



***Central Puget Sound
Regional Transit Authority***

*Single Audit Reports for the
Year Ended December 31, 2011*

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MANAGEMENT'S DISCUSSION AND ANALYSIS

For the years ended December 31, 2011 and 2010

Management's Discussion and Analysis ("MD&A") presents a narrative overview and analysis of the financial activities of the Agency for the years ended December 31, 2011 and 2010. 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 footnotes as a whole.

Central Puget Sound Regional Transit Authority, a public corporation acting under the service name of Sound Transit, is a regional transit authority implementing and providing a high-capacity transportation system throughout parts of King, Pierce and Snohomish counties through commuter rail ("Sounder"), light rail ("Link") and a regional express bus system ("ST Express"). The initial phase of the voter-approved regional mass transit system "Sound Move" is scheduled for completion in 2016. The second phase "ST2," approved by the voters in November 2008, is scheduled for a 2023 completion. As individual transit system elements are completed, service will expand.

Sound Transit's financial statements reflect a growth in operating revenues and capital assets. In 2011, operating revenues increased significantly due to increases in ridership and fares on ST Express and Central Link. Sales and Use tax revenues also increased, mostly due to the Department of Revenue's (DOR) Amnesty Program, but also a growth in sales tax revenues in the latter part of the year. Operating expenses increased by less than 2.0%, as routes and schedules were adjusted to capitalize on efficiencies of higher demand routes and lower maintenance costs were incurred. Major sources of non-operating revenue continue to exceed expenses providing an increase in net assets as Sound Transit continues to build out the voter-approved capital program.

Financial Highlights

- Total operating revenues were \$51.9 million for 2011, an increase of 29.4% from the prior year. Passenger fares increased by \$8.5 million from the prior year primarily as a result of increased ridership and pricing on business passport contracts, as well as an increase in fares on ST Express and Central Link light rail in 2011.
- Loss from operations was \$271.5 million for 2011, a decrease of 3.0% from the prior year.
 - Overall operations and maintenance expenses increased by 1.9% from 2010. Costs increased in vehicle and facility maintenance as the light rail vehicles come out of warranty. Also, there were increases in fuel, fare enforcement and security costs incurred on ST Express and Sounder commuter rail, offset substantially by savings from the restructuring of ST Express service, the preservation of ST Express operating rates at 2010 levels and delays in major mid-life maintenance for Sounder commuter rail.
 - General and administrative expenses decreased by 13.5%, primarily due to a decrease in professional fees incurred in support of construction claim resolution.
- Non-operating revenues, net of expenses were \$497.8 million, a 5.9% decrease from prior year primarily as a result of increases in contributions to other governments. Tax revenues increased by \$23.6 million or 4.1%, largely due to the collection of prior year taxes from 2007 to 2011 under the DOR Amnesty Program. Investment income increased \$6.8 million or 47.8% due to an increase in the market value of investments. Capital contributions to other governments increased \$74.0 million with the completion of Mountlake Terrace Freeway Station, Kirkland Transit Center and Edmonds Station in 2011.

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Management's Discussion and Analysis, continued

- Capital contributions from federal, state and local funding arrangements were \$174.3 million, an increase of 6.4% from the prior year mostly due to higher drawdowns on the University Link full funding grant agreement resulting from increased construction spending on that project.
- Total net assets at December 31, 2011 were \$4.4 billion, an increase of \$400.6 million or 9.9% from 2010. The change in net assets in 2011 is less than the change in net assets in 2010 primarily due to the increase in capital contributions to other governments in 2011 consisting mostly of contributions to Washington State Department of Transportation (WSDOT) for the Mountlake Terrace Freeway Station that was completed and donated in 2011.
- Total capital assets, net of accumulated depreciation and amortization, were \$5.0 billion at December 31, 2011, an increase of \$386.3 million or 8.4% from 2010. The increase in total capital assets was mostly attributable to the progress on the University Link and the Sounder D Street – M Street Track & Signal project. In 2011, \$214.2 million in expenditures related to completed projects or land acquisitions were transferred to land, permanent easements, transit facilities, vehicles and equipment.

Overview of the Financial Statements

Sound Transit's financial statements are prepared in conformity with United States Generally Accepted Accounting Principles (GAAP). The 2011 and 2010 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 and liabilities associated with the operation of Sound Transit are included in the Balance Sheets and depreciation and amortization of capital assets is recognized in the Statements of Revenues, Expenses and Changes in Net Assets.

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 assets, segregated by invested in capital assets (net of related debt), restricted and unrestricted. Net assets are the difference between Sound Transit's assets and liabilities 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 Assets

Sound Transit's total net assets at December 31, 2011, were \$4.4 billion, an increase of \$400.6 million or 9.9% from 2010. Total assets increased \$277.7 million or 4.7% and total liabilities decreased by \$122.9 million or 6.6%. The large increase in total assets reflects capital program spending, most significantly the University Link light rail projects and the Sounder D Street to M Street Track & Signal project, as well as the acquisition of an additional Sounder easement in the South corridor and replacement buses for ST Express. See the following table for a summary of Sound Transit's net asset position.

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Management's Discussion and Analysis, continued

Net Asset Position

<i>(in millions)</i>	December 31			% Change	
	2011	2010	2009	2011-2010	2010-2009
Assets					
Current assets, excluding restricted assets	\$ 988.6	\$ 1,090.6	\$ 918.8	(9.4)%	18.7%
Restricted assets	108.3	109.3	239.7	(0.9)	(54.4)
Capital assets	4,996.8	4,610.5	4,200.7	8.4	9.8
Other non-current assets	87.8	93.4	92.0	(6.0)	1.5
Total assets	6,181.5	5,903.8	5,451.2	4.7	8.3
Liabilities					
Current liabilities, excluding interest payable from restricted assets	134.1	228.4	167.4	(41.3)	36.4
Interest payable from restricted assets	18.0	18.2	19.0	(1.1)	(4.3)
Long-term debt	1,529.0	1,550.5	1,571.3	(1.4)	(1.3)
Other long-term liabilities	65.5	72.4	72.1	(9.6)	0.4
Total liabilities	1,746.6	1,869.5	1,829.8	(6.6)	2.2
Net assets					
Invested in capital assets, net of related debt	3,457.9	3,051.5	2,775.5	13.3	9.9
Restricted net assets	90.3	91.1	78.3	(0.9)	16.4
Unrestricted net assets	886.7	891.7	767.6	(0.6)	16.2
Total net assets	\$ 4,434.9	\$ 4,034.3	\$ 3,621.4	9.9%	11.4%

Current assets, excluding restricted assets, decreased in 2011 by 9.4% from 2010. Cash and investments decreased due to further capital program spending in 2011, as significant Sound Move projects were completed and as ST2 projects progressed. In 2010 current assets, excluding restricted assets, increased by 18.7% from 2009 as cash received from revenues exceeded 2010 capital and operating expenditures for the year, allowing Sound Transit to increase its investment position in that year.

In 2011, restricted assets were similar to prior year levels while in 2010 restricted assets decreased by 54.4% from 2009 as cash that was restricted from the 2009 bond issuance was fully spent down.

Capital assets increased in 2011 by 8.4% from 2010 reflecting construction spending on University Link and Sounder D Street to M Street Track & Signal projects, the acquisition of the second permanent easement from the BNSF Railway Company (BNSF) and the purchase of thirty-five replacement buses. In 2010, capital assets increased 9.8% over 2009 as construction ramped up on the University Link project, the acquisition of a permanent easement from BNSF and the purchase of twenty-seven new buses.

Total capital project spending for 2011 was \$578.1 million (2010 was \$520.6 million). University Link represented the largest capital spending component comprising 54.5% of spending on capital projects. In all, total capital spending for light rail was \$405.7 million or 69.8% of the total capital spending (\$339.2 million or 65.5% in 2010). Capital spending on Sounder and ST Express projects as a percentage of total capital spending was 16.8% and 7.1%, respectively (18.9% and 5.6% in 2010). Transfers out of capital projects in progress were \$297.4 million (\$201.1 million in 2010) as projects were completed and transferred to property, transit facilities, vehicles and equipment or expensed as indicated in the following table:

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Management's Discussion and Analysis, continued

Transfers Out of Capital Projects in Progress

(in millions)

	For the Year Ended December 31		
	2011	2010	2009
Transferred to property, vehicles and equipment	\$ 214.2	\$ 191.5	\$ 2,387.9
Expensed to contributions to other governments	81.7	7.7	25.5
Transferred to prepaid expenses, inventory and non-capitalized expenditures	-	0.1	0.5
Link start-up expenditures	-	-	12.8
Write-off of overhead, discontinued and impaired project costs and loss on disposal of assets	1.5	1.8	11.2
Total	\$ 297.4	\$ 201.1	\$ 2,437.9

Costs written off to general and administrative for 2011 were comparable to 2010. In 2010, costs written off to general and administrative expenses decreased as the majority of excess overhead incurred on Sounder projects were written off in 2009 and as no major project impairments were identified.

Current liabilities, in 2011, excluding interest payable from restricted assets, decreased by 41.3% as significant construction claims were settled during the year. Current liabilities, in 2010, excluding interest payable from restricted assets, increased by 36.4% as higher amounts were payable at year-end with the increase in construction activity in 2010. Interest payable and long-term debt decreased in 2011 and 2010 reflecting principal payments made on the 1999, 2005A and 2007A bonds. Other long-term liabilities decreased by 9.6% due to payments made on the capital lease obligation for Sounder rail cars.

The following table presents the net asset components and their relative percentage to total net assets:

Net Assets

(in millions)

	December 31			% Total Net Assets		
	2011	2010	2009	2011	2010	2009
Invested in capital assets, net of related debt	\$ 3,457.9	\$ 3,051.5	\$ 2,775.5	78.0%	75.6%	76.6%
Restricted net assets	90.3	91.1	78.3	2.0	2.3	2.2
Unrestricted net assets	886.7	891.7	767.6	20.0	22.1	21.2
Total	\$ 4,434.9	\$ 4,034.3	\$ 3,621.4	100.0%	100.0%	100.0%

Sound Transit's net assets represent the cumulative effect of the excess of revenues over expenses together with the impact of Sound Transit's financing decisions. Invested in capital assets reflects investment in property, net of related debt, construction in progress and depreciable assets used in its operations. Restricted net assets are assets restricted by a third party for use by the agency for a specific purpose and unrestricted net assets are the remainder of net assets not invested in capital nor restricted for a specific purpose. Net asset categories as a percentage of total net assets were comparable for 2011, 2010 and 2009.

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Management's Discussion and Analysis, continued

Changes in Net Assets

Changes in net assets reflect the excess of revenue over expenses for a year. In 2011, revenues exceeded expenses by \$400.6 million, while in 2010 it was \$412.9 million. Operating revenues, primarily passenger fares, increased 29.4%, while non-operating revenues, net of expenses decreased 5.9% due to increased capital contributions to other governments primarily consisting of the contribution of the completed Mountlake Terrace Freeway Station project. Sound Transit's Statement of Revenue, Expenses and Changes in Net Assets is summarized in the table below:

Changes in Net Assets					
<i>(in millions)</i>	For the Year Ended December 31			% Change	
	2011	2010	2009	2011-2010	2010-2009
Operating revenues					
Passenger fares	\$ 46.1	\$ 37.6	\$ 29.0	22.7%	29.4%
Other	5.8	2.5	3.6	128.3	(29.6)
Total operating revenues	51.9	40.1	32.6	29.4	22.9
Operating expenses					
Total operating expenses, before depreciation and loss on disposal of assets	213.0	215.7	192.7	(1.3)	12.0
Depreciation and loss on disposal of assets	110.4	104.3	65.8	5.9	58.5
Total operating expenses	323.4	320.0	258.5	1.0	23.8
Loss from operations	(271.5)	(279.9)	(225.9)	(3.0)	23.9
Non-operating revenues, net of expenses	497.8	529.0	492.9	(5.9)	7.3
Income before capital contributions	226.3	249.1	267.0	(9.1)	(6.7)
Capital contributions	174.3	163.8	176.4	6.4	(7.1)
Change in net assets	400.6	412.9	443.4	(3.0)	(6.9)
Total net assets, beginning	4,034.3	3,621.4	3,178.0	11.4	14.0
Total net assets, ending	\$ 4,434.9	\$ 4,034.3	\$ 3,621.4	9.9%	11.4%

Operating Revenues

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

Passenger Fare Revenue

Passenger fares are derived from the sale of Sounder commuter rail and Central Link tickets from ticket vending machines, farebox 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. Sound Transit experienced overall growth in passenger fare revenue of 22.7% and 29.4% in 2011 and 2010, respectively, due to increases in both ridership and fares. ST Express continues to be the largest revenue generating mode due to the nature of its service serving major corridors and transit centers in the Sound Transit

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Management's Discussion and Analysis, continued

District as well as serving as a connector between other Sound Transit modes and local bus services. The effect of each component on passenger fare revenue is discussed in the sections below.

The following table displays passenger fare revenue by mode:

Passenger Fare Revenue					
<i>(in millions)</i>					
	2011	2010	2009	% Change	
				2011-2010	2010-2009
ST Express	\$ 25.7	\$ 20.9	\$ 18.9	23.5%	10.3%
Link	12.0	9.6	2.3	25.3	305.1
Sounder	8.4	7.1	7.8	16.8	(8.3)
Total	\$ 46.1	\$ 37.6	\$ 29.0	22.7%	29.4%

Overall Sound Transit ridership increased 10.7% in 2011 to 26.0 million riders. ST Express ridership increased 11.0% as increases in automobile fuel prices attracted riders and service redeployments that moved resources to serve higher capacity routes. In 2010, while down 5.0% from 2009, ridership on ST Express was preserved due to route enhancements deployed on heavily traveled routes that included increased service hours of 3.1% in 2010.

Link consists of Central Link and Tacoma Link. Ridership on Link increased 11.6% from 2010 due to continued growth in ridership on Central Link, which opened in 2009, and the opening of the Commerce Street station on Tacoma Link in September 2011. In 2010 Central Link ridership increased by 4.5 million riders, as new ridership was derived from the community as well as other Sound Transit service modes and local bus service that services the Central Link corridor. Ridership on Tacoma Link in 2010 was comparable to that of 2009.

Sounder commuter rail ridership increased to 2.6 million or 5.9% from 2.5 million riders in 2010 as a few major businesses relocated to the downtown Seattle area and automobile fuel prices increased. Sounder commuter rail ridership in 2010 was comparable to the prior year, with growth impacted by a slowing regional economy, lower automobile fuel prices and reduced congestion, which combined to reduce the incentives to use rail transit.

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

Ridership					
<i>(in thousands)</i>					
	2011	2010	2009	% Change	
				2011-2010	2010-2009
ST Express	14,534.4	13,092.8	13,784.8	11.0%	(5.0)%
Link	8,831.8	7,914.4	3,421.8	11.6	131.3
Sounder	2,626.7	2,480.1	2,492.4	5.9	(0.5)
Total	25,992.9	23,487.3	19,699.0	10.7%	19.2%

In addition to the effects of the changes in ridership, the overall average fare per boarding (AFB) in 2011 increased \$0.20 or 11.5%, mostly due to changes in pricing methodology for annual business passport contracts that began utilizing actual account ridership data from the ORCA system. Business passport contracts represent the largest source of revenue for each mode. ST Express and Central Link AFB's further increased as a result of a \$0.50 and \$0.25 fare increase for regular fares on ST Express and Central Link, respectively, and a \$0.25 fare increase for youth fares on ST Express. Fares were increased in 2011 on ST Express to align fares with partner transit agencies. The 2011 Sounder commuter rail AFB

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Management's Discussion and Analysis, continued

increased \$0.29 or 10.2% from 2010 due to the new pricing methodology utilized in 2011 for business passport contracts.

The increase in the overall AFB in 2010 from 2009 was 5.0% primarily due to a fare increase on ST Express and an increase in ridership on Central Link. In 2010, the increase in ST Express AFB from \$1.47 to \$1.67 is the result of a \$0.50 regular fare increase to maintain established farebox recovery levels. The Central Link AFB increased in 2010 from \$0.98 to \$1.38 as a result of the line completing its first full year of service. Sounder commuter rail AFB decreased 7.7% from \$3.12 to \$2.88 in 2010 due to varying ridership patterns and greater utilization of the service by business account riders in which revenue is derived from fixed price multi-modal contracts. See the table below for the AFB by mode.

Average Fare per Boarding

	% Change				
	2011	2010	2009	2011-2010	2010-2009
ST Express	\$ 1.90	\$ 1.67	\$ 1.47	13.5%	13.6%
Link	1.53	1.38	0.98	11.1	40.2
Sounder	3.17	2.88	3.12	10.2	(7.7)
Combined average fare per boarding	1.92	1.72	1.64	11.5	5.0

Other Operating Revenues

Other operating revenues consist of vehicle advertising, rental of equipment and facilities, operating grants and other miscellaneous revenue. Other operating revenues of \$5.8 million were up \$3.3 million or 128.3% from 2010. In 2011, \$2.4 million in operating grants from WSDOT were obtained for airspace lease rights for Mountlake Terrace Freeway Station and University of Washington Station upon the opening of University Link scheduled for 2016. Furthermore, rental revenue substantially increased in 2011 as buses were leased to Pierce Transit following the compressed natural gas tank explosion at their maintenance facility in February 2011. In 2010, other operating revenues were down \$1.1 million or 29.6% from 2009 as the vehicle lease arrangements with Metrolink were terminated for several Sounder revenue vehicles to meet planned service expansion requirements on the Sounder South Line in 2010.

Operating Expenses

Operating expenses are comprised of operations and maintenance costs, general and administrative, fare and regional planning, and depreciation and amortization.

Operations and Maintenance

Operations and maintenance expenses increased in 2011 by \$3.4 million or 1.9% and by \$16.3 million or 10.0% in 2010 due to increases in the overall operating cost of Central Link as light rail vehicles come out of warranty and as facilities maintenance increases as a result of increased use. The operating cost of ST Express and Sounder commuter rail in 2011 remained comparable to 2010.

These expenses are classified by function using National Transit Database definitions as prescribed by the Federal Transit Administration into vehicle operations, vehicle maintenance and non-vehicle maintenance. Vehicle operations expenses consist of costs to dispatch and operate vehicles while in revenue service including security and fare collection. Vehicle maintenance expenses include costs associated with ensuring the revenue vehicles are operational, fueled, inspected and repaired. Non-vehicle maintenance expenses include costs necessary to ensure buildings, equipment, and transit structures and systems are operational. See the following table for operating and maintenance expenses by function.

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Management's Discussion and Analysis, continued

Operations and Maintenance Expenses by Function

<i>(in millions)</i>				% Change	
	2011	2010	2009	2011-2010	2010-2009
Vehicle operations	\$ 112.5	\$ 107.1	\$ 97.8	5.1%	9.5%
Vehicle maintenance	45.6	46.7	45.4	(2.5)	2.8
Non-vehicle maintenance	24.0	24.9	19.2	(3.5)	29.7
Total	\$ 182.1	\$ 178.7	\$ 162.4	1.9%	10.0%

The increase of \$5.4 million or 5.1% in 2011 for vehicle operations expense stems from increases in fuel costs, fare enforcement and security on all modes and increases in Central Link operator rates, offset partially by savings realized from the restructuring of ST Express service. The restructure of ST Express service resulted in more cost effective operations as higher capacity routes and peak service times were served more effectively. The increase in 2010 of \$9.3 million or 9.5% resulted from the operation of a full year of an additional reverse commute for Sounder commuter rail, which started in June 2009, implementation of ST2 service enhancements for ST Express and the operation of a full year of revenue service on Central Link.

Vehicle maintenance expenses decreased \$1.1 million or 2.5% in 2011 (increased \$1.3 million or 2.8% in 2010) reflecting the delay in further mid-life maintenance scheduled for Sounder commuter rail to 2012 as well as the replacement of buses that had reached their full service life in 2011. As the agency replaced ST Express buses and expanded the fleet in 2010 and 2011 bus maintenance costs have declined. In 2011, the delay in planned mid-life maintenance for Sounder commuter rail was accomplished without impact to operations or safety of those vehicles and these savings helped offset increases in light rail vehicle maintenance costs that increased as the vehicles came out of warranty during the year. Vehicle maintenance expense increased in 2010 due to performance of mid-life maintenance on Sounder commuter rail and increased maintenance on the aging ST Express fleet as well as a full year of maintenance performed on Central Link light rail vehicles that went into service in June 2009.

Non-vehicle maintenance expenses decreased \$0.9 million or 3.5% in 2011 (increased \$5.7 million or 29.7% in 2010) due to a decrease in major maintenance related to the Downtown Seattle Transit Tunnel (DSTT) for ST Express and Central Link that was completed in 2010. The decrease in DSTT major maintenance offset increases in facility and track maintenance for Central and Tacoma Link and Sounder commuter rail in 2011. The amount increased in 2010 with the full year impact of the deployment of fare collection equipment for light rail, a full year of increased share of maintenance costs related to the DSTT and transit facilities supporting the Central Link light rail service, opened July 2009, as well as an increase in maintenance performed at existing transit facilities in 2010.

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Management's Discussion and Analysis, continued

The following table presents operating and maintenance expenses by mode.

Operations and Maintenance Expenses by Mode					
<i>(in millions)</i>					
	2011	2010	2009	% Change	
				2011-2010	2010-2009
ST Express	\$ 96.7	\$ 96.6	\$ 85.0	0.1%	13.7%
Link	53.3	49.4	43.1	8.0	14.4
Sounder	32.1	32.7	34.3	(1.8)	(4.7)
Total	\$ 182.1	\$ 178.7	\$ 162.4	1.9%	10.0%

Major modal expense categories consist of services, materials, supplies, utilities, insurance, taxes, and purchased transportation, allocated overhead from staff divisions and operating leases and rentals. Purchased transportation represents amounts paid to Community Transit, King County Department of Transportation (DOT) and Pierce Transit who operate Sound Transit's express bus service and King County DOT Rail Division, which operates the Central Link light rail and to BNSF, which operates Sounder commuter rail. Purchased transportation services accounts for 62.8% of this category in 2011 and 63.1% in 2010. Services are the next largest expenditure category and include the Sounder vehicle maintenance contracted to Amtrak and various contracts for facilities maintenance and security at Sound Transit owned and shared facilities. Services were 19.2% in 2011 and 19.7% in 2010 of total operating and maintenance expenses.

ST Express operating and maintenance costs for 2011 were comparable to 2010 levels whereas 2010 experienced an increase of 13.7% over 2009. Costs were maintained in 2011 as a result of transferring routes 566 and 567 from King County DOT to Pierce Transit, a lower cost operator, and a decrease in bus maintenance costs with the majority of the aging New Flyer fleet being replaced. The 2010 increase was a result of an increase in purchased transportation costs of \$11.4 million as the majority of the ST2 related service enhancements were implemented, operator fees increased, significant maintenance was performed on the aging New Flyer bus fleet and maintenance fees for facilities and the DSTT increased.

Link operating and maintenance expenses include both Tacoma Link and Central Link light rail lines. Total light rail operating and maintenance expenses increased \$3.9 million or 8.0% from 2010 (\$6.3 million or 14.4% from 2009) as a result of increases in Central Link operating rates as additional employees were needed to perform revenue vehicle and transit facility maintenance. Total operating and maintenance expense for Central Link was \$46.0 million in 2010, an increase of 16.3% from 2009, due to the operation of its first full year of revenue service in 2010. Tacoma Link operating and maintenance expenses were comparable for 2011, 2010 and 2009.

Operating and maintenance costs on Sounder commuter rail were slightly down from 2010 as service levels remained substantially unchanged compared to a 4.7% decrease in 2010 from the prior year. The cost savings realized in 2011 were as a result of fuel saving measures implemented at layover facilities throughout 2010 and improved cost structure related to the Amtrak maintenance contract that offset the increase in service operating rates related to BNSF and increase in fuel prices. In 2010, service costs decreased \$2.3 million as security and fare collection services were shared with other modes, resulting in a significant per unit cost decrease for Sounder commuter rail. Purchased transportation costs increased in 2010 with the full year operation of an additional reverse commute trip deployed in June 2009 in the South Corridor.

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Management's Discussion and Analysis, continued

General and Administrative

General and administrative expenses comprise Agency staff and administrative costs not allocated to operations and maintenance or to capital projects. Major expense categories include salaries, benefits, services and professional fees, and other expenses. In 2011, general and administrative expenses decreased by \$4.7 million or 13.5%, while in 2010 they increased by \$9.6 million or 38.9% primarily due to the amount incurred in legal defense costs related to construction claim resolution.

General and Administrative Expenses

<i>(in millions)</i>				% Change	
	2011	2010	2009	2011-2010	2010-2009
Salaries	\$ 10.7	\$ 10.1	\$ 10.8	6.0%	(6.3)%
Benefits	5.3	5.6	5.7	(5.5)	(2.4)
Services and professional fees	10.6	14.1	4.7	(24.3)	197.9
Other	<u>2.9</u>	<u>4.4</u>	<u>3.4</u>	<u>(34.1)</u>	<u>31.1</u>
Total	<u>\$ 29.5</u>	<u>\$ 34.2</u>	<u>\$ 24.6</u>	<u>(13.5)%</u>	<u>38.9%</u>

Salaries and benefits increased 1.9% in 2011 due to an increase in staff to support critical organizational functions needed to support the ST2 program as well as agency wide services and initiatives such as asset and records management. Salaries and benefits decreased by 5.0% in 2010 as staff were assigned to support the transition of University Link to construction and the ramp up of Central Link operations.

Services and professional fees decreased \$3.5 million or 24.3% in 2011 (increased \$9.4 million or 197.9% in 2010) reflecting less costs incurred to support construction claim resolution as most outstanding construction claims related to Central Link were settled in 2010. Excluding claims costs, services and professional fees were comparable between years.

Other expenses decreased by \$1.5 million or 34.1% from 2010 as additional costs were charged to capital projects in support of the ST2 capital program. Other expenses increased in 2010 by \$1.0 million or 31.1% due to a full-year lease of additional office space that commenced at the end of 2009.

Fare and Regional Planning

Fare and regional planning expense 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. In 2011, fare and regional planning expenses decreased by \$1.6 million or 53.8% as more costs were allocated to capital projects as ST2 projects began preliminary design as well as a decrease in ORCA implementation costs from 2010. In 2010, fare and regional planning expenses decreased by \$2.8 million or 49.3% as planning related to East Link was completed in 2009.

Depreciation and Amortization

Depreciation and amortization includes insignificant gain or loss on disposal of assets used in operations. Depreciation and amortization increased in 2011 by \$6.1 million or 5.9% from the prior year (\$38.5 million or 58.5% increase in 2010) due to additional revenue vehicles that went into service for ST Express and Central Link light rail as well as additional costs that were capitalized related to Central Link assets as construction contracts reach full completion. In 2010, the increase in depreciation and amortization from 2009 reflects the Central Link light rail system that went into service in July 2009.

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Management's Discussion and Analysis, continued

Non-Operating Revenues (Expenses)

Net non-operating revenues decreased by \$31.2 million or 5.9% in 2011 compared to an increase of \$36.1 million or 7.3% in 2010. In 2011, net non-operating revenues decreased as capital contributions to other governments increased by \$74.0 million that offset increases in tax revenues of \$23.6 million and \$6.8 million in investment income. In 2010 net non-operating revenues increased primarily as a result of the increase in sales and use tax revenue collected at the higher sales and use tax rate of 0.9% for the entire year compared to 9 months in 2009.

Non-operating Revenues and Expenses

<i>(in millions)</i>	% Change				
	2011	2010	2009	2011-2010	2010-2009
Non-operating revenues					
Sales and use tax	\$ 528.0	\$ 504.1	\$ 440.9	4.7%	14.3%
Motor vehicle excise tax	65.9	65.8	67.3	0.2	(2.2)
Rental car tax	2.0	2.4	2.9	(18.7)	(16.0)
Investment income	20.9	14.1	12.4	47.8	14.3
Other revenues	8.6	10.8	0.9	(18.7)	1,070.0
Total	625.4	597.2	524.4	4.7	13.9
Non-operating expenses					
Interest expense	76.0	76.4	62.5	(0.6)	22.3
Interest expense, capitalized	(32.2)	(23.6)	(62.3)	36.5	(62.1)
Interest expense, net	43.8	52.8	0.2	(17.1)	28,875.0
Capital contributions to other governments	81.7	7.7	25.5	961.2	(69.8)
Discontinued/impaired projects	2.1	7.7	5.8	(72.3)	32.4
Total	127.6	68.2	31.5	87.3	116.4
Non-operating revenues	\$ 497.8	\$ 529.0	\$ 492.9	(5.9)%	7.3%

Sales and Use tax revenues increased by \$23.9 million or 4.7% in 2011 due to taxes received from the DOR Amnesty Program that provided incentives to businesses to satisfy their tax obligations for years 2007 through 2011 by waiving non-compliance penalties and interest, as well as an increase in tax revenues due to faster economic growth. Sales and Use tax revenues increased in 2010 by \$63.2 million or 14.3% due to a full year collection of tax at the ST2 voter approved rate of 0.9% that became effective April 2009 versus the prior rate of 0.4%. Motor Vehicle Excise and Rental Car Sales tax revenues were comparable for 2009, 2010 and 2011.

Investment earnings increased by \$6.8 million in 2011 due to increases in the fair market value of investments. In 2010, the investment income increased as a result of higher cash and investment balances on hand during the year from the issuance of bonds in September 2009. Other revenue decreased by \$2.2 million from 2010 as no insurance recoveries were received in 2011 as there had been in 2010.

Interest expense, net decreased \$9.0 million from 2010 as more interest was capitalized due to higher construction spending from the prior year. In 2010 interest expense, net increased \$52.6 million as additional interest was incurred on the bonds issued in September 2009 and less interest was capitalized

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

with the decreased capital program spending as Initial Segment construction reached substantial completion and construction on University Link project had not yet fully ramped up.

Capital contributions to other governments are pursuant to capital improvement or funding agreements and are dependent upon the timing and scope of project activities that results in significant fluctuations year over year. In 2011, capital contributions increased \$74.0 million from 2010 reflecting the completion of Mountlake Terrace Freeway Station, Kirkland Transit Center and Edmonds Station projects now owned by WSDOT, City of Kirkland and Community Transit, respectively. In 2010 capital contributions decreased \$17.8 million from 2009 as Newcastle Transit Center was the only project completed in which Sound Transit didn't retain an ownership interest.

Impairments result from permanent loss in utility of an asset or one of its components. As such, assets and capital projects are reviewed annually for reductions in functionality resulting from obsolescence, scope changes and loss due to casualty that cause impairment, thereby resulting in a write-off of the associated cost. In 2011, impairments decreased by \$5.6 million (and increased in 2010 from 2009 by \$1.9 million) as costs incurred to mitigate the Beacon Hill Tunnel voids created during the construction of the Initial Segment project were primarily incurred in 2010.

Capital Contributions

Capital contributions include federal grant funding and state and local contributions to Sound Transit. Capital contributions increased in 2011 by \$10.5 million or 6.4% due to increased spending on eligible federally funded capital projects. The following table summarizes capital contributions by major category:

Capital Contributions <i>(in millions)</i>	% Change				
	2011	2010	2009	2011-2010	2010-2009
Federal	\$ 168.7	\$ 151.8	\$ 153.1	11.1%	(0.8)%
State and local governments	5.6	12.0	23.3	(53.5)	(48.6)
Total	\$ 174.3	\$ 163.8	\$ 176.4	6.4%	(7.1)%

Federal contributions increased by \$16.9 million in 2011 reflecting the increased spending on the University Link project that provided for increased grant drawdowns of the University Link full funding grant agreement provided by the Federal Transportation Authority. State and local government contributions decreased in 2011 by \$6.4 million over 2010 as the state regional mobility grants related to Mountlake Terrace Freeway Station and the purchase of expansion buses were fully expended in 2010. In 2010, state and local contributions decreased \$11.3 million from 2009 due to the receipt of a land bank contribution in 2009 from WSDOT for the right to cross under I-5 for the construction and operating of University Link. The Sounder D Street to M Street Track & Signal project also received \$3.1 million and \$3.2 million in state regional mobility grants in 2011 and 2010, respectively.

Capital Assets

As of December 31, 2011, Sound Transit had invested \$5.0 billion in capital assets, net of accumulated depreciation and amortization, which included \$3.2 billion of depreciable assets in service. This represents a \$386.3 million or an 8.4% increase over 2010. The increase reflects capital project spending for University Link, Sounder South Line corridor and Regional Express fleet replacement. Capital Projects in Progress (CIP) increased \$280.7 million or 39.5% while non-depreciable and depreciable assets increased \$50.9 million or 7.1% and \$54.7 million or 1.7%, respectively.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

Capital Assets (Net of Depreciation)

(in millions)	December 31			% Change	
	2011	2010	2009	2011-2010	2010-2009
Land	\$ 392.7	\$ 388.1	\$ 379.0	1.2%	2.4%
Permanent easements	374.1	327.8	285.6	14.1	14.8
Capital projects in progress					
Sound Transit	968.1	661.0	368.1	46.5	79.6
Other governments	23.4	49.8	23.2	(52.9)	114.4
Total capital projects in progress	991.5	710.8	391.3	39.5	81.6
Total non-depreciable assets	1,758.3	1,426.7	1,055.9	23.2	35.1
Buildings, transit facilities & rail	2,346.6	2,370.2	2,329.1	(1.0)	1.8
Access rights	400.6	421.6	445.3	(5.0)	(5.3)
Revenue vehicles	487.1	386.0	362.1	26.2	6.6
Equipment, vehicles & other	4.2	6.0	8.3	(30.2)	(28.6)
Total depreciable assets	3,238.5	3,183.8	3,144.8	1.7	1.2
Total net capital assets	\$ 4,996.8	\$ 4,610.5	\$ 4,200.7	8.4%	9.8%

Land increased by \$4.6 million in 2011, reflecting acquisitions for the North Link project and the Tacoma to Lakewood corridor project and by \$9.1 million in 2010, also for the North Link project as well as the reclassification of land from inventory for land Sound Transit will use in the South Link project.

Permanent easements increased in 2011 by \$46.3 million with the acquisition of the second of four permanent easements from BNSF to operate an additional round trip in the Sounder Seattle to Tacoma corridor and by \$42.2 million in 2010 for the acquisition of the first of four permanent easements.

CIP had a net increase of \$280.7 million in 2011 (\$319.5 million in 2010). In 2011, total capital spending was \$578.1 million, up 11.0% from 2010, as the tunnel and light rail vehicle portion of the University Link project were completed ahead of schedule while transfers out of CIP increased \$96.3 million as new light rail vehicles and buses and Mountlake Terrace Freeway Station were placed into service. Total capital spending in 2010 increased 30.1% from 2009 as University Link project entered construction. Transfers out of CIP decreased by \$2.2 billion in 2010 due to the Initial Segment project starting revenue service in 2009. Capital projects that incurred major spending activity in 2011 and 2010 are summarized in the following table.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

Major Capital Project Activities from 2011 and 2010			
	Souder	Link	ST Express
2011	<ul style="list-style-type: none"> D Street to M Street Track & Signal Souder South Expanded Service 	<ul style="list-style-type: none"> First Hill Link Street Car East Link (Downtown to Bellevue) Northlink (UW Station to Northgate) University Link (PSST to UW Station) University Link (University Tunnel) University Link (UW Station and Capital Hill Station) South Link (176th to 200th) 	<ul style="list-style-type: none"> Burien Transit Center Parking Expansion Fleet Replacement I-90 2-Way Transit & HOV Stage 2
2010	<ul style="list-style-type: none"> D Street to M Street Track & Signal Souder South Expanded Service Tacoma to Lakewood Track & Signal 	<ul style="list-style-type: none"> Central Link (Beacon Hill Tunnel) East Link (Downtown to Bellevue) Northlink (UW Station to Northgate) University Link (PSST to UW Station) University Maintenance Base Expansion South Link (176th to 200th) 	<ul style="list-style-type: none"> Fleet Expansion & Replacement Mountlake Terrace Freeway Station

Building, transit facilities, and rail, net of depreciation and amortization, decreased in 2011 by \$23.6 million due to depreciation exceeding current year asset additions. In 2010, this category increased by \$41.1 million, primarily related to the capitalization of Tacoma to Lakewood Track & Signal project and additional capitalized costs to close out the Initial Segment light rail projects.

Access rights, net of depreciation and amortization, decreased by \$21.0 million in 2011 and decreased by \$23.7 million in 2010. Access rights decreased due to depreciation and amortization exceeding current year additions. Access rights reflect the cost of acquiring rights from the Cities of Seattle, Tukwila and Sea Tac for the purposes of running the light rail in city right of way, rights acquired from BNSF to operate Souder train service, as well as a right to use Washington State Fairgrounds for Souder commuter rail parking.

Revenue vehicles, net of depreciation and amortization, increased in 2011 by \$101.1 million with the delivery of thirty-five buses (the balance of the ST2 replacement and service expansion bus program) and delivery of twenty-seven light rail vehicles for University Link that were deployed in revenue service in 2011. In 2010, revenue vehicles, net of depreciation and amortization, increased \$23.9 million with the purchase of additional buses for bus replacement and service expansion.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

More detailed information about Sound Transit's capital assets is presented in note 5 to the Financial Statements.

Long-Term Debt

Sound Transit issued no debt in 2011 and 2010. 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 2010 assessed valuations for collection of 2011 taxes, Sound Transit's nonvoter approved remaining debt capacity is \$4.7 billion and its voter approved remaining debt capacity is \$19.4 billion.

Economic Conditions

Recovery from the economic recession continues to impact Sound Transit's tax collections with slower recovery in retail and motor vehicle sales that have translated into lower tax revenues than planned, but also the agency has experienced lower construction bid costs on the ST2 capital program. Tax revenues increased in 2011 due to the collection of past due taxes from 2007 through 2011 under DOR's Amnesty Program and a slight easing of the recession and in 2010 due to the impact of a 0.5% Sales and Use Tax increase effective April 1, 2009, implemented to fund the ST2 program approved by voters in November 2008. Without the increased collections received from the Amnesty Program and the rate increase, tax revenues would be comparable to 2009 levels.

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KPMG LLP
Suite 900
801 Second Avenue
Seattle, WA 98104

Independent Auditors' Report

The Board of Directors
Central Puget Sound Regional Transit Authority:

We have audited the accompanying balance sheets of Central Puget Sound Regional Transit Authority (a public corporation acting under the service name Sound Transit) as of December 31, 2011 and 2010, and the related statements of revenue, expenses, and changes in net assets and cash flows (herein referred to as the financial statements) for the years then ended. These financial statements are the responsibility of Sound Transit's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sound Transit as of December 31, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

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

May 25, 2012

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CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

BALANCE SHEETS

(in thousands)

	December 31	
	2011	2010
ASSETS		
Current assets		
Cash and cash equivalents (note 3)	\$ 85,949	\$ 124,746
Restricted assets (note 3)	2,230	2,812
Investments (note 3)	752,108	815,089
Taxes and other receivables (note 4)	130,696	132,709
Inventory	14,190	12,334
Prepaid expenses	5,645	5,727
Total current assets	990,818	1,093,417
Non-current assets		
Capital assets, net of accumulated depreciation (note 5)	4,996,822	4,610,501
Restricted assets (note 3)	106,087	106,512
Investment held to pay capital lease obligation (note 6)	57,578	63,308
Unamortized bond issuance costs	9,302	9,890
Prepaid expense and deposits	20,859	20,149
Total non-current assets	5,190,648	4,810,360
Total assets	\$ 6,181,466	\$ 5,903,777
LIABILITIES AND NET ASSETS		
Current liabilities		
Accounts payable and accrued liabilities (note 7)	\$ 109,573	\$ 131,784
Deferred receipts	3,050	2,058
Interest payable from restricted assets	18,017	18,225
Current portion, long-term debt (note 8)	19,195	18,465
Other claims and short-term obligations	2,232	76,075
Total current liabilities	152,067	246,607
Non-current liabilities		
Long-term debt (note 8)	1,529,002	1,550,473
Capital lease obligations (note 6)	57,578	63,308
Other long-term obligations (note 9)	7,907	9,099
Total non-current liabilities	1,594,487	1,622,880
Total liabilities	1,746,554	1,869,487
Commitments and contingencies (notes 6, 9, 11, and 12)		
Net assets		
Invested in capital assets, net of related debt	3,457,927	3,051,453
Restricted for debt service and other (note 10)	90,299	91,099
Unrestricted	886,686	891,738
Total net assets	4,434,912	4,034,290
Total liabilities and net assets	\$ 6,181,466	\$ 5,903,777

See accompanying notes to financial statements.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

<i>(in thousands)</i>	December 31	
	2011	2010
Operating revenues		
Passenger fares	\$ 46,116	\$ 37,589
Other operating revenue	5,814	2,547
Total operating revenues	<u>51,930</u>	<u>40,136</u>
Operating expenses		
Vehicle operations	112,511	107,092
Vehicle maintenance	45,598	46,757
Non-vehicle maintenance	23,997	24,869
General and administrative	29,542	34,165
Fare and regional planning	1,337	2,891
Depreciation, amortization and accretion	110,413	104,285
Total operating expenses	<u>323,398</u>	<u>320,059</u>
Loss from operations	(271,468)	(279,923)
Non-operating revenues (expenses)		
Sales tax	528,022	504,101
Motor vehicle excise tax	65,893	65,788
Rental car tax	1,958	2,409
Investment income	20,875	14,122
Other revenues	8,676	10,678
Contributions to other governments	(81,742)	(7,703)
Interest expense	(43,728)	(52,765)
Discontinued and impaired projects	(2,118)	(7,659)
Total non-operating revenues, net	<u>497,836</u>	<u>528,971</u>
Income before capital contributions	226,368	249,048
Federal capital contributions	168,671	151,824
State and local capital contributions	5,583	12,003
Total capital contributions	<u>174,254</u>	<u>163,827</u>
Change in net assets	400,622	412,875
Total net assets, beginning of year	<u>4,034,290</u>	<u>3,621,415</u>
Total net assets, end of year	<u>\$ 4,434,912</u>	<u>\$ 4,034,290</u>

See accompanying notes to financial statements.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

STATEMENTS OF CASH FLOWS

(in thousands)

	December 31	
	2011	2010
Cash flows from operating activities		
Cash receipts from fares	\$ 45,642	\$ 39,907
Cash receipts from other operating revenue	2,928	2,856
Payments to suppliers	(67,526)	(64,485)
Payments to transportation service providers	(112,655)	(100,929)
Payments to employees for wages and benefits	(36,002)	(35,584)
Net cash used by operating activities	(167,613)	(158,235)
Cash flows from non-capital financing activities		
Taxes received	593,350	569,565
Net cash provided by non-capital financing activities	593,350	569,565
Cash flows from capital and related financing activities		
Capital contributions from grants	182,142	187,300
Proceeds for betterments and recoverable costs	457	774
Purchase of property, vehicles and equipment	(1,428)	(358)
Payments in respect of capital projects in progress	(624,961)	(446,746)
Payments to employees capitalized to capital projects in progress	(17,898)	(14,925)
Payments for bond principal	(18,465)	(8,065)
Recovery (payments) for owner controlled insurance premiums	339	(3,942)
Cash paid for interest	(70,684)	(71,463)
Other	-	(32)
Net cash used by capital and related financing activities	(550,498)	(357,457)
Cash flows from investing activities		
Purchases of investments	(517,481)	(809,448)
Proceeds from sales or maturities of investments	590,481	302,709
Investment income	12,973	10,256
Net cash provided (used) by investing activities	85,973	(496,483)
Net decrease in cash and cash equivalents	(38,788)	(442,610)
Cash and cash equivalents		
Beginning of year	173,973	616,583
End of year	\$ 135,185	\$ 173,973
Cash and cash equivalents (note 3)		
Unrestricted	\$ 85,949	\$ 124,746
Current restricted	1,024	1,018
Non-current restricted	48,212	48,209
	\$ 135,185	\$ 173,973

See accompanying notes to financial statements.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

STATEMENTS OF CASH FLOWS, *continued*

<i>(in thousands)</i>	December 31	
	2011	2010
Loss from operations	\$ (271,468)	\$ (279,923)
Adjustments to reconcile loss from operations to net cash used by operating activities		
Depreciation, amortization and accretion	110,413	104,285
Land bank operating contribution	(2,359)	-
Airspace lease amortization	514	232
Changes in operating assets and liabilities		
(Increase) decrease in accounts receivable	(551)	323
(Increase) decrease in due from other governments	(2,405)	2,686
(Increase) in grants receivable	(14)	(4)
(Increase) in materials, parts and supplies	(63)	(575)
(Increase) decrease in prepaid expenses	(1,028)	279
Increase in accounts payable, accrued and other liabilities	4,911	4,445
Increase in salaries, wages and benefits payable	585	409
Increase in deferred pass fare receipts	1,002	442
(Decrease) increase in due to other governments	(5,201)	10,114
(Decrease) in other current liabilities	(1,949)	(948)
Net cash used by operating activities	<u>\$ (167,613)</u>	<u>\$ (158,235)</u>

<i>(in thousands)</i>	December 31	
	2011	2010
Supplemental disclosures of non-cash operating, investing and financing activities		
Capital contributions to other governments	\$ (81,742)	\$ (7,703)
Capital contributions from Land Bank	35	173
Construction in progress in current liabilities	58,699	153,951
Interest income from investments held to pay capital leases, net	26	844
Interest expense on capital leases	(26)	(844)
Increase (decrease) in fair value of investments	10,095	(982)

See accompanying notes to financial statements.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

NOTES TO FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2011 AND 2010

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 tax, motor vehicle excise tax and rental car tax in Sound Transit's operating jurisdiction. In addition, Sound Transit receives capital funding from federal, state and local agencies.

Sound Transit is governed by an 18-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.

Accounting principles generally accepted in the United States of America require that 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 accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. All applicable GASB pronouncements, as well as all Financial Accounting Standards Board (FASB) codification have been applied, except for FASB codification that contradicts GASB pronouncements.

Tax revenues include taxes on retail sales of goods and services, rental car revenue and a motor vehicle excise tax. These taxes are levied within the district at a rate of 0.9% for sales and use, 0.8% on rental car revenue and 0.3% for motor vehicle excise. For collections April 1, 2009 and thereafter, the sales and use tax rate increased from 0.4% to 0.9%. These taxes are collected on Sound Transit's behalf by the Department of Revenue and the Department of Licensing of the State of Washington and are recorded in the period when the underlying transaction occurs on which the tax is imposed.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Operating revenues consist primarily of passenger fares, which are recognized in the period in which services are provided and are earned, and 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 Balance Sheets. Depreciation and amortization of capital assets and amortization of deferred revenue, bond issuance costs, asset retirement obligation and deferred rent is recognized in the Statements of Revenues, Expenses and Changes in Net Assets.

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 is recorded using the straight line method over the estimated useful lives of the assets and leasehold improvements over the shorter of the life of the asset or length of the related agreement as follows:

	Estimated useful life
Access rights	5 – 100 years
Buildings	8 – 30 years
Fixed guideways	30 – 150 years
Furniture and equipment, administrative vehicles	3 – 10 years
Operations maintenance facilities	30 – 75 years
Park-and-ride lots and shelters	10 – 20 years
Pedestrian bridges	30 – 100 years
Revenue vehicles – buses	12 – 15 years
Revenue vehicles – cab cars and coach cars	40 years
Revenue vehicles – light rail	25 – 30 years
Revenue vehicles – locomotives	29 years
Transit facilities, rail, equipment and leasehold improvements	6 – 70 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 decline in the service utility that is large in magnitude 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 attributable to capital projects, as well as certain indirect costs that are allocated to the projects based on various applicable factors supporting the overhead rates used, are capitalized. Capital projects in progress 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.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Access rights include costs incurred or rights acquired that allow Sound Transit to operate its commuter rail and light rail service in the right of way of other entities. Access rights are amortized over the life of the underlying asset constructed or the term of the contractual agreement granting the related right. See note 12, Commitments and Contingencies, for additional access right details.

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 or their wholly owned subsidiaries for transit-related capital improvements. For assets constructed for other governments, these costs are capitalized and included in capital projects in progress 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.

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. Sick leave is payable at the rate of 50% of accrued hours upon resignation, retirement or death for employees hired before January 1, 2004 and is limited up to 120 days, and 25% for employees hired after that date, and is limited to 240 days for termination other than for retirement or death.

Environmental Remediation Obligations— Environmental remediation activities are reviewed routinely to determine if 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 accrued and expensed as soon as a reasonable estimate can be obtained.

Inventory— Inventory includes land held for sale, parts, materials and supplies, and is recorded at the lower of purchased cost or net realizable value. These assets are reviewed periodically for slow moving and obsolete items and any impairment in value is reflected as a charge to operations.

Investment Valuation—Investments are stated at fair value.

New Accounting Pronouncement— In June 2010, the GASB issued Statement No. 59 Financial Instruments Omnibus (GASB No. 59), effective for years beginning after June 15, 2010. GASB No. 59 statement amends existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools. As of January 1, 2011, Sound Transit adopted GASB No. 59 and found there was no material impact on the reporting of applicable financial instruments and external investment pools.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Reclassifications— Certain reclassifications have been made to the 2010 Financial Statements to conform to the current year's presentation.

Restricted Net Assets— Restricted net assets consist of net assets that contain externally imposed legal and contractual obligations. Restricted net assets 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.

Reserves— Sound Transit has internally designated an operating reserve, consisting of two months of average annual operating expenses for the years ended December 31, 2011 and 2010. In addition, Sound Transit has established an investment fund for capital replacement, as established by resolution of its board in 2007. As these cash and investment reserves are derived from internal restrictions, they are included in unrestricted net assets.

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.

Undivided Interests— Sound Transit participates in a joint operation (or undivided interest), jointly governed with seven other agencies for the provision of regional smart card fare collection services (ORCA). Sound Transit reports its undivided interest in assets, liabilities, expenses, and revenues of ORCA within its financial statements, as they are specifically identifiable to Sound Transit in accordance with GASB Statement No. 14 – *The Financial Reporting Entity*.

Use of Estimates—The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect 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. Investments in the Local Government Investment Pool (LGIP) are 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. Investments in the LGIP are considered a 2a7-like fund as defined by the amended Investment Company Act of 1940 (the Act). All LGIP investments are managed in accordance with the Act to ensure a stable value and average investment maturity remains within 60 days and has a unit value of \$1.

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 held in the LGIP and the KCIP is managed by the Washington State Treasurer's Office and the King County Finance Division, respectively. These pools represent an interest in a group of securities and have no specific security subject to custodial risk.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

All surplus cash is invested in accordance with Washington state statute, and an investment policy approved by Sound Transit's Board and certified by the Association of Public Treasuries of the United States and Canada. 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 investment 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. Modified duration is presented in years.

In 2010, Sound Transit entered into a new agreement governing the investment of its funds in the KCIP. While available for withdrawal within established timeframes in the agreement, the underlying commitment under the new agreement is to hold the funds as long-term.

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 internally managed 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 estimates the sensitivity of a bond's price to interest rate changes. Modified duration benchmarks for the internally managed fund was 0.65 and for the capital replacement fund was 2.99. For the Prior and Parity Bond Debt Service funds and the University Link Owner-Controlled Insurance Program (OCIP) fund, interest rate risk is managed by using the specific identification method.

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 whereby no single Agency exceeds 50% of the overall portfolio, or 25% for repurchase agreements, general obligation bonds, PDPC financial institution sponsored investment accounts or 20% for deposit bank notes or 10% for certificates of deposit, bankers' acceptances, reverse repurchase agreements and A1/P1 commercial paper. Treasury securities and investments in the LGIP may comprise up to 100% of the portfolio. Agency securities (combined) may comprise up to 75% of the portfolio. Participation in the KCIP is limited to 50% of the portfolio.

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, 2011, all treasury and agency securities are rated with one of the three highest credit ratings of a nationally recognized statistical rating organization and all but one of the general obligation bonds are rated with one of the three highest credit ratings 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 certificate of deposit is covered by the PDPC and all short-term investments are rated A1/P1 as of December 31, 2011. The KCIP's rating of AA Af has not been restored as King County is re-evaluating the pursuit of a rating while it establishes a credit review process and completes the implementation of new reporting software. The LGIP is a 2a7-like pool and is 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.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Cash, cash equivalents, investments and restricted assets are as follows:

(in thousands)	2011			2010		
	Fair value	Maturity	Call date	Fair value	Maturity	Call date
Investments - Debt Service Reserve						
Municipal bonds:						
Pennsylvania State GO						
Unlimited BAB	\$ 11,702	2/15/2030	**	\$ 10,080	2/15/2030	**
Georgia State GO Unlimited	8,647	4/1/2026	4/1/2017*	7,319	4/1/2026	4/1/2017*
Florida State Public						
Education BAB	5,341	6/1/2030	6/1/2019*	4,885	6/1/2030	6/1/2019*
Hawaii State GO						
Unlimited BAB	4,540	2/1/2024	—	4,065	2/1/2024	—
Georgia State GO						
Unlimited BAB	4,786	11/1/2027	—	4,052	11/1/2027	—
U.S. Agency securities:						
Federal Home Loan						
Mortgage Corp.	12,922	9/15/2029	—	11,105	9/15/2029	—
Federal Home Loan						
Mortgage Corp.	8,059	2/7/2028	2/7/2013*	8,068	2/7/2028	2/7/2013*
	<u>55,997</u>			<u>49,574</u>		
University Link OCIP						
U.S. Agency securities:						
Federal National Mortgage						
Association	1,148			—		
	<u>57,145</u>			<u>49,574</u>		
Cash and cash equivalents						
Washington State Local						
Government Investment Pool	—			187		
	<u>\$ 57,145</u>			<u>\$ 49,761</u>		

* Continuously callable from this date forward

** Sinking fund begins in 2027, ends in 2030

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

<i>(in thousands)</i>	2011			2010		
	Fair value	Modified duration	Percentage of portfolio	Fair value	Modified duration	Percentage of portfolio
Investments – Internally Managed						
King County Investment Pool	\$ 301,056	0.720	49.70%	\$ 300,569	0.710	41.68%
U.S. Agency securities:						
Federal Farm Credit Bank	24,992	1.741	4.13	68,880	2.437	9.52
Federal Home Loan Bank	40,261	1.144	6.65	73,719	0.898	10.19
Federal Home Loan Mortgage Corporation	83,495	1.673	13.78	39,885	2.826	5.51
Federal National Mortgage Association	100,872	1.383	16.65	140,392	1.501	19.40
U.S. Treasury securities	20,033	0.498	3.31	75,914	0.469	10.49
Municipal bonds	14,965	1.258	2.47	15,256	2.159	2.11
Certificate of deposit	20,078	1.470	3.31	8,000	0.170	1.10
	\$ 605,752	1.063	100.00%	\$ 722,615	1.163	100.00%
Investments – Capital Replacement						
U.S. Agency securities:						
Federal Farm Credit Bank	\$ 28,611	4.870	19.55%	\$ 6,662	7.812	6.63%
Federal Home Loan Bank	21,897	1.120	14.96	18,638	1.787	18.55
Federal Home Loan Mortgage Corporation	31,185	3.234	21.31	24,471	3.764	24.36
Federal National Mortgage Association	26,947	4.180	18.41	14,674	1.972	14.60
Municipal bonds	37,716	4.289	25.77	27,515	4.413	27.39
U.S. Treasury securities	—	—	—	8,514	0.247	8.47
	\$ 146,356	3.684	100.00%	\$ 100,474	3.284	100.00%

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

(in thousands)	December 31	
	2011	2010
Cash and cash equivalents		
Investment pools		
King County	\$ 1,024	\$ 1,018
Washington State Local Government *	116,444	157,538
FDIC or PDPC insured bank deposits	6,965	11,226
Cash on hand	2,736	2,062
Escrow funds	8,016	2,129
	<u>135,185</u>	<u>173,973</u>
Investments and debt service reserve		
Debt service and OCIP reserves	57,145	49,574
Investments – internally managed	605,752	722,615
Investments – capital replacement	146,356	100,474
	<u>809,253</u>	<u>872,663</u>
Other restricted assets		
Deductible liability protection policy	1,206	1,794
Interest receivable on restricted investments	730	729
	<u>1,936</u>	<u>2,523</u>
Total cash and cash equivalents, investments and other restricted assets	<u>\$ 946,374</u>	<u>\$ 1,049,159</u>

* Portion segregated for the Prior Debt Reserve. See also table on Page 28.

(in thousands)	December 31	
	2011	2010
Balance sheet classifications		
Current assets		
Cash and cash equivalents	\$ 85,949	\$ 124,746
Current restricted assets:		
Cash equivalents	1,024	1,018
Deductible liability protection policy	1,206	1,794
Total current restricted assets	<u>2,230</u>	<u>2,812</u>
Investments	752,108	815,089
Non-current restricted assets		
Cash equivalents	48,212	48,209
Investments	57,145	57,574
Interest receivable	730	729
Total non-current restricted assets	<u>106,087</u>	<u>106,512</u>
Total cash and cash equivalents, investments and restricted assets	<u>\$ 946,374</u>	<u>\$ 1,049,159</u>

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

4. RECEIVABLES

Receivables consist of the following:

<i>(in thousands)</i>	December 31	
	2011	2010
Taxes receivable	\$ 101,842	\$ 99,577
Grants receivable	17,911	25,799
Accounts receivable, net	607	56
Due from other governments	8,543	5,337
Interest receivable	1,793	1,940
	<u>\$ 130,696</u>	<u>\$ 132,709</u>

Amounts due from other governments include amounts due under the ORCA program, 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.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

5. CAPITAL ASSETS

Capital assets are summarized as follows:

<i>(in thousands)</i>	December 31		Disposals		December 31
	2010	Additions	Retirements	Transfers	2011
Non-depreciable assets					
Land	\$ 388,086	\$ —	\$ —	\$ 4,644	\$ 392,730
Permanent easements	327,757	—	—	46,350	374,107
Capital projects in progress:					
Sound Transit	661,048	528,570	(8,357)	(213,150)	968,111
Other governments	49,820	49,511	(74,868)	(1,018)	23,445
Total non-depreciable assets	1,426,711	578,081	(83,225)	(163,174)	1,758,393
Depreciable assets					
Transit facilities, rail and heavy equipment	2,509,702	—	(186)	28,896	2,538,412
Access rights	499,644	322	—	5,847	505,813
Buildings and leasehold improvements	26,469	1,815	—	234	28,518
Revenue vehicles	498,382	—	(20,992)	126,087	603,477
Furniture, equipment and vehicles	22,456	—	(385)	2,110	24,181
Total depreciable assets	3,556,653	2,137	(21,563)	163,174	3,700,401
Accumulated depreciation					
Transit facilities, rail and heavy equipment	(156,045)	(53,194)	186	—	(209,053)
Access rights	(78,060)	(27,190)	—	—	(105,250)
Buildings and leasehold improvements	(9,868)	(1,366)	—	—	(11,234)
Revenue vehicles	(112,393)	(25,012)	20,991	—	(116,414)
Furniture, equipment and vehicles	(16,497)	(3,656)	132	—	(20,021)
Total accumulated depreciation	(372,863)	(110,418)	21,309	—	(461,972)
	3,183,790	(108,281)	(254)	163,174	3,238,429
Total capital assets, net	\$ 4,610,501	\$ 469,800	\$ (83,479)	\$ —	\$ 4,996,822

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

<i>(in thousands)</i>	December 31		Disposals		December 31
	2009	Additions	Retirements	Transfers	2010
Non-depreciable assets					
Land	\$ 378,965	\$ 2,416	\$ —	\$ 6,705	\$ 388,086
Permanent easements	285,573	—	—	42,184	327,757
Capital projects in progress:					
Sound Transit	368,130	487,059	(2,658)	(191,483)	661,048
Other governments	23,238	33,576	(6,994)	—	49,820
Total non-depreciable assets	1,055,906	523,051	(9,652)	(142,594)	1,426,711
Depreciable assets					
Transit facilities, rail and heavy equipment	2,416,424	237	—	93,041	2,509,702
Access rights	496,503	—	—	3,141	499,644
Buildings and leasehold improvements	25,093	238	—	1,138	26,469
Revenue vehicles	454,193	—	—	44,189	498,382
Furniture, equipment and vehicles	21,245	126	—	1,085	22,456
Equipment under capital lease	230	—	(230)	—	—
Total depreciable assets	3,413,688	601	(230)	142,594	3,556,653
Accumulated depreciation					
Transit facilities, rail and heavy equipment	(103,449)	(52,596)	—	—	(156,045)
Access rights	(51,250)	(26,810)	—	—	(78,060)
Buildings and leasehold improvements	(8,920)	(948)	—	—	(9,868)
Revenue vehicles	(92,145)	(20,248)	—	—	(112,393)
Furniture, equipment and vehicles	(12,945)	(3,552)	—	—	(16,497)
Equipment under capital lease	(201)	(29)	230	—	—
Total accumulated depreciation	(268,910)	(104,183)	230	—	(372,863)
	3,144,778	(103,582)	—	142,594	3,183,790
Total capital assets, net	\$ 4,200,684	\$ 419,469	\$ (9,652)	\$ —	\$ 4,610,501

During 2011, Sound Transit capitalized \$32.2 million of interest costs (\$23.6 million in 2010), representing interest cost incurred in respect of Sound Transit's capital program for the year, net of premium, discounts and bond issue costs, on its outstanding bonds (see note 8).

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

6. CAPITAL AND OPERATING LEASES

Capital lease obligation at December 31, 2011 and 2010 is \$57.6 million and \$63.3 million, respectively.

Lease/Leaseback— On May 31, 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 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 balance sheet.

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 S&P and "Aaa" by Moody's. However, starting in March 2005, AIG suffered a series of credit rating downgrades to reach a level of "A-" by S&P and "A3" by Moody's by end of year 2009. As a result of these 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. As of year-end 2011 and 2010, the defeasance accounts were unrated as they were no longer invested in marketable securities.

Sound Transit has negotiated the terms of an agreement with the transaction participants on the requirements to replace the debt defeasance, letter of credits and payment undertaker as required under the transaction. The draft terms provide for Sound Transit to potentially provide additional collateral in a securities custodial account for the benefit of the equity investor to satisfy Sound Transit's obligation under the Participation Agreement related to AIG equity defeasance accounts and credit enhancement. The transaction participants and Sound Transit have agreed to postpone the date for replacement of the debt defeasance, letter of credits and payment undertaker as required under the transaction in order to explore alternative arrangements and possible legislative solutions. Sound Transit has received confirmation from transaction participants that no default conditions exist under the agreements as of year-end 2011. Under its agreements with the transaction participants, Sound Transit may request successive three-month extensions of the date for replacement of the debt defeasance, letter of credits and payment undertaker. If the investor does not consent to such an extension, or if an event of default occurs in the upcoming year, the investor could demand a termination payment from Sound Transit of approximately \$16.0 million.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

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

(in thousands)

	2011	2010
Net sublease, January 1	\$ 63,308	\$ 62,464
Accrued interest	26	4,675
Less payment	(5,756)	(3,831)
Net sublease, December 31	\$ 57,578	\$ 63,308

Amtrak Lease/Sublease— In September 2000, Sound Transit entered into a 40-year agreement to lease its 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, Sound Transit assigned to Amtrak its commuter rail operating agreement, which it had entered into with BNSF in May 2000 to provide commuter rail service. In order to give BNSF possession and use of the rolling stock for purposes of providing commuter rail service on Amtrak's behalf for Sound Transit, Amtrak entered into a 40-year sublease of the rolling stock to BNSF for a nominal rental payment of \$1.

Under the legal structure of these transactions and pursuant to a Department of Revenue ruling, the equipment is exempted from Washington State sales and use taxes; Sound Transit and Amtrak have agreed by a Memorandum of Understanding to use funds that would otherwise be payable for these taxes for projects that mutually benefit Pacific Northwest intercity rail passenger service. Sound Transit maintains title and continuing control of the assets through the end of the lease, upon which the assets will be returned to Sound Transit.

Operating Rentals— Sound Transit has entered into leases of ground, office space, parking, land, storage at various locations, as well as equipment leases under non-cancelable operating leases in excess of one year with lease terms expiring between 2012 and 2016, with some leases containing options to renew for one year beyond the original lease term. Significant lease arrangements include office space and parking adjacent to Union Station. In 2009, Sound Transit entered into two new 10-year lease agreements for space adjacent to Union Station and extended the existing adjacent office space lease for an additional 5 years. Minimum lease payments through 2016 are as follows (in thousands):

2012	\$ 3,640
2013	3,749
2014	3,775
2015	3,688
2016	3,764
	<u>\$ 18,616</u>

Total rental expenses for 2011, which include non-cancelable leases as well as other month-to-month rentals, were \$3.9 million, of which \$158.0 thousand was for capital projects in progress. Total rental expenses for 2010, which include non-cancelable leases as well as other month-to-month rentals, were \$3.7 million, of which \$391.0 thousand was for capital projects in progress.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following:

<i>(in thousands)</i>		
	2011	2010
Accounts payable	\$ 3,941	\$ 37,187
Accrued liabilities	61,947	41,424
Due to other governments	39,564	46,778
Accrued salaries, wages and benefits	3,808	3,175
Retainage payable	313	3,220
	<u>\$ 109,573</u>	<u>\$ 131,784</u>

8. LONG-TERM DEBT

Long-term debt consists of the following:

<i>(in thousands)</i>					
	2011			2011 Ending	Amounts due
	Beginning	Additions	Reductions	balance	within
	balance				one year
Bonds payable					
Series 1999 Bonds, at par	\$ 326,790	\$ —	\$ (5,320)	\$ 321,470	\$ 5,595
Series 2005A Bonds, at par	397,815	—	(5,810)	392,005	6,015
Series 2007A Bonds, at par	417,445	—	(7,335)	410,110	7,585
Series 2009P-1 Bonds, at par	23,155	—	—	23,155	—
Series 2009P-2T Bonds, at par	76,845	—	—	76,845	—
Series 2009S-2T Bonds, at par	300,000	—	—	300,000	—
	1,542,050	—	(18,465)	1,523,585	19,195
Plus unamortized premium	32,104	—	(2,652)	29,452	—
Less unamortized discount	(5,216)	—	376	(4,840)	—
Total bonds payable	1,568,938	—	(20,741)	1,548,197	19,195
Total long-term debt	\$ 1,568,938	\$ —	\$ (20,741)	\$ 1,548,197	\$ 19,195

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

<i>(in thousands)</i>	2010			2010 Ending		Amounts due
	Beginning			balance		within
	balance	Additions	Reductions	balance		one year
Bonds payable						
Series 1999 Bonds, at par	\$ 331,855	\$ —	\$ (5,065)	\$ 326,790	\$	5,320
Series 2005A Bonds, at par	397,815	—	—	397,815		5,810
Series 2007A Bonds, at par	420,445	—	(3,000)	417,445		7,335
Series 2009P-1 Bonds, at par	23,155	—	—	23,155		—
Series 2009P-2T Bonds, at par	76,845	—	—	76,845		—
Series 2009S-2T Bonds, at par	300,000	—	—	300,000		—
	1,550,115	—	(8,065)	1,542,050		18,465
Plus unamortized premium	34,792	—	(2,688)	32,104		—
Less unamortized discount	(5,594)	—	378	(5,216)		—
Total bonds payable	1,579,313	—	(10,375)	1,568,938		18,465
Total long-term debt	\$ 1,579,313	\$ —	\$ (10,375)	\$ 1,568,938	\$	18,465

In the ordinary course of financing its activities, Sound Transit issues debt as shown in the tables below. There are currently two categories of debt: Prior Bonds and Parity Bonds. Prior Bonds have first claim upon the local option taxes. Parity Bonds are subordinate to the Prior Bonds, but they have the same priority of claim upon the Sales and Use and Rental Car Taxes among each Parity Bond issue. The following tables set forward average and effective coupon rates, rating agency information, principal payment commencement, fair value, amounts currently restricted for debt service and debt requirements to maturity.

Prior Bonds— The Prior Bonds comprise the 1999, 2009P-1 and 2009P-2T issues. These bonds are payable in February and August of each year and are secured by Sales and Use, Motor Vehicle Excise and Rental Car taxes.

<i>(in millions)</i>		Average rate		Ratings		Principal	Fair value*		Principal and interest restricted	
Issue date		Coupon	Effective	Moody's	S&P	Payment begins	2011	2010	2011	2010
Series 1999	Dec 1, 1998	4.88	5.03	Aa1	AAA	Feb 1, 2006 \$	344.60	\$ 343.60	\$ 12.20	\$ 12.00
Series 2009P-1	Sept 29, 2009	4.31	2.52	Aa1	AAA	Feb 1, 2015	26.00	25.70	0.40	0.40
Series 2009P-2T	Sept 29, 2009	5.01	3.31**	Aa1	AAA	Feb 1, 2020	86.90	76.90	1.60	1.60

* Estimated using quoted market prices

**Effective rate reduced due to 35% subsidy provided by U.S. Government for Build America Bonds

Parity Bonds— The Parity Bonds comprise the 2005A, 2007A and 2009S-2T issues. These bonds are payable in May and November each year and are secured by Sales and Use and Rental Car taxes.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

(in millions)	Issue date	Average Rate		Ratings		Principal Payment begins	Fair value*		Principal and interest restricted	
		Coupon	Effective	Moody's	S&P		2011	2010	2011	2010
Series 2005A	Mar 31, 2005	4.95	4.60	Aa2	AAA	Nov 1, 2011	\$ 428.90	\$ 414.10	\$ 9.30	\$ 9.10
Series 2007A	Dec 18, 2007	4.99	4.76	Aa2	AAA	Nov 1, 2008	437.70	416.40	11.00	10.80
Series 2009S-2T	Sept 29, 2009	5.49	3.62**	Aa2	AAA	Nov 1, 2029	359.60	299.70	2.70	2.70

* Estimated using quoted market prices

** Effective rate reduced due to 35% subsidy provided by U.S. Government for Build America Bonds

Sound Transit is required to maintain certain minimum deposits as defined in the respective bond resolution for each bond issue to meet debt service requirements. In addition, Sound Transit is required to maintain a common debt service reserve account for all Prior Bonds and series specific debt service reserve accounts for the Parity Bonds. As of December 31, 2011, the common debt service reserve account for Prior bonds comprise a surety policy in the amount of \$31.7 million purchased in 1999 and a \$7.9 million cash reserve funded at the time the 2009P bonds were issued. For the Parity Bonds, a cash reserve was established in 2005 for the 2005A bonds. The required balance for the Parity debt service reserve account was \$41.1 million at the end of 2011.

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. No reserve account was required to be established for the 2007A and 2009S-2T series bonds. Reserve account proceeds are primarily invested in AAA rated Agency and General Obligation bonds.

Sound Transit's long-term debt requirements are displayed in the table below.

Year ending December 31, 2011	(in thousands)		
	Principal	Interest	Total
2012	\$ 19,195	\$ 76,948	\$ 96,143
2013	20,135	76,006	96,141
2014	19,395	75,036	94,431
2015	24,475	73,935	98,410
2016	24,480	72,468	96,948
2017 – 2021	199,670	340,531	540,201
2022 – 2026	289,615	277,684	567,299
2027 – 2031	312,805	204,425	517,230
2032 – 2036	357,610	126,123	483,733
2037 – 2039	256,205	28,473	284,678
	\$ 1,523,585	\$ 1,351,629	\$ 2,875,214

Proceeds from all bond issues except for the 2009P-1 are used for funding Agency capital construction projects. The 2009P-1 issue was for the purpose of refunding a portion of the 2005A bonds. The partial defeasance of the 2005A Series bonds decreased aggregate debt service payments by \$3.6 million resulting in a net present value savings to the Agency in the amount of \$2.5 million.

The American Recovery and Reinvestment Act of 2009 created the Build America Bond (BAB) program, which authorizes state and local governments to issue BABs as taxable bonds in 2009 and 2010 to finance

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

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 on BABs equal to 35 percent of the total coupon interest paid to investors. The direct federal subsidy once earned, will be considered a non-exchange transaction separate from the interest payments made by the Agency and will be recorded in other non-operating revenue when Sound Transit makes its interest payment. 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 the agency's risk management program and employee compensated absences as follows:

<i>(in thousands)</i>	2011			2011	Amounts due
	Beginning	Additions and	Reductions	Ending	within
	balance	accretion		balance	one year
Asset retirement obligations					
Sounder station platforms	\$ 1,051	\$ 52	\$ —	\$ 1,103	\$ —
Tacoma link surface rail	1,521	77	—	1,598	—
Total asset retirement obligations	2,572	129	—	2,701	—
Uninsured losses					
Owner controlled insurance program	3,833	(232)	(1,118)	2,483	720
Transit operations	981	(501)	—	480	140
Total uninsured losses	4,814	(733)	(1,118)	2,963	860
Compensated absences	4,493	4,225	(3,789)	4,929	1,826
Total other long-term obligations	\$ 11,879	\$ 3,621	\$ (4,907)	\$ 10,593	\$ 2,686

<i>(in thousands)</i>	2010			2010	Amounts due
	Beginning	Additions and	Reductions	Ending	within
	balance	accretion		balance	one year
Asset retirement obligations					
Sounder station platforms	\$ 1,001	\$ 50	\$ —	\$ 1,051	\$ —
Tacoma link surface rail	1,449	72	—	1,521	—
Total asset retirement obligations	2,450	122	—	2,572	—
Uninsured losses					
Owner controlled insurance program	4,627	(222)	(572)	3,833	869
Transit operations	1,208	(227)	—	981	285
Total uninsured losses	5,835	(449)	(572)	4,814	1,154
Compensated absences	4,106	4,295	(3,908)	4,493	1,626
Total other long-term obligations	\$ 12,391	\$ 3,968	\$ (4,480)	\$ 11,879	\$ 2,780

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 of

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

those 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 to improve mobility for the Central Puget Sound, which includes construction projects and agency and rail operations, Sound Transit is exposed to various types of risks and exposures of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to persons; and natural disasters. Sound Transit has established a comprehensive risk management and insurance program. For its agency and railroad operation, a commercial insurance program has been put in place that provides coverage for all property, primary and excess liability, commercial auto liability, premises pollution liability, public officials & employment practices liability, crime & fidelity, and fiduciary liability to provide Sound Transit with the appropriate protections for these various types of risks and exposures.

For ST Express bus operations, under Sound Transit's interagency agreements, insurance coverage is provided by its bus partner agencies, which is included in the pro-rata transit operations cost rate that is established by Sound Transit and its bus partner agencies. However, under its interagency agreement for ST Express Bus Service Operations and Maintenance in Pierce County, Sound Transit reimburses Pierce Transit for the costs of all individual claims paid up to \$1 million per occurrence for all liability claims generated from ST Regional Express Bus service through December 31, 2009. In 2010, Sound Transit entered into a new operations and maintenance agreement with Pierce Transit that transfers this risk and general liability claim responsibility back to Pierce Transit, and establishes a pro-rata transit operations cost rate structure similar to Sound Transit's operations and maintenance agreements with King County DOT and Community Transit.

Sound Transit has utilized two OCIP programs for its larger capital development projects to address general liability claims due to third-party injuries and/or property damage related to project construction activities carried out by Sound Transit's third-party contractors. Its first OCIP program was secured in 2001, primarily for construction of the Central Link light rail segment and subsequently amended to include the Airport Link light rail segment and provided coverage from January 1, 2001 through December 31, 2009, with three years of completed operations coverage. The only remaining insurance policy that has not expired is the professional liability and contractor's pollution policy, which provides coverage through December 31, 2016 with an additional three-year reporting period extending to December 31, 2019. This insurance policy was extended in order to provide insurance coverage for the final design of the University Link light rail project.

A second OCIP program was procured in October 2008 for the University Link Light rail segment. The funding of the premium for this OCIP was structured with initial premium payments of \$6.8 million in 2008 and the final premium payments in 2010 of \$3.9 million, with a coverage period provided from October 20, 2008 through September 30, 2016. The University Link OCIP insurance coverage includes: primary commercial general liability, excess commercial general liability, builders risk, and contractors pollution liability policies.

On each of its commercial insurance policies, Sound Transit is responsible for either a specific deductible or a self-insured retention. Most of these insurance policies are written either on a per occurrence basis or on a claims-made basis. For its Initial Segment Light Rail OCIP general liability policy, Sound Transit procured a deductible liability protection policy as collateral to supplement the deductible responsibility with the comprehensive general liability (CGL) insurer for the probable maximum claims exposure. This collateral account was established at the inception of the policy and estimated at \$6.5 million, which Sound Transit deposited with the CGL insurer in an interest-bearing loss fund account.

Annually, Sound Transit engages an actuary to prepare an actuarial report in order to estimate its total claim exposure under all of these risk management and insurance programs. The claim amounts estimated

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

to be paid within the next year are included as an accrual in other current liabilities of the financial statements.

Compensated Balances—Amounts estimated to be paid within the next year are included in accrued salaries, wages and benefits.

10. RESTRICTED NET ASSETS

Restricted net assets consist of the following:

(in thousands)

	2011	2010
Debt service	\$ 68,864	\$ 70,557
Contractual arrangements	20,229	18,748
Deductible liability protection policy	1,206	1,794
	<u>\$ 90,299</u>	<u>\$ 91,099</u>

11. EMPLOYEE BENEFITS

Sound Transit provides a defined contribution money purchase plan and trust (401(a) Plan) to its employees. Prior to December 31, 1999, employees had a choice of participating in either the 401(a) Plan or in the Washington Public Employees' Retirement System (PERS). In 1999, the Washington State Legislature amended the laws governing PERS requiring employers to either terminate their participation in PERS or permit all new employees to participate in PERS regardless of their simultaneous participation in a 401(a) plan. Effective December 31, 1999, Sound Transit terminated its status as a PERS employer with regard to all employees hired after that date. Individuals who were active members at that date were eligible to continue their membership in PERS for the duration of their continuous employment with Sound Transit. At December 31, 2011, 2010 and 2009, there was one remaining employee participating in PERS.

A summary of the 401(a) Plan is as follows:

401(a) Plan— In 2010 the ICMA Retirement Corporation administered the Central Puget Sound Regional Transit Authority Pension Plan and served as the plan's trustee. In June 2011, the Agency entered into an agreement with Great West Retirement Services to be 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.

Any eligible employee who was employed on the effective date of this plan was eligible to participate in the plan. Any other eligible employee shall be eligible to participate 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 2011 and 2010 was \$41.2 million and \$37.4 million, respectively, and total payroll was \$41.9 million and \$38.0 million, respectively. The

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

required contribution rates expressed as a percentage of covered payroll and required Sound Transit contributions during 2011, 2010, and 2009 are as follows:

	Contribution rate			Contributions (in thousands)		
	2011	2010	2009	2011	2010	2009
Employer	12%	12%	12%	\$ 4,944	\$ 4,490	\$ 3,972
Employee	10	10	10	4,120	3,742	3,310
Total	22%	22%	22%	\$ 9,064	\$ 8,232	\$ 7,282

12. COMMITMENTS AND CONTINGENCIES

Operations and Maintenance Agreements— In May, 2000, Sound Transit entered into a 40 year agreement with BNSF for the operation of commuter trains by BNSF between Seattle and Tacoma and for the compensation paid to BNSF for train crews, maintenance of way, and other expenses incurred in the operation of the Sounder service. The compensation is based on the actual costs of crew, dispatch and management, as well as costs for maintenance of way plus performance incentives.

Between June 2000 and February 2006, the cities of Seattle, Tukwila and SeaTac granted Sound Transit perpetual light rail access rights to operate its light rail service in their municipalities in return for Sound Transit constructing public right of way improvements in each of these cities light rail transit ways. Costs included in the public right of way improvements necessary to operate light rail service include the costs to acquire real property and relocate existing residents and businesses.

In September 2000, Sound Transit entered into an agreement with Amtrak for the operations and maintenance of its Sounder commuter rail rolling stock, expiring December 31, 2009. A memorandum of agreement was entered into for the continuance of operations from January 2010 to February 2010 under the original contract terms. A new five-year agreement was entered into effective March 1, 2010 with one two year option for renewal at Sound Transit's consent and three one year renewal options at the mutual consent of both parties. Under the agreement, 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. Sound Transit pays a negotiated rate for additional service above this baseline operating plan. See related agreements described in note 6.

In June 2002, Sound Transit entered into an agreement with King County DOT to share DSTT maintenance and operation costs in exchange for the right to use the DSTT for light rail operations. Sound Transit's ongoing obligations include reimbursement of costs and payment of a share of King County DOT debt service owed for the original tunnel construction. Sound Transit is also committed under this agreement to share costs for future capital repairs or replacements as they arise. 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. The DSTT agreement is in effect for five years after the opening of light rail operations in 2009 at which point Sound Transit will either be required to purchase the DSTT or Sound Transit and King County DOT will enter into another operating agreement for joint use.

In June 2003, Sound Transit entered into a Central Link Light Rail system operation and maintenance agreement with King County DOT. Compensation for this service is based on reimbursement for King

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

County DOT expenses based on a fixed amount for a baseline level of service, with additional costs billed for service changes directed by Sound Transit. This agreement was revised effective December 21, 2009 for a term of five years.

In December 2003, Sound Transit entered into an agreement with BNSF for the operation of the commuter trains by BNSF between Seattle and Everett and the compensation paid to BNSF for train crews, maintenance of way and other expenses incurred in the operation of the Sounder service. The compensation is structured as an hourly rate per train mile operated for a baseline service plan, with inflation adjustments plus performance incentives. The term of the agreement is for 12 years with an option of five additional years that must be agreed to by both parties, for a maximum term of 17 years. In addition, a first amendment was executed to the existing long term agreement for commuter service from Seattle to Tacoma, covering service for the Lakewood to Tacoma corridor, provided Sound Transit eventually operates in the corridor.

On April 17, 2006, Sound Transit entered into a Construction Services Agreement with the Port of Seattle. The agreement provides construction and operating terms for Airport Link. The agreement will not expire as long as Sound Transit operates rail transit systems on the segment.

On January 1, 2010, Sound Transit entered into new service agreements with King County DOT and Pierce Transit for the operation of its ST Express bus service. The agreements expire December 31, 2012 and contain two 1 year renewal options at the mutual consent of both parties. The Community Transit 2004 bus service agreement was extended to March 31, 2010, following which a new service agreement was entered into effective April 1, 2010 and expiring March 31, 2012, with two 1 year renewal options at the mutual consent of both parties. Service is compensated based upon a fixed fee agreed to annually, with certain items subject to variable pricing, such as fuel and special services.

In October 2010, Sound Transit entered into a 20-year agreement with the Washington State Fair Association to use one of its parking lots for commuter rail passengers accessing Puyallup Station. The amount paid to acquire the right was equal to costs incurred to improve the existing parking lot to be able to accommodate commuter rail passengers.

Agreements with BNSF for Sounder Commuter Rail Service Easements in the Everett-to-Seattle and Lakewood-to-Tacoma Corridors— In May 2000, Sound Transit entered into a construction agreement with BNSF in which track and signal improvements necessary to operate its service in the Seattle to Tacoma corridor would be constructed in exchange for the right to operate commuter rail service for 40 years. In the Everett to Seattle corridor operating rights were acquired through direct acquisition of easements and include Sound Transit's direct and indirect costs related to planning and design, environmental management and permitting for that corridor.

In December 2003, Sound Transit entered into a number of agreements with BNSF for, among other things, the purchase of four perpetual easements between 2003 and 2007, each in exchange for a payment of \$50 million for commuter rail service between Everett and Seattle, the purchase of railroad right of way between Nisqually and Tacoma for service and station improvements, terms for joint use of the railroad right of way and the purchase of operation services in each corridor. Each easement allows the addition by Sound Transit of one round trip commuter train service.

The Joint Use Agreement for the Everett to Seattle corridor provides the mechanism for determining the cost to Sound Transit for the maintenance of way and rehabilitation activities on the corridor.

The Joint Use Agreement for the Lakewood to Tacoma corridor sets forth the cost to BNSF for the maintenance of way and rehabilitation activities on the corridor and Sound Transit and BNSF's responsibilities during the interim period before Sound Transit starts operating on each portion of the

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

corridor. However, as Sound Transit incrementally commences construction of the line, Sound Transit will be responsible for maintenance activities on those sections.

In July 2010, Sound Transit entered into an agreement with BNSF to acquire four perpetual easements on its Seattle to Tacoma corridor. The easements will be acquired between 2010 and 2013 for total compensation of \$185.0 million. As of December 31, 2011, two easements totaling \$85.0 million have

been acquired. Each easement allows the operation of one round trip commuter train service no earlier than the later of either the agreed upon effective operational date of each easement or 24 months after Sound Transit has obtained required approvals and permits to allow BNSF to construct related improvements necessary for the operation of each easement. The cost of each remaining easement is listed in the table below.

<u>Closing date</u>	<u>Amount</u>
	<i>(in millions)</i>
July 2012	\$ 52.0
July 2013	48.0
	<u>\$ 100.0</u>

Amended and Restated Agreement for Regional Fare Coordination System— In April 2009, Sound Transit entered into an amended agreement establishing the design, implementation, operation and maintenance of the Regional Fare Coordination System (RFCS) among seven participating agencies that simplifies and establishes a common, non-cash fare system through their service areas. The amended agreement defines and establishes a framework for the Operating Phase of the RFCS, which launched on April 1, 2009. The participating agencies have committed to utilizing the RFCS for a minimum of 10 years and funding a proportionate share of regionally shared costs.

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

	<u>December 31</u>	
	<u>2011</u>	<u>2010</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 4,834,779	\$ 3,492,218
Accounts receivable	4,998,869	6,431,590
Total assets	<u>\$ 9,833,648</u>	<u>\$ 9,923,808</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 3,572,156	\$ 7,877,942
Deferred receipts	6,261,492	2,045,866
Total liabilities	<u>\$ 9,833,648</u>	<u>\$ 9,923,808</u>
Total operating revenues	\$ 33,744,323	\$ 24,407,982
Total expenses	\$ 865,498	\$ 466,925

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Governmental Agreements— In its ordinary course of planning design and construction of its projects, Sound Transit enters into agreements with other governments. These agreements establish the working relationships with the other governmental entities and may obligate Sound Transit to pay for services over the lifecycle of a construction project, and often include provisions to transfer property or property rights upon completion of construction. Significant governmental agreements include:

University of Washington Master Implementation Agreement: Entered into on July 2, 2007, this agreement allows Sound Transit entry to the University's Seattle Campus to construct Link light rail; establishes compensation amounts for certain staffing costs, parking mitigation in the amount of \$15.2 million, which was paid in 2007, and consideration for easements granted by the University in the amount of \$20.0 million, which was paid in May 2008. Both parties anticipate additional agreements providing terms for the operation of Link light rail on University property.

WSDOT Funding and Cooperative Agreement: Entered into on November 2008, this agreement establishes the project scope, management and construction of certain improvements within the Lakewood track improvements and Point Defiance Bypass project. WSDOT will reimburse Sound Transit for actual costs incurred up to a maximum amount of \$9.5 million.

WSDOT Construction Administration Agreement: Entered into on March 16, 2009, this agreement establishes the terms of construction, construction engineering, contract administration, support and payments for WSDOT to construct the I-5, Mountlake Terrace Freeway Station. Sound Transit's estimated expense for this project is \$22.6 million. The station went into service March 2011, however Sound Transit is required to pay for environmental monitoring for 2 years after construction under the agreement.

City of Seattle Construction Services Agreement: Entered into on August 12, 2009, this agreement covers areas including quality assurance, inspections, emergency services, traffic signal design, and utility work by city crews during Sound Transit's development of the University Link Project up to \$6.0 million. The agreement also commits Sound Transit to accomplish certain improvements as requested by the City, at the City's expense.

City of Seattle Funding and Cooperative Agreement for the implementation of the First Hill Streetcar Connector Project: Entered into on November 11, 2009, 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 were established in the November 2009 funding and cooperative agreement. The City will own the First Hill Streetcar facilities and vehicles, while Sound Transit will assume operation of the Streetcar service if the City and King County DOT fail to reach an initial operating agreement or after the initial five years of operation by King County DOT.

WSDOT Umbrella Agreement for R8A Project and East Link Light Rail: On August 26, 2010, Sound Transit was authorized to enter into an umbrella agreement with WSDOT 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 has agreed to fund Stages 2 and 3 of the I-90 Two Way Transit and HOV projects for \$153.2 million in exchange 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.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

City of Bellevue Binding Umbrella Memorandum of Understanding and Transitway Agreement for East Link Project: On November 17, 2011, Sound Transit and the City of Bellevue (the City) entered into an agreement in which the City will contribute up to \$100 million for the construction of a tunnel through downtown Bellevue and \$60 million as a contingent contribution. The City also agreed to establish a collaborative partnership with Sound Transit in which project risks and benefits would be shared and both parties would work together during final design, permitting and construction to manage the project. Furthermore, a transitway agreement was executed in which the City granted Sound Transit non-exclusive use of City right-of-way to construct, operate and maintain the project.

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 has 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 in which Sound Transit can 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 light rail guideways located on WSDOT property governed under multiple forty-year airspace leases issued under the land bank agreement. 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, 2011, the value of the unused land bank credits that have not been conveyed by WSDOT to Sound Transit was \$131.3 million. This value is not recorded in the financial statements. The following table provides information on additions to and uses of credits accruing to the benefit of Sound Transit in 2011 and 2010.

(in millions)

	2011	2010
Balance in Land Bank, beginning of year	\$ 133.6	\$ 133.8
Credits (Draws):		
Mountlake Terrace Freeway Station	(2.3)	—
University Link I-5 Twin Bore Tunnel Crossing	—	1.8
East Link	—	(0.1)
D Street to M Street Track & Signal	—	(1.9)
Balance in Land Bank, end of year	\$ 131.3	\$ 133.6

Purchases— At December 31, 2011 and 2010, Sound Transit had outstanding construction commitments of approximately \$585.7 million and \$844.2 million, respectively.

Grants— Sound Transit participates in several federal 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, 2011 and 2010 may be impaired. In the opinion of management, there are no significant contingent liabilities relating to noncompliance with the rules and

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

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.

Subsequent Event— Management has evaluated events and transactions that have occurred after December 31, 2011, through May 25, 2012, the date these financial statements were issued.

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**Report on Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statements
Performed in Accordance With *Government Auditing Standards***

Board of Directors
Central Puget Sound Regional Transit Authority

We have audited the financial statements of Central Puget Sound Regional Transit Authority (a public corporation acting under the service name Sound Transit) as of and for the year ended December 31, 2011, and have issued our report thereon dated May 25, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of Sound Transit is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Sound Transit's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Sound Transit's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Sound Transit's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Sound Transit's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



This report is intended solely for the information and use of management, the Board of Directors, others within the entity, and federal and state awarding agencies and pass through entities, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

May 25, 2012



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Independent Auditors' Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

Audit and Reporting Committee
Central Puget Sound Regional Transit Authority

Compliance

We have audited Central Puget Sound Regional Transit Authority's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Central Puget Sound Regional Transit Authority's major federal programs for the year ended December 31, 2011. Central Puget Sound Regional Transit Authority's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Central Puget Sound Regional Transit Authority's management. Our responsibility is to express an opinion on Central Puget Sound Regional Transit Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Central Puget Sound Regional Transit Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Central Puget Sound Regional Transit Authority's compliance with those requirements.

In our opinion, Central Puget Sound Regional Transit Authority complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2011.

Internal Control Over Compliance

Management of Central Puget Sound Regional Transit Authority is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Central Puget Sound Regional Transit Authority's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Central Puget Sound Regional Transit Authority's internal control over compliance.



A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of Central Puget Sound Regional Transit Authority as of and for the year ended December 31, 2011, and have issued our report thereon dated May 25, 2012 which contained an unqualified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Central Puget Sound Regional Transit Authority's basic financial statements. We have not performed any procedures with respect to the audited financial statements subsequent to May 25, 2012. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditure of federal awards is fairly stated, in all material respects in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of management, the Audit and Reporting Committee, others within the entity, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

June 22, 2012

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS YEAR ENDED DECEMBER 31, 2011

Federal Grantor / Pass Through Grantor / Program Title	CFDA Number	Federal Award Expended
Federal Transit Cluster		
U.S. Department of Transportation:		
Federal Transit Administration, Capital Improvement Grants	20.500	\$ 142,646,875
Capital Investment Grant (Passed-Through via King County Metro)	20.500	<u>8,515,000</u>
Subtotal- 20.500		151,161,875
Federal Transit Administration, Operating and Capital Assistance Formula Grants	20.507	15,669,444
ARRA-Federal Transit Administration, Operating and Capital Assistance Formula Grants	20.507	<u>79,792</u>
Subtotal- 20.507		<u>15,749,236</u>
Total U.S. Department of Transportation		<u>166,911,111</u>
Total Federal Transit Cluster		<u>166,911,111</u>
Highway Planning and Construction		
U.S. Department of Transportation:		
Federal Transit Administration, Highway Planning and Construction (Flexible Funds from Federal Highway Administration to Federal Transit Administration)	20.205	<u>480,502</u>
Total U.S. Department of Transportation		<u>480,502</u>
Total Highway Planning and Construction		<u>480,502</u>
Transit Services Program		
U.S. Department of Transportation:		
Federal Transit Administration, Job Access-Reverse Commute	20.516	42,939
Federal Transit Administration, New Freedom Program	20.521	2,792
Federal Transit Administration, Alternative Analysis	20.522	<u>961,149</u>
Total U.S. Department of Transportation		<u>1,006,880</u>
Total Transit Services Program		1,006,880
Other Federal Awards		
U.S. Department of Homeland Security:		
Federal Emergency Management Agency, Transit Security Grant Program	97.075	384,298
Office of Grant Programs, Buffer Zone Protection Program (Passed-Through via WA State Military Department)	97.075	<u>13,790</u>
Total U.S. Department of Homeland Security		<u>398,088</u>
Total Other Federal Awards		<u>398,088</u>
Total Expenditures of Federal Awards		<u>\$ 168,796,581</u>

Note to Schedule of Expenditures of Federal Awards:

The information in this schedule is prepared on the accrual basis of accounting.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS Year ended December 31, 2011

PART I—SUMMARY OF AUDITORS’ RESULTS

Financial Statements

Type of auditors’ report issued: **Unqualified**

Internal control over financial reporting:

- Material weakness(es) identified: **No**
- Significant deficiency(ies) identified that are not considered to be material weaknesses: **None reported**

Noncompliance material to financial statements noted: **No**

Federal Awards

Internal control over major programs:

- Material weakness(es) identified: **No**
- Significant deficiency(ies) identified that are not considered to be material weaknesses: **None reported**

Type of auditors’ report issued on compliance for major programs: **Unqualified**

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133: **No**

Identification of major program:

<u>Federal grantor and program title</u>	<u>CFDA number</u>
Federal Transit Cluster	20.500 and 20.507
Highway Planning and Construction Cluster	20.205

Dollar threshold used to distinguish between type A and type B programs: **\$3,000,000**

Auditee qualified as low-risk auditee: **Yes**

PART II—FINANCIAL STATEMENT FINDINGS SECTION

No matters reported.

PART III—FEDERAL AWARD FINDINGS AND QUESTIONED COST SECTION

No matters reported.