

## Principal Funds, Inc. 2016 Tax Reporting Supplement

The enclosed information is provided to assist shareholders in preparing their 2016 tax returns. The information contained herein should not be deemed to be tax advice. Due to the many differences in state and local regulations, shareholders should consult their tax advisors regarding this information. If you have questions concerning the information we have furnished, please call us at 1-800-222-5852.

### Government Obligations Percentage

A portion of the dividends paid by the following funds during 2016 was derived from investments in obligations of the U.S. government or its agencies. Some of these dividends may be exempt from state and local taxes depending on the tax laws of your individual state or local taxing authority. Some states treat income from federal agency obligations differently than income from direct federal obligations. Please consult your tax advisor to determine which, if any, of the obligations listed below may be exempt from your state income tax.

Fund	Direct Federal Obligations	Indirect Federal Obligations	Repurchase Agreements
PFI Bond Market Index Fund	24.03%	27.92%	0.00%
PFI Core Plus Bond Fund	7.43%	14.97%	0.00%
PFI Credit Opportunities Explorer Fund	4.04%	0.00%	0.00%
PFI Diversified Real Asset Fund	8.63%	0.03%	0.00%
PFI Global Diversified Income Fund	0.01%	0.14%	0.00%
PFI Global Multi-Strategy Fund	3.70%	0.00%	0.53%
PFI Government & High Quality Bond Fund	2.96%	48.21%	0.00%
PFI High Yield Fund	0.08%	0.00%	0.00%
PFI Income Fund	8.23%	17.54%	0.00%
PFI Inflation Protection Fund	95.10%	0.00%	0.00%
PFI Money Market Fund	0.01%	0.00%	0.00%
PFI Principal LifeTime 2010 Fund	6.47%	5.90%	0.00%
PFI Principal LifeTime 2015 Fund	5.68%	5.67%	0.00%
PFI Principal LifeTime 2020 Fund	5.20%	5.49%	0.00%
PFI Principal LifeTime 2025 Fund	4.64%	5.07%	0.00%
PFI Principal LifeTime 2030 Fund	3.75%	4.08%	0.00%
PFI Principal LifeTime 2035 Fund	3.24%	4.42%	0.00%
PFI Principal LifeTime 2040 Fund	2.45%	3.27%	0.00%
PFI Principal LifeTime 2045 Fund	1.96%	2.43%	0.00%
PFI Principal LifeTime 2050 Fund	1.47%	1.73%	0.00%
PFI Principal LifeTime 2055 Fund	1.05%	1.10%	0.00%
PFI Principal LifeTime 2060 Fund	1.03%	1.04%	0.00%
PFI Principal LifeTime Hybrid 2015 Fund	10.07%	7.70%	0.00%
PFI Principal LifeTime Hybrid 2020 Fund	8.12%	7.14%	0.00%
PFI Principal LifeTime Hybrid 2025 Fund	7.31%	6.52%	0.00%
PFI Principal LifeTime Hybrid 2030 Fund	5.68%	5.16%	0.00%
PFI Principal LifeTime Hybrid 2035 Fund	4.85%	4.50%	0.00%
PFI Principal LifeTime Hybrid 2040 Fund	3.53%	3.28%	0.00%
PFI Principal LifeTime Hybrid 2045 Fund	2.45%	2.50%	0.00%
PFI Principal LifeTime Hybrid 2050 Fund	1.75%	1.71%	0.00%
PFI Principal LifeTime Hybrid 2055 Fund	1.33%	1.21%	0.00%
PFI Principal LifeTime Hybrid 2060 Fund	1.19%	1.05%	0.00%
PFI Principal LifeTime Hybrid Income Fund	16.98%	11.06%	0.00%
PFI Principal LifeTime Strategic Income Fund	7.39%	6.96%	0.00%
PFI SAM Balanced Portfolio	2.64%	8.55%	0.00%
PFI SAM Conservative Balanced Portfolio	3.39%	12.09%	0.00%
PFI SAM Conservative Growth Portfolio	1.23%	4.03%	0.00%
PFI SAM Flexible Income Portfolio	4.16%	11.52%	0.00%
PFI SAM Strategic Growth Portfolio	0.01%	0.00%	0.00%
PFI Short-Term Income Fund	0.00%	0.04%	0.00%

PFI = Principal Funds, Inc.

Principal Funds, Inc. 2016 Tax Reporting Supplement (continued)

**Alternative Minimum Tax**

The percentage of 2016 exempt interest dividends subject to the Federal Alternative Minimum Tax is summarized below. Please consult with your tax advisor to determine if you are subject to AMT.

Fund	AMT
PFI California Municipal Fund	7.33%
PFI Opportunistic Municipal Fund	17.05%
PFI Tax-Exempt Bond Fund	11.62%

**Qualified Dividends & Dividends Received Deduction**

Qualified dividends received and distributed by a fund are eligible to be taxed at lower rates. Qualified dividends are generally distributed from domestic corporations and certain qualified foreign corporations that meet certain holding requirements. The ordinary dividends that may qualify for the lower tax rates are shown in Box 1b of Form 1099-DIV. Shareholders must meet the holding period requirement to qualify for the lower ordinary dividend tax rates. To be eligible to treat all or a portion of the fund's dividend as qualified, a shareholder must have held the fund's shares for at least 61 days during the 121-day period surrounding the ex-dividend date. For additional information, see IRS Publication 550 at [www.irs.gov](http://www.irs.gov).

Dividends Received Deduction. For corporate shareholders, the percentage of ordinary income distributions (dividend income and short-term gains, if any) for 2016, that qualifies for the Dividends Received Deduction are as follows:

Fund	QDI	DRD	Fund	QDI	DRD
PFI Blue Chip Fund	100.00%	100.00%	PFI Principal Capital Appreciation Fund	100.00%	100.00%
PFI Capital Securities Fund	55.18%	22.01%	PFI Principal LifeTime 2010 Fund	29.70%	17.42%
PFI Core Plus Bond Fund	0.79%	0.57%	PFI Principal LifeTime 2015 Fund	37.68%	22.00%
PFI Credit Opportunities Explorer Fund	11.71%	9.42%	PFI Principal LifeTime 2020 Fund	44.07%	25.17%
PFI Diversified International Fund	100.00%	0.00%	PFI Principal LifeTime 2025 Fund	53.54%	30.23%
PFI Diversified Real Asset Fund	33.05%	8.20%	PFI Principal LifeTime 2030 Fund	60.55%	35.46%
PFI Dynamic High Yield Explorer Fund	1.33%	0.00%	PFI Principal LifeTime 2035 Fund	65.80%	37.93%
PFI EDGE MidCap Fund	27.10%	26.95%	PFI Principal LifeTime 2040 Fund	70.79%	40.08%
PFI Equity Income Fund	100.00%	82.50%	PFI Principal LifeTime 2045 Fund	76.24%	43.47%
PFI Finisterre Unconstrained Emerging Markets Bond Fund	0.24%	0.00%	PFI Principal LifeTime 2050 Fund	79.59%	45.71%
PFI Global Diversified Income Fund	11.83%	6.41%	PFI Principal LifeTime 2055 Fund	83.45%	47.83%
PFI Global Multi-Strategy Fund	100.00%	100.00%	PFI Principal LifeTime 2060 Fund	82.99%	47.49%
PFI Global Opportunities Equity Hedged Fund	100.00%	74.74%	PFI Principal LifeTime Hybrid 2015 Fund	43.54%	30.38%
PFI Global Opportunities Fund	100.00%	48.13%	PFI Principal LifeTime Hybrid 2020 Fund	51.17%	36.00%
PFI Global Real Estate Securities Fund	41.81%	0.00%	PFI Principal LifeTime Hybrid 2025 Fund	57.61%	39.68%
PFI High Yield Fund	0.76%	0.00%	PFI Principal LifeTime Hybrid 2030 Fund	64.28%	45.34%
PFI High Yield Fund I	1.33%	0.79%	PFI Principal LifeTime Hybrid 2035 Fund	70.12%	49.05%
PFI Income Fund	0.91%	0.88%	PFI Principal LifeTime Hybrid 2040 Fund	74.81%	53.00%
PFI International Emerging Markets Fund	100.00%	0.00%	PFI Principal LifeTime Hybrid 2045 Fund	78.13%	54.76%
PFI International Equity Index Fund	85.00%	0.00%	PFI Principal LifeTime Hybrid 2050 Fund	80.15%	56.77%
PFI International Fund I	100.00%	0.00%	PFI Principal LifeTime Hybrid 2055 Fund	82.09%	58.11%
PFI International Small Company Fund	93.79%	0.00%	PFI Principal LifeTime Hybrid 2060 Fund	80.95%	57.35%
PFI LargeCap Growth Fund	100.00%	100.00%	PFI Principal LifeTime Hybrid Income Fund	23.94%	15.84%
PFI LargeCap Growth Fund I	100.00%	100.00%	PFI Principal LifeTime Strategic Income Fund	19.66%	11.62%
PFI LargeCap Growth Fund II	100.00%	100.00%	PFI Real Estate Allocation Fund	25.77%	0.00%
PFI LargeCap S&P 500 Index Fund	100.00%	100.00%	PFI Real Estate Securities Fund	7.08%	0.00%
PFI LargeCap Value Fund	100.00%	100.00%	PFI SAM Balanced Portfolio	61.08%	39.93%
PFI LargeCap Value Fund III	100.00%	100.00%	PFI SAM Conservative Balanced Portfolio	34.32%	22.55%
PFI MidCap Fund	100.00%	100.00%	PFI SAM Conservative Growth Portfolio	100.00%	68.05%
PFI MidCap Growth Fund	100.00%	100.00%	PFI SAM Flexible Income Portfolio	22.71%	15.30%
PFI MidCap S&P 400 Index Fund	100.00%	96.01%	PFI SAM Strategic Growth Portfolio	100.00%	83.55%
PFI MidCap Value Fund I	100.00%	100.00%	PFI SmallCap Fund	100.00%	100.00%
PFI MidCap Value Fund III	100.00%	90.26%	PFI SmallCap S&P 600 Index Fund	74.03%	72.95%
PFI Multi-Manager Equity Long/Short Fund	85.26%	46.08%	PFI SmallCap Value Fund II	100.00%	100.00%
PFI Origin Emerging Markets Fund	100.00%	0.00%	PFI Small-MidCap Dividend Income Fund	58.92%	47.74%
PFI Overseas Fund	100.00%	0.62%	PFI SystematEx International Fund	82.98%	0.00%
PFI Preferred Securities Fund	67.13%	37.72%	PFI SystematEx Large Value Fund	100.00%	100.00%

Principal Funds, Inc. 2016 Tax Reporting Supplement (continued)

**Foreign Tax**

Foreign source income is the income earned by a fund from investments in foreign securities. Many countries impose a tax on income earned by investors beyond their borders. These taxes are paid by the fund. The following funds have elected to pass-through to shareholders the foreign taxes paid. Accordingly, this permits a shareholder to either take a federal income tax credit or a deduction from gross income. The amount of foreign tax credit that is utilized by a shareholder may be limited due to general credit limitation rules as well as a reduction in foreign source income associated with qualified dividend income. The percentage of the foreign source income that is qualified dividend income is shown in the Qualified Dividends table of this Tax Reporting Supplement. Refer to the IRS Form 1116 instructions for additional information regarding foreign tax credits. Please consult with your tax advisor to determine whether it is more beneficial for you to take the credit or deduction.

The information below summarizes the portion of income that was derived from foreign sources with regard to the applicable fund.

<u>Fund</u>	<u>Foreign Source Income</u>	<u>Foreign Tax Paid</u>
PFI Diversified International Fund	99.73%	\$ 0.0303
PFI International Emerging Markets Fund	99.86%	\$ 0.0477
PFI International Equity Index Fund	98.13%	\$ 0.0242
PFI International Fund I	99.74%	\$ 0.0332
PFI International Small Company Fund	99.42%	\$ 0.0042
PFI Origin Emerging Markets Fund	99.67%	\$ 0.0264
PFI Overseas Fund	99.27%	\$ 0.0269
PFI Principal LifeTime 2010 Fund	8.28%	\$ 0.0031
PFI Principal LifeTime 2015 Fund	11.13%	\$ 0.0031
PFI Principal LifeTime 2020 Fund	13.36%	\$ 0.0048
PFI Principal LifeTime 2025 Fund	16.67%	\$ 0.0044
PFI Principal LifeTime 2030 Fund	18.79%	\$ 0.0062
PFI Principal LifeTime 2035 Fund	23.47%	\$ 0.0057
PFI Principal LifeTime 2040 Fund	25.99%	\$ 0.0079
PFI Principal LifeTime 2045 Fund	27.83%	\$ 0.0066
PFI Principal LifeTime 2050 Fund	29.16%	\$ 0.0084
PFI Principal LifeTime 2055 Fund	30.76%	\$ 0.0073
PFI Principal LifeTime 2060 Fund	31.25%	\$ 0.0077
PFI Principal LifeTime Hybrid 2015 Fund	12.65%	\$ 0.0031
PFI Principal LifeTime Hybrid 2020 Fund	13.82%	\$ 0.0038
PFI Principal LifeTime Hybrid 2025 Fund	16.81%	\$ 0.0044
PFI Principal LifeTime Hybrid 2030 Fund	17.37%	\$ 0.0048
PFI Principal LifeTime Hybrid 2035 Fund	20.24%	\$ 0.0055
PFI Principal LifeTime Hybrid 2040 Fund	20.42%	\$ 0.0057
PFI Principal LifeTime Hybrid 2045 Fund	22.21%	\$ 0.0060
PFI Principal LifeTime Hybrid 2050 Fund	21.81%	\$ 0.0061
PFI Principal LifeTime Hybrid 2055 Fund	22.90%	\$ 0.0063
PFI Principal LifeTime Hybrid 2060 Fund	22.09%	\$ 0.0062
PFI Principal LifeTime Hybrid Income Fund	7.89%	\$ 0.0015
PFI Principal LifeTime Strategic Income Fund	5.14%	\$ 0.0017
PFI SAM Balanced Portfolio	11.10%	\$ 0.0052
PFI SAM Conservative Balanced Portfolio	6.49%	\$ 0.0029
PFI SAM Conservative Growth Portfolio	17.14%	\$ 0.0083
PFI SAM Flexible Income Portfolio	2.31%	\$ 0.0012
PFI SAM Strategic Growth Portfolio	24.08%	\$ 0.0126
PFI SystematEx International Fund	99.94%	\$ 0.0236

**Reallocation of Principal Funds, Inc. Distributions: Return of Capital Redesignation**

A portion of the ordinary income and/or long-term capital gains dividends paid by Principal Funds, Inc. – Capital Securities Fund and Principal Funds, Inc. - Credit Opportunities Explorer Fund have been redesignated as non-taxable return of capital. Your Form 1099-DIV reports the proper amount of “nondividend distribution” for income tax purposes. If a return of capital was reported to you, an adjustment to the basis of your shares will be necessary. Please consult your tax advisor for further information.

## Principal Funds, Inc. 2016 Tax Reporting Supplement (continued)

### Tax-Exempt Income by State

A portion of the dividends you received in 2016 may be exempt from state and local taxes, depending on the tax laws of your individual state or local taxing authority. For this purpose, a percentage breakdown of income by state or U.S. possession for 2016 is provided below. For shareholders residing in the state of California, payments of exempt interest-dividends on federally tax-exempt non-California municipal bonds are being reported to the California Franchise Tax Board (FTB) as required under Revenue & Taxation Code (R&TC) Section 18639.

State	PFI			State	PFI		
	California Municipal Fund	PFI Opportunistic Municipal Fund	PFI Tax- Exempt Bond Fund		California Municipal Fund	PFI Opportunistic Municipal Fund	PFI Tax- Exempt Bond Fund
Alabama	0.34%	1.79%	2.81%	Nebraska	0.00%	0.00%	1.03%
Alaska	0.00%	0.00%	0.53%	Nevada	0.00%	0.64%	1.13%
Arizona	0.00%	4.92%	2.42%	New Hampshire	0.00%	0.00%	0.33%
Arkansas	0.00%	0.00%	0.00%	New Jersey	0.00%	9.30%	2.97%
California	97.90%	14.01%	18.53%	New Mexico	0.00%	0.00%	0.00%
Colorado	0.00%	4.74%	0.88%	New York	0.00%	7.68%	9.54%
Connecticut	0.00%	4.16%	2.82%	North Carolina	0.00%	1.19%	0.56%
Delaware	0.00%	0.00%	0.00%	North Dakota	0.00%	0.00%	0.00%
District of Columbia	0.00%	0.00%	1.92%	Northern Mariana Islands	0.00%	0.00%	0.00%
Florida	0.00%	2.21%	2.16%	Ohio	0.00%	1.69%	2.55%
Georgia	0.00%	0.69%	0.39%	Oklahoma	0.00%	0.29%	0.22%
Guam	0.57%	0.00%	0.04%	Oregon	0.00%	0.56%	0.03%
Hawaii	0.00%	0.00%	0.00%	Pennsylvania	0.00%	4.98%	3.60%
Idaho	0.00%	0.00%	0.85%	Puerto Rico	0.00%	0.00%	0.00%
Illinois	0.00%	11.96%	12.79%	Rhode Island	0.00%	0.00%	0.00%
Indiana	0.00%	0.72%	1.28%	South Carolina	0.00%	1.02%	1.67%
Iowa	0.00%	0.50%	1.14%	South Dakota	0.00%	0.00%	0.00%
Kansas	0.00%	0.00%	0.36%	Tennessee	0.00%	1.77%	0.88%
Kentucky	0.00%	0.00%	1.38%	Texas	0.00%	9.28%	8.09%
Louisiana	0.00%	5.11%	3.56%	Utah	0.00%	0.00%	0.00%
Maine	0.00%	0.17%	0.28%	Vermont	0.00%	0.00%	0.00%
Maryland	0.00%	1.38%	0.52%	Virgin Islands	1.19%	0.29%	0.30%
Massachusetts	0.00%	0.14%	2.47%	Virginia	0.00%	1.21%	1.82%
Michigan	0.00%	2.08%	1.25%	Washington	0.00%	0.25%	2.11%
Minnesota	0.00%	0.94%	0.72%	West Virginia	0.00%	0.24%	0.55%
Mississippi	0.00%	0.00%	0.00%	Wisconsin	0.00%	3.01%	3.07%
Missouri	0.00%	1.08%	0.45%	Wyoming	0.00%	0.00%	0.00%
Montana	0.00%	0.00%	0.00%				

### Long-Term Capital Gain Distribution

Certain funds distributed long-term capital gain dividends during the calendar year ended December 31, 2016. Unless otherwise designated, long-term capital gain dividends are subject to a maximum tax rate of 20-percent, 15-percent, or 0-percent, depending on the shareholder's taxable income. To the extent necessary to distribute such capital gains, certain Funds may also utilize, and hereby designate, earnings and profits distributed to shareholders on redemptions of shares as part of the dividends paid deduction. Please consult your tax advisor if you have any questions.

### Tax Information Disclosure

Certain funds may invest in securities that reclassify income distributions after you have received your original Form 1099-DIV. Although at the time of mailing we supplied you with the most current information, reclassifications from income to return of capital, may occur as a result of REIT (real estate investment trust) or MLP (master limited partnership) investments. Once the REITs or MLPs notify Principal Funds, Inc., of any reclassifications, a determination will be made if such reclassifications require 1099-DIVs to be amended. Amended 1099-DIVs will be sent by March 20, 2017.