SOUNDTRANSIT

Central Puget Sound Regional Transit Authority

Single Audit Reports for the Year Ended December 31, 2012

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MANAGEMENT'S DISCUSSION AND ANALYSIS

For the years ended December 31, 2012 and 2011

Management's Discussion and Analysis ("MD&A") presents a narrative overview and analysis of the financial activities of Sound Transit for the years ended December 31, 2012 and 2011. The MD&A is designed to assist readers of financial statements in focusing on significant financial activities and issues and to identify any significant changes. As this information is presented in summary form, it should be read in conjunction with the financial statements and notes to the financial statements as a whole.

Sound Transit is a regional transit authority implementing and 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").

Sound Transit's financial statements reflect a growth in net position of $390.4 million in 2012 as major sources of revenue continue to exceed expenses. In addition to overall ridership growth, service expanded in 2012 with the opening of the Tacoma-Lakewood Sounder commuter rail corridor. Furthermore, growth in total assets reflects increases in capital spending on the ST2 capital program while total liabilities remain comparable to 2011.

Financial Highlights

- Total operating revenues were $58.0 million for 2012, an increase of 11.6% from the prior year. Passenger fare revenue increased by $8.0 million from the prior year, primarily from increases in ridership and business passport contract revenue.

- Loss from operations was $275.9 million for 2012, similar to the prior year.

  - Overall operations and maintenance expenses increased by 5.0% from 2011 as purchased transportation contract costs related to vehicle operations and track and facility maintenance increased.

  - General and administrative expenses decreased by 13.4%, as professional fees incurred in support of construction claim resolution decreased, more than offsetting increases in salary and benefit costs.

- Non-operating revenues, net of expenses, were $535.0 million, an 8.0% increase from 2011 primarily resulting from increased tax revenues of $24.3 million and lower interest expense and contributions to other governments, which decreased $11.9 million and $11.3 million, respectively.

- Capital contributions from federal, state and local funding arrangements were $131.3 million, a decrease of 24.6% from the prior year, mostly due to lower federal capital contributions received in 2012 on the University Link project as spending on the revenue vehicle portion of the project was completed ahead of schedule in 2011 causing grant drawdowns to be accelerated into 2011.

- Total net position at December 31, 2012 was $4.8 billion, an increase of $390.4 million or 8.8% from 2011. The change in net position in 2012 is comparable to that of 2011.

- Total capital assets, net of accumulated depreciation and amortization, were $5.4 billion at December 31, 2012, an increase of $370.6 million or 7.4% from 2011, reflecting progress on the University Link, First Hill Street Car and Sounder South Expanded Service projects. In 2012, $241.2 million in expenditures related to completed projects and land acquisitions were transferred to completed capital assets, most significantly related to the completion of the Sounder commuter rail Tacoma-Lakewood expansion corridor.

Overview of the Financial Statements

Sound Transit's financial statements are prepared in conformity with United States Generally Accepted Accounting Principles (GAAP). The 2012 and 2011 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 Statements of Net Position and depreciation and amortization of capital assets is recognized in the Statements of Revenues, Expenses and Changes in Net Position.

The financial statements provide both long term and short term information about Sound Transit's overall financial status as well as Sound Transit's net position, segregated by net investment in capital assets, restricted and unrestricted. Net position is the difference between Sound Transit's assets 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 Position

Sound Transit's total net position at December 31, 2012 was $4.8 billion, an increase of $390.4 million or 8.8% from 2011. Total assets increased $367.0 million or 5.9% and total liabilities decreased $23.4 million or 1.3%. The increase in total assets reflects capital program spending, most significantly the University Link light rail projects, the acquisition of an additional Sounder easement in the South corridor, the completion of the Sounder D-to-M Streets Track & Signal project as well as the purchase of replacement buses for ST Express. See the following table for a summary of Sound Transit's net position.

Statement of Net Position

(in millions)	December 31			% Change	
	2012	**2011**	**2010**	**2012-2011**	**2011-2010**
Assets					
Current assets, excluding restricted assets	$ 1,006.0	$ 988.6	$ 1,090.6	1.8%	(9.4)%
Restricted assets	96.7	108.3	109.3	(10.7)	(0.9)
Capital assets	5,373.7	4,996.8	4,610.5	7.5	8.4
Other non-current assets	72.1	87.8	93.4	(17.8)	(6.0)
Total assets	**6,548.5**	**6,181.5**	**5,903.8**	**5.9**	**4.7**
Liabilities					
Current liabilities, excluding interest payable from restricted assets	173.7	134.1	228.4	29.6	(41.3)
Interest payable from restricted assets	19.3	18.0	18.2	7.2	(1.1)
Long-term debt	1,465.8	1,529.0	1,550.5	(4.1)	(1.4)
Other long-term liabilities	64.4	65.5	72.4	(1.9)	(9.6)
Total liabilities	**1,723.2**	**1,746.6**	**1,869.5**	**(1.3)**	**(6.6)**
Net Position					
Net investment in capital assets	3,882.4	3,457.9	3,051.5	12.3	13.3
Restricted net position	77.4	90.3	91.1	(14.3)	(0.9)
Unrestricted net position	865.5	886.7	891.7	(2.4)	(0.6)
Total net position	**$ 4,825.3**	**$ 4,434.9**	**$ 4,034.3**	**8.8%**	**9.9%**

Current assets, excluding restricted assets, for 2012 were comparable to that of 2011, which were down 9.4% from 2010 as cash and investments were used to pay for expenditures incurred on capital projects. Spending varies year to year as projects progress through Sound Transit's capital program management process.

In August 2012, a majority of the 2005 bonds were refunded in advance of their 2030 maturity date by issuing replacement bonds at a lower effective interest rate (see note 8). The advanced refunding defeased $350.6 million of the outstanding 2005 bond debt. The defeasance of a majority of the 2005 bonds resulted in a 10.7% decrease in restricted assets from 2011 as debt service reserve requirements related to the 2005 bonds were reduced. Restricted assets were comparable between 2011 and 2010.

Capital assets increased 7.5% from 2011 and 8.4% from 2010, most significantly related to construction spending on University Link and Sounder D-to-M Streets Track & Signal project, the acquisition of one additional permanent easements each year from the BNSF Railway Company (BNSF) and the purchase of twenty-four (thirty-five in 2011) replacement buses.

Total capital project spending for 2012 was $551.1 million (2011 was $578.1 million). University Link represented the largest capital spending component comprising 39.4% of total spending on capital projects. In all, total capital spending for light rail was $389.5 million or 70.7% of the total capital spending ($405.7 million or 69.8% in 2011). Capital spending on Sounder and ST Express projects as a percentage of total capital spending was 21.3% and 7.3%, respectively (16.8% and 7.1% in 2011). Transfers out of capital projects in progress were $311.6 million ($297.4 million in 2011) as projects were completed and transferred to property, transit facilities, and vehicles or expensed as indicated in the following table.

Transfers Out of Capital Projects in Progress

(in millions)	For the Year Ended December 31		
	2012	2011	2010
Transferred to property, vehicles and equipment	$ 241.2	$ 214.2	$ 191.5
Expensed to contributions to other governments	70.4	81.7	7.7
Transferred to prepaid expenses, inventory and non-capitalized expenditures	-	-	0.1
Write-off of overhead, discontinued and impaired project costs	-	1.5	1.8
Total	**$ 311.6**	**$ 297.4**	**$ 201.1**

Other non-current assets decreased 17.8% from 2011 as Washington State Department of Transportation (WSDOT) airspace leases were reclassified to capital assets. Airspace leases grant Sound Transit use of WSDOT property for construction and operation of transit assets in lieu of an easement that is unable to be granted under current state regulations. Prior to 2012, airspace leases were recognized as prepaid expenses and amortized to lease expense over the life of the lease. In 2011, other non-current assets decreased 6.0% due to payments received from the capital financing lease of Sounder rail cars.

Current liabilities, excluding interest payable from restricted assets, increased 29.6% from 2011 related to contributions due to the City of Seattle for work performed on the First Hill Street Car project and an increase in bond principal with the first principal payment on the 2012 parity bonds due February 2013. In 2011, current liabilities, excluding interest payable from restricted assets, decreased 41.3% as significant construction claims were settled during the year.

Interest payable from restricted assets increased 7.2% from 2011 reflecting the change in timing of interest payments on the refunded 2005 bonds. Long-term debt decreased 4.1% as principal payments were made on outstanding bond series. In 2011, principal payments on the 1999, 2005 and 2007 bonds caused interest payable from restricted assets and long-term debt to decrease from 2010 by 1.1% and 1.4%, respectively. Other long-term liabilities for 2012 were comparable to that of 2011 whereas payments made on the capital lease obligation for Sounder rail cars caused a 9.6% decrease in 2011 from 2010.

The following table presents the net position components and their relative percentage to total net position.

Net Position

(in millions)	December 31			% Total Net Position		
	2012	2011	2010	2012	2011	2010
Net investment in capital assets	$ 3,882.4	$ 3,457.9	$ 3,051.5	80.5%	78.0%	75.6%
Restricted net position	77.4	90.3	91.1	1.6	2.0	2.3
Unrestricted net position	865.5	886.7	891.7	17.9	20.0	22.1
Total	**$ 4,825.3**	**$ 4,434.9**	**$ 4,034.3**	**100.0%**	**100.0%**	**100.0%**

Sound Transit's net position represents the cumulative effect of the excess of revenues over expenses together with the impact of Sound Transit's financing decisions. Net investment in capital assets reflects investment in construction in progress, non-depreciable assets and depreciable assets, net of related debt used in its operations. Restricted net position comprises assets restricted for a specific purpose by a third party. Unrestricted net position is the remainder of assets net of liabilities not invested in capital nor restricted for a specific purpose. Net investment in capital assets increased 12.3% from 2011 reflecting increased spending on University Link and ST2 capital programs. Restricted net position decreased 14.3% from 2011 as debt service reserves decreased from the advanced refunding of the 2005 bonds. Unrestricted net position decreased 2.4% from 2011 as Sound Transit's investment in capital assets increased. Net position categories as a percentage of total net position were comparable for 2012, 2011 and 2010.

Changes in Net Position

Changes in net position reflect the excess of revenue over expenses for a year. In 2012, revenues exceeded expenses by $390.4 million ($400.6 million in 2011). Loss from operations was comparable to 2011 while non-operating revenues, net of expenses increased 8.0% from 2011 and capital contributions decreased 24.6% from 2011. Sound Transit's Statement of Revenue, Expenses and Changes in Net Position is summarized in the table below.

Changes in Net Position

(in millions)	For the Year Ended December 31			% Change	
	2012	**2011**	**2010**	**2012-2011**	**2011-2010**
Operating revenues					
Passenger fares	$ 54.1	$ 46.1	$ 37.6	17.2%	22.7%
Other	3.9	5.8	2.5	(33.1)	128.3
Total operating revenues	**58.0**	**51.9**	**40.1**	**11.6**	**29.4**
Operating expenses					
Total operating expenses, before depreciation and loss on disposal of assets	216.4	210.7	214.4	2.7	(1.8)
Depreciation and loss on disposal of assets	117.5	110.4	104.3	6.4	5.9
Total operating expenses	**333.9**	**321.1**	**318.7**	**4.0**	**0.7**
Loss from operations	**(275.9)**	**(269.2)**	**(278.6)**	**2.5**	**(3.4)**
Non-operating revenues, net of expenses	535.0	495.5	527.7	8.0	(6.1)
Income before capital contributions	**259.1**	**226.3**	**249.1**	**14.5**	**(9.1)**
Capital contributions	131.3	174.3	163.8	(24.6)	6.4
Change in net position	**390.4**	**400.6**	**412.9**	**(2.5)**	**(3.0)**
Total net position, beginning	4,434.9	4,034.3	3,621.4	9.9	11.4
Total net position, ending	**$ 4,825.3**	**$ 4,434.9**	**$ 4,034.3**	**8.8%**	**9.9%**

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, state and federal sources.

Passenger Fare Revenue

Passenger fares are derived from the sale of Sounder commuter rail and Central Link tickets at ticket vending machines (TVMs), 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 17.2% and 22.7% in 2012 and 2011, respectively, due to increases in both ridership and fares. ST Express continues to be the largest revenue generating mode providing 56.6% of total passenger fare revenue compared to Link and Sounder commuter rail providing 25.9% and 17.5% of total passenger fare revenue, respectively. 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

(in millions)	2012	2011	2010	% Change 2012-2011	% Change 2011-2010
ST Express	$ 30.6	$ 25.7	$ 20.9	18.9%	23.5%
Link	14.0	12.0	9.6	16.2	25.3
Sounder	9.5	8.4	7.1	13.7	16.8
Total	**$ 54.1**	**$ 46.1**	**$ 37.6**	**17.2%**	**22.7%**

Ridership

Sound Transit provided 28.5 million rides in 2012, an increase of 9.8% from 2011 as economic growth led riders to use Sound Transit services to commute to work. Additional changes in ridership by mode are discussed below.

ST Express ridership increased 10.2% in 2012 (11.0% in 2011) due to the full year effect of the June 2011 service redeployments that continue to prove effective in serving high capacity routes, and increased weekend ridership as ST Express is the primary weekend service provider in its transit service area and other transit operators have reduced service. In 2011, increased automobile fuel prices attracted riders to public transit that led to additional increases in ridership.

Link consists of Central Link and Tacoma Link. In 2012, Link ridership increased 10.1% from 2011 (12.8% from 2010) as the Central Link service establishes itself in the community and as Tacoma Link sees continued growth from the opening of the Commerce Street Station in September 2011, more effectively serving downtown Tacoma businesses. Tacoma Link served over one million passengers in 2012.

Sounder commuter rail ridership increased 6.7% in 2012 (5.9% in 2011) reflecting the full year effect of relocation of businesses from Tacoma to downtown Seattle in fall 2011, as well as the opening of the Tacoma-Lakewood corridor in October 2012 that brought new riders to the service. Further influencing the 2011 increase in ridership were increases in automobile fuel prices from that of 2010.

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

Ridership *(in thousands)*	**2012**	**2011**	**2010**	**% Change** **2012-2011**	**2011-2010**
ST Express	16,012.4	14,534.4	13,092.8	10.2%	11.0%
Link	9,725.2	8,831.8	7,831.9	10.1	12.8
Sounder	2,803.1	2,626.7	2,480.1	6.7	5.9
Total	**28,540.7**	**25,992.9**	**23,404.8**	**9.8%**	**11.1%**

Average Fare per Boarding

The combined average fare per boarding (AFB) increased $0.10 or 5.2% from 2011 due to the full year effect of the June 2011 fare increases on ST Express and Central Link and increases in business passport contract pricing as all existing contracts were priced using actual ridership data upon renewal. Business passport contracts continue to represent the largest source of fare revenue for Sound Transit and contributed the greatest amount to each mode's increased AFB.

In 2011, the combined AFB increased $0.20 or 11.5% from 2010 related to changes in business passport contract pricing and due to fare increases implemented in June 2011. The fare changes increased regular fares $0.50 on ST Express and $0.25 on Central Link, and increased youth fares $0.25 on ST Express, aligning Sound Transit fares with partner transit agencies and positively affecting the AFB on these two modes. The new business passport contract pricing strategy described above led to an increase of $0.29 or 10.2% in the Sounder commuter rail AFB from 2010. See the following table for the AFB by mode.

Average Fare per Boarding	**2012**	**2011**	**2010**	**% Change** **2012-2011**	**2011-2010**
ST Express	$ 2.00	$ 1.90	$ 1.67	5.3%	13.5%
Link	1.61	1.53	1.38	5.0	11.1
Sounder	3.38	3.17	2.88	6.6	10.2
Combined average fare per boarding	**2.02**	**1.92**	**1.72**	**5.2**	**11.5**

Other Operating Revenues

Other operating revenues consist of vehicle advertising, rental of equipment and facilities, operating grants and other miscellaneous revenue. Other operating revenues decreased by $1.9 million or 33.1% from 2011 primarily due to decreases in operating grants received as no additional rights to operate transit facilities were obtained from WSDOT in 2012. In 2011, other operating revenues were up $3.3 million or 128.3% from 2010 with the rental of buses to Pierce Transit after a compressed natural gas tank exploded at their maintenance facility in February 2011, as well as the receipt of $2.4 million in access rights from WSDOT for operation and maintenance of Mountlake Terrace Freeway Station and University of Washington Station.

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 Expenses by Function

Operations and maintenance 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.

Operations and maintenance expenses increased $9.2 million or 5.0% in 2012 from increases in vehicle operations and non-vehicle maintenance costs. In 2011 operations and maintenance expenses increased $3.4 million or 1.9% due to increases in vehicle operations costs while non-vehicle maintenance costs remained comparable to 2010. Vehicle maintenance costs remained comparable between 2012, 2011 and 2010. See the following table for operating and maintenance expenses by function.

Operations and Maintenance Expenses by Function

(in millions)				% Change	
	2012	**2011**	**2010**	**2012-2011**	**2011-2010**
Vehicle operations	$ 117.4	$ 112.5	$ 107.1	4.3%	5.1%
Vehicle maintenance	44.9	45.6	46.7	(1.6)	(2.5)
Non-vehicle maintenance	29.0	24.0	24.9	20.9	(3.5)
Total	**$ 191.3**	**$ 182.1**	**$ 178.7**	**5.0%**	**1.9%**

Vehicle operations expenses increased $4.9 million or 4.3% in 2012, as operator rates increased on all modes. Vehicle operations expenses increased $5.4 million or 5.1% in 2011 as savings realized from the restructuring of ST Express service to serve high capacity routes and peak service times helped offset increases in fuel costs, fare enforcement, security and Central Link operator rates.

Vehicle maintenance expenses were similar to 2011 as maintenance savings realized from the replacement of twenty-four buses that had reached the end of their useful life in 2012 offset increases in vehicle maintenance contract rates and costs of maintenance materials used on aging locomotives and the original thirty-five light rail vehicles, as those vehicles are no longer covered by maintenance warranty. Vehicle maintenance expenses decreased $1.1 million or 2.5% in 2011 as the replacement of sixty-two buses that had reached their full service life in 2011 offset increases in light rail vehicle maintenance costs as those vehicles came out of warranty.

Non-vehicle maintenance expenses increased $5.0 million or 20.9% in 2012 with increased maintenance for rail right-of-way and light rail traction power maintenance staff needed to support increased facility maintenance requirements as facilities age and usage increases. In 2011, non-vehicle maintenance expenses decreased $0.9 million or 3.5% as decreases in major maintenance related to the Downtown Seattle Transit Tunnel (DSTT) offset increases in rail facility and track maintenance.

Operations and Maintenance Expenses by Mode

Major modal expense categories consist of services, materials, supplies, utilities, insurance, taxes, and purchased transportation, allocated overhead from general and administrative divisions and operating leases and rentals. Purchased transportation includes amounts paid to Community Transit, King County Department of Transportation (DOT) and Pierce Transit who operate Sound Transit's express bus service 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 62.3% of this category in 2012 and 62.8% in 2011. 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 17.3% in 2012 and 17.0% in 2011 of total operating and maintenance expenses.

The following table presents operating and maintenance expenses by mode.

Operations and Maintenance Expenses by Mode

(in millions)				% Change	
	2012	2011	2010	2012-2011	2011-2010
ST Express	$ 101.5	$ 96.7	$ 96.6	4.9%	0.1%
Link	56.5	53.3	49.4	6.0	8.0
Sounder	33.3	32.1	32.7	3.7	(1.8)
Total	**$ 191.3**	**$ 182.1**	**$ 178.7**	**5.0%**	**1.9%**

ST Express operations and maintenance costs increased $4.8 million or 4.9% from 2011, most significantly from increased purchased transportation contract costs. ST Express operating and maintenance costs for 2011 were comparable to that of 2010 due to decreases in bus maintenance costs as the majority of the aging New Flyer fleet was replaced in 2011, as well as due to decreases in purchased transportation contract costs resulting from the transfer of routes 566 and 567 to Pierce Transit from King County DOT.

Link operations and maintenance expenses include both Tacoma Link and Central Link light rail lines. Link operations and maintenance expenses increased $3.2 million or 6.0% from 2011 ($3.9 million or 8.0% from 2010) primarily resulting from increases in Central Link purchased transportation costs related to the full year effect of additional vehicle and facility maintenance employees added in 2011 as twenty-seven additional light rail vehicles went into service and as facilities experienced increased usage. Tacoma Link operations and maintenance expenses were comparable for 2012, 2011 and 2010.

Sounder commuter rail operations and maintenance costs increased $1.2 million or 3.7% from 2011 due to increases in Amtrak overall vehicle maintenance contract costs, increases in electricity costs for locomotive recharging at the layover yards and increases in excise taxes related to increased fare revenue. Sounder commuter rail operating and maintenance costs were comparable for 2011 and 2010 as fuel savings resulting from the full year effect of wayside power used for locomotive recharging implemented in 2010, along with decreases in Amtrak baseline vehicle maintenance costs resulting from a contract restructuring in 2010, were able to offset increases in BNSF operating costs and locomotive diesel fuel prices.

General and Administrative

General and administrative expenses comprise 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. General and administrative expenses decreased in 2012 by $3.6 million or 13.4% ($6.1 million or 18.8% in 2011) primarily due to a decrease in legal defense costs related to construction claim resolution, which more than offset increases in salaries and benefits related to supporting agency activities.

General and Administrative Expenses

(in millions)				% Change	
	2012	**2011**	**2010**	**2012-2011**	**2011-2010**
Salaries	$ 11.9	$ 10.5	$ 10.1	13.8%	3.6%
Benefits	6.5	5.2	5.6	26.0	(8.0)
Services and professional fees	2.2	8.2	12.7	(73.2)	(35.6)
Other	2.5	2.8	4.4	(13.2)	(35.4)
Total	**$ 23.1**	**$ 26.7**	**$ 32.8**	**(13.4)%**	**(18.8)%**

Salaries and benefits increased 17.8% from 2011 as staff vacancies related to legal, finance and IT decreased as positions were filled in 2012. Salaries and benefits for 2011 were comparable to that of 2010.

Services and professional fees decreased $6.0 million or 73.2% in 2012 ($4.5 million or 35.6% in 2011) as costs incurred in support of construction claims resolution decreased with the settlement of all outstanding Central Link construction claims in 2011. Excluding claims costs, services and professional fees decreased in 2012 by $1.1 million or 35.4% due to a decrease in consulting services used to support agency activities including grants processing, administering the project labor agreement and financial advisory services. Excluding claims costs, services and professional fees were comparable between 2011 and 2010.

In 2012, other expenses were comparable to that of 2011. In 2011, other expenses decreased $1.6 million or 35.4% from 2010 as additional costs were charged to capital projects and operations in support of those activities.

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. Fare and regional planning expenses in 2012 were comparable to that of 2011. The completion of ST2 planning and implementation of ORCA in 2010 caused a reduction in fare and regional planning expenses in 2011 by $1.1 million or 36.0% from that of 2010.

Depreciation and Amortization

Depreciation and amortization comprises non-cash expenses that reduces the value of capital assets over time and includes insignificant gain or loss on disposal of assets used in operations. For 2012, depreciation and amortization increased $7.1 million or 6.4% from 2011 resulting from the capitalization of airspace leases and the start of revenue service in the Tacoma-Lakewood commuter rail corridor in October 2012. The additional ST Express and Central Link revenue vehicles placed into service as well as capitalization of additional costs related to Central Link close out increased depreciation and amortization in 2011 by $6.1 million or 5.9% from that of 2010.

Non-Operating Revenues (Expenses)

Net non-operating revenues increased by $39.5 million or 8.0% in 2012 resulting from a growth in tax revenues, lower net interest expense and lower capital contributions to other governments. In 2011, net non-operating revenues decreased $32.2 million or 6.1% from 2010 as capital contributions to other governments increased by $74.0 million which more than offset increases in tax revenues of $23.6 million and $6.8 million in investment income.

Non-operating Revenues and Expenses

(in millions)				% Change	
	2012	2011	2010	2012-2011	2011-2010
Non-operating revenues					
Sales and use tax	$ 551.9	$ 528.0	$ 504.1	4.5%	4.7%
Motor vehicle excise tax	65.8	65.9	65.8	(0.1)	0.2
Rental car tax	2.5	2.0	2.4	29.1	(18.7)
Investment income	12.2	20.9	14.1	(41.7)	47.8
Other revenues	7.4	8.6	10.8	(15.1)	(18.7)
Total	**639.8**	**625.4**	**597.2**	**2.3**	**4.7**
Non-operating expenses					
Interest expense	69.8	76.0	76.4	(8.1)	(0.6)
Interest expense, capitalized	(37.9)	(32.2)	(23.6)	17.8	36.5
Interest expense, net	31.9	43.8	52.8	(27.1)	(17.1)
Contributions to other governments	70.4	81.7	7.7	(13.8)	961.2
Tax collection fees	2.4	2.3	1.3	(0.8)	79.0
Loss on disposal of assets	0.1	-	-	-	-
Impaired projects	-	2.1	7.7	(99.1)	(72.3)
Total	**104.8**	**129.9**	**69.5**	**(19.4)**	**87.1**
Non-operating revenues, net	**$ 535.0**	**$ 495.5**	**$ 527.7**	**8.0%**	**(6.1)%**

Sales and Use tax revenues increased by 4.5% in 2012 and 4.7% in 2011 with a strengthened economy and the Department of Revenue Amnesty Program that waived non-compliance penalties and interest for tax obligations related to years 2007 through 2011 that were settled between February and April 2012. Motor Vehicle Excise and Rental Car Sales tax revenues were comparable for 2012, 2011 and 2010.

Investment income decreased by $8.7 million in 2012 (increased by $6.8 million in 2011) due to changes in the fair market value of investments. Other revenues decreased by $1.2 million from 2011 (decreased $2.2 million from 2010) as recoveries related to the settlement of investment and construction claims for the Initial Segment and Airport Link projects were received in 2011 and 2010, respectively.

Net interest expense decreased $11.9 million from 2011 with the refunding of the 2005 bonds at lower effective interest rates. Net interest expense decreased $9.0 million from 2010 as more interest was capitalized with increased construction spending as University Link progressed through construction and ST2 capital projects entered preliminary engineering.

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 2012, capital contributions were $70.4 million, a decrease of 13.8% from 2011, comprising contributions to the City of Seattle for the construction of First Hill Street Car and the contribution of I-90 Two-Way Transit & HOV Operations, Stage 2 to WSDOT. 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.

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, thereby resulting in a write-off of the associated cost. In 2012, no significant impairments were incurred as Beacon Hill Tunnel void mitigation work was completed in 2011. Impairments decreased by $5.6 million in 2011 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 decreased in 2012 by $43.0 million or 24.6% due to decreased spending on eligible federally funded capital projects. The following table summarizes capital contributions by major category.

Capital Contributions					
(in millions)				**% Change**	
	2012	**2011**	**2010**	**2012-2011**	**2011-2010**
Federal	$ 127.7	$ 168.7	$ 151.8	(24.3)%	11.1%
State and local governments	3.6	5.6	12.0	(35.2)	(53.5)
Total	**$ 131.3**	**$ 174.3**	**$ 163.8**	**(24.6)%**	**6.4%**

Federal capital contributions decreased by $41.0 million in 2012 primarily due to the timing of spending on the University Link project, a Federal Transportation Authority approved full funding grant agreement project. Draw downs related to the light rail vehicle portion of the University Link project were accelerated into 2011, and the tunnel boring project completed the first twin tunnel early and had not mobilized by the end of 2012 on the next tunnel, accelerating when contributions were received. In 2011, federal capital contributions increased $16.9 million or 11.1% from 2010 primarily resulting from increased capital spending and related grant drawdowns for the University Link project as the light rail vehicle and tunnel boring portions of the project incurred a majority of their spending in 2011.

State and local government contributions decreased in 2012 by $2.0 million as the state regional mobility grants related to Tacoma-Lakewood commuter rail expansion were exhausted in 2011. State and local capital contributions decreased $6.4 million or 53.5% in 2011 as regional mobility grants related to Mountlake Terrace Freeway Station and acquisition of expansion buses were fully expended in 2010.

Management's Discussion and Analysis, continued

Capital Assets

As of December 31, 2012, Sound Transit had invested $5.4 billion in capital assets, net of accumulated depreciation and amortization, which included $3.3 billion of depreciable assets in service. This represents a $370.6 million or a 7.4% increase over 2011. The increase reflects capital project spending for all light rail expansion corridors, Sounder South Line corridor and Regional Express fleet replacement. Capital projects in progress (CIP) increased $239.5 million or 24.2% while non-depreciable and depreciable assets increased $85.3 million or 11.2% and $52.1 million or 1.6%, respectively. A summary of Sound Transit's capital assets are presented in the following table.

Capital Assets, net

(in millions)	December 31 2012	2011	2010	% Change 2012-2011	2011-2010
Land	$ 418.0	$ 387.0	$ 382.3	8.0%	1.2%
Permanent easements	428.4	374.1	327.8	14.5	14.1
Capital projects in progress					
Sound Transit	1,227.5	968.1	660.6	26.8	46.5
Other governments	3.6	23.5	50.3	(84.6)	(53.4)
Total capital projects in progress	1,231.1	991.6	710.9	24.2	39.5
Total non-depreciable assets	**2,077.5**	**1,752.7**	**1,421.0**	**18.5**	**23.3**
Buildings, transit facilities & heavy equipment	2,384.6	2,343.7	2,367.4	1.7	(1.0)
Access rights	430.3	409.3	430.4	5.1	(4.9)
Revenue vehicles	478.7	487.2	386.0	(1.7)	26.2
Software, furniture, equipment & vehicles	2.6	3.9	5.7	(33.7)	(31.3)
Total depreciable assets	**3,296.2**	**3,244.1**	**3,189.5**	**1.6**	**1.7**
Total capital assets, net	**$ 5,373.7**	**$ 4,996.8**	**$ 4,610.5**	**7.5%**	**8.4%**

Land increased $31.0 million in 2012 related to right-of-way acquisitions for the East Link and North Link projects and additional transfers of land costs from CIP related to the Tacoma-Lakewood corridor project that entered revenue service in October 2012. In 2011, land increased by $4.7 million resulting from acquisitions for the North Link project and the Tacoma-Lakewood corridor project.

Permanent easements increased by $54.4 million in 2012 and $46.3 million in 2011 with the acquisition of an additional permanent easement from BNSF to operate an additional round trip in the Sounder Seattle-Tacoma corridor in each year.

CIP had a net increase of $239.5 million in 2012 ($280.7 million in 2011). Total capital project spending was $551.1 million in 2012, a decrease of 4.7% from 2011 as the University Link project experienced lower construction costs on its tunnel boring project and as the Tacoma-Lakewood project had decreased spending as it completed construction in summer 2012. Transfers out of CIP increased 4.8% from 2011 with the Tacoma-Lakewood corridor project going into service. Total capital spending in 2011 increased 11.0% from 2010 with the early completion of the light rail vehicle portion of the University Link project, while transfers out of CIP increased $96.3 million in 2011 with the addition of new light rail vehicles and buses and the completion of the Mountlake Terrace Freeway Station, which entered revenue service in 2011. Capital projects that incurred major spending activity in 2012 and 2011 are summarized in the following table.

Major Capital Project Activities from 2012 and 2011			
	Sounder	**Link**	**ST Express**
2012	• D to M Streets Track & Signal • Sounder South Expanded Service • Sounder ST2 Fleet Expansion	• East Link (Downtown to Bellevue) • First Hill Link Street Car • Lynnwood Link (Northgate to Lynnwood) • Northlink (UW Station to Northgate) • South Link (176th to 200th) • University Link (PSST to UW Station) • University Link (University Tunnel) • University Link (UW Station and Capital Hill Station)	• Fleet Replacement
2011	• D to M Streets Track & Signal • Sounder South Expanded Service	• East Link (Downtown to Bellevue) • First Hill Link Street Car • Northlink (UW Station to Northgate) • South Link (176th to 200th) • University Link (PSST to UW Station) • University Link (University Tunnel) • University Link (UW Station and Capital Hill Station)	• Burien Transit Center Parking Expansion • Fleet Replacement • I-90 2-Way Transit & HOV Stage 2

Buildings, transit facilities, and heavy equipment, net of depreciation as well as software, furniture, equipment, and vehicles, net of amortization and depreciation were comparable for 2012, 2011 and 2010.

Access rights, net of amortization, increased $21.0 million in 2012 with the reclassification of previously entered into WSDOT airspace leases (see note 2) and new access rights obtained from the City of Tacoma related to the operation of the Tacoma-Lakewood Sounder corridor compared to a decrease of $21.1 million in 2011 as amortization exceeded current year asset additions.

Revenue vehicles, net of depreciation, decreased $8.5 million in 2012 as current year depreciation exceeded asset additions related to replacement of twenty-four buses that had reached their full service lives. Revenue vehicles, net of depreciation, increased in 2011 by $101.2 million as the remaining ST2 service expansion buses and the University Link light rail vehicles entered revenue service.

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

Long-Term Debt

In 2012, Sound Transit issued two series of bonds with a par value of $313.7 million refunding a majority of its 2005 Series bonds in advance of their 2030 maturity date. This resulted in total debt defeasement of $350.6 million. No additional debt was incurred on the refunding. The bonds were issued at a premium of $59.1 million for net proceeds before bond issuance costs of $372.8 million. Total bond issuance costs were $0.4 million. The advanced refunding resulted in $120.4 million in interest savings through 2030, which equates to a net present value savings of $50.8 million. No debt was issued in 2011.

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 2011 assessed valuations for collection of 2012 taxes, Sound Transit's current non-voter approved remaining debt capacity is $4.6 billion and its additional remaining debt capacity subject to voter approval is $20.1 billion.

Sound Transit's 2012 bond credit ratings remained unchanged from those of 2011. All outstanding prior and parity bond issuances are rated Aa1 and Aa2, respectively, by Moody's and AAA by Standard & Poor's (S&P).

Economic Conditions

Sound Transit's total 2012 tax revenues increased 4.1% over prior year, reflecting continued recovery since the 2009 economic recession. Although year-over-year tax revenues increased, taxable retail sales, which generate approximately 89% of total tax revenue, remains 12% below pre-recession levels. Lower than anticipated construction costs, inflation and interest rates have contributed to offsetting lower tax revenues.

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Independent Auditors' Report

Audit and Reporting Committee
Central Puget Sound Regional Transit Authority

Report on the Financial Statements

We have audited the accompanying financial statements of Central Puget Sound Regional Transit Authority (a public corporation acting under the service name of Sound Transit) as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise Sound Transit's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sound Transit as of December 31, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matter

Required Supplementary Information

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis on pages 1 through 15 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 24, 2013 on our consideration of Sound Transit's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Sound Transit's internal control over financial reporting and compliance.

KPMG LLP

Seattle, Washington
May 24, 2013

STATEMENTS OF NET POSITION

(in thousands)	December 31 2012	December 31 2011
ASSETS		
Current assets		
Cash and cash equivalents (note 3)	$ 69,137	$ 85,949
Restricted assets (note 3)	2,151	2,230
Investments (note 3)	770,378	752,108
Taxes and other receivables (note 4)	147,835	130,696
Inventory	12,774	14,190
Prepaid expenses	5,770	5,645
Total current assets	**1,008,045**	**990,818**
Non-current assets		
Capital assets, net (note 5)	5,373,733	4,996,822
Restricted assets (note 3)	94,619	106,087
Investment held to pay capital lease obligation (note 6)	58,846	57,578
Unamortized bond issuance costs	7,708	9,302
Prepaid expense and deposits	5,539	20,859
Total non-current assets	**5,540,445**	**5,190,648**
Total assets	**6,548,490**	**6,181,466**
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (note 7)	135,049	109,573
Unearned revenue	3,935	3,050
Interest payable from restricted assets	19,320	18,017
Current portion, long-term debt (note 8)	33,250	19,195
Other claims and short-term obligations	1,506	2,232
Total current liabilities	**193,060**	**152,067**
Non-current liabilities		
Long-term debt (note 8)	1,465,831	1,529,002
Capital lease obligations (note 6)	58,846	57,578
Other long-term obligations (note 9)	5,414	7,907
Total non-current liabilities	**1,530,091**	**1,594,487**
Total liabilities	**1,723,151**	**1,746,554**
Commitments and contingencies (notes 6, 9, 11, and 12)		
NET POSITION		
Net investment in capital assets	3,882,360	3,457,927
Restricted for debt service and other (note 10)	77,450	90,299
Unrestricted	865,529	886,686
Total net position	**$ 4,825,339**	**$ 4,434,912**

See accompanying notes to financial statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

(in thousands)	December 31 2012	December 31 2011
Operating revenues		
Passenger fares	$ 54,068	$ 46,116
Other operating revenue	3,887	5,814
Total operating revenues	**57,955**	**51,930**
Operating expenses		
Vehicle operations	117,384	112,511
Vehicle maintenance	44,869	45,598
Non-vehicle maintenance	29,015	23,997
General and administrative	23,080	26,660
Fare and regional planning	2,010	1,850
Depreciation, amortization and accretion	117,495	110,413
Total operating expenses	**333,853**	**321,029**
Loss from operations	**(275,898)**	**(269,099)**
Non-operating revenues (expenses)		
Sales tax	551,898	528,022
Motor vehicle excise tax	65,844	65,893
Rental car tax	2,527	1,958
Investment income	12,176	20,875
Other revenues	7,365	8,676
Contributions to other governments	(70,426)	(81,742)
Interest expense	(31,857)	(43,728)
Tax collection fees	(2,351)	(2,369)
Loss on disposal of assets	(134)	-
Impaired projects	(19)	(2,118)
Total non-operating revenues, net	**535,023**	**495,467**
Income before capital contributions	**259,125**	**226,368**
Federal capital contributions	127,682	168,671
State and local capital contributions	3,620	5,583
Total capital contributions	**131,302**	**174,254**
Change in net position	**390,427**	**400,622**
Total net position, beginning of year	**4,434,912**	**4,034,290**
Total net position, end of year	**$ 4,825,339**	**$ 4,434,912**

See accompanying notes to financial statements.

STATEMENTS OF CASH FLOWS

(in thousands)

	December 31 2012	December 31 2011
Cash flows from operating activities		
Cash receipts from fares	$ 54,752	$ 45,894
Cash receipts from other operating revenue	3,960	3,241
Payments to suppliers	(71,541)	(76,269)
Payments to transportation service providers	(123,065)	(113,322)
Payments to employees for wages and benefits	(27,984)	(23,633)
Net cash used by operating activities	**(163,878)**	**(164,089)**
Cash flows from non-capital financing activities		
Taxes received	613,681	593,350
Tax collection fees paid	(2,283)	(2,757)
Net cash provided by non-capital financing activities	**611,398**	**590,593**
Cash flows from capital and related financing activities		
Capital contributions from grants	120,578	182,142
Proceeds on issuance of bonds	19	-
Proceeds for betterments and recoverable costs	611	457
Purchase of property, vehicles and equipment	(47)	(1,428)
Payments for capital projects in progress	(446,460)	(613,642)
Payments to employees capitalized to capital projects in progress	(35,360)	(29,984)
Payments for bond principal	(46,882)	(18,465)
Payments for bond issue costs	(784)	-
Recovery of owner controlled insurance program (OCIP) premiums	441	339
Cash paid for interest	(61,221)	(70,684)
Net cash used by capital and related financing activities	**(469,105)**	**(551,265)**
Cash flows from investing activities		
Purchases of investments	(325,026)	(517,481)
Proceeds from sales or maturities of investments	339,394	590,481
Investment income	12,092	12,973
Net cash provided by investing activities	**26,460**	**85,973**
Net increase (decrease) in cash and cash equivalents	**4,875**	**(38,788)**
Cash and cash equivalents		
Beginning of year	135,185	173,973
End of year	**$ 140,060**	**$ 135,185**
Cash and cash equivalents (note 3)		
Unrestricted	$ 69,137	$ 85,949
Current restricted	1,018	1,024
Non-current restricted	69,905	48,212
	$ 140,060	**$ 135,185**

See accompanying notes to financial statements.

STATEMENTS OF CASH FLOWS, continued

(in thousands)	December 31	
	2012	2011
Loss from operations	**$ (275,898)**	**$ (269,099)**
Adjustments to reconcile loss from operations to net cash used by operating activities		
Depreciation, amortization and accretion	117,495	110,413
Airspace lease donation	-	(2,359)
Bad debt expense	(13)	38
Materials allowance	166	-
Equipment and leases expense	(7)	514
Changes in operating assets and liabilities		
Decrease (increase) in accounts receivable	104	(202)
Increase in due from other governments	(1,375)	(2,405)
Increase in grants receivable	(19)	(14)
Increase in inventory	(112)	(63)
Increase in prepaid expenses	(794)	(14)
Decrease in OCIP loss fund	75	588
(Decrease) increase in accounts payable and accrued liabilities	(6,875)	4,910
Increase in salaries and benefits payable	431	386
Increase in unearned revenue	885	1,002
Increase (decrease) in due to other governments	3,150	(5,882)
Decrease in other current liabilities	(1,091)	(1,902)
Net cash used by operating activities	**$ (163,878)**	**$ (164,089)**

(in thousands)	December 31	
	2012	2011
Supplemental disclosures of non-cash operating, investing and financing activities		
Capital contributions to other governments	$ (70,426)	$ (81,742)
Capital contributions from Land Bank	-	35
Construction in progress in current liabilities	86,416	60,035
Interest income from investments held to pay capital leases, net	4,310	26
Interest expense on capital leases	(4,310)	(26)
Increase (decrease) in fair value of investments	3,101	10,095
Like-kind land exchange	173	-
Advanced bond refunding	313,710	-
Capitalization of airspace access rights	11,899	-
Capitalization of rotable parts	1,901	-
Land held for resale	-	322

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2012 AND 2011

1. ORGANIZATION AND REPORTING ENTITY

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

Reporting Entity—Sound Transit is a special purpose government supported primarily through sales and use tax, motor vehicle excise tax and rental car sales tax assessed in Sound Transit's operating jurisdiction (the district). In addition, Sound Transit receives capital funding from federal, state and local agencies. Sound Transit is governed by an eighteen member board, seventeen of whom are appointed by the respective member county executives and confirmed by the council of each member county. Membership is based on the population from the portion of each county that lies within Sound Transit's service area. Representation on the board includes an elected official representing the largest city in each county and ensures proportional representation from other cities and from unincorporated areas of each county. The final board position is held by the Secretary of Transportation, Washington State Department of Transportation.

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.

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. 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.

Operating revenues consist primarily of passenger fares recognized in the period in which services are provided. Operating expenses are recognized in the period in which they are incurred. All assets and liabilities associated with the operation of Sound Transit are included in the Statements of Net Position. Depreciation and amortization of capital assets and amortization of deferred revenue, bond issuance costs, asset retirement obligations and deferred rent is recognized in the Statements of Revenues, Expenses and Changes in Net Position.

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

	Estimated useful life
Access rights	5 – 100 years
Buildings and leasehold improvements	8 – 30 years
Furnitures, equipment and vehicles	3 – 10 years
Revenue vehicles	12 – 40 years
Software and transit systems	3 – 5 years
Transit facilities, rail and heavy equipment	6 – 150 years

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

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

Access rights include costs incurred or rights acquired that allow Sound Transit to operate its services in public and private right of ways. Access rights are amortized over the life of the underlying asset constructed or the term of the contractual agreement granting the related right. 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 CIP until the asset is substantially completed and accepted, at which time it is charged to contributions to other governments.

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

Compensated Absences— Vacation leave that has been earned but not paid is accrued. Similarly, sick leave is accrued as the benefits are earned but only to the extent that Sound Transit will compensate the employees through cash payments conditional on the employee's termination, retirement or death. Vacation pay, which may be accumulated up to 50 days, is payable upon termination, retirement or death. 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 whether an obligating event, as defined by GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, has occurred, when the liability should be accrued and whether the cost should be expensed or capitalized. Generally such costs are incurred with respect to properties that Sound Transit is preparing for its own use or are required in the construction of its projects and subsequently resold. As such, these costs are recorded as incurred and capitalized to the project. Costs in excess of the property's fair market value, or that do not meet capitalization criteria under generally accepted accounting principles, are expensed as soon as a reasonable estimate can be obtained.

Inventory— Inventory includes land held for sale and spare parts, and is recorded at the lower of purchased cost or net realizable value. Allowances for excess and obsolete parts are provided for over the estimated useful lives of the related assets for parts expected to be on hand at the date the assets are retired and for spare parts currently identified as excess and obsolete. Allowances are reflected as a charge to operations and are based on management's estimate that are subject to change. As of December 31, 2012 inventory reflects an allowance of $166 thousand. No allowance for excess and obsolete parts was provided for at December 31, 2011.

Investment Valuation— Investments are stated at fair value.

New Accounting Pronouncements— As of January 1, 2012, Sound Transit adopted the following GASB statements, and found there was no material impact to its financial statements.

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements (GASB No. 62)*, effective for years beginning after December 15, 2011. GASB No. 62 incorporates into the GASB authoritative literature accounting and financial reporting guidance collectively referred to as "FASB and AICPA pronouncements" issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position (GASB No. 63)*, effective for years beginning after December 15, 2011. GASB No. 63 provides reporting guidance for deferred outflows of resources and deferred inflows of resources and makes them required components of the residual measure and renames the residual measure net position from net assets to be consistent with these elements as defined in Concepts Statement No. 4, *Elements of Financial Statements*.

Reclassifications— Certain reclassifications have been made to the 2011 Financial Statements to conform to the current year's presentation.

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

Reserves— Sound Transit has internally designated an operating reserve, consisting of two months of average annual operating expenses for the years ended December 31, 2012 and 2011. 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 position.

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 fare collection services (RFCS). Sound Transit reports its undivided interest in assets, liabilities, expenses, and revenues of RFCS within its financial statements, as they are specifically identifiable to Sound Transit 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.

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.

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 3.17. For the Prior and Parity Bond Debt Service funds and the University Link 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 U.S. 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. U.S. 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, 2012, all Treasury and U.S. 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, 2012. The LGIP and KCIP are unrated.

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

Notes to Financial Statements, continued

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

(in thousands)	December 31	
	2012	2011
Cash and cash equivalents		
Washington State Local Government Investment Pool	$ 66,427	$ 86,293
FDIC or PDPC insured bank deposits	(457)	(3,080)
Cash on hand	3,167	2,736
	69,137	**85,949**
Restricted assets - current		
Deductible liability protection policy	1,133	1,206
Cash equivalent - King County Investment Pool	1,018	1,024
	2,151	**2,230**
Investments		
Undesignated	562,903	605,752
Capital replacement	207,475	146,356
	770,378	**752,108**
Restricted assets - non-current		
Cash and cash equivalents		
Washington State Local Government Investment Pool	51,849	30,154
FDIC or PDPC insured bank deposits	10,052	10,042
Escrow funds	8,004	8,016
	69,905	**48,212**
Investments - Debt service and OCIP reserve	24,550	57,145
Interest receivable on restricted investments	164	730
	94,619	**106,087**
Total cash, cash equivalents, investments and restricted assets	**$ 936,285**	**$ 946,374**

Unrestricted investments consist of the following:

(in thousands)	2012			2011		
	Fair value	**Modified duration**	**Percentage of portfolio**	**Fair value**	**Modified duration**	**Percentage of portfolio**
Investments – Undesignated						
King County Investment Pool	$ 272,764	1.360	48.46%	$ 301,056	0.720	49.70%
U.S. Agency securities:						
Federal Farm Credit Bank	115,155	1.679	20.46	24,992	1.741	4.13
Federal Home Loan Mortgage Corporation	40,031	1.138	7.11	83,495	1.673	13.78
Federal Home Loan Bank	37,992	1.250	6.75	40,261	1.144	6.65
Federal National Mortgage Association	25,158	0.408	4.47	100,872	1.383	16.65
U.S. Treasury securities	37,223	1.334	6.61	20,033	0.498	3.31
Certificate of deposit	20,235	0.480	3.59	20,078	1.470	3.31
Municipal bonds	14,345	0.303	2.55	14,965	1.258	2.47
	$ 562,903	**1.299**	**100.00%**	**$ 605,752**	**1.063**	**100.00%**
Investments – Capital Replacement						
U.S. Agency securities:						
Federal National Mortgage Association	$ 66,822	4.114	32.21%	$ 26,947	4.180	18.41%
Federal Home Loan Mortgage Corporation	65,159	5.035	31.41	31,185	3.234	21.31
Federal Home Loan Bank	9,622	5.576	4.64	21,897	1.120	14.96
Federal Farm Credit Bank	6,923	7.098	3.33	28,611	4.870	19.55
Municipal bonds	51,747	5.572	24.94	37,716	4.289	25.77
U.S. Treasury securities	7,202	1.032	3.47	-	-	-
	$ 207,475	**4.827**	**100.00%**	**$ 146,356**	**3.684**	**100.00%**

Notes to Financial Statements, continued

Non-current restricted investments consist of the following:

(in thousands)	2012			2011		
	Fair value	**Maturity**	**Call date**	**Fair value**	**Maturity**	**Call date**
Debt Service Reserve						
Municipal bonds:						
Georgia State GO Unlimited	$ 9,310	4/1/2026	4/1/2017*	$ 8,647	4/1/2026	4/1/2017*
Florida State Public Education BAB	5,737	6/1/2030	6/1/2019*	5,341	6/1/2030	6/1/2019*
Georgia State GO Unlimited BAB	4,982	11/1/2027	-	4,786	11/1/2027	-
Hawaii State GO Unlimited BAB	3,287	2/1/2024	-	4,540	2/1/2024	-
Pennsylvania State GO Unlimited BAB	-	-	-	11,702	2/15/2030	**
U.S. Agency securities:						
Federal Home Loan Mortgage Corp.	-	-	-	12,922	9/15/2029	-
Federal Home Loan Mortgage Corp.	-	-	-	8,059	2/7/2028	2/7/2013*
	23,316			**55,997**		
University Link OCIP						
U.S. Agency securities:						
Federal National Mortgage Association	1,234	-	-	1,148	-	-
	$ 24,550			**$ 57,145**		

* Continuously callable from this date forward

** Sinking fund begins in 2027, ends in 2030

4. TAXES AND OTHER RECEIVABLES

Taxes and other receivables consist of the following:

(in thousands)	December 31	
	2012	**2011**
Taxes receivable	$ 108,366	$ 101,842
Grants receivable	28,652	17,911
Due from other governments	8,050	8,562
Interest receivable	2,657	1,793
Accounts receivable, net	110	588
	$ 147,835	**$ 130,696**

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

5. CAPITAL ASSETS

Capital assets are summarized as follows:

(in thousands)	2012 Beginning balance	Additions	Disposals Reductions	Transfers	2012 Ending balance
Non-depreciable assets					
Land	$ 386,952	$ -	$ (192)	$ 31,244	$ 418,004
Permanent easements	374,135	-	-	54,320	428,455
Capital projects in progress:					
Sound Transit - tangible	964,228	438,869	(156)	(187,928)	1,215,013
Sound Transit - intangible	3,873	62,285	(481)	(53,192)	12,485
Other governments - tangible	23,455	49,970	(69,818)	-	3,607
Total non-depreciable assets	**1,752,643**	**551,124**	**(70,647)**	**(155,556)**	**2,077,564**
Depreciable assets					
Transit facilities, rail and heavy equipment	2,535,734	-	(4,100)	100,290	2,631,924
Access rights	514,586	-	-	49,249	563,835
Buildings and leasehold improvements	28,518	-	(140)	192	28,570
Revenue vehicles	603,477	-	(6,797)	18,778	615,458
Furniture, equipment and vehicles	9,303	-	-	656	9,959
Software	14,533	-	-	199	14,732
Total depreciable assets	**3,706,151**	**-**	**(11,037)**	**169,364**	**3,864,478**
Accumulated depreciation					
Transit facilities, rail and heavy equipment	(209,146)	(58,479)	4,100	-	(263,525)
Access rights	(105,269)	(28,252)	-	-	(133,521)
Buildings and leasehold improvements	(11,234)	(1,193)	61	-	(12,366)
Revenue vehicles	(116,414)	(26,787)	6,393	-	(136,808)
Furniture, equipment and vehicles	(7,019)	(824)	-	-	(7,843)
Software	(12,890)	(1,356)	-	-	(14,246)
Total accumulated depreciation	**(461,972)**	**(116,891)**	**10,554**	**-**	**(568,309)**
	3,244,179	**(116,891)**	**(483)**	**169,364**	**3,296,169**
Total capital assets, net	**$ 4,996,822**	**$ 434,233**	**$ (71,130)**	**$ 13,808**	**$ 5,373,733**

Notes to Financial Statements, continued

(in thousands)	2011 Beginning balance	Additions	Disposals Reductions	Transfers	2011 Ending balance
Non-depreciable assets					
Land	$ 382,308	$ -	$ -	$ 4,644	$ 386,952
Permanent easements	327,785	-	-	46,350	374,135
Capital projects in progress:					
Sound Transit - tangible	652,325	480,744	(3,854)	(164,987)	964,228
Sound Transit - intangible	8,248	46,507	(2,720)	(48,162)	3,873
Other governments - tangible	50,295	50,830	(76,651)	(1,019)	23,455
Total non-depreciable assets	**1,420,961**	**578,081**	**(83,225)**	**(163,174)**	**1,752,643**
Depreciable assets					
Transit facilities, rail and heavy equipment	2,507,024	-	(186)	28,896	2,535,734
Access rights	508,417	-	-	6,169	514,586
Buildings and leasehold improvements	26,469	1,815	-	234	28,518
Revenue vehicles	498,382	-	(20,991)	126,086	603,477
Furniture, equipment and vehicles	8,021	-	(132)	1,414	9,303
Software	14,090	-	(254)	697	14,533
Total depreciable assets	**3,562,403**	**1,815**	**(21,563)**	**163,496**	**3,706,151**
Accumulated depreciation					
Transit facilities, rail and heavy equipment	(156,116)	(53,216)	186	-	(209,146)
Access rights	(78,060)	(27,209)	-	-	(105,269)
Buildings and leasehold improvements	(9,900)	(1,334)	-	-	(11,234)
Revenue vehicles	(112,392)	(25,013)	20,991	-	(116,414)
Furniture, equipment and vehicles	(6,242)	(909)	132	-	(7,019)
Software	(10,153)	(2,737)	-	-	(12,890)
Total accumulated depreciation	**(372,863)**	**(110,418)**	**21,309**	**-**	**(461,972)**
	3,189,540	**(108,603)**	**(254)**	**163,496**	**3,244,179**
Total capital assets, net	**$ 4,610,501**	**$ 469,478**	**$ (83,479)**	**$ 322**	**$ 4,996,822**

During 2012, Sound Transit capitalized $37.9 million of interest costs ($32.2 million in 2011), 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).

6. CAPITAL AND OPERATING LEASES

Capital lease obligations at December 31, 2012 and 2011 are $58.8 million and $57.6 million, respectively.

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

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

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

The lease documentation established minimum credit levels by AIG for the equity and debt defeasance accounts. At the time these transactions closed, AIG was rated “AAA” by 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 of year-end 2012 and 2011, the defeasance accounts were unrated, as they were no longer invested in marketable securities.

As a result of credit rating downgrades under the lease transaction, Sound Transit is required to replace AIG for its undertaking agreements and credit enhancements provision in the transaction and AIG is required to post collateral for the debt defeasance accounts. However, in January 2009, Sound Transit entered into a waiver agreement with the Owner Participant, Lessor, Lender, and Debt Payment Undertaker waiving any existing default or event of default based on a failure to comply with the ratings downgrade provisions of the Participation Agreement, Loan Agreement, Debt Payment Agreement, and Debt Payment Guarantee until March 1, 2009. Under its agreements with the transaction participants, Sound Transit may request successive six-month extensions of the waiver agreement until September 30, 2014, unless extended by agreement of the parties. If the default is not cured and the extension is not granted by September 30, 2014, the investor could demand a termination payment from Sound Transit of approximately $16.0 million. Sound Transit has received confirmation from transaction participants that no default conditions exist under the agreements as of year-end 2012.

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

(in thousands)	2012	2011
Net sublease, January 1	$ 57,578	$ 63,308
Accrued interest	4,310	26
Less payment	(3,042)	(5,756)
Net sublease, December 31	**$ 58,846**	**$ 57,578**

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 non-cancelable operating leases in excess of one year for the use of the DSTT, ground, office space, parking, land, storage at various locations, and equipment with lease terms expiring between 2013 and 2020, with some leases containing options to renew. Minimum lease payments through 2017 are as follows (in thousands):

2013	$ 9,347
2014	8,778
2015	8,651
2016	8,761
2017	8,834
	$ 44,371

Total rental expenses for 2012, which include non-cancelable leases as well as other month-to-month rentals, were $8.8 million, of which $264.4 thousand was for capital projects in progress. Total rental expenses for 2011, which include non-cancelable leases as well as other month-to-month rentals, were $8.4 million, of which $158.0 thousand was for capital projects in progress.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following:

(in thousands)	2012	2011
Accounts payable	$ 4,206	$ 13,022
Accrued liabilities	56,892	52,866
Due to other governments	66,859	39,564
Accrued salaries, wages and benefits	7,018	3,808
Retainage payable	74	313
	$ 135,049	**$ 109,573**

8. LONG-TERM DEBT

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 of Sales and Use, Rental Car, and Motor Vehicle Excise tax. 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. 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, 2009P-2T and 2012P-1 issues. These bonds are payable in February and August of each year and are secured by local option taxes.

(in millions)		Average rate		Ratings		Principal	Fair value*		Principal and interest restricted	
	Issue date	Coupon	Effective	Moody's	S&P	Payment begins	2012	2011	2012	2011
Series 1999	Dec 1, 1998	4.88	5.03	Aa1	AAA	Feb 1, 2006	$ 336.9	$ 344.6	$ 12.4	$ 12.2
Series 2009P-1	Sept 29, 2009	4.31	2.52	Aa1	AAA	Feb 1, 2015	25.5	26.0	0.4	0.4
Series 2009P-2T	Sept 29, 2009	5.01	3.31**	Aa1	AAA	Feb 1, 2020	91.7	86.9	1.6	1.6
Series 2012P-1	Aug 22, 2012	4.97	2.62	Aa1	AAA	Feb 1, 2013	255.5	-	16.8	-

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

Parity Bonds— The Parity Bonds comprise the 2005A, 2007A, 2009S-2T and 2012S-1 issues. These bonds are payable in May and November each year and are secured by Sales and Use and Rental Car taxes.

(in millions)		Average Rate		Ratings		Principal	Fair value*		Principal and interest restricted	
	Issue date	Coupon	Effective	Moody's	S&P	Payment begins	2012	2011	2012	2011
Series 2005A	Mar 31, 2005	4.95	4.60	Aa2	AAA	Nov 1, 2011	$ 38.1	$ 428.9	$ 10.0	$ 9.3
Series 2007A	Dec 18, 2007	4.99	4.76	Aa2	AAA	Nov 1, 2008	451.8	437.7	7.9	11.0
Series 2009S-2T	Sept 29, 2009	5.49	3.62**	Aa2	AAA	Nov 1, 2029	373.9	359.6	2.7	2.7
Series 2012S-1	Aug 22, 2012	4.91	2.73	Aa2	AAA	Nov 1, 2016	119.3	-	0.8	-

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

Notes to Financial Statements, continued

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, 2012, the common debt service reserve account for Prior bonds comprise a surety policy in the amount of $31.7 million purchased in 1999, a $7.9 million cash reserve funded at the time the 2009P bonds were issued and an $11.5M cash reserve funded at the time the 2012P-1 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 $3.2 million at the end of 2012.

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, 2009S-2T and 2012S-1 series bonds. Reserve account proceeds are invested in municipal bonds.

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

		(in thousands)	
Year ending December 31, 2012	**Principal**	**Interest**	**Total**
2013	$ 33,250	$ 72,773	$ 106,023
2014	33,545	71,962	105,507
2015	34,935	70,346	105,281
2016	30,430	68,666	99,096
2017	33,235	67,133	100,368
2018 – 2022	215,375	306,179	521,554
2023 – 2027	313,600	241,743	555,343
2028 – 2032	224,130	177,725	401,855
2033 – 2037	375,105	108,101	483,206
2038 – 2039	173,850	14,405	188,255
	$ 1,467,455	**$ 1,199,033**	**$ 2,666,488**

The American Recovery and Reinvestment Act of 2009 created the Build America Bond (BAB) program, which authorized state and local governments to issue BABs as taxable bonds in 2009 and 2010 to finance any capital expenditures for which they otherwise could issue tax-exempt municipal bonds. The issuers receive a direct federal subsidy payment for a portion of their borrowing costs paid to investors of BABs. The direct federal subsidy once earned, is considered a non-exchange transaction separate from the interest payments made and is recorded in other non-operating revenue when Sound Transit makes its interest payment. The 2009P-2T bonds and the 2009S-2T bonds are Build America Bonds.

In August 2012, Sound Transit issued $216.2 million of Series 2012P-1 bonds and $97.5 million of Series 2012S-1 bonds to advance refund $350.6 million of the 2005A bonds with average interest rates between 2.0% and 5.0%. A total of $399.6 million (net proceeds of $371.9 million after payment of $0.4 million in issuance costs plus an additional deposit of $27.7 million from the liquidation of a portion of the 2005A Debt Service Reserve) was deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the advance refunded portion of 2005A Series bonds. As a result, the refunded portion of the 2005A Series bonds are considered defeased and the liability for those bonds has been removed from the corresponding long-term debt accounts. The advance refunding reduced aggregate debt service payments by $120.4 million through 2030 and produced net present value savings of $50.8 million.

Proceeds from all bond issues except for the 2009P-1, 2012P-1 and 2012S-1 are used for funding capital construction projects.

Long-term debt consists of the following:

(in thousands)	2012 Beginning balance	Additions	Reductions	2012 Ending balance	Amounts due within one year
Bonds payable					
Series 1999 Bonds, at par	$ 321,470	$ -	$ (5,595)	$ 315,875	$ 5,890
Series 2005A Bonds, at par	392,005	-	(356,660)	35,345	9,675
Series 2007A Bonds, at par	410,110	-	(7,585)	402,525	4,570
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	-
Series 2012P-1 Bonds, at par	-	216,165	-	216,165	13,115
Series 2012S-1 Bonds, at par	-	97,545	-	97,545	-
	1,523,585	**313,710**	**(369,840)**	**1,467,455**	**33,250**
Plus unamortized premium	29,452	59,064	(15,057)	73,459	-
Less unamortized discount	(4,840)	(29)	379	(4,490)	-
Less deferred amount on refunding	-	(40,367)	3,024	(37,343)	-
Total bonds payable	**1,548,197**	**332,378**	**(381,494)**	**1,499,081**	**33,250**
Total long-term debt	**$ 1,548,197**	**$ 332,378**	**$ (381,494)**	**$ 1,499,081**	**$ 33,250**

(in thousands)	2011 Beginning balance	Additions	Reductions	2011 Ending balance	Amounts due within 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**

9. OTHER LONG-TERM OBLIGATIONS

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

(in thousands)	2012 Beginning balance	Additions, accretion and changes in estimates	Reductions	2012 Ending balance	Amounts due within one year
Asset retirement obligations					
Sounder station platforms	$ 1,103	$ 55	$ -	$ 1,158	$ -
Tacoma link surface rail	1,598	80	-	1,678	-
Total asset retirement obligations	**2,701**	**135**	**-**	**2,836**	**-**
Uninsured losses					
Owner controlled insurance program	2,483	(503)	(74)	1,906	587
Transit operations	480	172	-	652	234
Total uninsured losses	**2,963**	**(331)**	**(74)**	**2,558**	**821**
Compensated absences	**4,929**	**4,781**	**(4,337)**	**5,373**	**4,532**
Total other long-term obligations	**$ 10,593**	**$ 4,585**	**$ (4,411)**	**$ 10,767**	**$ 5,353**

(in thousands)	2011 Beginning balance	Additions, accretion and changes in estimates	Reductions	2011 Ending balance	Amounts due within 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**

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

Risk Management— In the ordinary course of planning, building, and operating its regional transit systems and services 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.

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 under the first OCIP program 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 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 POSITION

Restricted net position consists of the following:

(in thousands)	2012	2011
Debt service	$ 56,009	$ 68,864
Contractual arrangements	20,308	20,229
Deductible liability protection policy	1,133	1,206
	$ 77,450	**$ 90,299**

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, 2012, 2011 and 2010, there was one remaining employee participating in PERS.

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

401(a) Plan— Through May 2011 the ICMA Retirement Corporation administered the Sound Transit Pension Plan (the plan) and served as the plan's trustee. In June 2011, an agreement was entered into 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 2012 and 2011 was $47.5 million and $41.2 million, respectively, and total payroll was $48.1 million and $41.9 million, respectively. The required contribution rates expressed as a percentage of covered payroll and required Sound Transit contributions during 2012, 2011, and 2010 are as follows:

	Contribution rate			Contributions (in thousands)		
	2012	2011	2010	2012	2011	2010
Employer	12%	12%	12%	$ 5,697	$ 4,944	$ 4,490
Employee	10	10	10	4,747	4,120	3,742
Total	**22%**	**22%**	**22%**	**$ 10,444**	**$ 9,064**	**$ 8,232**

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 June 2012, Sound Transit entered into a second agreement with the city of SeaTac in which perpetual light rail access rights to operate light rail service were granted for South Link thereby extending the light rail transit way from SeaTac/Airport Station to South 200th Street.

In March 2010, Sound Transit and Amtrak entered into a new five-year agreement 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 July 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 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.

Notes to Financial Statements, continued

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.

In April 2006, Sound Transit entered into a Construction Services and Operations 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.

In January 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 expired December 31, 2012 and contained two one-year renewal options at the mutual consent of both parties, of which the first one-year renewal option was exercised thus extending the agreements through December 31, 2013. In April 2010, Sound Transit entered into a new three year service agreement with Community Transit. The agreement with Community Transit contains two one-year renewal options at the mutual consent of both parties, of which the first of two one-year renewal options was executed at the mutual consent of both parties extending the agreement through March 31, 2014. 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 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, 2012, three easements totaling $137.0 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 the remaining easement is $48.0 million.

Amended and Restated Agreement for Regional Fare Coordination System— In April 2009, Sound Transit entered into an amended agreement to operate and maintain a RFCS that establishes a common, non-cash fare system throughout seven participating transit agencies service areas and commits the agencies to using the RFCS for a minimum of ten years. Each agency shares in operating and maintaining the RFCS in accordance with the agreement. Sound Transit’s proportionate share of RFCS operating and maintenance costs for years 2012 and 2011 is 18.1% and 17.9%, respectively.

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

(in thousands)	December 31 2012	December 31 2011
Assets		
Current assets		
Cash and cash equivalents	$ 6,196	$ 4,835
Accounts receivable	571	413
Total assets	**6,767**	**5,248**
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	7,958	6,786
Unearned revenue	3,932	3,047
Total liabilities	**11,890**	**9,833**
Net position	**$ (5,123)**	**$ (4,585)**
Total operating revenues	**$ 41,646**	**$ 33,744**
Total expenses	**$ 1,051**	**$ 866**

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:

> ***City of Seattle Construction Services Agreement:*** In August 2009, Sound Transit and the City of Seattle entered into a construction service agreement covering quality assurance, inspections, emergency services, traffic signal design, and utility work by city crews during Sound Transit's development of the University Link project. In January 2012 the agreement was amended to extend services to the Northgate Link Extension project thus increasing the commitment to $19.5 million. The agreement also commits Sound Transit to accomplish certain improvements as requested by the City, at the City's expense.
>
> ***City of Bellevue Binding Umbrella Memorandum of Understanding and Transitway Agreement for East Link Project:*** In November 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 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 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, 2012, the value of the unused land bank credits that have not been conveyed by WSDOT to Sound Transit was $244.4 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 2012 and 2011.

(in millions)	2012	2011
Balance in Land Bank, beginning of year	$ 131.3	$ 133.6
Credits (Draws):		
Mountlake Terrace Freeway Station	-	(2.3)
Debits (Additions):		
Eastgate Transit HOV Direct Access	27.5	-
South Everett Freeway Station	25.2	-
I-90 Two-Way Transit & HOV Operations, Stage 1	23.0	-
I-90 Two-Way Transit & HOV Operations, Stage 2	12.1	-
SR 522 HOV Enhancements at Kenmore	8.3	-
SR 522 HOV Enhancements at Bothell	8.1	-
85th Corridor Kirkland	4.5	-
I-405 Bellevue Transit Center Direct Access	2.7	-
Federal Way HOV Access/South 317th	1.4	-
I-5 Lynnwood Direct Access Ramp & other highway improvements	0.3	-
Balance in Land Bank, end of year	**$ 244.4**	**$ 131.3**

Purchases— At December 31, 2012 and 2011, Sound Transit had outstanding construction commitments of approximately $968.6 million and $585.7 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, 2012 and 2011 may be impaired. In the opinion of management, there are no significant contingent liabilities relating to noncompliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying financial statements for such contingencies.

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

Subsequent Event— The Build America Bond interest subsidy is reduced from 35% to 26.3% effective March 31, 2013 through September 30, 2013 resulting from a sequestration order issued pursuant to the Balanced Budget and Emergency Deficit Control Act of 2011. See note 8 for Build America Bond details.

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Independent Auditors' 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*

Audit and Reporting Committee
Central Puget Sound Regional Transit Authority:

We have audited, in accordance with the 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, the financial statements of Central Puget Sound Regional Transit Authority (a public corporation acting under the service name of Sound Transit), which comprise the statement of net position as of December 31, 2012, and the related statements of revenue, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 24, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Sound Transit's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of Sound Transit's internal control.

A deficiency in internal control 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, 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. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Sound Transit's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Sound Transit's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Sound Transit's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Seattle, Washington
May 24, 2013

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Independent Auditors’ Report on Compliance for Each Major Program; Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

Audit and Reporting Committee
Central Puget Sound Regional Transit Authority:

Report on Compliance for Each Major Federal Program

We have audited Central Puget Sound Regional Transit Authority’s (a public corporation acting under the service name of Sound Transit) 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 Sound Transit’s major federal programs for the year ended December 31, 2012. Sound Transit’s major federal programs are identified in the summary of auditor’s results section of the accompanying schedule of findings and questioned costs.

Management’s Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors’ Responsibility

Our responsibility is to express an opinion on compliance for each of Sound Transit’s major federal programs based on our audit of the types of compliance requirements referred to above. 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 Sound Transit’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 on compliance for each major federal program. However, our audit does not provide a legal determination of Sound Transit’s compliance.

Opinion on Each Major Federal Program

In our opinion, Sound Transit complied, in all material respects, with the types of 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, 2012.

Report on Internal Control Over Compliance

Management of Sound Transit is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Sound Transit’s internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 Sound Transit'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. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards by OMB Circular A-133

We have audited the financial statements of Sound Transit as of and for the year ended December 31, 2012, and have issued our report thereon dated May 24, 2013, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. 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 financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 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 financial statements as a whole.

KPMG LLP

Seattle, Washington
May 24, 2013

SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED DECEMBER 31, 2012

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**	$ 114,839,858
Federal Transit Administration, Operating and Capital Assistance Formula	**20.507**	5,804,663
ARRA-Federal Transit Administration, Operating and Capital Assistance Formula Grants	**20.507**	1,495,556
Subtotal: 20.507		7,300,219
Total U.S. Department of Transportation		122,140,077
Total Federal Transit Cluster		122,140,077
Transit Services Program		
U.S. Department of Transportation:		
Federal Transit Administration, Job Access-Reverse Commute	**20.516**	73,593
Federal Transit Administration, Alternative Analysis	**20.522**	1,120,423
Total U.S. Department of Transportation		1,194,016
Total Transit Services Program		1,194,016
Other Federal Awards		
U.S. Department of Transportation:		
Federal Transit Administration, Clean Fuels	**20.519**	2,270,925
Office of the Secretary (OST) Administration Secretariate, National Infrastructure Investments	**20.933**	2,150,400
		4,421,325
Total Other Federal Awards		4,421,325
Total Expenditures of Federal Awards		$ 127,755,418

Notes to Supplemental Schedule of Expenditures of Federal Awards

1. BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal grant activity of Sound Transit under programs of the federal government for the year ended December 31, 2012. The information in this schedule is presented in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of Sound Transit, it is not intended to and does not present the net position, changes in net positition or cash flows of Sound Transit.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

SUPPLEMENTAL SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended December 31, 2012

PART I—SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: **Unmodified**

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: **Unmodified**

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:

Federal grantor and program title	CFDA number
Federal Transit Cluster	20.500 and 20.507
Clean Fuels	20.519

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.