/15/2022	
	$ 2,296	**$ 2,241**		
	$ 22,187	**$ 21,755**		

** Continuously callable from this date forward*

Concentration of Credit Risk— Concentration of credit risk is the risk associated with a lack of diversification or having too much invested in a few individual issues. The investment policy sets forth maximum concentration guidelines. At December 31, 2017 and 2016, Sound Transit portfolios were within these guidelines.

Investment Type Per Investment Policy	Maximum
Treasury securities and investments in the LGIP	100%
Total U.S. Agency securities	75%
Single U.S. Agency and investments in the KCIP	50%
Repurchase agreements, general obligation Bonds, PDPC financial institution sponsored investment accounts	25%
Deposit bank notes	20%
Certificates of deposit, bankers' acceptances, reverse repurchase agreements and A1/P1 commercial paper	10%

Credit Risk— Credit risk is the chance that an issuer will fail to pay principal or interest in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause the price of the investment to decline. As of December 31, 2017, all Treasury, U.S. Agency, general obligation bonds, and commercial paper securities are rated in one of the two highest credit rating categories of a nationally recognized statistical rating organization. After a bond has been purchased, if it is downgraded below one of the three highest ratings, a case-by-case review is conducted to determine the reason for the downgrade and to evaluate whether or not to continue to hold the bond. The LGIP and KCIP are unrated.

Custodial Credit Risk— Custodial credit risk is the risk that, in the event of the failure of the counterparty, Sound Transit would not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All investments purchased by Sound Transit are held and registered in Sound Transit's name in the trust or safekeeping department of a financial institution as established by a written third-party safekeeping agreement between Sound Transit and the financial institution.

4. TAXES AND OTHER RECEIVABLES

Taxes and other receivables consist of the following:

(in thousands)	December 31	
	2017	**2016**
Taxes receivable	$ 257,044	$ 141,818
Grants receivable	5,379	27,295
Due from other governments	22,196	17,650
Interest receivable	4,470	2,921
Accounts receivable, net	819	432
	$ 289,908	**$ 190,116**

Amounts due from other governments include amounts due through the regional fare collection system "ORCA" for fare revenues and administration expenses (see also note 12), and amounts reimbursable under interlocal agreements for operating expenses or capital contributions for transit facilities and betterments. Payment terms are generally defined in the various agreements with other governments and range from 21 days to 60 days. Where payment terms are not defined by agreement, they are due in accordance with the terms specified in the invoice, which is generally 30 days.

5. CAPITAL AND OPERATING LEASES

Capital lease obligations at December 31, 2017 and 2016 are $62.8 million and $61.9 million, respectively.

Lease/Leaseback— In May 2001, Sound Transit entered into a transaction to lease 22 rail passenger cab and coach cars and 5 locomotives (the headlease) to an investor and simultaneously subleased the vehicles back (the sublease). Under these transactions, Sound Transit maintains the right to continued use and control of the assets through the end of the leases and is required to insure and maintain the assets. The headlease and sublease have been recorded as capital leases for accounting purposes. The current lease expires on September 17, 2040.

The vehicles had a fair market value of $61.3 million with a book value of $37.7 million at closing. Sound Transit received a prepayment equivalent to the net present value of the headlease obligations totaling $61.3 million. From those proceeds, $50.4 million was deposited with AIG-FP Special Finance Ltd. to partially meet Sound Transit's obligations under the sublease payments. In addition, $5.7 million was deposited with AIG Matched Funding Corp. and invested in securities issued or guaranteed by the United States government to meet the remaining obligations under the sublease. The remaining $4.9 million (net of closing costs of $363 thousand) was retained by Sound Transit and recorded as non-operating revenues during the year ended December 31, 2001.

The net present value of the future sublease payments has been recorded as a long-term capital lease obligation. The underlying investments have been structured to meet all future obligations under the sublease when due and, as such, have been recorded to equal the sublease obligations on the accompanying statements of net position.

The lease documentation established minimum credit levels by AIG for the equity and debt defeasance accounts. At the time these transactions closed, AIG was rated “AAA” by Standard & Poor’s and “Aaa” by Moody’s Investment Service. However, starting in March 2005, AIG suffered a series of credit rating downgrades and as of December 31, 2017 was rated “BBB+” by Standard & Poor’s and “Baa1” by Moody’s Investment Service. As of December 31, 2017 and 2016, the defeasance accounts were unrated.

Because of credit rating downgrades under the lease transaction, Sound Transit is required to replace AIG for its undertaking agreements and credit enhancements provision in the transaction and AIG is required to post collateral for the debt defeasance accounts. However, in January 2009, Sound Transit entered into a waiver agreement and temporary waiver of delivery of required items letter with the Owner Participant, Lessor, Lender, and Debt Payment Undertaker waiving any existing default or event of default based on a failure to comply with the ratings downgrade provisions of the Participation Agreement, Loan Agreement, Debt Payment Agreement, and Debt Payment Guarantee until March 1, 2009. Under the fourth amendment to the waiver agreement and fourth temporary waiver of delivery of required items letter with the transaction participants, Sound Transit may request successive six-month extensions of the waiver agreements until September 30, 2018, unless extended by agreement of the parties. Sound Transit requested and has been granted an extension of the wavier agreements through September 30, 2018. If the default is not cured and the extension is not granted, the investor could demand a termination payment from Sound Transit of approximately $13.9 million.

Net changes in the sublease are shown in the following table:

(in thousands)	2017	2016
Net sublease, January 1	$ 61,916	$ 61,063
Accrued interest	4,634	4,571
Less payment	(3,718)	(3,718)
Net sublease, December 31	**$ 62,832**	**$ 61,916**

Operating Rentals— Sound Transit has entered into non-cancelable operating leases in excess of one year for the use of the Downtown Seattle Transit Tunnel, ground, office space, parking, land, storage at various locations, and equipment with lease terms expiring between 2018 and 2037, with some leases containing options to renew. Minimum lease payments through 2037 are as follows (in thousands):

	Year ending December 31
2018	$ 17,612
2019	17,665
2020	9,710
2021	8,958
2022	9,028
2023-2027	8,418
2028-2032	625
2033-2037	214
	$ 72,230

Total rental expenses for 2017, which include non-cancelable leases as well as other month-to-month rentals, were $18.3 million, of which $3.1 million was capitalized for capital projects in progress. Total rental expenses for 2016, which include non-cancelable leases as well as other month-to-month rentals, were $13.5 million, of which $1.5 million was capitalized for capital projects in progress.

6. CAPITAL ASSETS

Capital assets are summarized as follows:

(in thousands)	2017 Beginning balance	Additions	Disposals / reductions	Transfers	2017 Ending balance
Non-depreciable assets					
Land	$ 631,661	$ 1,580	$ (371)	$ 120,360	$ 753,230
Permanent easements	520,134	-	-	21,355	541,489
Capital projects in progress:					
Sound Transit - tangible	2,013,273	1,330,929	(4,440)	(357,483)	2,982,279
Sound Transit - intangible	29,602	6,896	-	(21,347)	15,151
Other governments - tangible	167,266	109,229	(274,282)	1,948	4,161
Total non-depreciable assets	**3,361,936**	**1,448,634**	**(279,093)**	**(235,167)**	**4,296,310**
Depreciable assets					
Access rights	569,094	126,415	-	-	695,509
Buildings and leasehold improvements	29,137	-	(30)	4,373	33,480
Furniture, equipment and vehicles	15,069	-	(24)	1,578	16,623
Revenue vehicles	672,900	-	-	38,094	710,994
Software	20,994	-	-	1,424	22,418
Transit facilities, rail and heavy equipment	4,329,099	11	(6,832)	182,593	4,504,871
Total depreciable assets	**5,636,293**	**126,426**	**(6,886)**	**228,062**	**5,983,895**
Accumulated depreciation					
Access rights	(201,270)	(12,901)	-	-	(214,171)
Buildings and leasehold improvements	(16,685)	(1,328)	30	-	(17,983)
Furniture, equipment and vehicles	(11,468)	(1,754)	11	-	(13,211)
Revenue vehicles	(234,643)	(29,941)	-	334	(264,250)
Software	(18,281)	(2,449)	-	-	(20,730)
Transit facilities, rail and heavy equipment	(515,139)	(111,903)	6,832	435	(619,775)
Total accumulated depreciation	**(997,486)**	**(160,276)**	**6,873**	**769**	**(1,150,120)**
Total depreciable assets, net	**4,638,807**	**(33,850)**	**(13)**	**228,831**	**4,833,775**
Total capital assets, net	**$ 8,000,743**	**$ 1,414,784**	**$ (279,106)**	**$ (6,336)**	**$ 9,130,085**

(in thousands)	2016 Beginning balance	Additions	Disposals / reductions	Transfers	2016 Ending balance
Non-depreciable assets					
Land	$ 543,841	$ -	$ (6)	$ 87,826	$ 631,661
Permanent easements	489,443	-	-	30,691	520,134
Capital projects in progress:					
Sound Transit - tangible	3,003,841	802,998	(6,602)	(1,786,964)	2,013,273
Sound Transit - intangible	24,633	7,671	-	(2,702)	29,602
Other governments - tangible	82,291	84,575	400	-	167,266
Total non-depreciable assets	**4,144,049**	**895,244**	**(6,208)**	**(1,671,149)**	**3,361,936**
Depreciable assets					
Access rights	569,094	-	-	-	569,094
Buildings and leasehold improvements	28,940	-	(252)	449	29,137
Furniture, equipment and vehicles	14,128	-	(151)	1,092	15,069
Revenue vehicles	665,537	-	(9,604)	16,967	672,900
Software	18,461	-	-	2,533	20,994
Transit facilities, rail and heavy equipment	2,689,793	-	(10)	1,639,316	4,329,099
Total depreciable assets	**3,985,953**	**-**	**(10,017)**	**1,660,357**	**5,636,293**
Accumulated depreciation					
Access rights	(188,369)	(12,901)	-	-	(201,270)
Buildings and leasehold improvements	(15,736)	(1,201)	252	-	(16,685)
Furniture, equipment and vehicles	(9,983)	(1,636)	151	-	(11,468)
Revenue vehicles	(212,240)	(31,606)	9,203	-	(234,643)
Software	(15,586)	(2,695)	-	-	(18,281)
Transit facilities, rail and heavy equipment	(428,960)	(86,183)	4	-	(515,139)
Total accumulated depreciation	**(870,874)**	**(136,222)**	**9,610**	**-**	**(997,486)**
Total depreciable assets, net	**3,115,079**	**(136,222)**	**(407)**	**1,660,357**	**4,638,807**
Total capital assets, net	**$ 7,259,128**	**$ 759,022**	**$ (6,615)**	**$ (10,792)**	**$ 8,000,743**

During 2017, Sound Transit capitalized $82.0 million of interest costs ($82.5 million in 2016), representing interest costs incurred in respect of Sound Transit's capital program for the year, net of premium, discounts and deferred amount on debt refunding, on its outstanding bonds (see note 8).

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following:

(in thousands)	2017	2016
Accounts payable	$ 5,172	$ 17,914
Accrued liabilities	149,374	101,421
Accrued salaries, wages and benefits	11,336	9,178
Due to other governments	62,884	84,917
Retainage payable	769	496
	$ 229,535	**$ 213,926**

8. LONG-TERM DEBT

In the ordinary course of financing its activities, Sound Transit has issued debt as follows:

(in thousands)	2017 Beginning balance	Additions	Reductions	2017 Ending balance	Amounts due within one year
Bonds payable					
Series 1999	$ 290,410	$ -	$ (7,220)	$ 283,190	$ 7,600
Series 2009P-2T	76,845	-	-	76,845	-
Series 2009S-2T	300,000	-	-	300,000	-
Series 2012P-1	178,095	-	(20,140)	157,955	22,520
Series 2012S-1	91,940	-	(5,875)	86,065	2,540
Series 2015S-1	792,840	-	-	792,840	2,900
Series 2015S-2A	75,000	-	-	75,000	-
Series 2015S-2B	75,000	-	-	75,000	-
Series 2016S-1	400,000	-	-	400,000	-
	2,280,130	**-**	**(33,235)**	**2,246,895**	**35,560**
Plus unamortized premium	198,101	-	(13,096)	185,005	-
Less unamortized discount	(3,656)	-	380	(3,276)	-
Total long-term debt	**$ 2,474,575**	**$ -**	**$ (45,951)**	**$ 2,428,624**	**$ 35,560**

(in thousands)	2016 Beginning balance	Additions	Reductions	2016 Ending balance	Amounts due within one year
Bonds payable					
Series 1999	$ 297,270	$ -	$ (6,860)	$ 290,410	$ 7,220
Series 2009P-1	17,620	-	(17,620)	-	-
Series 2009P-2T	76,845	-	-	76,845	-
Series 2009S-2T	300,000	-	-	300,000	-
Series 2012P-1	178,440	-	(345)	178,095	20,140
Series 2012S-1	97,545	-	(5,605)	91,940	5,875
Series 2015S-1	792,840	-	-	792,840	-
Series 2015S-2A	75,000	-	-	75,000	-
Series 2015S-2B	75,000	-	-	75,000	-
Series 2016S-1	-	400,000	-	400,000	-
	1,910,560	**400,000**	**(30,430)**	**2,280,130**	**33,235**
Plus unamortized premium	129,652	78,791	(10,342)	198,101	-
Less unamortized discount	(4,036)	-	380	(3,656)	-
Total long-term debt	**$ 2,036,176**	**$ 478,791**	**$ (40,392)**	**$ 2,474,575**	**$ 33,235**

Proceeds from bond issues are used for funding Sound Transit's capital program or refunding prior bond issues. Currently Sound Transit's long-term debt is comprised of three categories of debt: Prior Bonds, Parity Bonds and Second Tier Junior Obligations (the "TIFIA Bonds"). Prior Bonds have first claim upon the local option taxes of Sales and Use, Rental Car and Motor Vehicle Excise tax. Parity Bonds are subordinate to the Prior Bonds and have claim upon the Sales and Use, Rental Car and Motor Vehicle tax. TIFIA Bonds are subordinate to both Prior Bonds and Parity Bonds and have a claim on the Sales and Use, Rental Car and Motor Vehicle tax. At year-end, no draws had occurred against the TIFIA Bonds, however they are deemed incurred for purposes of calculating capacity under statutory debt limitations.

Prior and Parity Bonds

In December 2016, Sound Transit issued additional Parity Bonds of $400.0 million of Series 2016S-1 Sales Tax and Motor Vehicle Excise Tax Bonds. Net proceeds were $478.8 million. Issuance costs were $1.8 million with $477.0 million used to reimburse prior project expenditures deeming all net proceeds spent as of closing.

Sound Transit designated the 2016 Parity Bonds as Green Bonds based on the planned use of the proceeds to finance projects that adhere to Sound Transit's Sustainability Plan. The Series 2016S-1 parity bonds bear an average fixed interest rate of 5.0%, with interest payments on each May 1 and November 1, commencing May 2017. The Series 2016S-1 parity bonds mature between November 1, 2021 and 2046. With the issuance of the Series 2016 Parity Bonds, S&P affirmed the Prior Bonds' AAA rating and removed the negative outlook from the Parity Bonds AAA rating and Moody's upgraded Sound Transit's Prior Bonds to Aaa from Aa1 and the Parity Bonds to Aa1 from Aa2.

Variable Rate Debt

The variable rate Series 2015S-2 parity bonds have been issued initially as index floating rate bonds through May 1, 2018, at which time the issuance is subject to prior optional redemption or conversion to a new index floating rate period or to another interest rate mode. Interest is payable on the first business day of each month, commencing October 1, 2015 at the Securities Industry and Financial Markets Association ("SIMFA") index rate plus a spread of 70 basis points.

The following tables set forward average and effective coupon rates, rating agency information, principal payment commencement, fair value and amounts currently restricted for debt service.

Prior Bonds— Debt service requirements for Prior Bonds are payable in February and August of each year and are secured by local option taxes.

(in millions)		Average rate		Ratings		Principal	Fair value*		Principal and interest restricted	
	Issue date	Coupon	Effective	Moody's	S&P	Payment begins	2017	2016	2017	2016
Series 1999	Dec 1, 1998	4.88	5.03	Aaa	AAA	Feb 1, 2006	$ 304.7	$ 312.4	$ 13.4	$ 13.1
Series 2009P-2T	Sep 29, 2009	5.01	3.31**	Aaa	AAA	Feb 1, 2020	85.3	84.9	1.6	1.6
Series 2012P-1	Aug 22, 2012	4.97	2.62	Aaa	AAA	Feb 1, 2013	173.7	197.1	25.8	23.8

* Estimated using quoted market prices
**Effective rate reduced due to interest subsidy provided by U.S. Government for Build America Bonds

Sound Transit is required to maintain a common debt service reserve account for all Prior Bonds. The common debt service reserve requirement for these bonds is met by a surety policy in the amount of $31.7 million purchased in 1999, a $7.9 million cash reserve funded, at the time the 2009P bonds were issued, and an $11.5 million cash reserve funded at the time the 2012P-1 bonds were issued (see also note 3).

Parity Bonds— Debt service requirements for Parity Bonds are payable in May and November each year and are secured by local option taxes.

(in millions)		Average Rate		Ratings		Principal	Fair value*		Principal and interest restricted	
	Issue date	Coupon	Effective	Moody's	S&P	Payment begins	2017	2016	2017	2016
Series 2009S-2T	Sep 29, 2009	5.49	3.62**	Aa1	AAA	Nov 1, 2029	$ 383.8	$ 372.9	$ 2.7	$ 2.7
Series 2012S-1	Aug 22, 2012	4.91	2.73	Aa1	AAA	Nov 1, 2016	96.9	104.4	3.2	6.5
Series 2015S-1	Sep 10, 2015	4.67	3.89	Aa1	AAA	Nov 1, 2018	916.8	833.1	9.1	6.2
Series 2015S-2A	Sep 10, 2015	Var	Var	Aa1	AAA	Nov 1, 2041	75.1	75.0	0.1	0.1
Series 2015S-2B	Sep 10, 2015	Var	Var	Aa1	AAA	Nov 1, 2041	75.1	75.0	0.1	0.1
Series 2016S-1	Dec 19, 2016	5.00	3.60	Aa1	AAA	Nov 1, 2021	502.6	478.9	3.3	0.7

* Estimated using quoted market prices
** Effective rate reduced due to interest subsidy provided by U.S. Government for Build America Bonds

No reserve account was required to be established for the 2009S-2T, 2012S-1, 2015S-1, 2015S-2A, 2015S-2B and 2016S-1 series bonds.

Sound Transit is required to maintain certain minimum deposits as defined in the Prior Master Bond Resolution and the Parity Master Bond Resolution to meet debt service requirements. A Prior Bond Account and a Parity Bond Account are funded with monthly deposits so that the balance is sufficient to pay the interest, or principal and interest, next coming due on the bonds (see also note 3). Under the bond covenants, Sound Transit is required to value at market the investments held in debt service reserve accounts annually and to make up any deficiency within six months after the date of the valuation. As of December 31, 2017, the market value of the Prior debt service reserve exceeded the required reserve amount by $1.0 million. Reserve account proceeds are invested in municipal bonds.

Second Tier Junior Obligations (TIFIA Bonds)

TIFIA Master Credit Agreement

On June 22, 2017, Sound Transit entered into the second TIFIA Loan Agreement under the TIFIA Master Credit Agreement for up to $87.7 million with a fixed rate of 2.73% to fund a portion of the project costs for the Operations and Maintenance Facility East. The loan is subordinate to both the Parity and Prior bonds. This loan has not been drawn on and therefore there is no debt outstanding related to this loan.

On December 22, 2016, Sound Transit entered into a TIFIA Master Credit Agreement with a contingent commitment for $1,990.3 million for TIFIA loans for the Northgate Link Extension, Lynnwood Link Extension, Federal Way Extension, and the Operations and Maintenance Facility East. Concurrently, December 22, 2016, Sound Transit entered into the first TIFIA Loan Agreement under the TIFIA Master Credit Agreement for up to $615.3 million with a fixed rate of 3.13% to fund a portion of the project costs for the Northgate Link Extension. The loan is subordinate to both the Parity and Prior bonds. This loan has not been drawn on and therefore there is no debt outstanding related to this loan.

TIFIA East Link Loan

With the execution of the TIFIA Master Credit Agreement, the East Link Loan Agreement was amended and restated to be consistent with the TIFIA Master Credit Agreement however, it is not included in the scope of the Master Credit Agreement. This loan has not been drawn on and therefore there is no debt outstanding related to this loan.

Long-term debt requirements are displayed in the table below:

(in thousands) Year ending December 31	Principal	Interest *	Total
2018	$ 35,560	$ 108,340	$ 143,900
2019	39,520	106,408	145,928
2020	42,915	104,322	147,237
2021	54,300	102,058	156,358
2022	58,390	99,275	157,665
2023-2027	401,675	444,539	846,214
2028-2032	351,815	351,806	703,621
2033-2037	455,700	261,764	717,464
2038-2042	400,540	142,635	543,175
2043-2047	304,725	60,314	365,039
2048-2052	101,755	9,437	111,192
	$ 2,246,895	**$ 1,790,898**	**$ 4,037,793**

* Does not deduct 35% BABs subsidy on the interest payments of the Build America Bonds

The American Recovery and Reinvestment Act of 2009 created the Build America Bond (BAB) program, which authorized state and local governments to issue BABs as taxable bonds in 2009 and 2010 to finance any capital expenditures for which they otherwise could issue tax-exempt municipal bonds. The issuers receive a direct federal subsidy payment for a portion of their borrowing costs paid to investors of BABs. The direct federal subsidy, $6.6 million in 2017 and 2016, once earned, is considered a non-exchange transaction separate from the interest payments made and is recorded in other non-operating revenue when Sound Transit makes its interest payment. The direct federal subsidy was reduced in 2013 because of a sequestration order issued pursuant to the Balanced Budget and Emergency Deficit Control Act of 2011. The reduction rate changes annually. The table below summarizes the sequestration rate reduction history for the last five years:

Time Period	Sequestration Rate
October 1, 2017 through September 30, 2018	6.6%
October 1, 2016 through September 30, 2017	6.9%
October 1, 2015 through September 30, 2016	6.8%
October 1, 2014 through September 30, 2015	7.3%
October 1, 2013 through September 30, 2014	7.2%

The subsidy received in 2017 and 2016 was reduced by $482 thousand and $486 thousand, respectively, as compared to the amount that would have been received if the rate had not been reduced. The 2009P-2T bonds and the 2009S-2T bonds are Build America Bonds.

9. OTHER LONG-TERM OBLIGATIONS

Other long-term obligations include provisions for asset retirement obligations, uninsured losses related to Sound Transit's risk management program, employee compensated absences and deferred compensation as follows:

(in thousands)	2017 Beginning balance	Additions, accretion and changes in estimates	Reductions	2017 Ending balance	Amounts due within one year
Asset retirement obligations					
Sounder station platforms	$ 1,407	$ 70	$ -	$ 1,477	$ -
Tacoma link surface rail	2,040	102	-	2,142	-
Total asset retirement obligations	**3,447**	**172**	**-**	**3,619**	**-**
Uninsured losses					
OCIP	482	(197)	(13)	272	134
Transit operations	1,320	1,345	(77)	2,588	650
Total uninsured losses	**1,802**	**1,148**	**(90)**	**2,860**	**784**
Compensated absences	**8,100**	**8,044**	**(7,013)**	**9,131**	**8,467**
Total other long-term obligations	**$ 13,349**	**$ 9,364**	**$ (7,103)**	**$ 15,610**	**$ 9,251**

(in thousands)	2016 Beginning balance	Additions, accretion and changes in estimates	Reductions	2016 Ending balance	Amounts due within one year
Asset retirement obligations					
Sounder station platforms	$ 1,340	$ 67	$ -	$ 1,407	$ -
Tacoma link surface rail	1,943	97	-	2,040	-
Total asset retirement obligations	**3,283**	**164**	**-**	**3,447**	**-**
Uninsured losses					
OCIP	199	377	(94)	482	206
Transit operations	492	861	(33)	1,320	308
Total uninsured losses	**691**	**1,238**	**(127)**	**1,802**	**514**
Compensated absences	**7,389**	**6,862**	**(6,151)**	**8,100**	**7,373**
Deferred compensation	**193**	**-**	**(193)**	**-**	**-**
Total other long-term obligations	**$ 11,556**	**$ 8,264**	**$ (6,471)**	**$ 13,349**	**$ 7,887**

Asset Retirement Obligations— In the course of entering into agreements with other governments and rail providers to construct Sound Transit's capital assets used in providing transportation services, certain agreements contain clauses that impose a legal burden on Sound Transit to remove all or a portion of those constructed assets at the termination of those agreements.

Risk Management— In the ordinary course of planning, building and operating its regional transit systems and services, Sound Transit is exposed to various types of risks and exposures of loss including: torts; theft of, damage to and destruction of assets; errors and omissions; job related injuries to persons; natural disasters; and environmental occurrences.

Sound Transit has established a comprehensive risk management and insurance program to mitigate the potential for loss and for the administration of claims through a combination of commercial insurance or coverage under partner agency operating agreements. Sound Transit's agency operations and rail operations insurance policies are written on an occurrence or claims made basis, with a specific deductible or self-insured retention, renewing annually. Agency Operation policies renew on May 1st and Rail Operation policies renew on November 1st. Worker's compensation is insured through the state.

Major coverages under these programs are as follows:

Program	Major Coverage	Limit / Deductible or Retention *
Agency Operation	Property (Earthquake) Primary and Excess Liability Commercial Auto / Excess Liability Pollution / Excess Liability Public Officials / Employer Liability Fiduciary Liability	$400M ($150M) / $100K ($2.5M) $100M / $50K $50M / $500 comp or $1K collision $50M / $100K * $25M / $250K $10M / $0
Rail Operation	Light Rail / Excess Liability Heavy Rail / Excess Liability Property – Rolling Stock	$100M / $1.5M $295M / $2M $40M / $50K or $500K derailment
Bus Operations	Provided through partner agency operating agreements	N/A

For certain larger capital projects, Sound Transit utilizes Owner Controlled Insurance Programs (OCIP's) to address general liability, builders risk and contractors' pollution liability claims related to project construction carried out by Sound Transit's third-party contractors, as well as professional liability coverage extending through 12/31/2019 for Central Link.

Sound Transit's first OCIP was secured in 2001, for construction of the Central Link light rail project, and subsequently amended to include the Airport Link light rail extension. Coverage for the Central Link OCIP is now expired, with the exception of Professional Liability which provides coverage for final design through 12/31/2019. Sound Transit secured a second OCIP in October 2008 for the University Link Light rail extension project with coverage provided from October 20, 2008 through March 19, 2016. On-going operations coverage is now expired, but the University Link Light rail extension OCIP provides six years of completed operations coverage, which will expire March 19, 2022. Sound Transit's third OCIP was secured in December 2012 for the North Link Light rail extension project with coverage provided from December 31, 2012 to December 31, 2021 and includes six years of completed operations coverage, which will expire December 31, 2027.

Major coverages under these programs are as follows:

Program	**Major Coverage**	**Limit / Deductible or Retention ***
Central Link OCIP	Professional Liability (extended reporting period)	$50M / $250K *
University Link OCIP	Primary and Excess Liability (completed operations) Pollution Liability (completed operations)	$100M / $100K $50M / $250K *
Northgate Link OCIP	Primary and Excess Liability Pollution Liability Builders Risk	$100M / $100K $50M / $250K * $400M / $500K

Sound Transit has set aside two investments held at Wells Fargo Bank in satisfaction of OCIP reserve requirements for the University Link OCIP of $1.0 million and an additional $700 thousand for the North Link OCIP. At December 31st, 2017, the market value of those investments was $2.3 million (see also note 3, Restricted Investments - OCIP Reserve). While Sound Transit is directly responsible for payment of the deductible to the insurers, it has further transferred its risk of loss through its construction contracts, requiring contractors covered by these programs to be responsible for 100% of the deductible on general liability and pollution liability claims ($100 thousand and $250 thousand respectively) and the first $250 thousand of any builders risk loss.

Self-insured liabilities are recorded when probable that a loss has occurred and the amount can be reasonably estimated and includes estimates for claims that have been incurred but not yet reported. As actual liabilities depend on a number of complex factors the process used in estimating the claims liability does not necessarily result in an exact amount. Annually, Sound Transit engages an actuary to prepare an independent actuarial analysis and to prepare an actuarial report in order to estimate its total insurance claim exposure under all of its insurance and risk management programs. The insurance claim amount estimated to be paid within the next year is included in other claims and short-term obligations.

Compensated Balances— Amounts estimated to be paid within the next year are included in accounts payable and accrued liabilities.

10. RESTRICTED NET POSITION

Restricted net position consists of the following:

(in thousands)	2017	2016
Debt service	$ 54,980	$ 52,655
Contractual arrangements	14,344	13,375
Deductible liability protection policy	-	5
	$ 69,324	**$ 66,035**

11. EMPLOYEE BENEFITS

Sound Transit provides a defined contribution money purchase plan and trust (401(a) Plan) to its employees. Great West Retirement Services is the plan's administrator and trustee. This plan is a fixed employer system, and membership in the system includes all full time Sound Transit employees and members of the Sound Transit Board eligible for compensation. The vesting schedule of the plan is 20% immediately upon employment, 40% after one year of service, 60% after two years, 80% after three years and 100% after four years. Employees are responsible for directing the investment of their contributions and Sound Transit's contributions.

Eligible employees are required to participate in the plan on the first day of employment. Sound Transit's actual contribution rates, which were the required contribution rates, are expressed as a percentage of covered payrolls. The amount of covered payroll during 2017 and 2016 was $75.0 million and $67.2 million, respectively, and total payroll was $75.2 million and $67.3 million, respectively. The required contribution rates expressed as a percentage of covered payroll and required Sound Transit contributions during 2017, 2016, and 2015 are as follows:

	Contribution rate			**Contributions** *(in thousands)*		
	2017	**2016**	**2015**	**2017**	**2016**	**2015**
Employer	12%	12%	12%	$ 8,998	$ 8,066	$ 7,697
Employee	10	10	10	7,498	6,722	6,415
Total	**22%**	**22%**	**22%**	**$ 16,496**	**$ 14,788**	**$ 14,112**

12. COMMITMENTS AND CONTINGENCIES

In the ordinary course of its operations, Sound Transit enters into a number of agreements with other governmental and quasi-governmental agencies, including: the operation and maintenance of buses and trains that it has purchased; right of way access and use; planning, building and operation of its facilities; and collection of its taxes. With the exception of Tacoma Link light rail, all service is operated by partner agencies. A summary of significant agreements follows:

ST Express— Agreements have been entered into with King County Department of Transportation (DOT), Community Transit and Pierce Transit for the operations and maintenance of its bus service, covering vehicle maintenance, operations, coordination of service planning, revenue processing, customer service, personnel and performance standards, and information and compliance reporting. The agreements set forth the process for annual financial authorization for service and the basis of compensation, substantially comprised of a baseline cost rate for purchased transportation, as well as fuel and other costs provided for, but not included, as part of the baseline. Baseline cost rates, including allocated costs, are established by no later than December 15th for the upcoming year and are reconciled to actual incurred by no later than March 31st of the year following. The current agreements are for 1 year, expiring December 31, 2018, with an option to extend for two additional 1-year periods, with a minimum of 12 months written notice to exercise an option year.

Link Light Rail— Sound Transit contracts with King County DOT for the operation and maintenance of its light rail service, operating in between Angle Lake and UW. The agreement sets forth the process for annual financial authorization for service and the basis of compensation, substantially comprised of a baseline cost rate for purchased transportation, as well as other costs provided for, but not included as part of the baseline. Baseline cost rates, including allocated costs, are established by no later than December 15th for the upcoming year and are reconciled to actual incurred by no later than March 31st of the year following. The current agreement was for 5 years and was extended to July 2018.

Sound Transit has also entered into the following agreements related to light rail or station operations:

Downtown Seattle Transit Tunnel (DSTT) Agreement— This agreement with King County and City of Seattle provides for the cost sharing with regard to the maintenance and operation in the Downtown Tunnel in exchange for the right to use the tunnel for light rail operations and to provide for the temporary continued joint-use for light rail and bus. Sound Transit’s ongoing obligations include reimbursement of costs and payment of a prescribed share of King County DOT debt service owed for the original tunnel construction and to share costs for future capital repairs or replacements as they arise. Upon extension of light rail service to Northgate Station, Sound Transit shall become responsible for 100% of debt service. Compensation is calculated as reimbursement of certain King County DOT costs based on fixed percentages related to Sound Transit’s share of usage of the DSTT. If Sound Transit does not use King County as its light rail operator, then Sound Transit may be required by the County to purchase the tunnel in order to continue light rail operations.

Light Rail Agreements— Sound Transit has entered into a variety of agreements to secure the right to operate light rail under, upon and over streets and property owned by the City of Seattle, Tukwila, SeaTac, the Port of Seattle, Bellevue, Lynnwood, Shoreline, Mountlake Terrace, Federal Way, Kent, Des Moines and Tacoma granting permanent light rail access rights to operate its light rail service in the municipalities’ right of way. The cost of public right of way improvements have been capitalized to rail access rights and include those costs necessary to operate light rail service, such as costs to acquire real property and relocate existing residents and businesses, as well as certain improvements to city right of way required under those agreements.

WSDOT Umbrella Agreement for R8A Project and East Link Light Rail—Sound Transit entered into an umbrella agreement with WSDOT in November 2011 to implement the remainder of the R8A project that consists of the I-90 Two-Way Transit and HOV Operations Project Stages 2 and 3 and the use of the I-90 center lanes for construction and operation of East Link. Sound Transit agreed to fund Stages 2 and 3 of the I-90 Two Way Transit and HOV projects in exchange for landbank credit which could be used for a temporary construction airspace lease for the construction of light rail along the I-90 center lanes as well as a 40 year airspace lease with an option to renew for 35 years for the operation of light rail in the center lanes of I-90.

Stage 2 of this work was completed in March of 2012 for a total commitment of $20.2 million. In June of 2014 and February 2017, task orders under construction and professional services umbrella agreements with WSDOT were executed for Stage 3, for an estimated total commitment of $190.9 million. In June 2017, WSDOT turned over the center roadway of I-90 to Sound Transit to begin guideway construction, although substantial completion will not occur until 2018. At December 31, 2017, $179.2 million has been incurred with a remaining commitment for Stage 3 of $11.7 million.

Sounder— Agreements have been entered into with the BNSF Railway Company (BNSF) for the operation of its Sounder commuter rail service and the National Railroad Passenger Corporation (Amtrak) for maintenance of the locomotives, cab and coach cars (rolling stock). Service between Everett and Seattle and Seattle and Tacoma is on rail right of way owned and operated by BNSF.

South Line— Service between Seattle and Lakewood are provided by BNSF under a 40-year service agreement for the operation of 18 daily one-way commuter rail trips that expires in 2040. The agreement establishes the compensation paid to BNSF for train crews, maintenance of way and other expensed incurred in the operation of the Sounder Service and is based on actual cost of crew, dispatch and management, as well as cost for maintenance of way and performance incentives. The agreement was amended to extend BNSF's operations beyond Tacoma to the City of Lakewood and to add up to 8 additional daily one-way trips were added by way of commuter rail easements purchased by Sound Transit. The agency is operating all 13 daily round-trips provided under these agreements (11 daily round-trips in 2016). Upon expiration of the service agreement, Sound Transit's use of BNSF track will be bound by a dormant Joint Use Agreement for BNSF's Seattle-Tacoma corridor.

North Line— BNSF operates four daily commuter rail round trips for Sound Transit under a service agreement. The service agreement expires in December 2020. At that time Sound Transit's four round trips under commuter rail easements purchased by Sound Transit from BNSF on its Seattle to Everett corridor will be governed by a now dormant joint use agreement.

Rolling Stock— Lease of the initial portion of its fleet of locomotives, passenger coaches and cab cars (rolling stock) to the National Railroad Passenger Corporation (Amtrak) for $1. Under the agreement, Amtrak is obligated to repair, maintain and service the rolling stock at Amtrak's maintenance facility in return for payment by Sound Transit. By separate agreement, Amtrak subleased this rolling stock to BNSF for operation of Sounder Service. Both lease agreements are for a 40-year term, expiring in 2040.

Maintenance Service Agreement— In 2016 Sound Transit entered into an amended agreement with Amtrak, under which Sound Transit pays a flat monthly fixed price dependent upon the number of one-way trips and train sets in operation for a baseline set of operating assumptions. A negotiated rate is also established for additional service above the baseline operating plan. The agreement expires in 2021.

First Hill Streetcar— This agreement establishes the minimum scope of work for the project and funding obligations for Sound Transit. In October 2010, Sound Transit agreed to fully fund $132.8 million of the costs necessary to design, construct and operate the First Hill Streetcar that was established in the November 2009 funding and cooperative agreement, of which $5.0 million is payable annually through 2023 for annual operations and maintenance expenses. The City will own and operate the First Hill Streetcar facilities and vehicles.

Land Bank Agreement— Sound Transit entered into an agreement called the Land Bank Agreement with WSDOT in July 2000 and as restated in December 2003, the purpose of which is to establish a framework within which WSDOT can from time to time convey portions of WSDOT property to Sound Transit and to make other portions of other WSDOT property available for non-highway use by Sound Transit in consideration for Sound Transit's funding of highway purpose improvements. In August 2010, as part of the Umbrella Agreement with WSDOT to complete the R8A Project, WSDOT agreed to grant Sound Transit land bank credits for all of its funding on the R8A projects as well as to extend the land bank agreement to 2080. Sound Transit will continue to earn land bank credits for projects involving highway improvements and use credits on projects that are located within the public highway right of way. Sound Transit has guideways located on WSDOT property governed under multiple twenty-year airspace leases issued under the land bank agreement. These airspace leases have options to renew for an additional 20 years, at no additional cost or use of Land Bank Agreement credits. Should Sound Transit and WSDOT not enter into a new agreement at the end of the leases, property ownership transfers to WSDOT. At December 31, 2017, the value of the unused land bank credits that have not been conveyed by WSDOT to Sound Transit was $92.8 million. This value is not recorded in the financial statements as there is not sufficient certainty that the credit will be utilized.

The following table provides information on additions to and uses of credits accruing to the benefit of Sound Transit in 2017 and 2016.

(in millions)	2017	2016
Balance in Land Bank, beginning of year	$ 341.4	$ 294.8
Additions:		
85th Corridor Kirkland	-	0.8
I-90 Two-Way Transit & HOV	23.8	101.2
Draws:		
Bellevue Park and Ride Parcel	(1.6)	-
I-90 Center Roadway Improvement Repayment	(69.2)	-
Temporary Construction Airspace Lease (TCAL):		
SR-520 Roadway	(14.9)	(55.4)
I-405 Roadway	(0.4)	-
I-90 Center Roadway	(74.8)	-
Airspace Lease:		
I-405 Roadway	(0.3)	-
I-90 Center Roadway	(111.2)	-
Balance in Land Bank, end of year	**$ 92.8**	**$ 341.4**

Amended and Restated Agreement for Regional Fare Coordination System— In April 2009, Sound Transit entered into an amended agreement to operate and maintain a RFCS that establishes a common, non-cash fare system throughout seven participating transit agencies service areas and commits the agencies to using the RFCS for a minimum of ten years. Each agency shares in operating and maintaining the RFCS in accordance with the agreement. Sound Transit's proportionate share of RFCS operating and maintenance costs is 20.6% for years 2017 and 2016.

The following table represents the amounts included in these financial statements of Sound Transit's participation:

(in thousands)	December 31	
	2017	**2016**
Assets		
Current assets		
Cash and cash equivalents	$ 13,422	$ 11,918
Accounts receivable	11,982	10,007
Total assets	**25,404**	**21,925**
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	15,059	13,013
Unearned revenue	10,345	8,912
Total liabilities	**25,404**	**21,925**
Net position	**$ -**	**$ -**
Total operating revenues	**$ 76,287**	**$ 66,047**
Total expenses	**$ 1,875**	**$ 1,603**

Purchases— At December 31, 2017 and 2016, Sound Transit had outstanding construction commitments of approximately $3.3 billion and $2.0 billion, respectively.

Grants— Sound Transit participates in several federal, state and local grant programs that are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that Sound Transit has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectability of any related receivable at December 31, 2017 and 2016 may be impaired. In the opinion of management, there are no significant contingent liabilities relating to noncompliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying financial statements for such contingencies.

Claims— In the ordinary course of business, Sound Transit has been named as a defendant in a number of lawsuits relating to contractual matters. Although the ultimate outcome, if any, of these matters is presently unknown, management has evaluated all claims and potential claims and, where that exposure is probable, has reflected in the accounts of Sound Transit its best estimate of the exposure.