

Port of Seattle

*Financial Statements for the
Years Ended December 31, 2003, 2002, and 2001,
and Independent Auditors' Report*

INDEPENDENT AUDITORS' REPORT

Port Commission
Port of Seattle
Seattle, Washington

We have audited the accompanying statements of net assets of the Port of Seattle (the "Port") as of December 31, 2003 and 2002, and the related statements of revenues, expenses, and changes in net assets and of cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Port's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Port of Seattle as of December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis on pages 2 through 7 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Deloitte & Touche LLP

April 9, 2004

PORT OF SEATTLE

MANAGEMENT'S DISCUSSION AND ANALYSIS YEARS ENDED DECEMBER 31, 2003 AND 2002

INTRODUCTION

The following Management's Discussion and Analysis ("MD&A") of the Port of Seattle's (the "Port") activities and financial performance provides an introduction to the financial statements of the Port of Seattle for the fiscal year ended December 31, 2003, with selected comparative information for the year ended December 31, 2002. The MD&A presents certain required supplementary information regarding capital assets and long-term debt activity during the year, including commitments made for capital expenditures. The information contained in this MD&A has been prepared by management and should be considered in conjunction with the financial statements and the notes thereto, which follow this section. The notes are essential to thoroughly understand the data contained in the financial statements.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial section of this annual report consists of three parts: MD&A, the basic financial statements, and the notes to the financial statements. The report includes the following three basic financial statements: the statements of net assets, the statements of revenues, expenses, and changes in net assets, and the statements of cash flows.

FINANCIAL POSITION SUMMARY

The statements of net assets present the financial position of the Port at the end of the fiscal year. The statements include all assets and liabilities of the Port. Net assets, the difference between total assets and total liabilities, is an indicator of the current fiscal health of the organization and the Port's financial position over time. A summarized comparison of the Port's assets, liabilities, and net assets at December 31 is as follows:

(In thousands)	2003	2002
ASSETS:		
Current, long-term, and other assets	\$ 1,000,977	\$ 699,055
Capital assets	<u>3,748,515</u>	<u>3,321,922</u>
Total assets	<u>\$ 4,749,492</u>	<u>\$ 4,020,977</u>
LIABILITIES:		
Current liabilities	\$ 326,311	\$ 315,659
Long-term liabilities	<u>2,700,385</u>	<u>2,086,775</u>
Total liabilities	<u>\$ 3,026,696</u>	<u>\$ 2,402,434</u>

(In thousands)	2003	2002
NET ASSETS:		
Invested in capital assets—net of related debt	\$ 1,616,676	\$ 1,484,172
Restricted net assets	29,376	75,318
Unrestricted net assets	<u>76,744</u>	<u>59,053</u>
Total net assets	<u>\$ 1,722,796</u>	<u>\$ 1,618,543</u>

The Port's assets exceeded liabilities by \$1.7 billion, a \$104 million increase over total net assets as of December 31, 2002. For the year ended December 31, 2003, the largest portion of the Port's net assets represents its investment in capital assets, less the related debt outstanding used to acquire those capital assets. The Port uses these capital assets to provide services to its tenants, passengers, and customers of the Airport and Seaport divisions; consequently, these assets are not available for future spending. Although the Port's investment in its capital assets is reported net of related debt, it is noted that the resources required to repay this debt must be provided annually from operations, since the capital assets themselves cannot be used to liquidate liabilities.

The Port's reduction in restricted net assets is the result of lower passenger facility charge cash and cash equivalents in the current year due to spending being higher than receipts during 2003.

The remaining unrestricted net assets of \$76.7 million may be used to satisfy the Port's ongoing obligations, of which \$43 million in the aviation development fund will be used solely for the Airport's ongoing obligations.

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The change in net assets is an indicator of whether the overall fiscal condition of the Port has improved or worsened during the year. Following is a summary of the statements of revenues, expenses, and changes in net assets:

(In thousands)	2003	2002
Operating revenues	\$ 321,753	\$ 307,360
Operating expenses	<u>209,067</u>	<u>220,939</u>
Operating income before depreciation	112,686	86,421
Depreciation	<u>85,076</u>	<u>84,853</u>
Operating income	27,610	1,568
Nonoperating income—net	<u>76,643</u>	<u>68,339</u>
Increase in net assets	104,253	69,907
Net assets—beginning of year	<u>1,618,543</u>	<u>1,548,636</u>
Net assets—end of year	<u>\$ 1,722,796</u>	<u>\$ 1,618,543</u>

FINANCIAL OPERATION HIGHLIGHTS

Portwide operating revenues increased 5% from \$307 million to \$322 million. The Aviation Division's operating revenues increased \$14 million, largely due to an increase in debt service costs for the year. Such an increase, under a residual airline agreement, results in increased revenues from the airlines to the Port. Seaport Division operating revenues remained relatively flat although significant fluctuations occurred within

business revenue categories. Increases in Seaport revenues were primarily a result of an overall increase in container terminal rental revenues from an increase in the blended rate charged tenants, increased Terminal 18 (“T18”) net revenues, reflecting rental income in excess of debt service payments, which were higher as a result of the bond defeasance of the T18 special facility bonds in 2002, and a \$4.1 million increase in security grant revenues. These increases were offset by a decline in revenues from the closure of the warehouse, chill, and auto facilities by \$7.1 million and termination payments received from tenants in 2002.

Portwide operating expenses declined 5% from \$221 million to \$209 million. Aviation Division operating expenses declined \$4.4 million, largely due to a reduction made in the reserves previously established for damages to the Airport incurred during the February 2001 earthquake. Seaport Division operating expenses declined \$10 million as a result of lower operating costs due to the closure of the warehouse and chill lines of business of \$12.9 million along with a reduction in the 2003 environmental reserve expense for the Seaport Division from 2002 of \$3.7 million. These decreases were partially offset by an increase in primarily grant funded security operating expenses of \$4.7 million and an increase in the Seaport earthquake reserves of \$1.6 million due to revised estimates.

As a result of the above, operating income before depreciation increased \$26 million from 2002.

Nonoperating income—net increased \$8 million, largely due to an increase in the tax levy in 2003, increased grant receipts for the year, and lower public asset funding due to project delays. These increases were offset by a loss recorded when marking the investment portfolio to market and an increase in bond interest expense related to 2003 issues in addition to losses from the demolition of assets and a write-off of tank farm assets at Terminal 91 during the year.

Net income for 2003 was \$104 million, compared to \$70 million in 2002. This increase was due to higher operating revenues, lower operating expenses, and increases in nonoperating revenues when netted with expenses.

BUDGETARY HIGHLIGHTS

The following represents the Port’s budget highlights for the year ended December 31, 2003:

(In thousands)	Actual 2003	Budget 2003
Operating revenues	\$ 321,753	\$ 318,220
Operating expenses	<u>209,067</u>	<u>206,545</u>
Operating income before depreciation	112,686	111,675
Depreciation	<u>85,076</u>	<u>91,025</u>
Operating income	27,610	20,650
Nonoperating income—net	<u>76,643</u>	<u>100,003</u>
Net income	<u>\$ 104,253</u>	<u>\$ 120,653</u>

Portwide operating revenues were above budget by \$3.5 million with each division contributing to the increase. The Aviation Division increase was primarily due to landing fees which were greater than budget as a result of a delay in the effective date of the new landing fee agreement that would have dropped the debt service coverage ratio and due to Aviation security grant revenues of \$1.5 million that were not budgeted for. The Seaport Division increase was largely due to T18 container revenues. Original special facility revenue bond proceeds, in excess of amounts needed for the T18 project, were used to defease some of the bonds and

make debt service payments. Offsetting this increase was a decline in Seaport security grant revenues from what was budgeted.

Port operating expenses before depreciation were higher than budget by \$2.5 million. The Aviation Division was under budget by \$3.9 million, which was comprised of significant budget cuts and lower spending in 2003 in conjunction with a \$2.8 million reduction to the earthquake reserves that was not budgeted for. This was partially offset by write-offs of \$8.6 million from changes in divisional capital spending plans. The Seaport Division's operating expenses increased by \$4.6 million, largely due to a \$4.9 million charge to the environmental reserve and write-offs of \$2.6 million. These increases were partially offset by lower security costs than budgeted.

Depreciation expense was \$6 million below budget due to changes in estimates of when projects were placed in service.

As a result of the above, operating income was \$7 million above budget.

Nonoperating income—net is \$23 million below budget. Larger unfavorable variances from budget include an increase in losses from the demolition of various assets and the write-off of tank farm assets at Terminal 91 and a loss recorded when marking the investment portfolio to market during the year. Additionally, grants and donations were under budget due to fewer Airport improvement program receipts during the year than originally budgeted. Finally, these unfavorable variances were slightly offset by decreased spending on public assets during the year since spending was curtailed from the delay of some projects.

As a result of the above, net income was \$16 million below budget.

CAPITAL ASSETS

The Port's capital assets as of December 31, 2003, amounted to \$3,748,515 (net of accumulated depreciation). This investment in capital assets includes land, air rights, facilities improvements, equipment, furniture and fixtures, and construction work in progress. The total increase in the Port's investment in capital assets after accumulated depreciation for 2003 was 13%, or \$427 million.

During 2003, completed projects totaling \$264 million were closed from construction-in-progress to their respective capital accounts. The major completed projects were:

Airport:	
Satellite Transportation System	\$63 million
Communication Infrastructure System	20 million
Concourse HVAC Upgrade	12 million
South Terminal Expansion Project (STEP) Apron	9 million
Seaport:	
Terminal 46 Hanjin Terminal Redevelopment	\$35 million
Terminal 46 Crane Purchase	16 million
Terminal 30 Cruise Terminal	16 million

Capital asset acquisitions are capitalized at cost and depreciated using the straight-line method. The Port collected \$58,028,485 in property taxes through a King County ad valorem tax levy. Through this tax levy, passenger facility charges, federal and state grants, net increase in assets, and various bond issues, the Port funds capital assets. Additional information on the Port's capital assets can be found in Note 4 in the accompanying notes to the financial statements.

DEBT ADMINISTRATION

As of December 31, 2003, the Port had outstanding revenue bonds and notes of \$2.3 billion, a \$506 million increase from 2002. In May 2003, the Port issued \$121 million in fuel hydrant special facility revenue bonds. In July 2003, the Port issued \$355 million in revenue bonds and in August 2003, the Port issued \$200 million in subordinate lien bonds. During 2003, subordinate lien revenue notes (tax-exempt commercial paper) decreased \$11 million from \$116 million in 2002 to \$105 million.

As of December 31, 2003, the Port had outstanding general obligation bonds (“GO” bonds) of \$217 million, a \$12 million decrease from 2002 due to scheduled principal payments. On February 12, 2004, the Port issued \$299 million of GO bonds, including \$131.3 million of bonds used to refund the long-term portions of the General Obligation Bonds Series 1994 and Revenue Bonds, Series 1994B.

As of December 31, 2003, the Port had outstanding passenger facility (“PFC”) charge revenue bonds of \$251 million, a \$7 million decrease from 2002 due to scheduled principal payments.

As of December 31, 2003, the Port had outstanding special facility bonds (Terminal 18 Project) of \$188.6 million, a decrease of \$28.8 million from 2002 due to defeasance with excess bond proceeds available after facility completion. The Terminal 18 special facility bonds are not an obligation of the Port; no tax funds or revenue of the Port (other than Terminal 18 lease revenue) is pledged to pay the debt service on the bonds. The Terminal 18 facility is leased to the trustee for the benefit of bondholders, and the bonds are not recorded in the Port’s financial statements.

Current Bond Ratings:	Fitch	Moody's	S&P
General obligation bonds	AA+	Aa1	AA+
First lien revenue bonds	AA	Aa2	AA-
Subordinate lien revenue bonds	A+	A1	A-

Above are the underlying ratings for Port of Seattle bonds. In addition, the Port has outstanding variable rate bonds backed by letters of credit; these bonds carry the ratings of the specific letter of credit bank. The Port also has bonds backed by the collection of PFC fees and special facility revenue bonds backed by the lease payments of SeaTac Fuel Facilities LLC; these bonds are insured.

FUTURE EVENTS

Aviation Division—Effective January 1, 2004, the Port entered into new signatory airline lease and operating agreements (“Airline Agreements”) that establish a modified compensatory rate-making methodology for 2004 and 2005. Under the modified compensatory methodology, the Port will assume more financial risk relative to the residual methodology in prior years in return for more facility control and the potential to generate more discretionary cash flow. The Port will receive the benefit of any increases in non-airline revenues and will have more control over its capital program, but will not have the signatory airlines’ commitment to generate sufficient gross revenue to meet required debt service coverage. The signatory airlines will pay rates and charges equal to airfield and terminal revenue requirement as defined in the Airlines Agreements. The Port will be responsible for any costs not otherwise paid by the signatory airlines and will retain any net operating income. The agreements will include provisions for potential revenue sharing with the signatory airlines. During the budget approval process, the Port will establish a revenue sharing percentage between 135% and 145%. For 2004, the revenue sharing percentage is 135%. At the end of 2004, if the Aviation Division portion of net revenues exceeds 135% of the Aviation Division portion of revenue bond debt service, the Port will credit 50% of that amount by which Aviation Division net revenues exceed 135% of Aviation Division revenue bond debt service to the signatory airlines for the following year. The signatory airlines’ share will be credited on a pro rata basis, with each signatory airlines receiving a credit against the terminal rents and landing fees that it would otherwise owe in the following year.

Seaport Division—The Port is expected to take over the Warehousemen’s Pension Plan and Trust (“the Plan”). The Port will amend and restate the Plan as a governmental plan maintained and operated solely by the Port. The Plan provides that only service credited and compensation earned prior to April 1, 2004, shall be utilized to calculate benefits under the Plan, and the Port agrees to maintain the frozen Plan and to contribute funds to the Plan in such amounts that may be necessary to enable the Plan to pay vested accrued benefits as they become due and payable to participants and beneficiaries in the ordinary course of business.

PORT OF SEATTLE

STATEMENTS OF NET ASSETS DECEMBER 31, 2003 AND 2002 (In thousands)

ASSETS	2003	2002
CURRENT ASSETS:		
Cash and cash equivalents	\$ 60,557	\$ 71,224
Short-term investments	47,460	36,466
Accounts and contracts receivable, less allowance of \$742 and \$534 for doubtful accounts	35,790	31,422
Federal grants-in-aid receivable	14,506	5,008
Earthquake-related receivables	3,643	8,724
Taxes receivable	1,636	1,226
Maintenance supplies	3,181	4,393
Prepayments and other current assets	<u>3,961</u>	<u>4,785</u>
Total current assets	170,734	163,248
RESTRICTED CASH, CASH EQUIVALENTS, AND INVESTMENTS:		
Bond funds:		
Short-term investments	117,973	5,038
Long-term investments	593,670	500,534
Fuel hydrant assets held in trust:		
Cash and cash equivalents	32,282	
Short-term investments	21,823	
Long-term investments	20,996	
Contract retainage—cash and cash equivalents	<u>231</u>	<u>261</u>
Total restricted cash, cash equivalents, and investments	786,975	505,833
CAPITAL ASSETS:		
Land and air rights	1,096,765	1,078,841
Facilities and improvements	2,168,023	1,970,966
Equipment, furniture, and fixtures	<u>252,644</u>	<u>238,999</u>
Total capital assets	3,517,432	3,288,806
Less accumulated depreciation	875,870	825,890
Construction work in progress	<u>1,106,953</u>	<u>859,006</u>
Total capital assets—net	3,748,515	3,321,922
DEFERRED FINANCE COSTS—Net of accumulated amortization of \$12,818 and \$9,595	<u>43,268</u>	<u>29,974</u>
TOTAL	<u><u>\$4,749,492</u></u>	<u><u>\$4,020,977</u></u>

See notes to financial statements.

LIABILITIES AND NET ASSETS	2003	2002
CURRENT LIABILITIES:		
Checks and warrants outstanding	\$ 6,362	\$ 10,726
Accounts payable and accrued expenses	74,446	56,798
Accrued earthquake expenses	3,178	11,513
Payroll and taxes	31,899	26,731
Bond interest payable	34,481	25,274
Lease deposits and customer advances	3,275	2,195
Current maturities of long-term debt	<u>172,670</u>	<u>182,422</u>
Total current liabilities	326,311	315,659
LONG-TERM LIABILITIES:		
Accrued environmental expenses	9,277	10,159
Accrued long-term expenses	1,673	8,639
LONG-TERM DEBT—Less current maturities:		
Revenue bonds	2,103,155	1,586,480
General obligation bonds	204,850	217,285
Passenger facility charges revenue bonds	243,475	250,940
Fuel hydrant special facility bonds	121,140	
Unamortized bond premiums—net of accumulated amortization	35,531	32,251
Unamortized bond discount—net of accumulated amortization	<u>(18,716)</u>	<u>(18,979)</u>
Total long-term debt	<u>2,689,435</u>	<u>2,067,977</u>
Total liabilities	3,026,696	2,402,434
COMMITMENTS AND CONTINGENCIES (Notes 10 and 11)		
NET ASSETS:		
Invested in capital assets—net of related debt	1,616,676	1,484,172
Restricted net assets	29,376	75,318
Unrestricted net assets	<u>76,744</u>	<u>59,053</u>
Total net assets	1,722,796	1,618,543
Total	<u>\$4,749,492</u>	<u>\$4,020,977</u>

PORT OF SEATTLE

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001

(In thousands)

	2003	2002	2001
REVENUE:			
Services	\$ 168,650	\$ 170,853	\$ 180,456
Property rentals	145,947	131,157	140,361
Fuel hydrant facility revenues	435		
Security grant and contract revenues	<u>6,721</u>	<u>5,350</u>	<u> </u>
Total revenue	321,753	307,360	320,817
OPERATING EXPENSES:			
Operations and maintenance	164,931	165,903	175,693
Earthquake repair expense—net of insurance and other recoveries	(2,590)	882	6,861
Law enforcement	15,852	18,166	13,913
Administration	26,803	27,381	24,488
Environmental	<u>4,071</u>	<u>8,607</u>	<u>(1,033)</u>
Total operating expenses before depreciation	<u>209,067</u>	<u>220,939</u>	<u>219,922</u>
Net operating income before depreciation	112,686	86,421	100,895
Depreciation	<u>85,076</u>	<u>84,853</u>	<u>81,115</u>
OPERATING INCOME	27,610	1,568	19,780
NONOPERATING (EXPENSE) INCOME:			
Ad valorem tax levy revenue	57,793	39,309	35,721
Passenger facility charges revenue and related interest income	54,373	53,675	43,961
Grants and donations	32,790	17,175	27,822
Investment income—net	5,469	17,419	14,450
Revenue and capital appreciation bond interest expense	(44,136)	(36,815)	(35,698)
Passenger facility charges revenue bond interest expense	(3,869)	(3,121)	(2,323)
General obligation bond interest expense—net	(9,674)	(8,431)	(7,317)
Public assets expense	(396)	(5,425)	(3,843)
Other expense—net	<u>(15,707)</u>	<u>(5,447)</u>	<u>(5,942)</u>
Total nonoperating income—net	<u>76,643</u>	<u>68,339</u>	<u>66,831</u>
INCREASE IN NET ASSETS	104,253	69,907	86,611
TOTAL NET ASSETS:			
Beginning of year	<u>1,618,543</u>	<u>1,548,636</u>	<u>1,462,025</u>
End of year	<u>\$1,722,796</u>	<u>\$1,618,543</u>	<u>\$1,548,636</u>

See notes to financial statements.

PORT OF SEATTLE

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001 (In thousands)

	2003	2002	2001
OPERATING ACTIVITIES:			
Cash received from customers	\$310,035	\$297,984	\$ 321,661
Cash paid to suppliers for goods and services	(64,961)	(70,025)	(79,631)
Cash paid to employees for salaries, wages, and benefits	(133,012)	(143,950)	(136,436)
Security grant revenues	<u>6,721</u>	<u>5,350</u>	<u> </u>
Net cash provided by operating activities	118,783	89,359	105,594
CAPITAL AND RELATED FINANCING ACTIVITIES:			
Proceeds from sale of revenue and fuel hydrant bonds	665,145	315,297	435,533
Proceeds from issuance of commercial paper	128,820	54,907	32,596
Proceeds used for refunding of revenue bonds	(51,680)	(305,625)	(11,595)
Acquisition and construction of capital assets	(526,804)	(516,670)	(443,424)
Principal payments on revenue bonds, PFC, GO bonds, and commercial paper	(142,756)	(65,452)	(77,063)
Interest payments on revenue and fuel hydrant bonds, PFC, GO bonds, and commercial paper	(49,443)	(50,871)	(41,099)
Interest received on invested bond proceeds	203	145	296
Proceeds from sale of capital assets	1,113	6,728	2,021
Public asset expenses	(396)	(5,425)	(3,843)
Ad valorem tax levy receipts	57,383	39,506	35,480
Receipts from federal grants-in-aid	23,292	30,124	10,257
Passenger facility charges receipts	52,510	53,542	37,370
Other	<u>(1,973)</u>	<u>371</u>	<u>(1,590)</u>
Net cash provided by (used in) capital and related financing activities	155,414	(443,423)	(25,061)
INVESTING ACTIVITIES:			
Purchases of investment securities	(864,825)	(302,832)	(1,166,150)
Proceeds from sales and maturities of investments	596,602	629,871	947,724
Interest received on investments	<u>15,611</u>	<u>15,167</u>	<u>16,182</u>
Net cash (used in) provided by investing activities	<u>(252,612)</u>	<u>342,206</u>	<u>(202,244)</u>
NET INCREASE (DECREASE) IN CASH	21,585	(11,858)	(121,711)
CASH AND CASH EQUIVALENTS:			
Beginning of year	<u>71,485</u>	<u>83,343</u>	<u>205,054</u>
End of year	<u>\$ 93,070</u>	<u>\$ 71,485</u>	<u>\$ 83,343</u>

(Continued)

PORT OF SEATTLE

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001 (In thousands)

	2003	2002	2001
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:			
Operating income	\$ 27,610	\$ 1,568	\$ 19,780
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	85,076	84,853	81,115
(Increase) decrease in assets:			
Accounts receivable	(4,368)	(3,924)	1,124
Earthquake-related receivables	5,081	17,140	(25,863)
Maintenance supplies, prepaid items, and other	2,036	209	(786)
Increase (decrease) in liabilities:			
Accounts payable and accrued long-term expenses	10,682	4,865	2,397
Accrued earthquake expenses	(8,335)	(18,264)	29,777
Checks and warrants payable and payroll/taxes payable	804	2,673	(2,972)
Accrued environmental expenses	(883)	(35)	811
Lease deposits and customer advances	<u>1,080</u>	<u>274</u>	<u>211</u>
Net cash provided by operating activities	<u>\$118,783</u>	<u>\$ 89,359</u>	<u>\$ 105,594</u>

See notes to financial statements.

(Concluded)

PORT OF SEATTLE

NOTES TO FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2003, 2002, and 2001

1. ACCOUNTING POLICIES

Reporting Entity—The Port of Seattle (the “Port”) is a municipal corporation organized on September 5, 1911, through enabling legislation by consent of the voters within the Port district. In 1942, the local governments in King County selected the Port to operate the Seattle-Tacoma International Airport. The Port is considered a special purpose government with a separately elected commission of five members and is legally separate and fiscally independent of other state or local governments. The Port has no stockholders or equity holders. All revenues or other receipts must be disbursed in accordance with provisions of various statutes, applicable grants, and agreements with the holders of its bonds.

The accompanying financial statements include the activities of the Port and its component unit, the Industrial Development Corporation (“IDC”), a special-purpose government with limited powers and governed by the Board of Directors, composed of the same members as the Port commission, that finances industrial development for acquiring, constructing, and renovating transshipment and manufacturing facilities within the corporate boundaries of the Port. Under Governmental Accounting Standards Board (“GASB”) Statement No. 14, *The Financial Reporting Entity*, the Port is financially accountable for the IDC; as such, the financial position and operations of the IDC are included in the accompanying financial statements.

Organization—The Port comprises three operating divisions. The Aviation Division (“Airport”) serves the predominate air travel needs of a five-county area. The Airport has 19 U.S.-flag passenger air carriers (including regional and commuter air carriers) and seven foreign-flag airport carriers providing daily nonstop service from the Airport to 73 cities, including 18 foreign cities. The Seaport Division (“Seaport”) focuses primarily on containerized cargo. International containerized cargo arriving by ship is transferred to various modes of land transportation destined for other regions of the country. Domestic containerized cargo arriving by various modes of land transportation is transferred to outbound ships for distribution to other countries around the world. The Port is a seaport landlord with major tenants, including shipping companies, terminal operators, and other marine-related businesses. Both of these divisions have labor workforces subject to various collective bargaining agreements. These workforces support the operations and maintenance of the divisions. The Economic Development Division was formed in December 2002 to oversee Port real estate development, economic development, and regional transportation issues.

The Port segregates expenses for public assets. This includes expenses for the Freight Action Strategy for the Everett-Seattle-Tacoma Corridor project, a joint planning activity of the Washington State Department of Transportation and the Puget Sound Regional Council. The project is intended to help update the State and region’s transportation plans to better meet the needs for rapid movement of freight and goods. These assets are not reflected in the Port’s financial statements as the projects are controlled by other governmental entities. These nonoperating expenses are funded by the ad valorem tax levy.

Basis of Accounting—The Port is accounted for on a flow of economic resources measurement focus. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to governmental units using the accrual basis of accounting. The GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Port has applied all applicable GASB pronouncements as well as the following pronouncements (unless they conflict with or contradict GASB pronouncements): statements and interpretations of the Financial Accounting Standards Board (“FASB”), Accounting Principles Board

opinions, and accounting research bulletins of the Committee on Accounting Procedure. The more significant of the Port's accounting policies are described below.

Use of Estimates—The preparation of the Port's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Estimates and assumptions are used to record environmental, legal, insurance, and earthquake reserves; allowances for doubtful accounts; grants-in-aid receivable; and arbitrage liabilities. Actual results could differ from those estimates.

Significant Risks and Uncertainties—The Port is subject to certain business risks that could have a material impact on future operations and financial performance. These risks include economic conditions, collective bargaining disputes, security, federal, state, and local government regulations, and changes in law.

Landing Fees—The cost of Airport facilities constructed or acquired with proceeds from revenue bonds is to be recovered under the provisions of a contract with the tenant airlines. The contractual agreement with the airlines, using a residual rate-setting methodology, provides that they will pay annual charges of the sum of the net cost of operating the Airport and a coverage factor of 1.35 times the required debt service on the revenue bonds. This contract expired December 31, 2002. The provisions of this contract were extended on a month-to-month basis through 2003. New agreements with the tenant airlines were signed effective January 1, 2004. Under the new structure, the Port assumes the financial risk for the airport's financial performance, and the signatory airlines will pay rates and charges equal to the costs of the facilities they use. The agreements include provisions for potential revenue sharing in 2004.

Ad Valorem Tax Levy Revenue—Ad valorem taxes received by the Port are utilized for the acquisition and construction of facilities, for the payment of principal and interest on general obligation bonds issued for the acquisition or construction of facilities, and for environmental expenses. The Port includes ad valorem tax revenues and interest on general obligation bonds in the statements of revenues, expenses, and changes in net assets.

Passenger Facility Charges—As determined by applicable federal legislation, passenger facility charges ("PFC") generate revenue to be expended by the Port for eligible capital projects and the payment of principal and interest on specific revenue bonds. PFC revenues received from the airlines are recorded as nonoperating income in the statements of revenues, expenses, and changes in net assets upon passenger enplanement.

Federal Grants-in-Aid—The Port receives federal grants-in-aid funds for construction of Airport and Seaport facilities and other capital activities.

Land, Facilities, and Equipment—Land, facilities, and equipment are stated at cost, less accumulated depreciation. Costs applicable to noise damage remedies and air rights, together with the cost of litigation, generally are capitalized as a cost of the property. The Port capitalizes interest during construction until the asset is placed into service, based on actual debt service rates for related construction and average interest rates on other construction. Depreciation is computed on a straight-line basis. Buildings and improvements are assigned lives of 30 to 50 years, equipment three to 20 years, and furniture and fixtures five to 10 years. The Port periodically reviews its long-lived assets for impairment and, upon indication that the carrying value of such assets may not be recoverable, recognizes an impairment loss by a charge against current operations.

Employee Benefits—Eligible Port employees earn paid time off annually, depending on length of service. A stipulated maximum of paid time off and extended illness leave may be accumulated by

employees. Terminated employees are entitled to be paid for unused paid time off and, under certain conditions, a portion of unused extended sick leave.

The Port also offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan is available to all salaried employees of the Port and to wage employees as negotiated. In 1998, the Port placed its deferred compensation plan assets in a separate trust as required under the Small Business Job Protection Act of 1996. The trust requirements were met by establishing a qualifying insurance contract, and as such, the related assets and liabilities are not included in the Port's financial statements.

On an annual basis, the Port has the option of offering a 401(a) supplemental savings plan for salaried employees. The Plan establishes a 401(a) tax-deferred savings account for each eligible employee, which increases with tenure. The Port's flat contribution amount ranges from \$500 to \$1,000 annually based on years of service. Additionally, the Port matches employee contributions to the Plan dollar-for-dollar up to a fixed maximum of \$2,200. This matching contribution also increases with tenure. Employees are able to direct the 401(a) funds to any investment options available under the Plan.

Investments and Cash Equivalents—All short-term investments with a maturity of three months or less at date of purchase are considered to be cash equivalents. Investments are carried at fair value plus accrued interest. Fair values are determined based on quoted market rates. Gains or losses due to market valuation changes are recognized in the statements of revenues, expenses, and changes in net assets.

Environmental Reserves—The Port's policy is to accrue amounts for environmental liabilities when they are determined to be probable, reasonably estimable, and required by law. When the Port's obligation becomes fixed or reliably determinable, the liability is discounted using the Port's cost of capital and the projected periods of cash payments. Insurance proceeds, if any, are evaluated separately from the Port's liability.

Debt Discount, Premium, and Issuance Costs—Debt discounts, premiums, and issuance costs relating to the sale of bonds are amortized over the lives of the related bonds using the effective interest method.

Refunds of Debt—The accounting gain or loss resulting from debt refundings is deferred and amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter.

It is the Port's practice when defeasing bonds to place the proceeds of the new bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not recorded in the financial statements. As of December 31, 2003, there were no funds that were required to be held in trust, as all defeased debt has been called and all future debt payments satisfied.

Payments in Lieu of Taxes—The Port, on behalf of the state of Washington, collects applicable leasehold taxes from its tenants. The taxes are a pass-through to the state and are, therefore, not reflected as an expense or revenue by the Port. The Port also pays business and occupation excise taxes on its retail services and other commercial activities.

Net Assets—As required by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, net assets (equity) have been classified on the statement of net assets into the following categories:

- Invested in capital assets—net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

- Restricted: Net assets subject to externally imposed stipulations on their use.
- Unrestricted: All remaining net assets that do not meet the definition of “invested in capital assets—net of related debt” or “restricted.”

Accounting Changes—In March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures*. This statement establishes and modifies disclosure requirements related to investment risks: credit risk (including custodial credit risk and concentrations of credit risk), interest rate risk, and foreign currency risk. This statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk and foreign currency risk. The requirements of this statement are effective for the Port’s financial statements for periods beginning after June 15, 2004 (January 1, 2005). The Port is in the process of determining the impact of this standard on the Port’s financial statements.

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also clarifies and establishes accounting requirements for insurance recoveries. The Port will adopt this statement effective January 1, 2005; however, the Port does not expect a material impact on its financial statements.

In June 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This standard was adopted by the Port during 2003. The adoption of SFAS No. 143 did not have a material effect on the Port’s financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 revises the accounting for exit and disposal activities as prescribed by the consensus reached in Emerging Issues Task Force Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity*. Commitment to a plan to exit an activity or dispose of long-lived assets will no longer be sufficient to record a one-time charge for most anticipated costs. Instead, SFAS No. 146 requires exit or disposal costs be recorded when they are “incurred” and can be measured at fair value. The provisions of SFAS No. 146 are effective prospectively for exit or disposal activities initiated after December 31, 2002. The adoption of SFAS No. 146 did not have a material effect on the Port’s financial position or results of operations.

Nonexchange Transactions—GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, establishes uniform revenue recognition criteria and financial reporting standards regarding when (i.e., in which fiscal year) to report the results of nonexchange transactions involving cash and other financial and capital resources. These transactions, which include taxes, intergovernmental grants, entitlements, and other financial assistance, are reported as revenue in the statements of revenues, expenses, and changes in net assets.

Operating and Nonoperating Revenues—Fees for services, rents and charges for the use of Port facilities, Airport landing fees, operating grants, and other revenues generated from operations are reported as operating revenue. Ad valorem tax levy revenues, nonoperating grants and contributions, PFCs, and other revenues generated from nonoperating sources are classified as nonoperating.

Reclassifications and Presentation—Certain reclassifications of prior years’ balances have been made to conform with the current year presentation.

2. EARTHQUAKE

On February 28, 2001, an earthquake occurred in the Puget Sound area. The Port has insurance policies, in addition to financial relief from the Federal Emergency Management Agency (“FEMA”) and the State, to cover a significant portion of the property losses incurred. The Port has established a reserve for its earthquake expenditures. The total cost of earthquake damage on its various Aviation and Seaport properties is estimated to be about \$28.3 million, with anticipated insurance/FEMA/state/Federal Aviation Administration reimbursements of about \$22.6 million. During 2003, the Port reversed a portion of the accrual previously recognized due to a reduction in the total estimated costs and an increase in FEMA receivables associated with earthquake-related repairs. As of December 31, 2003, \$3.2 million of accrued earthquake expenses remain as yet to be expended for repairs, along with a \$3.6 million receivable from insurance, FEMA, and state reimbursements.

3. FUEL HYDRANT FACILITY BONDS

During May 2003, the Port issued Fuel Hydrant Special Facility Revenue bonds in the amount of \$121,140,000 to pay for all or a portion of the costs of the acquisition, design, and construction by the Port of jet aircraft fuel storage and delivery facilities at the Seattle-Tacoma International Airport. The Port is undertaking the development of the fuel system to lower the cost of fuel service at the Airport, improve Airport safety by reducing the need for fuel trucks to operate on the airfield, and address environmental concerns created by the current fuel system. The fuel facility will be leased for 40 years (including two five-year option periods) to SeaTac Fuel Facilities LLC (“Lessee”), a limited liability company formed by a consortium of airlines for the purpose of providing jet fuel storage and distribution at the Airport. The Port owns the system and the Lessee will oversee day-to-day management. The Lessee is obligated to collect the fuel system fees and to make monthly rent payments including a base rent for the land to the Port and facilities rent to Wells Fargo Bank Northwest, National Association (“Trustee”). Facilities rent is established at an amount sufficient to pay monthly debt service, replenish any deficiency in the debt service reserve fund, and pay other fees associated with the bonds, including the Trustee fee. In addition, the Lessee is providing a guaranty and a security agreement to the Trustee, securing the Lessee’s obligation to pay principal and interest on the bonds.

At December 31, 2003, \$75 million of bond proceeds remain unspent, of which \$54 million is comprised of short-term restricted cash and investments and \$21 million is comprised of long-term restricted investments. Proceeds from the bonds are held by the Trustee and are available to the Port on a reimbursement basis as funds are spent for construction. Construction work-in-progress includes \$30 million relating to the construction of the fuel hydrant facility, and facilities improvements include \$15 million for the purchase of a fuel farm system. Fuel hydrant bonds in the amount of \$121 million are included in long-term debt on the statements of net assets.

4. CAPITAL ASSETS

Capital assets consist of the following at December 31 (in thousands):

	Beginning of Year	Additions	Retirements	End of Year
2003:				
Land and air rights	\$ 1,078,841	\$ 20,813	\$ (2,889)	\$ 1,096,765
Facilities and improvements	1,970,966	240,849	(43,792)	2,168,023
Equipment, furniture, and fixtures	<u>238,999</u>	<u>20,018</u>	<u>(6,373)</u>	<u>252,644</u>
	3,288,806	281,680	(53,054)	3,517,432
Less accumulated depreciation	<u>(825,890)</u>	<u>(85,077)</u>	<u>35,097</u>	<u>(875,870)</u>
Total capital assets	<u>\$ 2,462,916</u>	<u>\$ 196,603</u>	<u>\$ (17,957)</u>	<u>\$ 2,641,562</u>
2002:				
Land and air rights	\$ 1,045,010	\$ 39,387	\$ (5,556)	\$ 1,078,841
Facilities and improvements	1,798,518	185,582	(13,134)	1,970,966
Equipment, furniture, and fixtures	<u>244,479</u>	<u>29,439</u>	<u>(34,919)</u>	<u>238,999</u>
	3,088,007	254,408	(53,609)	3,288,806
Less accumulated depreciation	<u>(782,099)</u>	<u>(84,869)</u>	<u>41,078</u>	<u>(825,890)</u>
Total capital assets	<u>\$ 2,305,908</u>	<u>\$ 169,539</u>	<u>\$ (12,531)</u>	<u>\$ 2,462,916</u>

For the year ended December 31, 2003, \$14 million is recorded in other expense—net, of which \$6.6 million relates to the Aviation Division and \$7.4 million relates to the Seaport Division, representing losses from the demolition of assets and write-offs of tank farm assets at Terminal 91 and Terminal 25.

5. DEPOSITS WITH FINANCIAL INSTITUTIONS AND INVESTMENTS

On July 31, 2002, the Port became its own treasurer to better manage cash flow and enhance investment earnings. State investment statutes and Port investment policy authorize the Port treasurer to invest in certificates of deposits with qualified public depositories; certificates, notes, bonds, bills, or other obligations of the U.S. government or its agencies, or of any corporation wholly owned by the U.S. government; obligations of U.S. government-sponsored corporations eligible as collateral for advances to member banks as determined by the Board of Governors of the Federal Reserve System; bankers' acceptances of the 50 largest world banks purchased in the secondary market; commercial paper rated no lower than A1P1 not to exceed 180 days purchased in the secondary market; and repurchase and reverse repurchase agreements and municipal bonds in compliance with RCW 39.59.020.

Deposits—Port bank deposits, by state statute, can only be deposited in qualified public depositories. These amounts are carried at face value. Certificates of deposit are held in safekeeping in qualified depositories. Certificates of deposit in excess of the Federal Deposit Insurance Corporation insurance limitation are collateralized by the assets of the financial institutions in the State of Washington Public Deposit Protection Commission pool. Certificates of deposits are carried at cost plus accrued interest.

Cash, Cash Equivalents, and Investments—The Port's cash balances are fully collateralized. The Port's safekeeping agent takes possession of marketable investment securities. The Port's investment policies require that repurchase and reverse repurchase agreements will not exceed 60 days in duration. Repurchase agreements shall only be executed with primary government bond dealers and will be collateralized in excess of 102% if under 30 days and 105% from 30 – 60 days. Investments are to be

categorized to give an indication of the level of credit risk assumed by the Port. All the Port's investments reside in category 1, which includes investments that are insured, registered, or for which the securities are held in the Port's name by its agent. The fuel hydrant facility financing is administered by a trustee—Wells Fargo Bank—of which a portion of the investments are registered in the Port's name held by the trustee (\$43 million), which are category 1 investments, and a portion of the investments are in Wells Fargo Bank money market funds (\$32 million), which are category 3 investments, as the investments are registered in the name of the trustee.

Cash, cash equivalents, and investments consist of the following at December 31, of which \$819.9 million represents investments held in the Port's portfolio and \$75 million relates to fuel hydrant cash, cash equivalents, and investments in trust not held in the Port's investment portfolio (in thousands):

	2003	2002
Port of Seattle Portfolio:		
Cash	\$ 801	\$ 1,584
Federal agency securities	461,618	366,548
Treasury bills, notes, and bonds	290,949	183,142
Repurchase agreements	35,000	30,000
Commercial paper	<u>25,597</u>	<u>25,599</u>
	813,965	606,873
Accrued interest	<u>5,926</u>	<u>6,650</u>
Total cash, cash equivalents, and investments	<u>\$ 819,891</u>	<u>\$ 613,523</u>
Fuel hydrant assets held in trust:		
Cash and cash equivalents	32,282	
Federal agency securities	31,966	
Treasury bills, notes, and bonds	<u>10,853</u>	
Total cash, cash equivalents, and investments	<u>\$ 75,101</u>	

6. ACCOUNTING FOR LEASES

A significant portion of the Seaport terminal land, facilities, and equipment is leased to tenants under operating leases. Due to the nature of the contractual agreement with tenant airlines as discussed in Note 1, minimum rentals applicable to Airport leases that are accounted for as operating leases are not determinable.

Minimum future rental income on noncancelable operating leases on Seaport terminal facilities is as follows (in thousands):

Year Ending December 31	
2004	\$ 36,616
2005	34,808
2006	32,462
2007	30,373
2008	34,203
Thereafter	<u>1,849,423</u>
	<u>\$2,017,885</u>

Effective June 2003, the Port entered into a lease agreement with SeaTac Fuel Facilities LLC in a fuel system lease whereby the members are some of the commercial air carriers currently operating at the Airport. The lessee payments of facilities rent are made directly to a trustee in the amounts and at the times required to pay the principal and premium, if any, and interest on the Special Facility Revenue bonds issued to pay for all or a portion of the costs of the acquisition, design, and construction by the Port of jet aircraft fuel storage and delivery facilities at the Airport. The fuel system is intended to be the exclusive system for storage and delivery to commercial air carriers of jet aircraft fuel at the Airport. The lease, which represents an unconditional obligation of the lessee, extends until the later of July 31, 2033, or the repayment of the 2003 bonds. SeaTac Fuel was created by the consortium of airlines operating at the Airport for the purpose of entering the lease and managing the fuel hydrant system. The future rental income based on debt service requirements is \$6,363,210 for 2004, \$6,076,275 for 2005, \$8,201,275 for 2006, \$8,200,025 for 2007, \$8,198,525 for 2008, and \$204,968,688 for the years thereafter; these amounts are not included in the schedule above. All special facility lease revenues are restricted and are to be used solely for debt service on the bonds and not for Port operations.

7. LONG-TERM DEBT

The Port's long-term debt consists of tax-exempt bonds. The majority of the Port's outstanding bonds are revenue bonds, which are secured by a pledge of net operating revenues of the Port. Revenue from passenger facility charges is pledged to secure passenger facilities charges revenue bonds. The Port also issues general obligation bonds payable from ad valorem taxes. Outstanding long-term debt as of December 31, 2003, consists of the following (in thousands):

Bond Type (by Bond Issue)	Rates	Maturity Dates	Beginning Balance	Principal (Payments) (Refunding) Issuance	Ending Balance
General obligation bonds:					
1985 variable GO bonds	1.06% *	2004	\$ 5,200	\$ (2,500)	\$ 2,700
1994 GO bond	5.35%-5.9%	2004-2014	111,410	(6,715)	104,695
2000 GO bond	4.8%-6.0%	2004-2025	112,420	(2,530)	109,890
			229,030	(11,745)	217,285
Revenue bonds:					
First lien:					
Series 1990 A	7.2%-7.35%	2003	2,362	(2,362)	
Series 1990 B	7.2%-7.35%	2003	2,180	(2,180)	
Series 1992 A	6.3%-6.4%	2004-2005	2,030	(635)	1,395
Series 1992 B	6.40%	2003	2,850	(2,850)	
Series 1994 A	4.5%-5.0%	2004-2011	24,550	(305)	24,245
Series 1994 B	4.7%-5.375%	2004-2019	42,830	(1,635)	41,195
Series 1994 C	4.6%-5.0%	2004-2009	24,320	(3,160)	21,160
Series 1996 A	5.5%	2017-2021	31,820		31,820
Series 1996 B	5.0%-6.0%	2004-2017	62,295	(2,925)	59,370
Series 1997 A	5.125%-6%	2005-2022	120,375		120,375
Series 1997 B	5.125%-5.25%	2004-2005	9,890	(3,735)	6,155
Series 1998 A Refund Bond	4.4%-5.375%	2004-2017	49,875	(10,435)	39,440
Series 1998 A Refund Bond	5.125%-5.375%	2012-2014	8,300	(45)	8,255
Series 2000 A	5.5%-5.625%	2024-2030	130,690		130,690
Series 2000 B	5.5%-6.0%	2004-2024	221,590		221,590
Series 2000 C	4.65%-4.7%	2004-2005	7,120	(2,385)	4,735
Series 2000 D	5.5%-6.0%	2004-2011	20,930	(5,260)	15,670
Series 2001 A	5%	2024-2031	176,105		176,105
Series 2001 B	5.1%-5.625%	2006-2024	251,380		251,380
Series 2001 C	5.5%-5.625%	2012-2014	12,205		12,205
Series 2001 D	5.75%	2004-2017	68,580		68,580
Series 2003 A	5.0%-5.25%	2006-2033		190,470	190,470
Series 2003 B	4.25%-5.5%	2007-2029		164,900	164,900
Total			1,272,277	317,458	1,589,735
Subordinate lien:					
Series 1997	1.327% *	2022	108,830		108,830
Series 1998	4.5%-5.375%	2004-2017	22,810	(1,080)	21,730
Series 1999 A	4.75%-5.5%	2016-2024	121,840		121,840
Series 1999 B	5.0%-5.5%	2004-2016	108,740		108,740
Series 2003 C	1.02%-1.1% *	2033		200,000	200,000
Total			362,220	198,920	561,140
Commercial paper	0.966%-1.103%	2004	115,550	(10,500)	105,050
Revenue bond totals			1,750,047	505,878	2,255,925

(Continued)

Bond Type (by Bond Issue)	Rates	Maturity Dates	Beginning Balance	Principal (Payments) (Refunding) Issuance	Ending Balance
Passenger facility charge revenue bonds:					
Series 1998 A	5%	2016-2023	\$ 118,490	\$ -	\$ 118,490
Series 1998 B	5.0%-5.375%	2004-2016	<u>139,560</u>	<u>(7,110)</u>	<u>132,450</u>
Total			258,050	(7,110)	250,940
Fuel hydrant special facility bonds	3.0%-5.5%	2006-2033		121,140	121,140
Bond total			2,237,127	608,163	2,845,290
Unamortized bond premiums—net of discounts and amortization			<u>13,272</u>	<u>3,543</u>	<u>16,815</u>
Total debt			2,250,399	<u>\$ 611,706</u>	2,862,105
Less current maturities of long term debt			<u>182,422</u>		<u>172,670</u>
Long-term debt			<u>\$ 2,067,977</u>		<u>\$ 2,689,435</u>

* As of December 31, 2003

(Concluded)

During August 2003, the Port issued \$190,470,000 Series 2003 A, \$164,900,000 Series 2003 B, and \$200,000,000 Series 2003 C revenue bonds to finance or refinance a portion of the costs of certain ongoing capital improvements at the Airport, and to satisfy a portion of the debt service reserve fund requirement for Series 2003 bonds. Interest on the Series 2003 A and B bonds from the date of delivery is payable on January 1 and July 1 of each year, commencing January 1, 2004, and are subject to optional and mandatory redemption. Series 2003 C bonds are issued as variable rate bonds; currently, interest rates are determined by auction every 35 days.

During May 2003, the Port issued \$121,140,000 in Fuel Hydrant Special Facility Revenue bonds to pay or to repay commercial paper issued to pay, among other costs, all or a portion of the costs of the acquisition, design, and construction by the Port of jet aircraft fuel storage and delivery facilities at the Airport. The Port entered into a lease agreement with SeaTac Fuel Facilities LLC in a fuel system lease whereby the members are some of the commercial air carriers currently operating at the Airport. Debt service payments are funded by lessee payments of facilities rent made directly to a trustee in the amounts and at the times required to pay the principal and interest on the special facility revenue bonds. Interest on the Fuel Hydrant Special Facility Revenue bonds is payable on June 1 and December 1 of each year, commencing December 1, 2003.

During 2002, the Port issued its Port of Seattle Revenue Refunding Bonds, Series 2001 D, for \$68,580,000 to refund certain outstanding bonds of the Port and to satisfy a portion of the debt service reserve fund requirement for the Series 2001 bonds. The economic gain resulting from this transaction was \$2,054,004. The difference between the cash flows required to service the outstanding bonds and the cash flows required to service the new debt was a loss of \$349,000. This amount will be amortized over the life of the defeased bonds. Interest on the Series 2001 D bonds from the date of delivery is payable on May 1 and November 1 of each year, commencing November 1, 2004.

In November 2002, the Port converted \$244 million of existing 1999 subordinate lien revenue bonds from short-term weekly variable mode to long-term fixed mode to lock in low long-term interest rates.

The Commission authorized the sale of subordinate lien revenue notes (commercial paper) in an aggregate principal amount not to exceed \$250,000,000 for the purpose of financing and refinancing capital improvements within the Port, for working capital, and for paying maturing revenue notes of the same series and/or reimbursing the credit providers for advances made.

Passenger facility revenue bonds are secured by a lien pledge of the revenues generated from the passenger facility charges imposed by the Airport. The remaining revenue bonds are secured by a pledge of net revenues of the Port. The general obligation bonds and interest thereon are payable from ad valorem taxes.

The Port monitors the existence of any rebatable arbitrage interest income associated with its tax-exempt debt. The rebate is based on the differential between the interest earnings from the investment of the bond proceeds as compared to the interest expense associated with the respective bonds. As of December 31, 2003, the Port has estimated that arbitrage rebates of \$1,673,592, \$174,795, and \$11,982 existed in conjunction with its Series 2003 C revenue bonds, 1998 passenger facility charge bonds, and 1997 Series revenue bonds, respectively. Amounts are recorded as accrued long-term expenses in the statements of net assets. The actual payment of arbitrage rebate is due in 2008 and 2007. Other outstanding bond issues have potential arbitrage rebatable earnings; however, management estimates indicate that no additional potential arbitrage rebate liability exists as of December 31, 2003.

Interest expense costs capitalized were \$66,437,016, \$61,363,084, and \$51,866,128, and interest income capitalized was \$9,996,513, \$17,179,984, and \$22,324,442, for 2003, 2002, and 2001, respectively.

Aggregate annual payments on revenue and general obligation bonds and commercial paper outstanding at December 31, 2003 (in thousands):

	Principal	Interest	Total
2004	163,750	128,796	292,546
2005	58,855	136,602	195,457
2006	71,580	133,296	204,876
2007	77,365	129,471	206,836
2008	83,555	125,317	208,872
2009 – 2014	637,760	644,562	1,282,322
2015 – 2020	668,940	434,434	1,103,374
2021 – 2026	598,645	224,546	823,191
2027 – 2033	484,840	73,173	558,013
	<u>\$2,845,290</u>	<u>\$2,030,197</u>	<u>\$4,875,487</u>

The fair value of long-term debt was \$3,010,455,116 and \$2,373,022,513 as of December 31, 2003 and 2002, respectively. This fair value is estimated using quoted market prices.

In February 2004, the Port issued \$298,810,000 in Series 2004A and Series 2004B general obligation bonds and 2004C general obligation refunding bonds to fund or reimburse the Port for the payment of a portion of the costs of the ongoing capital improvement program and to refund the General Obligation Bonds Series 1994 and Revenue Bonds, Series 1994B. Interest is payable on May 1 and November 1 of each year, commencing November 1, 2004. The Series A Bonds and Series B bonds are subject to optional redemption, while the Series C bonds are not subject to optional redemption prior to maturity. The bonds have coupon rates ranging from 2% to 5.250%, with maturities ranging from 2004 to 2023.

8. CONDUIT DEBT

The Port has the following conduit debt obligations totaling \$273,830,000 and \$309,625,000 as of December 31, 2003 and 2002, respectively, which are not a liability or contingent liability of the Port under GASB Interpretation No. 2, *Disclosure of Conduit Debt Obligations*. The Port has not recorded these obligations, or the related assets, on the accompanying financial statements of the Port, as the Port has no obligation for the outstanding bonds beyond what is provided in the leasing arrangements.

In 1999, the Port issued special facility revenue bonds to pay, among other things, a portion of the costs of the expansion of Terminal 18. The Port has agreed to lease the site of Terminal 18 and the existing and future improvements thereon to Stevedoring Services of America, Inc. and its affiliate, SSA Terminals, LLC (“SSA”). The bonds are secured by lease payments paid by SSA to the trustee (Chase Manhattan Trust Company, National Association). No tax funds or revenues of the Port (other than Terminal 18 lease revenue) are pledged to pay the debt service on the bonds, and no liens (other than the Terminal 18 properties) are pledged as collateral for the debt. At December 31, 2003 and 2002, special facility revenues bonds of \$188,630,000, after defeasance, and \$217,425,000 were outstanding, respectively. In 2002, total facility completion triggered debt service payments on the special facility bonds. The Port records the net rental revenue after debt service in its statements of revenues, expenses, and changes in net assets.

In 1982, the Port, through its component unit, the IDC, issued tax-exempt nonrecourse revenue bonds to finance industrial development for acquiring, constructing, and renovating transshipment and manufacturing facilities within the corporate boundaries of the Port. These revenue bonds are secured by revenues derived from the industrial development facilities funded by the revenue bonds and leased to the IDC. No tax funds or revenues of the Port (other than the IDC lease revenue) are pledged to pay the debt service on the bonds, and no liens (other than the IDC properties) are pledged as collateral for the debt. At December 31, 2003 and 2002, industrial revenue bonds of \$85,200,000 and \$92,200,000, respectively, were outstanding. The outstanding industrial revenue bonds are not recorded in the Port’s or the IDC’s financial statements, as they represent conduit debt.

9. PENSION PLANS

Public Employees’ Retirement System (“PERS”)—Substantially all of the Port’s full-time and qualifying part-time employees, other than those covered under union plans, participate in PERS. This is a statewide local government retirement system administered by the Washington State Department of Retirement Systems, under cost-sharing, multiple-employer defined benefit public employee retirement plans. The PERS system includes three plans.

Participants who joined the system by September 30, 1977, are PERS Plan I members. Those joining thereafter are enrolled in PERS Plan II. In March 2000, Governor Gary Locke signed into law a new retirement plan for members of the PERS Plan II. The new plan, entitled PERS Plan III, provides members with a defined benefit plan similar to PERS Plan II and the opportunity to invest their retirement contributions in a defined contribution plan.

PERS Plan I members are eligible for retirement at any age after 30 years of service, at age 60 with five years of service, or at age 55 with 25 years of service. The annual pension is 2% of the average final compensation per year of service, capped at 60%. The average final compensation is based on the greatest compensation earned during any 24 eligible consecutive compensation months.

PERS Plan II members may retire at age 65 with five years of service or at 55 with 20 years of service. The annual pension is 2% of the average final compensation per year of service. PERS Plan II retirements prior to 65 are actuarially reduced. On July 1 of each year following the first full year of retirement service, the benefit will be adjusted by the percentage change in the Consumer Price Index (“CPI”) of Seattle, capped at 3% annually.

PERS Plan III is structured as a dual benefit program that will provide members with the following benefits:

- A defined benefit allowance similar to PERS Plan II calculated as 1% of the average final compensation per year of service (versus a 2% percent formula) and funded entirely by employer contributions.

- A defined contribution account consisting of member contributions plus the full investment return on those contributions.

Each biennium, the state Pension Funding Council adopts PERS Plan I employer contribution rates and PERS Plan II employer and employee contribution rates. Employee contribution rates for PERS Plan I are established by statute at 6% and do not vary from year to year. The employer and employee contribution rates for PERS Plan II are set by the director of the Department of Retirement Systems, based on recommendations by the Office of the State Actuary, to continue to fully fund PERS Plan II. Unlike PERS Plan II, which has a single contribution rate (which is currently 1.18%), with PERS Plan III, the employee chooses how much to contribute from one to six contribution rate options. Once an option has been selected, the contribution rate choice is irrevocable unless the employee changes employers.

All employers are required to contribute at the level established by state law. The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.26 RCW.

The Port’s covered payroll for PERS for the year ended December 31, 2003, was \$63,986,885.

The Port’s contribution rates during 2003 expressed as a percentage of covered payroll for employer ranged from 1.10% to 1.18% for PERS Plan I, PERS Plan II, and PERS Plan III. The employer rates do not include the employer administrative expense fee currently set at .22%. For employees, the rate was 6% for PERS Plan I and a range of .65% to 1.18% for PERS Plan II, and PERS Plan III depends on the option the employee has chosen.

Both the Port and the employees made the required contributions. The Port’s required contributions for the years ended December 31 were as follows:

	PERS Plan I	PERS Plan II	PERS Plan III
2003	\$ 593,922	\$ 710,868	\$ 28,057
2002	482,157	761,908	2,100
2001	539,226	1,456,976	

The pension obligation was calculated on a pension system basis and cannot be disclosed on a plan basis. PERS does not make separate measurements of assets and pension obligations for individual employers.

Law Enforcement Officers’ and Fire Fighters’ Retirement System (“LEOFF”)—LEOFF is a cost-sharing multiple-employer defined benefit pension plan. Membership in the plan includes all full-time, fully compensated local law enforcement officers and fire fighters. LEOFF comprises solely nonstate employees. The LEOFF system includes two plans.

Participants who joined the system by September 30, 1977, are LEOFF Plan I members. Those joining thereafter are enrolled in LEOFF Plan II. Retirement benefits are financed from employee and employer contributions, investment earnings, and state contributions. Retirement benefits in both LEOFF Plan I and LEOFF Plan II are vested after completion of five years of eligible service.

LEOFF Plan I members are eligible to retire with five years of service at age 50. The service retirement benefit is dependent upon the final average salary and service credit years at retirement. On April 1 of each year following the first full year of retirement service, the benefit will be adjusted by the percentage change in the CPI of Seattle.

Term of Service	Percent of Final Average
5 – 9 years	1.0 %
10 – 19 years	1.5
20 or more years	2.0

LEOFF Plan II members are eligible to retire at the age of 50 with 20 years of service or at 53 with five years of service. Retirement benefits prior to age 53 are actuarially reduced at a rate of 3% per year. The benefit is 2% of the final average salary per year of service. The final average salary is determined as the 60 highest paid consecutive service months. There is no limit on the number of service credit years which may be included in the benefit calculation. On July 1 of each year following the first full year of retirement service, the benefit will be adjusted by the percentage change in the CPI of Seattle, capped at 3% annually.

LEOFF Plan I employer and employee contribution rates are established by statute, and the state is responsible for the balance of the funding at rates set by the Pension Funding Council to fully amortize the total costs of the plan. Employer and employee rates for LEOFF Plan II are set by the director of the Department of Retirement Systems, based on recommendations by the Office of the State Actuary, to continue to fully fund the plan. LEOFF Plan II employers and employees are required to contribute at the level required by state law. The methods used to determine the contribution rates are established under state statute in accordance with Chapters 41.26 and 41.45 RCW.

The Port’s current year covered payroll for LEOFF for the year ended December 31, 2003, was \$13,226,641.

The Port’s required contribution rates during 2003 expressed as a percentage of covered payroll for LEOFF Plan I was -0-% for both employer and employee. For LEOFF Plan II (Firefighters), the range of rates was 2.64% to 3.03% for employer and 4.39% to 5.05% for employees. For LEOFF Plan II (Police), the range of rates was 4.38% to 5.04% for employer and 4.39% to 5.05% for employees. The employer rates do not include the employer administrative expense fees currently set at .22% for LEOFF Plan I and LEOFF Plan II (Firefighters) and .23% for LEOFF Plan II (Police).

Both the Port and the employees made the required contributions. The Port’s required contributions for the years ended December 31 were as follows:

	LEOFF Plan I	LEOFF Plan II (Firefighters)	LEOFF Plan II (Police Officers)
2003	\$ 916	\$ 141,407	\$ 403,575
2002	1,118	133,738	402,353
2001	1,049	153,093	358,203

Historical trend information regarding all of these plans is presented in Washington State's Department of Retirement Systems' annual financial report. A copy of this report may be obtained at:

Department of Retirement Systems
 Point Plaza West
 1025 East Union Street
 P.O. Box 48380
 Olympia, Washington 98504-8380
 Internet Address: www.drs.wa.gov

10. CONTINGENCIES

The Port is a defendant in various legal actions and claims, including environmental cleanup actions, which arise during the normal course of business, some of which may be covered by insurance. Although certain lawsuits and claims are significant in amount, the final dispositions are not determinable, and in the opinion of management, the outcome of any litigation of these matters will not have a material effect on the financial position or results of operations of the Port. In some cases, the Port has provided reserves for these matters, which, in the opinion of management, are adequate.

As of December 31, 2003, the Port's environmental reserves are anticipated to be spent over the following time frame in the following amounts (in thousands):

2004	\$ 8,087
2005	3,789
2006	2,396
2007	1,167
2008	605
Thereafter	<u>1,320</u>
Total	<u>\$17,364</u>

Amounts received or receivable under federal grants-in-aid programs are subject to audit and adjustment by the granting agency. Any disallowed claims, including amounts already received, may constitute a liability of the Port. The amount, if any, of expenditures that may be disallowed cannot be determined at this time, although the Port expects such amounts, if any, to be insignificant.

11. COMMITMENTS

As of December 31, 2003, the Port has authorized or made commitments for acquisition and construction as follows (in thousands):

Funds committed:	
Seaport terminals	\$ 161,926
Airport facilities	782,712
Corporate	7,050
Economic and trade development	5,306
Funds authorized but not yet committed:	
Seaport terminals	15,195
Airport facilities	401,473
Corporate	<u>3,447</u>
	<u>\$1,377,109</u>

12. BUSINESS INFORMATION

For the Port's two major business activities, operations consist of Seaport terminals and Airport facilities. Indirect costs have been allocated to Seaport terminals and Airport facilities using various methods based on estimated hours of work, revenue plus expenses, full-time equivalent units, and other factors.

The Port's major customers individually provided revenues equal to at least 36% of the applicable division's total operating revenues. For the Seaport, the revenues from its major customers accounted for 39%, 19%, and 32% of total operating revenues in 2003, 2002, and 2001, respectively. For the Airport, the revenues from its major customers accounted for 35%, 36%, and 29% of total operating revenues in 2003, 2002, and 2001, respectively.

Operating revenues, as reflected in the statements of revenues, expenses, and changes in net assets, from the Port's major customers are as follows (in thousands):

	2003	2002	2001
Seaport division:			
Revenues	\$ 34,412	\$ 16,791	\$ 32,039
Number of major customers	2	1	2
Aviation division:			
Revenues	\$ 81,196	\$ 77,774	\$ 63,645
Number of major customers	2	2	2
Total revenues of all major customers	\$ 115,608	\$ 94,565	\$ 95,684
Total number of major customers	4	3	4

The Port's operating revenues are derived from various sources. The Seaport's operating revenues are principally derived from the leasing of Seaport terminal facilities. The Airport's operating revenues are derived primarily from its airline agreements, concession agreements, and other business arrangements.

Operating revenues, as reflected in the statements of revenues, expenses, and changes in net assets, from the Port's major sources are as follows (in thousands):

	2003	2002	2001
Seaport division:			
Property rentals	\$ 49,699	\$ 41,100	\$ 49,645
Equipment rentals	7,433	7,588	12,566
Distribution and storage	19	4,762	9,749
Security grants	4,501	379	
Other	<u>26,079</u>	<u>34,497</u>	<u>28,665</u>
Total Seaport division revenues	<u>\$ 87,731</u>	<u>\$ 88,326</u>	<u>\$ 100,625</u>
Aviation division:			
Property rentals	\$ 96,471	\$ 89,844	\$ 90,440
Landing fees	83,159	73,250	71,790
Parking	40,217	40,233	46,475
Security grants	1,575	4,972	
Other	<u>11,728</u>	<u>10,734</u>	<u>11,487</u>
Total Aviation division revenues	<u>\$ 233,150</u>	<u>\$ 219,033</u>	<u>\$ 220,192</u>

Financial information by division for the years ended December 31 is as follows (in thousands):

	2003		2002		2001	
	Seaport	Airport	Seaport	Airport	Seaport	Airport
Revenue	\$ 87,731	\$ 233,150	\$ 88,326	\$ 219,034	\$ 100,625	\$ 220,192
Operation and maintenance	48,729	116,213	55,116	110,787	58,920	114,723
Earthquake repair expense—net	227	(2,817)	(1,394)	2,276	5,345	1,516
Law enforcement	2,871	12,861	3,196	14,970	1,959	11,954
Administration	8,456	14,230	9,675	15,993	9,025	14,880
Environmental	4,859	(799)	8,570	37	1,272	(255)
Total operating expenses before depreciation	<u>65,142</u>	<u>139,688</u>	<u>75,163</u>	<u>144,063</u>	<u>76,521</u>	<u>142,818</u>
Net operating income before depreciation	22,589	93,462	13,163	74,971	24,104	77,374
Depreciation	<u>31,753</u>	<u>53,275</u>	<u>33,054</u>	<u>51,799</u>	<u>33,274</u>	<u>47,840</u>
Operating (loss) income	(9,164)	40,187	(19,891)	23,172	(9,170)	29,534
Nonoperating (expense) income:						
Ad valorem tax levy revenue	57,793		39,309		35,721	
Passenger facility charges revenue and related interest income		54,373		53,675		43,961
Grants and donations	2,841	29,670	826	16,349	7,224	20,597
Investment income—net	1,828	3,641	2,909	14,510	2,574	11,876
Revenue and capital appreciation bond interest expense	(8,585)	(35,577)	(9,782)	(27,033)	(11,198)	(24,500)
Passenger facility charges revenue bond interest expense		(3,870)		(3,121)		(2,323)
General obligation bond interest expense—net	(9,673)		(8,431)		(7,317)	
Public assets expense	(396)		(5,425)		(3,843)	
Other expense—net	(7,303)	(8,441)	(3,850)	(1,591)	(266)	(5,677)
Total nonoperating income—net	<u>36,505</u>	<u>39,796</u>	<u>15,556</u>	<u>52,789</u>	<u>22,895</u>	<u>43,934</u>
Increase in net assets	\$ <u>27,341</u>	\$ <u>79,983</u>	\$ <u>(4,335)</u>	\$ <u>75,961</u>	\$ <u>13,726</u>	\$ <u>73,468</u>
Identifiable fixed assets	\$1,070,399	\$1,525,017	\$1,019,056	\$1,398,004	\$1,005,159	\$1,252,301
Other identifiable assets	<u>159,423</u>	<u>1,874,520</u>	<u>139,403</u>	<u>1,421,290</u>	<u>175,919</u>	<u>1,432,644</u>
Identifiable assets	<u>\$1,229,822</u>	<u>\$3,399,537</u>	<u>\$1,158,459</u>	<u>\$2,819,294</u>	<u>\$1,181,078</u>	<u>\$2,684,945</u>
Capital expenditures	\$ <u>115,035</u>	\$ <u>411,768</u>	\$ <u>60,953</u>	\$ <u>455,717</u>	\$ <u>51,602</u>	\$ <u>391,822</u>
Total long-term debt—including current maturities	\$ <u>513,242</u>	\$ <u>2,348,863</u>	\$ <u>492,959</u>	\$ <u>1,757,440</u>	\$ <u>507,967</u>	\$ <u>1,740,116</u>

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