

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the City of Tacoma, we offer readers of the City of Tacoma's financial statements this narrative overview and analysis of the financial activities of the City of Tacoma for the fiscal year ended December 31, 2012. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our Letter of Transmittal, which can be found on pages 1-1 to 1-4 of this report. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

Financial Highlights

- Total assets exceeded the City's liabilities by \$2.5 billion. Of this amount, \$254 million were reported as unrestricted net position, amounts which are available to meet the City's on-going obligations to citizens and creditors.
- The City's net position increased by \$37 million. This increase is due to an increase in capital assets and a decrease in liabilities for Business Activities.
- Tacoma Power reported a change in net position of \$15.9 million, down \$4.7 million from the change in 2011.
- Tacoma Water reported change in net position of \$23.7 million, up \$12.2 million from the change in 2011.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City of Tacoma's basic financial statements. The City of Tacoma's basic financial statements consist of three components: 1) the government-wide financial statements, 2) the fund financial statements, and 3) the notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements.

Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the City of Tacoma's finances, and are similar to private sector financial statements. The statements also include the discretely presented component units, Tacoma Community Redevelopment Authority (TCRA), the Greater Tacoma Regional Convention Center Public Facilities District (GTRCCPD), and the Foss Waterway Development Authority (FWDA.)

The Statement of Net Position includes information on all the assets and liabilities of the City of Tacoma's general government as well as its business-type activities. The difference between the assets and liabilities is reported as net position. Over time, increases and decreases in net position may serve as a useful indicator of whether the financial position of the City of Tacoma is improving or deteriorating.

The Statement of Activities presents information showing how the government's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses reported in this statement for some items will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

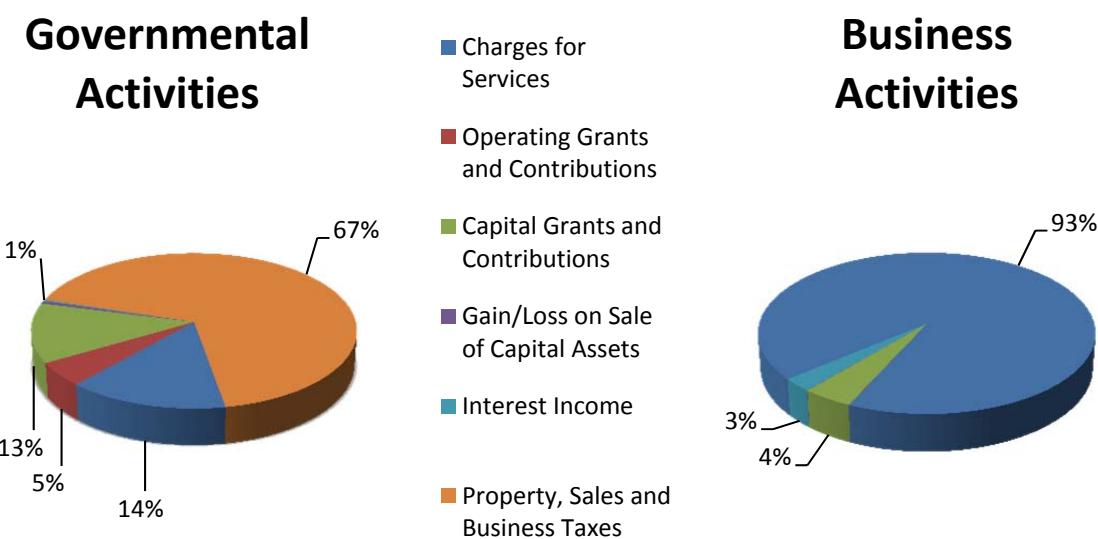


Figure 1. Comparison of Governmental and Business Activity Revenues

Both the Statement of Net Position and the Statement of Activities differentiate the functions of general government from the functions of business-type activities. Governmental activities reflect the City's basic functions such as general government, public safety, transportation, economic environment, mental and physical health, and culture and recreation. Governmental activities are primarily supported by taxes and intergovernmental revenues. Business-type activities, primarily utilities, are intended to recover most if not all of their costs through user fees and charges for services. The government-wide financial statements can be found on pages 3-2 to 3-5 of this report.

Governmental Activities Expenses

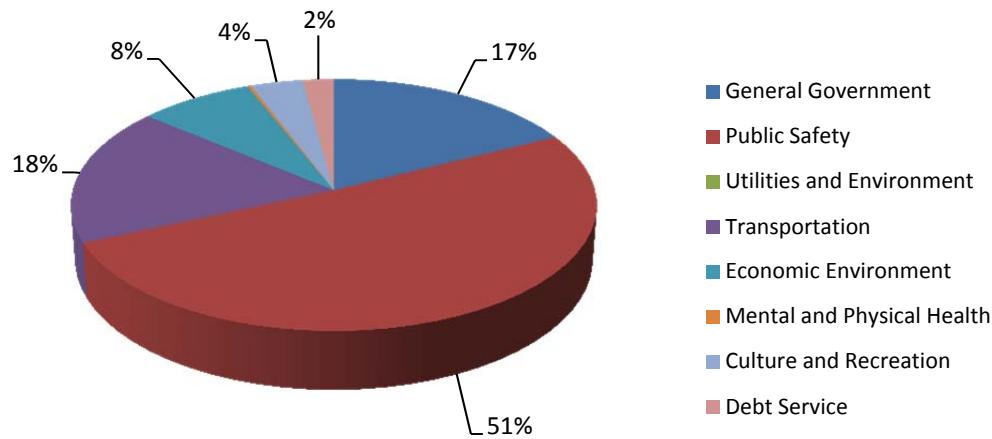


Figure 2. Governmental Activities Expenses

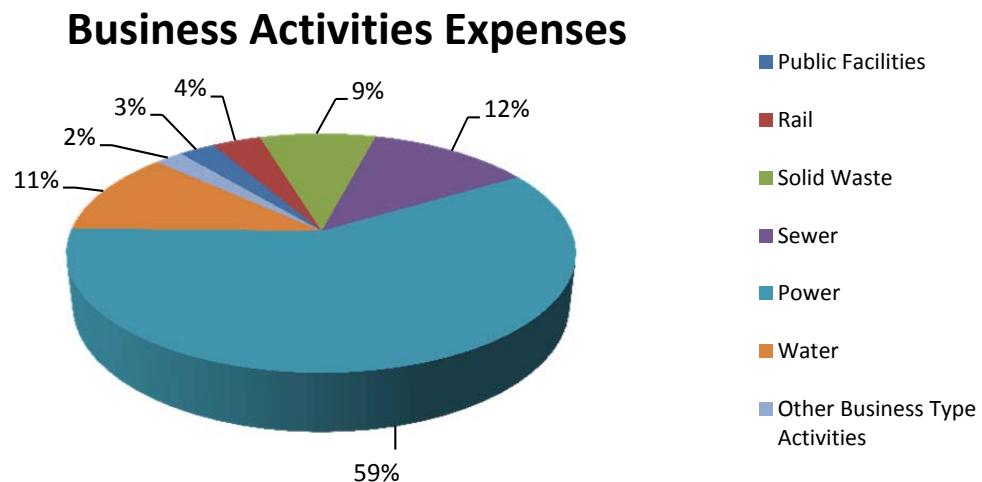


Figure 3. Business Activities Expenses

Fund Financial Statements

A fund is a grouping of related accounts used to maintain control over resources that have been segregated for specific activities or objectives. The City of Tacoma, like other local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All the funds of the City of Tacoma can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental Funds

Governmental funds are used to account for the functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near term inflows and outflows of expendable resources, as well as on balances of expendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of government-wide financial statements, it is useful to compare the information presented for the governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate this comparison.

The focus of the governmental fund statements is on major funds. A fund is considered major if it represents at least 10% of the assets, liabilities, revenues or expenditures of its fund category and at least 5% of the corresponding totals for the governmental and business-type activities combined. All other governmental funds are combined and presented as a single column in the respective governmental fund statements. Individual fund data for each of these combined non-major funds is provided in the form of combining statements elsewhere in this report. The Street fund was added to governmental activities as a major fund in 2011.

The City of Tacoma adopts a biennial budget for its General Fund. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with the budget.

The basic governmental fund financial statements can be found on pages 3-6 to 3-9 of this report.

Proprietary Funds

There are two types of proprietary funds, internal service and enterprise, both of which the City of Tacoma uses. Internal service funds are used to accumulate and allocate costs internally among the City of Tacoma's various functions. Because these services primarily benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements. There is one exception with the Utility Fleet fund which only services utilities funds and is included within business type activities. Enterprise funds account for various utilities which provide services such as power, water, sewer, and solid waste collection. The service area for these utilities is generally broader than the corporate limits of the City. The activities in these funds are primarily supported by user fees and are presented as business-type activities in the government-wide financial statements. The Solid Waste fund was added to business activities as a major fund in 2012. The basic proprietary fund financial statements can be found on pages 3-10 to 3-21 of this report.

Fiduciary Funds

Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City of Tacoma's programs. The accounting used by the fiduciary funds is similar to that used for proprietary funds. The basic fiduciary fund statements can be found on pages 3-22 to 3-23 of this report.

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential for a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 3-24 to 3-78 of this report.

Required Supplementary Information

In addition to the basic financial statements and accompanying notes, this report also contains certain required supplementary information (RSI) concerning the City of Tacoma's budget. Required supplementary information can be found on pages 4-1 to 4-6 of this report.

Combining Statements – Non-Major funds

The combining statements referred to earlier in connection with Non-Major governmental funds, internal service funds, and fiduciary funds can be found on pages 5-1 to 5-107 of this report.

Other Supplementary Information

This section provides schedules of capital assets used in the operations of Governmental Funds and statistical information on Local Improvement District assessments. The Other Supplementary Information section can be found on pages 5-109 to 5-111.

Statistical Section

This section provides financial trends, revenue and debt capacity, and demographic and economic information about the City's operations. The Statistical Section can be found on pages 6-1 to 6-36 of this report.

Government-wide Financial Analysis

As noted earlier, net position may serve as a useful indicator of a government's financial position. The City's total assets exceeded total liabilities by \$2.5 billion at December 31, 2012. 83% of the total net position reflects the City's investment in capital less any outstanding debt used to acquire those assets. The City uses these capital assets to provide services to its citizens; thus, they do not represent resources available for future spending. 10% of the City's net position is unrestricted, meaning they are available for meeting the City's ongoing obligations. The remaining 7% of net position are restricted for other purposes such as debt redemption and new capital construction. Governmental activities represent 28.2% of total net position and business activities represent 71.8% of total net position.

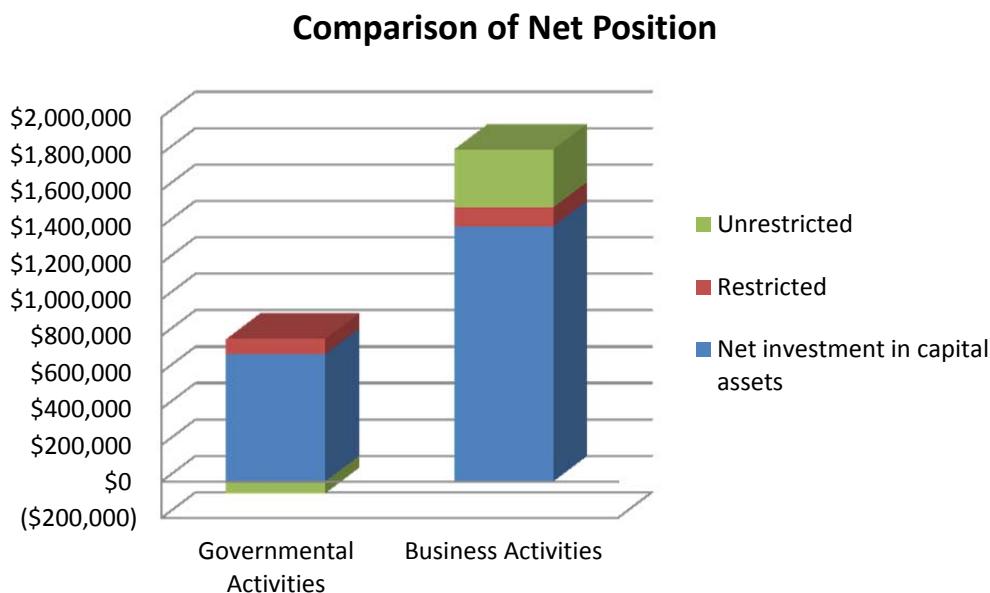


Figure 4. Comparison of Net Position, By Activity Type (Amounts expressed in thousands)

**Statement of Net Position
For the Year Ended December 31, 2012**

(Amounts expressed in thousands)	Governmental Activities		Business Activities		Total	
	2012	2011	2012	2011	2012	2011
Current and other assets	\$ 227,307	\$ 231,103	\$ 985,763	\$ 1,049,161	\$ 1,213,070	\$ 1,280,264
Capital assets	855,746	835,352	2,494,084	2,405,670	3,349,830	3,241,022
Total assets	\$ 1,083,053	\$ 1,066,455	\$ 3,479,847	\$ 3,454,831	\$ 4,562,900	\$ 4,521,286
Current and other liabilities	\$ 112,310	\$ 102,865	\$ 306,648	\$ 267,178	\$ 418,958	\$ 370,043
Long-term liabilities outstanding	253,921	234,232	1,349,250	1,413,289	1,603,171	1,647,521
Total liabilities	\$ 366,231	\$ 337,097	\$ 1,655,898	\$ 1,680,467	\$ 2,022,129	\$ 2,017,564
Net Position:						
Net investment in capital assets	\$ 699,307	\$ 732,174	\$ 1,401,679	\$ 1,365,324	\$ 2,100,986	\$ 2,097,498
Restricted	82,405	84,842	103,350	126,952	185,755	211,794
Unrestricted	(64,890)	(87,658)	318,920	282,088	254,030	194,430
Total net position	\$ 716,822	\$ 729,358	\$ 1,823,949	\$ 1,774,364	\$ 2,540,771	\$ 2,503,722

Table 1. Summary Statement of Net Position

In 2012, the City's net position increased by \$37 million. This is due to an increase in capital assets and a decrease in liabilities for business activities.

Net Position - Governmental Activities

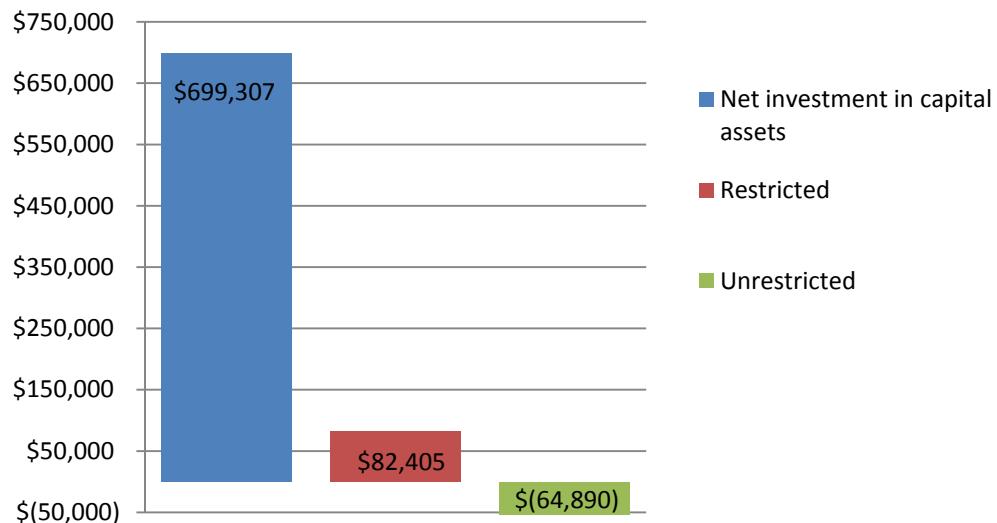


Figure 5. Composition of Net Position--Governmental Activities (Amounts expressed in thousands)

Net Position - Business Activities

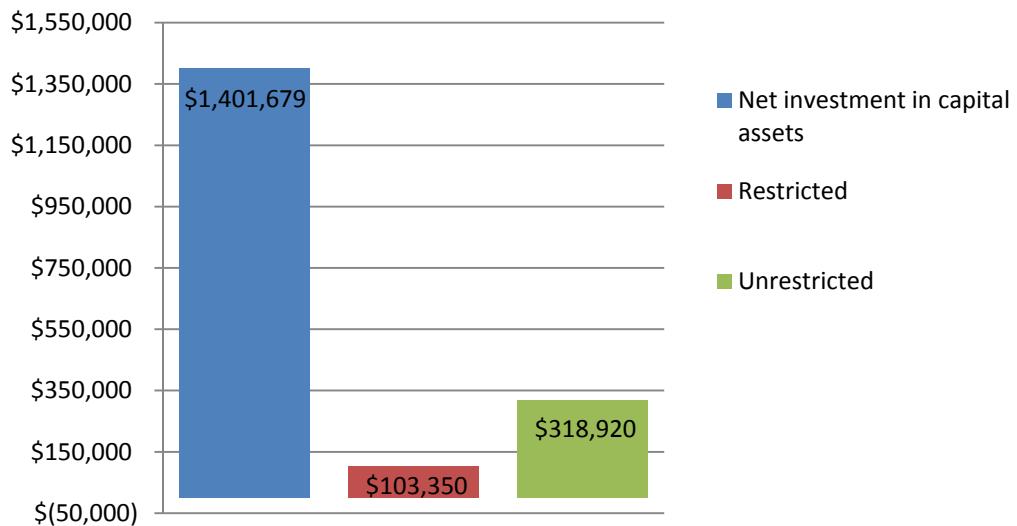


Figure 6. Composition of Net Position--Business Activities (Amounts expressed in thousands)

City of Tacoma, Washington
Changes in Net Position

(Amounts expressed in thousands)	Governmental Activities		Business Activities		Total	
	2012	2011	2012	2011	2012	2011
Revenues:						
Program revenues						
Charges for services	\$ 43,079	\$ 29,251	\$ 662,612	\$ 623,110	\$ 705,691	\$ 652,361
Operating grants and contributions	14,974	13,138	180	601	15,154	13,739
Capital grants and contributions	37,338	38,445	31,222	61,585	68,560	100,030
General revenues						
Property taxes	64,900	60,733	-	-	64,900	60,733
Other taxes	137,448	129,672	-	-	137,448	129,672
Other	2,540	5,949	19,288	23,324	21,828	29,273
Total revenue	\$ 300,279	\$ 277,188	\$ 713,302	\$ 708,620	\$ 1,013,581	\$ 985,808
Expenses:						
General government	\$ 52,038	\$ 34,732	\$ -	\$ -	\$ 52,038	\$ 34,732
Public safety	150,575	163,575	-	-	150,575	163,575
Utilities and environment	2	102	-	-	2	102
Transportation	52,424	75,692	-	-	52,424	75,692
Mental and Physical Health	757	3,129	-	-	757	3,129
Economic Environment	23,510	24,023	-	-	23,510	24,023
Culture and recreation	10,690	43,460	-	-	10,690	43,460
Debt Service	6,351	6,121	-	-	6,351	6,121
Public assembly facilities	-	-	18,424	17,966	18,424	17,966
Rail	-	-	24,753	22,089	24,753	22,089
Solid waste	-	-	59,391	54,518	59,391	54,518
Sewer	-	-	83,294	79,390	83,294	79,390
Water	-	-	76,755	76,161	76,755	76,161
Power	-	-	396,331	372,192	396,331	372,192
Other business-type funds	-	-	14,408	12,803	14,408	12,803
Total expenses	\$ 296,347	\$ 350,834	\$ 673,356	\$ 635,119	\$ 969,703	\$ 985,953
Increase/(Decrease) in net position before transfers	3,932	(73,646)	39,946	73,501	43,878	(145)
Transfers	(10,186)	(6,320)	10,186	6,320	-	-
Increase/(Decrease) in net position	\$ (6,254)	\$ (79,966)	\$ 50,132	\$ 79,821	\$ 43,878	\$ (145)
Net position--January 1, 2012	729,358	811,226	1,774,363	1,694,579	2,503,721	2,505,805
Prior Period Adjustments	(6,282)	(1,902)	(546)	(36)	(6,828)	(1,938)
Change in accounting principle	-	-	-	-	-	-
Net position--January 1, 2012	723,076	809,324	1,773,817	1,694,543	2,496,893	2,503,867
Net position--December 31, 2012	\$ 716,822	\$ 729,358	\$ 1,823,949	\$ 1,774,364	\$ 2,540,771	\$ 2,503,722

Table 2. Changes in Net Position

The governmental activities net position decreased by \$12.5 million in 2012 due to an increase in assets of \$16.6 million and an increase of \$29.1 million in liabilities.

Business activities net position increased by \$49.6 million in 2012 due to an increase in assets of \$25.0 million and a decrease of \$24.6 million in liabilities.

Information on significant outstanding claims can be found in Note 9.

Financial Analysis of the City's Fund Statements

The City prepares fund statements for governmental funds and for proprietary funds.

Governmental Fund Statements

Fund balance for the City's General Fund increased by \$7.8 million in 2012 from an increase in tax revenues. Fund balance for the Street fund decreased by \$1.3 million in 2012 from a decrease in revenues. Fund balance for the Non-Major governmental funds, which include debt service funds, capital projects funds, and special revenue funds, increased by \$5.6 million. The Non-Major governmental funds fund balance increased from an increase in revenues and a decrease in expenditures.

Fund Balances

At December 31, 2012, the City's governmental funds reported combined ending fund balances of \$149.4 million. Of this amount, \$18.6 million is nonspendable, either due to its form or legal constraints. \$82.4 million is restricted for specific programs by external constraints. \$21.8 million is committed for specific purposes as approved by City Council. \$8.1 million is assigned to specific purposes by management and the remaining \$18.5 million is unassigned.

Proprietary Fund Statements

The total net position for enterprise funds' increased by \$50.7 million in 2012. The Power, Water, Solid Waste and Sewer utilities make up the majority of the proprietary funds. Activity in these utilities was the primary driver for the change in the net position. The Power fund had an increase in net position of \$15.9 million from a decrease in liabilities. The Water fund had a significant increase in their net position of \$23.7 million due to an increase in capital construction. The Sewer fund had an increase in net position of \$6.6 million from a decrease in bond liabilities. The Solid Waste fund had no significant change in activity. The non-major Enterprise funds had an increase in net assets of \$4.5 million from a decrease in bond liabilities. The total net position for internal service funds' increased by \$4.7 million in 2012. This is the result of decreased liabilities of \$6.7 million and a decrease of \$2.0 million in assets.

General Fund Budgetary Highlights

In 2011, the City made budgetary adjustments as part of the 2011-2012 Mid-Biennium Budget Amendment. Budget revisions included \$401 thousand for 2009-2010 outstanding contract obligations. The City's budget is a two year biennium budget which begins every odd year. There were no budget changes in 2012.

Capital Assets, Infrastructure, Bond Debt Administration

Capital Assets

The City of Tacoma's investment in capital assets, net of accumulated depreciation, for its governmental and business type activities as of December 31, 2012, is \$3.3 billion. This investment in capital assets includes land, construction in process, property, plant and equipment, and infrastructure. The vast majority of this amount represents assets held by the City's various utilities and infrastructure.

The following table summarizes the City's investment in capital assets.

City of Tacoma, Washington
Schedule of Capital Assets

(Amounts expressed in thousands)	Governmental Activities		Business Activities		Total	
	2012	2011	2012	2011	2012	2011
Land	\$ 34,726	\$ 28,656	\$ 149,491	\$ 141,475	\$ 184,217	\$ 170,131
Construction in progress	54,758	124,562	125,512	83,809	180,270	208,371
Property, plant and equipment	225,430	228,581	3,577,987	3,458,235	3,803,417	3,686,816
Infrastructure	1,303,723	1,190,680	-	-	1,303,723	1,190,680
Less accumulated depreciation	(762,891)	(737,127)	(1,358,906)	(1,277,849)	(2,121,797)	(2,014,976)
Other Non-Current Assets	-	-	-	-	-	-
	\$ 855,746	\$ 835,352	\$ 2,494,084	\$ 2,405,670	\$ 3,349,830	\$ 3,241,022

Table 3. Schedule of Capital Assets

Additional information on the City's capital assets can be found in Notes 1-D5 and 4-C of the Notes to the Financial Statements.

Outstanding Debt

The City's debt at December 31, 2012 was \$1.73 billion. Approximately 81% of the bonded debt is related to utilities with repayment pledged by specific revenue sources generated by the utilities. Of the remaining 19% bonded debt, debt is either secured by voter approved special levies or general government resources. Additional information on the City of Tacoma's long-term debt can be found in Note 4-F and Note 12 of the Notes to the Financial Statements.

City of Tacoma, Washington
Schedule of Long Term Debt

(Amounts expressed in thousands)	Governmental Activities		Business Activities		Total	
	2012	2011	2012	2011	2012	2011
Bonded debt and loans	\$ 224,243	\$ 186,903	\$ 1,314,094	\$ 1,373,939	\$ 1,538,337	\$ 1,560,842
Capital leases	626	1,251	35,831	36,576	36,457	37,827
Claims and judgments	40,589	51,502	1,516	1,950	42,105	53,452
Accrued landfill liability	-	-	27,936	29,412	27,936	29,412
Net Pension Obligation	5,000	160	-	-	5,000	160
Other Post Employment Benefits	35,178	27,408	11,291	8,987	46,469	36,395
Compensated absences	17,142	15,514	17,827	17,023	34,969	32,537
	\$ 322,778	\$ 282,738	\$ 1,408,495	\$ 1,467,887	\$ 1,731,273	\$ 1,750,625

Table 4. Schedule of Long Term Debt

The City's debt rating for 2012 is as follows:

Bond	Moody's	S&P	Fitch
GO	Aa3	AA	A
LTGO	A1	AA	A
Solid Waste	A2	AA	AA-
Sewer	Aa2	AA+	AA+
Water	Aa2	AA	--
RWSS	Aa2	AA	--
Power	Aa3	AA	AA-
Convention Center Revenue	A2	A	A+

Economic Factors

From 2002 until the fourth quarter 2008, the City benefitted from modest positive job growth and home sales. In the fourth quarter of 2008, the recession began affecting the Puget Sound area. At the end of the first quarter of 2010, sales tax and other economically sensitive revenues stopped falling and began to grow. 2012 general revenues were slightly higher than 2011 by \$8.5 million. Still, forecasts indicate expenses will continue to exceed revenues. Economic indicators and actual revenue collections will be reviewed each quarter of the biennium along with appropriate actions, if any, which may be needed to maintain a balanced 2013-14 budget.

Other Considerations

In response to the slow economic recovery, the City has taken steps to reduce discretionary spending. General government activities took significant expenditure reductions in 2012 to bring levels of service to those that are affordable and sustainable. Revenue growth is limited by several citizen initiatives that limit the growth of property tax collections.

Requests for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the City of Tacoma Finance Department, 747 Market Street Room 132, Tacoma, Washington 98402.