# The Northwest Seaport Alliance

Financial Report
December 31, 2018

THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

RSM

# The Northwest Seaport Alliance
## Financial Report

**For The Year Ended**
**December 31, 2018**

## Contents

# Independent Auditor's Report

The Managing Members
The Northwest Seaport Alliance
Tacoma, Washington

**Report on the Financial Statements**
We have audited the accompanying financial statements of The Northwest Seaport Alliance (the NWSA) as of and for the years ended December 31, 2018 and 2017, and the related notes to the financial statements, which, collectively, comprise the NWSA's basic financial statements as listed in the table of contents.

**Management's Responsibility for the Financial Statements**
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**
Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

**Opinion**
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the NWSA as of December 31, 2018 and 2017, and the respective changes in financial position and cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

**Other Matters**

***Required Supplementary Information:*** Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the schedule of NWSA's share of net pension asset/liability as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated April 5, 2019, on our consideration of the NWSA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to solely describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the NWSA's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering NWSA's internal control over financial reporting and compliance.

RSM US LLP

Tacoma, Washington
April 5, 2019

# The Northwest Seaport Alliance
## MANAGEMENT'S DISCUSSION AND ANALYSIS
## YEARS ENDED DECEMBER 31, 2018 and 2017

## INTRODUCTION

The Northwest Seaport Alliance (NWSA) Management Discussion and Analysis (MD&A) of financial activities and performance introduces the 2018 and 2017 financial statements of the NWSA, a Port Development Authority. NWSA management prepared this MD&A and readers should consider it in conjunction with the financial statements and the notes thereto.

The notes are essential to a full understanding of the data contained in the financial statements. This report also presents information about the formation of the NWSA and certain required supplementary financial information.

## 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 financial statements include: the statements of net position, the statements of revenues, expenses and changes in net position, and the statements of cash flows.

The statements of net position present information on the NWSA's assets and deferred outflows and liabilities and deferred inflows, with the difference between the assets and deferred outflows, and liabilities and deferred inflows reported as net position. Over time, increases or decreases in net position may serve as an indicator of whether the financial position of the NWSA is improving or deteriorating. The statements of revenues, expenses and changes in net position shows how the NWSA's net position changed during the year. These changes are reported in the period in which the underlying event occurs, regardless of the timing of related cash flows.

**Formation of The Northwest Seaport Alliance**
The ports of Seattle and Tacoma (the home ports) joined forces in August 2015, forming the NWSA to unify management of marine cargo facilities and business to strengthen the Puget Sound gateway and attract more marine cargo and jobs to the region.

The NWSA is a special purpose governmental entity established as a Port Development Authority (PDA), similar to Public Development Authorities formed by cities and counties. The PDA is governed by the home ports as equal members (each a "Managing Member" and collectively, "Managing Members") with each home port acting through its elected commissioners. As approved, the charter for the NWSA ("Charter") may be amended only by mutual agreement of the Managing Members. Each home port will remain a separate legal entity, independently governed by its own elected commissioners. Each home port has granted to the NWSA a license for the NWSA's exclusive use, operation and management of certain facilities, but ownership of the licensed facilities remains with the home ports, not with the NWSA.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

**Membership Interests**

The home ports made an initial contribution of certain cargo terminals and related marine cargo business activities to the NWSA through license agreements ("Licensed Properties"). Under these agreements, the NWSA is charged with managing the properties as an agent on behalf of the Managing Members. The initial contribution of each home port to the NWSA was 50 percent (based on the value of the contributed facilities using cash flow forecasts for each parcel that went to the NWSA) with a revaluation review that was deferred until 2019 by the Managing Members. The revaluation review is to determine if material changes in cash flows from the Licensed Properties have occurred since the initial valuation. A change in the valuation of the cash flow forecasts of these facilities could result in a change in Membership Interests. The Managing Members shall approve any change in Membership Interest by vote, to include provision for addressing any change to distributions and allocations as a result of the change in Membership Interest. Changes in Membership Interest do not affect a Managing Member's voting rights under the Charter, as votes are not weighted by or otherwise determined by Membership Interest.

On April 2, 2019, In lieu of completing the required reevaluation of Membership Interest, the Managing Members approved, and the Port of Seattle commission agreed to an additional contribution from the Port of Seattle to the NWSA of up to $32 million in recognition that certain forecasted revenue streams in the initial valuation were not secured by long-term contractual agreements. Additional information is provided in Note 11, Subsequent Events.

**Financial Framework**

The NWSA intends to support the credit profiles of both home ports, and its financial framework will preserve both ports' commitment to financial strength and fiscal stewardship. The NWSA distributes cash to each home port based on cash flow from operations, calculated pursuant to generally accepted accounting principles (GAAP). Distributions are to be made no less than quarterly based on each Managing Member's Membership Interest. Cash flow from operations will be distributed to home ports and not retained by the NWSA for funding capital investments.

The NWSA is responsible for capital investments, including renewal and replacement projects and new development. Both home ports work cooperatively with the NWSA to develop an annual capital investment plan for approval by each Managing Member. Capital funding will be provided by joint contributions from the home ports. Each Managing Member must approve its capital contributions.

The Charter recognizes that each home port's respective share of revenues received by the NWSA with respect to the Licensed Properties has been or may be pledged in connection with the home port's bond obligations. Under the Charter, the Managing Members instruct the Chief Executive Officer (CEO) to manage the PDA in a prudent and reasonable manner in support of the home ports' respective bond covenants. The home ports shall keep the CEO and the NWSA management informed of their respective bond obligations, and shall each notify the other home port of any proposed change to such home port's governing bond resolutions as soon as practical before adoption. The Charter does not modify or alter the obligations of each home port with respect to its own bond obligations. The NWSA does not assume any obligations to the home ports' bondholders.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

With respect to bonds of each home port that were outstanding at the time of the formation of the NWSA, the Managing Members shall establish and maintain a requirement for the NWSA to calculate and establish a minimum level of net income from the NWSA equal to the amount required for the home ports to meet their bond rate covenants in effect at the time of formation of the NWSA ("Bond Income Calculation," initially calculated to be $90 million). The Managing Members shall require the Bond Income Calculation to be reviewed annually as part of the NWSA budget process and the Managing Members may adjust the Bond Income Calculation so long as it does not cause any home port to fail to comply with its rate covenant in effect at the time of formation of the NWSA. The NWSA may not take any action that reasonably would reduce NWSA income below the minimum level established by the Bond Income Calculation unless each Managing Member separately votes to approve that action. Such a vote by each Managing Member must occur even if the action is within the CEO's delegated authority. The Bond Income Calculation is subject to adjustment, including reductions resulting from payment or refunding of bonds outstanding at the time of the formation of the NWSA.

**Funding**

The NWSA's operations began January 1, 2016. Each home port provided an initial contribution for working capital of $25.5 million, for a total initial working capital funding of $51.0 million. Working capital cannot be redirected to fund capital construction as defined in the Charter.

Future needs are evaluated during the annual budget process or if the working capital reserve should decline below a target minimum established by the Managing Members. Managing Members each must vote affirmatively to approve additional working capital contributions.

In 2016, each home port also provided initial capital construction contributions of $13.5 million (totaling $27.0 million), equal to the budgeted capital investment plan. The home ports also provided $8.9 million and $7.9 million, respectively, in noncash construction in process for capital projects that started in the home ports and were completed by NWSA. Throughout the year the home ports provided additional combined contributions of $29.1 million to fund capital construction cash flow needs for 2016.

During 2017, the home ports made capital construction contributions of $69.1 million of which $61.2 million was spent on container terminal improvements and container crane acquisitions at Husky Terminal on Pier 4 and $3.4 million was spent on Terminal 5 (T5) design and other terminal developments in the North Harbor.

During 2018, the home ports funded NWSA's capital construction spending of $83.3 million in 2018, of which $51.2 million was spent on container cranes and improvements on Pier 4, $15.0 million was for stormwater improvements, and $8.0 million for dock improvements at Terminal 46. More information is presented in the Capital Assets section below.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

### Financial Position Summary

The statements of net position present the financial position of the NWSA. The statements include all of the NWSA's assets and deferred outflows, and liabilities and deferred inflows. Net position serves as an indicator of the NWSA's financial position. The NWSA's current assets consist primarily of cash and cash equivalents, investments and accounts receivable.

**Statements of Net Position (dollars in thousands):**

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Current assets | $ 91,948 | $ 100,803 | $ 119,740 |
| Capital assets, net | 234,235 | 152,228 | 80,532 |
| Long-term investments | 13,369 | 12,535 | - |
| Other assets | 2,600 | 3,025 | 3,447 |
| **Total assets** | $ 342,152 | $ 268,591 | $ 203,719 |
| Deferred outflows of resources | $ 1,652 | $ 481 | $ - |
| Current liabilities | $ 36,837 | $ 41,553 | $ 58,927 |
| Noncurrent liabilities | 21,710 | 19,642 | 13,655 |
| **Total liabilities** | $ 58,547 | $ 61,195 | $ 72,582 |
| Deferred inflows of resources | $ 1,258 | $ 349 | $ - |
| Net investment in capital assets | $ 234,235 | $ 152,228 | $ 80,532 |
| Unrestricted | 49,764 | 55,300 | 50,605 |
| **Total net position** | $ 283,999 | $ 207,528 | $ 131,137 |

The NWSA's total net position was $284.0 million at December 31, 2018. Of this amount, $234.2 million was the net investment in capital assets and $49.8 million was unrestricted and available to finance operating activities. The NWSA's total net position was $207.5 million at December 31, 2017. Of this amount, $152.2 million was the net investment in capital assets and $55.3 million was unrestricted and available to finance operating activities. The NWSA's net investment in capital assets represents capital assets for the NWSA's terminal and real estate facilities.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

The change in net position is an indicator of whether the overall fiscal condition of the NWSA has improved or worsened during the year. The following summary compares operating results for 2018, 2017 and 2016.

**Statements of Revenues, Expenses and Changes in Net Position (dollars in thousands):**

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Operating revenues | $ 192,574 | $ 194,985 | $ 195,170 |
| Operating expenses | 89,132 | 85,895 | 80,264 |
| **Operating income** | 103,442 | 109,090 | 114,906 |
| Non-operating revenues (expenses): | | | |
| Interest income | 1,254 | 777 | 755 |
| Net increase (decrease) in the fair value of investments | 23 | (43) | (328) |
| Other non-operating income (expense), net | 3,361 | (297) | 7,835 |
| **Total non-operating revenues, net** | 4,638 | 437 | 8,262 |
| Capital grant contributions | 3,905 | 324 | - |
| **Increase in net position before Managing Members contributions (distributions), net** | $ 111,985 | $ 109,851 | $ 123,168 |
| Increase in net position before Managing Members contributions (distributions), net | $ 111,985 | $ 109,851 | $ 123,168 |
| Managing Members contributions (distributions), net | (35,514) | (33,460) | 7,969 |
| **Increase in net position** | 76,471 | 76,391 | 131,137 |
| Net position, beginning of year | 207,528 | 131,137 | - |
| **Net position, end of year** | $ 283,999 | $ 207,528 | $ 131,137 |

The NWSA operates three major business lines:

**Container business:** International and domestic container cargo is a core business for the NWSA. As one of the northernmost gateways on the U.S. West Coast, the Pacific Northwest has long been the primary hub for waterborne trade with Alaska, as well as a major gateway for trans-pacific trade. The gateway's on-dock and near-dock intermodal rail yards, along with international and domestic rail services to the U.S. Midwest, are an integral part of the container business. The NWSA also has on-dock intermodal yards that generate revenue from loading containers to and from rail cars.

**Non-container business:** This line of business is comprised of breakbulk (roll-on and roll-off, also known as RoRo), bulk and auto cargoes. Aside from handling agricultural and mining equipment and other rolling stock, the NWSA's South Harbor is designated as a strategic military port for transport of military cargoes.

Auto customers include Kia, Mazda and Mitsubishi. Auto Warehousing Company (AWC), a tenant, is the largest auto processor on the U.S. West Coast.

**Real estate business:** This line of business is focused on non-terminal industrial and commercial properties and facilities that complement the container and non-container businesses and offer a broad range of services for the NWSA's international and domestic customers, including warehousing, distribution, manufacturing and marine services.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

A summary of revenue and operating expenses for the years ended December 31 is presented in the following table (dollars in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Revenue: | | | |
| Container | $ 159,667 | $ 162,695 | $ 163,711 |
| Non-container | 20,745 | 20,750 | 20,013 |
| Real estate | 12,162 | 11,540 | 11,446 |
| **Total revenue** | 192,574 | 194,985 | 195,170 |
| Operating expenses | 89,132 | 85,895 | 80,264 |
| **Operating income** | $ 103,442 | $ 109,090 | $ 114,906 |

**2018 Revenues, Expenses and Changes in Net Position versus the Prior Year**

Container business revenue decreased $3.0 million as container revenues were down $4.0 million primarily due to the APM Terminal lease termination payment in the prior year of $5.7 million. The new shipping alliances that were formed in 2017 continued to shift cargo from the South Harbor to the North Harbor and Canada, increasing Terminal 18 revenue by $2.6 million and decreasing revenues at East Sitcum and Husky terminals by $1.0 million. The shifting of cargo also decreased intermodal revenue by $0.7 million at the north intermodal yard in the South Harbor.

Breakbulk revenues were up $0.5 million as the mix of higher weight cargo increased revenue based on tonnage. Auto revenues were down $0.4 million due to a 4 percent decrease in auto units as Kia shifted production from Asia to Mexico.

Real estate revenue was up $0.6 million over the prior year due to short-term rents at Terminal 5 of $0.2 million, and multiple other locations had increased rent revenue due to escalations.

Operating expense of $89.1 million increased $3.2 million over the prior year. Depreciation expense increased by $4.1 million as a result of new asset additions and operating expenses were up by $1.1 million for Terminal 46 apron and crane rail design. These increases were offset by lower variable intermodal operating costs (longshore labor, equipment expense) of $1.3 million at the north intermodal yard due to container cargo shifting to the North Harbor and Canada and a decrease of $1.0 million from the 2017 extended gate program that was initiated to improve truck turn times and mitigate traffic congestion.

Non-operating income in 2018 was $4.2 million more than the prior year primarily due to the contributed stormwater improvement asset of $3.1 million at Terminal 18. Interest income and an adjustment in fair value of investments of $0.7 million was up $0.3 million versus 2017 due to the rising interest rate environment.

Capital grant contributions from the TIGER grant were $3.8 million in 2018 and $0.3 million in 2017.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

### 2017 Revenues, Expenses and Changes in Net Position versus the Prior Year

Container revenue of $162.7 million was down $1.0 million versus the prior year. Rent revenue at Terminal 5 was down $5.4 million due to the expiration of a lease with Foss Maritime. The Grand Alliance also did not renew its lease at Washington United Terminal and the cargo was diverted from Washington United Terminal and Pierce County Terminal to Husky Terminal and Terminal 18 (T18). Husky Terminal benefited from this shift of cargo as it increased their crane and strad revenue $2.9 million over the prior year. However, expiration of the lease at East Sitcum Terminal offset the increase at Husky by $2.0 million versus the prior year. In 2017, the inland point intermodal cargo handled at NWSA trended down, while local cargo transported via truck increased which reduced intermodal volume and revenue. The lease expirations at East Sitcum Terminal and at Washington United Terminal shifted cargo to Husky Terminal and to Terminal 18 and resulted in an intermodal revenue reduction of $3.9 million over the previous year.

These were offset by positive variances of $5.7 million at West Sitcum terminal, for the payment that became due as a result of APM exercising its early termination option and a $1.0 million annual rental adjustment at Terminal 18.

Non-container revenue of $20.8 million was up $0.7 million versus the prior year. Breakbulk revenue was up $1.2 million due to military moves which were offset by auto business revenues down $0.4 million as volumes decreased by 11 percent due to an automobile customer shifting production to Mexico from Asia, resulting in lower storage revenue.

Real estate revenue of $11.5 million was up $0.1 million for annual rent escalations.

Operating expense of $85.9 million was up $5.6 million and 7.0 percent compared to the prior year. Maintenance costs increased $2.6 million primarily for facility improvements to buildings and paving of $1.5 million and increased crane and strad repairs of $0.8 million. Depreciation expense was up $1.6 million over the prior year for assets (container crane upgrades, building and roof renovations, rail, and yard improvements) placed into service in 2016 and 2017. Administrative expenses were up $1.2 million as consulting costs were up $0.9 million for IT system development to replace older systems and governmental affairs consulting that was recorded in the home ports in the prior year. Operations expenses were up $0.4 million primarily due to revenue-related operating expenses to support non-container revenue that increased by $0.7 million, offset by North Harbor maintenance dredging down $0.5 million from the prior year. Environmental expense was down $0.4 million versus the prior year due to dredging-related environmental costs of $0.9 million in the North Harbor in 2016, offset by environmental project spending up $0.5 million compared with the prior year.

This resulted in operating income of $109.1 million compared to prior year operating income of $114.9 million, a decrease of $5.8 million.

**Non-Operating Income**

Net non-operating income increased $4.2 million over the prior year from contribution income of $3.1 million for the tenant's contribution to stormwater improvements in the North Harbor and higher interest income.

Non-operating income in 2017 was $7.8 million less than the prior year primarily due to the contributed stormwater improvement asset of $7.8 million in 2016. Interest income and an adjustment in fair value of investments of $0.7 million was up $0.3 million versus 2016 due to the rising interest rate environment.

Capital grant contributions were $0.3 million in 2017 from the TIGER grant that is funding improvements on Terminal 46 in the North Harbor.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

### Net Position

The net position reflects the investments received from the home ports, and the NWSA's earnings and distributions to Managing Members. The net position is presented as follows (dollars in thousands):

| Description | 2017 | 2018 Activity | 2018 |
|---|---|---|---|
| Working capital contributions | $ 51,000 | $ - | $ 51,000 |
| Capital construction contributions | 125,260 | 83,326 | 208,586 |
| Non-cash capital work-in-process contributions | 16,793 | - | 16,793 |
| **Total contributions** | 193,053 | 83,326 | 276,379 |
| Increase in net position before Managing Members contributions and distributions | 233,019 | 111,985 | 345,004 |
| Distributions to Managing Members | (218,544) | (118,840) | (337,384) |
| **Net position, end of year** | $ 207,528 | $ 76,471 | $ 283,999 |

**Capital assets:** The home ports provided NWSA with initial funding of $27.0 million to support a five-year capital investment plan in 2016. Additional capital construction contributions to support the capital investment plan are reviewed at least annually as part of the budget process or may occur during the year when major projects are authorized by the Managing Members. The investments in capital assets, also referred to as post-formation assets, may include buildings, improvements, machinery and equipment, and construction in process. The Charter restricts the purchase of land.

During 2018, capital construction contributions from the home ports amounted to $83.3 million with major projects presented in the following table (dollars in thousands):

| | |
|---|---|
| Pier 4 redevelopment and container cranes | $ 51,211 |
| North and South Harbor terminal stormwater improvements | 15,041 |
| Terminal 46 dock rehabilitation | 8,028 |
| Container straddle carriers | 3,080 |
| Marine terminal dock fender replacements | 1,657 |
| Air quality systems infrastructure | 1,389 |
| Terminals 5 and 18 dock rehabilitation design and improvements | 1,255 |
| | $ 81,661 |

During 2016 and 2017, the Managing Members authorized additional capital construction contributions for redevelopment of Pier 4 and the backlands, improvements to the gate, and a total of eight cranes to support an amended terminal lease agreement in the South Harbor. The total estimated project costs for this terminal are $255.0 million of which $149.3 million has been spent through 2018 with project completion expected in 2020. Home port capital construction contributions during 2017 and 2016 were $69.1 million and $56.1 million, respectively, of which $98.1 million funded Pier 4 construction and container cranes and $27.1 million funded building, facility and stormwater improvements.

The NWSA's investment in capital assets, net of depreciation, for its business activities as of December 31, 2018, 2017 and 2016, amounted to $234.2 million, $152.2 million and $80.5 million, respectively. This investment in capital assets includes building and land improvements, machinery and equipment, and construction in process. See Note 3 for additional information.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Concluded)

## REQUEST FOR INFORMATION

The Northwest Seaport Alliance designed this financial report to provide our citizens, customers, investors and creditors with an overview of the NWSA's finances. If you have questions or need additional information please visit our website at http://www.nwseaportalliance.com or contact: Chief Financial Officer, P.O. Box 2985, Tacoma, Washington, 98401-2985, Telephone 800-657-9808.

# Financial Statements

**The Northwest Seaport Alliance**

**Statements of Net Position**
**December 31, 2018 and 2017**
**(Dollars in Thousands)**

| | | 2018 | | 2017 |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ | 10,261 | $ | 7,134 |
| Investments, at fair value | | 53,807 | | 60,225 |
| Trade accounts receivable, net of allowance for doubtful accounts | | 14,448 | | 21,555 |
| Related-party receivable - Managing Members | | 10,696 | | 9,028 |
| Prepayments and other current assets | | 2,736 | | 2,861 |
| **Total current assets** | | 91,948 | | 100,803 |
| Non-current assets: | | | | |
| Long-term investments: | | | | |
| Restricted investments, at fair value | | 13,369 | | 12,535 |
| **Long-term investments** | | 13,369 | | 12,535 |
| Capital assets: | | | | |
| Buildings | | 11,637 | | 4,991 |
| Improvements | | 125,810 | | 17,553 |
| Machinery and equipment | | 55,604 | | 2,832 |
| Construction in process | | 50,203 | | 129,564 |
| **Total cost** | | 243,254 | | 154,940 |
| Less accumulated depreciation | | 9,019 | | 2,712 |
| **Net capital assets** | | 234,235 | | 152,228 |
| Other assets | | 2,600 | | 3,025 |
| **Total noncurrent assets** | | 250,204 | | 167,788 |
| **Total assets** | $ | 342,152 | $ | 268,591 |
| Deferred outflows of resources | | | | |
| **Pension deferred outflows** | $ | 1,652 | $ | 481 |

See notes to financial statements.

**The Northwest Seaport Alliance**

**Statements of Net Position**
**December 31, 2018 and 2017**
**(Dollars in Thousands)**

| | 2018 | 2017 |
|---|---|---|
| **Liabilities and Net Position** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | $ 26,597 | $ 19,024 |
| Related-party payable - Managing Members | 8,833 | 21,391 |
| Payroll and taxes payable | 1,407 | 1,138 |
| **Total current liabilities** | 36,837 | 41,553 |
| Noncurrent liabilities: | | |
| Security deposits | 14,415 | 13,619 |
| Net pension liability | 3,059 | 2,123 |
| Other noncurrent liabilities | 4,236 | 3,900 |
| **Total noncurrent liabilities** | 21,710 | 19,642 |
| **Total liabilities** | $ 58,547 | $ 61,195 |
| Deferred inflows of resources | | |
| **Pension deferred inflows** | $ 1,258 | $ 349 |
| Net position: | | |
| Net investment in capital assets | $ 234,235 | $ 152,228 |
| Unrestricted | 49,764 | 55,300 |
| **Total net position** | $ 283,999 | $ 207,528 |

See notes to financial statements.

**The Northwest Seaport Alliance**

**Statements of Revenues, Expenses and Changes in Net Position**
**Years Ended December 31, 2018 and 2017**
**(Dollars in Thousands)**

| | 2018 | 2017 |
|---|---|---|
| Operating revenues: | | |
| Property rentals | $ 192,574 | $ 194,985 |
| **Total operating revenues** | 192,574 | 194,985 |
| Operating expenses: | | |
| Operations | 41,298 | 40,800 |
| Maintenance | 15,786 | 17,329 |
| Administration | 19,283 | 19,560 |
| Security | 4,306 | 4,235 |
| Environmental | 2,154 | 1,791 |
| **Total before depreciation** | 82,827 | 83,715 |
| Depreciation | 6,305 | 2,180 |
| **Total operating expenses** | 89,132 | 85,895 |
| **Operating income** | 103,442 | 109,090 |
| Non-operating revenues (expenses): | | |
| Interest income | 1,254 | 777 |
| Net increase (decrease) in the fair value of investments | 23 | (43) |
| Other non-operating income (expense), net | 3,361 | (297) |
| **Total non-operating revenues, net** | 4,638 | 437 |
| **Increase in net position, before capital contributions** | 108,080 | 109,527 |
| Capital grant contributions | 3,905 | 324 |
| **Increase in net position before Managing Members contributions and distributions** | 111,985 | 109,851 |
| Capital construction contributions | 83,326 | 69,120 |
| Distributions to Managing Members | (118,840) | (102,580) |
| **Total Managing Members investment** | (35,514) | (33,460) |
| Beginning of year, net position | 207,528 | 131,137 |
| **Net position, end of year** | $ 283,999 | $ 207,528 |

See notes to financial statements.

**The Northwest Seaport Alliance**

**Statements of Cash Flows**
**Years Ended December 31, 2018 and 2017**
**(Dollars in Thousands)**

| | 2018 | 2017 |
|---|---|---|
| Cash flows from operating activities: | | |
| Cash received from customers | $ 200,183 | $ 184,104 |
| Cash paid to suppliers, longshore labor and employees | (43,088) | (49,644) |
| Cash paid to home ports for support services | (38,252) | (35,779) |
| Cash held for customer deposits | 796 | 3,864 |
| **Net cash provided by operating activities** | 119,639 | 102,545 |
| Cash flows from non-capital financing activities: | | |
| Cash distributions to Managing Members | (121,400) | (113,320) |
| **Net cash used in non-capital financing activities** | (121,400) | (113,320) |
| Cash flows from capital and related financing activities: | | |
| Cash received from Managing Members for capital construction | 85,435 | 75,678 |
| Acquisition and construction of capital assets | (87,590) | (76,624) |
| Cash received from federal grants | 155 | 112 |
| **Net cash used in capital and related financing activities** | (2,000) | (834) |
| Cash flows from investing activities: | | |
| Purchases of investments | (96,841) | (65,142) |
| Proceeds from sales and maturities of investment securities | 102,500 | 61,300 |
| Interest received on investments | 1,229 | 767 |
| **Net cash provided by (used in) investing activities** | 6,888 | (3,075) |
| **Net increase (decrease) in cash** | 3,127 | (14,684) |
| Cash and cash equivalents: | | |
| Beginning of year | 7,134 | 21,818 |
| End of year | $ 10,261 | $ 7,134 |

(Continued)

**The Northwest Seaport Alliance**

**Statements of Cash Flows (Continued)**
**Years Ended December 31, 2018 and 2017**
**(Dollars in Thousands)**

| | 2018 | 2017 |
|---|---|---|
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | $ 103,442 | $ 109,090 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Non-operating income (expense) | 731 | (249) |
| Depreciation | 6,305 | 2,180 |
| Changes in assets and liabilities: | | |
| Decrease (increase) in trade accounts receivable | 7,527 | (10,024) |
| Decrease (increase) in prepayments and other current assets | 126 | (622) |
| Increase in accounts payable and accrued liabilities | 3,594 | 4,627 |
| Decrease in related-party payable - Managing Members | (3,814) | (7,700) |
| Increase in security deposits | 812 | 3,175 |
| Increase in payroll and taxes payable | 242 | 77 |
| Increase in pension related accounts | 674 | 1,991 |
| **Total adjustments and changes** | 16,197 | (6,545) |
| **Net cash provided by operating activities** | $ 119,639 | $ 102,545 |
| Non-cash investing and financing activities: | | |
| Capital asset additions and other purchases financed with accounts payable | $ 866 | $ 4,739 |
| Contributions receivable from Managing Members for capital construction | $ 6,919 | $ 9,028 |
| Distributions payable to Managing Members | $ (7,580) | $ (10,140) |
| Increase (decrease) in fair value of investments | $ 23 | $ (43) |

See notes to financial statements.

## Note 1. Summary of Significant Accounting Policies

**Reporting entity:** The ports of Seattle and Tacoma formed The Northwest Seaport Alliance (NWSA), a special purpose governmental entity established as a Port Development Authority (PDA), with an effective date of August 4, 2015 (the Effective Date). The PDA was formed pursuant to a provision in Title 53 Revised Code of Washington (RCW) that grants ports that meet certain criteria the authority to create a separate PDA, similar to public development authorities created by Washington cities and counties. Each Port Commission is a Managing Member of the NWSA. Each port will remain a separate legal entity, independently governed by its own elected commissioners. As formed, the NWSA is to continue for an indefinite term until dissolution. As approved, the Charter for the NWSA may be amended only by mutual agreement of both ports as the NWSA's Managing Members. On January 1, 2016, the NWSA became a separate legal entity.

The State Legislature granted qualifying ports the authority to create a PDA for the management of maritime activities and to allow ports to act cooperatively and use financial resources strategically, while remaining separate entities and complying with federal regulations. Pursuant to the PDA statute, if a PDA is created jointly by more than one port district, the PDA must be managed by each port district as a member, in accordance with the terms of the statute and the Charter. Any port district that creates a PDA must oversee the affairs, operations, and funds of the PDA to correct any deficiency, and ensure the purposes of each program undertaken are reasonably accomplished. The statute permits a PDA, in managing maritime activities of a port district or districts, to own and sell real and personal property; to enter into contracts, to sue and be sued; to loan and borrow funds; to issue bonds, notes, and other evidences of indebtedness; to transfer funds, real or personal property, property interests, or services; and to perform community services related to maritime activities managed by the PDA. As previously discussed, the statute allows, but the Charter prohibits, the NWSA to issue bonds, borrow funds, or enter into other debt instruments. By statute, PDAs do not have the power of eminent domain or the power to levy taxes or special assessments. In transferring real property to a PDA, the port district or districts creating the PDA must impose appropriate deed restrictions necessary to ensure the continued use of the property for the public purpose for which the property is transferred.

The NWSA is governed by its Managing Members, with each Managing Member acting pursuant to the Charter through its elected commissioners. The Managing Members appointed a Chief Executive Officer who is responsible for staffing and day-to-day operations. In addition, both Managing Members provide services through support service agreements with a portion of staff time allocated to and reimbursed by the NWSA.

Effective January 1, 2016, the revenues and expenses associated with Licensed Properties were accounted for and reported by the NWSA. The home ports agreed to share investments, earnings and distributions on a 50/50 basis. The home ports initial contribution of Licensed Properties to the NWSA was 50 percent (based on the value of the contributed facilities using cash flow forecasts for each parcel that went to the NWSA). The initial cash investment totaling $78 million, of which $51 million funded working capital and $27 million funded capital construction projects, were shared equally. The home ports contributed an additional $16.8 million of non-cash work in process capital projects that started in the home ports and will be completed by NWSA for an opening investment of $94.8 million.

### Note 1. Summary of Significant Accounting Policies (Continued)

The NWSA distributes cash to each home port based on cash flow from operations, calculated pursuant to generally accepted accounting principles (GAAP). Distributions are to be made no less than quarterly based on each Managing Member's percentage of total shares; however, distributions have generally been made in the following month after the amount due was determined. Additional information about the formation of the NWSA is presented in the MD&A.

**Nature of business:** The PDA is used to account for the general operations of the NWSA as more fully described below.

The NWSA is authorized by Washington law to provide and charge rentals, tariffs and other fees for docks, wharves and similar harbor facilities, including associated storage and traffic handling facilities, for waterborne commerce. The NWSA may also provide freight and passenger terminals and transfer and storage facilities for other modes of transportation, including air, rail and motor vehicles.

**Measurement focus, basis of accounting and presentation:** The financial statements of the NWSA have been prepared in conformity with accounting principles generally accepted in the United States of America, as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The NWSA is accounted for on a flow of economic resources measurement focus and the full-accrual basis of accounting where revenues are recognized when earned and expenses are recognized when incurred, regardless of the timing of the related cash flows.

The accounting records of the NWSA are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09, RCW. The NWSA also follows the Uniform System of Accounts for Port Districts in the State of Washington.

**Use of estimates:** The preparation of 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. Significant estimates also affect the reported amounts of revenues and expenses during the reporting period. Significant estimates made by the NWSA include depreciation, pension related accounts, investments and the allocation of expenses from each home port. Actual results could differ from those estimates.

**Significant risks and uncertainties:** The NWSA 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, federal, state and local government regulations, and changes in law.

The formation of the NWSA is intended to reduce pricing competition between the home ports by creating a unified gateway, to allow for coordination regarding customer relationships, to improve capacity utilization between the home ports, and to rationalize strategic capital investments. The formation of the NWSA may or may not successfully address these risks, and may create new risks, including the risks associated with a new joint venture funded by the Managing Members with equal Membership Interests, and reliance on the financial strength of the home ports to fund future capital expenditures and shortfall in working capital.

## Note 1. Summary of Significant Accounting Policies (Continued)

The Charter requires that the NWSA maintain the Bond Income Calculation and not to take any action that would reasonably reduce its income below this minimum net operating income level unless each Managing Member votes separately to approve that action. This minimum net operating level was established based on the amount required at formation of the NWSA for the Managing Members to meet their then current bond rate covenants, and may not always reflect the amount required to meet bond rate covenants on a go-forward basis.

If net operating income before depreciation of the NWSA is not sufficient for either home port to be in compliance with a rate covenant (as described in each Managing Member's governing bond resolutions in effect as of the Effective Date), then: (i) upon that Managing Member's request, the NWSA shall hire an independent third-party consultant to perform analysis and make recommendations for actions needed to achieve bond covenant compliance; (ii) if the consultant recommends an action that the NWSA is unwilling, unable or refuses to undertake, either Managing Member can require dissolution of the NWSA following the dispute resolution process even if within the "Initial Period" (as defined in the Charter, "the expiration of 20 years following the NWSA's formation"); and (iii) the NWSA shall have at least four months to respond, act and or dissolve following its receipt of the consultant's recommended action, unless a shorter time is required by the applicable bond covenants.

The NWSA selected as its Chief Executive Officer, the Chief Executive Officer of the Port of Tacoma, who may serve in those dual roles for up to five years.

**Cash:** Cash represents cash and demand deposits. The NWSA maintains its cash in bank deposit accounts, which are covered by the Public Deposit Protection Commission of the State of Washington.

**Trade accounts receivable:** Trade accounts receivable are carried at original invoice amount less an estimate made for doubtful accounts based on a review of all outstanding amounts. Management determines the allowance for doubtful accounts by identifying delinquent accounts and by using historical experience applied to an aging of accounts. Trade accounts receivable are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received. The allowance for doubtful accounts at December 31, 2018 and 2017, was \$3.5 million and \$2.4 million, respectively.

**Investments:** Investments are stated at fair value which is the price that would be received in an orderly transaction between market participants at the measurement date. The NWSA also has investments in the state Local Government Investment Pool (LGIP). The LGIP is similar to a money market fund recognized by the Securities and Exchange Commission. The LGIP invests in U.S. Agency Securities, Repurchase Agreements, U.S. Treasury Securities, Interest Bearing Bank Deposits, and Certificates of Deposit. The investments are limited to high-quality obligations with limited maximum and average maturities. These investments are valued at amortized cost. Interest income on investments is recognized as earned. Interest income and changes in the fair value of investments are recognized on the statements of revenues, expenses and changes in net position. The NWSA's general policy is to not hold more than 20 percent of its holdings in any one investment. See Note 2 for further information.

**Capital assets and depreciation:** Capital assets are recorded at cost. Donated assets are recorded at acquisition value on the date donated.

## Note 1. Summary of Significant Accounting Policies (Continued)

The NWSA's policy is to capitalize all asset additions greater than $20,000 and with an estimated life of more than three years. Depreciation is computed on the straight-line method. The following lives are used:

| | Years |
|---|---|
| Buildings and improvements | 10-75 |
| Machinery and equipment | 3-20 |

Preliminary costs incurred for proposed projects are reported as construction in process on the statements of net position during the period of construction. As projects are constructed, the project costs are transferred to the appropriate capital asset accounts; charges that relate to abandoned projects are expensed when the project is abandoned.

**Net position:** Net position consists of net investment in capital assets, restricted and unrestricted net position. Net investment in capital assets consists of capital assets, net of accumulated depreciation which was $234.2 million and $152.2 million at December 31, 2018 and 2017, respectively. Net position is reported as restricted when there are limitations imposed on its use either through the enabling legislation adopted by the NWSA or through external restrictions imposed by creditors, grantors, laws or regulations of other governments. There were no restrictions on net position at December 31, 2018 and 2017. The unrestricted component of net position is the net amount of the assets less liabilities that are not included in the determination of net investment in capital assets or the restricted components of net position. Unrestricted net position was $49.8 million and $55.3 million at December 31, 2018 and 2017, respectively.

**Retentions payable:** The NWSA enters into construction contracts that may include retention provisions such that a certain percentage of the contract amount is held for payment until completion of the contract and acceptance by the NWSA. The NWSA's policy is to pay the retention due only after completion and acceptance have occurred. Retentions payable totaled $219,000 and $130,000 at December 31, 2018 and 2017, respectively. Retentions payable are included in accounts payable and accrued liabilities on the accompanying statements of net position.

**Federal and state grants:** The NWSA may receive federal and state grants as reimbursement for construction of facilities and other capital projects. These grants are included in capital grant contributions on the accompanying statements of revenues, expenses and changes in net position.

**Employee benefits:** The NWSA accrues unpaid vacation and sick leave benefit amounts as earned and payable upon termination. These benefits are accrued at current rates of compensation. Accrued vacation and sick leave are included in payroll and taxes payable and amounted to $405,000 and $198,000, respectively, at December 31, 2018, and $398,000 and $195,000, respectively, at December 31, 2017. Vacation and sick leave paid in 2018 were $363,000 and $222,000, respectively, and $345,000 and $185,000, respectively, in 2017. The estimated total amount of vacation and sick leave expected to be paid in 2019 is $405,000 and $198,000, respectively. Vacation benefits allow for a maximum hours accrual of two years of benefit and the benefit balance is paid out upon termination. Sick leave benefits allow for a maximum of 120 hours to accrue each year and hours over 240 are cashed out annually and the balance is paid out upon termination.

## Note 1. Summary of Significant Accounting Policies (Continued)

The NWSA provides health care benefits for eligible employees through the voluntary employees' beneficiary association (VEBA) which is a tax-exempt health and welfare trust and through the health reimbursement arrangement (HRA) plan. The NWSA employees were grandfathered into the plan because of their prior employment with the home ports (plan closed to employees hired after April 1, 2013). The plan requires the NWSA to contribute $229 and $222 per month in 2018 and 2017, respectively, to the VEBA accounts of eligible employees. The NWSA contributed $81,000 and $82,000 to eligible employee VEBA accounts in 2018 and 2017, respectively.

The NWSA offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all NWSA employees, permits them to defer a portion of their salary until future years. In accordance with GASB authoritative guidance, accounting and reporting for Internal Revenue Code Section 457 deferred compensation plans, employee assets are not reflected in the NWSA's financial statements. This plan is fully funded and held in an external trust.

**Pensions:** The NWSA's full-time and qualifying part-time employees participate in the cost-sharing, multiple-employer public employee defined benefit retirement plans administered by the Washington State Department of Retirement Systems (DRS). On January 1, 2017, the NWSA established a separate account with DRS and recorded its share of the DRS pension liability. In 2016, the NWSA employees were on the Port of Tacoma DRS account and the NWSA made all required contributions directly to DRS for its employees.

The net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, pension expense, information about the fiduciary net position of the Washington State Department of Retirement Systems Plan (PERS) and additions to/deductions from PERS's fiduciary net position have been determined on the same basis as they are reported to PERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value (see Note 6).

**Environmental remediation costs:** The NWSA environmental remediation policy requires accrual of pollution remediation obligation amounts when: (a) one of the following specific obligating events is met and (b) the amount can be reasonably estimated. Obligating events include: imminent endangerment to the public; permit violation; NWSA named as party responsible for sharing costs; NWSA named in a lawsuit to compel participation in pollution remediation; or commenced or legally obligated to commence pollution remediation. Potential cost recoveries such as insurance proceeds, if any, are evaluated separately from the NWSA's pollution remediation obligation. Costs incurred for pollution remediation obligations are typically recorded as non-operating environmental expenses unless the expenditures relate to the NWSA's principal ongoing operations, in which case they are recorded as operating expenses. Costs incurred for pollution remediation obligations can be capitalized if they meet specific criteria. Capitalization criteria include: preparation of property in anticipation of a sale; preparation of property for use if the property was acquired with known or suspected pollution that was expected to be remediated; performance of pollution remediation that restores a pollution-caused decline in service utility that was recognized as an asset impairment; or acquisition of property, plant and equipment that have a future alternative use not associated with pollution remediation efforts.

The NWSA licenses property from the home ports for its operations. Remediation costs associated with contamination on Licensed Properties that occurred before the formation of the NWSA shall remain the responsibility of the home port in which the Licensed Property is located. Remediation costs associated with redevelopment on Licensed Properties shall be the responsibility of the NWSA. At December 31, 2018 and 2017, the NWSA determined that there was no environmental remediation liability to be recognized.

## Note 1. Summary of Significant Accounting Policies (Concluded)

**Lease securities:** Under the terms of certain Licensed Property lease agreements, the NWSA's customers or tenants are required to provide security in the event of delinquencies in rent payment, default, or other events defined in these agreements. The security amounts are determined by lease terms. The NWSA held $14.4 million and $13.6 million in lease securities at December 31, 2018 and 2017, respectively.

**Operating and non-operating revenues and expenses:** Property rental revenues are charges for use of the NWSA's facilities and are reported as operating revenue. Other revenues generated from non-operating sources are classified as non-operating.

Operating expenses are costs primarily related to the property rental activities. Interest expense and other expenses incurred not related to the operations of the NWSA's terminal and property rental activities are classified as non-operating.

**Recent accounting pronouncements:** In January 2017, the GASB issued Statement No. 84, *Fiduciary Activities.* The objective of this statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported and this statement establishes criteria for identifying fiduciary activities of all state and local governments. The requirements of this statement are effective for reporting periods beginning after December 15, 2018. The NWSA is currently evaluating the effect of the adoption of this standard on its financial statements and related disclosures.

In May 2017, GASB issued Statement No. 87, *Leases*. The objective of this statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. The requirements of this statement are effective for reporting periods beginning after December 15, 2019. The NWSA is currently evaluating the effect of the adoption of this standard on its financial statements and related disclosures.

In August 2018, GASB issued Statement No.90, *Majority Equity Interests – an Amendment of GASB Statements No. 14 and No. 61.* The primary objectives of this statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. The requirements of this statement are effective for reporting periods beginning after June 15, 2018. The NWSA is currently evaluating the effect of the adoption of this standard on its financial statements and related disclosures.

**Recent accounting pronouncement, adopted:** In March 2017, GASB issued Statement No. 85, *Omnibus 2017*. The objective of this statement is to address practice issues that have been identified during implementation and application of certain GASB statements. The requirements of this statement are effective for reporting periods beginning after June 15, 2017. The adoption of this standard in the current year did not have an effect on the financial statements and related disclosures.

## Note 2. Deposits and Investments

**Discretionary deposits:** The NWSA's cash of $10.3 million and $7.1 million at December 31, 2018 and 2017, respectively, were deposited in qualified depositories as required by state statute. Deposits in excess of federal depository insurance coverage are covered by the Public Deposit Protection Commission of the State of Washington (PDPC). The PDPC is a statutory authority under Chapter 39.58 RCW. Currently, all public depositories with the state fully collateralize uninsured public deposits at 50 percent.

**Investments:** State of Washington statutes authorize the NWSA to invest in direct obligations of the U.S. Government, certificates of deposit, bankers' acceptances, repurchase agreements, commercial paper, supranationals and certain municipal bonds. These investments must be placed with or through qualified public depositories of the State of Washington.

**Risks:**

***Interest rate risk:*** Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The NWSA's investment guideline is to maximize investment return while preserving liquidity. To the extent possible, the NWSA will attempt to match its investments with anticipated cash flow requirements using the specific-identification method. The NWSA does not have a formal interest rate risk policy.

***Concentration risk:*** Concentration risk is defined as holdings greater than 5 percent as noted in the table below. The NWSA does not have a formal concentration risk policy.

***Credit risk:*** Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The local government investment pool (LGIP) is an external investment pool, as defined by the GASB. The NWSA does not have a formal credit risk policy.

***Custodial credit risk:*** Custodial credit risk is the risk that, in the event of the failure of the counterparty, the NWSA will not be able to recover the value of its investments or collateral securities that are in the possession of the outside party. To minimize this risk, the NWSA's policy requires that all security transactions are settled "delivery versus payment." This means that payment is made simultaneously with the receipt of the security. These securities are delivered to the NWSA's safekeeping bank. With the exception of the Washington State LGIP, the NWSA's investment securities are registered, or held by the NWSA or its agent in the NWSA's name. The certificates of deposit are covered by the PDPC. The PDPC is a statutory authority under Chapter 39.58 RCW. The PDPC approves which banks and thrifts can hold state and local government deposits and monitors collateral pledged to secure uninsured public deposits. This secures public treasurers' deposits when they exceed the amount insured by the FDIC by requiring banks and thrifts to pledge securities as collateral.

The LGIP manages a portfolio of securities that meet the maturity, quality, diversification and liquidity requirements set forth by the GASB for external investment pools that elect to measure, for financial reporting purposes, investments at amortized cost. The funds are limited to high quality obligations with regulated maximum and average maturities to minimize both market and credit risk. LGIP participants may contribute and withdraw funds on a daily basis. Participants must inform the Office of the State Treasurer of any contribution or withdrawal over $1 million no later than 9 a.m. on the same day the transaction is made. Contributions or withdrawals for $1 million or less can be requested at any time prior to 10 a.m. on the day of the transaction. However, participants may complete transactions greater than $1 million when notification is made between 9 a.m. and 10 a.m., at the sole discretion of the Office of the State Treasurer. All participants are required to file with the State Treasurer documentation containing the names and titles of the officials authorized to contribute or withdraw funds.

## Note 2. Deposits and Investments (Continued)

Investments and restricted investments for long-term-lease deposit and clean truck program funding on the statements of net position are as follows (dollars in thousands):

| | 2018 | 2017 |
|---|---|---|
| Investments | $ 53,807 | $ 60,225 |
| Restricted investments at fair value | 13,369 | 12,535 |
| Total deposits and investments | $ 67,176 | $ 72,760 |

The tables below identify the types of investments, concentration of investments in any one issuer, and maturities of the NWSA investment portfolio as of December 31, 2018 and 2017 (dollars in thousands):

| | 2018 | | | | |
|---|---|---|---|---|---|
| | | Maturities (in Years) | | | |
| Investment Type | Carrying Value | Less than 1 | 1-3 | More than 3 | Percentage of Total Portfolio |
| Federal Home Loan Bank | $ 11,398 | $ - | $ 8,872 | $ 2,526 | 17.0% |
| Federal National Mortgage Association | 4,961 | 4,961 | - | - | 7.4% |
| Municipal Bonds | 7,711 | - | 3,500 | 4,211 | 11.4% |
| Supranationals | 6,949 | 4,962 | 1,987 | - | 10.3% |
| United States Treasury Bonds | 7,971 | 6,015 | - | 1,956 | 11.9% |
| State Local Investment Pool * | 28,186 | 28,186 | - | - | 42.0% |
| Total investments | $ 67,176 | $ 44,124 | $ 14,359 | $ 8,693 | 100.00% |
| Percentage of total portfolio | | 65.7% | 21.4% | 12.9% | 100.0% |

| | 2017 | | | | |
|---|---|---|---|---|---|
| | | Maturities (in Years) | | | |
| Investment Type | Carrying Value | Less than 1 | 1-3 | More than 3 | Percentage of Total Portfolio |
| Federal Home Loan Bank | $ 8,864 | $ - | $ 4,918 | $ 3,946 | 12.2% |
| Federal National Mortgage Association | 6,952 | 2,000 | 4,952 | - | 9.6% |
| Municipal Bonds | 5,825 | - | 3,538 | 2,287 | 8.0% |
| Supranationals | 1,969 | - | 1,969 | - | 2.7% |
| United States Treasury Bonds | 1,969 | - | - | 1,969 | 2.7% |
| State Local Investment Pool * | 47,181 | 47,181 | - | - | 64.8% |
| Total investments | $ 72,760 | $ 49,181 | $ 15,377 | $ 8,202 | 100.0% |
| Percentage of total portfolio | | 67.6% | 21.1% | 11.3% | 100.0% |

***** Investments in Washington State Local Government Investment Pool. The investments in the pool are valued at the amortized cost of the pool shares.

See Note 10 for information regarding NWSA's fair value measurement of its investments.

## Note 2. Deposits and Investments (Concluded)

The tables below identify the credit risk of the NWSA's Investment portfolio as of December 31, 2018 and 2017 (dollars in thousands):

| | 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Moody's Equivalent Credit Ratings | | | | | | |
| Investment Type | Carrying Value | A1 | Aa3 | Aa2 | Aa1 | Aaa | No Rating |
| Federal Home Loan Bank | $ 11,398 | $ - | $ - | $ - | $ - | $ 11,398 | $ - |
| Federal National Mortgage Association | 4,961 | - | - | - | 4,961 | - | - |
| Municipal Bonds | 7,711 | - | 2,165 | 1,984 | 3,562 | - | - |
| Supranationals | 6,949 | - | - | - | - | 6,949 | - |
| United States Treasury Bonds | 7,971 | - | - | - | - | 7,971 | - |
| State Local Investment Pool * | 28,186 | - | - | - | - | - | 28,186 |
| Total | $ 67,176 | $ - | $ 2,165 | $ 1,984 | $ 8,523 | $ 26,318 | $ 28,186 |

| | 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Moody's Equivalent Credit Ratings | | | | | | |
| Investment Type | Carrying Value | A1 | Aa3 | Aa2 | Aa1 | Aaa | No Rating |
| Federal Home Loan Bank | $ 8,864 | $ - | $ - | $ - | $ - | $ 8,864 | $ - |
| Federal National Mortgage Association | 6,952 | - | - | - | - | 6,952 | - |
| Municipal Bonds | 5,825 | - | 2,286 | 2,006 | 1,533 | - | - |
| Supranationals | 1,969 | - | - | - | - | 1,969 | - |
| United States Treasury Bonds | 1,969 | - | - | - | - | 1,969 | - |
| State Local Investment Pool * | 47,181 | - | - | - | - | - | 47,181 |
| Total | $ 72,760 | $ - | $ 2,286 | $ 2,006 | $ 1,533 | $ 19,754 | $ 47,181 |

***** Investments in Washington State Local Government Investment Pool. The investments in the pool are valued at the amortized cost of the pool shares.

## Note 3. Capital Assets

The following capital asset activity took place during 2018 and 2017 (dollars in thousands):

| | 2018 | | | | |
|---|---|---|---|---|---|
| | Beginning of Year | Additions | Transfers | Retirements and Other | End of Year |
| Capital assets not being depreciated: | | | | | |
| Construction in process | $ 129,564 | $ 80,689 | $ (164,304) | $ 4,254 | $ 50,203 |
| Total capital assets not being depreciated | 129,564 | 80,689 | (164,304) | 4,254 | 50,203 |
| Capital assets being depreciated: | | | | | |
| Buildings | 4,991 | - | 6,646 | - | 11,637 |
| Improvements | 17,553 | 3,094 | 105,163 | - | 125,810 |
| Machinery and equipment | 2,832 | 277 | 52,495 | - | 55,604 |
| Total capital assets being depreciated | 25,376 | 3,371 | 164,304 | - | 193,051 |
| Less accumulated depreciation: | | | | | |
| Buildings | (830) | (852) | - | (2) | (1,684) |
| Improvements | (1,105) | (3,314) | - | - | (4,419) |
| Machinery and equipment | (777) | (2,139) | - | - | (2,916) |
| Total accumulated depreciation | (2,712) | (6,305) | - | (2) | (9,019) |
| Net, capital assets being depreciated | 22,664 | (2,934) | 164,304 | (2) | 184,032 |
| Net, capital assets | $ 152,228 | $ 77,755 | $ - | $ 4,252 | $ 234,235 |

## Note 3. Capital Assets (Concluded)

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Beginning of Year | Additions | Transfers | Retirements and Other | End of Year |
| Capital assets not being depreciated: | | | | | |
| Construction in process | $ 60,722 | $ 68,920 | $ (5,034) | $ 4,956 | $ 129,564 |
| Total capital assets not being depreciated | 60,722 | 68,920 | (5,034) | 4,956 | 129,564 |
| Capital assets being depreciated: | | | | | |
| Buildings | 4,706 | - | 285 | - | 4,991 |
| Improvements | 14,322 | - | 3,231 | - | 17,553 |
| Machinery and equipment | 1,314 | - | 1,518 | - | 2,832 |
| Total capital assets being depreciated | 20,342 | - | 5,034 | - | 25,376 |
| Less accumulated depreciation: | | | | | |
| Buildings | (156) | (674) | - | - | (830) |
| Improvements | (173) | (932) | - | - | (1,105) |
| Machinery and equipment | (203) | (574) | - | - | (777) |
| Total accumulated depreciation | (532) | (2,180) | - | - | (2,712) |
| Net, capital assets being depreciated | 19,810 | (2,180) | 5,034 | - | 22,664 |
| Net, capital assets | $ 80,532 | $ 66,740 | $ - | $ 4,956 | $ 152,228 |

## Note 4. Risk Management

The NWSA is exposed to various risks of loss related to torts; damage to, theft of, and destruction of assets or cargo; natural disasters; and employee injuries. To limit its exposure, the NWSA purchases a variety of insurance policies. For marine general liability, the NWSA purchases $150 million in coverage, subject to a $500,000 deductible. All risk property insurance is purchased by the home ports to include assets owned by the NWSA situated on home port land and the NWSA is listed as a named insured where its interest applies. For details concerning property insurance, please consult the notes to the year-end financial reports for the respective home ports.

The NWSA is self-insured for its regular medical coverage. The liability for unpaid medical claims is included in payroll and taxes payable on the accompanying statements of net position and is expected to be paid in 2019. Excess loss coverage has been purchased through an outside provider to limit individual loss to $110,000. Self-insured claim activity for December 31, 2018, 2017 and 2016, is as follows (dollars in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Claims liability, beginning of year | $ 121 | $ 105 | $ - |
| Claims reserve | 1,308 | 748 | 735 |
| Payments on claims | (1,072) | (732) | (630) |
| Claims liability, end of year | $ 357 | $ 121 | $ 105 |

The NWSA is self-insured for workers' compensation losses. These losses are subject to a $1.25 million self-insured retention as a Named Insured under the Port of Tacoma's excess workers' compensation policy. The estimated liability for workers' compensation is included in payroll and taxes payable on the accompanying statements of net position. At December 31, 2018, the estimated self-insurance liability for workers' compensation was $21,000 and this amount is expected to be paid in 2019. At December 31, 2017, the estimated self-insurance liability for workers' compensation was $22,000. The liability for unpaid claims represents the estimated future indemnity, medical, rehabilitation, and legal costs for all open claims.

Workers' compensation claim activity for December 31, 2018 and 2017, are as follows (dollars in thousands):

| | 2018 | 2017 |
|---|---|---|
| Claims liability, beginning of year | $ 22 | $ - |
| Claims incurred during the year | 71 | 28 |
| Changes in estimate for prior year claims | (8) | - |
| Payments on claims | (64) | (6) |
| Claims liability, end of year | $ 21 | $ 22 |

### Note 5. Lease Commitments

The NWSA leases land, office space and other equipment under operating leases that expire through 2023. Future minimum lease payments under non-cancellable operating leases are as follows (dollars in thousands):

| | | |
|---|---|---|
| Years ending December 31: | | |
| 2019 | $ | 1,282 |
| 2020 | | 1,061 |
| 2021 | | 500 |
| 2022 | | 500 |
| 2023 | | 500 |
| Total minimum payments required | $ | 3,843 |

Total rent expense under non-cancellable operating leases for the year ended December 31, 2018, was $1,227,000.

The NWSA, as a lessor (via licensing agreements with the home ports), leases land and facilities under terms of 1 to 42 years. In addition, some properties are rented on a month-to-month basis. Future minimum rents receivable under non-cancellable operating leases and subleases are as follows (dollars in thousands):

| | | |
|---|---|---|
| Years ending December 31: | | |
| 2019 | $ | 105,491 |
| 2020 | | 102,972 |
| 2021 | | 99,443 |
| 2022 | | 97,050 |
| 2023 | | 97,225 |
| Thereafter | | 1,059,055 |
| Total minimum future rents | $ | 1,561,236 |

Licensed assets of the home ports and NWSA assets held for rental and leasing purposes for the year ended December 31, 2018, are as follows (dollars in thousands):

| | | |
|---|---|---|
| Land | $ | 659,302 |
| Buildings, improvements and equipment, net | | 735,947 |
| Total, net of accumulated depreciation | $ | 1,395,249 |

### Note 6. Pension Plans

The NWSA’s full-time and qualifying part-time employees participate in the cost-sharing, multiple-employer public employee defined benefit retirement plans (PERS) administered by the Washington State Department of Retirement Systems. On January 1, 2017, the NWSA established a separate account with DRS. Prior to January 1, 2017, the NWSA employees remained on the Port of Tacoma payroll and participated in PERS under the Port of Tacoma DRS account. The NWSA made all required contributions directly to DRS prior to 2017.

## Note 6. Pensions (Continued)

Historical trend and other information regarding each plan are presented in the Washington State Department of Retirement Systems comprehensive annual financial report. A copy of this report may be obtained at:

Department of Retirement Systems
Communications Unit
P. O. Box 48380
Olympia, WA 98504-8380
Internet Address: www.drs.wa.gov

**Plan description and benefits:** PERS was established in 1947, and its retirement benefit provisions are contained in Chapters 41.34 and 41.40 RCW. PERS is a cost-sharing, multiple-employer retirement system composed of three separate pension plans for membership purposes. PERS Plan 1 and PERS Plan 2 are defined benefit plans, and PERS Plan 3 is a defined benefit plan with a defined contribution component.

PERS members include elected officials; state employees; employees of the Supreme, Appeals and Superior Courts; employees of the Legislature; employees of district and municipal courts; employees of local governments; and higher education employees not participating in higher education retirement programs (HERPs).

PERS is composed of and reported as three separate plans for accounting purposes: Plan 1, Plan 2/3 and Plan 3. Plan 1 accounts for the defined benefits of Plan 1 members. Plan 2/3 accounts for the defined benefits of Plan 2 members and the defined benefit portion of benefits for Plan 3 members. Plan 3 accounts for the defined contribution portion of benefits for Plan 3 members.

Although members can only be a member of either Plan 2 or Plan 3, the defined benefits of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of Plan 2/3 may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as the terms of the plans define. Therefore, Plan 2/3 is considered a single plan for accounting purposes.

As of June 30, 2018, 398 employers and 772 non-employer contributing entities were participating in PERS Plan 1. The plan is closed to new entrants. PERS 1 members were vested after the completion of five years of eligible service. PERS Plan 1 provides retirement, disability and death benefits. Retirement benefits are calculated using 2 percent of the member's Average Final Compensation (AFC) times the member's years of service. AFC is the average of the member's 24 consecutive highest-paid service credit months. Members are eligible for retirement from active status at any age with at least 30 years of service, at age 55 with at least 25 years of service, or at age 60 with at least five years of service.

PERS Plan 1 retirement benefits are actuarially reduced to reflect the choice of a survivor benefit. Members retiring from inactive status before the age of 65 may also receive actuarially reduced benefits. Other benefits include duty and nonduty disability payments, an optional Cost-of-Living Adjustment (COLA), and a one-time, duty-related death benefit, if found eligible by the Washington State Department of Labor & Industries.

The PERS Plan 1 member contribution rate is established by statute at 6 percent. The employer contribution rate is developed by the Office of the State Actuary (OSA) and includes an administrative expense component that is currently set at 0.18 percent.

**Note 6. Pensions (Continued)**

PERS Plan 2 members are vested after completing five years of eligible service. Plan 3 members are vested in the defined benefit portion of their plan after 10 years of service or after five years of service if 12 months of that service are earned after age 44. PERS Plan 2/3 provides retirement, disability and death benefits. Retirement benefits for Plan 2 are calculated using 2 percent of the member's AFC times the member's years of service. Retirement defined benefits for Plan 3 are calculated using 1 percent of AFC times the member's years of service. AFC is the monthly average of the member's 60 consecutive highest-paid service credit months. PERS Plan 2/3 has no cap on years of service credit.

Members are eligible for retirement with a full benefit at 65 with at least five years of service credit. Retirement before age 65 is considered an early retirement. PERS Plan 2/3 members who have at least 20 years of service credit and are 55 years of age or older are eligible for early retirement with a reduced benefit. The benefit is reduced by a factor that varies according to age for each year before age 65. PERS Plan 2/3 retirement benefits are actuarially reduced to reflect the choice of a survivor benefit. Other PERS Plan 2/3 benefits include duty and nonduty disability payments; a COLA based on the Consumer Price Index, capped at 3 percent annually; and a one-time, duty-related death benefit, if found eligible by the Washington State Department of Labor & Industries.

The PERS Plan 2/3 employer and employee contribution rates are developed by the OSA to fully fund Plan 2 and the defined benefit portion of Plan 3. The Plan 2/3 employer rates include a component to address the PERS Plan 1 unfunded actuarial accrued liability and an administrative expense that is currently set at 0.18 percent.

PERS Plan 3 members are immediately vested in the defined contribution portion of their plan. PERS Plan 3 defined contribution benefits are totally dependent on employee contributions and investment earnings on those contributions. PERS Plan 3 members choose their contribution rate when joining membership and can change rates only when changing employers. As established by Chapter 41.34 RCW, Plan 3 defined contribution rates are set at a minimum of 5 percent and a maximum of 15 percent; members have six rate options to choose from. Employers do not contribute to the defined contribution benefits.

**Contributions:** The required contribution rates, expressed as a percentage of covered payrolls, as of December 31, 2018 and 2017, were:

| | 2018 | | |
|---|---|---|---|
| | PERS Plan 1 | PERS Plan 2 | PERS Plan 3 |
| Employer* | 12.83% | 12.83% | 12.83% |
| Employee | 6.00% | 7.41% | *** |

| | 2017 | | |
|---|---|---|---|
| | PERS Plan 1 | PERS Plan 2 | PERS Plan 3 |
| Employer* | 12.70% | 12.70% | 12.70%** |
| Employee | 6.00% | 7.38% | *** |

* The employer rates include the employer administrative expense fee of 0.18% for 2018 and 2017
** Plan 3 defined benefit portion only
*** Rate selected by PERS 3 members, 5% minimum to 15% maximum

### Note 6. Pensions (Continued)

Both the NWSA and the employees made the required contributions. The NWSA's required contributions for the year ended December 31 is as follows (dollars in thousands):

| | | PERS Plan 1 | | PERS Plan 2/3 | | Total |
|---|---|---|---|---|---|---|
| Years ended December 31: | | | | | | |
| 2018 | $ | 309 | $ | 472 | $ | 781 |
| 2017 | | 286 | | 411 | | 697 |

**Pension liabilities, pension expense, and deferred inflows and outflows of resources related to pensions:** At December 31, 2018 and 2017, the NWSA reported a liability of $3.1 million and $2.1 million, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2018 and 2017, the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The NWSA's proportion of the net pension liability was based on a projection of the NWSA's long-term share of contributions to the pension plan relative to the projected contributions of all participating agencies, actuarially determined. At June 30, 2018, the NWSA's proportionate share of net pension liability and the change in proportionate share from June 30, 2017, is presented in the following table (dollars in thousands):

| | | PERS 1 | | PERS 2/3 | | Total |
|---|---|---|---|---|---|---|
| NWSA's proportionate share of the net pension liability: | | | | | | |
| 2018 | $ | 2,052 | $ | 1,007 | $ | 3,059 |
| 2017 | | 1,093 | | 1,030 | | 2,123 |

| | PERS 1 | PERS 2/3 |
|---|---|---|
| NWSA's proportionate share of the net pension liability: | | |
| 2018 | 0.0459% | 0.0590% |
| 2017 | 0.0230% | 0.0296% |
| Change in proportionate share | 0.0229% | 0.0294% |

| | | PERS 1 | | PERS 2/3 | | Total |
|---|---|---|---|---|---|---|
| NWSA's net pension expense/(benefit): | | | | | | |
| 2018 | $ | 982 | $ | (308) | $ | 674 |
| 2017 | | 987 | | 1,004 | | 1,991 |

## Note 6. Pensions (Continued)

For the year ended December 31, 2018 and 2017, deferred outflows of resources and deferred inflows of resources related to pensions were from the following sources (dollars in thousands):

| | 2018 | | |
|---|---|---|---|
| | PERS 1 | PERS 2/3 | Total |
| Sources of deferred outflow of resources: | | | |
| Net difference between projected and actual earnings on pension plan investments (2) | $ - | $ - | $ - |
| Changes in assumptions (1) | - | 12 | 12 |
| Differences between expected and actual experience (1) | - | 123 | 123 |
| Changes in proportion and differences between NWSA contributions and proprtionate share of contributions (1) | - | 1,111 | 1,111 |
| NWSA contributions subsequent to measurement date | 165 | 241 | 406 |
| Total | $ 165 | $ 1,487 | $ 1,652 |
| Sources of deferred inflow of resources: | | | |
| Net difference between projected and actual earnings on pension plan investments (2) | $ (82) | $ (618) | $ (700) |
| Changes in assumptions (1) | - | (287) | (287) |
| Differences between expected and actual experience (1) | - | (176) | (176) |
| Changes in proportion and differences between NWSA contributions and proportionate share of contributions (1) | - | (95) | (95) |
| Total | $ (82) | $ (1,176) | $ (1,258) |

(1) The recognition period for each plan is equal to the average of the expected remaining service lives of all employees provided with pensions through the pension plan, which was determined at the beginning of the measurement date.
(2) The recognition period is closed, 5-year period for all plans.

**Note 6. Pensions (Continued)**

| | 2017 | | |
|---|---|---|---|
| | PERS 1 | PERS 2/3 | Total |
| Sources of deferred outflow of resources: | | | |
| Net difference between projected and actual earnings on pension plan investments (2) | $ - | $ - | $ - |
| Changes in assumptions (1) | - | 11 | 11 |
| Differences between expected and actual experience (1) | - | 104 | 104 |
| Changes in proportion and differences between NWSA contributions and proprtionate share of contributions (1) | - | - | - |
| NWSA contributions subsequent to measurement date | 147 | 219 | 366 |
| Total | $ 147 | $ 334 | $ 481 |
| Sources of deferred inflow of resources: | | | |
| Net difference between projected and actual earnings on pension plan investments (2) | $ (41) | $ (274) | $ (315) |
| Changes in assumptions (1) | - | - | - |
| Differences between expected and actual experience (1) | - | (34) | (34) |
| Changes in proportion and differences between NWSA contributions and proportionate share of contributions (1) | - | - | - |
| Total | $ (41) | $ (308) | $ (349) |

(1) The recognition period for each plan is equal to the average of the expected remaining service lives of all employees provided with pensions through the pension plan, which was determined at the beginning of the measurement date.
(2) The recognition period is closed, 5-year period for all plans.

As of December 31, 2018, deferred outflows of resources related to pensions resulting from NWSA's contributions subsequent to the measurement date were $406,000 and will be recognized as a reduction of the net pension liability in the year ended December 31, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows (dollars in thousands):

| | PERS 1 | PERS 2/3 | Total |
|---|---|---|---|
| Years ending December 31: | | | |
| 2019 | $ 4 | $ 96 | $ 100 |
| 2020 | (18) | (9) | (27) |
| 2021 | (53) | (181) | (234) |
| 2022 | (15) | 57 | 42 |
| 2023 | - | 145 | 145 |
| Thereafter | - | (38) | (38) |
| Total | $ (82) | $ 70 | $ (12) |

### Note 6. Pensions (Continued)

**Actuarial assumptions:** The 2018 pension liability (TPL) for each of the plans was determined by an actuarial valuation as of June 30, 2017, with the results rolled forward to June 30, 2018. Besides the discount rate, the actuarial assumptions used in the June 30, 2017, valuation were based on the results of the 2007-2012 Experience Study Report and the 2017 Economic Experience Study. Additional assumptions for subsequent events and law changes are current as of the 2017 actuarial valuation report.

The 2017 pension liability (TPL) for each of the plans was determined by an actuarial valuation as of June 30, 2016, with the results rolled forward to June 30, 2017. Besides the discount rate, the actuarial assumptions used in the valuation are summarized in the Actuarial Section of DRS' Comprehensive Annual Financial Report located on the DRS employer-resource GASB webpage. These assumptions reflect the results of OSA's 2007-2012 Experience Study and the 2017 Economic Experience Study.

Additional assumptions for subsequent events and law changes are current as of the 2017 actuarial valuation report are as follows:

***Inflation:*** 2.75 percent total economic inflation; 3.50 percent salary inflation (2017: 3.0 percent for total economic inflation; 3.75 percent for salary inflation).

***Salary increases:*** In addition to the base 3.50 percent salary inflation assumption, salaries are also expected to grow by promotions and longevity (2017: salaries were expected to grow 3.75 percent).

**Mortality rates:** Rates were based on the *RP-2000* reports, "Combined Healthy Table" and "Combined Disabled Table", which the Society of Actuaries publishes. The OSA applied offsets to the base table and recognized future improvements in mortality by projecting the mortality rates using 100 percent Scale BB. Mortality rates are applied on a generational basis, meaning members are assumed to receive additional mortality improvements in each future year throughout their lifetimes.

**Long-term expected rate of return:** For 2018, the OSA selected a 7.40 percent long-term expected rate of return on pension plan investments using a building-block method (2017: 7.5 percent long-term expected rate of return). In selecting this assumption, OSA reviewed the historical experience data, considered the historical conditions that produced past annual investment returns, and considered Capital Market Assumptions (CMA) and simulated expected investment returns the Workplace Safety & Insurance Board (WSIB) provided.

The CMAs contain three pieces of information for each class of assets WSIB currently invests in:

- Expected annual return
- Standard deviation of the annual return
- Correlations between the annual returns of each asset class with every other asset class

The WSIB uses the CMAs and their target asset allocation to simulate future investment returns over various time horizons.

## Note 6. Pensions (Continued)

**Estimated rates of return by asset class:** Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2018, is summarized in the table below.

| Asset Class | Target Allocation | % Long-Term Expected Real Rate of Return Arithmetic |
|---|---|---|
| Fixed income | 20% | 1.70% |
| Tangible assets | 7% | 4.90% |
| Real estate | 18% | 5.80% |
| Global equity | 32% | 6.30% |
| Private equity | 23% | 9.30% |
| | 100% | |

The inflation component used to create the table is 2.20 percent and represents WSIB's most recent long-term estimate of broad economic inflation.

**Discount rate:** The discount rate used to measure the total 2018 pension liability was 7.40 percent for all plans (2017: 7.5 percent). To determine that rate, an asset sufficiency test was completed to test whether each pension plan's fiduciary net position was sufficient to make all projected future benefit payments of current plan members.

Contributions from plan members and employers are assumed to continue being made at contractually required rates (including PERS Plans 2 and 3 employers, whose rates include a component for the PERS Plan 1 liability). Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 7.40 percent (2017: 7.5 percent) was used as the discount rate to determine the total liability.

## Note 6. Pensions (Concluded)

**Sensitivity net pension liability to changes in the discount rate:** The table below presents the net pension liability of employers, calculated using the discount rate of 7.40 percent as well as what employers' net pension liability would be if it were calculated using a discount rate 1 percentage point lower (6.4 percent) or 1 percentage point higher (8.4 percent) than the current rate (dollars in thousands):

| | Pension Trust | 1% Decrease | Discount Rate | 1% Increase |
|---|---|---|---|---|
| December 31, 2018: | | | | |
| Discount rate | | 6.40% | 7.40% | 8.40% |
| Proportionate share of net pension liability | PERS 1 | $ 2,521 | $ 2,052 | $ 1,645 |
| Proportionate share of net pension liability/(asset) | PERS 2/3 | 4,606 | 1,007 | (1,944) |

| | Pension Trust | 1% Decrease | Discount Rate | 1% Increase |
|---|---|---|---|---|
| December 31, 2017: | | | | |
| Discount rate | | 6.50% | 7.50% | 8.50% |
| Proportionate share of net pension liability | PERS 1 | $ 1,332 | $ 1,093 | $ 887 |
| Proportionate share of net pension liability/(asset) | PERS 2/3 | 2,774 | 1,030 | (400) |

Detailed information about the pension plan's fiduciary net position is available in the separately issued DRS financial reports. Additional actuarial and pension plan information is included in the DRS 2017 Comprehensive Annual Financial Report (CAFR), including descriptions of actuarial data, assumptions, methods, and plan provisions relied on for the preparation of GASB 67 and GASB 68. Additional details regarding this information is included in OSA's 2017 Actuarial Valuation Report on the OSA website.

## Note 7. Commitments and Contingencies

**Commitments:** The NWSA has entered into separate contractual agreements for terminal maintenance, infrastructure improvements, environmental projects, and professional services. At December 31, 2018, the remaining commitments on these agreements amounted to $41.4 million.

| Description | Remaining Commitments (Thousands) |
|---|---|
| Terminal projects | $ 39,800 |
| Environmental | 305 |
| Other (including professional services) | 1,315 |
| | $ 41,420 |

During NWSA's start-up period, the Port of Tacoma and the Port of Seattle, acting as agents for the NWSA per support services agreements, issued contracts on behalf of the NWSA. The remaining commitments on these contracts totaled $6,411,000 at December 31, 2018, of which $448,000 are related to contracts issued by the Port of Tacoma and $5,963,000 are related to contracts issued by the Port of Seattle. Both ports will be reimbursed by the NWSA.

The NWSA agreed to purchase support services from both home ports during NWSA's startup and transition period. See Note 9, Related-Party Transactions, for additional information.

## Note 7. Commitments and Contingencies (Concluded)

**Contingencies:** The NWSA is named as a defendant in various lawsuits incidental to carrying out its function. The NWSA believes its ultimate liability, if any, will not be material to the financial statements.

## Note 8. Major Customers

Operating revenues for the year ended December 31, 2018, of $192.6 million included $139.0 million, or 72 percent, of operating revenue from ten customers. The top three customers accounted for 55 percent of operating revenues from the top ten customers, and 40 percent of total operating revenues. Receivables from the ten significant customers totaled $6.7 million, or 46 percent, of total trade receivables at December 31, 2018.

Operating revenues for the year ended December 31, 2017, of $195.0 million included $135.2 million, or 69 percent, of operating revenue from ten customers. The top three customers accounted for 56 percent of operating revenues from the top ten customers, and 39 percent of the total operating revenues. Receivables from the ten significant customers totaled $4.8 million, or 27 percent, of total trade receivables at December 31, 2017.

## Note 9. Related-Party Transactions

As more fully described in the MD&A, Note 1, Summary of Significant Accounting Policies, and Note 7, Commitments and Contingencies, the NWSA entered into licensing agreements with each home port for the exclusive use, operation and management of certain facilities or Licensed Properties. These licensing agreements generated 100 percent of NWSA revenues in 2018 and 2017.

**Support services agreements:** The NWSA entered into support services agreements with the home ports to receive support services during NWSA's start-up and transition period as the NWSA works to set up its back office infrastructure and staff positions. The support services received by the NWSA include finance, human resources, information technology, public affairs, risk management, capital construction and environmental project management and contracting, equipment and facilities maintenance, security, and office infrastructure. Support services charged to the NWSA from the home ports totaled $38.2 million and $38.8 million in 2018 and 2017, respectively. The expenses are included in operating expenses on the accompanying statements of revenues, expenses and changes in net position.

The NWSA entered into support services agreements with the Port of Tacoma to provide the Port of Tacoma executive management, commercial, environmental and planning support services. Support services provided to the Port of Tacoma by NWSA amounted to $1.4 million in 2018 and 2017. The amount of operating expenses on the accompanying statements of revenues, expenses and changes in net position are net of the charges to the Port of Tacoma. The NWSA did not enter into agreements to provide support services to the Port of Seattle.

**Related-party receivable and payable:** The NWSA generally repays the home ports for support services and operating costs incurred as agents for the NWSA, in the following month, after the amount due is determined. At December 31, 2018 and 2017, $1.2 million and $11.3 million, respectively, were payable to the home ports and are presented on the statements of net position as related-party payable - Managing Members.

The NWSA distributes cash flow from operations, calculated pursuant to GAAP to the home ports. Distributions have generally been made in the following month, after the amount due is determined. At December 31, 2018 and 2017, $7.6 million and $10.1 million, respectively, were payable to the home ports and are presented on the statements of net position as related-party payable - Managing Members.

## Note 9. Related-Party Transactions (Concluded)

The home ports generally fund capital contribution requirements in the following month, after the amount due is determined. During 2018 and 2017, home ports contributed $83.3 million and $69.1 million, respectively, of funding for capital construction projects in accordance with the capital investment plan approved by the Managing Members. At December 31, 2018 and 2017, $10.7 million and $9.0 million, respectively, were receivable from the home ports and are presented on the statements of net position as related-party receivable - Managing Members.

The Managing Members also serve as commissioners for their respective home ports. Additionally, the NWSA CEO also serves as the CEO of the Port of Tacoma. The CEO will serve in dual roles until a Port of Tacoma CEO is hired in 2019.

## Note 10. Fair Value Measurements

The NWSA's assets that are measured and reported on a fair value basis are classified and disclosed in one of the following three categories:

**Level 1:** Quoted market prices in active markets for identical assets or liabilities.

**Level 2:** Observable market-based inputs or unobservable inputs that are corroborated by market data.

**Level 3:** Unobservable inputs that are not corroborated by market data.

In determining the appropriate levels, the NWSA performs a detailed analysis of the assets and liabilities that are subject to the guidance. The NWSA's fair value measurements are evaluated by an independent third-party vendor. The third-party vendor uses a variety of methods when pricing these securities that incorporate relevant observable market data to arrive at an estimate of what a buyer in the marketplace would pay for a security under current market conditions. Level 1 inputs are quoted prices in active markets for identical assets assessed at the measurement date. An active market for the asset is a principal market in which transactions for the asset are open to many and occur with sufficient frequency and volume. Level 2 inputs include quoted prices for similar assets in active markets, quoted prices for identical or similar assets in markets where there isn't sufficient activity, and/or where price quotations vary substantially either over time or among market makers (some brokered markets, for example), or in which little information is released publicly. The NWSA does not have any Level 3 assets or liabilities at December 31, 2018 and 2017.

## Note 10. Fair Value Measurements (Concluded)

The tables below present the balances of assets measured at fair value by level within the hierarchy at December 31, 2018 and 2017 (dollars in thousands):

| | Fair Value of Investments as of December 31, 2018 | | |
|---|---|---|---|
| | Level 1 | Level 2 | Total |
| Investments: | | | |
| Federal Home Loan Bank | $ - | $ 11,398 | $ 11,398 |
| Federal National Mortgage Association | - | 4,961 | 4,961 |
| Municipal Bonds | 2,165 | 5,546 | 7,711 |
| Supranational Bonds | - | 6,949 | 6,949 |
| United States Treasury Bonds | 7,971 | - | 7,971 |
| Total investments | $ 10,136 | $ 28,854 | $ 38,990 |

| | Fair Value of Investments as of December 31, 2017 | | |
|---|---|---|---|
| | Level 1 | Level 2 | Total |
| Investments: | | | |
| Federal Home Loan Bank | $ - | $ 8,864 | $ 8,864 |
| Federal National Mortgage Association | 2,000 | 4,952 | 6,952 |
| Municipal Bonds | 2,286 | 3,539 | 5,825 |
| Supranational Bonds | - | 1,969 | 1,969 |
| United States Treasury Bonds | 1,969 | - | 1,969 |
| Total investments | $ 6,255 | $ 19,324 | $ 25,579 |

## Note 11. Subsequent Events

On April 2, 2019, the Managing Members and the Port of Seattle commission authorized the completion of the one-time Membership Interest Affirmation of 50/50 for each home port in satisfaction of the NWSA Charter. In lieu of completing the required reevaluation of Membership Interest, the Port of Seattle agreed to pay up to $32 million additional contribution to the NWSA. This additional contribution was in recognition that certain forecasted revenue streams not secured by long-term contractual agreements in the initial valuation may not be achieved without the redevelopment of Terminal 5. This additional contribution with be made to the NWSA in three installments. The first two installments of $11 million each will be made on or around March 31, 2020 and 2021, respectively. The final installment will be made in 2024 and may be adjusted if the actual redevelopment costs are less than the program authorization. The Managing Members also authorized the distribution of these affirmation payments to the home ports equally after the NWSA receives the funds from the Port of Seattle.

## The Northwest Seaport Alliance

## Required Supplementary Information

### Schedule of The Northwest Seaport Alliance's Share of Net Pension Asset/Liability (NPA/NPL)
### December 31, 2018 and 2017
### (Dollars in Thousands)

| | 2018 | 2017 |
|---|---|---|
| **PERS Plan 1** | | |
| NWSA's proportion of NPL | 0.0459% | 0.0230% |
| NWSA's proportionate share of NPL | $ 2,052 | $ 1,093 |
| NWSA's covered-employee payroll | $ - | $ - |
| NWSA's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll | NA | NA |
| Plan fiduciary net pension position as a percentage of the total pension liability | 63.22% | 61.24% |
| Contractually required contribution | $ 309 | $ 286 |
| Contributions in relation to the contractually required contribution | (326) | (286) |
| Contribution excess | (17) | $ - |
| NWSA's covered-employee payroll | $ - | $ - |
| Contributions as a percentage of covered-employee payroll | 0% | 0% |
| **PERS Plan 2/3** | | |
| NWSA's proportion of NPL | 0.0590% | 0.0296% |
| NWSA's proportionate share of NPL | $ 1,007 | $ 1,030 |
| NWSA's covered-employee payroll | $ 6,151 | $ 5,844 |
| NWSA's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll | 16.4% | 17.6% |
| Plan fiduciary net pension position as a percentage of the total pension liability | 95.8% | 91.0% |
| Contractually required contribution | $ 472 | $ 411 |
| Contributions in relation to the contractually required contribution | (495) | (411) |
| Contribution excess | $ (23) | $ - |
| NWSA's covered-employee payroll | $ 6,440 | $ 5,844 |
| Contributions as a percentage of covered-employee payroll | 7.7% | 7.0% |

(1) Information presented prospectively beginning with December 31, 2017, prior year reported with Port of Tacoma.

**Notes to required supplementary information**

See Note 6 of the financial statements for additional information on the plan.