

Principal Funds 2011 Tax Reporting Supplement

The enclosed information is provided to assist shareholders in preparing their 2011 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 any 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 2011 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.

<u>Fund</u>	<u>Direct Federal Obligations</u>	<u>Indirect Federal Obligations</u>	<u>Repurchase Agreements</u>
PFI Bond & Mortgage Securities Fund	6.36%	23.35%	0.07%
PFI Bond Market Index Fund	20.02%	42.55%	0.06%
PFI Core Plus Bond Fund I	6.38%	24.33%	0.23%
PFI Disciplined LargeCap Blend Fund	0.00%	0.00%	0.01%
PFI Diversified International Fund	0.00%	0.00%	0.03%
PFI Diversified Real Asset Fund	26.52%	0.11%	0.04%
PFI Equity Income Fund	0.00%	0.00%	0.04%
PFI Global Diversified Income Fund	0.00%	0.00%	0.01%
PFI Global Multi-Strategy Fund	0.00%	7.75%	1.07%
PFI Government & High Quality Bond Fund	3.25%	63.35%	0.05%
PFI High Yield Fund	0.07%	0.00%	0.04%
PFI High Yield Fund I	0.00%	0.00%	0.02%
PFI Income Fund	1.18%	15.43%	0.07%
PFI Inflation Protection Fund	97.91%	0.00%	0.00%
PFI International Emerging Markets Fund	0.00%	0.00%	0.01%
PFI International Equity Index Fund	0.00%	0.00%	0.02%
PFI International Fund I	0.00%	0.00%	0.05%
PFI International Growth Fund	0.00%	0.00%	0.02%
PFI International Value Fund I	0.00%	0.00%	0.03%
PFI LargeCap Blend Fund II	0.00%	0.00%	0.13%
PFI LargeCap Growth Fund I	0.00%	0.00%	0.28%
PFI LargeCap Growth Fund II	0.00%	0.00%	0.10%
PFI LargeCap S&P 500 Index Fund	0.00%	0.00%	0.09%
PFI LargeCap Value Fund	0.00%	0.00%	0.09%
PFI LargeCap Value Fund I	0.00%	0.00%	0.08%
PFI LargeCap Value Fund III	0.00%	0.00%	0.07%
PFI MidCap Blend Fund	0.00%	0.00%	0.05%
PFI MidCap Growth Fund	0.00%	0.00%	0.04%
PFI MidCap Growth Fund III	0.00%	0.00%	0.25%
PFI MidCap S&P 400 Index Fund	0.00%	0.00%	0.10%
PFI MidCap Value Fund I	0.00%	0.00%	0.13%
PFI MidCap Value Fund III	0.00%	0.00%	0.09%
PFI Money Market Fund	0.26%	0.00%	2.60%
PFI Preferred Securities Fund	0.00%	0.00%	0.02%
PFI Principal Capital Appreciation Fund	0.00%	0.00%	0.08%
PFI Principal LifeTime 2010 Fund	10.55%	9.46%	0.07%
PFI Principal LifeTime 2015 Fund	6.97%	8.62%	0.07%
PFI Principal LifeTime 2020 Fund	3.30%	8.06%	0.07%

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Government Obligations Percentage, continued

<u>Fund</u>	<u>Direct Federal Obligations</u>	<u>Indirect Federal Obligations</u>	<u>Repurchase Agreements</u>
PFI Principal LifeTime 2025 Fund	2.20%	6.20%	0.06%
PFI Principal LifeTime 2030 Fund	1.67%	4.54%	0.06%
PFI Principal LifeTime 2035 Fund	1.25%	3.36%	0.05%
PFI Principal LifeTime 2040 Fund	0.98%	2.41%	0.05%
PFI Principal LifeTime 2045 Fund	0.80%	1.97%	0.05%
PFI Principal LifeTime 2050 Fund	0.51%	1.03%	0.05%
PFI Principal LifeTime 2055 Fund	0.42%	0.85%	0.05%
PFI Principal LifeTime Strategic Income Fund	17.06%	10.88%	0.07%
PFI Real Estate Securities Fund	0.00%	0.00%	0.03%
PFI SAM Balanced Portfolio	1.65%	14.76%	0.05%
PFI SAM Conservative Balanced Portfolio	2.08%	18.84%	0.05%
PFI SAM Conservative Growth Portfolio	0.74%	8.23%	0.05%
PFI SAM Flexible Income Portfolio	1.12%	19.20%	0.05%
PFI SAM Strategic Growth Portfolio	0.04%	0.83%	0.05%
PFI Short-Term Income Fund	0.02%	0.99%	0.04%
PFI SmallCap Blend Fund	0.00%	0.00%	0.24%
PFI SmallCap Growth Fund	0.00%	0.00%	0.51%
PFI SmallCap Growth Fund I	0.00%	0.00%	1.35%
PFI SmallCap Growth Fund II	0.00%	0.00%	0.62%
PFI SmallCap S&P 600 Index Fund	0.00%	0.00%	0.12%
PFI SmallCap Value Fund	0.00%	0.00%	0.18%
PFI SmallCap Value Fund II	0.00%	0.00%	0.18%
PFI Small-MidCap Dividend Income Fund	0.00%	0.00%	0.02%

PFI = Principal Funds, Inc

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	90.67%	\$.0211
PFI Global Real Estate Securities Fund	54.85%	\$.0083
PFI International Emerging Markets Fund	89.66%	\$.0784
PFI International Equity Index Fund	86.88%	\$.0257
PFI International Fund I	90.47%	\$.0319
PFI International Growth Fund	90.49%	\$.0224
PFI International Value Fund I	58.38%	\$.0344

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

A portion of the income dividends paid by Principal Funds, Inc. – Bond & Mortgage Securities Fund and Principal Funds, Inc. – Income Fund have been redesignated as non-taxable return of capital. Your Form 1099-DIV for these funds 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.

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Qualified Dividends

Qualified dividends received and distributed by a fund are eligible to be taxed at lower rates. Qualified dividends are generally distributions 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 a fund's dividend as qualified, shareholders 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.

Fund	12/31/11 ODI %	12/31/11 DRD %	Fund	12/31/11 ODI %	12/31/11 DRD %
PFI Bond & Mortgage Securities Fund	0.07%	0.07%	PFI MidCap Value Fund III	100%	100%
PFI Core Plus Bond Fund I	0.40%	0.40%	PFI Preferred Securities Fund	20.18%	6.06%
PFI Disciplined LargeCap Blend Fund	100%	0.00%	PFI Principal Capital Appreciation Fund	100%	100%
PFI Diversified International Fund	100%	0.03%	PFI Principal LifeTime 2010 Fund	24.82%	11.29%
PFI Diversified Real Asset Fund	10.37%	5.76%	PFI Principal LifeTime 2015 Fund	32.35%	15.83%
PFI Equity Income Fund	100%	74.60%	PFI Principal LifeTime 2020 Fund	39.38%	18.63%
PFI Global Diversified Income Fund	13.30%	5.79%	PFI Principal LifeTime 2025 Fund	42.10%	20.39%
PFI Global Real Estate Securities Fund	12.27%	1.08%	PFI Principal LifeTime 2030 Fund	57.11%	21.24%
PFI High Yield Fund	1.39%	1.33%	PFI Principal LifeTime 2035 Fund	62.34%	24.04%
PFI High Yield Fund I	0.56%	0.37%	PFI Principal LifeTime 2040 Fund	71.00%	25.60%
PFI International Emerging Markets Fund	100%	0.23%	PFI Principal LifeTime 2045 Fund	62.29%	27.32%
PFI International Equity Index Fund	90.62%	0.00%	PFI Principal LifeTime 2050 Fund	66.25%	28.22%
PFI International Fund I	100%	0.00%	PFI Principal LifeTime 2055 Fund	77.77%	28.03%
PFI International Growth Fund	100%	0.00%	PFI Principal LifeTime Strategic Income Fund	10.72%	4.93%
PFI International Value Fund I	70.91%	3.40%	PFI Real Estate Securities Fund	4.13%	0.00%
PFI LargeCap Blend Fund II	100%	100%	PFI SAM Balanced Portfolio	54.80%	37.57%
PFI LargeCap Growth Fund I	100%	100%	PFI SAM Conservative Balanced Portfolio	29.66%	20.39%
PFI LargeCap Growth Fund II	100%	100%	PFI SAM Conservative Growth Portfolio	100%	76.75%
PFI LargeCap S&P 500 Index Fund	100%	100%	PFI SAM Flexible Income Portfolio	19.28%	12.77%
PFI LargeCap Value Fund	100%	100%	PFI SAM Strategic Growth Portfolio	100%	100%
PFI LargeCap Value Fund I	100%	100%	PFI Short-Term Income Fund	0.00%	0.01%
PFI LargeCap Value Fund III	100%	100%	PFI Small-MidCap Dividend Income Fund	69.08%	55.44%
PFI MidCap Blend Fund	70.80%	63.64%	PFI SmallCap S&P 600 Index Fund	100%	100%
PFI MidCap Growth Fund	14.30%	13.50%	PFI SmallCap Value Fund	100%	100%
PFI MidCap S&P 400 Index Fund	90.68%	85.54%	PFI SmallCap Value Fund II	100%	100%
PFI MidCap Value Fund I	100%	100%			

PFI = Principal Funds, Inc

Alternative Minimum Tax

The percentage of 2011 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	8.16%
PFI Tax-Exempt Bond Fund	11.46%

Special Tax Information for Real Estate Securities Fund Shareholders

A majority of Principal Funds, Inc. – Real Estate Securities Fund's investments are in real estate investment trusts (REITs), and many REITs will redesignate their 2011 dividends in early 2012. These redesignations may reduce ordinary income. Because of this REIT redesignation, shareholders of the Real Estate Securities Fund should be aware that the fund may issue amended Form 1099-DIVs prior to March 15, 2012. Once the final REIT redesignation information has been received, we will determine whether the Form 1099-DIVs will need to be amended.

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Tax-Exempt Interest Income by State

A portion of the dividends you received in 2011 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 2011 is provided below. For shareholders residing in the state of California, payments of 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.

<u>State</u>	<u>California Municipal</u>	<u>Tax-Exempt Bond</u>	<u>State</u>	<u>California Municipal</u>	<u>Tax-Exempt Bond</u>
	<u>Fund</u>	<u>Fund</u>		<u>Fund</u>	<u>Fund</u>
Alabama	0.00%	2.39%	Nebraska	0.00%	1.62%
Alaska	0.00%	3.36%	Nevada	0.00%	1.27%
Arizona	0.00%	3.14%	New Hampshire	0.00%	1.66%
Arkansas	0.00%	0.00%	New Jersey	0.00%	1.82%
California	99.45%	11.55%	New Mexico	0.00%	0.61%
Colorado	0.00%	2.22%	New York	0.00%	4.61%
Connecticut	0.00%	0.66%	North Carolina	0.00%	0.36%
Delaware	0.00%	0.00%	North Dakota	0.00%	0.03%
District of Columbia	0.00%	2.44%	Northern Mariana	0.00%	0.00%
Florida	0.00%	4.31%	Islands		
Georgia	0.00%	0.79%	Ohio	0.00%	2.51%
Guam	0.00%	0.00%	Oklahoma	0.00%	0.04%
Hawaii	0.00%	0.85%	Oregon	0.00%	0.88%
Idaho	0.00%	1.38%	Pennsylvania	0.00%	1.24%
Illinois	0.00%	10.65%	Puerto Rico	0.04%	1.47%
Indiana	0.00%	2.18%	Rhode Island	0.00%	0.00%
Iowa	0.00%	1.17%	South Carolina	0.00%	0.88%
Kansas	0.00%	1.18%	South Dakota	0.00%	0.00%
Kentucky	0.00%	2.48%	Tennessee	0.00%	1.33%
Louisiana	0.00%	1.55%	Texas	0.00%	7.91%
Maine	0.00%	0.00%	Utah	0.00%	1.44%
Maryland	0.00%	1.10%	Vermont	0.00%	0.00%
Massachusetts	0.00%	3.07%	Virginia	0.00%	0.80%
Michigan	0.00%	2.02%	Virgin Islands	0.51%	0.26%
Minnesota	0.00%	0.90%	Washington	0.00%	3.46%
Mississippi	0.00%	0.00%	West Virginia	0.00%	1.65%
Missouri	0.00%	1.31%	Wisconsin	0.00%	3.45%
Montana	0.00%	0.00%	Wyoming	0.00%	0.00%