



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

***Financial Statements for the
Years Ended December 31, 2006 and 2005 and
Independent Auditors' Report***

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STATEMENT OF MANAGEMENT'S RESPONSIBILITY

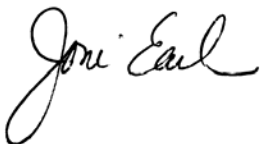
The financial statements of the Central Puget Sound Regional Transit Authority (Sound Transit) have been prepared from the Agency's accounting system in accordance with generally accepted accounting principles. The integrity and objectivity of information in Sound Transit's financial statements, including estimates and judgments, are the responsibility of management.

Sound Transit maintains a system of internal accounting controls designed to provide reasonable assurance as to the integrity and reliability of financial reporting, the safeguarding of assets and the prevention and detection of material errors or fraudulent financial reporting. Monitoring of such systems includes management's responsibility to objectively assess the effectiveness of internal accounting controls and recommend improvements therein.

Limitations exist in any system of internal accounting controls in which the cost of the system being implemented should not exceed the benefits derived. Sound Transit believes that the organization's system does provide reasonable assurance that transactions are executed in accordance with management's general or specific authorizations and is adequate to accomplish the stated objectives.

The independent auditors, whose report is included herein, were engaged to express an opinion on our 2006 financial statements. Their opinion is based on procedures performed in accordance with generally accepted auditing standards, including examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation.

In an attempt to assure objectivity, the financial information contained in this report is subject to review by the Board of Directors.



Joni Earl
Chief Executive Officer



Brian McCartan
Chief Financial Officer



Kelly A. Priestley
Controller

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MANAGEMENT'S DISCUSSION AND ANALYSIS

For the years ended December 31, 2006 and 2005

Management's Discussion and Analysis ("MD&A") presents a narrative overview and analysis of the financial activities of the Agency for the years ended December 31, 2006 and 2005. The MD&A is designed to assist readers of financial statements in focusing on significant financial activities and issues and to identify any significant changes. As this information is presented in summary form, it should be read in conjunction with the financial statements and footnotes as a whole.

Central Puget Sound Regional Transit Authority, a public corporation acting under the service name of Sound Transit, is a regional transit authority implementing and providing a high-capacity transportation system throughout parts of King, Pierce and Snohomish counties through commuter rail ("Sounder"), light rail ("Link") and a regional express bus system ("ST Express"). The implementation of the initial phase of the voter-approved regional transportation system ("*Sound Move*") is scheduled for a 20-year period, ending in 2016. In anticipation of a full funding grant agreement for University Link, this represents an extension of the Ten-Year Regional Transit System Plan previously scheduled to complete in 2009. The agency's activities to date have been concentrated on implementing service in all three transit modes and on the design, environmental review and construction of its capital projects.

Sound Transit's financial statements have reflected a growth in operating revenues and expenses each year, as well as growth in capital projects in progress and property, vehicles and equipment. As the Agency has not reached its full service levels and is in the construction phase on its light rail project, major sources of revenue exceed expenses resulting in a rising net asset position.

Financial Highlights

- Total operating revenues were \$21.5 million for 2006, an increase of 8.2% from the prior year. Passenger fares increased by \$1.6 million from the prior year as a result of large ridership gains on Sounder and ST Express.
- Total operating expenses, excluding depreciation and gains or losses on disposal of assets, were \$107.6 million, an increase of \$9.8 million or 10.0% from the prior year.
 - Operations and maintenance expenses increased by \$8.0 million. This increase reflects the full year impact of service increases on Sounder, a 4% increase in service levels on ST Express, as well as unit cost increases in the price of fuel and labor.
 - General and administrative expenses, after allocations to capital projects and operations and maintenance, increased by \$1.8 million. This reflects a write-off of overhead for the permanent Tukwila Sounder station, the construction of which has been delayed to the next phase of *Sound Move*.
- Non-operating revenues (expenses) were up \$38.7 million from the prior year, reflecting higher tax revenues that increased by \$23.5 million and higher investment income which increased by \$11.2 million, as the economy continues to perform strongly, rising interest rates in 2005 and available cash balances remained high.
- Capital contributions decreased by \$14.8 million, with federal, state and local contributions to Sound Transit increasing by \$2.1 million and the value of transfers to other governments increasing by \$16.9 million.
- Total net assets at December 31, 2006, were \$2.6 billion, an increase of \$302.6 million or 12.9% from 2005. This increase was up from an increase in 2005 of \$285.7 million or 13.9% from 2004. The

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

higher increase in net assets in 2006 from 2005 is a result of higher net non-operating revenues (expenses) less higher contributions to other governments.

- Total capital assets, net of accumulated depreciation, were \$2.9 billion at December 31, 2006, an increase of \$593 million or 26.0% from 2005. The increase in total capital assets reflects an increase in capital projects in progress as construction moves forward on the Link light rail projects, additional land acquisitions for light rail and further progress on the Sounder track and facilities projects. In 2006, \$227.6 million in rail access right expenditures and completed projects were transferred to depreciable assets or expensed as capital contributions to other governments.

Overview of the Financial Statements

Sound Transit's financial statements are prepared in conformity with United States generally accepted accounting principles ("GAAP") as applied to government units. The 2006 financial statements are presented using the economic resource measurement focus and accrual basis of accounting. As Sound Transit comprises a single proprietary fund, no fund level financial statements are shown.

In accordance with GAAP, all revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred. All assets and liabilities associated with the operation of Sound Transit are included in the Balance Sheets, and depreciation of capital assets is recognized in the Statements of Revenues, Expenses and Changes in Net Assets.

The financial statements provide both long-term and short-term information about Sound Transit's overall financial status as well as Sound Transit's net assets, segregated by invested in capital assets (net of related debt), restricted and unrestricted. Net assets are the difference between Sound Transit's assets and liabilities and over time may serve as a useful indicator of Sound Transit's financial position. The financial statements also include notes that provide additional information that is essential to a full understanding of the information provided.

Financial Analysis

Net Assets

Sound Transit's total net assets at December 31, 2006, were \$2.6 billion, an increase of \$302.6 million or 12.9% from 2005 (see Table A-1). Total assets increased \$300.3 million or 8.9% while total liabilities decreased slightly. The increase in total assets reflects capital spending activity. This compares to total net assets of \$2.3 billion at December 31, 2005, which was an increase of \$285.7 million from 2004 that also related to increased capital spending.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

Table A-1

Sound Transit Net Assets

<i>(in millions)</i>	As of December 31,			% Change	
	2006	2005	2004	2006-2005	2005-2004
Current assets, excluding restricted assets	\$ 587.1	\$ 679.5	\$ 550.7	(13.6)	23.4
Restricted assets	142.1	335.3	170.1	(57.6)	97.2
Capital assets	2,870.4	2,277.5	1,773.6	26.0	28.4
Other non-current assets	<u>67.9</u>	<u>74.9</u>	<u>67.4</u>	<u>(9.3)</u>	<u>11.1</u>
Total Assets	3,667.5	3,367.2	2,561.8	8.9	31.4
Current liabilities, excluding interest payable from restricted assets	162.9	155.0	82.6	5.1	87.7
Interest payable from restricted assets	10.5	10.6	7.2	(0.7)	48.0
Long-term debt	779.8	791.2	353.1	(1.4)	124.1
Other long-term liabilities	<u>67.0</u>	<u>65.7</u>	<u>59.9</u>	<u>2.0</u>	<u>9.8</u>
Total Liabilities	1,020.2	1,022.5	502.8	(0.2)	103.3
Net Assets					
Invested in capital assets, net of related debt	2,085.8	1,674.9	1,422.4	24.5	17.8
Restricted net assets	131.6	131.8	162.9	(0.2)	(19.1)
Unrestricted net assets	<u>429.9</u>	<u>538.0</u>	<u>473.7</u>	<u>(20.1)</u>	<u>13.6</u>
Total Net Assets	<u>\$ 2,647.3</u>	<u>\$ 2,344.7</u>	<u>\$ 2,059.0</u>	<u>12.9</u>	<u>13.9</u>

Current assets, excluding restricted assets, decreased in 2006 by 13.6% from 2005. This decrease was substantially due to a decrease in investments of \$175.8 million and decreased receivables of \$18.1 million. Investment balances decreased as the agency funded its construction program. In 2005, current assets increased by 23.4% from 2004, substantially due to increased cash, cash equivalents and investments of \$117.4 million and receivables of \$9.5 million. The increased cash and investment balances in 2005 reflected additional available cash as bond proceeds from the 2005A Sales Tax bond issue were available to fund construction spending.

Restricted assets decreased in 2006 by 57.6% from 2005, as \$201.0 million in proceeds from the 2005 bond issuance were spent in 2006, and payments were made to BNSF for construction out of funds restricted under contractual agreement. In 2005, restricted assets increased by 97.2% from 2004 related to the bond proceeds that were not fully spent down within that year.

Capital assets increased in 2006 by \$592.9 million or 26.0% from 2005, reflecting Sound Transit's ongoing capital program activity as construction progressed on projects. This compares to an increase of \$503.9 million in 2005 from 2004, also a result of progress in the capital program. In 2006, Sound Transit capitalized \$707.2 million (\$586.6 million in 2005) in design, construction, acquisition, interest and general and administrative costs allocated to capital projects in progress. The Central Link light rail project is in full construction, representing \$530.7 million of amounts capitalized in 2006 or 75.0% of total capital spending, while the Sounder and ST Express programs approach completion of several major program elements. In 2005, \$431.2 million for Central Link was capitalized to capital projects in progress or 73.5% of capital spending.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

Transfers out of capital projects in progress were \$235.9 million (\$165.7 million in 2005) as projects were completed and transferred to property, vehicles and equipment or expensed as follows:

<i>(in millions)</i>	2006	2005
Transferred to property, vehicles and equipment	\$ 154.8	\$ 103.5
Expensed to contributions to other governments	72.8	55.9
Transferred to recoverable costs or inventory	-	(1.0)
Write-off of overhead, discontinued and impaired project costs and loss on disposal of assets	8.3	7.3
	<u><u>\$ 235.9</u></u>	<u><u>\$ 165.7</u></u>

There were no discontinued projects in 2006; however, structural cracking related to a design error was identified on the Totem Lake Freeway Station project, and \$5.9 million in costs were considered impaired and were written off. Also written off was \$2.4 million in overhead of which \$1.4 million related to the Tukwila Sounder station, as full build out of the permanent station has been postponed to the second phase of *Sound Move*. In 2005, \$6.3 million in costs were included in discontinued projects that did not have continuing value with the change in alignment for North Link in 2005. Management annually reviews costs incurred to date on all projects and those costs not having continuing value are written-off.

Direct additions to property, vehicles or equipment in 2006 were \$2.2 million, which included \$1.3 million in transit facilities and equipment, \$0.2 million in administrative fleet vehicles, and \$0.7 million in furniture and office equipment. Direct additions in 2005 were \$15.7 million and included \$3.6 million in land contributions from Washington State under the Land Bank agreement, \$1.7 million in asset retirement obligations related to Tacoma Link and Sounder stations in South King and Pierce County, delivery to Sound Transit of \$6.5 million in buses for ST Express and \$1.6 million in regularly scheduled computer and related software replacements and replacement of the Agency's phone system.

The Land Bank agreement provides credits in recognition of projects constructed by Sound Transit that benefit the State and may be used toward future purchases or leases by Sound Transit of state-owned land or airspace. The value of Land Bank credits at December 31, 2006, were \$150.3 million and is not recorded in the financial statements. The following table provides information on additions to and uses of credits accruing to the benefit of Sound Transit in 2006 and 2005.

<i>(in millions)</i>	2006	2005
Balance in Land Bank, beginning of year	\$ 68.1	\$ 72.9
Credits:		
Totem Lake Freeway Station	56.0	-
Federal Way Direct Access	24.6	-
Lynnwood SR-99 and Lynnwood Transit Center	3.7	-
Ashway Park & Ride	1.1	-
Draws:		
Link (Airport, Central and North alignment)	(2.7)	(1.1)
ST Express (Federal Way HOV, S. Everett Freeway Station, Mercer Island Park & Ride, Issaquah and Lynnwood Transit Centers)	(0.5)	(3.7)
Balance in Land Bank, end of year	<u><u>\$ 150.3</u></u>	<u><u>\$ 68.1</u></u>

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

Offsetting the increase in capital spending, accumulated depreciation increased in 2006 by \$33.4 million from 2005 and by \$33.7 million in 2005 from 2004. In addition, in 2006 \$1.3 million of land cost was transferred to land held for resale for transit-oriented development, and \$0.9 million of land cost was capitalized to the Federal Way Transit Center project as a result of a property boundary adjustment by the City of Federal Way. In 2005 \$2.5 million in assets were disposed of including \$1.7 million in land exchanged with the University of Washington and \$0.8 million for the agency's phone system and copiers under capital lease.

Current liabilities, in 2006, excluding interest payable from restricted assets increased by 5.1%, reflecting a significant increase in other liabilities related to increased construction claims, which more than offset decreased accounts payable as several Link construction contracts approach completion. Current liabilities in 2005 increased by 87.7% from 2004, reflecting the award of significant contracts for the Central Link project at the end of 2004 for which most of the construction activity was still in the start up phase.

Long-term debt decreased by 1.4% reflecting the repayment of \$4.3 million of the 1999 Bonds and a \$6.0 million payment on the BNSF promissory notes. Long-term debt increased 124.1% between 2005 and 2004 reflecting the issuance of the 2005A Sales Tax Bonds ("2005 Bonds") in March, 2005 and a promissory note made to BNSF.

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

Net Assets <i>(in millions)</i>	As of December 31,			% Total Net Assets		
	2006	2005	2004	2006	2005	2004
Invested in capital assets, net of related debt	\$ 2,085.8	\$ 1,674.9	\$ 1,422.4	78.8	71.4	69.1
Restricted net assets	131.6	131.8	162.9	5.0	5.6	7.9
Unrestricted net assets	429.9	538.0	473.7	16.2	23.0	23.0
Total Net Assets	\$ 2,647.3	\$ 2,344.7	\$ 2,059.0	100.0	100.0	100.0

Invested in capital assets represents the agency's investment in property, construction in progress and depreciable net assets used in its operations, net of any related debt. As a percentage of total net assets, it increased from the prior year by 7.4% in 2006 and 2.3% in 2005 respectively. The increase reflects agency spending on its capital program, however, was more significant in 2006 as the agency did not issue new bonds in that year for funding for its program.

Restricted net assets represents assets restricted for use by the agency for a specific purpose, the most significant of which include funds restricted by letter of credit to BNSF and unspent bond proceeds. As a percentage of net assets, they decreased from the prior year by 0.6% in 2006 and 2.3% in 2005 as the BNSF Seattle-to-Tacoma segment funded by Sound Transit progressed and bond proceeds from the 2005A bond issue were fully spent.

Unrestricted net assets are the remainder of net assets not invested in capital nor restricted for a specific purpose. As a percentage of total net assets, they decreased from the prior year by 6.8% in 2006 reflecting the agency's spending on its capital program and increase in capital assets, but were comparable between 2005 and 2004 as capital expenditures were partially funded from the 2005A bond proceeds.

Changes in Net Assets

Changes in net assets reflect the excess of revenue over expenditures for a year. In 2006 net assets increased by \$302.6, as compared to an increase in 2005 of \$285.7 million and \$180.2 million in 2004 (see

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

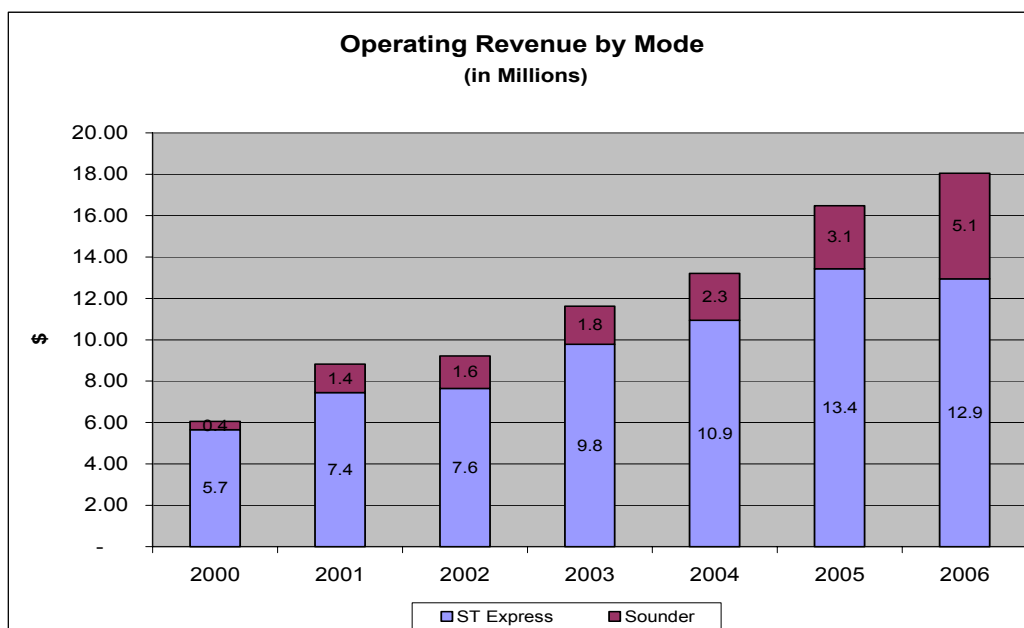
Operating Revenues

Operating revenues are composed of passenger fares and other revenue related to operations.

Passenger Fare Revenue

Passenger fare revenue consists of fares earned from the sale of Puget passes, Sounder tickets and bus farebox receipts from riders on Sounder and ST Express during the year.

The following chart displays revenue by mode from 2000 to 2006:



Sounder rail passenger revenue increased \$2.0 million or 67.5% from 2005 and by \$0.8 million or 35.0% in 2006 over 2004. Ridership for the same periods increased by 425 thousand boardings or 33.5% in 2006 and 313 thousand boardings or 32.7% in 2005. The increase in revenue from 2005 is attributable to the increase in boardings and an increase in the average fare per boarding (“AFB”). The change in the AFB reflects changes to the regional Puget Pass program and a change in the agency’s methodology to calculate the AFB between modes whereby greater pass revenue is now attributed to Sounder commuter rail. The AFB on Sounder in 2006 was \$3.02, while it was \$2.41 in 2005 and \$2.39 in 2004. The ridership increase on Sounder in 2006 and 2005 reflects both higher per train ridership and additional round-trip service between Everett-to-Seattle beginning in June 2005 and between Tacoma-to-Seattle in September 2005, as well as the initial Everett-to-Seattle service in December 2003, which was provided at no cost until February, 2004.

ST Express bus passenger revenue decreased by \$0.5 million or 3.6% from 2005 and increased by \$2.5 million or 22.7% in 2006 over 2004. Ridership for the same period increased by 862 thousand boardings or 9.8% in 2006 and 422 thousand boardings or 5.0% in 2005. The decline in revenues earned in 2006 while boardings increased is due to the change in the agency’s methodology used to calculate the AFB by mode, which decreased by \$0.18. Given the large ridership base on this service, increased ridership was not sufficient to offset the lower AFB in 2006. The AFB on ST Express was \$1.34 in 2006, \$1.52 in 2005 and \$1.30 in 2004. In 2005 ST Express fare prices were increased by \$0.25, effective in June of that year.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

Ridership on ST Express throughout the system was favorably impacted both in 2006 and 2005 by the impact of rising cost of fuel and increased congestion in the region, which has made public transportation a more attractive alternative. In addition, a service route was added between the new Federal Way Transit Center and downtown Seattle, beginning in February 2006. In 2006 and 2005 service hours increased by approximately 3.0%.

Service on Tacoma Link, a free fare service, was at essentially the same level as in 2005. The first full year of service for Tacoma Link was in 2004.

Ridership numbers by year and mode of transportation are as follows:

Ridership <i>(in thousands)</i>	% Increase				
	2006	2005	2004	2006-2005	2005-2004
Sounder	1,693.0	1,268.0	955.3	33.5	32.7
Link	885.6	884.9	794.6	0.1	11.4
ST Express	9,677.6	8,815.8	8,394.3	9.8	5.0
Total	12,256.2	10,968.7	10,144.2	11.7	8.1

Other Operating Revenues

Other operating revenues consist of vehicle advertising, rental of equipment and facilities and other miscellaneous revenue. Other revenues of \$3.4 million were comparable to 2005 and 2004.

Operating Expenses

Operating expenses are comprised of operations and maintenance costs, general and administrative expenses and depreciation.

Operations and Maintenance

Operations and maintenance, which increased in 2006 by \$8.0 million or 9.9% from 2005 and by \$10.2 million or 14.4% between 2005 and 2004, includes costs associated with the operation of the Sounder commuter rail, Link light rail in Tacoma and ST Express bus services. Major expense categories are services, materials, supplies, utilities, insurance, taxes, purchased transportation, allocated overhead from staff divisions and operating leases and rentals. Purchased transportation represents amounts paid to BNSF, Community Transit, King County Department of Transportation and Pierce Transit who operate Sound Transit's commuter rail and express bus service, accounting for 69% of this category (68% in 2005 and 70% in 2004). Services are the next largest expenditure in this category and include the Sounder vehicle maintenance contracted to Amtrak and various contracts for facilities maintenance at Sound Transit-owned facilities.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

Non-operating Revenues and Expenses

(in millions)	% Increase				
	2006	2005	2004	2006-2005	2005-2004
Non-operating revenues					
Sales tax	\$ 259.2	\$ 239.8	\$ 219.0	8.1	9.5
Motor vehicle excise tax	70.2	66.3	64.7	5.9	2.5
Rental car tax	2.4	2.2	2.2	8.1	3.7
Investment income	37.3	26.1	10.6	42.9	145.5
Other revenues	0.0	0.0	0.0	-	-
Total	\$ 369.1	\$ 334.4	\$ 296.5	10.4	12.8
Non-operating Expenses					
Non-operating expense	12.4	15.8	15.2	(21.7)	3.8
Interest expense	0.4	0.2	0.1	186.2	105.2
Discontinued/impaired projects	5.9	6.3	0.2	(6.1)	3,164.5
Loss on change in interlocal	-	-	4.6	-	(100.0)
Loss on disposal of assets	-	0.4	0.9	(100.0)	(61.6)
Total	18.7	22.7	21.0	(17.5)	8.3
Non-operating Revenues and Expenses	350.4	311.7	275.5	12.4	13.2

The most significant impact on non-operating revenues has been stronger tax revenues that improved by \$23.5 million over the prior year and \$22.4 million in 2005 over 2004. This performance reflects the continued strengthening of the regional economy from prior years. In addition, investment earnings increased by \$11.2 million in 2006 and \$15.5 million in 2005 as rising interest rates peaked toward the end of 2005, together with higher average investment balances in 2005 and a more favorable impact of measuring the agency's investments at fair market, as required under generally accepted accounting principles, than in 2005.

Other non-operating expenses include supplemental mitigation in the Rainier Valley, Phase II planning, costs not eligible to be capitalized, fare integration subsidies to other transit agencies, discontinued and impaired project costs and losses not related to operations. In 2006, there were fewer Phase II planning costs than anticipated due to the delay in the ballot measure for the next phase of the agency's capital plan which was postponed to 2007. Also, fare integration payments have been significantly reduced under the amended agreement for regional pass products.

Capital Contributions

Net capital contributions decreased in 2006 by \$14.8 million from 2005 and increased in 2005 by \$89.3 million from 2004. Capital contributions include federal grant funding, state and local contributions to Sound Transit, as well as contributions from Sound Transit to state and local governments pursuant to capital improvement or funding agreements. The following table summarizes capital contributions by major category:

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Management's Discussion and Analysis, continued

Long-Term Debt

In March, 2005, the agency issued sales tax bonds with a par value of \$422.8 million at a net premium of \$20.8 million for net proceeds before bond issue costs of \$443.6 million. Total bond issue costs were \$4.1 million. The agency also has outstanding sales and motor vehicle excise tax bonds issued in 1999, with a par value of \$345.7 million, for a total par value issued and outstanding at December 31, 2006, of \$768.5 million (\$772.8 million in 2005). Sound Transit made its first principal payment in 2006 for the 1999 Bonds in the amount of \$4.3 million. The 1999 Bonds have been rated as Aa3 by Moody's Investor Services, Inc. and AAA by Standard & Poor's (upgraded from AA in 2006) and the 2005 Bonds Aa3 and AA+ (upgraded from AA- in 2006), respectively.

Under state law, issuance of bonds payable from any type of taxes is subject to statutory debt limitations. Sound Transit is currently authorized to incur debt in an amount equal to 1-1/2 percent of the value of taxable property within the service area, without securing voter approval for bonds. With the approval of 60 percent of the region's voters, Sound Transit may incur aggregate indebtedness of up to 5 percent of the value of taxable property within the service area. Based on the 2005 assessed valuations for collection of 2006 taxes, Sound Transit's non-voter approved remaining debt capacity is \$4.2 billion and its voter approved remaining debt capacity is \$15.8 billion.

Economic Conditions

Sound Transit has experienced, and will continue to be exposed to the risks of, price increases in labor and key construction commodities. A number of key inputs for capital project construction have seen significant price increases over the past three years. Overall, materials and components for construction have risen an average of 4.4% per year from 1970-2006, but almost twice that level at 7.5% per year from 2003-2006. Factors most frequently cited for these price increases include strong worldwide economic growth, particularly in China and India, secondary impacts of rising oil prices on other commodities, relatively low U.S. dollar, low or disrupted supplies, and lack of adequate worldwide shipping. In addition, the high level of construction activity in the Puget Sound region has also reduced the supply of construction labor as well as the availability of construction firms to submit bids for public construction contracts. These price and supply pressures significantly impacted Sound Transit construction bids in 2006, with several key projects coming over initial engineering estimates. In particular, the agency received only a single bid, significantly over the engineer's estimate, for the Airport Station for Link light rail. The agency will continue to be subject to these market forces in the years ahead.



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Independent Auditors' Report

Audit and Reporting Subcommittee of the Board
Central Puget Sound Regional Transit Authority:

We have audited the accompanying basic financial statements of Central Puget Sound Regional Transit Authority (a public corporation acting under the service name of Sound Transit), as of and for the years ended December 31, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of Sound Transit's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sound Transit as of December 31, 2006 and 2005, and its changes in financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our reports dated June 15, 2007, on our consideration of the Sound Transit's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

The Management's Discussion and Analysis on pages 1 through 12 is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management



regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

KPMG LLP

June 15, 2007

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

BALANCE SHEETS

<i>(in thousands)</i>	December 31	
	2006	2005
ASSETS		
Current Assets		
Cash and cash equivalents <i>(Note 3)</i>	\$ 215,768	\$ 116,466
Restricted assets <i>(Note 3)</i>	7,919	8,817
Investments <i>(Note 3)</i>	280,095	455,856
Taxes and other receivables <i>(Notes 4 and 7)</i>	79,231	97,344
Other	12,055	9,820
Total Current Assets	595,068	688,303
Non-Current Assets		
Capital assets, net of accumulated depreciation <i>(Note 5)</i>	2,870,397	2,277,570
Restricted assets <i>(Note 3)</i>	134,190	326,463
Investment held to pay capital lease obligation <i>(Note 6)</i>	59,925	59,083
Long-term receivables <i>(Note 7)</i>	36	4,577
Unamortized bond issuance costs	6,015	6,446
Prepaid expense and deposits	1,910	4,771
Total Non-Current Assets	3,072,473	2,678,910
Total Assets	\$ 3,667,541	\$ 3,367,213
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities <i>(Note 8)</i>	\$ 100,544	\$ 121,841
Deferred receipts	3,594	3,471
Interest payable from restricted assets	10,511	10,582
Current portion, long-term debt <i>(Note 9)</i>	10,246	10,116
Current portion, capital lease obligation <i>(Note 6)</i>	191	177
Other	48,310	19,380
Total Current Liabilities	173,396	165,567
Non-Current Liabilities		
Long-term debt <i>(Note 9)</i>	779,828	791,198
Capital lease obligations <i>(Note 6)</i>	60,270	59,588
Other long-term obligations <i>(Note 10)</i>	6,767	6,138
Total Non-Current Liabilities	846,865	856,924
Total Liabilities	1,020,261	1,022,491
Commitments and Contingencies <i>(Notes 6, 10, 12, 13)</i>		
Net Assets		
Invested in capital assets, net of related debt	2,085,802	1,674,918
Restricted for contractual arrangements and other <i>(Note 11)</i>	131,599	131,799
Unrestricted	429,879	538,005
Total Net Assets	2,647,280	2,344,722
Total Liabilities and Net Assets	\$ 3,667,541	\$ 3,367,213

See Notes to Financial Statements.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

1. ORGANIZATION AND REPORTING ENTITY

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

Reporting Entity—Sound Transit is a special purpose government supported primarily through sales tax, motor vehicle excise tax and rental car tax in Sound Transit’s operating jurisdiction. In addition Sound Transit receives capital funding from federal and state agencies.

Sound Transit is governed by an 18-member board, seventeen of whom are appointed by the respective member county executives and confirmed by the council of each member county. Membership is based on the population from the portion of each county that lies within Sound Transit’s service area.

Representation on the board shall include an elected official representing the largest city in each county and ensures proportional representation from other cities and from unincorporated areas of each county. The final board position is held by the Secretary of Transportation, Washington State Department of Transportation.

Accounting principles generally accepted in the United States of America require that the reporting entity include the primary government, all organizations for which the primary government is financially accountable and other organizations that, by the nature and significance of their relationship with the primary government, would cause the financial statements to be incomplete or misleading if excluded. Based on these criteria, Sound Transit is considered a primary government and does not have any component unit relationships. Conversely, Sound Transit is not considered a component unit of any primary government.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following summary of significant accounting policies is presented to assist the reader in interpreting the financial statements and should be considered an integral part of the financial statements.

Basis of Accounting—The accounts are maintained and financial statements prepared using the economic resources measurement focus and accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America and methods prescribed by the State Auditor under the authority of RCW Chapter 43.09 for proprietary funds. The Governmental Accounting Standards Board (“GASB”) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. All applicable GASB pronouncements, as well as all Financial Accounting Standards Board (“FASB”) statements and interpretations have been applied, except for those FASB statements and interpretations that contradict GASB pronouncements.

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

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Operating revenues consist primarily of passenger fares, which are recognized in the period in which services are provided and are earned, and expenses are recognized in the period in which they are incurred. All assets and liabilities associated with the operation of Sound Transit are included in the Balance Sheets. Depreciation of capital assets and amortization of deferred revenue is recognized in the Statements of Revenues, Expenses and Changes in Net Assets.

Capital Assets—Capital assets are stated at cost, except for donated capital assets which are stated at the fair value on the date of donation. Expenditures for additions and improvements with a value in excess of \$5,000 and a useful life of more than one year are capitalized. Expenditures for maintenance, repairs and minor improvements are charged to operations as incurred. Upon disposal of capital assets, the accounts are relieved of the related costs and accumulated depreciation and the resulting gains or losses are reflected in the Statements of Revenues, Expenses and Changes in Net Assets. Depreciation of capital assets is recorded using the straight-line method over the estimated useful lives of the assets and leasehold improvements over the shorter of the life of the asset or length of the related agreement as follows:

	Estimated Useful Life
Rail access costs	37 years
Buildings	8–30 years
Transit facilities, rail, and equipment	7–30 years
Park-and-ride lots and shelters	10 years
Revenue vehicles—Cab cars and coach cars	40 years
Revenue vehicles—Locomotives	29 years
Revenue vehicles—Light rail	25 years
Revenue vehicles—Buses	7-12 years
Furniture and equipment	3–7 years
Administrative vehicles and leasehold improvements	5 years

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

All costs directly attributable to capital projects, as well as certain indirect costs that are allocated to the projects based on various applicable factors supporting the overhead rates used, are capitalized. Capital projects in progress balances include costs incurred for transportation projects not yet in service and are segregated between assets in which Sound Transit maintains a continuing ownership interest and capital assets that will be transferred to other governments upon completion.

Rail access costs reflect the cost of acquiring rights from BNSF for the Tacoma-to-Seattle and Everett-to-Seattle segments. In the Tacoma-to-Seattle corridor these rights were acquired in an amount equal to the funding of necessary track and signal improvements on the line and in the Everett-to-Seattle corridor through the direct acquisition of easements. In addition, these costs include Sound Transit's direct and indirect costs related to the planning and design, environmental management and permitting. The rail access rights for additional round trip service are acquired incrementally, as certain requirements are met under their respective agreements, and accordingly ongoing costs are capitalized to the depreciable asset on a quarterly basis.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Interest costs on funds borrowed through tax-exempt debt to finance the construction or acquisition of certain capital assets are capitalized during the period of construction or acquisition and are depreciated over the life of the related assets once placed into service.

Capital Contributions to Other Governments—Pursuant to capital improvement agreements, Sound Transit has provided funding to or constructed assets for various governments or their wholly-owned subsidiaries for transit-related capital improvements. For assets constructed for other governments, these costs are capitalized and included in capital projects in progress until the asset is substantially completed and accepted, at which time it is charged to contributions to other governments.

Cash and Cash Equivalents—Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments with maturities of three months or less when purchased, money market funds, investments in the Local Government Investment Pool and the King County Investment Pool, which are managed by the Washington State Treasurer's Office and the King County Finance Division, respectively.

Compensated Absences—Vacation leave that has been earned but not paid has been accrued in the accompanying financial statements. Similarly, sick leave is accrued as the benefits are earned but only to the extent that Sound Transit will compensate the employees through cash payments conditional on the employee's termination, retirement or death. Vacation pay, which may be accumulated up to 50 days, is payable upon termination, retirement or death. Sick leave is payable at the rate of 50% upon resignation, retirement or death for employees hired before January 1, 2004, and 25% thereafter and is limited to 120 days for termination other than for retirement or death.

Environmental Reserves—Environmental liabilities are evaluated at the time of purchase of land and are factored into the purchase price. The estimated cost of remediation is accrued at the time of purchase and relieved as remediation costs are incurred or at the time of discovery. Revisions to those estimates are accounted for as a project cost or expensed depending on the nature of the remediation required.

Investment Valuation—Investments are stated at fair value based on quoted market prices, as available.

Operating and Contingency Fund—In accordance with Board policy, Sound Transit maintains a cash reserve based on two months of average annual operating expenses, to be used in the event of budget shortfalls. As this is an internally-restricted cash balance, this balance is included in cash and cash equivalents.

Parts, Materials and Supplies—Parts, materials and supplies are recorded as inventory at the lower of purchased cost or net realizable value. These assets are reviewed periodically for slow-moving and obsolete items, and any impairment in value is reflected as a charge to operations.

Restricted Assets—Restricted assets are assets restricted by the covenants of long-term financial arrangements. Restricted assets are used in accordance with their requirements, and where both restricted and unrestricted resources are available for use, restricted resources are used first and then unrestricted resources as they are needed.

Revenue and Expense Classification—Sound Transit distinguishes operating revenues and expenses from non-operating items in the preparation of its financial statements. Operating revenues and expenses generally result from providing passenger services in connection with Sound Transit's principal ongoing operations. The principal operating revenues are passenger fares. Sound Transit's operating expenses include labor, materials, services, claims, purchased transportation and other expenses related to the delivery of passenger transportation within the Central Puget Sound region. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Reclassifications—Certain reclassifications have been made to the 2005 Financial Statements to conform to the current year's presentation.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Subarea Accounting—Sound Transit allocates equity to each of the included jurisdictions in accordance with *Sound Move* and established policies. Presentation of such allocation is not a required disclosure under accounting principles generally accepted in the United States of America. Accordingly, a separate agreed upon procedures report and Schedule of Subarea Equity is issued.

Use of Estimates—The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

3. CASH, CASH EQUIVALENTS, INVESTMENTS AND RESTRICTED ASSETS

Sound Transit's bank deposits are covered by the Federal Deposit Insurance Corporation ("FDIC") or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission ("PDPC"). All deposits not covered by the FDIC are covered by the PDPC. Cash held in the Local Government Investment Pool and the King County Investment Pool are managed by the Washington State Treasurer's Office and the King County Finance Division, respectively. These pools represent an interest in a group of securities and have no specific security subject to custodial risk.

All surplus cash is invested in compliance with state law and in accordance with an investment policy approved by Sound Transit's Board and certified by the Municipal Treasurer's Association. Qualifying investments under this policy include obligations of the United States government, Treasury and Agency securities, bankers' acceptances, certificates of deposit, commercial paper and repurchase agreements. Sound Transit's investment policy addresses common deposit and investment risks as described below.

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Sound Transit manages its exposure to fair value losses by matching its investments to cash flow requirements and by comparing the modified duration of fixed income securities in its investment portfolios to established benchmarks. Deviation from the established benchmark within 25% is considered acceptable. Modified duration estimates the sensitivity of a bond's price to interest rate changes. At December 31, 2006, benchmark duration for Sound Transit's unrestricted portfolio was 0.61 and its restricted portfolio was 0.47. Actual modified duration by investment type is presented in the table on the following page.

Concentration of Credit Risk—Concentration of credit risk is the risk associated with a lack of diversification or having too much invested in a few individual issues. The investment policy sets forth maximum concentration guidelines whereby no single Agency exceeds 50% of the overall portfolio, or 10% for certificates of deposit, bankers' acceptances, repurchase agreements, general obligation bonds and A1/P1 commercial paper. Treasury securities may comprise up to 100% of the portfolio, as well as participation in the Washington State Treasurer's Local Government Investment Pool. Agency securities (combined) may comprise up to 75% of the portfolio. Participation in the King County Investment Pool is limited to 50% of the portfolio. The table on the following page provides the percentage invested in each type of investment as of December 31, 2006.

Credit Risk—Credit risk is the chance that an issuer will fail to pay principal or interest in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause the price of the investment to decline. All Agency securities in our portfolios are rated AAA, and the Certificate of Deposit is covered by the PDPC. The King County Investment Pool is rated AAAs. The Washington State Treasurer's Local Government Investment Pool is a 2a7-like pool and is unrated.

Custodial Credit Risk—Custodial credit risk is the risk that, in the event of the failure of the counterparty, Sound Transit would not be able to recover the value of its investment or collateral securities that are in the

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

possession of an outside party. All investments purchased by Sound Transit are held and registered in Sound Transit's name in the Trust Department or safekeeping department of a financial institution, as established by a written third party safekeeping agreement between Sound Transit and the financial institution.

Cash, cash equivalents, investments and restricted assets are as follows (modified duration in years):

<i>(in thousands)</i>	2006			2005		
	Fair Value	Modified Duration	% of Portfolio	Fair Value	Modified Duration	% of Portfolio
Deposits and Investments						
US agency securities:						
Federal Farm Credit Bank	\$ 62,694	0.581	16.52%	\$ 59,626	0.833	8.45%
Federal Home Loan Bank	110,049	0.444	29.00%	222,913	0.815	31.60%
Federal Home Loan Mortgage Corporation (FHLMC)	80,192	0.527	21.13%	135,805	0.712	19.25%
Federal National Mortgage Association	10,079	0.213	2.66%	87,660	0.554	12.43%
US treasury securities	64,581	0.524	17.02%	165,198	0.634	23.42%
Certificate of deposit	8,000	1.100	2.11%	8,000	0.160	1.13%
Repurchase agreement	-	0.000	0.00%	250	0.000	0.04%
FDIC or PDPC insured bank deposits	43,890	0.000	11.57%	25,927	0.000	3.68%
	<u>379,485</u>	<u>0.454</u>	<u>100.00%</u>	<u>705,379</u>	<u>0.684</u>	<u>100.00%</u>
Cash and Cash Equivalents						
Investment Pools:						
King County Investment Pool	26,775	0.400		54,540	0.510	
Washington State Local Government Investment Pool	225,449			140,471		
US discount note: FHLMC	410	0.011		-		
Cash on hand	103			38		
	<u>252,737</u>			<u>195,049</u>		
Other Restricted Assets						
Deductible liability protection policy	5,254			6,372		
Interest receivable on restricted investments	496			802		
	<u>5,750</u>			<u>7,174</u>		
Total Cash, Cash Equivalents, Investments and other Restricted Assets	<u>\$ 637,972</u>			<u>\$ 907,602</u>		

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

<i>(in thousands)</i>	December 31	
	2006	2005
Balance Sheet Classifications		
Cash and cash equivalents	\$ 215,768	\$ 116,466
Current restricted assets:		
Cash equivalents	2,665	2,445
Deductible liability protection policy	<u>5,254</u>	<u>6,372</u>
	<u>7,919</u>	<u>8,817</u>
Investments	<u>280,095</u>	<u>455,856</u>
Non-current restricted assets:		
Cash Equivalents	86,194	110,064
Investments	47,500	215,596
Other assets	<u>496</u>	<u>803</u>
	<u>134,190</u>	<u>326,463</u>
	<u>\$ 637,972</u>	<u>\$ 907,602</u>

4. RECEIVABLES

Receivables consist of the following:

<i>(in thousands)</i>	December 31	
	2006	2005
Taxes receivable	\$ 54,149	\$ 51,315
Grants receivable	5,357	27,530
Accounts receivable, net	595	195
Due from Other Governments	15,614	13,728
Interest receivable	3,514	4,544
Current portion supplemental mitigation advances	<u>2</u>	<u>32</u>
	<u>\$ 79,231</u>	<u>\$ 97,344</u>

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

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

5. CAPITAL ASSETS

Capital assets are summarized as follows:

<i>(in thousands)</i>							
	December 31 2004	Additions	Transfers and Retirements	December 31 2005	Transfers In and Additions	Transfers Out and Retirements	December 31 2006
Non-Depreciable Assets							
Land	\$ 247,102	\$ 23,730	\$ (1,696)	\$ 269,136	\$ 23,910	\$ (2,170)	\$ 290,876
Permanent easements	158,098	2,869	-	160,967	55,718	-	216,685
Capital Projects in Progress							
Sound Transit	690,340	511,613	(130,827)	1,071,126	645,278	(157,842)	1,558,562
Other Governments	79,714	75,033	(34,895)	119,852	61,953	(78,027)	103,778
Total Non-Depreciable Assets	1,175,254	613,245	(167,418)	1,621,081	786,859	(238,039)	2,169,901
Depreciable Assets							
Transit facilities, rail and heavy equipment	213,428	10,379	-	223,807	41,838	-	265,645
Rail access rights	198,958	71,940	-	270,898	34,047	-	304,945
Buildings and leasehold improvements	22,899	300	(31)	23,168	-	-	23,168
Revenue vehicles	222,986	8,153	-	231,139	578	-	231,717
Furniture, equipment and vehicles	12,790	1,654	(469)	13,975	895	(23)	14,847
Equipment under capital lease	957	205	(299)	863	38	-	901
Total Depreciable Assets	672,018	92,631	(799)	763,850	77,396	(23)	841,223
Accumulated Depreciation							
Transit facilities and heavy equipment	(22,200)	(12,044)	-	(34,244)	(11,764)	-	(46,008)
Rail access rights	(456)	(7,826)	-	(8,282)	(7,765)	-	(16,047)
Buildings and leasehold improvements	(4,876)	(928)	19	(5,785)	(770)	-	(6,555)
Revenue vehicles	(36,521)	(11,788)	-	(48,309)	(11,356)	-	(59,665)
Furniture, equipment and vehicles	(9,374)	(1,594)	418	(10,550)	(1,533)	20	(12,063)
Equipment under capital lease	(254)	(202)	265	(191)	(198)	-	(389)
Total Accumulated Depreciation	(73,681)	(34,382)	702	(107,361)	(33,386)	20	(140,727)
Depreciable Assets, Net	598,337	58,249	(97)	656,489	44,010	(3)	700,496
Total Capital Assets, Net	\$ 1,773,591	\$ 671,494	\$ (167,515)	\$ 2,277,570	\$ 830,869	\$ (238,042)	\$ 2,870,397

During 2006, Sound Transit relieved \$235.9 million of costs from capital projects in progress of which \$72.8 million relate to completed projects and payments to other governments pursuant to capital related governmental agreements. Completed projects included Federal Way HOV Access/317th, Eastgate Transit Access/142nd, Sammamish Park & Ride/228th SE and contributions to other governments for projects not constructed by Sound Transit included SR522 HOV Enhancements, Kirkland Transit Enhancements and to the City of Federal Way for transit-oriented development. The costs of these completed projects are included in contributions to other governments in the Statement of Revenues, Expenses and Changes in Net Assets.

During 2005, Sound Transit relieved \$165.7 million of costs from capital projects in progress of which \$55.9 million relate to completed projects and payments to other governments pursuant to capital related governmental agreements. Completed projects and payments included Ash Way Transit Access/164th SW, SR900 Park & Ride Arterial improvements, Issaquah Highlands Park & Ride, City of Everett contribution – Everett Station, Redondo Heights Park & Ride/SR99, Smart Card partner agency contributions and Woodinville Arterial enhancements. The costs of these completed projects are included in contributions to other governments in the Statements of Revenues, Expenses and Changes in Net Assets.

During 2006, Sound Transit capitalized \$36.6 million of interest costs, (\$32.0 million in 2005), representing all of the interest, net of premium, discounts and bond issue costs, incurred on its bonds outstanding (see Note 9).

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

6. CAPITAL AND OPERATING LEASES

Capital leases are comprised of the following:

<i>(in thousands)</i>	2006	2005
Lease/leaseback	\$ 59,925	\$ 59,083
Copier leases	536	682
	<u>60,461</u>	<u>59,765</u>
Less current portion	<u>(191)</u>	<u>(177)</u>
	<u><u>\$ 60,270</u></u>	<u><u>\$ 59,588</u></u>

Lease/Leaseback—On May 31, 2001, Sound Transit entered into a transaction to lease 22 rail passenger cab and coach cars and 5 locomotives (the “headlease”) to an investor and simultaneously subleased the vehicles back (the “sublease”). Under these transactions, Sound Transit maintains the right to continued use and control of the assets through the end of the leases and is required to insure and maintain the assets. The headlease and sublease have been recorded as capital leases for accounting purposes.

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

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

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

<i>(in thousands)</i>	2006	2005
Net sublease, January 1	\$ 59,083	\$ 57,856
Accrued interest	4,422	4,330
Less payment	<u>(3,580)</u>	<u>(3,103)</u>
Net Sublease, December 31	<u><u>\$ 59,925</u></u>	<u><u>\$ 59,083</u></u>

Copier Leases—Sound Transit has entered into various agreements for the acquisition or rental of copiers. Certain of the equipment covered by these agreements is classified as a capital lease for accounting purposes and has been recorded as a capital asset with a corresponding long-term liability equal to the present value of future lease payments. Sound Transit records lease payments as reductions of the long-term liability and as interest expense over the life of the lease.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Future payments under the copier lease obligations are shown in the following table:

<i>(in thousands)</i>	December 31 2006
2007	\$ 213
2008	201
2009	144
2010	16
Total minimum lease payments	<u>574</u>
Amounts representing interest	<u>38</u>
Present value of lease obligations	536
Less current portion	<u>(191)</u>
Long-term portion	<u>\$ 345</u>

Amtrak Lease/Sublease—In September 2000, Sound Transit entered into a 40-year agreement to lease its locomotives, passenger coaches and cab cars (“rolling stock”) to the National Railroad Passenger Corporation (“Amtrak”) for \$1. Under the agreement Amtrak is obligated to repair, maintain and service the rolling stock at Amtrak’s maintenance facility in return for payment by Sound Transit. By separate agreement, Sound Transit assigned to Amtrak its commuter rail operating agreement which it had entered into with the BNSF Railway Company (“BNSF”) in May 2000 to provide commuter rail service. In order to give BNSF possession and use of the rolling stock for purposes of providing commuter rail service on Amtrak’s behalf for Sound Transit, Amtrak entered into a 40-year sublease of the rolling stock to BNSF for a nominal rental payment of \$1.

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

Operating Rentals—Sound Transit leases office space, parking, land and storage at various locations including space adjacent to Union Station, in Seattle's Rainier Valley district and in Tacoma under non-cancelable operating leases in excess of one year with lease terms expiring in 2007 through 2011. Effective July 1, 2005, the annual base rate decreased for the major lease from \$25.25 sf to \$14.25 sf. This amended lease includes a three-tier base rent structure for the next five years which is equal to 95% of the annual market rate for comparable space. The lease arrangements also include an allowance of \$5.00 sf for costs incurred by Sound Transit to refurbish the premises, and there is an option to extend the lease for another five-year term, beyond June 30, 2010.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Minimum lease payments through 2011 are as follows:

Operating Rentals, commitments next 5 years:

<i>(in thousands)</i>	
2007	\$ 1,806
2008	1,249
2009	1,145
2010	618
2011	70
	<u>\$ 4,888</u>

Total rental costs for 2006, which include non-cancelable leases as well as other month-to-month rentals, were \$2.2 million of which \$529 thousand was for capital projects in progress. Total rental costs for 2005 were \$1.9 million, of which \$127 thousand was for capital projects in progress.

7. LONG-TERM RECEIVABLES:

Long-term receivables consist of the following:

<i>(in thousands)</i>	2006	2005
City of Seattle	\$ 3,956	\$ 9,221
Supplemental mitigation advances	38	251
	<u>\$ 3,994</u>	<u>\$ 9,472</u>
Less current portion included in due from other governments	(3,958)	(4,895)
	<u>\$ 36</u>	<u>\$ 4,577</u>

Amounts owed by the City of Seattle relate to the Downtown Seattle Traffic and Street Improvements Agreement and the Memorandum of Agreement for Undergrounding of Overhead Utilities along Martin Luther King, Jr. Way South. Under those agreements, or as modified in writing, Sound Transit has accepted repayment of the amounts to be funded by the City through December, 2007. The balance due under these agreements is all due within one year and included in Due from Other Governments.

Supplemental mitigation advances are advances for working capital, tenant improvements and equipment purchases to qualifying Rainier Valley businesses and property owners to mitigate the effects of light rail construction. In 2006, all but one advance were sold to a third party. The remaining advance bears interest and must be repaid in full over the 7-year life of the agreement.

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following:

<i>(in thousands)</i>	2006	2005
Accounts payable	\$ 31,164	\$ 38,522
Accrued liabilities	22,422	39,431
Due to other governments	45,346	42,118
Accrued salaries, wages and benefits	1,550	1,695
Retainage payable	62	75
	<u>\$ 100,544</u>	<u>\$ 121,841</u>

9. LONG-TERM DEBT

Long-term debt consists of the following:

<i>(in thousands)</i>	2006			2006 Ending	Amounts Due
	Beginning		Reductions	Balance	within
	Balance	Additions			One Year
Bonds payable:					
Series 1999 Bonds, at par	\$ 350,000	\$ -	\$ (4,270)	\$ 345,730	\$ 4,445
Series 2005A Bonds, at par	422,815	-	-	422,815	-
	772,815	-	(4,270)	768,545	4,445
Plus unamortized premium	24,221	-	(1,761)	22,460	-
Less unamortized discount	(7,117)	-	385	(6,732)	-
Total bonds payable	789,919	-	(5,646)	784,273	4,445
Promissory notes:					
Lakeview North Line, replacement	3,000	-	(3,000)	-	-
Lakeview South Line	9,000	-	(3,000)	6,000	6,000
	12,000	-	(6,000)	6,000	6,000
Plus (minus) imputed interest	(605)	-	406	(199)	(199)
Total promissory notes payable	11,395	-	(5,594)	5,801	5,801
Total Long-Term Debt	\$ 801,314	\$ -	\$ (11,240)	\$ 790,074	\$ 10,246

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

<i>(in thousands)</i>	2005			2005 Ending	Amounts Due
	Beginning	Additions	Reductions	Balance	within
	Balance				One Year
Bonds payable:					
Series 1999 Bonds, at par	\$ 350,000	\$ -	\$ -	\$ 350,000	\$ 4,270
Series 2005A Bonds, at par	-	422,815	-	422,815	-
	350,000	422,815	-	772,815	4,270
Plus unamortized premium	4,764	20,888	(1,431)	24,221	-
Less unamortized discount	(7,433)	(67)	383	(7,117)	-
Total bonds payable	347,331	443,636	(1,048)	789,919	4,270
Promissory notes:					
Lakeview North Line, replacement	-	3,000	-	3,000	3,000
Lakeview South Line	-	9,000	-	9,000	3,000
Lakeview North Line	6,000	-	(6,000)	-	-
	6,000	12,000	(6,000)	12,000	6,000
Plus (minus) imputed interest	(260)	(712)	367	(605)	(154)
Total promissory notes payable	5,740	11,288	(5,633)	11,395	5,846
Total Long-Term Debt	\$ 353,071	\$ 454,924	\$ (6,681)	\$ 801,314	\$ 10,116

Sales Tax and Motor Vehicle Excise Tax Bonds, Series 1999—On January 6, 1999, Sound Transit issued tax-exempt Sales Tax and Motor Vehicle Excise Tax Bonds, Series 1999 dated December 1, 1998, in the amount of \$350 million. The average life of these bonds is 22.5 years with an average coupon rate of 4.88% and an effective rate of 5.03%. The bonds are special limited obligations of Sound Transit payable from and secured solely by a pledge of Sound Transit's sales and use tax, motor vehicle excise tax and rental car tax imposed at the rates of 0.4%, 0.3%, and 0.8% respectively.

Sound Transit is required to maintain certain minimum deposits as defined in the bond resolution to meet debt service requirements. At December 31, 2006 and 2005, cash restricted for debt service totaled \$11.5 million and \$11.4 million respectively. Principal payments are due February 1 of each year starting in 2006. Proceeds from this bond issue have been used for the Agency's capital projects. These bonds were upgraded from a rating of A1 to Aa3 (Moody's Investor Services) in 2005 and were upgraded in 2006 from AA to AAA by Standard & Poors.

The fair value of the Series 1999 bonds was \$361.9 million and \$366.1 million as of December 31, 2006, and 2005, respectively. This fair value was estimated using quoted market prices.

Sales Tax Bonds, Series 2005A—On March 31, 2005, Sound Transit issued tax-exempt Sales Tax Bonds, Series 2005A dated March 31, 2005, in the amount of \$422.8 million. These bonds were issued on a subordinate basis to the Sales Tax and Motor Vehicle Excise Tax Bonds, Series 1999. The average life of these bonds is 18.5 years with an average coupon rate of 4.95% and an effective rate of 4.60%. These bonds are special limited obligations of Sound Transit payable from and secured solely by a pledge of Sound Transit's sales and use tax and rental car tax imposed at the rates of 0.4% and 0.8% respectively.

Sound Transit is required to maintain certain minimum deposits as defined in the bond resolution to meet debt service requirements. Cash restricted for debt service totaled \$3.4 million at December 31, 2006 and 2005. Principal payments are due November 1 of each year starting in 2011. In addition, the Agency established a \$39.5 million reserve for the bonds, consistent with the Parity Bond Resolution. Proceeds from this bond issue are being used for the Agency's capital projects. The bonds received underlying

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Notes to Financial Statements, continued

ratings of Aa3 (Moody's Investor Services) and AA- (Standard and Poor's). In 2006, Standard and Poor's upgraded their rating of these bonds to AA+.

The fair value of the Series 2005A bonds was \$447.4 million and \$443.5 million as of December 31, 2006 and 2005, respectively. This fair value was estimated using quoted market prices.

Debt service requirements to maturity for bonds payable.			
Year Ending December 31	Principal	(in thousands) Interest	Total
2007	\$ 4,445	\$ 37,485	\$ 41,930
2008	4,620	37,301	41,921
2009	4,810	37,205	42,015
2010	5,065	36,951	42,016
2011	11,130	36,685	47,815
2012-2016	97,370	173,956	271,326
2017-2021	180,985	140,843	321,828
2022-2026	247,160	86,255	333,415
2027-2030	212,960	23,933	236,893
	<u>\$ 768,545</u>	<u>\$ 610,614</u>	<u>\$ 1,379,159</u>

Lakeview North and South Line Promissory Notes — On September 28, 2004, Sound Transit acquired a section of the Lakeview Subdivision between Lakewood and Nisqually called the North Line in exchange for a payment of \$6 million and a \$6 million promissory note payable to BNSF in September of 2006. In November 2004, a replacement note was agreed upon whereby if the south parcels were acquired (the "South Line") then \$3 million of the note became due on September 28, 2005, with the balance of \$3 million due at maturity on September 28, 2006.

The South Line acquisition closed on October 3, 2005, resulting in the change in the terms of the North Line note as described. In addition, Sound Transit paid \$3 million and assumed a promissory note payable of \$9 million to BNSF with a payment due of \$3 million on September 28, 2006, and \$6 million on September 28, 2007. These promissory notes were non-interest bearing and, in accordance with generally accepted accounting principles, have been discounted to reflect the imputed interest cost to the Agency.

10. OTHER LONG-TERM OBLIGATIONS

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

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

Additions and accretion include the impact of change in estimate of the future cash flows, accretion and the cumulative effect of the change in accounting treatment as follows:

<i>(in thousands)</i>	2006	2005
Additions or changes in cash flow estimate	\$ 446	\$ 1,709
Accretion	101	95
Cumulative effect of change in accounting policy	-	211
	<u>\$ 547</u>	<u>\$ 2,015</u>

Risk Management—In the ordinary course of its operations, Sound Transit is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to persons; and natural disasters. Sound Transit has established a comprehensive risk management program, utilizing the purchase of commercial insurance that has in force first-level coverage for property, liability, employment practices and crime and fidelity to provide protections from these exposures. Such coverage includes self-insured, per claim retention insignificant to Sound Transit’s risk of loss. There have been no changes to the policy since inception and no settlements have exceeded coverage under the plan.

Sound Transit also established an Owner-Controlled Insurance Program (“OCIP”) for all general liability claims by third-party injuries and/or property damage related to project construction activities carried out by third-party contractors. This commercially procured insurance program includes a self-insured retention level of \$500 thousand per claim. This program originally covered construction projects from January 1, 2001, through December 31, 2006, and all premium payments under the policies had been prepaid. During the year, a policy extension was negotiated through December 31, 2009, with the exception of the professional liability and contractor’s pollution policy, which was extended to December 31, 2016.

In addition, Sound Transit has also entered into a deductible liability protection policy to supplement the self-insured retention portion of the OCIP. Under this policy the probable maximum claims exposure, estimated at \$6.5 million, has been deposited with the insurer in an interest-bearing loss fund account.

Claim amounts estimated to be paid within the next year are included in other current liabilities.

Compensated Balances—Amounts estimated to be paid within the next year are included in accrued salaries, wages and benefits (see Note 8).

11. RESTRICTED NET ASSETS

Restricted net assets consist of the following:

<i>(in thousands)</i>	2006	2005
Contractual arrangements	\$ 80,098	\$ 110,347
Unspent bond proceeds, net of related obligations	-	8,658
Deductible liability protection policy	5,254	6,372
Debt service, net of related obligations	44,095	4,270
State appropriation	2,152	2,152
	<u>\$ 131,599</u>	<u>\$ 131,799</u>

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

12. EMPLOYEE BENEFITS

Sound Transit provides a defined contribution money purchase plan and trust (“401(a) Plan”) to its employees. Prior to December 31, 1999, employees had a choice of participating in either the 401(a) Plan or in the Washington Public Employees’ Retirement System (“PERS”). In 1999, the Washington State Legislature amended the laws governing PERS requiring employers either to terminate their participation in PERS or permit all new employees to participate in PERS regardless of their simultaneous participation in a 401(a) plan. Effective December 31, 1999, Sound Transit terminated its status as a PERS employer with regard to all employees hired after that date. Individuals who were active members at that date were eligible to continue their membership in PERS for the duration of their continuous employment with Sound Transit. At December 31, 2006, 2005 and 2004, there was one remaining employee participating in PERS.

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

401(a) Plan—A defined contribution money purchase plan and trust was established for the Agency in 1994 with the adoption of Board Resolution No. 32. This was amended by Resolution No. 100 in 1997 to recognize the contribution made to Sound Transit by its employees. The ICMA Retirement Corporation administers the Central Puget Sound Regional Transit Authority Pension Plan and serves as the plan’s trustee. This plan is a fixed employer system, and membership in the system includes all full-time Sound Transit employees and elected officials. The vesting schedule of the plan is 20% immediately upon employment, 40% after one year of service, 60% after two years, 80% after three years and 100% after four years. Employees are responsible for directing the investment of their contributions and Sound Transit’s contributions.

Any eligible employee who was employed on the effective date of this plan was eligible to participate in the plan. Any other eligible employee shall be eligible to participate on the first day of employment.

Sound Transit’s actual contribution rates, which were the required contribution rates, are expressed as a percentage of covered payrolls. The amount of covered payroll during 2006 and 2005 was \$25.9 million and \$25.3 million, respectively, and total payroll was \$26.3 million and \$25.6 million, respectively. The required contribution rates expressed as a percentage of covered payroll and required Sound Transit contributions during 2006, 2005, and 2004 are as follows:

	Contribution Rate			Contributions (in thousands)		
	2006	2005	2004	2006	2005	2004
Employer	12%	12%	12%	\$3,111	\$3,038	\$2,985
Employee	10%	10%	10%	2,592	2,532	2,488
Total	22%	22%	22%	\$5,703	\$5,570	\$5,473

13. COMMITMENTS AND CONTINGENCIES

Operations and Maintenance Agreements—Sound Transit entered into 40-year agreements in May of 2000 with BNSF and Amtrak for the operations and maintenance of its Sounder commuter rail service. Under the BNSF agreement, Sound Transit pays in accordance with an hourly rate schedule per train mile that is based on the number of trains per day. Under the Amtrak agreement, Sound Transit pays a flat monthly fixed price dependent upon the number of one-way trips. See related agreements described in Note 6: *Amtrak Lease/Sublease*.

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In 2004, Sound Transit entered into five-year agreements that expire September 2009 with Community Transit, King County Department of Transportation and Pierce Transit (“purchased transportation providers”) to operate its ST Express public transportation service within Sound Transit’s service area. Effective January 1, 2005, through the end of the agreement, service is to be compensated based upon a fixed fee agreed to annually, with certain items subject to variable pricing, such as fuel and special services.

Agreements with BNSF for Sounder Commuter Rail Service in the Everett-to-Seattle and Lakewood-to-Tacoma Corridors—On December 18, 2003, Sound Transit entered into a number of agreements with BNSF for, among other things, the purchase of four perpetual easements for commuter rail service between Everett and Seattle, the purchase of railroad right-of-way between Nisqually and Tacoma for service and station improvements, terms for joint use of the railroad right-of-way and the purchase of operation services in each corridor.

The acquisition of the easements and property occurred over a four-year payment period. The first easement in the Everett-to-Seattle corridor closed in December 2003, and the second easement closed in December 2004, each in exchange for a payment of \$79.0 million. The third easement closed in December 2006 for a payment of \$50 million. The acquisition of the remaining easement (fourth easement) in the Everett-to-Seattle corridor is expected to close in December 2007 in exchange for a payment of \$50 million.

Each easement allows the addition by Sound Transit of one round trip commuter train service. Closing by Sound Transit on the fourth easement is conditioned upon the lack of a determination that certain permits for improvements that BNSF is designing to construct are highly unlikely to be issued. If this condition is not met, Sound Transit has the option to not close with no additional payment due and no additional train service beyond that provided by prior accepted easements.

The easement acquisition agreements also contain post-closing options for Sound Transit for the resale of the second, third and fourth easements to BNSF should it appear that permitting will not be allowed. These options may be exercised as follows:

	Earliest Exercise Date	Latest Exercise Date	Exercise Price
2nd Easement	November, 2006	November, 2010	\$27.5 million
3rd Easement	December, 2008	December, 2012	\$50 million
4th Easement	December, 2009	December, 2013	\$50 million

Also in December of 2003, Sound Transit paid BNSF \$3.6 million for the purchase of certain parcels of property that will become part of the Lakeview Station and South Tacoma Station and \$4.4 million as a non-refundable deposit for the purchase of railroad right of way on the BNSF’s Lakeview Subdivision. In September 2004, Sound Transit closed on the purchase of the section of the Lakeview Subdivision between Lakewood and Tacoma (the “North Line”) and in October 2005 the section of the Lakeview Subdivision between Nisqually and Lakewood (the “South Line”). See Note 9 for a description of amounts paid at closing and promissory notes provided to BNSF. Total payments in respect of the Nisqually-to-Tacoma corridor under the agreement to BNSF are \$32 million, including interest on the promissory notes.

The Joint-Use Agreement for the Everett-to-Seattle corridor provides the mechanism for determining the cost to Sound Transit for the maintenance-of-way and rehabilitation activities on the corridor. The Joint Use Agreement also provides the conditions necessary to be satisfied by Sound Transit (such as the acquisition of certain environmental permits) before it may use its commuter rail easements. The Joint-Use Agreement for the Lakewood-to-Tacoma corridor sets forth the cost to BNSF for the maintenance-of-way and rehabilitation activities on the corridor and Sound Transit’s and BNSF’s responsibilities during the interim period before Sound Transit starts operating on each portion of the corridor. Initially, BNSF will

CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY

Notes to Financial Statements, continued

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

The Everett-to-Seattle Commuter Rail Service Agreement set forth the terms for the actual operation of the commuter trains by BNSF and the compensation paid to BNSF for train crews, maintenance-of-way and other expenses incurred in the operation of the Sounder service between Seattle and Everett. The compensation is structured to provide flat rates for maintenance and crews with inflation adjusters plus performance incentives after the initial pre-construction period. The term of the agreement is for 12 years with an option of five additional years that must be agreed to by both parties, for a maximum term of 17 years. In addition, a first amendment was executed to the existing long-term agreement for commuter service from Seattle to Tacoma, covering service for the Lakewood-to-Tacoma corridor, provided Sound Transit eventually operates in the corridor.

Purchases—At December 31, 2006 and 2005, Sound Transit had outstanding construction commitments of approximately \$708.3 million and \$916.0 million, respectively.

Grants—Sound Transit participates in several federal grant programs that are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that Sound Transit has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectibility of any related receivable at December 31, 2006 and 2005 may be impaired. In the opinion of management, there are no significant contingent liabilities relating to non-compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying financial statements for such contingencies.

Claims—In the ordinary course of business, Sound Transit has been named as a defendant in a number of lawsuits relating to personnel and contractual matters. Although the ultimate outcome, if any, of these matters is presently unknown, management has evaluated all claims and potential claims and where that exposure is probable, has reflected in the accounts of the Agency its best estimate. At December 31, 2006, \$46.0 million has been recorded in construction in progress and a corresponding liability accrued (\$16.6 million at December 31, 2005); however, as these are estimates, these amounts may be subject to change.